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**FortisBC Inc.**  
**Management Discussion & Analysis**  
**For the Three and Nine Months Ended September 30, 2016**  
**Dated November 4, 2016**

*The following FortisBC Inc. ("FBC" or the "Corporation") Management Discussion & Analysis ("MD&A") has been prepared in accordance with National Instrument 51-102 - Continuous Disclosure Obligations. Financial information for 2016 and comparative periods contained in the following MD&A has been prepared in accordance with accounting principles generally accepted in the United States ("US GAAP") and is presented in Canadian dollars unless otherwise specified. The MD&A should be read in conjunction with the Corporation's unaudited interim consolidated financial statements and notes thereto for the three and nine months ended September 30, 2016, with 2015 comparatives, prepared in accordance with US GAAP and the Corporation's annual audited consolidated financial statements and notes thereto together with the MD&A for the year ended December 31, 2015, with 2014 comparatives, prepared in accordance with US GAAP.*

### **FORWARD-LOOKING STATEMENT**

Certain statements in this MD&A contain forward-looking information within the meaning of applicable securities laws in Canada ("forward-looking information"). The words "anticipates", "believes", "budgets", "could", "estimates", "expects", "forecasts", "intends", "may", "might", "plans", "projects", "schedule", "should", "will", "would" and similar expressions are often intended to identify forward-looking information, although not all forward-looking information contains these identifying words.

The forward-looking information in this MD&A includes, but is not limited to, statements regarding the Corporation's expectations to meet interest payments on outstanding indebtedness from operating cash flows; the Corporation's expected level of capital expenditures and its expectations to finance those capital expenditures through credit facilities, equity injections from its parent FortisBC Pacific Holdings Inc. ("FortisBC Pacific"), and debenture issuances; the Corporation's estimated contractual obligations; and the expectation that the purchases under the Waneta Expansion Capacity Agreement ("WECA") and the timing of recognizing regulatory deferral adjustments will affect future interim quarterly earnings as compared to historical interim quarterly earnings.

The forecasts and projections that make up the forward-looking information are based on assumptions, which include but are not limited to: receipt of applicable regulatory approvals and requested rate orders; absence of administrative monetary penalties; the ability to continue to report under US GAAP beyond the Canadian securities regulators exemption to the end of 2018 or earlier; absence of asset breakdown; absence of environmental damage and health and safety issues; absence of adverse weather conditions and natural disasters; ability to maintain and obtain applicable permits; the adequacy of the Corporation's existing insurance arrangements; the First Nations' settlement process does not adversely affect the Corporation; the ability to maintain and renew collective bargaining agreements on acceptable terms; the ability of the Corporation to attract and retain skilled workforces; absence of information technology infrastructure failure; absence of cyber-security failure; continued electricity demand; the ability to arrange sufficient and cost effective financing; no material adverse ratings actions by credit rating agencies; that counterparties do not default on power supply contracts; and no weather related demand loss or significant and sustained loss of precipitation over the headwaters of the Kootenay River system.

The forward-looking information is subject to risks, uncertainties and other factors that could cause actual results to differ materially from historical results or results anticipated by the forward-looking information. The factors which could cause results or events to differ from current expectations include, but are not limited to: regulatory approval and rate orders risk (including the risk of imposition of administrative monetary penalties); continued reporting in accordance with US GAAP risk; asset breakdown, operation, maintenance and expansion risk; environment, health and safety matters risk; weather and natural disasters risk; permits risk; underinsured and uninsured losses; risks involving First Nations; labour relations risk; employee future benefits risk; human resources risk; information technology infrastructure risk; cyber-security risk; interest rates risk; impact of changes in economic conditions risk; capital resources and liquidity risk; competitiveness and commodity price risk; power purchase and capacity sale contracts risk; weather related risk; and, other risks described in the Corporation's most recent Annual Information Form. For additional information with respect to these risk factors, reference should be made to the section entitled "Business Risk Management" in this MD&A and the Corporation's MD&A for the year ended December 31, 2015.

All forward-looking information in this MD&A is qualified in its entirety by this cautionary statement and, except as required by law, the Corporation undertakes no obligation to revise or update any forward-looking information as a result of new information, future events or otherwise after the date hereof.

## **CORPORATE OVERVIEW**

FBC is an integrated, regulated electric utility operating in the southern interior of British Columbia ("BC"), serving approximately 167,600 customers directly and indirectly, focusing on the safe delivery of reliable and cost effective electricity.

