

**Enbridge Income Fund  
Management's Discussion & Analysis  
For the year ended December 31, 2010**

This Management's Discussion and Analysis (MD&A) for Enbridge Income Fund (the Fund) should be read in conjunction with the consolidated financial statements and notes thereto contained in the Fund's 2010 Annual Report. The Fund prepared its consolidated financial statements for the year ended December 31, 2010 in accordance with Canadian generally accepted accounting principles (Canadian GAAP). All financial measures presented in this MD&A are expressed in Canadian dollars, unless otherwise indicated. Additional information, including the Fund's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com). This MD&A is dated February 1, 2011.

**CONSOLIDATED RESULTS**

Year ended December 31, <i>(millions of Canadian dollars, except where otherwise noted)</i>	<b>2010</b>	2009	2008
Cash Provided by Operating Activities	<b>67.4</b>	94.2	98.1
Cash Available for Distribution <sup>1</sup>	<b>100.2</b>	90.1	91.2
Cash Distributions Declared <sup>2</sup>	<b>83.7</b>	83.7	74.9
Cash Distributions Declared Per Unit (dollars per unit) <sup>2</sup>	<b>1.152</b>	1.152	1.032

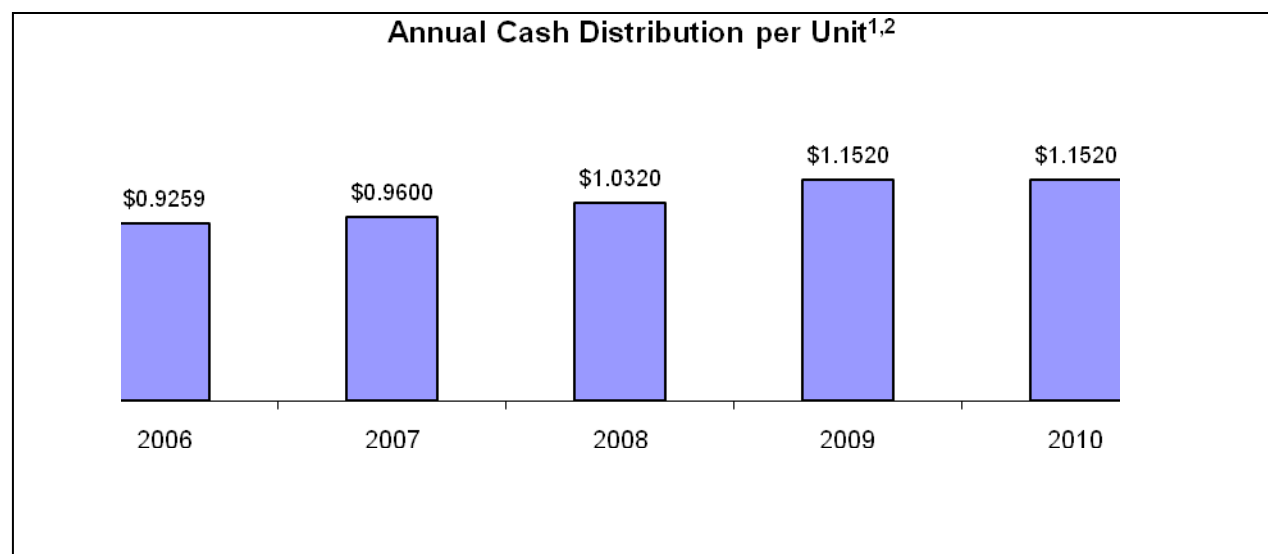
<sup>1</sup> See definition of this non-GAAP measure on page 4. Refer to page 19 for the reconciliation to Cash Provided by Operating Activities.

<sup>2</sup> Includes distributions declared on Trust Units and ECT Preferred Units.

The Fund delivered on its value proposition in 2010, paying out a high proportion of its Cash Available for Distribution (CAFD) to unitholders, on the strength of its diversified and growing portfolio of strategically located assets. CAFD for the year ended December 31, 2010 was \$100.2 million, exceeding the prior year by \$10.1 million. Growth in CAFD was largely a reflection of expansion of the Saskatchewan System, the key components of which were completed and placed into service during the year, and a one-time additional distribution from Alliance Canada of \$2.8 million. Total distributions paid to unitholders in 2010, including distributions on ECT Preferred Units, were \$83.7 million, representing cash distributions declared of \$1.152 per unit.

The results for 2010 build on the Fund's successful track record of steadily growing distributable cash flow through investment in low-risk energy infrastructure. In 2010, the Fund announced that it will partner with an affiliate to increase pipeline capacity and accommodate growing production from the Bakken region. The Bakken Expansion Project is expected to be an additional source of distributable cash in 2013 when it is expected to be placed into service.

Over the last five years, the Fund has declared the following distributions:



<sup>1</sup> Distributions include both a return on capital and a return of capital.

<sup>2</sup> Figures show distributions on both the Fund's Trust Units and ECT Preferred Units.

## FINANCIAL OVERVIEW

Year ended December 31,	2010	2009
<i>(millions of Canadian dollars)</i>		
<b>Earnings</b>		
Alliance Canada	57.3	59.3
Saskatchewan System	23.4	19.7
Green Power	2.5	4.0
Corporate	<b>(70.6)</b>	(70.0)
	<b>12.6</b>	13.0
<b>Cash Available for Distribution</b>		
Alliance Canada	76.4	71.7
Saskatchewan System	42.2	34.5
Green Power	4.5	4.7
Corporate	<b>(22.9)</b>	(20.8)
	<b>100.2</b>	90.1

The Fund's earnings and CAFD totalled \$12.6 million and \$100.2 million, respectively, for the year ended December 31, 2010. The Fund's earnings and cash available for distribution reflected stable returns from Alliance Canada and the Green Power segment, as well as growth attributable to Phase II of the Saskatchewan System Capacity Expansion, which was substantially completed and declared in service in December 2010. The Fund's earnings for the year ended December 31, 2010 were affected by costs related to one-time events, including the Virden crude oil release and the Plan to restructure the Fund.

Compared with the prior year, while performing as expected, Alliance Canada recorded year-over-year declines in earnings due to a reduced return on equity on its declining investment base, partially offset by an increase in its deemed income tax recovery. Alliance Canada CAFD increased in 2010 due to a one-time distribution associated with a favourable litigation settlement.

Saskatchewan System earnings and CAFD for the year ended December 31, 2010 increased over 2009 by 18.8% and 22.3%, respectively, owing to growth in customer connections and new project assets declared in-service in December 2010 from the Phase II expansion. Saskatchewan System earnings for the year ended December 31, 2010 included pre-tax costs of \$1.5 million related to the April 2010 Virden crude oil release, net of estimated insurance proceeds.

Green Power earnings for 2009 included an unrealized non-cash derivative gain. After removing the impact of this item, Green Power earnings of \$2.5 million for 2010 are comparable with the prior year. Green Power's waste heat facilities delivered improved operating performance in 2010 compared with 2009, whereas the wind energy assets experienced lower production due to lower wind resources.

Corporate costs include distributions on preferred units of ECT, a subsidiary of the Fund, as well as corporate financing costs, incentive fees, current and future income taxes and management and administrative costs. ECT Preferred Unit distributions were declared at a rate of \$1.152 per unit in 2010, consistent with the prior year, and totalled \$43.8 million. In 2011, due to a modification of the ECT Preferred Units, distributions on such units will no longer be reflected as a corporate cost but rather a charge to equity in the same fashion as common trust unit distributions.

Corporate costs incurred in 2010 also include one-time legal and other professional fees associated with restructuring the Fund of \$1.8 million. Compared with 2009, corporate costs for the year ended December 31, 2010 also reflected higher interest expense and lower income taxes.

## FORWARD-LOOKING INFORMATION

*In the interest of providing the Fund's unitholders and potential investors with information about the Fund, its subsidiaries and joint ventures, including management's assessment of the Fund, its subsidiaries' and joint ventures' future plans and operations, certain information provided in this MD&A constitutes forward-looking statements or information (collectively, "forward-looking statements"). This information may not be appropriate for other purposes. Forward-looking statements are typically identified by words such as "anticipate", "expect", "project", "estimate", "forecast", "plan", "intend", "target", "believe" and similar words suggesting future outcomes or statements regarding an outlook. In particular, forward-looking statements included or incorporated by reference in this document include, but are not limited to, statements with respect to:*

- *expected costs related to projects under construction;*
- *expected scope and in-service dates for projects under construction;*
- *expected timing and amount of recovery of capital costs of assets;*
- *expected capital expenditures;*
- *expected future levels of demand for the Fund's services;*
- *expected future earnings and cash flows;*
- *expected future actions of regulators;*
- *expected future distributions to unitholders and the taxability thereof; and*
- *expected cash available for distribution.*

*Although the Fund believes that these forward-looking statements are reasonable based on the information available on the date such statements are made and processes used to prepare the information, such statements are not guarantees of future performance and readers are cautioned against placing undue reliance on forward-looking statements. By their nature, these statements involve a variety of assumptions, known and unknown risks and uncertainties and other factors, which may cause actual results, levels of activity and achievements to differ materially from those expressed or implied by such statements. Material assumptions include assumptions about: the expected supply and demand for crude oil, natural gas and natural gas liquids; prices of crude oil, natural gas and natural gas liquids; expected exchange rates; inflation; interest rates; the availability and price of labour and pipeline construction materials; operational reliability; customer project approvals; maintenance of support and regulatory*

*approval for the Fund's projects; anticipated in-service dates and weather. Assumptions regarding the expected supply and demand of crude oil, natural gas and natural gas liquids, and the prices of these commodities, are material to and underlay all forward-looking statements. These factors are relevant to all forward-looking statements as they may impact current and future levels of demand for the Fund's services. Similarly, exchange rates, inflation and interest rates impact the economies and business environments in which the Fund operates, may impact levels of demand for the Fund's services and cost of inputs, and are therefore inherent in all forward-looking statements. Due to the interdependencies and correlation of these macroeconomic factors, the impact of any one assumption on a forward-looking statement cannot be determined with certainty, particularly with respect to expected earnings and associated per unit amounts, or estimated future distributions. The most relevant assumptions associated with forward-looking statements on projects under construction, including estimated in-service dates, and expected capital expenditures include: the availability and price of labour and pipeline construction materials; the effects of inflation on labour and material costs; the effects of interest rates on borrowing costs; and the impact of weather and customer and regulatory approvals on construction schedules.*

*The Fund's forward-looking statements are subject to risks and uncertainties pertaining to operating performance, regulatory parameters, project approval and support, weather, economic and competitive conditions, exchange rates, interest rates, commodity prices and supply and demand for commodities, including but not limited to those risks and uncertainties discussed in this MD&A and in the Fund's other filings with Canadian securities regulators. The impact of any one risk, uncertainty or factor on a particular forward-looking statement is not determinable with certainty as these are interdependent and the Fund's future course of action depends on management's assessment of all information available at the relevant time. Except to the extent required by law, the Fund assumes no obligation to publicly update or revise any forward-looking statements made in this MD&A or otherwise, whether as a result of new information, future events or otherwise. All subsequent forward-looking statements, whether written or oral, attributable to the Fund or persons acting on the Fund's behalf, are expressly qualified in their entirety by these cautionary statements.*

## **NON-GAAP MEASURES**

*This MD&A contains references to cash available for distribution. Cash available for distribution represents cash available to fund distributions on trust units and ECT preferred units, as well as for debt repayments and reserves. This measure is important to unitholders as the Fund's objective is to provide a predictable flow of distributable cash to unitholders. Please refer to the Cash Available for Distribution reconciliation on page 19. Cash available for distribution is not a measure that has standardized meaning prescribed by Canadian GAAP and is not considered a GAAP measure. Therefore, this measure may not be comparable with similar measures presented by other issuers.*

## **FUND STRATEGY**

### **Fund's Objective**

The Fund is an unincorporated open-ended trust established by a trust indenture under the laws of the Province of Alberta. The Fund commenced operations on June 30, 2003. Enbridge Management Services Inc. (EMSI or the Manager), a wholly owned subsidiary of Enbridge Inc. (Enbridge), administers the Fund. EMSI also serves as the manager of Enbridge Commercial Trust (ECT), a subsidiary of the Fund and Enbridge Income Fund Holdings Inc. (EIFH), a unitholder of the Fund. The Fund has investments in businesses that operate crude oil and natural gas pipelines as well as waste heat recovery and wind power facilities.

