



FortisBC Energy Inc.

An indirect subsidiary of Fortis Inc.

Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2016 and 2015

(Unaudited)

Prepared in accordance with United States Generally Accepted Accounting Principles

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

ASSETS	September 30, 2016	December 31, 2015
Current assets		
Cash and cash equivalents	\$ 5	\$ 3
Accounts receivable (notes 9 and 11)	102	196
Inventories	71	81
Prepaid expenses	21	4
Income taxes receivable	13	-
Regulatory assets	43	26
	255	310
Property, plant and equipment	4,078	3,957
Intangible assets	120	127
Goodwill	913	913
Regulatory assets	756	768
Other assets	10	9
	\$ 6,132	\$ 6,084
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Short-term notes (note 5)	\$ 273	\$ 391
Accounts payable and other current liabilities (notes 9 and 11)	315	236
Other taxes payable	16	36
Income taxes payable	-	17
Current portion of long-term debt (note 5)	-	205
Current portion of capital lease and finance obligations	6	6
Regulatory liabilities	65	80
	675	971
Long-term debt (note 5)	2,056	1,757
Capital lease and finance obligations	93	99
Regulatory liabilities	101	106
Deferred income taxes	429	418
Other liabilities (notes 7 and 9)	211	209
	3,565	3,560
Shareholder's equity		
Common shares ⁽¹⁾ (note 13)	1,171	1,141
Additional paid-in capital	1,245	1,245
Retained earnings	141	128
	2,557	2,514
Non-controlling interest	10	10
	2,567	2,524
	\$ 6,132	\$ 6,084

⁽¹⁾ No par value; 500 million authorized common shares; 325.9 million issued and outstanding at September 30, 2016 and 323.9 million issued and outstanding at December 31, 2015.

The accompanying notes are an integral part of these interim consolidated financial statements.

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

	Three months ended		Nine months ended	
	2016	2015	2016	2015
Revenues				
Natural gas transmission and distribution	\$ 151	\$ 168	\$ 758	\$ 884
Other income (note 11)	42	9	70	13
	193	177	828	897
Expenses				
Cost of natural gas	29	47	204	337
Operation and maintenance (note 11)	53	54	161	159
Depreciation and amortization	50	48	152	146
Property and other taxes	16	15	48	46
	148	164	565	688
Operating income	45	13	263	209
Finance charges (note 6 and 11)	71	40	156	108
(Loss) earnings before income taxes	(26)	(27)	107	101
Income taxes	(16)	(9)	13	26
Net (loss) earnings	(10)	(18)	94	75
Net earnings attributable to non-controlling interest	1	1	1	1
Net (loss) earnings attributable to controlling interest	\$ (11)	\$ (19)	\$ 93	\$ 74

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

	Common Shares	Additional Paid-in Capital	Non-controlling Interest	Retained Earnings	Total
As at December 31, 2014	\$ 1,056	\$ 1,245	\$ 11	\$ 112	\$ 2,424
Net earnings	-	-	1	74	75
Issuance of common shares	85	-	-	-	85
Net distribution to Mt. Hayes Storage LP partners	-	-	(1)	-	(1)
Dividend on common shares	-	-	-	(97)	(97)
As at September 30, 2015	1,141	1,245	11	89	2,486
As at December 31, 2015	1,141	1,245	10	128	2,524
Net earnings	-	-	1	93	94
Issuance of common shares	30	-	-	-	30
Net distribution to Mt. Hayes Storage LP partners	-	-	(1)	-	(1)
Dividends on common shares	-	-	-	(80)	(80)
As at September 30, 2016	\$ 1,171	\$ 1,245	\$ 10	\$ 141	\$ 2,567

The accompanying notes are an integral part of these interim consolidated financial statements.

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

	Three months ended		Nine months ended	
	2016	2015	2016	2015
Cash flows provided by (used for)				
Operating activities				
Net (loss) earnings	\$ (10)	\$ (18)	\$ 94	\$ 75
Adjustments for non-cash items				
Depreciation and amortization	50	48	152	146
Deferred income taxes	-	(1)	-	(1)
Equity component of allowance for funds used during construction	(4)	(3)	(11)	(7)
Change in long-term regulatory assets and liabilities	4	(4)	(7)	(63)
Change in non-cash working capital (note 8)	(49)	(65)	37	129
	(9)	(43)	265	279
Investing activities				
Property, plant and equipment	(80)	(114)	(233)	(335)
Intangible assets	(3)	(3)	(8)	(7)
Cost of removal	(3)	(4)	(9)	(11)
Contributions in aid of construction	1	-	3	1
Change in other assets and other long-term liabilities	3	1	2	2
	(82)	(120)	(245)	(350)
Financing activities				
Increase (decrease) in short-term notes	204	236	(118)	34
Deposit received for development expenditures (note 12)	63	-	63	-
Repayment of capital lease and finance obligations	(2)	(1)	(5)	(9)
Proceeds from issuance of debentures	-	-	300	150
Repayment of debentures and long-term debt	(200)	(75)	(205)	(100)
Debt issuance costs	-	-	(2)	(1)
Net distribution to non-controlling interest	(1)	-	(1)	(1)
Issuance of common shares	30	-	30	85
Dividend on common shares	-	-	(80)	(97)
	94	160	(18)	61
Net increase (decrease) in cash and cash equivalents				
	3	(3)	2	(10)
Cash and cash equivalents at beginning of period	2	3	3	10
Cash and cash equivalents at end of period	\$ 5	\$ -	\$ 5	\$ -