The Corporation's regulated business includes four hydroelectric generating plants with an aggregate capacity of 225 megawatts ("MW"), approximately 7,200 kilometers of transmission and distribution power lines, and a peak demand of 746 MW. In February 2016, FBC and its subsidiaries completed the sale of the 0395518 Power Partnership (formerly Walden Power Partnership) ("WPP") non-regulated hydroelectric power plant assets. Prior to the sale, the WPP non-regulated assets were reclassified from property, plant and equipment to assets held for sale on the consolidated balance sheet as at December 31, 2015.

The Corporation is an indirect, wholly-owned subsidiary of Fortis Inc. ("Fortis"). Fortis is a leader in the North American electric and gas utility business, serving customers across Canada, the United States and the Caribbean.

## **REGULATION**

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

In September 2014, the British Columbia Utilities Commission ("BCUC") issued its decision on FBC's 2014 PBR Application. The approved PBR Plan incorporates an incentive mechanism for improving operating and capital expenditure efficiencies. Operation and maintenance expenses and base capital expenditures during the PBR period, 2014 to 2019, are subject to an incentive formula reflecting incremental costs for inflation and half of customer growth, less a fixed productivity adjustment factor of 1.03 per cent each year. The PBR Plan also includes a 50/50 sharing of variances ("Earnings Sharing Mechanism") from the formula-driven operation and maintenance expenses and capital expenditures over the PBR period, and a number of service quality measures designed to ensure FBC maintains service levels. It also sets out the requirements for an annual review process which provides a forum for discussion between FBC and interested parties regarding its current performance and future activities.

In December 2015, the BCUC issued its decision on FBC's 2016 rates. The decision results in a 2016 average rate base of approximately \$1,286 million and a rate increase of 2.96 per cent over 2015 rates.

In August 2016, FBC filed its application for approval of 2017 rates under the PBR Plan. The 2017 application includes a forecast average rate base of approximately \$1,285 million and requests approval of a customer rate increase of 2.76 per cent over 2016 rates.

### **Allowed Return on Equity ("ROE") and Capital Structure**

A Generic Cost of Capital ("GCOC") Proceeding to establish the allowed ROE and capital structures for BC regulated utilities occurred from 2012 to 2014. FortisBC Energy Inc. ("FEI"), a related company under common control, was designated as the benchmark utility and a BCUC decision established that the ROE for the benchmark utility would be set at 8.75 per cent effective January 1, 2013. Additionally, the allowed ROE for FBC was confirmed at 9.15 per cent, recognizing a risk premium over the benchmark utility of 40 basis points, and the common equity component of capital structure of FBC was confirmed at 40 per cent, both effective January 1, 2013. The allowed ROE and common equity component of capital structure remained in effect through December 31, 2015.

The BCUC decision on the first stage of the GCOC Proceeding, received in May 2013, directed FEI to file an application to review the 2016 benchmark utility ROE and common equity component of capital structure by no later than November 30, 2015.

In October 2015, FEI filed its application to review the 2016 benchmark utility ROE and common equity component of capital structure. In December 2015, the BCUC determined that FEI's existing ROE will remain the benchmark on an interim basis, effective January 1, 2016. In August 2016, the BCUC issued its decision on FEI's application. In its decision, the BCUC determined that FEI's existing common equity component of capital structure and ROE will remain at 38.5 per cent and 8.75 per cent, respectively. The BCUC also determined that the ROE approved for FEI will serve as the benchmark cost of equity for all other regulated

entities in BC that use the benchmark utility to set rates, and that the ROE will remain in effect until otherwise determined by the Commission. As a result, FBC's ROE remains unchanged at 9.15 per cent.

## CONSOLIDATED RESULTS OF OPERATIONS

Periods Ended September 30	Quarter			Year to date		
	2016	2015	Variance	2016	2015	Variance
Electricity sales (GWh)	<b>728</b>	752	(24)	<b>2,265</b>	2,311	(46)
(\$ millions)						
Electricity revenue	<b>78.0</b>	77.1	0.9	<b>243.1</b>	237.0	6.1
Other revenue	<b>6.8</b>	4.8	2.0	<b>20.7</b>	14.9	5.8
	<b>84.8</b>	81.9	2.9	<b>263.8</b>	251.9	11.9
Power purchase costs	<b>32.1</b>	30.9	1.2	<b>93.2</b>	76.8	16.4
Operating costs	<b>18.4</b>	19.2	(0.8)	<b>57.3</b>	57.8	(0.5)
Depreciation and amortization	<b>14.2</b>	14.0	0.2	<b>42.7</b>	42.9	(0.2)
	<b>64.7</b>	64.1	0.6	<b>193.2</b>	177.5	15.7
Other income	<b>0.1</b>	0.1	-	<b>0.7</b>	0.3	0.4
Finance charges	<b>9.2</b>	9.8	(0.6)	<b>27.9</b>	29.0	(1.1)
Earnings before income taxes	<b>11.0</b>	8.1	2.9	<b>43.4</b>	45.7	(2.3)
Income taxes	<b>1.5</b>	2.0	(0.5)	<b>5.8</b>	6.4	(0.6)
Net earnings	<b>9.5</b>	6.1	3.4	<b>37.6</b>	39.3	(1.7)

### Net Earnings

Net earnings for the third quarter ended September 30, 2016 were \$9.5 million, an increase of \$3.4 million from the \$6.1 million of net earnings in the third quarter of 2015. On a year-to-date basis, net earnings were \$37.6 million, a decrease of \$1.7 million from the \$39.3 million for the same period in 2015.

