



Terasen Gas Inc.
2004 Annual Report

Corporate Profile

Terasen Gas Inc. is the largest distributor of natural gas in the Pacific Northwest, with more than 792,000 residential, commercial and industrial customers in more than 100 communities in British Columbia. Terasen Gas Inc., with 1,183 employees, is a wholly owned subsidiary of Terasen Inc.

2004 Management's Discussion and Analysis

For the Year Ended December 31, 2004

Dated February 17, 2005

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This discussion should be read in conjunction with the consolidated financial statements of the Company and related notes for the years ended December 31, 2004 and 2003. In this MD&A, we, us, our, the Company and Terasen Gas mean Terasen Gas Inc.

Performance Highlights – provides an overview of the financial and operational achievements of 2004 and a look ahead at the opportunities for 2005.

About Terasen Gas – describes Terasen Gas' core businesses and strategy.

Key Risk and Success Factors – discusses key factors influencing the Company's financial and operating performance and the risk management activities designed to mitigate the risks associated with the key success factors.

Financial and Capital Management – provides a detailed discussion of how we manage our financial and capital resources.

Financial Results – provides a comparative review of the financial performance for the consolidated Company over the past two years. It also provides an analysis of the performance of the separate business units.

Business Development – reviews the Company's activities with regard to system expansions and growth by acquisition.

Critical Accounting Policies and Estimates – provides a summary of the critical accounting policies and estimates used in the preparation of the Company's consolidated financial statements.

PERFORMANCE HIGHLIGHTS

REVIEW OF 2004

Terasen Gas reported earnings of \$70.8 million in 2004, compared with \$70.4 million in 2003. In 2004 Terasen Gas' allowed return on equity (ROE) was 9.15%, down from 9.42% in 2003. The Company was able to offset the lower allowed ROE by achieving operating efficiencies, which were shared equally with its customers, and through growth in customers.

OUTLOOK FOR 2005

Looking ahead to 2005, Terasen Gas remains focused on achieving operational efficiencies and pursuing opportunities for new customer additions. A performance-based regulatory framework is in place and provides the opportunity to create value for both customers and shareholders by achieving operating efficiencies. Terasen Gas will also continue to pursue opportunities such as the delivery of additional gas transportation capacity and will support Terasen Gas (Vancouver Island) (TGVI) in its efforts to work with Island communities and stakeholders in the installation of a liquefied natural gas storage facility on Vancouver Island. The successful completion of this project would provide additional transportation revenue to Terasen Gas.

ABOUT TERASEN GAS

Terasen Gas is the largest distributor of natural gas in the Pacific Northwest, serving more than 792,000 customers in more than 100 communities in British Columbia. Major areas served by Terasen Gas are Greater Vancouver, the Fraser Valley and the Thompson, Okanagan, Kootenay and North Central Interior regions of the province. Terasen Gas provides transmission and distribution services to its customers, and obtains natural gas supplies primarily on behalf of residential and commercial customers. Gas supplies are sourced primarily from northeastern British Columbia and, through the Company's Southern Crossing Pipeline, from Alberta.

STRATEGY

Near term growth opportunities for Terasen Gas will be to focus on increasing new customer capture rates and maintaining the efficiencies achieved through the operational integration of Terasen Gas and TGVI. Through programs and activities designed to deliver operational excellence together with incentivized regulatory arrangements, Terasen Gas derives value from its natural gas transmission and distribution assets. The Company's long term growth objective for its natural gas distribution business is to capitalize on its operating competencies by combining the ownership and/or operatorship of additional transmission and distribution assets with its existing asset base. The competencies applicable to natural gas distribution are also applicable to electricity distribution and water distribution.

KEY RISK AND SUCCESS FACTORS

Terasen Gas' operating and financial performance is influenced by a number of success factors which include, but are not limited to, the following:

- Appropriate regulatory arrangements
- Appropriate risk management and governance processes
- Safe, reliable and efficient asset management processes
- Focused business development activities
- Energy market conditions
- Ready access to capital markets

The following is a discussion of these success factors and the activities Terasen Gas undertakes to mitigate associated risks.

Regulatory Arrangements

Terasen Gas is regulated by the British Columbia Utilities Commission (BCUC), which approves rates for services and issues certificates for the construction of major facilities. Traditionally, rates have been set using the cost of service approach to utility regulation. Since 1996, however, incentive-based regulation has been used in the rate-setting process in order to enhance value to customers and provide opportunities for enhanced returns to shareholders.

Terasen Gas' rates are based on estimates of several items, such as natural gas sales volumes, cost of natural gas, and interest rates. In order to manage the risks associated with some of these estimates, a number of regulatory deferral accounts are in place.

Two mechanisms to ameliorate unanticipated changes in sales volumes, such as changes caused by weather, have been implemented specifically for Terasen Gas. The first, originally called the Gas Cost Reconciliation Account (GCRA), relates to the recovery of all gas costs through a deferral account which captures all variances (overages and shortfalls) from forecasts. Balances are either refunded to or recovered from customers via an application with the BCUC. Creation of the GCRA was approved by the BCUC in October 1993; effective April 2004 the GCRA was split into two new deferral accounts called the Commodity Cost Reconciliation Account (CCRA) and the Midstream Cost Reconciliation Account (MCRA). The CCRA and MCRA were created to support

commodity unbundling and the refund / recovery mechanism works the same as that used for the GCRA. The second mechanism seeks to stabilize revenues from residential and commercial customers through a deferral account that captures variances in the forecast versus actual customer use throughout the year. This mechanism is called the Revenue Stabilization Adjustment Mechanism (RSAM).

The RSAM and CCRA/MCRA accounts reduce Terasen's earnings exposure to related risks by deferring any variances between projected and actual gas consumption and gas costs, and refunding or recovering those variances in rates in subsequent periods. Variances in usage by large volume, industrial transportation and sales customers are not covered by these deferral accounts as their usage is more predictable and less likely to be significantly affected by weather.

Recovery of the deferral account balances in rates charged to customers led to a decline in the regulatory deferral accounts during the year. In 2004, the net balances of the RSAM and CCRA/MCRA accounts declined to \$14.1 million from \$38.5 million in 2003.

In order to ensure that the balances in the CCRA/MCRA accounts are recovered on a timely basis, Terasen prepares quarterly calculations to determine whether customer rate adjustments are needed to reflect prevailing market prices for natural gas costs.

Short-term and long-term interest rate deferral accounts have also been in place to absorb interest rate fluctuations. The interest rate deferral accounts which were in place during 2004 effectively fixed the interest expense on short-term funds attributable to Terasen's regulated assets at 3.25% during 2004. The effective fixed short-term interest rate for 2005 has been set at 4.00%.

The Company's pension obligations are funded by pension plan investments in a variety of assets, including equities, where investment returns may be insufficient to meet pension obligation liabilities. The Company's pension obligations relate to regulated businesses, where pension deficits are generally recoverable through the regulatory process. As part of the 2004-2007 PBR settlement for Terasen Gas, a

new deferral account was established for pension costs. In addition, the PBR settlement set forth new a deferral account for insurance premiums, which had not been included in previous regulatory settlements.

Allowed Return on Equity (ROE)

Terasen Gas' allowed ROE is determined annually based on a formula that applies a risk premium to a forecast of long-term Government of Canada bond yields. For 2005, the application of the ROE formula set Terasen Gas' allowed ROE at 9.03%, down from 9.15% in 2004. The ROE reduction reflects lower forecasted long-term bond yields for 2005, compared to those used in the 2004 ROE calculation.

2004-2007 Performance Based Rate Plan

In July 2003, Terasen Gas received BCUC approval of a negotiated settlement for a 2004-2007 Performance Based Rate Plan (PBR Settlement). The PBR Settlement establishes a process for determining Terasen Gas' delivery charges and incentive mechanisms for improved operating efficiencies. The four-year agreement includes incentives for Terasen Gas to operate more efficiently through the sharing of the benefits between Terasen Gas and its customers. The PBR Settlement includes 10 service quality measures designed to ensure Terasen Gas maintains service levels. It also sets out the requirements for an annual review process which will provide a forum for discussion between Terasen Gas and interested parties regarding the Company's current performance and future activities.

Operation and maintenance costs and base capital expenditures are subject to an incentive formula reflecting increasing costs due to customer growth and inflation, less a productivity factor based on 50 percent of inflation during the first two years and 66 percent of inflation during the last two years. Base capital expenditure amounts are a function of customer numbers and projected customer additions. The PBR Settlement provides for a 50/50 sharing mechanism of earnings above or below the allowed return on equity beginning in 2004.

Upon expiry of the 2004-2007 PBR, there is no certainty as to whether a new negotiated settlement will be entered into, or what the terms of a new settlement might be.

Natural Gas Commodity Unbundling

Over the past several years, Terasen Gas, the BCUC, and interested parties have laid the groundwork for the introduction of natural gas commodity unbundling for commercial customers. On May 1, 2004, commercial customers of Terasen Gas became eligible to sign up to buy their natural gas commodity supply from third party suppliers beginning November 1, 2004. Terasen Gas continues to provide delivery of the natural gas. Approximately 78,000 commercial customers are eligible to participate in commodity unbundling. By December 2004, 2,067 customers elected to participate in this program. The introduction of the unbundling program is not expected to have a material impact on the Company's financial results.

Risk Management and Governance

In order to ensure that operating and financial results meet customer, regulatory and shareholder expectations, an effective system of risk management and governance is essential. Terasen Gas and its parent, Terasen, have implemented an Enterprise Risk Management (ERM) framework and a risk management process across the organization to ensure that significant business risks are identified, evaluated and appropriately managed and monitored.

Pursuant to Multilateral Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings (MI52-109), Terasen Gas' management is proactively evaluating the effectiveness of the design and operation of the Company's disclosure controls and procedures in consultation with external advisors. The evaluation is being conducted in conjunction with the efforts being performed by Terasen Gas' parent company.

