# FortisBC Energy Inc.

An indirect subsidiary of Fortis Inc.

Condensed Consolidated Interim Financial Statements
For the three and nine months ended September 30, 2018 and 2017
(Unaudited)

Prepared in accordance with accounting principles generally accepted in the United States of America

FORTIS BC

**FortisBC Energy Inc.**
**Condensed Consolidated Balance Sheets (Unaudited)**
**As at**
(in millions of Canadian dollars)

| ASSETS | September 30, 2018 | December 31, 2017 |
|---|---|---|
| **Current assets** | | |
| Cash | **$ 5** | $ - |
| Accounts receivable (notes 7 and 9) | **119** | 231 |
| Inventories | **45** | 50 |
| Prepaid expenses | **19** | 3 |
| Income taxes receivable | **23** | - |
| Regulatory assets (note 7) | **34** | 79 |
| **Total current assets** | **245** | 363 |
| **Property, plant and equipment, net** | **4,565** | 4,356 |
| **Intangible assets, net** | **120** | 124 |
| **Regulatory assets** | **756** | 746 |
| **Other assets** (note 7) | **8** | 9 |
| **Goodwill** | **913** | 913 |
| **TOTAL ASSETS** | **$ 6,607** | $ 6,511 |
| **LIABILITIES AND EQUITY** | | |
| **Current liabilities** | | |
| Credit facility | **$ 182** | $ 111 |
| Accounts payable and other current liabilities (notes 7 and 8) | **268** | 287 |
| Income taxes payable | **-** | 15 |
| Other taxes payable | **20** | 38 |
| Current portion of capital lease and finance obligations | **31** | 32 |
| Regulatory liabilities (note 7) | **112** | 90 |
| **Total current liabilities** | **613** | 573 |
| **Long-term debt** (note 7) | **2,376** | 2,376 |
| **Capital lease and finance obligations** | **55** | 59 |
| **Regulatory liabilities** | **163** | 160 |
| **Deferred income taxes** | **461** | 450 |
| **Other liabilities** (notes 5 and 7) | **222** | 230 |
| **Total liabilities** | **3,890** | 3,848 |
| **Equity** | | |
| Common shares | **1,211** | 1,171 |
| Additional paid-in capital | **1,245** | 1,245 |
| Retained earnings | **251** | 237 |
| Shareholder’s equity | **2,707** | 2,653 |
| Non-controlling interests | **10** | 10 |
| **Total equity** | **2,717** | 2,663 |
| **TOTAL LIABILITIES AND EQUITY** | **$ 6,607** | $ 6,511 |

The accompanying notes are an integral part of these Condensed Consolidated Interim Financial Statements.

**FortisBC Energy Inc.**
**Condensed Consolidated Statements of Earnings (Unaudited)**
**For the three and nine months ended September 30**
(in millions of Canadian dollars)

| | Three months ended **2018** | Three months ended 2017 | Nine months ended **2018** | Nine months ended 2017 |
|---|---|---|---|---|
| **Revenues** | | | | |
| Revenue from contracts with customers | **$ 159** | $ 151 | **$ 801** | $ 828 |
| Alternative revenue | **(2)** | - | **4** | - |
| Other revenue | **4** | 5 | **11** | 5 |
| **Total revenues** (notes 2 and 9) | **161** | 156 | **816** | 833 |
| **Expenses** | | | | |
| Cost of natural gas | **31** | 38 | **216** | 292 |
| Operation and maintenance | **54** | 48 | **171** | 160 |
| Property and other taxes | **15** | 15 | **49** | 49 |
| Depreciation and amortization | **56** | 50 | **168** | 152 |
| **Total expenses** | **156** | 151 | **604** | 653 |
| **Operating income** | **5** | 5 | **212** | 180 |
| Other income | **46** | 49 | **107** | 112 |
| Finance charges | **78** | 73 | **204** | 183 |
| **(Loss) Earnings before income taxes** | **(27)** | (19) | **115** | 109 |
| Income tax (recovery) expense | **(18)** | (16) | **5** | (4) |
| **Net (loss) earnings** | **(9)** | (3) | **110** | 113 |
| Net earnings attributable to non-controlling interest | **1** | 1 | **1** | 1 |
| **Net (loss) earnings attributable to controlling interest** | **$ (10)** | $ (4) | **$ 109** | $ 112 |