Variances from regulated forecasts used to set rates for electricity revenue and power purchase costs are flowed back to customers in future rates through approved regulatory deferral mechanisms and therefore these variances do not have an impact on net earnings in either 2016 or 2015. As part of the PBR Decision received in September 2014 and effective 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.

The timing of recognizing regulatory deferral adjustments for setting customer rates has had an effect on the quarterly net earnings comparison. While FBC's annual revenue is set to fully recover approved forecasted costs of service, including the recognition of regulatory deferral adjustments to be recovered from, or refunded to, customers on an annualized basis, both the revenue and regulatory deferral adjustments will be recognized differently each quarter. Therefore the comparable net earnings will vary on a quarterly basis due to the timing of recognizing regulatory deferral adjustments.

The \$3.4 million increase in net earnings for the third quarter ended September 30, 2016 as compared to the third quarter ended September 30, 2015 was primarily due to:

- the timing of recognizing regulatory deferral adjustments for setting customer rates and the timing of power purchase costs during 2015 which resulted in lower net earnings for the third quarter of 2015. The revenue recognized in the interim quarters of 2015 were based on electricity rates established to recover the annual regulated costs of service, which included increased power purchase costs. These increased power purchase costs primarily related to a new power purchase agreement that did not begin until the second quarter of 2015. As a result, net earnings were higher during the first part of 2015 and the timing effect reversed in subsequent quarters resulting in lower 2015 third quarter net earnings compared to the third quarter of 2016, and
- lower operating and maintenance expenses, net of the regulated Earnings Sharing Mechanism, as compared to operating costs allowed in rates under the PBR formula.

The \$1.7 million decrease in net earnings for the nine months ended September 30, 2016 as compared to the same period of 2015 was primarily due to:

- the timing of recognizing regulatory deferral adjustments for setting customer rates and the timing of power purchase costs, which had the opposite effect on quarterly net earnings as described above,
- partially offset by an increase in rate base and lower operating and maintenance expenses.

### **Electricity Sales**

The decrease for both comparable periods was primarily due to electricity sales derived from WPP non-regulated hydroelectric power plant assets during both 2015 periods which did not materialize to the same degree in 2016 due to the sale of the WPP assets in February 2016, as well as lower consumption as a result of unfavourable weather conditions. On a year-to-date basis the decrease in electricity sales was due to the same previously mentioned factors for the quarterly variance, partially offset by higher consumption as a result of favourable weather conditions in the first quarter of 2016.

### **Electricity Revenue**

The increase in electricity revenue for both comparable periods was primarily due to a 5.1 per cent rate increase effective August 1, 2015 as compared to 2014 rates, and a 2.96 per cent rate increase effective January 1, 2016 as compared to 2015 rates, partially offset by a decrease in electricity sales.

### **Other Revenue**

Other revenue consists of management fees for third party contract work, pole attachment revenue, wheeling revenue, surplus capacity sales, other miscellaneous rental revenues, the Earnings Sharing Mechanism and certain flow-through adjustments for variances from the forecast used to set rates.

The increase in other revenue for the third quarter of 2016 was primarily due to:

- an increase in surplus capacity sales to Powerex, under the Capacity and Energy Purchase and Sale Agreement ("CEPSA"), and
- an increase in current period flow-through adjustment variances to be collected from customers in future rates,
- partially offset by an increase in the Earnings Sharing Mechanism to be refunded to customers in future rates.

On a year-to-date basis, the increase in other revenue was primarily due to:

- the same previously mentioned factors for the quarterly variance,
- an increase in surplus capacity sales to BC Hydro, under the Residual Capacity Agreement ("RCA"), as this arrangement was not effective until May 2015,
- and an increase in amortization of prior period flow-through adjustment variances returned to customers in the current period.

### **Power Purchase Costs**

The increase in power purchase costs for the third quarter of 2016 were primarily due to higher average power purchase prices, partially offset by a decrease in electricity sales. On a year-to-date basis, the increase in power purchase costs was primarily due to the Corporation not purchasing capacity under the WECA until the second quarter of 2015 as well as higher average power purchase prices.