Both Terasen Gas and Terasen take their responsibilities under MI52-109 very seriously. The companies are leveraging its existing ERM framework and risk management process to apply a consistent risk-based approach to certification compliance efforts. The Company's rigorous risk management and reporting mechanisms, together with tight linkage between risk management and the annual enterprise-wide internal audit plan, are factors that reduce the enterprise's risk with regards to potential misrepresentations and internal control weaknesses.

Asset Management

The focus of asset management is to ensure reliable, cost effective, quality service with full regard for the safety of employees and the public while operating in an environmentally responsible manner. Appropriate regulatory arrangements provide incentives to manage costs and maintain or improve service quality. Once opportunities are available, asset management skills are key to capitalizing on these incentives

Terasen Gas maintains comprehensive facility risk assessment, pipeline integrity management programs, and pipeline security systems as preventive measures to mitigate the risk of a pipeline failure or other loss of system integrity. These programs are intended to reduce both the likelihood and severity of the business interruption and/or environmental liability that could result from a pipeline failure or loss of integrity.

The actions necessary to abandon pipeline systems at the eventual end of their useful lives has not been defined and the costs of these actions are not currently determinable and may not be fully recovered in rates. Until such time as the specified requirements of abandonment and the funding mechanism for the eventual recovery of negative salvage is determined, the Company, like those of other Canadian pipeline systems, makes no provision for these amounts.

Terasen Gas could be exposed to significant operational disruptions and environmental liability in the event of an accident involving natural gas. Terasen Gas has taken all reasonable and prudent steps to minimize its exposure in the case of a catastrophic event or environmental upset.

Terasen Gas has detailed emergency preparedness plans in place to respond to natural disasters, accidents and emergencies, and regularly tests these plans in simulations involving employees and other emergency response organizations. The Company is also committed to monitor and assess its safety and environmental performance regularly. Terasen Gas incorporates safety performance measures into its employee compensation system, sets targets and objectives for environmental performance, and conducts safety and environmental audits.

Safety and environmental management is a key aspect of effective asset management. Terasen

Gas has established programs to use resources more efficiently and effectively including a greenhouse gas management program, industrial waste recycling and salvage shop operations. For the sixth consecutive year, Terasen Gas was awarded gold level reporting status from Canada's Climate Change Voluntary Challenge and Registry (VCR). In 2003 Terasen Gas received the VCR Leadership award, becoming the only company in its sector to have received the honour twice, previously in 2001. The VCR ranking acknowledges Terasen Gas' efforts to develop specific measures and voluntarily set reduction targets. In 2003 Terasen Gas reduced its operating emissions 5% below 2000 levels (before offsets) and 14% below 2000 levels after accounting for offset project emission reductions. These results were accomplished through operational efficiencies, equipment selection and offset project investment.

Through the terms of its regulatory settlements, Terasen Gas has been successful in achieving and exceeding its productivity targets and capitalizing on incentives. A recent independent analysis of operating costs found that Terasen Gas was the best performer among ten Canadian gas distribution utilities on the measures of customers per employee and operating costs per customer.

Business and Project Development

Terasen Gas' success in business and project development is dependent on a number of key skills and competencies. The nature of Terasen Gas' core business requires sound regulatory and political relationships in order to minimize risk and enhance support for new business initiatives.

The construction of the Southern Crossing pipeline on-time and on-budget demonstrated Terasen Gas' project management and execution skills, which will continue to be applied to new infrastructure construction opportunities. A key aspect of construction project management for Terasen is ensuring that contractors are responsible for risks that they can best manage.

Energy Market Conditions

Terasen Gas' financial performance, business development activities, and acquisition opportunities are impacted by energy market conditions including, but not limited to, general economic conditions, market competitiveness,

changes in demand and supply, and commodity prices. The Company has in place various risk management activities designed to mitigate the impact of these factors on its operating and financial performance. The following is a discussion of the key energy market conditions that affect Terasen Gas' business and the activities designed to manage the Company's exposure to market risk.

Competitiveness – Natural gas maintains a competitive advantage in terms of pricing when compared with alternative sources of energy in British Columbia. However, because electricity prices in British Columbia continue to be set based on the historical average cost (primarily hydro-electric dams) of production, rather than based on market forces, they have remained artificially low compared to market priced electricity and, as a result, marginally higher than market-based natural gas costs. Over time, these pricing signals may distort energy use decisions by British Columbia consumers, thereby decreasing the use of natural gas by customers.

Terasen Gas is also working with BC Hydro on demand side management and partnering with communities to assess how the Company can best serve them in the future.

Impact of Changes in Economic Conditions – New customer additions at Terasen Gas are typically a result of population growth and new housing starts, which are affected by the state of the provincial economy. The Company is also affected by changes in trends in housing starts from single family dwellings to multi-family dwellings, for which natural gas has a lower penetration rate. While new housing starts have increased in B.C. in 2004, growth of new multi-family housing starts has significantly outpaced that of new single-family housing starts.

Fluctuations in natural gas use per residential and commercial customer, whether arising from weather or price levels, are deferred and recovered in customer rates and have no earnings impact on the Company.

Commodity Prices – The Company employs a number of tools to reduce its customers' exposure to natural gas price volatility. These include purchasing gas for storage and adopting hedging strategies, which include a combination of both physical and financial transactions, to reduce price volatility and ensure natural gas commodity costs remain competitive against

electric rates. Activities related to the hedging of gas prices are approved by the BCUC and gains or losses accrue entirely to customers. The Company's commodity derivatives are discussed more fully in the section "Financial Instruments".

Natural Gas Supply – By bringing the Southern Crossing Pipeline into service in 2000, Terasen Gas has improved the security and competitiveness of the gas supply arrangements in place for Terasen Gas' customers. To the extent possible, Terasen Gas has also minimized gas supply and price risk through the use of long-term transportation, storage and supply contracts, hedging instruments, and a diverse supply portfolio.

However, regional market prices have been higher from time to time than prices elsewhere in North America as a result of insufficient pipeline capacity to serve the increasing demand for natural gas in B.C. and the U.S. Pacific Northwest. In addition, Terasen Gas continues to be dependent on a limited selection of pipeline and storage providers, particularly for the Vancouver and Fraser Valley service areas where the majority of the Company's natural gas distribution customers are located. Terasen is actively exploring opportunities to cost-effectively expand pipeline capacity to these regions through initiatives such as the Inland Pacific Connector Project – a proposal to extend the Southern Crossing Pipeline from Oliver (in the interior of British Columbia) to the regional natural gas trading hub of Sumas, near Vancouver.

Terasen Gas is also supporting TGV I in its efforts to provide additional gas transportation capacity through increased compression and the installation of a liquefied natural gas (LNG) storage facility on Vancouver Island. Terasen Gas has indicated to the BCUC, its willingness to lease storage capacity on the system if TGV I proceeds with the expansion.

Access to Capital

In order to meet the capital investment and return requirements of its businesses, Terasen Gas must have reliable access to cost effective capital. The Company's requirements for capital and access to capital are discussed more fully under "Liquidity and Capital Resources".

Earnings and cash flow volatility arise from general financial market risk, including movements in interest rates and fluctuations in

the Canadian dollar relative to other foreign currencies. Terasen Gas has established risk management policies to oversee the use of derivative financial instruments designed to offset its exposure to financial market risk. Continuous monitoring and regular reporting to senior management are in place to assess the derivative activity. The Company does not use derivative financial instruments to engage in speculative transactions. The financial instruments outstanding are described in the section "Financial Instruments".

Interest Rates – The allowed returns on equity for Terasen Gas are determined by formulae that result in lower allowed ROEs if long-term Canada bond yields decline. As a result, if long-term interest rates decreased by 1.0% for an extended period of time, the estimated impact on Terasen's annual consolidated net earnings would be a reduction of approximately \$7.7 million. Terasen Gas' exposure to short-term interest rates are covered by regulatory deferral

accounts, however it is exposed to changes in short-term interest rates through debt on non-regulated operations. As a result, a 1% increase in short-term interest rates for an extended period of time, the estimated impact on Terasen Gas' annual consolidated net earnings would be a reduction of approximately \$0.6 million. Terasen Gas has hedging programs in place for its interest rate and foreign exchange risks which have been factored into the sensitivities described above, and which are described further in the "Financial Instruments" section.

Counterparty Credit Risk - The Company is exposed to credit risk in the event of non-performance by counterparties to derivative instruments. The Company is also exposed to significant credit risk on physical off-system sales. Because it deals with high credit quality institutions in accordance with established credit approval practices, the Company does not expect any counterparties to fail to meet their obligations.

FINANCIAL AND CAPITAL MANAGEMENT

LIQUIDITY AND CAPITAL RESOURCES

Consolidated Cash Flow

Cash from operations refers to cash generated before the impact of working capital and deferral accounts. During 2004, Terasen's cash from operations increased to \$151.5 million from \$144.9 million in 2003. The increase in cash from operations was primarily a result of higher earnings for the year as adjusted for non-cash charges such as depreciation and amortization. Cash flow from operating activities, which includes the impact of changes in working capital and deferral accounts, increased to \$191.4 million in 2004 from \$145.6 million in 2003. Changes in non-cash working capital returned to normal levels in 2004. In 2003, changes in non-cash working capital were affected by higher accounts receivable and inventory levels relating to higher gas prices and a reduction in contributions from the rate stabilization accounts.

Terasen Gas' working capital requirements fluctuate seasonally based on natural gas consumption. Given the low-risk, regulated nature of its business, Terasen Gas is able to maintain negative working capital balances. Terasen Gas maintains adequate committed credit facilities to meet its working capital requirements. On an annual basis, the Company generates sufficient cash flow to meet its working capital requirements.