The Fund's objectives are to provide a predictable flow of distributable cash and to increase, where prudent, cash distributions per trust unit. During 2010, the Fund completed a restructuring whereby all of the public's, and a portion of Enbridge's units of the Fund were exchanged for share of a new publicly-traded corporation, EIFH. As a result of the restructuring, the Fund now has two unitholders, EIFH and Enbridge. The restructuring has not altered the Fund's objective to deliver a safe and dependable cash

payout to its unitholders.

### **Core Business**

The Fund's activities are carried out through three operating segments:

- Alliance Canada includes the Fund's 50% interest in the Canadian portion of the Alliance System. The Alliance System is a natural gas pipeline system, comprised of Alliance Canada and Alliance US, that transports natural gas from supply areas in northwestern Alberta and northeastern British Columbia to delivery points near Chicago, Illinois.
- Saskatchewan System owns and operates crude oil and liquids pipeline systems primarily connecting producing fields in southeastern Saskatchewan and southwestern Manitoba with Enbridge's mainline pipeline for transportation to the United States. Saskatchewan System also includes the Fund's ongoing business development activities in the Bakken region.
- Green Power includes entities that produce electricity via alternative energy sources and consists of a 50% interest in each of NRGreen and the Sunbridge wind project, as well as a 33% interest in each of the Magrath and Chin Chute wind projects.

### **Strategy**

In order to achieve the Fund's objectives, the Manager pursues low-risk strategies, which include:

- maximizing the efficiency and profitability of its existing assets;
- pursuing organic growth and expansion opportunities; and
- acquiring and developing new energy infrastructure businesses that are complementary and in keeping with the risk and return profile of its existing business.

### **Alliance Canada**

Alliance Canada manages its pipeline assets and related infrastructure with the objective of maximizing shipping capacity, optimizing operating performance and maintaining the competitiveness of its tolls. Alliance Canada has continued to meet or exceed its targets in all key areas of operational performance which include: availability, reliability, safe operations, throughput and efficiency. Alliance Canada has successfully implemented several pipeline optimization projects and will continue to pursue further efficiency initiatives, new service offerings and other growth opportunities all with the aim of sustaining the long-run competitiveness of its natural gas transportation services.

Alliance has firm transportation agreements with its shippers through to December 1, 2015 for all of its firm service capacity. Approximately 8% of shippers have elected to extend their existing shipper agreements until at least December 2016.

Alliance Canada's assets are located near areas of growing liquids-rich natural gas production and provide Alliance Canada additional opportunities to transition from a single service, single toll export pipeline to a new multi-service business model. Alliance Canada's strategy with respect to amending its service offering over the next five years include leveraging its geographic positioning and high pressure operating capability to move liquids-rich gas to market.

### **Saskatchewan System**

The Saskatchewan System operates its pipelines and supporting assets with the objective of providing reliable, cost effective transportation solutions for its customers. In recent years, the Saskatchewan System has addressed increases in crude oil production and growing demand for pipeline capacity in the areas served by its systems through expansion and development initiatives, such as the Phase II Saskatchewan System Capacity Expansion, which was substantially completed in late 2010, and the Bakken Expansion Program, which was announced during 2010 and is expected to be in-service in 2013.

### **Green Power**

The objective of Green Power is to produce reliable, cost effective electricity via alternative energy sources to ensure stable, predictable cash flow streams for the Fund. Power production by the Green

Power segment is supported by long-term Power Purchase Agreements (PPAs) and power swap agreements which serve to mitigate the risk of fluctuating power prices thereby stabilizing cash flows.

To successfully pursue the strategies discussed above, the Fund must mitigate certain business risks. These risks, and the Fund's strategies for managing them, are described under "Risk Management."

### Competitive Advantage

Asset positioning and operational excellence are key to the successful execution of the Fund's strategy. The Fund's assets are well-positioned to take advantage of emerging sources of liquids and natural gas supply in Western Canada. The combination of Alliance Canada's proximity to liquids rich shale gas plays in northeastern British Columbia and the strategic positioning of the Saskatchewan System crude oil assets in the Bakken play in southeastern Saskatchewan is providing the Fund with organic growth opportunities such as the Bakken Expansion Program.

### Plan of Arrangement

On December 17, 2010, a plan of arrangement (the Plan) to restructure the Fund took effect. Under the Plan, all 20,125,000 publicly held trust units of the Fund, as well as 5,000,000 trust units held by Enbridge, were exchanged on a one-for-one basis for shares of a taxable Canadian corporation, EIFH. Concurrently, the Fund's trust units ceased trading on the Toronto Stock Exchange.

In connection with the Plan, amendments to the attributes of the ECT Preferred Units were made, resulting in the elimination of a liquidity right and the creation of an exchange right. The exchange right provides Enbridge, as the holder of the ECT Preferred Units, with the right to exchange such units for units of the Fund on a one-for-one basis at any time prior to redemption. No change was made to the June 30, 2033 maturity date of the ECT Preferred Units or the terminal redemption value of \$10 per preferred unit as a result of these amendments.

Subsequent to implementation of the Plan, the Fund ceased to be a specified investment flow-through (SIFT) entity and therefore is not subject to SIFT tax legislation.

## SELECTED OPERATING HIGHLIGHTS

Year ended December 31,	2010	2009
Average Daily Throughput Volume		
Alliance Canada (millions of cubic feet per day)	<b>1,600.0</b>	1,601.0
Saskatchewan System <sup>1</sup> (thousands of barrels per day)		
Westspur System	<b>196.0</b>	197.8
Saskatchewan Gathering System	<b>133.4</b>	136.7
Weyburn System	<b>33.2</b>	35.9
Virden System	<b>16.2</b>	16.4
Green Power (thousands of megawatt hours produced)	<b>352.5</b>	367.0

<sup>1</sup>Totals are not presented as the same volumes can be transported through a combination of the pipelines comprising the Saskatchewan System.

Alliance Canada transportation deliveries for the year ended December 31, 2010, including Authorized Overrun Service (AOS), averaged 1,600 million cubic feet per day (mmcf/d) (20.7% in excess of firm capacity of 1,325 mmcf/d) compared with 1,601 mmcf/d (20.8% in excess of firm capacity) in 2009. AOS refers to the physical capacity available on the Alliance Canada pipeline, over and above the contracted firm capacity. The AOS service is provided to shippers at no additional cost, aside from the cost of associated fuel requirements. Therefore, AOS does not impact earnings; however, it does increase the competitiveness of Alliance Canada's tolls.

Throughputs for the Saskatchewan System for the year ended December 31, 2010 declined slightly for each system compared with the prior year. The decline is primarily attributable to apportionment arising from capacity restrictions on the Enbridge mainline. Throughput variances do not directly impact earnings

on the Saskatchewan Gathering and Westpur Systems since these systems are cost of service based. Throughput levels directly impact earnings of the Weyburn and Virden systems, which operate on a basis similar to a common carrier and charge a market-based toll per barrel of crude oil transported.

The decrease in energy production by the Green Power segment resulted primarily from lower wind resource in 2010 compared with the prior year. This decline is partially offset by increased energy production by NRGreen which benefited from improved operational reliability in 2010.

## **ALLIANCE CANADA**

### **Overview**

Alliance Canada consists of approximately 1,560 kilometres of the Alliance System's mainline beginning near Gordondale, Alberta and connecting to Alliance US at the Canada/United States border near Carnduff, Saskatchewan. Alliance Canada also includes the Alliance System's lateral pipelines, which connect the mainline to a number of upstream receipt points, primarily at natural gas processing facilities in northwestern Alberta and northeastern British Columbia, and related infrastructure.

The Alliance System is designed to transport 1,325 mmcf/d of natural gas on a firm service basis primarily from supply areas in northwestern Alberta and northeastern British Columbia to delivery points near Chicago, Illinois. Alliance Canada has transportation service agreements (TSAs) with shippers for 100% of its available firm transportation capacity. The initial term of these agreements expires in December 2015, except for 1.5% of contracted transportation capacity, which is contracted on a short-term basis to a related entity.

The TSAs are designed to provide Alliance Canada with a steady and predictable cash flow stream through 2015. Additional transportation capacity is available to shippers for no additional cost other than the cost of the associated fuel requirements through Alliance Canada's AOS.

Tolls and tariffs for Alliance Canada are regulated by the National Energy Board (NEB). Alliance Canada's TSAs are designed to provide toll revenues sufficient to recover prudently incurred costs of service, including operating and maintenance costs, costs of indebtedness, an allowance for income tax, capital taxes, depreciation and an allowed return on equity of 11.26% after tax, based on a deemed 70/30 debt-to-equity ratio. Each shipper's charges are proportionate to the shipper's contracted capacity. Toll adjustments, based on variances between the cost of service forecast used to calculate the toll and the actual cost of service, are made annually. Following consultation with shippers, amended tolls are filed annually with the regulator.

Depreciation expense on the transmission plant included in the cost of service is based on negotiated depreciation rates contained in the TSAs while the depreciation expense in the financial statements is recorded on a straight-line basis of 4% per annum. The negotiated depreciated rates are generally less than the straight-line rates in the earlier years and higher than straight-line depreciation in later years of the TSAs. This results in the recognition of a long-term receivable, referred to as deferred transportation revenue, expected to be recovered from shippers in subsequent rates. At December 31, 2010, \$97.8 million (2009 – \$91.5 million) was recorded as deferred transportation revenue.

In December 2010, shippers representing approximately 8% of the original firm transportation capacity elected to extend their existing contracts to December 1, 2016 and also retained the option to continue to extend their capacity commitments on an annual basis. Remaining shippers, representing the balance of originally contracted capacity, elected not to extend their commitments beyond 2015 under the terms of the original contracts.

The completion of the capacity election process provides Alliance Canada the flexibility to remarket the capacity that has not been contracted beyond 2015. Over the next five years, the Alliance System is expected to transition from a single-service, single toll export pipeline to a new multi-service business model, providing customers with a choice from an assortment of transportation services. Among other

things, Alliance Canada may seek to implement new receipt services and short-haul delivery to complement its existing bullet line delivery service to Chicago. Alliance Canada is well placed to benefit from incremental unconventional volumes from shale plays in British Columbia, and is currently evaluating opportunities to expand its service offerings in this area.

Alliance Canada's maintenance program maintains its productive capacity and helps to ensure the future sustainability of its distributions. The program includes semi-annual inspections of all compressor stations as well as internal corrosion inspections and annual pipe-to-soil surveys, atmospheric inspections, above ground indirect assessments and the repair and replacement of compressor parts. Mainline pipeline inspection is completed on a seven year recurring schedule. Other maintenance performed includes soil resistance surveys and corrosion deficiency reports. Maintenance expenditures may vary from year to year.

## Financial Results

Year ended December 31, <i>(millions of Canadian dollars)</i>	2010	2009
Revenues	230.8	224.7
Earnings	57.3	59.3

The increase in Alliance Canada revenues of \$6.1 million over 2009 were the result of an increase in firm transportation tolls from \$0.863 per mcf to \$0.894/mcf effective January 1, 2010. Under Alliance Canada's cost of service tolling model, increased operating costs result in higher revenues. Higher operating expenses were due to increased pipeline integrity activities, a river crossing remediation, increased property taxes and higher head office costs, partially offset by reduced compressor maintenance costs.