### **Operating Costs**

Operating costs include operating and maintenance expenses, property taxes, water fees and wheeling. The decrease in operating costs for the third quarter of 2016 was primarily due to a decrease in operating and maintenance expenses resulting from the sale of the WPP non-regulated assets in February 2016 as well as operating cost savings experienced through the advanced metering infrastructure project, partially offset by higher property taxes and water fees. On a year-to-date basis, the decrease in operating costs is primarily due to the previously mentioned factors that decreased operating costs for the quarter, partially offset by higher water fees.

### **Depreciation and Amortization**

The increase in depreciation and amortization for the third quarter of 2016 was primarily due to an increase in depreciation from the collection of removal costs as a component of depreciation on an accrual basis as well as a higher depreciable asset base, offset by a lower composite depreciation rate, both effective January 1, 2016 as approved by the BCUC decision on FBC's 2016 rates.

On a year-to-date basis, the decrease was primarily due to the lower composite depreciation rate partially offset by a higher depreciable asset base, an increase in depreciation from the collection of removal costs and an increase in amortization of certain regulatory deferrals for 2016.

### Other Income

Other income for the third quarter of 2016 was comparable with the third quarter of 2015. On a year-to-date basis, the increase in other income was primarily due to recognizing a \$0.5 million gain, net of tax and transaction costs, on the sale of the WPP non-regulated hydroelectric power plant assets in February 2016.

### Finance Charges

The decrease in finance charges for both comparable periods was primarily due to the repayment of the Series H debenture of \$25 million due February 1, 2016, partially offset by interest incurred on higher credit facility borrowings.

### Income Taxes

The decrease in income tax expense for the third quarter of 2016 as compared with the same period of 2015 was primarily due to the timing of recognizing deductible temporary differences, partially offset by higher pre-tax earnings. On a year-to-date basis, the decrease in income tax in 2016 as compared with the same period of 2015 was primarily due to lower pre-tax earnings.

## CONSOLIDATED FINANCIAL POSITION

The following table outlines the significant changes in the consolidated balance sheets between September 30, 2016 and December 31, 2015:

<b>Balance Sheet Account</b>	<b>(Decrease) Increase (\$ millions)</b>	<b>Explanation</b>
Accounts receivable	<b>(8.9)</b>	The decrease was primarily due to a decrease in trade accounts receivable and unbilled revenue due to seasonality.
Regulated assets	<b>21.1</b>	The increase was primarily due to the recognition of \$11.8 million relating to the Brilliant Power Purchase Agreement ("BPPA") asset and obligation under capital lease and an increase of \$9.8 million in regulated deferred income tax liabilities, both of which have been offset by a regulatory asset of the same amount.
Assets held for sale	<b>(8.5)</b>	The decrease was a result of the sale of the Corporation's non-regulated WPP assets in February 2016.
Credit facilities	<b>22.2</b>	The increase was primarily due to increased borrowings which were used to repay the Series H debenture of \$25 million due February 1, 2016.
Current portion of long-term debt	<b>(25.0)</b>	The decrease was a result of the repayment of the Series H debenture of \$25 million due February 1, 2016.
Deferred income taxes	<b>10.0</b>	The increase was primarily due to an increase in tax timing difference relating to capital expenditures, and regulatory assets and liabilities, the offset of which has been recognized in regulatory assets.

## LIQUIDITY AND CAPITAL RESOURCES

### Summary of Consolidated Cash Flows

Nine Months Ended September 30	2016	2015	Variance
(\$ millions)			
Cash flows provided by (used for)			
Operating activities	<b>77.1</b>	91.9	(14.8)
Investing activities	<b>(37.6)</b>	(77.1)	39.5
Financing activities	<b>(41.8)</b>	(14.5)	27.3
Net (decrease) increase in cash and cash equivalents	<b>(2.3)</b>	0.3	(2.6)

#### Operating Activities

Cash flows provided by operating activities was \$14.8 million lower compared to the same period in 2015. The decrease was primarily due to lower net earnings, changes in long-term regulatory assets and liabilities and changes in non-cash working capital.

#### Investing Activities

Cash flows used for investing activities was \$39.5 million lower compared to the same period in 2015 primarily due to lower property, plant and equipment expenditures as well as proceeds received from the sale of the Corporation's non-regulated WPP assets in February 2016.

#### Financing Activities

Cash flows used for financing activities was \$27.3 million higher compared to the same period in 2015 primarily due to the repayment of the Series H debenture of \$25 million due February 1, 2016 using proceeds from credit facilities, as well as higher dividends paid as compared to the prior period.

During the three and nine months ended September 30, 2016, FBC paid common share dividends of \$14.0 million (2015 - \$4.5 million) and \$39.0 million (2015 - \$13.5 million) to its parent company, FortisBC Pacific.