Supplementary Information to Consolidated Statements of Cash Flows (note 8).

The accompanying notes are an integral part of these interim consolidated financial statements.

FortisBC Energy Inc.
Notes to the Interim Consolidated Financial Statements (US GAAP) (Unaudited)
For the three and nine months ended September 30, 2016 and 2015

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.

FEI is the largest distributor of natural gas in British Columbia ("BC"), serving approximately 986,000 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

These interim consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States ("US GAAP") for interim financial statements and are presented in Canadian dollars unless otherwise specified. As a result, these interim consolidated 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 2015 annual audited consolidated financial statements prepared in accordance with US GAAP. In management's opinion, the interim consolidated financial statements include all adjustments that are of a recurring nature and necessary to present fairly the consolidated financial position of the Corporation.

The accounting policies and methods of application used in the preparation of these interim consolidated financial statements are consistent with the accounting policies used in FEI's year-end audited consolidated financial statements as at December 31, 2015, except as described below.

The interim consolidated 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 material inter-company transactions and balances have been eliminated upon consolidation.

An evaluation of subsequent events through November 1, 2016, the date these interim consolidated financial statements were available to be issued, was completed to determine whether any circumstances warranted recognition and disclosure of events or transactions in the interim consolidated financial statements as at September 30, 2016. Subsequent events have been appropriately disclosed in these interim consolidated financial statements.

Certain comparative figures have been reclassified to conform to the current year's presentation.

New Accounting Policy

Amendments to the Consolidation Analysis

Effective January 1, 2016, FEI 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 FEI's consolidated 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.

FortisBC Energy Inc.
Notes to the Interim Consolidated Financial Statements (US GAAP) (Unaudited)
For the three and nine months ended September 30, 2016 and 2015

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 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 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 natural gas sales to customers. 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 other revenue streams, and all 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 expedient 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.

FortisBC Energy Inc.
Notes to the Interim Consolidated Financial Statements (US GAAP) (Unaudited)
For the three and nine months ended September 30, 2016 and 2015

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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. FEI does not expect that the adoption of this update will have a material impact on its consolidated financial statements and related disclosures.

3. REGULATORY MATTERS

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 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, 2014-2019, 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 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 provides 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 the rate base of approximately \$11 million for Fort Nelson) and a customer delivery rate increase of 1.79 per cent over 2015 rates.

In August 2016, FEI filed its application for approval of 2017 delivery rates under the PBR Plan. The 2017 application includes a forecast average rate base of approximately \$3,705 million (excluding Fort Nelson) and requests no increase in customer delivery rates.

Allowed Return on Equity (“ROE”) and Capital Structure

The 2016 ROE and common equity component of capital structure for FEI is 8.75 per cent and 38.5 per cent, respectively, which is unchanged from the 2015 ROE and common equity component of capital structure.

In October 2015, FEI filed its application to review the 2016 benchmark utility ROE and common equity component of capital structure. 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 common equity component of capital structure and ROE for FEI will remain in effect until otherwise determined by the Commission.

4. SEASONALITY OF OPERATIONS

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 net earnings are not indicative of net earnings on an annual basis.

FortisBC Energy Inc.
Notes to the Interim Consolidated Financial Statements (US GAAP) (Unaudited)
For the three and nine months ended September 30, 2016 and 2015

5. CREDIT FACILITY AND DEBENTURES

Credit Facility

As at September 30, 2016, the Corporation had a \$700 million syndicated credit facility available of which \$375 million (December 31, 2015 - \$256 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)	September 30, 2016	December 31, 2015
Total credit facility	700	700
Short-term notes	(273)	(391)
Letters of credit outstanding	(52)	(53)
Credit facility available	375	256

Debentures

On April 8, 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.

Using proceeds from short-term notes, FEI repaid the \$5 million Government loan repayable in June 2016 and the \$200 million Series B Purchase Money Mortgage due September 30, 2016.