Capital Expenditures

Capital expenditures totaled \$93.9 million in 2004 compared with \$116.2 million in 2003. The primary reason for the decline in capital spending was a reduction in base capital expenditures and lower project capital. In 2005, Terasen Gas expects capital expenditures to be approximately \$168.0 million. The major project expenditure included in this total is the \$50 million acquisition of the Coastal Facilities buildings.

Coverage Ratios

Due to the capital intensive nature of the Company's businesses and the need to raise debt frequently in the fixed income market, maintenance of its financial ratios is a priority for Terasen Gas. The most significant ratios are considered to be interest coverage and debt as a percentage of total capital.

FINANCIAL RATIOS	2004	2003
Interest coverage	2.0	2.0
Debt to total capital (as at December 31)	66%	68%

Terasen Gas' deemed equity component as a percentage of total capital structure continues to be 33%. Interest coverage is targeted to be at or

above 2.0 for Terasen Gas. The Company does not anticipate any material changes in the relative mix or cost of its capital resources.

Public Issues

In April 2004, Terasen Gas issued \$150 million of medium term note debentures at an interest rate of 6.50%. In September 2003, Terasen Gas issued \$150 million of medium term note debentures at a floating interest rate. Funds generated from the issuance of medium term note debentures were used for general corporate purposes.

Dividends

In 2004, Terasen Gas paid \$60 million in dividends to its parent Terasen Inc., compared with \$80 million in 2003.

Lines of Credit

As at December 31, 2004, the Company had lines of credit in place totaling \$500 million to finance cash requirements. These lines enable Terasen Gas to borrow directly from its bankers, issue bankers' acceptances and support commercial paper issued by the Company. Bank lines of \$363 million were unutilized at the end of 2004. Virtually all short-term cash needs are funded through commercial paper and bankers' acceptances in the Canadian market at rates generally below bank prime. Terasen Gas does not have, nor does it expect to have, any defaults or arrears.

Contractual Obligations

The table below sets forth Terasen Gas' financial obligations due in the years indicated.

<i>In millions of dollars</i>	Total	2005	2006-2007	2008-2010	2011 and later
Long-term debt	\$1,437.8	\$ 395.0	\$ 220.0	\$ 248.0	\$ 574.8
Capital lease obligations	10.8	2.2	4.4	4.2	-
Operating leases	213.4	16.0	30.9	46.8	119.7
Purchase obligations ¹	1,136.1	710.7	389.3	36.1	-
Other long-term obligations	-	-	-	-	-
Total contractual obligations	\$2,798.1	\$1,123.9	\$ 644.6	\$ 335.1	\$ 694.5

¹Purchase obligations include gas purchase contracts that are based on market prices that vary with gas commodity indices. The amounts disclosed reflect index prices that were in effect at December 31, 2004.

Gas purchase agreements contain provisions whereby Terasen Gas could be obliged to provide security to gas suppliers if they have reasonable grounds for insecurity.

Credit Ratings

Securities issued by Terasen Gas are rated by DBRS Inc. (DBRS) and Moody's Investors Service Inc. (Moody's). The ratings assigned to its securities are reviewed by these agencies on an ongoing basis. The table below summarizes the ratings assigned to the Company's various securities at December 31, 2004.

CREDIT RATINGS	DBRS	Moody's
Commercial paper	R-1 (Low)	
Unsecured long-term debt	A	A2
Secured long-term debt	A	A1

After reassessing its relationship with Standard & Poor's Ratings Services, a division of the McGraw-Hill Companies (Canada) Corporation (S&P), Terasen Gas decided early in 2004 to discontinue the engagement of S&P to provide credit ratings on the debt of Terasen Gas. Terasen Gas believes the credit ratings issued by Moody's and DBRS will be sufficient to service the requirements of creditors and maintain the Company's access to capital. S&P continues to provide an unsolicited rating on Terasen Gas' outstanding debt based on publicly available information. As of December 31, 2004, Terasen Gas' unsecured long-term debt was rated BBB by S&P.

Terasen Gas has arranged committed credit facilities that the Company believes would be adequate to meet these requirements.

Off-Balance Sheet Arrangements

In 2000, Terasen Gas entered into a leasing arrangement with a syndicate of Canadian banks and the BCG Coastal Facilities Trust, a special-purpose entity, to finance new building facilities in the Greater Vancouver area. The Coastal Facilities synthetic lease agreement has been accounted for as an off-balance sheet item. As at December 31, 2004, the value of the Coastal Facilities leasing agreement was approximately \$49.4 million. Lease payments of approximately \$4.5 million were made by Terasen Gas in 2004.

In 2004, Terasen Gas applied to the BCUC for and received approval to unwind the synthetic lease and include the Coastal Facilities assets in rate base. On January 4th, 2005, Terasen Gas paid approximately \$49.4 million to BCG Coastal Facilities Trust to unwind the synthetic lease. The Coastal Facilities assets have been included in the Terasen Gas rate base commencing January 2005.

There are no other material off-balance sheet agreements other than the Coastal Facilities lease, which has been refinanced.

FINANCIAL INSTRUMENTS

Fair Value Estimates

The fair value of the Company's long-term debt, calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues at December 31, 2004, or by using available quoted market prices, is estimated at \$1,649.8 million. The majority of the Company's long-term debt relates to regulated operations which enables the Company to recover the existing financing charges through rates.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment.

Derivative Instruments

As approved by the regulator, derivatives are used to manage natural gas price risk and foreign exchange risk. The majority of the natural gas supply contracts have floating, rather than fixed prices. The Company uses natural gas price swap contracts to fix the effective purchase price. Any differences between the effective cost of natural gas purchased and the price of natural gas included in rates are recorded in a deferral account (CCRA), and subject to regulatory approval, are passed through in future rates to customers.

Foreign currency risk relates mainly to purchases and sales of natural gas denominated in U.S. dollars, and are thereby managed through the regulatory process. Certain foreign currency risks are managed through the use of foreign currency derivatives on behalf of customers. As at December 31, 2004, Terasen Gas had no outstanding foreign currency swaps.

The carrying value of natural gas derivatives at December 31, 2004 was an asset of \$1.7 million and the fair value of the derivatives was an liability of \$6.8 million, compared with a carrying value liability of \$7.4 million and a fair value asset of \$4.6 million at the end of 2003. These derivatives have terms to maturity of up to two years as at December 31, 2004. The natural gas derivatives fair value reflects only the value of the natural gas derivatives and not the offsetting change in value of the underlying future purchases of natural gas. These fair values reflect the estimated amounts the Company would receive or pay to terminate the contracts at the stated dates. Any gains or losses associated with the Company's financial instruments are subject to deferral accounts.

OUTSTANDING SHARE DATA

As at February 28, 2004, Terasen Gas had issued and outstanding 59,591,732 common shares, which are 100% owned by Terasen Inc.

FINANCIAL RESULTS

<i>In millions of dollars</i>	2004	2003	2002
Revenues	\$ 1,305.2	\$ 1,305.6	\$ 1,246.4
Operating expenses			
Cost of natural gas	807.0	805.2	749.4
Operation and maintenance	164.4	160.9	155.0
Depreciation and amortization	81.6	76.7	77.8
Property and other taxes	39.6	41.4	39.0
	1,092.6	1,084.2	1,021.2
Operating income	212.6	221.4	225.2
Financing costs	106.4	111.9	112.5
Earnings before income taxes	106.2	109.5	112.7
Income taxes	35.4	39.1	45.6
Net earnings	\$ 70.8	\$ 70.4	\$ 67.1

Terasen Gas reported revenue of \$1,305.2 million during 2004, compared with \$1,305.6 million in 2003. Revenues are set at levels designed to recover the cost of delivery service, together with the cost of the natural gas commodity. As a result, changes in consumption levels and changes in the commodity cost of natural gas do not materially impact revenue or earnings due to regulatory deferral accounts. The decline in revenue in 2004 was attributable to lower consumption, which more than offset the increase in the commodity cost recovered in rates charged to customers, which became effective in the third quarter of 2004.

Terasen Gas reported 11,750 net customer additions during 2004, bringing the total number of Terasen Gas customers to 792,130 at year-end. Net customer additions improved from the addition of 5,822 customers in 2003. Solid economic conditions and continued strength in new housing starts in British Columbia helped drive the net customer additions in 2004.

Terasen Gas industrial sales volumes decreased by 621 terajoules while transportation volumes increased by 511 terajoules from the previous year. Terasen Gas earns approximately the same margin regardless of whether a customer contracts for sales or transportation service. In 2004, the cost of natural gas increased to \$807.0 million in 2004 from \$805.2 million in 2003. The increase in the commodity cost of gas in 2004 more than offset the decline in natural gas sales volume.

Operating and maintenance expenses increased to \$164.4 million in 2004 from \$160.9 million in 2003. The primary driver of higher operating expenses was an increase in insurance costs and transmission integrity costs, which are recoverable through customer rates. Depreciation and amortization increased by \$4.9 million as a result of a higher rate base and an increase in the approved rate of depreciation and amortization, which is recoverable in customer rates. Financing costs declined to \$106.4 million in 2004 from \$111.9 million in the previous year. The decline was mainly a result of lower short-term debt balances and lower interest rates. Net earnings increased to \$70.8 million in 2004 from \$70.4 million in 2003. An analysis of the increase is as follows:

<i>In millions of dollars</i>	
Net earnings in 2003	\$ 70.4
Restructuring charge taken in 2003	3.0
Decrease in allowed ROE	(2.0)
Earnings sharing	(4.7)
Operating efficiencies	2.7
Other	1.4
Net earnings in 2004	\$ 70.8

In the fourth quarter of 2004, revenue declined to \$442.3 million from \$462.4 million in the same quarter of 2003. Revenue declined as a result of lower natural gas sales volume due to warmer weather relative to the corresponding quarter of 2003. The cost of natural gas sold declined in line with natural gas sales volume. Fourth quarter earnings increased to \$37.5 million in 2004, from \$35.4 million in the corresponding quarter of 2003. Included in the fourth quarter 2003 results was a one-time restructuring charge of \$3.0 million.