Earnings of \$57.3 million for the year ended December 31, 2010 represent a decrease of \$2.0 million compared with the prior year. The decline is primarily attributable to a lower return on equity resulting from Alliance Canada's depreciating investment base. This was partially offset by an increase in the allowance for deemed income taxes. The rate used to calculate the equity return is not expected to change; however, the investment base upon which the equity return is calculated will change over time due to depreciation. The increase in the allowance for deemed income taxes is primarily due to lower capital cost allowance deductions.

## Business Growth

### *Gathering Receipt Service*

During 2010, Alliance Canada initiated construction activities on three new gathering receipt point interconnections, Septimus, Sunrise and Pine Creek. Septimus was placed into service in September 2010, and the other two receipt points are expected to be completed in the first half of 2011. All three receipt points together allow for additional gathering receipt capacity of 42 mmcf/d. These projects do not increase the mainline capacity but will enable Alliance to ship incremental gas out of the respective areas.

## Regulatory Matters

### *2011 Toll Filing*

On October 29, 2010, following consultation with its shippers, Alliance Canada filed its 2011 tolls with the NEB. Alliance Canada's 2011 tolls increased slightly from \$0.894/mcf to \$0.914/mcf on January 1, 2011. The increased toll for 2011 reflects increased expenditures for pipeline maintenance and system optimization activities, pipeline integrity and compliance projects, renewal and replacement of aging applications and infrastructure and labour costs.

## Capital Expenditures

The Fund's 50% proportionate interest in Alliance Canada capital expenditures in 2010 of \$4.7 million (2009 - \$1.7 million) related to the construction of the three new receipt point interconnections and leasehold improvements, and was offset by a \$6.1 million recovery of original construction costs from a third party vendor.

In 2011, the Fund expects its share of Alliance Canada's capital expenditures to be approximately \$4.8 million.

### **Compressor Control Panel Replacements**

Alliance Canada is undertaking a project to replace control panel equipment currently in operation at seven facility locations and has entered into an agreement with a supplier to replace the control panels. This project is expected to be completed by 2013. The costs associated with this project are expected to be recovered through future tolls.

### **Business Risks**

The risks identified below are specific to Alliance Canada. General risks that affect the Fund as a whole are described under Risk Management.

#### *Contracting Risk*

The revenue generated by Alliance Canada is derived from tolls that are based on the TSAs. 98.5% of Alliance's capacity is contracted under firm TSAs until December 1, 2015, and 8% of the contracted capacity has been extended through to December 2016. Alliance Canada expects that evolving North American gas markets will bring demand for new services and requests for commercial terms that differ from those in the TSAs. Given the advantages that Alliance Canada can provide in operational efficiency, the wide spectrum of operating parameters that the Alliance System can accommodate to transport gas streams of variable heat content or energy value, the proximity to emerging gas developments and the ability to potentially incorporate new deliveries off the system into current or new pipeline systems, hubs and industrial areas, Alliance Canada expects that the Alliance System will be well utilized beyond 2015 under new transportation agreements with shippers.

#### *Pipeline Operating Risks*

Operation of the Alliance System involves many risks, several of which are beyond the control of Alliance Canada, including but not limited to: breakdown or failure of equipment, information systems or processes; the performance of equipment at levels below those originally intended; catastrophic events such as natural disasters, fires, explosions, pipeline failure, wars, acts of terrorism and other similar events; lack of spare parts; operator error; and disputes with interconnecting facilities and carriers. The occurrence or continuance of any of these events could increase the cost of operating the Alliance System and/or reduce its transportation capacity, potentially impacting cash flow. Alliance Canada maintains safety policies, disaster recovery procedures and insurance coverage at industry acceptable levels to mitigate these risks.

#### *Recovery of Capital*

When the primary term of the TSAs expire, Alliance Canada is expected to have recovered approximately 56% of the capital cost of the Alliance Canada pipeline through depreciation charges collected from shippers. Since there is no guarantee as to the form and term of new contracts that may be established subsequent to expiry of the original TSAs, the remaining capital cost of property, plant and equipment and intangible assets, and deferred transportation revenue may not be recovered as soon as expected. In order to mitigate this risk, Alliance Canada will continue to focus on the competitiveness of its future tolls and is evaluating its service offering beyond 2015.

#### *Competition*

The Alliance System faces competition for pipeline transportation services to the Chicago area from both existing and proposed pipeline projects. Existing pipelines, other than Alliance Canada, provide natural gas transportation services from the Western Canada Sedimentary Basin (WCSB) to natural gas markets in the mid-western United States. In addition, there are several proposals to upgrade existing pipelines or to build new pipelines serving such areas and markets. Any new or upgraded pipelines could either: allow shippers and competing pipelines to have greater access to natural gas markets in addition to the markets served by the Alliance System and the pipelines to which it is connected; or offer natural gas transportation services that are more desirable to shippers than those provided by the Alliance System because of location, facilities or other factors. In addition, these pipelines could charge rates or provide transportation services to locations that result in greater net profit for shippers, with the effect of forcing

Alliance Canada to realize lower revenues and cash flows. This risk is partially mitigated through TSAs, the primary term of which expires in 2015.

There is also competition from new sources of natural gas such as the Marcellus Basin, which is in close proximity to the Chicago hub served by the Alliance System. The development of the Marcellus Basin could provide an alternate source of gas to the Chicago area as well as decrease the northeastern United States region reliance on natural gas imports from Canada.

#### *Exposure to Shippers*

Alliance Canada is dependent on shippers for revenues from contracted capacity on the Alliance Canada system. Failure of the shippers to fulfill their contractual obligations under the TSAs or failure to replace such shippers could have an adverse effect on the cash flows and financial condition of Alliance Canada and could impair the ability of Alliance Canada to meet its debt obligations and make distributions to its limited partners. A prolonged economic downturn in the energy industry, significant reductions in the supply of natural gas in the WCSB, competition from alternative sources of natural gas supply and from other providers of natural gas transportation services, and the price of and demand for natural gas and natural gas transportation services in markets served by Alliance Canada, among other things, could impact the ability of some or all of the shippers to fulfill their obligations under the TSAs.

#### *Credit Risk*

Currently, approximately 3.0% of firm capacity on Alliance Canada's system is contracted to shippers who do not have an investment grade rating or equivalent strong credit status and are required to post security. These shippers have provided security to Alliance Canada, but in no case does it fully cover more than one year's demand charges under the TSAs. There can be no assurance that the security will be adequate to compensate Alliance Canada if a shipper is unable to fulfill its obligations under its TSA.

#### *Recovery of Costs*

Pursuant to the terms of the TSAs and in accordance with the negotiated toll principles accepted by the NEB, Alliance Canada is permitted to recover from shippers costs incurred in the construction and operation of the Alliance System that are actually and reasonably incurred. There can be no certainty that all costs incurred by Alliance Canada will be recoverable through the transportation tolls. Transportation tolls are set in advance based on forecast expenses, and adjusted periodically to reflect actual expenses, there is no assurance that the variances in the estimate will be recovered from shippers in subsequent periods, although historically all of these variances have been recovered.

#### *Dependence on Interconnected Systems and Facilities*

The Alliance System operates as an integrated pipeline; therefore, any matters which limit or restrict the ability of Alliance US to operate will equally affect the ability of Alliance Canada to operate. Alliance Canada may have no control over matters which may adversely affect Alliance US.

There is a significant degree of dependency on Aux Sable Liquid Products LP (Aux Sable), a related party to Alliance Canada through common ownership interest, to satisfy its requirements to provide heat content management services to Alliance US. Should Aux Sable fail to provide heat content management services for any reason, Alliance Canada may experience operational issues, including an interruption or curtailment of transportation service on the Alliance System. It is not possible to predict the extent or duration of these operational problems or their precise financial or operational effect on Alliance Canada.

## **SASKATCHEWAN SYSTEM**

### **Overview**

The Saskatchewan System transports crude oil from producing fields in southeastern Saskatchewan and southwestern Manitoba, as well as natural gas liquids (NGLs) from the Steelman gas processing plant, to Cromer, Manitoba where the crude oil and NGLs enter Enbridge's mainline pipeline to be transported to the United States.

The Saskatchewan System is comprised of the Saskatchewan Gathering, Westspur, Weyburn and Virden pipeline systems. Collectively referred to as the Saskatchewan System, these crude oil and liquids pipeline systems include approximately 388 kilometres of trunk line, 1,900 kilometres of gathering pipeline and related terminals and tankage facilities. The capacity of each of the Saskatchewan Gathering and the Westspur Systems is 255,000 barrels per day (bpd) and the capacity of the Weyburn and Virden Systems is approximately 47,000 bpd and 37,000 bpd, respectively.

Phase II of the Saskatchewan System Capacity Expansion, which included three separate projects that served to reduce capacity constraints at a variety of locations, was substantially completed and new project assets declared in-service in December 2010. The Benson Expansion project on the Saskatchewan Gathering System included terminal modifications, pump upgrades and installation of new pipe, and the Bryant to Steelman Expansion project on the Westspur System which involved installation of new crude oil pipe, and station and terminal upgrades. Remaining construction activities on the Steelman Crude/NGL Conversion project, which involves the conversion of an existing NGL line to crude oil on the Westspur System as well as the conversion of an existing crude oil line combined with a new NGL pipeline and pump station on the Saskatchewan Gathering System to relocate NGLs from the BP Steelman Gas Plant to an existing Westspur NGL line originating at Alida, Saskatchewan, are expected to be completed in early 2011, along with remaining seasonal and restoration work. Collectively, the projects comprising the Phase II expansion will increase crude oil capacity across the gathering systems by approximately 125,000 bpd at a revised estimated total cost of \$158.0 million.

The Saskatchewan Gathering System and the Westspur System are regulated by Saskatchewan Ministry of Energy and Resources (SMER) and the NEB, respectively. Both systems follow the principles for establishing tolls outlined in agreements with shippers, signed in 1985 and which expired in 1995, and now monitor established tolls on a customer complaint basis. The Saskatchewan Gathering System and the Westspur System tolling agreements are based on a cost of service methodology and are designed to provide toll revenues sufficient to recover operating costs, depreciation, deemed interest expense, deemed income tax and to provide an administrative expense allowance as well as a return on the asset base. The rate used to calculate the equity return is not expected to change. However, the rate base upon which the equity return is calculated will change over time due to depreciation as well as maintenance and enhancement capital additions and expansions. This tolling methodology increases the stability and predictability of cash flows generated by these systems.

The Weyburn and Virden Systems are regulated by SMER and Manitoba Innovation, Energy and Mines, respectively. Rates are established based on historical precedence, signed customer agreements, or both, and are updated to reflect changing market conditions when warranted. As a result, earnings from Weyburn and Virden reflect toll revenue less costs incurred.

The SMER and the NEB exercise statutory authority over various matters such as construction and operations, and may exercise authority over rates and ratemaking agreements with customers and underlying accounting principles. The regulators do not regularly review or approve the rates established by the pipeline systems comprising the Saskatchewan System. However, in the event of a customer complaint, the regulator would review and provide a ruling on the rates in question. There have been no formal customer toll complaints filed with the regulator to date for any of the systems comprising the Saskatchewan System.

On December 17, 2010, Saskatchewan System filed amended Westpur tariffs with the NEB with an effective date of February 1, 2011. In January 2011, a shipper on the Westpur system requested the NEB make the tolls "interim" effective February 1, 2011, pending discussions between the shipper and Saskatchewan System on information requests put forward by the shipper. Saskatchewan System filed with the NEB a response to the shipper request on January 21, 2010, noting that Saskatchewan System is working with the shipper to address their information requests. As of February 1, 2011, the NEB has yet to respond to the shipper request.

