FortisBC Energy Inc.
Management Discussion & Analysis
For the Three and Six Months Ended June 30, 2016
Dated July 29, 2016

The following FortisBC Energy Inc. ("FEI" 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. The MD&A should be read in conjunction with the Corporation's unaudited interim consolidated financial statements and notes thereto for the three and six months ended June 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.

In this MD&A, FAES refers to FortisBC Alternative Energy Services Inc., FHI refers to the Corporation's parent, FortisBC Holdings Inc., FBC refers to FortisBC Inc., ACGS refers to Aitken Creek Gas Storage ULC, and Fortis refers to the Corporation's ultimate parent, Fortis Inc.

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 estimated costs for the Tilbury Liquefied Natural Gas Facility Expansion Project ("Tilbury Expansion Project") and associated in-service date; 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 FHI and debenture issuances; the Corporation's belief that changes in consumption levels of sales customers and changes in the commodity cost of natural gas do not materially impact earnings as a result of regulatory deferral accounts; and the Corporation's estimated contractual obligations.

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 energy demand; the ability to arrange sufficient and cost effective financing; no material adverse ratings actions by credit rating agencies; the competitiveness of natural gas pricing when compared with alternate sources of energy; continued population growth and new housing starts, and the availability of natural gas supply.

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; counterparty credit risk; natural gas supply 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

The Corporation is the largest distributor of natural gas in British Columbia ("BC"), serving approximately 985,000 residential, commercial and industrial and transportation customers in more than 135 communities. Major areas served by the Corporation are the Mainland, Vancouver Island, and Whistler regions of BC. 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.

The Corporation is an indirect, wholly-owned subsidiary of 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

Customer Rates and Quarterly Gas Cost Changes

Customer rates include both the delivery charge, and the cost of natural gas. The cost of natural gas, consisting of the commodity and storage and transport costs, is passed through to customers without mark-up.

In addition to annual delivery rate changes, the Corporation reviews natural gas and propane charges every three months with the British Columbia Utilities Commission ("BCUC") in order to ensure the rates charged to customers are sufficient to cover the cost of purchasing natural gas and contracting for third-party pipeline and storage capacity.

The table below shows the residential rate changes since January 1, 2015 for a typical residential customer in FEI's Mainland service area:

	2015				2016	
	Jan 1	April 1	Aug 1	Oct 1	**Jan 1**	**April 1**
Effective rate per gigajoule[1]	$10.24	$8.95	$8.96	$8.96	**$8.24**	**$7.66**
Percentage change in rate	(0.6%)	(12.6%)	0.1%	-	**(8.0%)**	**(7.0%)**

1. Based on an average annual usage of 90 gigajoule.

When comparing June 30, 2016 to June 30, 2015, an average bill for a Mainland residential customer decreased by approximately 14.4 per cent, primarily due to a decrease in natural gas costs.

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

In September 2014, the BCUC issued its decision on FEI'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 1.1 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 FEI maintains service levels. It also sets out the requirements for an annual review process which will provide a forum for discussion between FEI and interested parties regarding its current performance and future activities.

In December 2015, the BCUC issued its decision on FEI's 2016 delivery rates. The decision results in a 2016 average rate base of approximately $3,693 million (excluding rate base of approximately $11 million for Fort Nelson) and a customer delivery rate increase of 1.79 per cent over 2015 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. FEI 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 with a 38.5 per cent common equity component of capital structure, both effective January 1, 2013. The benchmark utility 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 common equity component of capital structure and ROE will remain the benchmark on an interim basis, effective January 1, 2016. A hearing on the cost of capital proceeding concluded in March 2016 and a decision on the application is expected in the third quarter of 2016.

Price Risk Management Application

In December 2015, the Corporation filed a 2015 Price Risk Management Application ("Application") with the BCUC. The Corporation requested BCUC approval to implement specific price risk management tools and strategies to limit the exposure to fluctuations in natural gas prices for customers who receive commodity supply from FEI. These included enhancements to the commodity rate setting mechanism as well as the use of derivative instruments based on pre-defined market price targets and maximum volume limits. In June 2016, the BCUC approved the Application. FEI's future commodity rate setting will now incorporate the rate setting enhancements and FEI will implement derivative instruments if the market price targets are reached for any terms out to March 2019.