Related Party Transactions

The Company sold property, plant and equipment totaling \$3.1 million in 2004 (2003 – nil) to its parent company, Terasen Inc., at net book value and transferred accrued employee benefit plan liabilities of \$6.5 million to its parent in 2004.

The Company received \$4.0 million in 2004 (2003 - \$3.9 million) from Terasen Gas (Vancouver Island) Inc. (“TGVI”), a subsidiary company of Terasen Inc., for transporting gas through the Company’s pipeline system.

The Company paid approximately \$42.4 million during the year ended December 31, 2004 (2003 - \$42.4 million) for customer care and billing services to a limited partnership. Terasen Inc. holds a 30% interest in the limited partnership and jointly controls it. The Company is committed to pay approximately \$42.0 million per year as base contract fees through the end of 2006.

The Company paid \$8.6 million in 2004 to its parent company for management services. At the

beginning of 2004 employees and assets relating to corporate services were transferred from the Company to Terasen Inc. to separate these functions from the regulated operations. As a result of the separation, a management fee was established that would retain the level of cost as approved in the 2003 revenue requirement. In 2003, \$8.6 million of operating expenses were included in the Company’s financial results related to these employees and assets.

The Company charged affiliated companies \$3.6 million in 2004 (2003 – \$0.3 million) for management services. During the fourth quarter of 2003 the Company and TGVI incurred restructuring charges, as disclosed in Note 2, to facilitate the operational integration of the two companies. The integration exercise facilitates a shared services approach that enables both companies to harness the benefits from economies of scale by having a single management and support structure that avoids duplication of work and allows customers to benefit from the synergies created.

ANNUAL FINANCIAL INFORMATION

The following selected consolidated financial information of the Company is a summary of information contained in the audited consolidated financial statements for the periods indicated.

<i>(dollars in millions except per share amounts)</i>	Year Ended December 31		
	2004	2003	2002
Revenues	\$ 1,305.2	\$ 1,305.6	\$ 1,246.4
Net earnings	70.8	70.4	67.1
Earnings applicable to common shares	70.8	70.4	67.1
Total assets	2,747.2	2,793.2	2,658.3
Long-term debt ²	1,051.4	1,297.3	1,148.0
Current portion of long-term debt	397.2	2.2	102.3

¹ Terasen Inc. owns all of the common shares of Terasen Gas

² Excluding current portion of long-term debt

QUARTERLY FINANCIAL INFORMATION

<i>In millions of dollars</i>	Quarter Ended							
	2004				2003			
	Dec.	Sept.	June	Mar.	Dec.	Sept.	June	Mar.
Revenues	\$ 442.3	\$ 161.6	\$ 211.6	\$ 489.7	\$ 462.4	\$ 158.8	\$ 256.2	\$ 428.2
Net earnings (loss) ¹	37.5	(13.4)	(1.3)	48.0	35.4	(14.4)	(1.7)	51.1

¹ Earnings from Terasen Gas have been restated to adjust for changes in the quarterly accounting for income tax. Previously, Terasen Gas’ annual tax expense had been allocated based on income tax estimated to be collected in rates for the four quarters. Beginning in the fourth quarter of 2004, Terasen Gas’ income tax expense is determined by applying the effective annual tax rate to the pre-tax income in the quarter. The change affects income tax expense and net earnings for each of the quarters but has no impact on annual income tax expense and net earnings.

SEASONALITY

Because of natural gas consumption patterns, the natural gas distribution operations of Terasen Gas normally generate higher net earnings in the first and fourth quarters, which are offset by net losses in the second and third quarters.

BUSINESS DEVELOPMENT

INLAND PACIFIC CONNECTOR

The Inland Pacific Connector is a proposed natural gas transmission line connecting the Southern Crossing pipeline to the Lower Mainland and Sumas. The advancement of the project is dependent on potential shippers and their requirements to diversify supply sources. The potential size of the project is \$300 to \$500 million.

VANCOUVER ISLAND GAS SUPPLY

TGVI is actively pursuing alternatives for the supply of additional natural gas capacity to Vancouver Island. The Company is responding to the need for delivery of increased gas supply and, accordingly, is supporting plans for new gas-fired power generation on Vancouver Island. TGVI's proposal for new natural gas capacity involves a combination of compression and pipeline looping as well the addition of a liquefied natural gas (LNG) storage facility on Vancouver Island. The expansion costs are estimated at approximately \$100 to \$120 million for the additional compression and the new LNG tank. The proposed tank would have the capacity to hold one billion cubic feet of natural gas.

MUNICIPAL LEASING TRANSACTIONS

Certain municipalities in Terasen Gas' service area have an option to purchase the gas distribution franchise within their municipal boundary. In order to address these purchase options, the Company has developed a leasing arrangement that allows Terasen Gas to continue to operate the gas distribution assets by effectively selling the assets to the municipality and leasing them back for a 17 year period. After 17 years, Terasen Gas has an option to repurchase the assets at depreciated value. At December 31, 2004, Terasen Gas had entered into transactions involving a total value of \$143 million. If all of the eligible municipalities execute similar transactions, the total value (including those already completed) is expected to be approximately \$164 million.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Terasen Gas' critical accounting policies are defined as those that are both significant to the presentation of the Company's financial position and operations and those that require management to make judgments based on underlying estimates and assumptions about future events and their effects. Underlying estimates and assumptions are based on historical experience and other factors that management believes to be reasonable and prudent under the circumstances. These estimates and assumptions are subject to change as new events occur, as more industry experience is acquired, as additional information is obtained and as the general operating environment changes. The Company believes the following are the most critical accounting policies and estimates used in the preparation of its consolidated financial statements.

RATE REGULATION

The Company follows generally accepted accounting principles, which may differ for regulated operations from those otherwise expected in non-regulated businesses. These differences occur when the regulatory agencies render their decisions on rate applications and generally involve the timing of revenue and expense recognition to ensure that the actions of the regulator, which create assets and liabilities, have been reflected in the financial statements.

The accounting for these items is based on an expectation of the future actions of the regulator. For example, Terasen Gas does not record future income taxes related to its regulated operations as the taxes payable method is prescribed by the regulator for rate-making purposes and there is reasonable expectation that all such future income taxes will be recovered in rates when they become payable. Similarly, the deferral of differences between amounts included in rates and actual experience for specified expenses is based on the expectation that the regulator will approve the refund to or recovery from ratepayers of the deferred balance, normally in the following year.

If the regulator's future actions are different from the Company's expectations, the timing and amount of the recovery of liabilities or refund of assets, recorded or unrecorded, could be substantially different from that reflected in the financial statements.

DEPRECIATION EXPENSE

Terasen's regulated property, plant and equipment assets are depreciated on a straight-line basis at rates approved by regulatory authorities. Depreciation rates require the use of management estimates of the useful lives of the assets. The cost of depreciable property retired, together with the removal costs less salvage, are recoverable based on the cost of provided the products or services. The Company's non-regulated property, plant and equipment assets are recorded using declining balance method of depreciation.

CHANGES IN ACCOUNTING POLICIES**ASSET RETIREMENT OBLIGATIONS**

On January 1, 2004, the Company adopted the Canadian Institute of Chartered Accountants (CICA) new standard for recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. Under the new standard the fair value of a liability for an asset retirement obligation must be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value is added to the carrying amount of the associated asset, which is then expensed over the asset's estimated useful life. The liability is accreted over the estimated useful life of the asset through charges to expenses.

As the fair value of future removal and site restoration costs are not currently determinable, the adoption of this policy does not result in the recording of an asset retirement liability and therefore the financial statements have not been impacted by this new standard. In addition, for regulated operations there is a reasonable expectation that asset retirement costs would be recoverable through future rates.

HEDGING RELATIONSHIPS

Effective January 1, 2004, the Company adopted the new accounting guideline on hedging relationships which specifies the circumstances in which hedge accounting is appropriate, including the identification, documentation, designation, and effectiveness of hedges. The guideline also identifies situations where hedge accounting is to be discontinued. The Company has met the criteria for all designated hedging relationships. The accounting treatment for financial instruments substantially conforms with those used in the Company's most recent annual consolidated financial statements.

RATE REGULATED ENTITIES

In 2003 the CICA reintroduced proposals to develop accounting standards for rate regulated enterprises which could have a significant impact on the Company's regulated operations. Although the CICA continues to deliberate on recognition and measurement issues related to rate regulation, in September 2004 the CICA issued a draft Guideline for comment on disclosures by entities with rate regulated operations. The proposed Guideline addresses certain aspects of disclosure and presentation of information in the financial statements of entities which have rate-regulated operations. The proposed disclosures are comprised of general information that facilitates an understanding of the effects of rate regulation on an entity's financial statements and additional information on how specific financial statement items have been affected. If approved, the draft guideline could be effective for annual and interim periods beginning on or after April 1, 2005.

VARIABLE INTEREST ENTITIES

The CICA has adopted Accounting Guideline 15 "Consolidation of Variable Interest Entities", which requires entities to consolidate those companies in which it holds a significant interest if it meets certain risk and reward criteria. On January 4th, 2005, Terasen Gas unwound its Coastal Facilities lease agreement and the assets have been included in the Terasen Gas rate base commencing January 2005.