The Saskatchewan System maintenance program maintains its productive capacity and includes sump tanks, berm and line repairs, piping modifications, and tank and meter repairs. Maintenance expenditures

will vary year to year as some maintenance is performed on a cyclical basis. For example, software upgrades are scheduled every five years. Tank repairs occur annually, although the extent of repairs will fluctuate each year based on the age and size of the tank. The program also includes annual system integrity management which consists of cathodic protection, installation and maintenance, inline inspections and repairs, station and tank inspection and repairs, as well as chemical injections which serve as corrosion inhibitors.

## Financial Results

Year ended December 31, <i>(millions of Canadian dollars)</i>	2010	2009
Revenues	87.6	78.8
Earnings	23.4	19.7

Revenue for the year ended December 31, 2010 of \$87.6 million increased \$8.8 million compared with the prior year. Revenue growth is primarily due to the December 2010 substantially completed Phase II expansion assets that were declared in-service, as well as toll increases on the Weyburn and Virden Systems effective June 2010 and April 2010, respectively.

Earnings for the year ended December 31, 2010 increased by \$3.7 million over the prior year due to higher earnings on the Saskatchewan and Westpur systems as a result of substantially completed Phase II expansion assets that were declared in-service, additional earnings contributions from customer connections completed on the Weyburn and Saskatchewan Gathering Systems, and toll increases on the Weyburn System. These increases were partially offset by costs associated with a crude oil release on the Virden System in April 2010. Net of estimated insurance proceeds, costs associated with the release totalled \$1.5 million pre-tax.

## Business Growth

In August 2010, the Fund and Enbridge Energy Partners L.P. (EEP), an affiliate of the Fund, announced an agreement to undertake, subject to customary regulatory approvals, a joint project to further expand crude oil pipeline capacity to accommodate growing production from the Bakken and Three Forks formations located in Montana, North Dakota, Manitoba and Saskatchewan. The Bakken Expansion Program will increase takeaway capacity from the Bakken area by an initial 145,000 bpd, which can be readily expanded to 325,000 bpd.

The Bakken Expansion Program involves construction of new pipelines and related facilities which will be undertaken by the Fund at a cost of approximately \$190.0 million. The expansion program will originate in North Dakota, in the heart of the Bakken, and will follow EEP's and the Fund's existing rights of way, delivering crude oil to the Enbridge mainline terminal at Cromer, Manitoba. The Fund and EEP have received sufficient long-term shipping commitments from anchor shippers to enable the Bakken Expansion Program to proceed. The Bakken Expansion Program is expected to be completed by the first quarter of 2013.

Construction of the facilities related to the Portal Reversal Expansion Project (PREP) to receive 25,000 barrels per day (bdp) of new export capacity from North Dakota in Saskatchewan continues as planned. Regulatory approvals were received in the fourth quarter of 2010 as anticipated. Expenditures are forecasted to be within \$1.9 million for the work to be undertaken by the Fund in Saskatchewan. PREP is expected to be in service in the first quarter of 2011.

## Capital Expenditures

Capital expenditures for the year ended December 31, 2010 were \$129.6 million (2009 – \$37.2 million), including \$4.8 million (2009 – \$5.6 million) in maintenance capital. The majority of 2010 capital expenditures related to Phase II of the Saskatchewan System Capacity Expansion, which was substantially completed in December 2010. Additional costs of approximately \$32.7 million are expected to be incurred in early 2011 to complete the NGL conversion project and remaining seasonal and restoration work. Expenditures in 2009 were directed primarily to Phase II as well as sustaining capital

infrastructure through pipeline integrity and tank and line repairs.

Saskatchewan System anticipates capital expenditures of approximately \$51.6 million in 2011, exclusive of remaining Phase II expenditures. Of this amount, \$10.3 million is allocated to maintenance capital expenditures for annual repair and inspection programs. Additionally, \$25.9 million is allocated to growth enhancement capital, primarily to support new business customer connections, and the remaining \$15.4 million is expected to be spent on the early components of the Bakken Expansion Program.

### **Business Risks**

The risks identified below are specific to the Saskatchewan System. General risks that affect the Fund as a whole are described under Risk Management.

#### *Competition*

The Saskatchewan System faces competition in pipeline transportation from other existing or proposed pipelines as well as other forms of transportation, most notably trucking. These alternative transportation options could charge rates or provide service to locations that result in greater net profit for shippers with the effect of forcing the Saskatchewan System to lower its transportation rates to avoid losing shippers, thereby reducing cash flow. The Saskatchewan System manages exposure to competition by ensuring its tolls are competitive and by providing a high level of service. Further, the Saskatchewan System's right-of-way and ongoing expansion efforts to ensure available capacity have created a competitive advantage. The Phase II Expansion and the Bakken Expansion Program announced in 2010 are two examples of the Fund's ability to competitively respond to new opportunities.

#### *Demand for Services*

Operations and tolls for the Saskatchewan Gathering and the Westspur Systems are based on expired agreements with certain crude oil shippers and tolls are monitored on a customer complaint basis. The majority of the volumes shipped on these systems are transported on a basis similar to a common carrier, with no specific on-going volume commitments. There is no assurance that shippers will continue to utilize these systems in the future or transport volumes on similar terms or at similar tolls.

#### *Credit Risk*

The Saskatchewan System's trade receivables consist primarily of amounts due from companies operating in the oil and gas exploration and development industry. The credit risk associated with these receivables is mitigated by utilization of credit exposure limits where appropriate, and requiring less creditworthy shippers to provide credit enhancement which may include letters of credit, posting of collateral, netting provisions or other contractual requirements.

## **GREEN POWER**

### **Overview**

#### *Wind Power*

Green Power includes the Fund's interest in three wind power projects including a 50% interest in the Sunbridge project at Gull Lake, Saskatchewan and a 33% interest in each of the Magrath and Chin Chute projects in southern Alberta. Collectively referred to as Wind Power, the Sunbridge, Magrath and Chin Chute wind power projects have a combined electricity capacity of 71 megawatts (MW). Sunbridge consists of 17 turbines, each with a capacity of 0.66 MW for a total of 11 MW. The power from Sunbridge is delivered into the Saskatchewan power grid and is sold under a long term PPA which expires in 2022. Each of the Magrath and Chin Chute wind projects utilize 20 turbines, each with a capacity of 1.5 MW, for a total capacity of 30 MW per project. The energy produced at Magrath and Chin Chute is delivered into the Alberta power grid. The Fund has entered into long-term agreements to substantially fix the price received for its share of production on these projects. The Magrath contract expires on November 30, 2024 while the Chin Chute contracts expire on December 31, 2017.

The Fund entered into a contract to sell all available emission reduction credits generated by the Fund's interest in the Chin Chute and Magrath projects to Enbridge. The contract has an initial 20-year term

ending October 1, 2026 and provides for a fixed price of \$5 per tonne of avoided CO<sub>2</sub> emissions plus applicable taxes, based on a negotiated formula for converting megawatts generated to tonnes of emissions reduced. Emission credits associated with the power sold by the Sunbridge project are included in the price of the power and automatically transferred to the purchaser.

Each of the Magrath and Chin Chute wind power projects receive \$10 per megawatt hour (MWh) for electricity generated for a 10-year term under federal government support programs for renewable power. The Magrath project will continue to receive Wind Power Production Incentive (WPPI) payments until August 16, 2014, and the Chin Chute project will continue to receive ecoENERGY Renewable Power Program Incentive (eRPP) payments until March 31, 2017.

Various inspection and monitoring methods as well as ongoing maintenance protocols are utilized to maintain the safety and integrity of the wind turbines and related facilities, and to minimize system disruptions. The Wind Power assets are subject to regular maintenance programs to maintain the life of the turbines. Given the infancy of this industry, the timing and magnitude of maintenance capital expenditures will likely vary from year to year.

#### *NRGreen*

NRGreen operates four non-regulated waste heat recovery facilities located in Saskatchewan, along the Alliance Pipeline. The first facility located at Kerrobert, Saskatchewan has been operating since December 2006. The three other facilities, located in Loreburn, Estlin and Alameda, Saskatchewan, began operations during 2008. Electricity is generated by harnessing the waste heat produced by Alliance Canada's gas turbines at its compressor stations and converting it to electrical energy. With four waste heat recovery facilities in operation, NRGreen's facilities can generate 20 MW of power.

The power generated from all four of the NRGreen facilities is sold under long-term PPAs to SaskPower. The PPAs expire ten years after the in-service date for each facility. However, each PPA permits two five-year renewal notices at NRGreen's election. These may be renewed successively to provide an additional ten-year extension to the initial PPA.

Regular maintenance of NRGreen's facilities is performed concurrently with the Alliance Canada semi-annual inspection of the Kerrobert, Loreburn, Estlin and Alameda compressor stations.

#### **Financial Results**

Year ended December 31,	2010	2009
<i>(millions of Canadian dollars)</i>		
Revenues	<b>9.7</b>	11.3
Earnings	<b>2.5</b>	4.0

Green Power revenues for 2010 decreased by \$1.6 million compared to 2009.

During 2010, the impact of lower wind resources that negatively impacted most wind projects across Western Canada and maintenance outages on several wind assets, were offset by improved contributions from NRGreen due to improved operational reliability in 2010 compared with 2009. During the first quarter of 2009, NRGreen experienced unscheduled outages at all four of the NRGreen waste heat facilities due to extremely cold weather in Saskatchewan. Comparability of revenues year-over-year is also impacted by the recognition of an unrealized non-cash gain on derivative instruments of \$1.3 million in 2009, which resulted from derivative instruments utilized to fix the price of power on a wind power project that were not designated hedges for accounting purposes. Further, in the fourth quarter of 2009, the Fund entered into an offsetting power swap with terms similar to the original swap which served to reduce earnings volatility related to non-qualifying derivative instruments, the full effect of which was seen in 2010.

Green Power earnings totaled \$2.5 million in the year ended December 31, 2010 compared with earnings of \$4.0 million for the year ended December 31, 2009. After removing the impact of the non-cash

derivative gain from the prior year, earnings are comparable year-over-year, reflecting increased NRGreen contributions and reduced earnings from the wind power projects.

### Capital Expenditures

Capital expenditures of \$0.4 million in 2010 (2009 - \$1.5 million) related to finalization of winterization project activities on the NRGreen facilities and wind equipment replacement. Prior year capital expenditures were incurred by NRGreen and included final construction costs for the three projects brought into service in 2008, interconnection of the Alameda facility and the winterization project on all four NRGreen facilities.

### Business Risks

The risks identified below are specific to the Green Power segment. General risks that affect the Fund as a whole are described under Risk Management.

#### *Variable Wind Resource*

The generation of electricity associated with the Fund's interest in its Wind Power projects is dependent on the wind resource at each location. The wind resource fluctuates daily and seasonally. Despite weak wind resource experienced during 2010, the long-term actual wind resource attained at each of the wind power projects has generally met its expected wind resource, as forecast with the support of extensive long-term wind studies. However, there is no assurance that the wind resource and thus electricity generation at each location will continue to meet expectations.

#### *Dependence*

The NRGreen waste heat recovery facilities generate electricity from the waste heat emitted from Alliance Canada's compressor stations. As a result, any shutdowns for maintenance or reduction in activity at these compressor stations will have a negative impact on the level of production for NRGreen.