#### Contractual Obligations

The following table sets forth the Corporation's estimated contractual obligations due in the years indicated:

As at September 30, 2016	Total	Due Within 1 Year	Due in Year 2	Due in Year 3	Due in Year 4	Due in Year 5	Due After 5 Years
(\$ millions)							
Power purchase obligations	2,974.5	91.9	82.5	72.5	70.7	69.3	2,587.6
Capital lease obligations	2,242.2	42.5	43.2	44.0	44.8	45.6	2,022.1
Interest obligations on long-term debt	875.2	35.4	35.4	35.4	35.4	35.4	698.2
Long-term debt <sup>1</sup>	660.0	-	-	-	-	-	660.0
Defined benefit pension funding contributions	1.0	1.0	-	-	-	-	-
Other	5.4	0.5	0.3	2.7	0.3	0.3	1.3
Totals	6,758.3	171.3	161.4	154.6	151.2	150.6	5,969.2

<sup>1</sup> Excludes unamortized debt issuance costs of \$5.9 million.

#### Capital Structure

The Corporation's principal business of regulated electricity generation, transmission and distribution requires ongoing access to capital in order to allow the Corporation to fund the maintenance, replacement and expansion of infrastructure. The Corporation maintains a capital structure in line with the deemed regulatory capital structure approved by the BCUC at 40 per cent equity and 60 per cent debt. This capital structure excludes the effects of goodwill and other items that do not impact the deemed capital structure.

#### Credit Ratings

There have been no changes to the Corporation's credit ratings from those reported in the Corporation's 2015 annual MD&A.

### Projected Capital Expenditures

The Corporation has estimated 2016 capital expenditures before contributions in aid of construction and including cost of removal of approximately \$75 million.

### Cash Flow Requirements

The Corporation's cash flows fluctuate seasonally based primarily on electricity consumption. The Corporation maintains adequate committed credit facilities.

It is expected that operating expenses and interest costs will generally be paid out of operating cash flows, with varying levels of residual cash flow available for capital expenditures and/or for dividend payments. Cash required to complete capital expenditure programs is also expected to be financed from a combination of borrowings under credit facilities, equity injections from its parent, FortisBC Pacific, and debenture issuances.

The Corporation's ability to service its debt obligations and pay dividends on its common shares is dependent on the financial results of the Corporation. Depending on the timing of cash payments, borrowings under the Corporation's credit facilities may be required from time to time to support the servicing of debt and payment of dividends. The Corporation may have to rely upon the proceeds of new debenture issuances to meet its principal debt obligations when they come due.

### Credit Facilities

As at September 30, 2016, the Corporation had bank credit facilities of \$160 million, comprised of a \$150 million operating credit facility and a \$10 million demand overdraft facility. In April 2016 the \$150 million operating credit facility was amended such that it now matures in May 2019.

The following summary outlines the Corporation's bank credit facilities:

(\$ millions)	<b>September 30, 2016</b>	December 31, 2015
Operating credit facility	<b>150.0</b>	150.0
Demand overdraft facility	<b>10.0</b>	10.0
Draws on operating credit facility	<b>(73.8)</b>	(50.9)
Draws on overdraft facility	<b>(4.3)</b>	(5.0)
Letters of credit outstanding	<b>(0.6)</b>	-
Credit facilities available	<b>81.3</b>	104.1

### OFF-BALANCE SHEET ARRANGEMENTS

As at September 30, 2016, the Corporation had no material off-balance sheet arrangements, with the exception of letters of credit outstanding of \$0.6 million (December 31, 2015 - \$nil) to support one of the Corporation's pension plans.

## RELATED PARTY TRANSACTIONS

In the normal course of business, the Corporation transacts with its parent, FortisBC Pacific, ultimate parent, Fortis, and other related companies under common control, including FEI, FortisBC Holdings Inc. ("FHI") and the Waneta Expansion Limited Partnership ("WELP"), to provide or receive services and materials. The following transactions were measured at the exchange amount unless otherwise indicated.

### Related Party Recoveries

The amounts charged to the Corporation's parent and other related parties under common control for the three and nine months ended September 30 were as follows:

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Operating costs and other revenue charged to FortisBC Pacific (a)	<b>1.3</b>	1.3	<b>5.0</b>	6.3
Electricity revenue recovered from FEI	<b>0.2</b>	0.2	<b>0.5</b>	0.5
Operating costs charged to FEI (b)	<b>1.3</b>	0.9	<b>4.2</b>	3.7
Operating costs charged to FHI (b)	-	0.2	<b>0.2</b>	0.4
Operating costs charged to WELP (c)	-	-	<b>1.0</b>	-
	<b>2.8</b>	2.6	<b>10.9</b>	10.9

(a) The Corporation charged its parent, FortisBC Pacific, for management services, labour and materials.