FORWARD LOOKING STATEMENT

When used in this report, the words "anticipate", "expect", "project", "believe", "estimate", "forecast" and similar expressions are intended to identify forward looking statements, which include statements relating to pending and proposed projects or possible acquisitions. Such statements are subject to certain risks, uncertainties and assumptions pertaining to operating performance, regulatory parameters, economic conditions and, in the case of pending and proposed projects, risks relating to design and construction, regulatory processes, obtaining financing and performance of other parties, including partners, contractors and suppliers and in the case of possible acquisitions, obtaining financing, acquiring assets or companies at an appropriate price and the ability to effect synergies in a timely and cost-effective manner.

ADDITIONAL INFORMATION

Additional information relating to Terasen Gas Inc., including its Annual Information Form is available on SEDAR at www.sedar.com.

MANAGEMENT'S RESPONSIBILITY

The consolidated financial statements have been prepared by management, which is responsible for the integrity and objectivity of this information. These financial statements have been prepared in conformity with Canadian generally accepted accounting principles and, where appropriate, include some amounts that are based on management's best estimates and judgments. The financial information presented elsewhere in the annual report is consistent with that in the consolidated financial statements.

Management has established systems of internal control which are designed to provide reasonable assurance that assets are safeguarded from loss and that reliable financial records are maintained. These systems are monitored by internal auditors.

KPMG LLP, the independent auditors appointed by the shareholders, have audited the consolidated financial statements of the Company in accordance with Canadian generally accepted auditing standards and have expressed their opinion upon completion of such audits in the following report. In order to provide their opinion on these consolidated financial statements, the shareholders' auditors review the system of internal controls and conduct their work to the extent they consider appropriate.

The Board of Directors, through its Audit Committee, oversees management's responsibilities for financial reporting and internal control. The Audit Committee meets with the internal auditors, the independent auditors and management to discuss auditing and financial matters and to review the consolidated financial statements and the independent auditors' report. The Audit Committee reports its findings to the Board for consideration in approving the consolidated financial statements for issuance to the shareholders.

Signed: "*R.L. (Randy) Jespersen*"

President

Signed: "*Scott A. Thomson*"

Vice President, Finance and
Regulatory Affairs

Vancouver, Canada
February 2, 2005

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated statements of financial position of Terasen Gas Inc. as at December 31, 2004 and 2003 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Signed: "KPMG LLP"

Chartered Accountants

Vancouver, Canada
February 2, 2005

CONSOLIDATED STATEMENTS OF EARNINGS

<i>In millions of dollars</i>		
<i>Years ended December 31</i>	2004	2003
Revenues		
Natural gas distribution	\$ 1,305.2	\$ 1,305.6
Expenses		
Cost of natural gas	807.0	805.2
Operation and maintenance	164.4	160.9
Depreciation and amortization	81.6	76.7
Property and other taxes	39.6	41.4
	1,092.6	1,084.2
Operating income	212.6	221.4
Financing costs (note 10)	106.4	111.9
Earnings before income taxes	106.2	109.5
Current income taxes (note 11)	35.4	39.1
Net earnings	\$ 70.8	\$ 70.4

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

<i>In millions of dollars</i>		
<i>Years ended December 31</i>	2004	2003
Retained earnings, beginning of year	\$ 27.8	\$ 37.4
Net earnings	70.8	70.4
	98.6	107.8
Dividends on common shares	60.0	80.0
Retained earnings, end of year	\$ 38.6	\$ 27.8

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

<i>In millions of dollars</i> <i>As at December 31</i>	2004	2003
Assets		
Current assets		
Cash and short-term investments	\$ 1.7	\$ -
Accounts receivable	252.9	318.0
Inventories of gas in storage and supplies	151.5	113.6
Prepaid expenses	5.7	5.8
Current portion of rate stabilization accounts (note 4)	13.8	8.8
	425.6	446.2
Property, plant and equipment (note 3)	2,260.0	2,285.8
Rate stabilization accounts (note 4)	27.9	32.2
Other assets		
Deferred charges	25.5	23.9
Long-term receivables and investments	8.2	5.1
	\$ 2,747.2	\$ 2,793.2
Liabilities and shareholders' equity		
Current liabilities		
Bank indebtedness	\$ -	\$ 4.3
Short-term notes	107.0	352.9
Accounts payable and accrued liabilities	254.9	275.1
Income and other taxes payable	18.9	44.5
Current portion of rate stabilization account (note 4)	27.6	2.5
Current portion of long-term debt (note 5)	397.2	2.2
	805.6	681.5
Long-term debt (note 5)	1,051.4	1,297.3
Other long-term liabilities and deferred credits (note 6)	80.2	48.9
Future income taxes	0.5	0.5
	1,937.7	2,028.2
Shareholders' equity		
Share capital (note 7)	594.0	594.0
Contributed surplus (note 7)	176.9	143.2
Retained earnings	38.6	27.8
	809.5	765.0
	\$ 2,747.2	\$ 2,793.2

Approved by the Board:

Signed: "Mark L. Cullen" (Chairman)

Signed: "John M. Reid" (Vice Chairman)

CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>In millions of dollars</i>	2004	2003
Cash flows provided by (used for)		
Operating activities		
Net earnings	\$ 70.8	\$ 70.4
Adjustments for non-cash items		
Depreciation and amortization	81.6	76.7
Other	(0.9)	(2.2)
	151.5	144.9
Decrease in rate stabilization accounts	24.4	38.2
Changes in non-cash working capital	15.5	(37.5)
	191.4	145.6
Investing activities		
Property, plant and equipment	(93.9)	(116.2)
Proceeds on sale of natural gas distribution assets (note 6)	64.6	-
Proceeds on sale of property, plant and equipment (note 13(a))	3.1	-
Other assets	(2.4)	(3.7)
	(28.6)	(119.9)
Financing activities		
Increase (decrease) in short-term notes	(245.9)	2.9
Increase in long-term debt	152.1	152.4
Reduction of long-term debt	(3.0)	(103.2)
Dividends on common shares	(60.0)	(80.0)
	(156.8)	(27.9)
Increase (decrease) in cash	6.0	(2.2)
Bank indebtedness at beginning of year	(4.3)	(2.1)
Cash (bank indebtedness) at end of year	\$ 1.7	\$ (4.3)
Supplemental cash flow information		
Interest paid in the year	\$ 103.7	\$ 113.2
Income taxes paid in the year	31.7	25.2

Cash is defined as cash or bank indebtedness.

1. SIGNIFICANT ACCOUNTING POLICIES

The preparation of these consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses in the financial statements, as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

In the opinion of Management, these consolidated financial statements have been properly prepared within reasonable limits of materiality and reflect the following summary of significant accounting policies.

(a) BASIS OF PRESENTATION

On April 25, 2003, the Company changed its name from BC Gas Utility Ltd. to Terasen Gas Inc. The consolidated financial statements include the accounts of the Company and its subsidiaries, including Terasen Gas (Squamish) Inc. ("Squamish").

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

(b) REGULATION

The Company and Squamish are primarily engaged in the transmission and retail distribution of natural gas for residential, commercial and large industrial customers in British Columbia and are subject to the regulation of the British Columbia Utilities Commission ("the BCUC").

The BCUC exercises statutory authority over such matters as rates of return, construction and operation of facilities, accounting practices, rates, and contractual agreements with customers.

In order to recognize the economic effects of regulation, the timing of recognition of certain revenues and expenses in these operations may differ from that otherwise expected under generally accepted accounting principles.

(c) INVENTORIES

Inventories of gas in storage are valued at weighted-average cost. Supplies and other inventories are valued at the lower of cost and net realizable value.

(d) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost less accumulated depreciation and unamortized contributions in aid of construction. Cost includes all direct expenditures for system expansions, betterments and replacements, an allocation of overhead costs and an allowance for funds used during construction. When allowed by the BCUC, regulated operations capitalize an allowance for equity funds used during construction at approved rates.

Depreciation of regulated assets is recorded on a straight-line basis over their useful lives. Depreciation rates for regulated assets are approved by the respective regulator.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The cost of regulated depreciable property retired, together with removal costs less salvage, is charged to accumulated depreciation as is any gain or loss incurred on disposal.

(e) IMPAIRMENT OF LONG-LIVED ASSETS

On January 1, 2004, the Company adopted the Canadian Institute of Chartered Accountants ("CICA") standard for recognizing, measuring and disclosing impairment of long-lived assets held for use. A long-lived asset is tested for recoverability when events or circumstances indicate that its carrying amount may not be recoverable. The new standard has had no impact on the Company's financial results.

(f) ASSET RETIREMENT OBLIGATIONS

On January 1, 2004, the Company adopted the new CICA standard for the recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. Under the new standard the fair value of a liability for an asset retirement obligation must be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The fair value is added to the carrying amount of the associated asset, which is then expensed over the asset's estimated useful life. The liability is accreted over the useful life of the asset through charges to expenses.

As the fair value of future removal and site restoration costs are not currently determinable, the adoption of the policy does not result in the recording of an asset retirement liability and therefore the consolidated financial statements have not been impacted by the new standard. In addition, for regulated operations there is a reasonable expectation that asset retirement costs would be recoverable through future rates.

(g) RATE STABILIZATION ACCOUNTS

The Company is authorized by the BCUC to maintain rate stabilization accounts to mitigate the effect on its earnings of unpredictable and uncontrollable factors, namely volume volatility caused principally by weather and natural gas cost volatility. The Revenue Stabilization Adjustment Mechanism ("RSAM") accumulates the margin impact of variations in the actual versus forecast use for residential and commercial customers.

In 2004 the Gas Cost Reconciliation Account ("GCRA"), which accumulates differences between actual natural gas costs and forecast natural gas costs as recovered in base rates, was replaced by the Commodity Cost Reconciliation Account ("CCRA") and the Midstream Cost Reconciliation Account ("MCRA"). The two new accounts were approved by the BCUC to segregate costs that are allocable to all sales customers (MCRA) and all residential customers and certain commercial and industrial customers for whom Terasen Gas acquires gas supply (CCRA).