#### *Counterparty Risk*

The primary source of fixed price revenue for each wind project and for NRGreen is a single counterparty. The stability of the Fund's revenue and cash flows from this segment is dependent upon the ability of this counterparty to pay their monthly charges. If this counterparty is unable to fulfill their obligations under their purchase agreements and an alternate counterparty is not available, Green Power would be exposed to variable power prices. This risk has been mitigated through contracting with a strong investment grade counterparty.

## CORPORATE

### Financial Results

Year ended December 31,	2010	2009
<i>(millions of Canadian dollars)</i>		
Total costs	(70.6)	(70.0)

The Corporate segment captures management and administrative costs, corporate financing costs, distributions to ECT preferred unitholders, business development activities not attributable to a specific business segment and other corporate costs including current and future income taxes.

The increase in Corporate costs for the year ended December 31, 2010 was due to costs associated with restructuring the Fund of \$1.8 million, increased interest expense associated with a greater proportion of long-term debt outstanding at higher rates, offset by a recovery of income taxes as current period losses were carried back to prior years.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Financing Strategy**

In keeping with its low risk value proposition, the Fund actively monitors and manages exposure to financial risks to ensure the ongoing stability and predictability of cash flow. The Fund's financing strategy is to maintain a strong, investment grade credit rating and ongoing access to debt capital markets in virtually all market conditions. To protect against more severe market disruptions, the Manager targets to maintain sufficient liquidity in the form of committed standby credit facilities to finance all anticipated operating and capital requirements for at least a year without having to access long-term capital markets. Market price risk (primarily exposure to movements in interest rates and commodity prices) is closely monitored and substantially mitigated using hedging instruments approved by the Board of Trustees.

During 2010, the Fund raised \$200.0 million in unsecured MTNs, through two separate issuances of \$100.0 million in June and November. The MTNs have maturity dates of June 22, 2017 and November 12, 2020. Proceeds were used to pay down credit facility borrowings and Fund growth projects.

In June of 2010, the Fund amended one of its existing unsecured third party credit facilities to establish a new \$300.0 million unsecured revolving standby credit facility with a syndicate of commercial banks. As a result, an existing \$50.0 million, 364-day third party credit facility and a \$100.0 million credit facility provided by Enbridge, were both cancelled. The Fund has the option to extend the maturity date of the outstanding amounts drawn under the amended and restated facility by an additional year from the end of the applicable revolving term.

At December 31, 2010, the Fund had \$169.6 million of available standby credit capacity. The Fund maintains a current shelf prospectus with the Canadian securities regulator, which enables ready access to Canadian public capital markets, subject to market conditions. During the year, NRGreen converted its facilities, in accordance with extension terms, into a single operating facility of \$52.0 million, of which the Fund's share is \$26.0 million. Cash from operations in combination with available committed standby credit facilities is expected to be sufficient to meet the current forecasted liquidity and capital resource requirements of the Fund.

The total notional principal of interest rate derivative instruments outstanding at December 31, 2010 was \$75.0 million (2009 – \$350.0 million), related to short-term borrowings that have been hedged through to December 2013, at an average rate of 3.62%. The interest rate derivative instruments existing at December 31, 2010 are used to mitigate the Fund's exposure to interest rate volatility on its credit facilities. The Fund also periodically hedges the interest rate on planned long-term debt issuances. During 2010, new pre-issuance hedges were settled in conjunction with the issuances of \$100.0 million of MTNs in June and November. The settlement of these hedges resulted in a net payment to swap counterparties which has been recorded in OCI and will be amortized to earnings over the remaining life of the related debt.

The Fund's current liabilities routinely exceed current assets; however, the Fund maintains sufficient short-term credit facilities to meet its obligations as they come due. The Fund's cash balance at December 31, 2010 of \$21.4 million includes \$15.6 million held in trust in Alliance Canada, pursuant to finance agreements entered into by Alliance Canada.

### **Operating Activities**

Cash provided by operating activities was \$67.4 million for the year ended December 31, 2010, a decrease of \$26.8 million from the prior year. The variance is due to changes in working capital, primarily movements in accounts receivable and accounts payable balances.

### **Investing Activities**

Cash used in investing activities of \$107.4 million increased \$66.3 million over 2009. Current year capital expenditures were primarily directed to Phase II of the Saskatchewan System Capacity Expansion and customer connections on the Saskatchewan Gathering and Weyburn Systems. Capital additions in 2009 primarily consisted of Phase II expenditures, maintenance capital on the Saskatchewan System,

completion activities on Alliance Canada's BC Expansion and modifications to the NRGreen waste heat facilities to improve operational performance in cold weather.

Additions to property, plant and equipment in 2010 also included expenditures in the amount of \$8.8 million related to the Bakken Expansion Program, a joint project to further develop the Fund's Saskatchewan infrastructure.

### Financing Activities

Financing activities for the year ended December 31, 2010 included payment of monthly distributions to trust unitholders, repayments of non-recourse long-term debt, total MTN issuances of \$200.0 million and changes in outstanding indebtedness under credit facilities. During the year ended December 31, 2010, Alliance Canada made debt repayments, of which the Fund's share was \$33.9 million. Alliance Canada debt repayments occur semi-annually in June and December each year.

Average monthly trust unit distributions in 2010 were \$0.096 per unit, consistent with that declared in 2009.

Payments due under contractual obligations over the next five years and thereafter are as follows:

	Total	Less than 1 year	2 years	3 years	4 years	5 years	Thereafte r
<i>(millions of Canadian dollars)</i>							
Long-Term Debt <sup>1</sup>	420.0	-	-	-	90.0	-	330.0
Non-recourse Long-term Debt <sup>1</sup>	698.4	36.3	39.9	39.9	41.7	44.2	496.4
Operating Leases	34.6	4.3	3.8	3.5	3.0	3.0	17.0
	1,153.0	40.6	43.7	43.4	134.7	47.2	843.4

<sup>1</sup> Includes amounts outstanding under credit facilities at December 31, 2010 in their year of expiry.

Alliance Canada holds various classes of Master Asset Vehicle (MAV) notes which were received in exchange for Alliance Canada's investment in asset-backed commercial paper (ABCP) that was unable to be redeemed upon maturity in 2007 due to the deterioration of liquidity in the ABCP market. An "A" rating has been assigned by DBRS to 49% of the notes, a "BBB" rating is assigned to 41% of the notes, while the Class B and Class C notes are not rated. The legal maturity of the notes is July 15, 2056, but the actual expected repayment of the notes, if held to maturity, is January 22, 2017.

The investment in the MAV notes is classified as held for trading and is measured at its fair value of \$4.5 million. The Fund does not anticipate that the investment in the MAV notes will have a significant impact on Alliance Canada's results from operations or cash flow.

## CASH AVAILABLE FOR DISTRIBUTION<sup>1</sup>

Year ended December 31,	2010	2009
<i>(millions of Canadian dollars)</i>		
Cash Provided by Operating Activities	67.4	94.2
Add/(Deduct):		
ECT Preferred Unit distributions <sup>2</sup>	43.8	43.8
Alliance Canada debt repayments <sup>4</sup>	(33.9)	(31.0)
Alliance Canada other cash retained <sup>5</sup>	(6.5)	(16.5)
Green Power debt repayment	(1.0)	-
Green Power cash retained <sup>5</sup>	(1.5)	(2.0)
Saskatchewan System maintenance capital expenditures <sup>3</sup>	(4.8)	(5.6)
Change in operating assets and liabilities in the year <sup>6</sup>	36.7	7.2
<b>Cash Available for Distribution</b>	<b>100.2</b>	<b>90.1</b>
Cash Available for Distribution is comprised of the following:		
Alliance Canada distributions	76.4	71.7
Saskatchewan System operating income before depreciation and amortization	47.0	40.1
Saskatchewan System maintenance capital expenditures	(4.8)	(5.6)
Green Power distributions	4.5	4.7
Corporate management and administrative expense	(11.3)	(9.7)
Corporate interest expense	(11.1)	(10.7)
Corporate other income	(1.2)	0.2
Corporate current income taxes	0.7	(0.6)
<b>Cash Available for Distribution</b>	<b>100.2</b>	<b>90.1</b>
ECT Preferred Unit Distributions Declared	43.8	43.8
Trust Unit Distributions Declared	39.9	39.9
<b>Cash Distributions Declared</b>	<b>83.7</b>	<b>83.7</b>

<sup>1</sup> See Non-GAAP measures on page 4.

<sup>2</sup> The cash available for distribution above is compared with total distributions, including the ECT preferred unit distributions. Since ECT preferred units were treated as debt under Canadian GAAP in 2010 and 2009 with distributions deducted from earnings, the ECT preferred unit distributions have been added back to cash provided from operating activities.

<sup>3</sup> Maintenance capital expenditures reduce cash available for distribution since these expenditures are funded through cash from operations.

<sup>4</sup> Debt repayments in Alliance Canada are deducted from cash from operations in deriving cash available for distribution because they are funded from cash from Alliance Canada's operations.

<sup>5</sup> The cash retained or distributed by Alliance Canada and Green Power reflects the cash from operations of these segments that has not been distributed to the Fund or distributions in excess of cash earnings in the period. While this cash from operations is proportionately consolidated and included in the Fund's cash provided by operating activities, it is not available for distribution by the Fund until it has been received from Alliance Canada and the Green Power segment. Cash retained by Alliance Canada and Green Power includes debt service reserves, capital expenditures and other cash needed to fund working capital or other requirements of these segments.

<sup>6</sup> Change in operating assets and liabilities in the period reflect changes in non-cash working capital related to operating activities. The change has been added back to cash available for distribution since fluctuations in working capital are expected each period and are not indicative of changes in cash available to be distributed.

As set out in the above table, cash available for distribution consists of operating cash flow from the Fund's underlying businesses less deductions for maintenance capital expenditures, the Fund's administrative and operating expenses, corporate segment interest expense, applicable taxes and other reserves determined by the Manager.

CAFD represents cash available to fund distributions on trust units and ECT preferred units, as well as for debt repayments and reserves.

## ANALYSIS OF CASH DISTRIBUTIONS DECLARED

Year ended December 31,	2010	2009
<i>(millions of Canadian dollars)</i>		
Cash Provided by Operating Activities	<b>67.4</b>	94.2
Earnings	<b>12.6</b>	13.0
Trust Unit Cash Distributions Declared <sup>1</sup>	<b>39.9</b>	39.9
Excess of cash provided by operating activities over cash distributions declared	<b>27.5</b>	54.3
Shortfall of earnings compared with cash distributions declared	<b>(27.3)</b>	(26.9)

<sup>1</sup> ECT Preferred Unit Distributions have been excluded from this reconciliation since these distributions were reductions to earnings under Canadian GAAP.

For the year ended December 31, 2010, cash provided by operating activities in the period exceeded cash distributions paid to trust unitholders by \$27.5 million (2009 – \$54.3 million). This excess represented cash reserved for debt repayments, working capital requirements and maintenance capital expenditures, as well as cash retained by joint ventures.

Earnings were \$27.3 million (2009 – \$26.9 million) lower than cash distributions to trust unitholders for the year. Under Canadian GAAP, earnings reflect non-cash items such as amortization of deferred financing costs, depreciation and future income taxes, all of which do not impact cash flow. Depreciation does not necessarily represent the cost of maintaining productive capacity; therefore, cash required for maintenance is generally lower than depreciation expense. An excess of distributions over earnings is expected to continue in the future and partly represents a return of capital to unitholders.

## DISTRIBUTIONS

The Fund's distribution policy is to distribute approximately 95% of cash available for distribution each calendar year. The distribution will not typically be adjusted in circumstances where a change in cash available for distribution is not considered to be recurring. The remaining 5% of cash available for distribution retained by the Fund is used to repay debt obligations, for general purposes and to level distributions.