(b) The Corporation charged FEI and FHI for management services.

(c) The Corporation charged WELP for the recovery of a portion of water fees.

### Related Party Costs

The amounts charged by the Corporation's ultimate parent and other related parties under common control for the three and nine months ended September 30 were as follows:

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Power purchase costs charged by WELP (a)	<b>13.8</b>	12.9	<b>31.8</b>	15.2
Operating costs charged by Fortis (b)	<b>0.6</b>	0.5	<b>2.0</b>	1.6
Operating costs charged by FEI (c)	<b>1.0</b>	0.8	<b>2.7</b>	2.4
Operating costs charged by FHI (d)	<b>0.1</b>	0.2	<b>0.4</b>	0.4
	<b>15.5</b>	14.4	<b>36.9</b>	19.6

(a) The Corporation was charged by WELP for purchasing capacity under the WECA.

(b) The Corporation was charged by its ultimate parent, Fortis, for corporate management services and other compensation.

(c) The Corporation was charged by FEI for natural gas transmission and distribution sales, office rent, and management services.

(d) The Corporation was charged by FHI for management services, board of director costs, and other compensation.

## Balance Sheet Amounts

The amounts due from related parties, which are included in accounts receivable on the consolidated balance sheets, and the amounts due to related parties, which are included in accounts payable and other current liabilities on the consolidated balance sheets, are as follows:

(\$ millions)	September 30, 2016		December 31, 2015	
	Amount Due From	Amount Due To	Amount Due From	Amount Due To
Fortis	-	0.2	-	0.1
FortisBC Pacific	0.4	-	0.5	-
FEI	0.9	0.3	0.4	0.4
FHI	-	0.2	-	0.1
WELP	-	11.3	-	10.3
	1.3	12.0	0.9	10.9

In March 2016, FEI paid FBC \$6.2 million to repay FBC for funds that were transferred from FBC's tax instalment account at the Canada Revenue Agency ("CRA") to FEI's tax instalment account at the CRA. The transfer resulted in a decrease to FBC's income tax receivable balance and a decrease to FEI's income taxes payable balance as permitted by the CRA for associated entities.

## BUSINESS RISK MANAGEMENT

The business risks of the Corporation remain substantially unchanged from those outlined in the Corporation's 2015 annual MD&A.

## NEW ACCOUNTING POLICIES

### Property, Plant and Equipment

Effective January 1, 2016, as applied for in FBC's application for 2016 rates under the PBR Plan and approved by the BCUC, the Corporation adopted a new accounting policy on a prospective basis. Removal costs are now collected as a component of depreciation and recognized as a regulatory liability, with actual removal costs incurred drawing down the regulatory liability balance. Removal costs are the direct costs incurred by the Corporation in taking assets out of service. Prior to 2016, actual removal costs were recorded in property, plant and equipment when incurred. As a result of adopting this policy, a regulatory liability balance of \$6.1 million was recognized as at September 30, 2016 which was comprised of approximately \$7.5 million collected from customers through depreciation expense, partially offset by actual removal costs incurred of approximately \$1.4 million during the nine months ended September 30, 2016.

### Amendments to the Consolidation Analysis

Effective January 1, 2016, FBC adopted Accounting Standards Update ("ASU") No. 2015-02 that changed the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. Specifically, the amendments note the following with regard to limited partnerships: (i) modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities or voting interest entities; and (ii) eliminate the presumption that a general partner should consolidate a limited partnership. The adoption of this update did not impact FBC's consolidated financial statements.

## FUTURE ACCOUNTING PRONOUNCEMENTS

FBC 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 FBC. 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.

### Revenue from Contracts with Customers

ASU No. 2014-09 was issued in May 2014 and the amendments in this update create Accounting Standards Codification ("ASC") Topic 606, *Revenue from Contracts with Customers*, and supersede 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 can be applied consistently across various transactions, industries and capital markets. This standard was originally effective for annual and interim periods beginning after December 15, 2016 and is to be applied on a full retrospective or modified retrospective basis. ASU No. 2015-14 was issued in August 2015 and the

amendments in this update defer the effective date of ASU No. 2014-09 by one year to annual and interim periods beginning after December 15, 2017. Early adoption is permitted as of the original effective date.

ASU No. 2016-08, *Principal versus Agent Considerations*, was issued in March 2016, ASU No. 2016-10, *Identifying Performance Obligations and Licensing*, was issued in April 2016 and ASU No. 2016-12, *Narrow-Scope Improvements and Practical Expedients*, was issued in May 2016. The above noted ASUs clarify implementation guidance in ASC Topic 606. The effective date and transition requirements of these updates are the same as ASU No. 2014-09.