**FortisBC Energy Inc.**
**Condensed Consolidated Statements of Changes in Equity (Unaudited)**
**For the nine months ended September 30**
(in millions of Canadian dollars)

| | **Common Shares** | **Additional Paid-in Capital** | **Non-controlling Interests** | **Retained Earnings** | **Total** |
|---|---|---|---|---|---|
| As at December 31, 2016 | $ 1,171 | $ 1,245 | $ 10 | $ 178 | $ 2,604 |
| Net earnings | - | - | 1 | 112 | 113 |
| Net distribution to Mt. Hayes Storage LP Partners | - | - | (1) | - | (1) |
| Dividends on common shares | - | - | - | (84) | (84) |
| As at September 30, 2017 | 1,171 | 1,245 | 10 | 206 | 2,632 |
| | | | | | |
| As at December 31, 2017 | **1,171** | **1,245** | **10** | **237** | **2,663** |
| Net earnings | **-** | **-** | **1** | **109** | **110** |
| Net distribution to Mt. Hayes Storage LP Partners | **-** | **-** | **(1)** | **-** | **(1)** |
| Issuance of common shares | **40** | **-** | **-** | **-** | **40** |
| Dividends on common shares | **-** | **-** | **-** | **(95)** | **(95)** |
| **As at September 30, 2018** | **$ 1,211** | **$ 1,245** | **$ 10** | **$ 251** | **$ 2,717** |

The accompanying notes are an integral part of these Condensed Consolidated Interim Financial Statements.

**FortisBC Energy Inc.**
**Condensed Consolidated Statements of Cash Flows (Unaudited)**
**For the three and nine months ended September 30**
(in millions of Canadian dollars)

| | Three months ended **2018** | Three months ended 2017 | Nine months ended **2018** | Nine months ended 2017 |
|---|---|---|---|---|
| **Operating activities** | | | | |
| Net (loss) earnings | **$ (9)** | $ (3) | **$ 110** | $ 113 |
| Adjustments for non-cash items | | | | |
| Depreciation and amortization | **56** | 50 | **168** | 152 |
| Equity component of allowance for funds used during construction | **(2)** | (6) | **(3)** | (14) |
| Deferred income taxes | **(1)** | (1) | **(1)** | (1) |
| Amortization of debt issue costs | **1** | 1 | **1** | 1 |
| Change in long-term regulatory assets and liabilities | **5** | 20 | **(12)** | 49 |
| Change in other long-term liabilities | **-** | - | **2** | 1 |
| Change in non-cash working capital (note 6) | **(56)** | (39) | **43** | 47 |
| **Cash (used in) from operating activities** | **(6)** | 22 | **308** | 348 |
| **Investing activities** | | | | |
| Property, plant and equipment additions (note 6) | **(115)** | (130) | **(309)** | (317) |
| Intangible asset additions | **(3)** | (2) | **(9)** | (10) |
| Contributions in aid of construction | **1** | - | **3** | 2 |
| Change in other assets and other liabilities | **-** | 1 | **(2)** | - |
| Restricted cash | **-** | - | **-** | 5 |
| **Cash used in investing activities** | **(117)** | (131) | **(317)** | (320) |
| **Financing activities** | | | | |
| Net proceeds from credit facility | **127** | 112 | **71** | 66 |
| Deposit received for development expenditures (note 8) | **-** | - | **4** | - |
| Repayment of capital lease and finance obligations | **(2)** | (2) | **(5)** | (5) |
| Net distributions to non-controlling interest | **(1)** | - | **(1)** | (1) |
| Issuance of common shares | **-** | - | **40** | - |
| Dividends on common shares | **-** | - | **(95)** | (84) |
| **Cash from (used in) financing activities** | **124** | 110 | **14** | (24) |
| **Net change in cash** | **1** | 1 | **5** | 4 |
| Cash at beginning of period | **4** | 3 | **-** | - |
| **Cash at end of period** | **$ 5** | $ 4 | **$ 5** | $ 4 |

Supplementary Information to Condensed Consolidated Statements of Cash Flows (note 6).

The accompanying notes are an integral part of these Condensed Consolidated Interim Financial Statements.

