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**FortisBC Energy Inc.**  
**Management Discussion & Analysis**  
**For the Three Months Ended March 31, 2017**  
**Dated May 2, 2017**

*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 2017 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 months ended March 31, 2017, with 2016 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, 2016, with 2015 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"), the Lower Mainland Intermediate Pressure System upgrade ("LMIPSU"), Coastal Transmission System ("CTS") project and their associated in-service dates; 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 expectations for employee future benefit costs; 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; no material change in employee future benefit costs; 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; the availability of natural gas supply; the ability to hedge certain risks including no counterparties to derivative instruments failing to meet obligations; and the final investment decision and estimated costs associated with the pipeline expansion to the proposed Eagle Mountain Woodfibre Liquefied Natural Gas ("LNG") site.

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, 2016.

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 997,500 residential, commercial and industrial and transportation customers in more than 135 communities. The Corporation provides transmission and distribution services to its customers, and obtains natural gas supplies on behalf of most residential, commercial and industrial customers. Gas supplies are sourced primarily from northeastern BC and, through the Corporation's Southern Crossing Pipeline, from Alberta.

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 Deferral Mechanisms**

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. The Corporation's customer rates are based on estimates and forecasts. In order to manage the risk of forecast error associated with some of these estimates, to manage volatility in rates, and to match costs with benefits, a number of regulatory deferral accounts are in place.

Variances from regulated forecasts used to set rates for natural gas revenue 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 2017 or 2016. 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.

In addition to annual delivery rate changes, the Corporation reviews natural gas and propane charges every three months with the 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.

### **Directions to the BCUC**

In November 2013, the BC Provincial government issued an Order of the Lieutenant Governor in Council ("2013 OIC") directing the BCUC to allow the Corporation to undertake the Tilbury Expansion Project at Tilbury Island in Delta, BC. The 2013 OIC, and the subsequent amendments made to the OIC by the BC Provincial government in December 2014 and March 2017, set out a number of requirements for the BCUC as follows:

- to exempt the Tilbury Expansion Project from a Certificate of Public Convenience and Necessity ("CPCN") process;
- to allow the Tilbury Expansion Project to proceed in two phases (Phase 1A and Phase 1B respectively);
- to impose an upper limit of \$425 million on capital costs before development costs and construction carrying costs related to the Tilbury Phase 1A Expansion Project;
- to impose an upper limit of \$400 million on capital costs before development costs and construction carrying costs related to the Tilbury Phase 1B Expansion Project;
- to allow for recovery of the costs of the Tilbury Expansion Project from customers;

- to amend the tariff rates for LNG customers served from the Tilbury LNG Facility;
- to exempt from a CPCN process the pipeline and compression facilities that would supply a third party operated LNG facility near Squamish, BC should such facility proceed;
- to exempt from a CPCN process certain transmission projects, including the CTS project, which will increase the Corporation's pipeline capacity on three transmission line segments, and one to increase the transmission line capacity to the Corporation's Tilbury LNG Facility; and
- to provide the methodologies for regulatory treatment of certain of the costs of these various projects.

### **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 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 resulted 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 December 2016, the BCUC issued its decision on FEI's 2017 delivery rates. The decision resulted in a 2017 average rate base of approximately \$3,705 million (excluding the rate base of approximately \$11 million for Fort Nelson) and no increase in customer delivery rates.

In addition to the rate base amounts approved in the 2016 and 2017 regulatory decisions, assets under construction earn a regulated return. Included in assets under construction are significant capital projects such as the Tilbury 1A Expansion Project. The cost for the scope of this project currently under construction is approximately \$400 million, before development costs and allowance for funds used during construction ("AFUDC") and is expected to be completed in 2017.

### **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 up to maximum volume limits. In June 2016, the BCUC approved the Application. Since July 2016, FEI's future commodity rate setting has incorporated the rate setting enhancements and FEI implements derivative instruments if the market price targets are reached for any terms out to March 2019. During the quarter ended March 31, 2017, the market price targets approved by the BCUC were reached and the Company entered into fixed price financial swaps to hedge against the physical natural gas contracts.

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**CONSOLIDATED RESULTS OF OPERATIONS**

| Quarter Ended March 31        | 2017       | 2016 | Variance |
|-------------------------------|------------|------|----------|
| Gas sales (petajoules)        | <b>83</b>  | 68   | 15       |
| (\$ millions)                 |            |      |          |
| Natural gas revenue           | <b>452</b> | 402  | 50       |
| Other (expense) revenue       | <b>(3)</b> | 4    | (7)      |
|                               | <b>449</b> | 406  | 43       |
| Cost of natural gas           | <b>181</b> | 135  | 46       |
| Operation and maintenance     | <b>55</b>  | 55   | -        |
| Property and other taxes      | <b>17</b>  | 16   | 1        |
| Depreciation and amortization | <b>51</b>  | 51   | -        |
|                               | <b>304</b> | 257  | 47       |
| Operating income              | <b>145</b> | 149  | (4)      |
| Other income                  | <b>12</b>  | 3    | 9        |
| Finance charges               | <b>37</b>  | 31   | 6        |
| Earnings before income taxes  | <b>120</b> | 121  | (1)      |
| Income taxes                  | <b>21</b>  | 30   | (9)      |
| Net earnings                  | <b>99</b>  | 91   | 8        |

**Net Earnings**

Net earnings for the first quarter ended March 31, 2017 were \$99 million, an increase of \$8 million from the net earnings of \$91 million in the first quarter of 2016.