The majority of FBC's revenue is generated from electricity sales to customers based on published tariff rates, as approved by the BCUC, and is expected to be in the scope of ASU No. 2014-09. FBC does not expect that the adoption of this standard, and all related ASUs, will have a material impact on the measurement of revenue generated from electricity sales to customers. FBC has not yet selected a transition method and is assessing the impact that the adoption of this standard, and all related ASUs, will have on its other revenue streams, and all related disclosures. FBC plans to have this assessment substantially complete by the end of 2016.

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

ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*, was issued in January 2016 and the amendments in this update address certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Most notably, the amendments require the following: (i) equity investments in unconsolidated entities (other than those accounted for using the equity method of accounting) to be measured at fair value through earnings; however, entities will be able to 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 financial liabilities to be presented separately in the notes to the consolidated financial statements, grouped by measurement category and form of financial asset. This update is effective for annual and interim periods beginning after December 15, 2017. FBC is assessing the impact that the adoption of this update will have on its consolidated financial statements and related disclosures.

### **Leases**

ASU No. 2016-02 was issued in February 2016 and the amendments in this update create ASC Topic 842, *Leases*, and supersede lease requirements in ASC Topic 840, *Leases*. The main provision of Topic 842 is the recognition of lease assets and lease liabilities on the balance sheet by lessees for those leases that were previously classified as operating leases. For operating leases, a lessee is required to do the following: (i) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, on the balance sheet; (ii) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; and (iii) classify all cash payments within operating activities in the statement of cash flows. These amendments also require qualitative disclosures along with specific quantitative disclosures. This update is effective for annual and interim periods beginning after December 15, 2018 and is to be applied using a modified retrospective approach with practical expedient options. Early adoption is permitted. FBC is assessing the impact that the adoption of this update will have on its consolidated financial statements and related disclosures.

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

ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, was issued in June 2016 and the amendments in this update require entities to use an expected credit loss methodology and to consider a broader range of reasonable and supportable information to form credit loss estimates. This update is effective for annual and interim periods beginning after December 15, 2020 and is to be applied on a modified retrospective basis. Early adoption is permitted for annual and interim periods beginning after December 15, 2018. FBC is assessing the impact that the adoption of this update will have on its consolidated financial statements and related disclosures.

### **Classification of Certain Cash Receipts and Cash Payments**

ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*, was issued in August 2016 and the amendments in this update address diversity in practice on how eight specific cash receipts and cash payments are presented in the statement of cash flows. This update is effective for annual and interim periods beginning after December 15, 2017 and is to be applied on a retrospective basis for each period presented. Early adoption is permitted. FBC does not expect that the adoption of this update will have a material impact on its consolidated financial statements and related disclosures.

## FINANCIAL INSTRUMENTS

### Fair Value Estimates

The following table summarizes the fair value measurements of the Corporation's long-term debt as of September 30, 2016 and December 31, 2015, all of which is Level 2 of the fair value hierarchy and recorded on the consolidated balance sheets at its carrying value:

(\$ millions)	September 30, 2016		December 31, 2015	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Long-term debt, including current portion <sup>1,2</sup>	<b>660.0</b>	<b>850.8</b>	685.0	801.7

<sup>1</sup> Includes secured and unsecured debentures for which the carrying value is measured at cost. Carrying value excludes unamortized debt issuance costs of \$5.9 million (2015 - \$6.0 million).

<sup>2</sup> Fair value is calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues at the measurement date or by using quoted market sources. The estimates cannot be determined with precision as they involve uncertainties and matters of judgment.

Power purchase contracts that have been designated as normal purchase or normal sale contracts are not reported at fair value under the accounting rules for derivatives.

### CRITICAL ACCOUNTING ESTIMATES

The preparation of the Corporation's interim unaudited consolidated financial statements in accordance with US GAAP requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Estimates and judgments are based on historical experience, current conditions and various other assumptions believed to be reasonable under the circumstances. Additionally, certain estimates and judgments are necessary since the regulatory environment in which the Corporation operates often requires amounts to be recorded at estimated values until these amounts are finalized pursuant to regulatory decisions or other regulatory proceedings. Due to changes in facts and circumstances and the inherent uncertainty in making estimates, actual results may differ significantly from current estimates. Estimates and judgments are reviewed periodically and, as adjustments become necessary, are recognized in the period in which they become known.

Interim financial statements may also employ a greater use of estimates than the annual financial statements. Other than as discussed below, there were no material changes in the nature of the Corporation's critical accounting estimates during 2016 from those disclosed in the Corporation's 2015 annual MD&A.