## 1. DESCRIPTION OF THE BUSINESS

FortisBC Energy Inc. ("FEI" or the "Corporation") is a wholly-owned subsidiary of FortisBC Holdings Inc. ("FHI"), which is a wholly-owned subsidiary of Fortis Inc. ("Fortis"), a Canadian public company.

The Corporation is the largest distributor of natural gas in British Columbia ("BC"), serving approximately 1,021,000 residential, commercial, industrial, and transportation customers in more than 135 communities. The Corporation provides transmission and distribution services to its customers, and obtains natural gas supplies on behalf of most residential, commercial, and industrial customers. Gas supplies are sourced primarily from northeastern BC and, through the Corporation's Southern Crossing Pipeline, from Alberta.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation

These Condensed Consolidated Interim Financial Statements have been prepared by management in accordance with accounting principles generally accepted in the United States of America ("US GAAP") for Condensed Consolidated Interim Financial Statements and are presented in Canadian dollars unless otherwise specified. As a result, these Condensed Consolidated Interim Financial Statements do not include all of the information and disclosures required in the Annual Consolidated Financial Statements and should be read in conjunction with the Corporation's 2017 Annual Audited Consolidated Financial Statements. In management's opinion, the Condensed Consolidated Interim Financial Statements include all adjustments that are necessary to present fairly the consolidated financial position of the Corporation.

With the exception of the new accounting policies listed below, the accounting policies and methods of application used in the preparation of these Condensed Consolidated Interim Financial Statements are consistent with the accounting policies used in FEI's Annual Audited Consolidated Financial Statements as at December 31, 2017.

The Condensed Consolidated Interim Financial Statements include the accounts of the Corporation and its subsidiaries and its 85 per cent interest in the Mt. Hayes Storage Limited Partnership ("MHLP"). The Corporation consolidates 100 per cent of its subsidiaries and recognizes 15 per cent of the MHLP as a non-controlling interest. All intercompany transactions and balances have been eliminated upon consolidation.

An evaluation of subsequent events through November 1, 2018, the date these Condensed Consolidated Interim Financial Statements were issued, was completed to determine whether any circumstances warranted recognition and disclosure of events or transactions in the Condensed Consolidated Interim Financial Statements as at September 30, 2018. Subsequent events have been appropriately disclosed in these Condensed Consolidated Interim Financial Statements.

### New Accounting Policies

#### *Revenue from Contracts with Customers*

Effective January 1, 2018, FEI adopted Accounting Standards Codification ("ASC") Topic 606, *Revenue from Contracts with Customers*, which supersedes the revenue recognition requirements in ASC Topic 605, *Revenue Recognition*, including most industry specific revenue recognition guidance throughout the codification. This standard clarifies the principles for recognizing revenue and enables users of financial statements to better understand and consistently analyze an entity's revenues across industries and transactions. The Corporation adopted the new revenue recognition guidance using the modified retrospective transition method, under which comparative periods are not restated and the cumulative impact of applying the standard is recognized at the date of initial adoption supplemented by additional disclosures. Upon adoption, there were no adjustments to the opening balance of the Corporation's retained earnings as there were no changes to the timing of how revenue is recognized.

The adoption of this standard did not materially change the Corporation's accounting policy for recognizing revenue. The Corporation's revenue recognition policy, effective January 1, 2018, is as follows:

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The majority of the Corporation's revenue is derived from natural gas sales to residential, commercial, industrial, and transportation customers. Most of the Corporation's contracts have a single performance obligation, the delivery of natural gas. Substantially all of the Corporation's performance obligations are satisfied over time as natural gas is delivered because of the continuous transfer of control to the customer, generally using an output measure of progress, gigajoules ("GJ") delivered. The billing of natural gas sales is based on the reading of customer meters, which occurs on a systematic basis throughout the month.

The Corporation disaggregates revenue by type of customer, as disclosed in note 9. This represents the level of disaggregation used by the Corporation to evaluate performance.

### *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*

Effective January 1, 2018, the Corporation adopted Accounting Standards Update ("ASU") No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost,* which requires current service costs to be disaggregated and grouped in the statement of earnings with other employee compensation costs arising from services rendered. The other components of net benefit costs must be presented separately and outside of operating income. Additionally, only the service cost component is eligible for capitalization. On adoption, the Corporation applied the presentation guidance retrospectively and the capitalization guidance prospectively. This resulted in a retrospective nil and $2 million reclassification from operation and maintenance expense to other income for the three and nine months ended September 30, 2017, respectively, in these Condensed Consolidated Interim Financial Statements (note 5).

