

COST ALLOCATION PROCESS

TransCanada's business operations are performed by functional areas that provide integrated services to its various lines of business. This organizational structure eliminates duplication of costs and maximizes operational efficiencies. It has resulted in significant cost savings since the merger of TransCanada PipeLines Limited and NOVA Corporation in 1998. As a result of this integrated structure, a cost allocation process is necessary to ensure that individual business lines receive a fair share of costs.

TransCanada's cost allocation process is based on the Operating Cost Allocation Policy that is attached to this Section.

The allocation policy is based on the principle of direct charging costs to lines of business where possible and allocating the remaining costs using appropriate allocation drivers. Costs are allocated at a departmental level or general expense cost type based on the allocation driver most appropriate to that department or general expense. The allocation drivers used are time/activity analysis, permanent full-time equivalents, enterprise full-time equivalents, head office full-time equivalents, Information Systems ("IS") asset allocation, capital employed, profit contribution, and usage. The cost allocation process is applied to both actual and forecast/budget costs.

OPERATING COST ALLOCATION POLICY

1.0 Purpose

The purpose of the "Operating Cost Allocation Policy" is to describe the methodology that TransCanada will utilize for allocating departmental costs, general expenses, and certain other costs to TransCanada's lines of business including wholly-owned pipelines. This policy is consistent with and shall replace all related existing operating cost allocation policies and practices, including the policies and procedures used by TransCanada and approved by the NEB in its RH-1-91 Reasons for Decision dated September 1991, and updated as schedule "C" to the Merger Costs and Benefits Agreement as approved by the EUB in Order U99076 on September 8, 1999, updated by the NEB in Order AO-1-TG-7-91 on September 23, 1999 and as incorporated in the 2003 Tolls and Tariff Application for the Mainline which was approved by the NEB in the RH-1-2002 Decision.

2.0 Organizational Structure

TransCanada is a leading North American energy company with operations in two principal business segments: gas transmission and services, and power generation and marketing. The business operations of TransCanada are performed in functional areas that provide integrated services to various lines of business throughout the organizations.

3.0 Allocation Principles

TransCanada's policy is to directly charge costs to lines of business where possible. When direct charge is not possible TransCanada's policy is to use appropriate allocation drivers to determine the charge by department or general expense to each line of business.

TransCanada employees also may periodically perform work for a specific project where a third party will be billed. In such cases, the cost of labour and overhead is billed to the third party. In addition, where employees are providing services in support of capital projects, the costs of those services are charged to capital. The effect of these charges is a reduction of departmental expenses prior to allocation to lines of business.

Also, departmental costs can either decrease or increase through cross-departmental project charges. Where applicable, the cross-departmental project charges provide an effective system to manage projects at the department level.

3.1 Cost Allocation Drivers

For those department costs and general expenses that are not directly charged, one or more of the methods detailed below are used as the basis for allocating costs. Management will periodically update the drivers for departmental and general expenses as the underlying business conditions and practices change.

- (i) **Time/Activity Analyses** - The Time/Activity Analyses ("TAA") cost driver is dependent upon an estimate of employee and contracted (in-house contractors) labour hours in support of each of the various businesses. The activities of each employee in a department, excluding support staff, are analyzed to determine the proportion of each employee's time spent on each line of business, or on common activities that benefit TransCanada as a whole.

The percentages that result from this analysis are then applied to the departmental costs to determine the allocation among the lines of business.

The costs of common activities and the support staff costs are allocated to the lines of business using the ratio established from the TAA for the department.

- (ii) **Enterprise full-time equivalents** - The enterprise full-time equivalents ("enterprise FTE's") cost driver utilizes the number of full-time equivalent employees and contractors (in-house contractors) in the entire TransCanada organization, including head office and field employees in all businesses. This calculation excluding contractors is referred to as **Permanent FTE's**.

To allocate costs using enterprise FTE's the number of enterprise FTE's in any one of the lines of business is divided by the total number of enterprise FTE's and then multiplied by the department's costs to determine the allocation to the lines of business.

- (iii) **Head office full-time equivalents** - The head office full-time equivalents ("head office FTE's") cost driver is calculated in the same manner as the enterprise full-time equivalents but excludes headcount for certain subsidiaries and field employees. This cost driver is used for certain general expenses and departments that provide

administrative services to the Calgary offices of TransCanada only.

To allocate department costs using head office FTE's, the number of head office FTE's in any one of the lines of business is divided by the total number of head office FTE's and then multiplied by the department's costs to determine the allocation to the lines of business.