6. FINANCE CHARGES

Finance charges for the three and nine months ended September 30 were as follows:

(\$ millions)	Three months ended		Nine months ended	
	September 30		September 30	
	2016	2015	2016	2015
Interest on long-term debt, capital leases, and finance obligations	36	35	103	104
Interest on short-term debt	38	7	61	9
Debt component of Allowance for Funds Used During Construction ("AFUDC")	(3)	(2)	(8)	(5)
	71	40	156	108

FortisBC Energy Inc.
Notes to the Interim Consolidated Financial Statements (US GAAP) (Unaudited)
For the three and nine months ended September 30, 2016 and 2015

7. 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. The Corporation also provides post-employment benefits ("OPEB") other than pensions for retired employees.

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

(\$ millions)	Defined Benefit Pension and Supplemental Plans		OPEB Plans	
	2016	2015	2016	2015
Service costs	4	5	1	1
Interest costs	6	6	1	1
Expected return on plan assets	(7)	(7)	-	-
Amortization of actuarial losses	1	2	-	2
Amortization of past service costs	-	-	(1)	(1)
Regulatory adjustment	1	(1)	1	-
Net benefit cost	5	5	2	3

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

(\$ millions)	Defined Benefit Pension and Supplemental Plans		OPEB Plans	
	2016	2015	2016	2015
Service costs	13	14	3	3
Interest costs	17	17	3	4
Expected return on plan assets	(21)	(20)	-	-
Amortization of actuarial losses	3	6	1	3
Amortization of past service costs	-	-	(2)	(2)
Regulatory adjustment	2	(1)	3	-
Net benefit cost	14	16	8	8

8. SUPPLEMENTARY INFORMATION TO CONSOLIDATED STATEMENTS OF CASH FLOWS

The supplementary information to the consolidated statements of cash flows for the three and nine months ended September 30, 2016 was as follows:

Significant Non-Cash Transactions

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Change in fair value of natural gas derivatives	(9)	(10)	9	2
Capital accruals	-	1	11	35
Regulatory assets and regulatory liabilities accruals	-	-	4	2
Whistler pipeline contribution in aid of construction included in regulatory assets	-	-	-	13
Regulated asset for deferred income taxes	-	-	11	11

FortisBC Energy Inc.
Notes to the Interim Consolidated Financial Statements (US GAAP) (Unaudited)
For the three and nine months ended September 30, 2016 and 2015

8. SUPPLEMENTARY INFORMATION TO CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

Change in Non-Cash Working Capital

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Accounts receivable	12	(2)	99	102
Inventories	(26)	(37)	10	7
Prepaid expenses	(20)	(19)	(17)	(15)
Accounts payable and other current liabilities	62	22	39	(1)
Other taxes payable	(31)	(31)	(20)	(25)
Income taxes receivable and payable	(14)	(12)	(30)	23
Net current regulatory assets and liabilities	(31)	13	(42)	40
Other	(1)	1	(2)	(2)
	(49)	(65)	37	129

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

(\$ millions)	2016	2015
Additions to property, plant and equipment and intangible assets included in current liabilities	10	26

9. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Corporation engages in price risk management activities to limit the exposure to fluctuations in natural gas prices.

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. Beginning in July 2016, FEI's future commodity rate setting now incorporates the rate setting enhancements and FEI will implement derivative instruments if the market price targets are reached for any terms out to March 2019. As at September 30, 2016, the market price targets and maximum volume limits were not reached and therefore the price risk strategies were not implemented.

Volume of Derivative Activity

As at September 30, 2016, the Corporation had the following notional volumes of outstanding natural gas commodity derivatives that are expected to be settled as outlined below:

	2016	2017	2018	2019	2020	Thereafter
Natural gas supply contracts (petajoules)	40	80	44	26	22	64

FortisBC Energy Inc.
Notes to the Interim Consolidated Financial Statements (US GAAP) (Unaudited)
For the three and nine months ended September 30, 2016 and 2015

9. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES (continued)

Presentation of Derivative Instruments in the Financial Statements

In the Corporation's consolidated balance sheets, derivative instruments are presented on a gross basis.

At September 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	2	(1)	-	1
Accounts payable and other current liabilities	8	(1)	-	7
Other liabilities	2	-	-	2

¹ See note 10 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 note 10 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 September 30, 2016 and December 31, 2015, with respect to all natural gas derivative contracts:

(\$ millions)	September 30, 2016	December 31, 2015
Unrealized loss on natural gas supply contract premiums ^{1,2}	8	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.

Cash inflows and outflows associated with the settlement of all derivative instruments are included in operating cash flows on the Corporation's consolidated statements of cash flows.

10. FAIR VALUE MEASUREMENT

Fair value is the price at which a market participant could sell an asset or transfer a liability to an unrelated party. A fair value measurement is required to reflect the assumptions that market participants would use in pricing an asset or liability based on the best available information. These assumptions include the risks inherent in a particular valuation technique, such as a pricing model, and the risks inherent in the inputs to the model. A fair value hierarchy exists that prioritizes the inputs used to measure fair value. The Corporation is required to record all derivative instruments at fair value except those which qualify for the normal purchases and normal sales exception.