### *Recognition and Measurement of Financial Assets and Financial Liabilities*

Effective January 1, 2018, the Corporation adopted ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities.* Principally, it requires: (i) equity investments in unconsolidated entities not accounted for using the equity method to be measured at fair value through earnings; however, entities may elect to record equity investments without readily determinable fair values at cost, less impairment, and plus or minus subsequent adjustments for observable price changes; and (ii) financial assets and liabilities to be presented separately in the financial statement notes, grouped by measurement category and form. Adoption of this ASU did not impact these Condensed Consolidated Interim Financial Statements.

### *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*

During the third quarter of 2018, the Corporation early adopted ASU No. 2018-15, *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract,* which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal use software. Accordingly, the amendments in this update require a customer in a hosting arrangement that is a service contract to follow the guidance in ASC 350, *Intangibles - Goodwill and Other*, to determine whether implementation costs should be capitalized or expensed. The Corporation adopted this ASU using the retrospective approach, which did not have a material impact on these Condensed Consolidated Interim Financial Statements.

### Future Accounting Pronouncements

FEI considers the applicability and impact of all ASUs issued by the Financial Accounting Standards Board ("FASB"). The following updates have been issued by FASB, but have not yet been adopted by FEI. Any ASUs not included below were assessed and determined to be either not applicable to the Corporation or are not expected to have a material impact on the Consolidated Financial Statements.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

***Leases***

ASU No. 2016-02, *Leases* (ASC Topic 842), was issued in February 2016, is effective for FEI January 1, 2019 with earlier adoption permitted, and is to be applied using a modified retrospective approach or an optional transition method with implementation options, referred to as practical expedients. Principally, it requires balance sheet recognition of a right-of-use asset and a lease liability by lessees for those leases that are classified as operating leases along with additional disclosures.

The Corporation expects to elect the optional transition method which allows entities to continue to apply the current lease guidance in the comparative periods presented in the year of adoption and apply the transition provisions of the new guidance on the effective date of the new guidance. FEI will elect a package of practical expedients that allows it to not reassess whether any expired or existing contract is a lease or contains a lease, the lease classification of any expired or existing leases, and the initial direct costs for any existing leases. The Corporation also will elect an additional practical expedient that permits entities to not evaluate existing land easements that were not previously accounted for as leases.

Based on the Corporation's assessment to date, leasing activities accounted for as operating leases primarily relate to office facilities. Ongoing implementation efforts include the evaluation of business processes and controls to support recognition under the new standard and preparation of expanded disclosures. FEI continues to assess the impact of adoption and monitor standard-setting activities that may affect transition requirements.

***Measurement of Credit Losses on Financial Instruments***

ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, issued in June 2016, is effective for FEI January 1, 2020, and is to be applied on a modified retrospective basis. Principally, it requires entities to use an expected credit loss methodology and to consider a broader range of reasonable and supportable information to estimate credit losses. The adoption of this ASU will not have a material impact on the Consolidated Financial Statements and related disclosures.

## 3. REGULATORY MATTERS

**Multi-year Performance Based Ratemaking Plan for 2014 to 2019 ("2014 PBR Application")**

The disclosures around the 2014 PBR Application, average rate base and customer rate impacts for 2017 are consistent with those described in FEI's Annual Audited Consolidated Financial Statements as at December 31, 2017.

In December 2017, the BCUC issued its decision on FEI's 2018 delivery rates. The decision resulted in a 2018 average rate base of approximately $4,370 million (excluding the rate base of approximately $11 million for Fort Nelson) and no increase in customer delivery rates. 2018 rates would have otherwise decreased had there not been approval to defer a revenue surplus for the year. The revenue surplus amounts derived from FEI's 2018 and 2017 delivery rate decisions will be refunded to customers in future rates.

## 4. SEASONALITY OF OPERATIONS

Interim results fluctuate due to the seasonal demands for natural gas, the movements of natural gas prices, and the timing and recognition of regulatory decisions. FEI's operations generally produce higher net earnings in the first and fourth quarters of the fiscal year and lower net earnings in the second quarter, which are partially offset by net losses in the third quarter. These fluctuations in quarterly net earnings are generally the result of changes in revenue from customer load as a result of weather, while certain expenses such as depreciation, interest and operating expenses remain more evenly distributed throughout the fiscal year. As a result of the seasonality, interim net earnings are not indicative of net earnings on an annual basis.