### Taxation of Distributions

Under Canadian tax laws, a component of the Fund's cash distributions are taxable in the hands of the unitholder, with the remaining portion treated as a return of capital unless held in a tax-deferred account. Based on current operations, 80% of cash distributed in 2010 will be included in the income of unitholders for income tax purposes. The remaining amount distributed represents a non-taxable return of capital.

### Sustainability of Distributions and Productive Capacity

The current level of distributions may change based on the performance of the Fund's businesses, the level of continued investment or the Fund's ability to raise capital for new investment. The Board of Trustees periodically approves changes to distributions in accordance with the Fund's distribution policy. Distributable cash flow is defined to generally mean cash from operating, investing and financing activities, less certain items, including repayment of any indebtedness required in the period and any cash withheld as a reserve as determined by the Manager.

The sustainability of the Fund's distributions is a function of several factors: the demand for the services provided by its businesses; the effective maintenance of the productive capacity of its assets; its ability to economically obtain financing to fund growth; operational requirements; and, its ability to comply with covenants in its debt agreements as well as repay or refinance its debt as it comes due.

Each operating segment maintains its productive capacity and ensures the future sustainability of its distributions through regular maintenance programs and periodic maintenance capital expenditures. Maintenance capital expenditures are funded through cash from operations. Refer to the "Capital Expenditures" sections within the description of each operating segment for further discussion on planned maintenance and enhancement capital activities for 2011.

## SELECTED ANNUAL FINANCIAL INFORMATION

	2010	2009	2008
<i>(millions of Canadian dollars, except where otherwise noted)</i>			
Revenues	<b>328.1</b>	314.8	297.0
Earnings	<b>12.6</b>	13.0	21.9
Total Assets	<b>1,975.5</b>	1,915.3	1,858.2
Total Long-Term Liabilities	<b>1,373.6</b>	1,560.3	1,412.8

Significant items that have impacted the selected annual financial information are as follows:

- 2010 revenues and earnings reflected the substantial completion of the Phase II Saskatchewan System Capacity Expansion project.
- Earnings in 2010 were negatively impacted by higher operating costs related to one-time occurrences, including the Virden crude oil release and costs associated with the restructuring of the Fund.
- Revenues in each year reflected Alliance Canada's annual toll adjustments.
- 2009 earnings reflected higher Corporate costs relative to 2008 due to the increases in the Fund's monthly distributions from \$0.086/unit to \$0.096/unit which results in increased incentive fees and preferred unit distributions.
- 2008 earnings reflected \$4.4 million, net of tax, received from a bankruptcy settlement in Alliance Canada.
- The decrease in long-term liabilities reflected a modification to the ECT Preferred Units pursuant to the Plan effected in December 2010 which resulted in a portion of the principal amount of this instrument being recorded as equity in 2010.
- Increased assets and long-term liabilities in 2009 resulted from a change in accounting policy related to income taxes which was effective January 1, 2009 and removed specific exemptions for rate regulated entities with respect to recording future income taxes. As a result of the revised standard, the Fund recognized a future income tax liability related to regulated assets, primarily property, plant and equipment, along with an offsetting regulatory asset of \$120.2 million on January 1, 2009.

## SELECTED QUARTERLY FINANCIAL INFORMATION

	2010				2009			
<i>(millions of Canadian dollars, except per unit amounts)</i>	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	<b>89.4</b>	81.1	80.3	77.3	83.4	79.4	77.3	74.7
Earnings	<b>4.1</b>	3.4	1.5	3.6	3.6	2.7	3.4	3.3
Earnings Per Unit (basic and diluted)	<b>0.12</b>	0.10	0.04	0.10	0.10	0.08	0.10	0.10
Cash Distributions Declared <sup>1</sup>	<b>20.9</b>	20.9	20.9	20.9	20.9	20.9	20.9	20.9

<sup>1</sup> Cash distributions declared on Trust units and ECT preferred units.

Significant items that have impacted quarterly financial information are as follows:

- The fourth quarter of 2010 reflected the substantial completion of Phase II of the Saskatchewan System Capacity Expansion in December of 2010.
- Earnings in the second quarter of 2010 were negatively impacted by higher operating costs related to one-time occurrences, including the Virden crude oil release and costs associated with restructuring the Fund.
- Fourth quarter revenues from the Fund's regulated entities, including Alliance Canada, the Westspur System and the Saskatchewan Gathering System, are typically higher than other quarters due to higher cost of service recoveries. The maintenance schedule of both Alliance Canada and the Saskatchewan System has some seasonal variance which generally results in more maintenance projects being undertaken in the latter half of the year.

### FOURTH QUARTER 2010 HIGHLIGHTS

Fourth quarter earnings for 2010 were \$4.1 million, or \$0.12 per unit, compared with \$3.6 million, or \$0.10 per unit, for the fourth quarter of 2009. The increase in earnings from the prior year reflects offsetting impacts within the operating segments, as discussed below.

During the fourth quarter of 2010, Saskatchewan System earnings increased, owing to the substantial completion of the Phase II expansion and related additions to rate base. Saskatchewan System earnings in the fourth quarter also reflected increased deemed interest recoveries, partially offset by a reduction in deemed income taxes compared with the corresponding period of 2009.

Offsetting earnings growth in Saskatchewan System was a slight decline in Alliance Canada earnings owing to its period-over-period decline in rate base. The fourth quarter of 2010 also included slightly higher interest costs and higher legal and professional fees associated with the Fund restructuring, partially offset by a reduction in income taxes.

### RELATED PARTY TRANSACTIONS

Alliance Canada has contracts with shippers who are also affiliates of the Fund through common ownership interests of Enbridge, a related party by virtue of its ECT Preferred Units and Trust Unit investment in the Fund. The Fund's share of Alliance Canada's revenue from affiliates for the year ended December 31, 2010 is \$16.0 million (2009 - \$13.3 million) of which \$1.7 million (2009 - \$1.1 million) was included in accounts receivable and other at December 31, 2010. The terms of these contracts are the same as those agreed to with independent third parties.

Administrative and operation services agreements allow for Alliance Canada to provide services to Alliance Pipeline US (an entity related to Alliance Canada by virtue of common ownership interests) in exchange for reimbursement of incurred costs or at rates consistent with the agreements. Certain amounts reimbursed under the services agreements with Alliance Pipeline US also include a recovery of costs relating to the use of common administrative assets. The Fund's share of amounts charged to Alliance Pipeline US during the year ended December 31, 2010 was \$15.0 million (2009 - \$14.1 million)

of which \$2.1 million (2009 - \$1.4 million) was included in accounts receivable and other as at December 31, 2010.

Administrative and facility support services are provided by Alliance Canada to Aux Sable Canada LP and Aux Sable Liquid Products LP, which are entities related to the Fund through common ownership. The Fund's share of amounts charged to Aux Sable Canada LP and Aux Sable Liquid Products LP during the year ended December 31, 2010 were \$0.2 million (2009 - \$0.2 million) and \$0.1 million (2009 - \$0.1 million), respectively.

The Saskatchewan System does not have any employees and uses the services of Enbridge for managing and operating the business. These services, which are charged at cost in accordance with service agreements, were \$20.5 million for 2010 (2009 - \$18.0 million) of which \$1.8 million (2009 - \$1.5 million) was included in accounts payable and accrued liabilities at December 31, 2010.

Certain wind power projects do not have any employees and use the services of Enbridge for managing and operating the business. These services, which are charged at cost, were \$0.3 million for 2010 (2009 - \$0.4 million) with \$0.2 million (2009 - nil) included in accounts payable and accrued liabilities at December 31, 2010.

The Fund has a contract to sell to Enbridge all available emission reduction credits generated by the Fund's interest in the Chin Chute and Magrath projects. The contract has an initial 20-year term ending October 1, 2026 and provides for a fixed price of \$5 per tonne of avoided CO<sub>2</sub> emissions, based on a negotiated rate of converting megawatts generated to tonnes of emissions reduced, plus applicable taxes. The Fund earned \$0.2 million (2009 - \$0.3 million) for the sale of these emission reduction credits in the year ended December 31, 2010.

One of the Fund's wind power projects, Magrath, has a long-term Power Purchase Agreement (PPA), expiring in 2024, with Enbridge Pipelines Inc., a wholly owned subsidiary of Enbridge. The terms of the PPA are for the sale of the project's total wind power production at a fixed price. Revenues of \$0.3 million (2009 - \$0.2 million) related to this PPA are reported within the Fund's revenue for the year ended December 31, 2010.

Under the management and administrative agreements with EMSI, a wholly owned subsidiary of Enbridge, an incentive fee was payable annually to EMSI equal to 25% of cash distributions above a base distribution level of \$0.825 per unit per year. During the year ended December 31, 2010, incentive fees were \$8.3 million (2009 - \$8.3 million) which were fully paid as of December 31, 2010, (2009 - \$8.3 million was included in the accounts payable and accrued liabilities). In addition, a base fee of \$0.1 million is payable annually for providing administrative and management services and is included in accounts payable at December 31, 2010. In connection with the Plan, the incentive fee calculation was amended such that the future fees will not differ materially from that which would have been paid had the restructuring not occurred.

On June 1, 2010, a newly created joint venture entity, Sable NGL Services L.P. (SNGL Services) in which the Fund holds a 50% interest and an unrelated third party holds the other 50% interest, secured 20 million cubic feet per day (mmcf/d) of firm capacity on the Alliance System (the Alliance Capacity) at tolls equal to those charged to third party shippers under 15-year transportation service agreements. Under renewals of that arrangement, this capacity has been contracted through to March 2011. Concurrent with obtaining this Alliance Capacity, SNGL Services entered into an agency agreement with a subsidiary of Enbridge to manage the Alliance Capacity on its behalf, including the purchase and sale of natural gas, in return for a management fee. In connection with this transaction, SNGL Services is eligible for inducements offered by an affiliate of Enbridge for transporting natural gas with higher heating values to supply the natural gas extraction facility located at the terminus of the Alliance System. Revenues and expenses of \$0.1 million and \$0.1 million, respectively, are reported within the Fund revenue and expenses for the year ended December 31, 2010. At December 31, 2010, \$0.2 million was included in accounts payable and accrued liabilities.

During 2010, ECT entered into an agreement with EIFH, under which it agreed to reimburse EIFH for general administrative costs. As at December 31, 2010, \$0.1 million was included in accounts payable and accrued liabilities.

## **RISK MANAGEMENT**

The Fund's business activities are subject to both financial and non-financial risks.

### **Financial Risks**

#### *Market Price Risk*

The Fund's earnings, cash flows and OCI are subject to movements in interest rates, commodity prices and foreign exchange prices (collectively, market price risk). The following summarizes the types of market price risks to which the Fund is exposed, and the risk management instruments used to mitigate such risks.

#### *Interest Rate Risk*

The Fund is exposed to cash flow interest rate risk and fair value interest rate risk as a result of fluctuations in market interest rates. Cash flows are impacted by changes in market interest rates on the cost of variable rate debt and anticipated fixed rate debt issues. The Fund may enter into interest rate derivatives such as floating to fixed interest rate swaps and forward rate agreements to mitigate the interest rate risk associated with this debt. The fair value of existing fixed rate long-term debt is also impacted by changes in market interest rates. The Fund does not typically manage the fair value risk of its debt instruments as they are classified as financial liabilities and recorded at amortized cost.

Information regarding the Fund's debt is included in Note 8 and Note 9 of the 2010 Annual Consolidated Financial Statements.

#### *Commodity Price Risk*

Commodity price risk is the risk of changes in cash flows or earnings due to changes in the market price of commodities. The Fund is exposed to movements in the price of power through its interest in certain wind power assets and movements in the price of natural gas through its interest in Sable NGL Services L.P. To manage its exposure to power pricing movements, the Fund uses fixed price power agreements that convert the floating price received when power is sold to a fixed price. Additionally, the Fund uses natural gas swaps to minimize its volatility exposure to natural gas prices.