CONSOLIDATED RESULTS OF OPERATIONS

	Quarter			Year to Date		
Periods Ended June 30	**2016**	2015	Variance	**2016**	2015	Variance
Gas sales (petajoules)	**34**	36	(2)	**102**	98	4
($ millions)						
Revenue	**226**	229	(3)	**635**	720	(85)
Expenses						
Cost of natural gas	**40**	73	(33)	**175**	290	(115)
Operation and maintenance	**53**	50	3	**108**	105	3
Depreciation and amortization	**51**	49	2	**102**	98	4
Property and other taxes	**16**	16	-	**32**	31	1
	160	188	(28)	**417**	524	(107)
Operating income	**66**	41	25	**218**	196	22
Finance charges	**54**	34	20	**85**	68	17
Earnings before income taxes	**12**	7	5	**133**	128	5
Income taxes	**(1)**	1	(2)	**29**	35	(6)
Net earnings	**13**	6	7	**104**	93	11

Net Earnings

The Corporation reported net earnings of $13 million for the three months ended June 30, 2016, and net earnings of $104 million for the six months ended June 30, 2016, compared to net earnings of $6 million and $93 million in the corresponding periods of 2015.

Net earnings were higher for the three months ended June 30, 2016 primarily due to the Corporation having a tax loss utilization plan ("TLUP") in place in the second quarter of 2016 which generated lower tax expense and higher allowance for funds used during construction ("AFUDC") partially offset by lower operation and maintenance expense savings, net of the regulated Earnings Sharing Mechanism prescribed by the PBR Decision.

Net earnings were higher for the six months ended June 30, 2016 primarily due to the Corporation having a TLUP in place in the second quarter of 2016 which generated lower tax expense, higher AFUDC and the timing of revenue versus the incurrence of the related expenses, which was more pronounced year-to-date 2016 versus the same period in 2015. The higher net earnings are partially offset by lower operation and maintenance expense savings, net of the regulated Earnings Sharing Mechanism prescribed by the PBR Decision.

As part of the TLUP, the Corporation received dividend income from FHI relating to a $1,900 million investment in preferred shares. A TLUP is a series of transactions, whereby the Corporation sets up an investment in an affiliate's preferred shares and issues subordinated debt to that affiliate; these two financial instruments are shown on a net basis. The Corporation receives non-taxable dividend income on the preferred shares and pays tax deductible interest on the debt. The effect of this transaction is to transfer tax losses between affiliated entities.

Gas Sales

For the three months ended June 30, 2016, gas sales volumes were lower compared to the corresponding period in 2015 primarily due to lower average consumption by residential and commercial customers as a result of warmer weather in the second quarter of 2016 partially offset by higher gas volumes for transportation customers due to certain transportation customers switching to natural gas compared to alternative fuel sources.

For the six months ended June 30, 2016, gas sales volumes were higher compared to the corresponding period in 2015 primarily due to higher average consumption by residential and commercial customers as a result of colder weather in the first quarter of 2016 and higher gas volumes for transportation customers for the six months due to certain transportation customers switching to natural gas compared to alternative fuel sources.

Revenue and Cost of Natural Gas

For the three and six months ended June 30, 2016, revenues decreased by $3 million and $85 million, respectively, compared to the corresponding periods in 2015.

Lower revenues for the three months ended June 30, 2016 were primarily due to lower natural gas costs and lower gas sales partially offset by higher delivery rates, higher revenue from the current year's TLUP, a higher equity component of AFUDC and the effects of flow-through deferral amounts.

Lower revenues for the six months ended June 30, 2016 were primarily due to lower natural gas costs and the effects of flow-through deferral amounts partially offset by higher delivery rates, higher gas sales, higher revenue from the current year's TLUP and a higher equity component of AFUDC.

For the three months ended June 30, 2016, cost of natural gas decreased by $33 million compared to the corresponding period in 2015 primarily due to lower natural gas costs and lower gas sales.

For the six months ended June 30, 2016, cost of natural gas decreased by $115 million compared to the corresponding period in 2015 primarily due to lower natural gas costs partially offset by higher gas sales.