All rate stabilization account balances are amortized and recovered through rates as approved by the BCUC.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(h) DEFERRED CHARGES

The Company defers certain charges which the regulatory authorities or contractual arrangements require or permit to be recovered through future rates. Deferred charges are amortized over various periods as approved by the BCUC and depending on the nature of the charges.

Deferred charges include long-term debt issue costs which are amortized over the term of the related debt.

Deferred charges not subject to regulation relate to projects which may benefit future periods and will be capitalized on completion, expensed on project abandonment, or are being amortized on a straight-line basis over their useful lives.

(i) DERIVATIVE FINANCIAL INSTRUMENTS

The Company utilizes derivatives and other financial instruments to manage its exposure to changes in foreign currency exchange rates, interest rates and energy commodity prices.

A derivative must be designated and effective to be accounted for as a hedge. The Company designates each derivative instrument as a hedge of specific assets or liabilities on the balance sheet or specific firm commitments or anticipated transactions. The Company also assesses, both at inception and on an ongoing basis, whether the derivative instruments that are used in each hedging transaction are effective in offsetting changes in fair values or cash flows of the hedged items.

As approved by the regulator, derivatives are used to manage natural gas price risk in the natural gas distribution operations. The majority of the natural gas supply contracts have floating, rather than fixed prices. The Company uses natural gas price swap contracts to fix the effective purchase price. Any differences between the effective cost of natural gas purchased and the price of natural gas included in rates are recorded in deferral accounts (CCRA and MCRA), and subject to regulatory approval, are passed through in future rates to customers.

The Company's short-term borrowings and variable rate long-term debt are exposed to interest rate risk.

Foreign currency risk in natural gas distribution operations relates mainly to purchases and sales of natural gas denominated in U.S. dollars, and is thereby managed through regulatory deferral accounts. Certain foreign currency risks in the natural gas distribution operations are managed through the use of foreign currency derivatives on behalf of customers.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(j) REVENUE RECOGNITION

The Company recognizes revenues when products have been delivered or services have been performed.

Revenues from natural gas sales are recorded on the basis of regular meter readings and estimates of customer usage since the last meter reading date to the end of the year and adjusted for the Revenue Stabilization Adjustment Mechanism and other BCUC approved orders.

(k) POST-EMPLOYMENT BENEFIT PLANS

The Company sponsors a number of employee benefits plans. These plans include both defined benefit and defined contribution pension plans, and various other post-retirement benefit plans.

The cost of pensions and other post-retirement benefits earned by employees is actuarially determined as the employee provides service, except when the BCUC requires costs to be expensed as paid. The Company uses the projected benefit method based on years of service and estimates of expected returns on plan assets, salary escalation, retirement age of employees, mortality and expected future health-care costs. The discount rate used to value liabilities is based on AA Corporate bond yields. The Company accrues the cost of defined benefit pensions and post-employment benefits as the employee provides services, except when the BCUC requires costs to be expensed as paid.

The expected return on plan assets is based on management's estimate of the long-term expected rate of return on plan assets and a market-related value of plan assets. The market-related value of assets as of December 31, 2004 is calculated as the average of the market value of invested assets at December 31, 2004 and two actuarially determined extrapolated market values of invested assets at December 31, 2004. The two extrapolated market values are calculated by using the market value of invested assets at December 31, 2002 rolled forward to December 31, 2004 using 2003 and 2004 net contributions and assumed investment returns, and the market value of invested assets at December 31, 2003 rolled forward to December 31, 2004 using 2004 net contributions and assumed investment returns. These three amounts are then averaged to determine the market-related value of plan assets used in calculating net benefit expense.

Adjustments, in excess of 10% of the greater of the accrued benefit obligation and plan asset value, that result from plan amendments, changes in assumptions and experience gains and losses are amortized over the expected average remaining service life of the employee group covered by the plan. Experience will often deviate from the actuarial assumptions resulting in actuarial gains and losses.

Defined contribution plan costs are expensed by the Company as contributions are payable.

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(I) INCOME TAXES

The Company and Squamish account for and recover income tax expense in rates as prescribed by the BCUC for ratemaking purposes. This includes accounting for income taxes by the taxes payable method and accounting for certain deferral and rate stabilization accounts on a net of realized tax basis, as approved by the BCUC. Therefore, future income taxes related to temporary differences are not recorded. The taxes payable method is followed as there is reasonable expectation that all future income taxes will be recovered in rates when they become payable.

2. RESTRUCTURING

During the year ended December 31, 2003, the Company's parent undertook a management and administrative restructuring and integration of its natural gas distribution operations. The initiative was undertaken to generate efficiencies and harmonize processes and systems between the Company and Terasen Gas (Vancouver Island) Inc., a company related by common ownership. As a result of the restructuring, the Company recorded a charge of \$3.0 million in 2003 and \$0.4 million in 2004, net of previously recorded accruals, tax and the deferral of an amount for future recovery from customers through rates. The pre-tax charges have been included in operations and maintenance expense.

3. PROPERTY, PLANT AND EQUIPMENT

2004				
	Weighted average depreciation rate	Cost	Accumulated depreciation	Net book Value
Natural gas distribution systems	2.40%	\$ 2,556.0	\$ 505.8	\$ 2,050.2
Plant, buildings and equipment	9.30%	223.1	94.5	128.6
Land and land rights	0.60%	82.5	1.3	81.2
		\$ 2,861.6	\$ 601.6	\$ 2,260.0

2003				
	Weighted average depreciation rate	Cost	Accumulated depreciation	Net book Value
Natural gas distribution systems	2.40%	\$ 2,546.4	\$ 470.6	\$ 2,075.8
Plant, buildings and equipment	8.40%	240.2	102.4	137.8
Land and land rights	0.60%	73.1	0.9	72.2
		\$ 2,859.7	\$ 573.9	\$ 2,285.8

4. RATE STABILIZATION ACCOUNTS

	2004	2003
<i>Current Assets</i>		
RSAM	\$ 11.1	\$ 8.8
CCRA	2.7	-
	13.8	8.8
<i>Long-Term Assets</i>		
RSAM	27.9	32.2
	27.9	32.2
<i>Current Liabilities</i>		
MCRA	(27.6)	-
GCRA	-	(2.5)
	(27.6)	(2.5)
Net rate stabilization accounts	\$ 14.1	\$ 38.5

The current portion of the rate stabilization accounts represents the amounts expected to be recovered in rates over the next twelve months. Actual recoveries will vary depending on actual natural gas consumption and recovery amounts approved by the BCUC.

The RSAM account is anticipated to be recovered in rates over three years. Recovery of the RSAM balance is dependent upon annually approved rates and actual gas consumption volumes. The MCRA and CCRA accounts are anticipated to be fully recovered or paid within the next fiscal year.

5. LONG-TERM DEBT

	2004	2003
(a) Purchase Money Mortgages:		
11.80% Series A, due September 30, 2015	\$ 74.9	\$ 74.9
10.30% Series B, due September 30, 2016	200.0	200.0
(b) Debentures and Medium Term Note Debentures:		
9.75% Series D, due December 17, 2006	20.0	20.0
10.75% Series E, due June 8, 2009	59.9	59.9
6.20% Series 9, due June 2, 2008	188.0	188.0
6.95% Series 11, due September 21, 2029	150.0	150.0
6.50% Series 12, due July 20, 2005	200.0	200.0
6.50% Series 13, due October 16, 2007	100.0	100.0
6.15% Series 16, due July 31, 2006	100.0	100.0
Floating Rate Series 17, interest rate of 2.93% (2003 – 3.02%) due September 26, 2005	150.0	150.0
6.50% Series 18, due May 1, 2034	150.0	-
Various series, weighted-average interest rate of 9.63% (2003 – 9.63%) due in 2005	45.0	45.0
Obligations under capital leases, at 6.23% (2003 – 6.20%)	10.8	11.7
Total long-term debt	1,448.6	1,299.5
Less: current portion of long-term debt	397.2	2.2
	\$ 1,051.4	\$ 1,297.3

5. LONG-TERM DEBT (CONTINUED)

(a) PURCHASE MONEY MORTGAGES:

The Series A and Series B Purchase Money Mortgages are secured equally and rateably by a first fixed and specific mortgage and charge on the Company's Coastal Division assets, and are subject to the restrictions of the Trust Indenture dated December 3, 1990. The aggregate principal amount of Purchase Money Mortgages that may be issued under the Trust Indenture is limited to \$425 million.

(b) DEBENTURES AND MEDIUM TERM NOTE DEBENTURES:

The Company's debentures are unsecured obligations but are subject to the restrictions of the Trust Indenture dated November 1, 1977, as amended and supplemented.

The Company's Series B Purchase Money Mortgages, Series E Debentures, and Series 11, Series 13, Series 16 and Series 18 Medium Term Note Debentures are redeemable in whole or in part at the option of the Company at a price equal to the greater of the Canada Yield Price, as defined in the applicable Trust Indenture, and the principal amount of the debt to be redeemed, plus accrued and unpaid interest to the date specified for redemption. The Canada Yield Price is calculated as an amount that provides a yield slightly above the yield on an equivalent maturity Government of Canada bond.

Required principal repayments over the next five years are as follows:

2005	\$ 397.2
2006	122.2
2007	102.2
2008	190.2
2009	62.1

6. OTHER LONG-TERM LIABILITIES AND DEFERRED CREDITS

	2004	2003
Pension and other post-employment benefit liabilities	\$ 19.9	\$ 18.7
Deferred gains on sale of natural gas distribution assets	60.3	30.2
	\$ 80.2	\$ 48.9

The deferred gains on sale of natural gas distribution assets occurred upon the sale of pipeline assets to certain municipalities in 2001, 2002 and 2004. The pre-tax gains of \$66.5 million on combined cash proceeds of \$135.9 million are being amortized over the 17-year terms of the operating leases that commenced at the time of the sale transactions. These operating lease commitments are included in the table in Note 14.