#### *Foreign Exchange Risk*

The Fund's earnings, cash flows, and OCI are subject to foreign exchange rate variability, primarily due to Alliance Canada euro-denominated maintenance contracts. To manage this exposure, the Alliance uses foreign currency derivative instruments to minimize volatility on its foreign currency contracts.

#### *Financing and Liquidity Risk*

Access to cost-effective sources of funding is central to the successful execution of the Fund's broader strategy. New debt and equity capital is required to fund planned growth projects and refinance maturing indebtedness. Fluctuations in the cost and availability of debt and equity capital could materially impair the ability of the Fund to execute its broader strategies and generate stable and predictable cash flow to its unitholders. Financing Risk is addressed through the maintenance of strong credit ratings and a pro-active investor relations program. The Fund also maintains a current shelf prospectus with Canadian securities regulators, which enables ready access to Canadian public debt markets, subject to market conditions. To protect against more severe capital market disruptions, the Manager targets to maintain sufficient liquidity in the form of committed standby credit facilities to finance all anticipated operating and capital requirements for at least a year without having to access long-term capital markets. The Fund regularly updates its short term and long-term liquidity position to ensure that it has sufficient committed standby credit on hand to meet planned requirements and contingencies.

### *Maturities of Financial Instruments*

The Fund generally has no financial liabilities, other than derivative instruments, maturing beyond one year with the exception of its long-term debt and non-recourse long-term debt. Additional information about the Fund's long-term debt and non-recourse long-term debt is included in Notes 8 and 9 of the 2010 Annual Consolidated Financial Statements.

The Fund has estimated the following undiscounted cash flows will arise from its derivative instruments based on valuation at the balance sheet date:

	2011	2012	2013	2014	2015	Thereafter
<i>(millions of Canadian dollars)</i>						
Cash inflows	0.2	0.2	0.3	0.3	0.2	1.3
Cash outflows	(1.7)	(1.2)	(0.8)	(0.1)	(0.1)	(0.2)
Net cash flows	(1.5)	(1.0)	(0.5)	0.2	0.1	1.1

The maturity profile of non-derivative financial liabilities is presented in Liquidity and Capital Resources.

### *Credit Risk*

Credit risk arises from trade receivables and is mitigated by use of counterparty credit exposure limits and by requiring less creditworthy shippers to provide credit enhancement which may include letters of credit, posting of collateral, netting provisions or other contractual requirements.

Entering into derivative financial instruments can also give rise to credit risk. Credit risk arises from the possibility that counterparty will default on its contractual obligations and is limited to those contracts where the Fund would incur a loss in replacing the instrument. The Fund minimizes credit risk by entering into risk management transactions only with institutions that possess solid investment grade credit ratings or have provided the Fund with an acceptable form of credit enhancement.

The Fund is exposed to credit risk through Alliance Canada's investment in the MAV notes. Due to the lack of active market for these instruments and the uncertainties regarding the fair value of the underlying assets, there is risk that Alliance Canada will not receive the carrying value of the instruments upon maturity.

### *Debt Covenants*

The Fund, NRGreen and Alliance Canada credit facilities include provisions that prohibit distributions in the event of default. The Fund's credit facility agreements include a covenant that limits unconsolidated indebtedness to four times earnings before interest, taxes, depreciation and amortization (EBITDA.) In the event of default and in the absence of a waiver from the lenders, failure to remediate this covenant could result in a reduction of distributions to unitholders. Under the NRGreen and Alliance Canada credit facilities, distributions cannot be made to owners if the debt service coverage ratio, calculated as of the applicable distribution date, falls below 1.25 to 1 for Alliance Canada and 1.4 to 1 for NRGreen for the four preceding fiscal quarters and the four succeeding fiscal quarters. The respective entities actively monitor debt covenants to ensure compliance. As at December 31, 2010 and 2009, the Fund, NRGreen and Alliance Canada were in full compliance with their respective debt covenants.

The following table summarizes the Fund's financial instrument carrying and fair values and provides a reconciliation to the balance sheet.

<b>December 31, 2010</b>	Held for Trading	Loans and Receivables	Other Financial Liabilities	Derivatives	Non- Financial Instruments	Total	Fair Value <sup>1</sup>
<i>(millions of Canadian dollars)</i>							
<b>Assets</b>							
Cash and cash equivalents	21.4	-	-	-	-	21.4	21.4
Accounts receivable and other	-	52.3	-	-	2.7	55.0	52.3
Deferred amounts and other assets	4.5	-	-	1.6	192.3	198.4	6.1
<b>Liabilities</b>							
Accounts payable and accrued liabilities	-	-	71.4	1.5	-	72.9	72.9
Distributions payable	-	-	3.3	-	-	3.3	3.3
Long-term debt	-	-	415.7	-	-	415.7	425.1
Non-recourse long-term debt	-	-	724.2	-	-	724.2	780.7
ECT Preferred Units	-	-	88.1	-	-	88.1	688.2
Long-term liabilities	-	-	4.1	1.6	4.7	10.4	1.6

<sup>1</sup>Fair value does not include non-financial instruments.

<b>December 31, 2009</b>	Held for Trading	Loans and Receivables	Other Financial Liabilities	Derivatives	Non- Financial Instruments	Total	Fair Value <sup>1</sup>
<i>(millions of Canadian dollars)</i>							
<b>Assets</b>							
Cash and cash equivalents	17.6	-	-	-	-	17.6	17.6
Accounts receivable and other	-	37.2	-	-	1.3	38.5	37.2
Deferred amounts and other assets	4.8	-	-	-	189.8	194.6	4.8
<b>Liabilities</b>							
Accounts payable and accrued liabilities	-	-	45.3	3.6	4.4	53.3	48.9
Distributions payable	-	-	3.3	-	-	3.3	3.3
Long-term debt	-	-	296.1	-	-	296.1	302.9
Non-recourse long-term debt	-	-	763.0	-	-	763.0	789.0
ECT Preferred Units	-	-	380.2	-	-	380.2	505.7
Long-term liabilities	-	-	-	0.6	2.3	2.9	0.9

The fair value of financial instruments reflects the Fund's best estimates based on generally accepted valuation techniques or models and supported by observable market prices and rates, where available. When such prices are not available, the Fund uses discounted cash flow analysis from applicable yield curves based on observable market inputs. The fair value of financial instruments, other than derivatives, represents the amounts that would have been received from or paid to counterparties to settle these instruments at the reporting date.

The fair value of the Fund's long-term debt is based on quoted market prices for instruments of similar yield, credit risk and tenure.

The fair value of the Fund's derivative financial instruments and investment in the MAV notes through Alliance Canada reflects the Fund's best estimates of market value based on generally accepted valuation techniques or models and supported by observable market prices, if available.

The fair value of the Fund's ECT Preferred Units is based on a December 31, 2010 quoted market price of \$18.10 for shares of EIFH.

The fair value of other financial assets and liabilities other than derivative instruments approximate their cost due to their short term to maturity.

### Summary of Derivative Instruments used as Cash Flow Hedges

The Fund uses the following cash flow hedges to manage fluctuations in power prices, interest rates, natural gas, and foreign exchange.

Year ended December 31, 2010	Maturity	Notional Principal or Quantity	Fair Value Receivable/ (Payable)	Realized Gains /(Losses) <sup>1</sup>	Unrealized Gains /(Losses) <sup>1</sup>
<i>(millions of Canadian dollars, unless otherwise noted)</i>					
Chin Chute Power Swap (MW/H)	2017	2.0	0.5	0.1	0.3
Magrath Power Swap (MW/H)	2024	2.8	1.1	0.3	1.2
Interest Rate Swaps	2013	75.0	(3.0)	0.1	1.3
Euro Foreign Exchange Forwards	2011-2012	4.6	(0.1)	-	(0.1)
			(1.5)	0.5	2.7
Income taxes				-	(1.6)
				0.5	1.1
Settled derivatives				(0.7)	(17.1)
Gains (losses) reflected in OCI, net of tax				(0.2)	(16.0)

<sup>1</sup> Changes in the fair value of effective cash flow hedging instruments are recorded in OCI and reclassified to earnings when the hedged item impacts earnings.

Year ended December 31, 2009	Maturity	Notional Principal or Quantity	Fair Value Receivable/ (Payable)	Realized Gains /(Losses) <sup>1</sup>	Unrealized Gains /(Losses) <sup>1</sup>
<i>(millions of Canadian dollars, unless otherwise noted)</i>					
Chin Chute Power Swap (MW/H)	2017	2.0	0.2	(0.2)	3.4
Magrath Power Swap (MW/H)	2024	2.8	(0.1)	(0.2)	8.1
Interest Rate Swaps	2010-2013	350.0	(4.3)	0.1	(4.3)
			(4.2)	(0.3)	7.2
Income taxes				-	2.2
				(0.3)	9.4
Settled derivatives				(0.2)	(3.4)
Gains (losses) reflected in OCI, net of tax				(0.5)	6.0

### Non-Qualifying Derivatives

At December 31, 2010, the Fund held two offsetting 1MW power swaps which both mature in 2017, that were classified as non-qualifying derivatives. Additionally, the Fund classified two natural gas swaps, with notional values of 10,000 mmbtu/day as non-qualifying. The natural gas swaps mature in 2011.

The Fund recognized an unrealized derivative loss of \$0.1 million net of tax, for the year ended December 31, 2010 (2009 – \$0.6 million gain after tax) related to non-qualifying derivatives not designated as hedging instruments. Gains and losses on the non-qualifying derivatives are reported in revenues. These instruments have a fair value payable of \$0.4 million at December 31, 2010 (2009 - \$0.3 million). The current and long-term portions of this payable are reported within accounts payable and accrued liabilities and long-term liabilities, respectively.

Additional information about the Fund's Risk Management and Financial Instruments is included in Notes 16 and 17 of the 2010 Annual Consolidated Financial Statements.

## **Non-Financial Risks**

### *Regulation and Legislation*

Earnings and expansion projects on Alliance Canada and the Saskatchewan Systems are subject to the actions of various regulators, including the NEB. Actions of the regulators related to tariffs, tolls and facilities impact earnings and the success of the expansion projects. Delays in regulatory approvals could result in cost escalations and construction delays.

Changes in regulation, including decisions by regulators on the applicable tariff structure or changes in interpretations of existing regulations by courts or regulators, could adversely affect the results of operations of Alliance Canada and the Saskatchewan System. Further, the nature and degree of regulation and legislation affecting energy companies in Canada has changed significantly in past years and there is no assurance that further substantial changes will not occur. Such regulations and legislation may adversely affect the toll structure or other aspects of the Fund's business or the operations and creditworthiness of shippers.

### *Supply and Demand*

The operation of the Fund's liquids and natural gas pipelines is dependent upon the supply of and demand for crude oil and natural gas from Western Canada. The demand for crude oil by refiners is dependent upon a number of factors including the price of crude oil, the cost of operating the refinery and market prices for the various refined products. Demand for natural gas is affected among other things, by weather, requirements for electric power and broader levels of economic activity. Supply of crude oil and natural gas is dependent upon a number of variables, including:

- the level of exploration, drilling, reserves, and production of crude oil and natural gas;
- the accessibility of Western Canadian crude oil and natural gas;
- the price and quality of crude oil and natural gas available from alternative Canadian and United States sources; and
- the regulatory environments in Canada and the United States, including the continued willingness of the governments of both countries to permit the export of crude oil and natural gas from Canada to the United States on a commercially acceptable basis.