Changes in consumption levels of customers and changes in the commodity cost of natural gas do not materially impact earnings as a result of regulatory deferral accounts.

Operation and Maintenance Expense

For the three and six months ended June 30, 2016, operation and maintenance expense increased by $3 million and $3 million, respectively, compared to the corresponding periods in 2015. The increase was primarily due to higher contracting costs related to the operation of the natural gas pipelines and higher materials and supplies costs related to natural gas pipeline materials partially offset by lower pension costs.

Depreciation and Amortization

For the three and six months ended June 30, 2016, depreciation and amortization expense increased by $2 million and $4 million, respectively, compared with the corresponding periods in 2015. The increase in depreciation expense was due to a higher depreciable asset base of the Corporation and higher amortization of regulatory asset deferral accounts.

Finance Charges

For the three and six months ended June 30, 2016, finance charges increased by $20 million and $17 million, respectively, compared to the corresponding periods in 2015 primarily due to the Corporation having a TLUP in place (a similar TLUP was put in place in the third quarter of 2015) which generated higher interest expense compared to the same periods in 2015. This was partially offset by a decrease in finance charges due to a lower average cost of long-term debt.

Income Taxes

For the three and six months ended June 30, 2016, income tax expense decreased by $2 million and $6 million, respectively, compared to the corresponding periods in 2015.

The decrease in income tax expense for the three months was primarily due to the Corporation having in place a TLUP which generated lower tax expense compared to the same period in 2015 partially offset by higher pre-tax earnings and lower deductible temporary differences.

The decrease in income tax expense for the six months was primarily due to the Corporation having in place a TLUP which generated lower tax expense compared to the same period in 2015 and higher deductible temporary differences partially offset by higher pre-tax earnings.

CONSOLIDATED FINANCIAL POSITION

The following table outlines the significant changes in the consolidated balance sheets as at June 30, 2016 compared to December 31, 2015:

Balance Sheet Account	(Decrease) Increase ($ millions)	Explanation
Short-term notes	**(322)**	The decrease was primarily due to proceeds from the issuance of long-term debt.
Accounts receivable	**(87)**	The decrease was mainly due to a decrease in trade accounts receivable and unbilled receivables due to seasonality, partially offset by an increase in off-system sales volumes.
Accounts payable and other current liabilities	**(38)**	The decrease was mainly due to a reduction in capital accruals related to the Tilbury Expansion Project and a decrease in gas costs payable.
Inventories	**(36)**	The decrease was primarily due to a lower average commodity cost of natural gas held in storage and the drawdown of natural gas in storage during the winter months.
Long-term debt	**293**	The increase was due to the issuance of long-term debt, partially offset by the repayment of the government loan repayable and increase in long term debt issuance costs.
Property, plant and equipment	**83**	The increase was primarily due to $153 million in capital expenditures incurred during the period partially offset by depreciation expense of $73 million and changes in non-cash capital accruals of $11 million.

LIQUIDITY AND CAPITAL RESOURCES

Summary of Consolidated Cash Flows

Six Months Ended June 30	**2016**	2015	Variance
($ millions)			
Cash flows provided by (used for):			
Operating activities	**274**	322	(48)
Investing activities	**(163)**	(230)	67
Financing activities	**(112)**	(99)	(13)
Net decrease in cash and cash equivalents	**(1)**	(7)	6

Operating Activities

Cash flows provided by operating activities were $48 million lower for the six months ended June 30, 2016 compared to the corresponding period in 2015 primarily due to changes in working capital partially offset by changes in long-term regulatory assets and liabilities.

Investing Activities

Cash used for investing activities was $67 million lower for the six months ended June 30, 2016 compared to the corresponding period in 2015 primarily due to a decrease in property, plant and equipment expenditures mainly related to the Tilbury Expansion Project.

Financing Activities

Cash used for financing activities was $13 million higher for the six months ended June 30, 2016 compared to the corresponding period in 2015. The increase was primarily due to higher net repayments of short-term notes and the FEI equity issuance in the second quarter of 2015 with no such equity issuance in 2016, partially offset by higher long-term debt issuances and a decrease in dividends paid. Dividends in 2015 included a one-time dividend to reduce the common equity component of the pre-amalgamation FEI regulated capital structure from 41.5 per cent to 38.5 per cent.