7. SHARE CAPITAL

The Company is authorized to issue 500,000,000 common shares, 100,000,000 first preference shares and 100,000,000 second preference shares, all without par value.

	2004	2003
Common shares, 59,591,732 shares issued	\$ 594.0	\$ 594.0

CONTRIBUTED SURPLUS

Income tax benefits in the amount of \$33.7 million (2003 - \$17.0 million) relating to transactions with entities under common control were recorded as a credit to contributed surplus in 2004.

8. EMPLOYEE BENEFIT PLANS

The Company is a sponsor of pension plans for eligible employees. The plans include registered defined benefit pension plans, supplemental unfunded arrangements, which provide pension benefits in excess of statutory limits, and defined contributory plans. The Company also provides post-employment benefits other than pensions for retired employees. The following is a summary of each type of plan:

DEFINED BENEFIT PLANS

Retirement benefits under the defined benefit plans are based on employees' years of credited service and remuneration. Company contributions to the plan are based upon independent actuarial valuations. The most recent actuarial valuations of the defined benefit pension plans for funding purposes were at December 31, 2002 and December 31, 2001 and the date of the next required valuations are December 31, 2005 and December 31, 2004. The December 31, 2004 valuation will not be completed until the second quarter of 2005. The expected weighted average remaining service life of employees covered by the defined benefit pension plans is 9.5 years (2003 - 9.5 years).

DEFINED CONTRIBUTION PLAN

Effective in 2000 all new non-union employees become members of defined contribution pension plans. Company contributions to the plan are based upon employee age and pensionable earnings.

SUPPLEMENTAL PLANS

Certain employees are eligible to receive supplemental benefits under both the defined benefit and defined contribution plans. The supplemental plans provide pension benefits in excess of statutory limits. The supplemental plans are unfunded and are secured by letters of credit.

8. EMPLOYEE BENEFIT PLANS (CONTINUED)

OTHER POST-EMPLOYMENT BENEFITS

The Company provides retired employees with other post-employment benefits that include, depending on circumstances, supplemental health, and life insurance coverage. Post-employment benefits are unfunded and annual expense is recorded on an accrual basis based on independent actuarial determinations, considering among other factors, health care cost escalation. The most recent actuarial valuations were completed as at December 31, 2002. The expected weighted average remaining service life of employees covered by these benefit plans is 9.0 years (2003 - 9.0 years).

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 each year. The financial positions of the employee defined benefit pension plans and other benefit plans are presented in the tables below:

	Pension benefit plans		Other benefit plans	
	2004	2003	2004	2003
Plan assets				
Fair value, beginning of year	\$ 169.8	\$ 146.8	\$ -	\$ -
Transfer to parent	(2.4)	-	-	-
Actual return on plan assets	19.2	20.5	-	-
Employers' contributions	3.7	7.4	0.8	0.6
Employees' contributions	2.4	2.4	-	-
Benefits and settlements paid	(7.4)	(7.1)	(0.8)	(0.6)
Other	(0.1)	(0.2)	-	-
Fair value, end of year	185.2	169.8	-	-
Accrued benefit obligation				
Obligation, beginning of year	189.4	171.4	48.5	36.0
Transfer to parent	(12.0)	-	(0.8)	-
Current service cost	4.8	5.5	0.8	0.9
Interest cost	11.1	11.3	3.0	2.4
Employees' contributions	2.4	2.4	-	-
Benefits and settlements paid	(7.4)	(7.1)	(0.8)	(0.6)
Change in discount rate	3.2	3.6	2.1	2.0
Actuarial loss	-	1.0	-	10.8
Past service cost and other	0.2	1.3	0.1	(3.0)
Balance, end of year	191.7	189.4	52.9	48.5
Funded status - plan deficit	(6.5)	(19.6)	(52.9)	(48.5)
Unamortized transitional obligation (benefit)	(14.0)	(16.7)	6.2	7.8
Unamortized actuarial loss	21.1	29.4	23.4	23.9
Unamortized past service costs	3.8	6.3	(1.0)	(1.3)
Accrued benefit asset (liability)	\$ 4.4	\$ (0.6)	\$ (24.3)	\$ (18.1)

The net accrued benefit liability is included in other long-term liabilities and deferred credits (Note 6).

8. EMPLOYEE BENEFIT PLANS (CONTINUED)

Included in the accrued benefit obligation and fair value of the plan assets at year-end are the following amounts in respect of plans with accrued benefit obligations in excess of fair value of assets:

	Pension benefit plans		Other benefit plans	
	2004	2003	2004	2003
Accrued benefit obligations:				
Unfunded plans	\$ 8.4	\$ 17.1	\$ 52.9	\$ 48.5
Funded plans	137.6	125.3	-	-
	146.0	142.4	52.9	48.5
Fair value of plan assets	136.5	120.5	-	-
Funded status deficit	\$ (9.5)	\$ (21.9)	\$ (52.9)	\$ (48.5)

The accrued benefit obligations for unfunded pension benefit plans are secured by letters of credit.

The net benefit plan expense is as follows:

	Pension benefit plans		Other benefit plans	
	2004	2003	2004	2003
Current service cost	\$ 4.8	\$ 5.5	\$ 0.8	\$ 0.9
Interest cost on projected benefit obligations	11.1	11.3	3.0	2.4
Actual positive return on plan assets	(19.2)	(15.0)	-	-
Net actuarial losses	3.2	2.8	2.1	2.2
Past service costs	0.2	0.8	-	(4.4)
Net benefit plan expense before adjustments	0.1	5.4	5.9	1.1
Adjustments to recognize the long-term nature of employee future benefit costs:				
Difference between actual and expected return on plan assets	7.0	3.0	-	-
Difference between actual and recognized actuarial losses in year	(1.7)	(2.4)	(0.2)	(12.0)
Difference between actual and recognized past service costs in year	0.2	(0.1)	-	4.4
Amortization of transitional obligation (benefit)	(1.8)	(1.9)	1.6	12.8
Other	1.1	0.2	0.1	-
Net benefit plan expense	\$ 4.9	\$ 4.2	\$ 7.4	\$ 6.3
Defined contribution plan expense	\$ 0.9	\$ 1.1		
	\$ 5.8	\$ 5.3		

8. EMPLOYEE BENEFIT PLANS (CONTINUED)

BENEFIT PLAN ASSETS

The weighted-average asset allocation by asset category of the Company's defined benefit pension plans and other funded benefit plans is as follows:

	Pension Benefit Plans	
	2004	2003
Equity securities	54%	56%
Fixed income securities	38%	35%
Other assets	8%	9%
Total assets	100%	100%

The investment policy for benefit plan assets is to optimize the risk-return using a portfolio of various asset classes. The Company's primary investment objectives are to secure registered pension plans, and maximize investment returns in a cost-effective manner while not compromising the security of the respective plans. The pension plans utilize external investment managers to manage the investment policy. Assets in the plan are held in trust by independent third parties.

The pension plans do not directly hold any shares of the Company's parent.

SIGNIFICANT ASSUMPTIONS

The discount rate assumption used in determining pension and post-retirement benefit obligations and net benefit expense reflects the market yields, as of the measurement date, on high-quality debt instruments. The expected rate of return on plan assets assumption is reviewed annually by management, in conjunction with actuaries. The assumption is based on the expected returns for the various asset classes, weighted by the portfolio allocation.

The weighted average significant actuarial assumptions used to determine the accrued benefit obligation and the benefit plan expense are as follows:

	Pension benefit plans		Other benefit plans	
	2004	2003	2004	2003
Accrued benefit obligation				
Discount rate at December 31, based on AA Corporate bonds	6.00%	6.25%	6.25%	6.50%
Rate of compensation increase	3.33%	3.32%	-	-
Net benefit plan expense				
Discount rate at January 1, based on AA Corporate bonds	6.25%	6.50%	6.25%	6.50%
Expected rate of return on plan assets	7.50%	7.50%	-	-

8. EMPLOYEE BENEFIT PLANS (CONTINUED)

The assumed health-care cost trend rates for other post-employment benefit plans are as follows:

	2004	2003
Extended health benefits		
Initial health care cost trend rate	9.0%	10.0%
Annual rate of decline in trend rate	1.0%	1.0%
Ultimate health care cost trend rate	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	2008	2008
Medical Services Plan Benefits Premium trend rate	4.0%	4.0%

A one percentage-point change in assumed health-care cost trend rates would have the following effects:

2004	One percentage-point increase	One percentage-point decrease
Effect on the total of the service costs and interest cost components of the benefit plan expense	\$ 0.9	\$ (0.7)
Effect on accrued benefit obligation	10.7	(8.9)

CASH FLOWS

Total cash contributions for employee benefits plans consist of:

	Pension benefit plans	
	2004	2003
Funded plans	\$ 3.3	\$ 6.6
Beneficiaries of unfunded plans	1.3	1.5
Defined contribution plans	0.9	1.1
Total	\$ 5.5	\$ 9.2

The contributions for 2005 are anticipated to be approximately the same as 2004 for defined pension benefit plans and other benefit plans.

BENEFIT CHANGES

Effective January 1, 2004, the Company modified its post-employment benefit program for non-union active employees in order to provide future retirees with more choice of coverage and to reduce the Company's exposure to future health and group life cost increases. The new plan is predominantly a defined contribution plan incorporating a Company-paid health spending account, a security health plan and life insurance. Provincial medical services plan premiums will now be paid by the retiree.