Supply and demand risk on Alliance Canada is mitigated by long-term TSAs under which substantially all of Alliance Canada's firm transportation capacity is contracted through 2015. Subsequent to 2015, demand for Alliance Canada's transportation services will be dependent upon the competitiveness of its tolls relative to alternative pipelines, the geographic location of its assets relative to natural gas production, and its ability to adopt its service offerings as necessary to meet shipper requirements.

Demand for the Fund's services is also affected by the supply of and demand for power generated by facilities within the Green Power segment. This risk is mitigated by the long-term PPAs entered into with customers.

### *Operating Risk*

The operation of Alliance Canada, the Saskatchewan System and Green Power involves risks, including the failure of equipment, information systems or processes, poor performance of equipment (whether due to misuse, unexpected degradation or design, construction or manufacturing defects), lack of spare parts, operator error, failure of internal controls, non-compliance with legal or other obligations, labour disputes, disputes or issues with interconnected facilities and carriers and catastrophic events such as natural disasters, fires, explosions, fractures, acts of terrorists and saboteurs, occurrence of a pandemic and other similar events, many of which are beyond the control of the respective systems. The occurrence or continuance of any of these events could increase the cost of operating Alliance Canada, the Saskatchewan System and Green Power and reduce transportation or generation capacity, thereby potentially impacting cash flow. The Fund employs various inspection and monitoring methods to manage pipeline, turbine and facility integrity as well as to minimize system disruptions. Additionally, the Fund maintains safety policies, disaster recovery procedures and insurance coverage at industry acceptable levels in the case of an incident.

The Fund and its operating affiliates have extensive programs to manage system integrity, which includes the development and use of in-line inspection tools. Maintenance, excavation and repair programs are directed to the areas of greatest benefit and pipe is replaced or repaired as required. The Company also maintains insurance coverage for significant pipeline leaks and has a security program designed to reduce security-related risks. While the Fund feels the level of insurance is adequate, it may not be sufficient to cover all potential losses.

### *Environmental Costs and Liabilities*

The operation of the Saskatchewan System and Alliance Canada are subject to federal, provincial and local laws and regulations relating to environmental protection and operational safety. Risks of substantial environmental costs and liabilities, including those from leaks and explosions, are inherent in pipeline operations and there can be no assurance that significant costs and liabilities, including those relating to claims for damages to property and persons resulting from operations of Alliance Canada and/or the Saskatchewan System, will not be incurred. To mitigate this risk, Alliance Canada and the Saskatchewan System have established safety and environmental policies that are designed to ensure that all aspects of their operations comply with existing regulations relating to personal safety and protection of the environment. It is not possible to predict the effect that any future changes in environmental laws and regulations will have on future earnings and there can be no assurance that environmental costs incurred by Alliance Canada or the Saskatchewan System will be partially or fully recoverable under their tolls.

### *Easement Rights*

Alliance Canada, Saskatchewan System and Green Power have acquired easement rights from landowners, tenants and service lease owners in order to construct, install and operate their pipelines and wind turbines. These easement rights were obtained through voluntary negotiation and, in certain cases, through statutory rights of entry. There can be no assurance that legal challenges will not be brought forward with respect to the form, content, or recording of such easements, or to business segments' compliance with the terms of such easements during the construction and operation of the pipelines or wind turbines.

### *Execution Risk*

The Fund's ability to successfully execute the development of its organic growth projects, such as the Bakken Expansion Program, may be influenced by capital constraints, third-party opposition, changes in shipper support for projects over time, delays or changes in government and regulatory approvals, cost escalations, construction delays, shortages and in-service delays. Early stage project risks include right-of-way procurement, special interest group opposition, Crown consultation, and environmental and regulatory permitting. Cost escalations may impact project economics. Construction delays due to slow delivery of materials, contractor non-performance, weather conditions and shortages may impact project development. Labour shortages, inexperience and productivity issues may also affect the successful completion of the projects. To mitigate these risks, clearly defined management and governance structures for all major projects are established and strategic relationships with landowners, suppliers, contractors and other stakeholders are formed and maintained. Additionally, Enbridge, the Fund's

Manager and the Fund's joint venture interests ensure that compensation programs, communications and working environments are designed to attract, develop and retain qualified personnel.

#### *Special Interest Groups*

The Fund is exposed to the risk of higher costs, delays or even project cancellations due to increasing pressure on government and regulators by aboriginal groups, landowners and other special interest groups. Recent Supreme Court decisions have increased the ability of special interest groups to make claims and oppose projects in regulatory and legal forums. The Fund and its contractors work proactively with special interest groups to identify and develop an appropriate response to concerns regarding its projects.

#### *Workforce Development*

With increased rates of retirement due to the current workforce demographic, the Fund relies on Enbridge's strong recruiting efforts, comprehensive training and leadership development programs, as well as succession planning initiatives to ensure the Manager has qualified staff to provide services to the Fund.

#### *Joint Venture Partners*

Certain segments of the Fund consist of joint venture partnerships with the Fund's ownership interests ranging from 33% to 50%. In these partnerships, the Fund does not have full control to execute initiatives without consent from the joint venture partners. This risk is mitigated through formal governance procedures as well as ongoing dialogue with joint venture partners.

## **CRITICAL ACCOUNTING ESTIMATES**

### **Depreciation**

Depreciation of property, plant and equipment, the Fund's largest asset with a net book value of \$1,305.1 million, or 66.1% of total assets at December 31, 2010, is generally provided on either a straight-line basis over the estimated service lives of the assets or a unit of throughput basis commencing when the asset is placed in service. When it is determined that the estimated service life of an asset does not reflect the expected remaining period of benefit, prospective changes are made to the estimated service life. In general, estimates of service lives are based on third party engineering studies, experience and industry practice. There are a number of assumptions inherent in estimating the service lives of the Fund's assets including the level of development, exploration, drilling, reserves and production of crude oil and natural gas in the supply areas served by the Fund's pipelines as well as the demand for crude oil and natural gas and the integrity of the Fund's systems. Changes in these assumptions could result in adjustments to the estimated service lives, which could result in material changes to depreciation expense in future periods in any of the Fund's operating segments.

### **Regulatory Assets and Liabilities**

Alliance Canada and certain pipelines within the Saskatchewan System are subject to regulation by various authorities, including but not limited to, the NEB and SER. Regulatory bodies exercise statutory authority over matters such as construction, rates and ratemaking, and agreements with customers. To recognize the economic effects of the actions of the regulator, the timing of recognition of certain revenues and expenses in operations may differ from that otherwise expected under Canadian GAAP for non rate-regulated entities. Also, the Fund records regulatory assets and liabilities to recognize the economic effects of the actions of the regulator. Regulatory assets represent amounts that are expected to be recovered from customers in future periods through rates. Regulatory liabilities represent amounts that are expected to be refunded to customers in future periods through rates. On refund or recovery of this difference, no earnings impact is recorded. Effectively, the income statement captures only the approved costs and the related revenue rather than the actual costs and related revenue. As of December 31, 2010, the Fund's regulatory assets totalled \$208.2 million (2009 - \$194.3 million) and regulatory liabilities totalled \$4.3 million (2009 - \$7.1 million). To the extent that the regulator's actions differ from the Fund's expectations, the timing and amount of recovery or settlement of regulatory balances could differ significantly from those recorded.

### **Asset Retirement Obligations**

The fair value of asset retirement obligations (AROs) associated with the retirement of long-lived assets are recognized as long-term liabilities in the period when they can be reasonably determined. The fair value approximates the cost a third party would charge in performing the tasks necessary to retire such assets and is recognized at the present value of expected future cash flows. AROs are added to the carrying value of the associated asset and depreciated over the asset's useful life. The corresponding liability is accreted over time through charges to earnings and is reduced by actual costs of decommissioning and reclamation. The present value of expected future cash flows is determined using assumptions such as the probability of abandonment in place versus removal and the estimated costs required upon abandonment in each case, the discount rate and the estimated time to abandonment. Changes in the assumptions used to calculate the present value of expected future cash flows could result in material changes to the asset retirement obligation and the accretion expense in future periods.

The NEB released a report in May 2009 detailing the financial issues associated with pipeline abandonment and established a goal for pipelines regulated under the NEB Act to begin setting aside funds, as required, for abandonment no later than the end of May 2014. In March 2010, the NEB issued a report revising certain base case assumptions and, as such, large pipeline companies, including Alliance Canada are required to file abandonment cost estimates by May 2011. The NEB is requiring that large pipeline companies, including Alliance Canada, file a proposed process for collecting and setting aside the funds for abandonment by May 2012. Both of the required submissions will need NEB approval and will result in increases to transportation tolls, the amount of which is uncertain at this time. Currently, the Fund does not have an ARO recorded on its consolidated financial statements for Alliance Canada and certain other assets due to the indeterminate timing and scope of asset retirements. However, should the NEB action plan result in a reasonable estimate of asset retirement obligations for accounting purposes, financial statement recognition of these amounts may be made in future periods.

### **Goodwill**

Goodwill represents the excess of the purchase price over the fair value of net identifiable assets upon acquisition of a business. Goodwill is not subject to amortization but is tested for impairment at least annually and written down to fair value if impairment occurs. For the purposes of impairment testing, reporting units comprise business operations with similar economic characteristics and strategies and may represent either a business segment or a business unit within a business segment. Potential impairment is identified when the carrying value of a reporting unit, including allocated goodwill, exceeds its fair value. Goodwill impairment is measured as the excess of the carrying amount of the reporting unit's allocated goodwill over the implied fair value of the goodwill, based on the fair value of the assets and liabilities of the reporting unit.

The determination of fair value of the assets and liabilities of the reporting unit involves the use of valuation techniques, including present value calculations of estimated future cash flows. This requires the use of various assumptions about future income, future operating costs, future demand, throughputs and discount rates. Any changes in these assumptions could result in an impairment of goodwill.

## **CHANGE IN ACCOUNTING POLICIES**

### **Future Accounting Policy Changes**

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

First-time adoption of Part I – International Financial Reporting Standards (Part I) of the Canadian Institute of Chartered Accountants (CICA) Handbook is mandatory for Canadian publicly accountable enterprises on January 1, 2011, with the exception of certain qualifying entities. Part I is mandatory for qualifying entities, including those with operations subject to rate regulation, for periods beginning on or after January 1, 2012. The Fund is a qualifying entity for purposes of this deferral and will continue to present its financial statements in accordance with pre changeover accounting standards, Part V of the CICA Handbook, during the 2011 deferral period.

While the Fund's IFRS conversion project was on track to meet the original conversion deadline, the Fund

has elected to use the one year deferral offered by the AcSB. This decision was made given the continuing uncertainty with respect to the application of IFRS to the rate regulated operations of the Fund, which are pervasive and central to its business model and performance measurement. The International Accounting Standards Board (IASB) originally issued an exposure draft on rate regulated activities in 2009 but has since failed to finalize the accounting standard or provide definitive guidance on the direction of the project.

During the deferral period, the Fund will present its financial statements in accordance with Part V of the CICA Handbook, will continue to closely monitor developments of the IASB, and will evaluate its alternatives to determine which course of action will provide the most useful and reliable presentation of its financial results for 2012 and future periods.

*Business Combinations*

CICA Section 1582, Business Combinations, replaces Section 1581. The standard requires assets and liabilities acquired in a business combination to be measured at fair value at the acquisition date. The standard also requires that acquisition-related costs, such as advisory or legal fees, incurred to effect a business combination are expensed in the period in which they are incurred. The adoption of the revised standard will impact the accounting treatment of future business combinations. The revised standard is effective for business combinations occurring on or after January 1, 2011.

**SUPPLEMENTARY INFORMATION**

**Outstanding Unit Data**

	<u>Number of Units Outstanding</u>
Trust Units	34,625,000
ECT Preferred Units	38,023,750

Outstanding unit information is provided as at February 1, 2011.