## 5. EMPLOYEE FUTURE BENEFITS

The Corporation is a sponsor of pension plans for eligible employees. The plans include registered defined benefit pension plans and supplemental unfunded arrangements. In addition to pensions, the Corporation provides other post-employment benefits ("OPEB") for certain of its retired employees.

The net benefit cost for the three months ended September 30 was as follows:

| | **Defined Benefit Pension and Supplemental Plans** | | **OPEB Plans** | |
|---|---|---|---|---|
| ($ millions) | **2018** | 2017 | **2018** | 2017 |
| Service costs | **4** | 5 | **1** | 1 |
| Interest costs | **6** | 6 | **1** | 2 |
| Expected return on plan assets | **(8)** | (8) | **-** | - |
| Amortization: | | | | |
| Actuarial losses | **2** | 1 | **-** | - |
| Past service credit | **-** | - | **-** | (1) |
| Regulatory adjustment | **(1)** | (1) | **1** | - |
| Net benefit cost | **3** | 3 | **3** | 2 |

The net benefit cost for the nine months ended September 30 was as follows:

| | **Defined Benefit Pension and Supplemental Plans** | | **OPEB Plans** | |
|---|---|---|---|---|
| ($ millions) | **2018** | 2017 | **2018** | 2017 |
| Service costs | **14** | 15 | **3** | 3 |
| Interest costs | **18** | 17 | **3** | 4 |
| Expected return on plan assets | **(25)** | (23) | **-** | - |
| Amortization: | | | | |
| Actuarial losses | **4** | 2 | **-** | 1 |
| Past service credit | **(1)** | (1) | **-** | (2) |
| Regulatory adjustment | **(2)** | (1) | **1** | - |
| Net benefit cost | **8** | 9 | **7** | 6 |

As a result of adopting ASU No. 2017-07, the components of net benefit cost, other than the service cost component, are included in other income in the Condensed Consolidated Statements of Earnings for both comparable periods.

During 2018, the Corporation expects to contribute $14 million for defined benefit pension plans and make payments of $2 million for OPEB plans.

## 6. SUPPLEMENTARY INFORMATION TO CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

The supplementary information to the Condensed Consolidated Statements of Cash Flows for the three and nine months ended September 30 was as follows:

**Significant Non-Cash Transactions**

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|---|---|---|---|
| ($ millions) | **2018** | 2017 | **2018** | 2017 |
| Change in fair value of derivative instruments (note 7) | **9** | (3) | **58** | 6 |
| Change in accrued capital expenditures | **(24)** | 22 | **(28)** | 6 |
| Change in regulated asset for deferred income taxes | **(4)** | 9 | **(11)** | 8 |

**Change in Non-Cash Working Capital**

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|---|---|---|---|
| ($ millions) | **2018** | 2017 | **2018** | 2017 |
| Accounts receivable | **8** | 32 | **122** | 117 |
| Inventories | **(17)** | (25) | **4** | (13) |
| Prepaid expenses | **(18)** | (19) | **(16)** | (17) |
| Accounts payable and other current liabilities | **34** | 17 | **(9)** | (15) |
| Other taxes payable | **(33)** | (33) | **(18)** | (21) |
| Income taxes receivable | **(27)** | (11) | **(38)** | 3 |
| Net current regulatory assets and liabilities | **(3)** | - | **(2)** | (7) |
| Change in non-cash working capital per Statements of Cash Flows | **(56)** | (39) | **43** | 47 |

The non-cash investing activities balances as at September 30 were as follows:

| ($ millions) | **2018** | 2017 |
|---|---|---|
| Accrued capital expenditures | **43** | 16 |

## 7. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS

The Corporation categorizes financial instruments into the three-level hierarchy based on inputs used to determine the fair value:

Level 1: Fair value determined using unadjusted quoted prices in active markets;
Level 2: Fair value determined using pricing inputs that are observable; and
Level 3: Fair value determined using unobservable inputs only when relevant observable inputs are not available.