- (iv) **IS Asset Allocation** - The Information Systems (IS) groups allocates its application support and design costs to the primary department users of applications. The costs of each primary user are subsequently allocated to each line on business based on the allocation methodology of the primary user. The IS uses the 'IS asset' list to determine the primary user of each asset or similar asset groups. Costs are recorded in functional system support groups to allow matching the supported asset.

- (v) **Capital Employed** - Capital employed is used to allocate the costs of departments performing activities that benefit the enterprise as a whole and for which time cannot be easily determined and for which the use of other cost drivers would not be appropriate.

To allocate costs using this cost driver, the capital employed by any one of the lines of business is divided by the total capital employed by TransCanada and then multiplied by the department's costs to determine the allocation for the lines of business.

Capital employed represents the sum of shareholders equity and any financing related liabilities.

- (vi) **Profit Contribution** - Profit contribution is used to allocate corporate donations. Profit contribution represents the after tax net income of each line of business.
- (vii) **Usage** – The costs of the aviation department are primarily allocated on the basis of flying time for direct usage by each line of business. Flying time that cannot be directly allocated to a line of business is allocated based on the executive TAA.

4.0 Categories

4.1 Departmental costs

Departmental costs include salaries, benefits, employee expenses, consulting and contracted services, and other expenses. Departmental costs that are not directly attributable to a line of business are allocated in the manner as described in Table A.

4.2 General expenses

General expenses include external costs, such as auditing and accounting services, outside legal services, directors' fees and expenses, donations, stock and debt administration, insurance and rent. General expenses also includes the cost of total direct compensation and benefits that are not attributed to specific departments, such as incentive compensation, long term incentive compensation, and residual employee benefits. General expenses that are not directly attributable to a line of business are allocated in the manner as described in Table B.

TABLE A
SUMMARY OF ALLOCATION BASES

Functional Area	Direct / Allocated	Allocated among the businesses based on:
Accounting	Allocated	TAA
Aviation	Allocated	Usage/Executive TAA
Corporate Strategy	Allocated	Capital Employed
Customer Service (incl. Systems Design and Operations, Regulatory, Sales, Market Development and Rates, and Customer)	Allocated	TAA
Engineering & Business Services	Allocated	TAA
Executive	Allocated	TAA
Field Operations (Transmission & Power)	Direct	-
Field Telecommunication	Direct	-
Finance	Allocated	TAA
Public Sector Relations	Allocated	Capital Employed/TAA
Health, Safety and Environment	Allocated	TAA
Human Resources	Allocated	Enterprise FTEs/Permanent FTEs.
Internal Audit	Allocated	TAA
Investor Relations	Allocated	Capital Employed
IS Infrastructure/Shared Services	Allocated	Enterprise FTEs
IS Support (FST's)		IS Asset Allocation and Enterprise FTEs
Law and General Counsel	Allocated	TAA/Capital Employed
Northern Development	Direct	
Office Solutions	Allocated	Enterprise FTEs
Power Administration & Marketing	Direct	-
Procurement	Allocated	TAA
Real Estate and Building Services	Allocated	Enterprise FTEs
Records Mgmt and Library	Allocated	Head Office FTEs
Regulatory Strategy	Allocated	TAA
Risk Management	Allocated	TAA
Strategy and Planning	Allocated	TAA/Capital Employed
Taxation	Allocated	TAA
Treasury	Allocated	TAA

Note:

Functional / departmental areas are a representative list only and can change due to internal business or management requirements. Multiple allocation drivers are shown for functional areas where more than one department represents the functional area.

TABLE B
SUMMARY OF ALLOCATION BASES FOR GENERAL EXPENSES

Functional Area	Direct / Allocated	Allocated among the businesses based on:
Auditing & accounting services:		
Business area specific	Direct	-
General corporate	Allocated	Capital Employed
Calgary rent	Allocated	Head office FTE's
Directors' fees & expenses	Allocated	Executive TAA
Donations	Allocated	Profit contribution
Dues & subscriptions:		
Business specific	Direct	-
General corporate	Allocated	Enterprise FTE's
Natural gas industry	Allocated	Capital Employed
Employee benefits (residual)	Allocated	Permanent FTE's
Insurance:		
Corporate Jet	Allocated	Usage/Executive TAA
Directors' & Officers' Liability	Allocated	Executive TAA
Other	Allocated	Capital Employed
Outside legal services:		
Business area specific	Direct	-
General corporate	Allocated	Capital Employed
Regulatory expenses	Direct	-
Incentive and Long Term Compensation	Allocated	Permanent FTE's ⁽¹⁾
Severance	Allocated	TAA
Stock & debt administration	Allocated	Capital Employed

(1) Variations of this driver may be used to ensure the most appropriate