FortisBC Energy Inc.
Notes to the Interim Consolidated Financial Statements (US GAAP) (Unaudited)
For the three and nine months ended September 30, 2016 and 2015

10. FAIR VALUE MEASUREMENT (continued)

The three levels of the fair value hierarchy are defined as follows:

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

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 and, therefore, may not be relevant in predicting the Corporation's future consolidated earnings or cash flows.

The following methods and assumptions were used to estimate the fair value of each significant class of financial instruments:

Cash and cash equivalents, accounts receivable, accounts payable and other current liabilities and short-term notes – the carrying values on the consolidated balance sheets of the Corporation approximate their fair values because of the short maturity of these instruments.

Long-term debt – the fair value is estimated using 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.

Natural gas commodity derivatives – the fair values are estimates of the amounts that the Corporation would receive or pay to terminate the outstanding contracts as at the balance sheet date. None of the natural gas commodity derivatives were designated as hedges of the natural gas supply contracts. However, any changes in the fair value of the natural gas commodity derivatives are deferred as a regulatory asset or liability for recovery from, or refund to, customers in future rates, as permitted by the BCUC.

The following table summarizes the fair value measurements of the Corporation's long-term debt and natural gas derivative contracts as of September 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:

(\$ millions)	September 30, 2016		December 31, 2015	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets				
<i>Current</i>				
Natural gas supply contract premiums ²	2	2	-	-
<i>Long-term</i>				
Natural gas supply contract premiums ²	-	-	-	-
Liabilities				
<i>Current</i>				
Long-term debt ¹	-	-	205	218
Natural gas supply contract premiums ²	8	8	16	16
<i>Long-term</i>				
Long-term debt ¹	2,070	2,701	1,770	2,175
Natural gas supply contract premiums ²	2	2	1	1

¹ Carrying value excludes unamortized debt issuance costs of \$14 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.

FortisBC Energy Inc.
Notes to the Interim Consolidated Financial Statements (US GAAP) (Unaudited)
For the three and nine months ended September 30, 2016 and 2015

11. RELATED PARTY TRANSACTIONS

In the normal course of business, the Corporation transacts with its parent, FHI, ultimate parent, Fortis, and other related companies under common control, including FortisBC Inc. ("FBC"), and Aitken Creek Gas Storage ULC ("ACGS"), in financing transactions and 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
Operation and maintenance expense charged to FBC (a)	1	-	3	2
Operation and maintenance expense charged to FHI (b)	1	1	1	1
Other income recovered from FHI (c)	38	6	59	6
	40	7	63	9

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

(b) The Corporation charged FHI for management services, labour and materials.

(c) As part of the tax loss utilization plan ("TLUP"), the Corporation received dividend income from FHI relating to a \$1,900 million (2015 - \$2,100 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 nine months ended September 30 were as follows:

(\$ millions)	Three months ended September 30		Nine months ended September 30	
	2016	2015	2016	2015
Operation and maintenance expense charged by FBC (a)	2	1	5	4
Operation and maintenance expense charged by FHI (b)	3	4	10	10
Finance charges paid to FHI (c)	38	6	59	6
Storage lease charges paid to ACGS (d)	4	-	9	-
	47	11	83	20

(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 - \$2,100 million) of inter-company subordinated debt.

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

FortisBC Energy Inc.
Notes to the Interim Consolidated Financial Statements (US GAAP) (Unaudited)
For the three and nine months ended September 30, 2016 and 2015

11. RELATED PARTY TRANSACTIONS (continued)
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
FHI	-	-	1	1
FBC	-	1	-	-
ACGS	-	2	-	-
	-	3	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.

12. GUARANTEES

The Corporation has letters of credit outstanding at September 30, 2016 totaling \$52 million (December 31, 2015 - \$53 million) primarily to support the Corporation's unfunded supplemental pension benefit plans.

During the third quarter of 2016, FEI received cash of approximately \$63 million as security for development expenditures incurred on the Eagle Mountain Woodfibre Gas Pipeline Project. This form of security replaces a letter of credit that was previously held. The cash deposit received will be refunded and replaced by a letter of credit if the project proceeds. Alternatively, the cash deposit will be used to offset FEI's existing development expenditures incurred should the project not proceed. The \$63 million cash deposit was used to repay FEI's short-term notes, with the offset recognized as a deposit in current liabilities, and was classified as a source of cash under financing activities in the statement of cash flow.

13. COMMON SHARES

On July 4, 2016, the Corporation issued 2,024,150 common shares to FHI for total proceeds of \$30 million.