### Financial Instruments Measured at Fair Value on a Recurring Basis

The following table presents the Corporation's assets and liabilities accounted for at fair value on a recurring basis, all of which are Level 2 of the fair value hierarchy:

| ($ millions) | **September 30, 2018** | December 31, 2017 |
|---|---|---|
| **Assets** | | |
| *Current* | | |
| Natural gas contracts subject to regulatory deferral [1] | **11** | 2 |
| *Long-term* | | |
| Natural gas contracts subject to regulatory deferral [1] | **3** | 4 |
| **Total assets** | **14** | 6 |
| **Liabilities** | | |
| *Current* | | |
| Natural gas contracts subject to regulatory deferral [1] | **(4)** | (47) |
| *Long-term* | | |
| Natural gas contracts subject to regulatory deferral [1] | **-** | (7) |
| **Total liabilities** | **(4)** | (54) |
| **Total assets (liabilities), net** | **10** | (48) |

[1] Derivative contracts that are "in the money" are included in accounts receivable or other assets, and "out of the money" are included in accounts payable and other current liabilities or other liabilities.

The Corporation has elected gross presentation for its derivative contracts under master netting agreements, which applies only to its natural gas derivatives. The table below presents the potential offset of counterparty netting and cash collateral:

| | | **Gross Amount Not Offset in the Balance Sheet** | | |
|---|---|---|---|---|
| **September 30, 2018** | **Gross Amount Recognized in the Balance Sheet** | **Counterparty Netting of Natural Gas Contracts [1]** | **Cash Collateral Posted** | **Net Amount** |
| ($ millions) | | | | |
| Natural gas contracts subject to regulatory deferral: | | | | |
| Accounts receivable | **11** | **(3)** | **6** | **14** |
| Other assets | **3** | **-** | **-** | **3** |
| Accounts payable and other current liabilities | **(4)** | **3** | **-** | **(1)** |

[1] Positions, by counterparty, are netted where the intent and legal right to offset exists.

## 7. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS (continued)

| December 31, 2017 | Gross Amount Recognized in the Balance Sheet | Gross Amount Not Offset in the Balance Sheet: Counterparty Netting of Natural Gas Contracts [1] | Gross Amount Not Offset in the Balance Sheet: Cash Collateral Posted | Net Amount |
|---|---|---|---|---|
| ($ millions) | | | | |
| Natural gas contracts subject to regulatory deferral: | | | | |
| Accounts receivable | 2 | (1) | 7 | 8 |
| Other assets | 4 | (1) | - | 3 |
| Accounts payable and other current liabilities | (47) | 1 | - | (46) |
| Other liabilities | (7) | 1 | - | (6) |

[1] Positions, by counterparty, are netted where the intent and legal right to offset exists.

**Derivative Instruments**

The Corporation generally limits the use of derivative instruments to those that qualify as accounting or economic hedges, or those that are approved for regulatory recovery. The Corporation records all derivative instruments at fair value, with certain exceptions including those derivatives that qualify for the normal purchase and normal sale exception.

FEI enters into physical natural gas supply contracts and financial commodity swaps to fix the effective purchase price of natural gas, as the majority of the natural gas supply contracts have floating, rather than fixed, prices. Swap contracts are agreements between two parties to exchange streams of payments over time according to specified terms. Swap contracts require receipt of payment for the notional quantity of the commodity based on the difference between a fixed price and the market price on the settlement date. The fair value of the natural gas derivatives is calculated using the present value of cash flows based on published market prices and forward curves for natural gas.

Natural gas contracts held by FEI are subject to regulatory recovery through rates. As at September 30, 2018, these natural gas contracts were not designated as hedges and any unrealized gains or losses associated with changes in the fair value of the derivatives were deferred as a regulatory asset or liability for recovery from, or refund to, customers in future rates, as permitted by the BCUC, and as shown in the following table:

| ($ millions) | **September 30, 2018** | December 31, 2017 |
|---|---|---|
| Unrealized net gain (loss) recorded to current regulatory liabilities (assets) | **10** | (48) |

Cash inflows and outflows associated with the settlement of all derivative instruments are included in operating cash flows on the Corporation's Condensed Consolidated Statements of Cash Flows.