### Removal Costs

As approved by the BCUC, effective January 1, 2016 removal costs are now collected as a component of depreciation on an accrual basis, with actual removal costs incurred drawing down the regulatory liability balance. Removal costs are the direct costs incurred by the Corporation in taking assets out of service.

As part of the customer rate-setting process, appropriate removal cost rates are approved by the BCUC for the Corporation's regulated operations. The rates are reviewed on an ongoing basis to ensure they continue to be appropriate. From time to time, independent third-party studies of these rates are performed and based on the results of these studies, the impact of any over-or-under collection as a result of actual experience differing from that expected and provided for in previous rates is generally reflected in future removal cost rates. These updated rates are used in future rate-setting processes and are generally reflected in future customer rates.

### SUMMARY OF QUARTERLY RESULTS

The following table sets forth unaudited quarterly information for each of the eight quarters ended December 31, 2014 through September 30, 2016. The information has been obtained from the Corporation's unaudited interim consolidated financial statements, which have been prepared in accordance with US GAAP. Past operating results are not necessarily indicative of results for any future period and should not be relied upon to predict future performance.

During the second quarter of 2015, the Corporation began purchasing capacity under the WECA which, in combination with the timing of recognizing regulatory deferral adjustments for setting customer rates, could result in future quarterly net earnings that differ from historical quarterly net earnings. However, quarterly net

earnings affected by the WECA and the timing of recognizing regulatory deferral adjustments are not indicative of net earnings on an annual basis as both power purchase and regulatory deferral adjustments are recognized in customer rates.

Quarter Ended (\$ millions)	<b>Electricity Revenue</b>	<b>Net Earnings</b>
September 30, 2016	78.0	9.5
June 30, 2016	73.8	14.0
March 31, 2016	91.3	14.1
December 31, 2015	88.7	6.3
September 30, 2015	77.1	6.1
June 30, 2015	72.7	11.3
March 31, 2015	87.2	21.9
December 31, 2014	85.9	11.3

A summary of the past eight quarters reflects the seasonality associated with the Corporation's business. The operations generally produce higher net earnings in the first two quarters of the fiscal year due to increased customer load as a result of cooler weather, while certain expenses such as depreciation, interest and operating expenses remain more evenly distributed throughout the fiscal year. As a result, interim net earnings are not indicative of net earnings on an annual basis.

**December 2015/2014** - The decrease in net earnings for the fourth quarter of 2015 was primarily due to the timing of recognizing regulatory deferral adjustments for setting customer rates and the timing of power purchase costs. Additionally, a one-time \$1.0 million impairment charge and a \$0.4 million increase in deferred income tax expense were recognized on the pending sale of the WPP non-regulated assets.

**March 2016/2015** - The decrease in net earnings was primarily due to the timing of recognizing regulatory deferral adjustments for setting customer rates and the timing of power purchase costs, partially offset by a one-time \$0.5 million gain on sale of the WPP non-regulated assets.

**June 2016/2015** - The increase in net earnings was primarily due to the timing of recognizing regulatory deferral adjustments and an increase in rate base, partially offset by a decrease of \$0.6 million in earnings derived from WPP operations in the second quarter of 2015 compared to no earnings in the second quarter of 2016 following the sale of the WPP non-regulated assets in February 2016.

**September 2016/2015** - The increase in net earnings for the third quarter of 2016 as compared to the third quarter of 2015 was primarily due to the timing of recognizing regulatory deferral adjustments for setting customer rates and lower operating and maintenance expenses.

## **BUSINESS OUTLOOK**

### **Contingencies**

The Province of BC filed a claim in the BC Supreme Court on June 8, 2012 claiming on its behalf, and on behalf of approximately 17 homeowners, damages suffered as a result of a landslide caused by a dam failure in Oliver, BC in 2010. The Province alleges in its claim that the dam failure was caused by the defendants, including FBC, through the use of a road on top of the dam. The Province estimates its damages, and the damages of the homeowners on whose behalf it is claiming, to be approximately \$15 million. FBC has notified its insurers; however, FBC has been advised by counsel for the Province that a response to the claim is not required at this time. The outcome cannot be reasonably determined or estimated at this time and, accordingly, no amount has been accrued in the financial statements.

### **Sale of Assets**

In February 2016, FBC and its subsidiaries sold the WPP non-regulated assets for gross proceeds of \$9.2 million. As a result, FBC recognized a gain on sale of \$0.5 million, after tax and transaction costs, in other income in the first quarter of 2016.

**OUTSTANDING SHARE DATA**

As at the filing date of this MD&A, the Corporation had issued and outstanding 2,191,510 common shares, all of which are owned by FortisBC Pacific, an indirect wholly-owned subsidiary of Fortis.

**ADDITIONAL INFORMATION**

Additional information about FBC, including its Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

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