On July 4, 2016, the Corporation issued 2,024,150 common shares to FHI for total proceeds of $30 million. The proceeds from the issuance will be used to finance capital expenditures.

During the three and six months ended June 30, 2016, the Corporation paid common share dividends of $40 million (2015 - $37 million) and $80 million (2015 - $97 million), respectively, to its parent company, FHI.

Contractual Obligations

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

As at June 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)							
Interest obligations on long-term debt	2,343	121	111	111	111	111	1,778
Long-term debt[1]	2,270	200	-	-	-	-	2,070
Gas purchase obligations	1,252	316	256	189	140	114	237
Capital lease and finance obligations	101	6	5	32	17	7	34
Power purchase obligations	486	2	5	6	8	9	456
Defined benefit pension funding contributions	11	11	-	-	-	-	-
Operating lease obligations	10	3	3	2	2	-	-
Totals	6,473	659	380	340	278	241	4,575

1. Excludes unamortized debt issuance costs of $15 million.

The natural gas supply contract obligations are based on gas commodity indices that vary with market prices. The amounts disclosed reflect index prices that were in effect at June 30, 2016.

Capital Structure

The Corporation’s principal business of regulated natural gas 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 38.5 per cent equity and 61.5 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 $370 million, an increase of $20 million from the $350 million projected in the Corporation’s 2015 annual MD&A. The increase primarily relates to an increase in base capital driven by customer growth.

Tilbury Expansion Project Phase 1A

In October 2014, FEI began construction on the expansion of its Tilbury LNG Facility in Delta, BC. The Tilbury Expansion Project Phase 1A is estimated to cost approximately $440 million including AFUDC and will include a new LNG storage tank and liquefier, both expected to be in service during the first quarter of 2017. During the second quarter of 2016, project progress included the continued construction of the internal LNG storage tank, the start of construction on the control building and the continued installation of the liquefaction process area major equipment, piping, electrical and instrumentation cable tray and cable.

Cash Flow Requirements

The Corporation's cash flows fluctuate seasonally based primarily on natural gas consumption. The Corporation maintains an adequate committed credit facility.

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 FHI 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 facility 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 Facility and Debentures

Credit Facility

As at June 30, 2016, the Corporation had a $700 million syndicated credit facility available of which $579 million was unused. In July 2016, the $700 million credit facility was extended by three years to mature in August 2021.

The following summary outlines the Corporation's credit facility:

($ millions)	**June 30, 2016**	December 31, 2015
Total credit facility	**700**	700
Short-term notes	**(69)**	(391)
Letters of credit outstanding	**(52)**	(53)
Credit facility available	**579**	256

Debentures

On April 5, 2016, FEI issued $150 million unsecured Medium Term Note Debentures ("MTN Debentures") Series 27 and $150 million unsecured MTN Debentures Series 28. The MTN Debentures Series 27 bears interest at a rate of 2.58 per cent to be paid semi-annually and matures on April 8, 2026. The MTN Debentures Series 28 bears interest at a rate of 3.67 per cent to be paid semi-annually and matures on April 9, 2046. The net proceeds were used to repay existing indebtedness and finance the Corporation's capital expenditure program.

OFF-BALANCE SHEET ARRANGEMENTS

As at June 30, 2016, the Corporation had no material off-balance sheet arrangements, with the exception of letters of credit outstanding of $52 million (December 31, 2015 - $53 million) primarily to support the Corporation's unfunded supplemental pension benefit plans.

As at June 30, 2016, FEI held a letter of credit of approximately $54 million as security for development expenditures incurred on the Eagle Mountain Woodfibre Gas Pipeline Project. In July 2016, FEI received cash to replace the letter of credit as security.

RELATED PARTY TRANSACTIONS

In the normal course of business, the Corporation transacts with its parent, ultimate parent and other related companies under common control 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 six months ended June 30, 2016 were as follows:

	Three months ended June 30		Six months ended June 30	
($ millions)	**2016**	2015	**2016**	2015
Operation and maintenance expense charged to FBC (a)	**1**	1	**2**	2
Other income recovered from FHI (b)	**21**	-	**21**	-
	22	1	**23**	2

(a) The Corporation charged FBC for natural gas transmission and distribution sales, office rent and management services.