**Volume of Derivative Activity**

As at September 30, 2018, the Corporation had various natural gas derivative contracts subject to regulatory deferral that will settle on various expiration dates through 2024. The volumes related to these natural gas derivatives are outlined below:

| (petajoules) | **September 30, 2018** | December 31, 2017 |
|---|---|---|
| Natural gas physically-settled supply contracts | **287** | 219 |
| Natural gas financially-settled commodity swaps | **34** | 47 |

## 7. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS (continued)

**Financial Instruments Not Carried At Fair Value**

The fair value of a financial instrument is the market price to sell an asset or transfer a liability at the measurement date. The Corporation uses the following methods and assumptions for estimating the fair value of financial instruments:

- The carrying values of cash, accounts receivable, accounts payable, other current assets and liabilities and borrowings under the credit facility on the Condensed Consolidated Balance Sheets of the Corporation approximate their fair values due to short-term nature of these financial instruments. These items have been excluded from the table below.
- For long-term debt, the Corporation uses quoted market prices when available. When quoted market prices are not available, the fair value is determined by discounting the future cash flows of the specific debt instrument at an estimated yield to maturity equivalent to benchmark government bonds or treasury bills, with similar terms to maturity, plus a market credit risk premium equal to that of issuers of similar credit quality. Since the Corporation does not intend to settle the long-term debt prior to maturity, the fair value estimate does not represent an actual liability and, therefore, does not include exchange or settlement costs.

The use of different estimation methods and market assumptions may yield different estimated fair value amounts. The following table includes the carrying value and estimated fair value of the Corporation's long-term debt:

| ($ millions) | Fair Value Hierarchy | September 30, 2018 Carrying Value | September 30, 2018 Estimated Fair Value | December 31, 2017 Carrying Value | December 31, 2017 Estimated Fair Value |
|---|---|---|---|---|---|
| **Liabilities** | | | | | |
| Long-term debt [1] | Level 2 | **2,395** | **2,822** | 2,395 | 2,955 |

[1] Carrying value excludes unamortized debt issuance costs.

## 8. GUARANTEES

The Corporation had letters of credit outstanding at September 30, 2018 totaling $53 million (December 31, 2017 - $56 million) primarily to support its unfunded supplemental pension benefit plans.

As at September 30, 2018, there was $6 million of cash deposits in accounts payable and other current liabilities, of which $4 million was received during the second quarter of 2018. These funds are being held as security for future development expenditures for the Eagle Mountain Woodfibre Gas Pipeline Project.

## 9. REVENUE

The majority of the Corporation's revenue is derived from natural gas sales to residential, commercial, industrial, and transportation customers. Most of the Corporation's contracts have a single performance obligation, the delivery of natural gas, as the promise to transfer individual goods or services is not separately identifiable from other promises in the contracts and therefore not distinct. Substantially all of the Corporation's performance obligations are satisfied over time as natural gas is delivered because of the continuous transfer of control to the customer, generally using an output measure of progress, GJ delivered. The billing of natural gas sales is based on the reading of customer meters, which occurs on a systematic basis throughout the month. The BCUC approved tariff states the billing terms with the customer. The majority of contracts have payment terms of 30 days from the date the bill is rendered. Any payment not received by the due date is considered delinquent and incurs a late payment finance charge. No component of the transaction price is allocated to unsatisfied performance obligations.

## 9. REVENUE (continued)

### Disaggregation of Revenues

As a result of adopting ASC Topic 606 using the modified retrospective approach, 2017 comparative figures have not been restated in the Condensed Consolidated Statements of Earnings. The following table presents the disaggregation of the Corporation's revenues by type of customer for the three and nine months ended September 30, 2018 and 2017. 2017 figures that are disclosed in this table in accordance with the new revenue guidance are provided for information purposes only.

| | Three months ended September 30 | | Nine months ended September 30 | |
|---|---|---|---|---|
| ($ millions) | **2018** | 2017 | **2018** | 2017 |
| Residential | **81** | 81 | **448** | 506 |
| Commercial | **38** | 39 | **218** | 251 |
| Industrial | **7** | 5 | **22** | 18 |
| Transportation | **25** | 21 | **88** | 80 |
| Other | **8** | 7 | **25** | 23 |
| **Revenue from contracts with customers** | **159** | 153 | **801** | 878 |
| Alternative revenue | **(2)** | (2) | **4** | (43) |
| Other revenue (expense) | **4** | 5 | **11** | (2) |
| **Total revenues** | **161** | 156 | **816** | 833 |