All plan members who have retired on or before December 31, 2004 receive benefits under the plans that were in effect when they retired, which includes the payment of provincial medical services plan premiums by the Company. Employees electing to retire during 2005 will have a choice between the new and old plan, and employees retiring after December 31, 2005 will participate in the new plan.

These assumptions, including the post-employment benefit plan changes, were included in the calculation of the accrued benefit obligation at December 31, 2003 and 2004.

9. STOCK-BASED COMPENSATION

The Company's parent, Terasen Inc., grants stock options to employees of the Company under its stock option plans. In 2004, 192,200 options (2003 – 148,200 options) to purchase shares in the Company's parent were issued to employees of the Company at an average exercise price of \$23.88 (2003 - \$19.75). In 2004, the Company was charged, and recorded as an expense, \$0.3 million (2003 - \$0.1 million) for the fair value of the stock compensation granted in 2004 by Terasen Inc.

10. FINANCING COSTS

	2004	2003
Interest and expense on long-term debt	\$ 99.2	\$ 104.7
Interest on short-term debt	7.7	7.8
Interest capitalized	(0.5)	(0.6)
	\$ 106.4	\$ 111.9

11. INCOME TAXES

VARIATION IN EFFECTIVE INCOME TAX RATE

Consolidated income taxes vary from the amount that would be computed by applying the federal and provincial combined statutory income tax rate of 34.58% (2003 – 36.02%) to earnings before income taxes as shown in the following table:

	2004	2003
Earnings before income taxes	\$ 106.2	\$ 109.5
Combined statutory income tax rate	34.58%	36.02%
Combined income taxes at statutory rate	\$ 36.7	\$ 39.4
Increase (decrease) in income taxes resulting from:		
Capital cost allowance and other deductions claimed for income tax purposes over amounts recorded for accounting purposes	(8.4)	(6.9)
Large Corporations Tax in excess of surtax	4.3	5.0
Non-deductible expenses and non-taxable income	4.2	3.1
Other	(1.4)	(1.5)
Actual consolidated income taxes	\$ 35.4	\$ 39.1
Effective Income Tax Rate	33.33%	35.71%

FUTURE INCOME TAXES

As a result of the Company accounting for income taxes following the taxes payable method for its regulated operations, the Company has not recognized net future income tax liabilities amounting to \$215.8 million at December 31, 2004 (2003 – \$206.1 million) and has not recognized a future income tax expense of \$9.7 million for the year ended December 31, 2004 (2003 – \$9.8 million), all of which were calculated using the asset and liability method.

12. FINANCIAL INSTRUMENTS

FAIR VALUE ESTIMATES

The carrying values of cash and short-term investments, accounts receivable, bank indebtedness, short-term notes and accounts payable and accrued liabilities approximate their fair values due to the relatively short period to maturity of the instruments.

The fair value of the Company's long-term debt, calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues at December 31, 2004, or by using available quoted market prices, is estimated at \$1,649.8 million (2003 - \$1,480.8 million). The majority of the Company's long-term debt relates to regulated operations which enables the Company to recover the existing financing charges through rates or tolls.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment.

DERIVATIVE INSTRUMENTS

The Company uses derivative instruments to hedge its exposures to fluctuations in natural gas prices, interest rates and foreign currency exchange rates.

Asset (Liability) <i>December 31</i> <i>(in millions)</i>	Number of swaps	Term to maturity (years)	2004		2003	
			Carrying Value	Fair Value	Carrying Value	Fair Value
Natural Gas						
Commodity Swaps	122	Up to 2	\$ 1.7	\$ (6.8)	\$ (7.4)	\$ 4.6
Foreign Currency Swaps	-	-	-	-	-	(0.9)

The natural gas derivatives fair value reflects only the value of the natural gas derivatives and not the offsetting change in value of the underlying future purchases of natural gas. These fair values reflect the estimated amounts the Company would receive or pay to terminate the contracts at the stated dates.

The Company is exposed to credit risk in the event of non-performance by counterparties to derivative instruments. Because it deals with high credit quality institutions in accordance with established credit approval practices, the Company does not expect any counterparties to fail to meet their obligations.

13. RELATED PARTY TRANSACTIONS

(a) The Company sold property, plant and equipment totaling \$3.1 million in 2004 (2003 – nil) to its parent company, Terasen Inc., at net book value and transferred accrued employee benefit plan liabilities of \$6.5 million to its parent in 2004.

(b) The Company received \$4.0 million in 2004 (2003 - \$3.9 million) from Terasen Gas (Vancouver Island) Inc. ("TGVI"), a subsidiary company of Terasen Inc., for transporting gas through the Company's pipeline system.

(c) The Company paid approximately \$42.4 million during the year ended December 31, 2004 (2003 - \$42.4 million) for customer care and billing services to a limited partnership. Terasen Inc. holds a 30% interest in the limited partnership and jointly controls it. The Company is committed to pay approximately \$42.0 million per year as base contract fees through the end of 2006.

14. RELATED PARTY TRANSACTIONS (CONT'D)

(d) The Company paid \$8.6 million in 2004 to its parent company for management services. At the beginning of 2004 employees and assets relating to corporate services were transferred from the Company to Terasen Inc. to separate these functions from the regulated operations. As a result of the separation, a management fee was established that would retain the level of cost as approved in the 2003 revenue requirement. In 2003, \$8.6 million of operating expenses were included in the Company's financial results related to these employees and assets.

(e) The Company charged affiliated companies \$3.6 million in 2004 (2003 – \$0.3 million) for management services. During the fourth quarter of 2003 the Company and TGVI incurred restructuring charges, as disclosed in Note 2, to facilitate the operational integration of the two companies. The integration exercise facilitates a shared services approach that enables both companies to harness the benefits from economies of scale by having a single management and support structure that avoids duplication of work and allows customers to benefit from the synergies created.

14. COMMITMENTS AND CONTINGENCIES

The Company has entered into operating leases for certain building space and natural gas distribution assets. In addition, the Company enters into gas purchase contracts.

The following table sets forth the Company's operating lease and purchase obligations due in the years indicated:

	Operating leases	Purchase obligations	Total
2005	\$ 16.0	\$ 710.7	\$ 726.7
2006	15.7	318.7	334.4
2007	15.2	70.6	85.8
2008	15.8	20.1	35.9
2009	15.7	16.0	31.7
2010 and later	135.0	-	135.0
	\$ 213.4	\$ 1,136.1	\$ 1,349.5

Gas purchase contract commitments are based on market prices that vary with gas commodity indices. The amounts disclosed reflect index prices that were in effect at December 31, 2004.

On January 4, 2005 the Company terminated an operating lease for a certain building and paid \$49.4 million to acquire the related building. Accordingly, payments related to this operating lease are not included in the above table. Effective January 4, 2005 the building is included in property, plant and equipment and has been included in the Company's rate base revenue requirement for 2005.

A number of claims and lawsuits seeking damages and other relief are pending against the Company. Management is of the opinion, based upon information presently available, that it is unlikely that any liability, to the extent not provided for through insurance or otherwise, would be material in relation to the Company's consolidated financial statements.

OPERATING SUMMARY - UNAUDITED

Dollar amounts in millions
Years ended December 31

	2004	2003	2002	2001	2000
Revenues					
Residential	\$ 778.2	\$ 769.6	\$ 731.0	\$ 813.6	\$ 627.8
Commercial	392.0	392.6	372.0	442.2	336.3
Small industrial	43.5	48.2	49.6	73.6	52.3
Large industrial and other	3.6	3.0	3.3	6.8	7.7
Total natural gas sales revenue	1,217.3	1,213.4	1,155.9	1,336.2	1,024.1
Transportation	65.5	62.3	62.0	56.0	40.9
Other	22.4	29.9	28.5	31.0	20.3
Total natural gas revenue	\$ 1,305.2	\$ 1,305.6	\$ 1,246.4	\$ 1,423.2	\$ 1,085.3
Volumes (PJs)*					
Residential	66.5	68.8	75.2	69.6	77.0
Commercial	38.3	39.0	42.5	42.2	46.7
Small industrial	4.9	5.6	6.5	8.4	10.3
Large industrial and other	0.4	0.3	1.2	0.7	1.6
Total natural gas sales volume (PJs)	110.1	113.7	125.4	120.9	135.6
Transportation	62.8	62.3	66.7	58.7	61.5
Other	39.3	34.8	36.9	69.7	63.4
Total natural gas volume (PJs)	212.2	210.8	229.0	249.3	260.5
Customers at year end					
Residential	712,304	701,335	694,787	687,375	682,401
Commercial	77,624	77,013	77,894	78,756	78,948
Small industrial	416	470	488	515	602
Large industrial and other	45	50	61	61	66
Transportation	1,741	1,512	1,328	1,141	856
	792,130	780,380	774,558	767,848	762,873
Customers statistics*					
Average use per customer (GJs)					
Residential	94	99	109	102	113
Commercial	495	504	543	535	594
Average rate per GJ					
Residential	\$ 11.70	\$ 11.19	\$ 9.72	\$ 11.69	\$ 8.15
Commercial	\$ 10.23	\$ 10.07	\$ 8.75	\$ 10.48	\$ 7.20
Natural gas purchased (PJs)*	110.2	113.8	125.4	126.5	147.0
Maximum day sendout (TJs)* (including interruptable)	1,473.2	1,108.6	1,559.0	1,167.0	1,269.0
Rate base	\$ 2,310.1	\$ 2,280.6	\$ 2,223.8	\$ 2,249.8	\$ 1,715.1
Degree days (Base 18°C)					
Coastal					
Actual	2,525	2,667	2,847	2,855	2,901
Normal	2,771	2,798	2,774	2,792	2,815
Interior					
Actual	3,760	3,831	4,004	3,913	4,160
Normal	3,895	3,924	3,887	4,138	4,165

*Volume statistics are stated in SI (metric) units

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