(b) As part of the TLUP, the Corporation received dividend income from FHI relating to a $1,900 million investment in preferred shares. A TLUP is a series of transactions, whereby the Corporation sets up an investment in an affiliate's preferred shares and issues subordinated debt to that affiliate; these two financial instruments are shown on a net basis. The Corporation receives non-taxable dividend income on the preferred shares and pays tax deductible interest on the debt. The effect of this transaction is to transfer tax losses between affiliated entities.

Related Party Costs

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

	Three months ended June 30		Six months ended June 30	
($ millions)	**2016**	2015	**2016**	2015
Operation and maintenance expense charged by FBC (a)	**2**	2	**3**	3
Operation and maintenance expense charged by FHI (b)	**4**	3	**7**	6
Finance charges paid to FHI (c)	**21**	-	**21**	-
Storage lease charges paid to ACGS (d)	**5**	-	**5**	-
	32	5	**36**	9

(a) FBC charged the Corporation for electricity purchases and management services.

(b) FHI charged the Corporation for board of director costs, management services, and labour and materials.

(c) As part of a TLUP, the Corporation paid FHI interest on $1,900 million (2015 - nil) of inter-company subordinated debt.

(d) ACGS charged the Corporation for the lease of natural gas storage capacity.

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:

	June 30, 2016		December 31, 2015	
($ millions)	**Amount Due From**	**Amount Due To**	Amount Due From	Amount Due To
FHI	**2**	**-**	1	1
FBC	**-**	**1**	-	-
	2	**1**	1	1

In March 2016, FEI paid FBC $6 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 POLICY

Amendments to the Consolidation Analysis

Effective January 1, 2016, FEI adopted Accounting Standard 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 FEI's consolidated financial statements.

FUTURE ACCOUNTING PRONOUNCEMENTS

FEI considers the applicability and impact of all ASU's 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.

Revenue from Contracts with Customers

ASU No. 2014-09 was issued in May 2014 and the amendments in this update create Accounting Standard 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 completes a joint effort by FASB and the International Accounting Standards Board to improve financial reporting by creating common revenue recognition guidance for US GAAP and International Financial Reporting Standards that clarifies the principles for recognizing revenue and that 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 FEI's revenue is generated from natural gas 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. FEI 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 consolidated financial statements and related disclosures. FEI 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. FEI 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 expedients options. Early adoption is permitted. FEI 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. FEI is assessing the impact that the adoption of this update will have 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 and natural gas derivative contracts as of June 30, 2016 and December 31, 2015, all of which are Level 2 of the fair value hierarchy and recorded on the consolidated balance sheets at their carrying value or fair value:

	June 30, 2016		December 31, 2015	
($ millions)	**Carrying Value**	**Estimated Fair Value**	Carrying Value	Estimated Fair Value
Assets				
Current				
Natural gas supply contract premiums[2]	**9**	**9**	-	-
Long-term				
Natural gas supply contract premiums[2]	**1**	**1**	-	-
Liabilities				
Current				
Long-term debt[1]	**200**	**204**	205	218
Natural gas supply contract premiums[2]	**6**	**6**	16	16
Long-term				
Long-term debt[1]	**2,070**	**2,649**	1,770	2,175
Natural gas supply contract premiums[2]	**3**	**3**	1	1

1. Carrying value excludes unamortized debt issuance costs of $15 million (2015 - $13 million). For the purposes of this disclosure, carrying value is used to approximate fair value for the repayable government loan.
2. Natural gas supply contract premiums 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 fair values of the Corporation's financial instruments, including derivatives, reflect a point-in-time estimate based on current and relevant market information about the instruments as at the balance sheet dates. The estimates cannot be determined with precision as they involve uncertainties and matters of judgment.

At June 30, 2016, the Corporation's outstanding derivative balances, which consisted of natural gas supply contract premiums were as follows:

($ millions)	**Gross Derivatives Balance[1]**	**Gross Amounts Not Offset in the Balance Sheet[2]**	**Margin Deposits Not Offset in the Balance Sheet**	**Total Net Derivatives Balance**
Natural gas supply contract premiums:				
Accounts receivable	**9**	**(2)**	**-**	**7**
Other assets	**1**	**(1)**	**-**	**-**
Accounts payable and other current liabilities	**6**	**(2)**	**-**	**4**
Other liabilities	**3**	**(1)**	**-**	**2**

1. See the June 30, 2016 unaudited interim consolidated financial statements for a discussion of the valuation techniques used to calculate the fair value of these instruments.
2. Positions, by counterparty, are netted where the intent and legal right to offset exists.