### Revenue from Contracts with Customers

The Corporation's tariff-based sales to residential, commercial, industrial, and transportation customers are regulated by the BCUC and recognized when gas is delivered at the amount of consideration that the Corporation expects to receive in exchange. Revenue from contracts with customers includes an estimate for unbilled revenues from service that has been provided but not yet billed by the end of an accounting period. At the end of the month, amounts of gas delivered since the last meter reading are estimated and the corresponding unbilled revenue is calculated using customer tariff rates. Unbilled revenues are dependent upon a number of factors that require management's judgment including estimates of tariff sales and customer usage patterns. The Corporation then records revenue for each customer class based on the approved tariff rates.

Other revenue from contracts with customers includes fees charged for utility customer connections, which is recognized as revenue when billed to the customer, as well as agreements with utility customers to provide firm and interruptible transportation of natural gas and agreements with certain customers to provide transportation of natural gas over utility owned infrastructure, which are both recognized as revenue as natural gas is delivered, using an output measure of progress, GJ delivered.

### Alternative Revenue

Alternative revenue programs allow utilities to adjust future rates in response to past activities or completed events if certain criteria established by the BCUC are met. The Corporation has identified its Earnings Sharing Mechanism, Revenue Stabilization Adjustment Mechanism, and Flow-through variances related to industrial customer revenue as alternative revenue.

The Earnings Sharing Mechanism allows for a 50/50 sharing of variances from the formula-driven operation and maintenance expenses and capital expenditures approved as part of the annual revenue requirements. This mechanism is in place until the expiry of the current performance based rate setting plan in 2019. In addition, FEI captures variances in the forecast versus actual customer use rate for residential and commercial customers throughout the year in a Revenue Stabilization Adjustment Mechanism, which is either refunded to or recovered from customers in rates within two years. Variances in the forecast versus actual customer use rate for industrial customer revenue are recognized in a flow-through deferral account to be either refunded to or recovered from customers in rates within two years.

Amounts collected from or refunded to customers for alternative revenue programs are presented in revenue from contracts from customers.

## 9. REVENUE (continued)

### Other Revenue (Expense)

Other revenue is primarily comprised of regulatory deferral adjustments resulting primarily from cost recovery variances in regulated forecasts used to set rates for natural gas revenue. As part of the PBR Decision received, effective January 1, 2014 and through to the end of the PBR term, the Corporation has a flow-through deferral account that captures variances from regulated forecast items, excluding formulaic operation and maintenance costs, that do not have separately approved deferral mechanisms, and flows those variances through customer rates in the following year.

### Accounts Receivable

The timing of revenue recognition, billings, and cash collections results in billed and unbilled accounts receivable. The opening and closing balances of the Corporation's accounts receivable were as follows:

| ($ millions) | **September 30, 2018** | December 31, 2017 |
|---|---|---|
| Billed accounts receivable from contracts with customers | **38** | 93 |
| Accrued unbilled revenue from contracts with customers | **37** | 114 |
| Fair value of derivative instruments (note 7) | **11** | 2 |
| Cash collateral posted (note 7) | **6** | 7 |
| Gas cost mitigation receivables [1] | **27** | 12 |
| Receivables for third party services and other [1] | **7** | 10 |
| Allowance for doubtful accounts | **(7)** | (7) |
| Total accounts receivable | **119** | 231 |

[1] Representative of receivables not related to contracts with customers.

### Practical Expedients

The Corporation has elected three practical expedients in implementing ASC 606, *Revenue from Contracts with Customers*. The Corporation has applied a portfolio approach in evaluating consideration from residential and commercial customers. The Corporation has also applied a practical expedient to consideration received from certain customers on a tariff schedule and has not adjusted the promised amount of consideration for the effect of a significant financing component because FEI expects that the period between the transfer of natural gas to the customer and the customer's payment for that service will be one year or less. Finally, FEI has elected to recognize revenue in the amount to which FEI has a right to invoice the customer.

## 10. SUBSEQUENT EVENTS

### Finance obligation termination

On October 31, 2018, the Corporation exercised an early termination payment option in the amount of $27 million on one of the lease-in, lease-out arrangements with a municipality FEI operates in. The arrangement is accounted for as a finance obligation by FEI. After exercising the option, the current portion of capital lease and finance obligations will decrease by $27 million.