At December 31, 2015, the Corporation's outstanding derivative balances, which consisted of natural gas supply contract premiums were as follows:

($ millions)	Gross Derivatives Balance[1]	Gross Amounts Not Offset in the Balance Sheet[2]	Margin Deposits Not Offset in the Balance Sheet	Total Net Derivatives Balance
Natural gas supply contract premiums:				
Accounts payable and other current liabilities	16	-	-	16
Other liabilities	1	-	-	1

1. See the December 31, 2015 consolidated financial statements for a discussion of the valuation techniques used to calculate the fair value of these instruments.
2. Positions, by counterparty, are netted where the intent and legal right to offset exists.

The following table shows the cumulative unrealized (gains) losses at June 30, 2016 and December 31, 2015, with respect to all natural gas derivative contracts:

($ millions)	**June 30, 2016**	December 31, 2015
Unrealized (gain) loss on natural gas supply contract premiums[1,2]	**(1)**	17

1. Unrealized gains and losses on commodity risk-related derivative instruments are recorded to current regulatory assets or liabilities rather than being recorded to the consolidated statement of earnings.
2. These amounts are fully passed through to customers in rates. Accordingly, net earnings were not impacted by realized amounts on these instruments.

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. 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.

SUMMARY OF QUARTERLY RESULTS

The following table sets forth unaudited quarterly information for each of the eight quarters ended September 30, 2014 through June 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.

Quarter Ended	**Revenue**	**Net Earnings (Loss)**
($ millions)		
June 30, 2016	226	13
March 31, 2016	409	91
December 31, 2015	456	76
September 30, 2015	177	(18)
June 30, 2015	229	6
March 31, 2015	491	87
December 31, 2014	452	57
September 30, 2014	238	(5)

Due to the seasonal nature of the Corporation's natural gas transmission and distribution operations and its impact on natural gas consumption patterns, the natural gas transmission and distribution operations of FEI normally generate higher net earnings in the first and fourth quarters and lower net earnings in the second quarter, which are partially offset by net losses in the third quarter. As a result of the seasonality, interim earnings are not indicative of net earnings on an annual basis.

September 2015/2014 – The higher net loss was primarily due to the discontinuance of the Rate Stabilization Deferral Account ("RSDA") mechanism, lower tax savings from the TLUP in 2015, and a lower ROE and deemed equity component of capital structure, partially offset by operation and maintenance expense savings, net of the regulated Earnings Sharing Mechanism prescribed by the PBR Decision and higher AFUDC.

December 2015/2014 – Net earnings were higher primarily due to the discontinuance of the RSDA mechanism, higher tax savings from the TLUP in 2015, the timing of revenue versus the incurrence of the related expenses, which was more pronounced in the fourth quarter of 2015 versus the same period in 2014, higher AFUDC and the effects of the flow-through deferral amounts, partially offset by lower operation and maintenance savings, net of the regulated Earnings Sharing Mechanism prescribed by the PBR Decision and a lower ROE and deemed equity component of capital structure.

March 2016/2015 – Net earnings were higher primarily due to higher AFUDC and the timing of revenue versus the incurrence of the related expenses, which was more pronounced in the first quarter of 2016 versus the same period in 2015.

June 2016/2015 - Net earnings were higher primarily due to the Corporation having a TLUP in place in the second quarter of 2016 which generated lower tax expense and higher AFUDC partially offset by lower operation and maintenance expense savings, net of the regulated Earnings Sharing Mechanism prescribed by the PBR Decision.

OUTSTANDING SHARE DATA

As at the filing date of this MD&A the Corporation had issued and outstanding 325,945,864 common shares, all of which are owned by FHI, a directly wholly-owned subsidiary of Fortis.

ADDITIONAL INFORMATION

Additional information about FEI, including its Annual Information Form, is available on SEDAR at www.sedar.com.

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