The higher net earnings for the three months ended March 31, 2017 was primarily due to:

- the timing of recognizing revenue versus the incurrence of the related expenses, which was more pronounced in the first quarter of 2017 compared to the same period of 2016,
- higher income tax recovery as a result of the Corporation having a tax loss utilization plan ("TLUP") in place in the first quarter of 2017 as compared to having a similar TLUP in place for the second quarter of 2016, higher investment in regulated assets,
- partially offset by lower operating and maintenance expense savings, net of the regulated Earnings Sharing Mechanism, as compared to operating costs allowed in rates under the PBR formula.

As part of the TLUP, the Corporation received dividend income from FHI relating to a \$2,500 million (2016 - nil) 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.

2017 and 2016 net earnings are both based on an allowed ROE of 8.75 per cent and a deemed equity component of capital structure of 38.5 per cent.

**Gas Sales**

The increase in gas sales volumes for the first quarter of 2017 was primarily due to customer growth, higher average consumption by residential and commercial customers as a result of colder weather, and higher gas volumes for transportation customers due to certain transportation customers switching to natural gas compared to alternative fuel sources.

**Natural Gas Revenue and Cost of Natural Gas**

The increase in natural gas revenue for the first quarter of 2017 was primarily due to higher gas sales volumes and a higher cost of natural gas as a result of higher natural gas prices. 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.

### Other (Expense) Revenue

Other expense and revenue consists of the Earnings Sharing Mechanism, certain flow-through adjustments for variances from the forecast used to set rates, and other miscellaneous operating revenue items. The variance between other expense for the first quarter of 2017 compared to other revenue recognized for the first quarter of 2016 was primarily due to recognizing an increase in flow-through deferral amounts to be refunded to customers in future rates.

### Operation and Maintenance

Operation and maintenance expense was comparable between periods.

### Property and Other Taxes

Property and other taxes were comparable between periods.

### Depreciation and Amortization

Depreciation and amortization was comparable between periods.

### Other Income

Other income primarily consists of dividend income from TLUPs and the equity component of AFUDC.

The increase in other income for the first quarter of 2017 was primarily due to higher dividend income from the Corporation having a TLUP in place in the first quarter of 2017, as compared to implementing a similar TLUP not until the second quarter of 2016, and higher equity component of AFUDC.

### Finance Charges

The increase in finance charges for the first quarter of 2017 was primarily due to the Corporation having a TLUP in place in the first quarter of 2017 generating finance charges, partially offset by a lower average cost of debt which resulted from the repayment of higher interest-bearing Purchase Money Mortgages which matured in September 2016 and were replaced with lower interest-bearing debentures in April 2016 and December 2016.

### Income Taxes

The decrease in income tax expense for the first quarter of 2017 was primarily due to an increase in deductible temporary differences, a decrease in taxable permanent differences, the current year's TLUP tax recovery and lower pre-tax book income.

## CONSOLIDATED FINANCIAL POSITION

The following table outlines the significant changes in the consolidated balance sheets between March 31, 2017 and December 31, 2016:

| <b>Balance Sheet Account</b>              | <b>Increase<br/>(Decrease)<br/>(\$ millions)</b> | <b>Explanation</b>  |
|---|--|---|
| Accounts receivable                       | <b>36</b>  | The increase was primarily due to higher residential customer consumption and higher off-system sales volumes, partially offset by decreased unbilled receivables as a result of warmer weather and lower midstream rates.          |
| Inventories                               | <b>(35)</b>                                      | The decrease was primarily due to the drawdown of natural gas in storage during the winter months, partially offset by an increase in the average price of gas.   |
| Property, plant and equipment             | <b>47</b>  | The increase was primarily due to \$90 million in capital expenditures incurred during the period, partially offset by depreciation expense of \$45 million.  |
| Regulatory assets (current and long-term) | <b>(50)</b>                                      | The decrease was primarily due to a lower RSAM deferral balance, which captures the variances in delivery revenue for residential and commercial customers, as well as a decrease in the regulated asset for deferred income taxes. |

| <b>Balance Sheet Account</b>                   | <b>Increase<br/>(Decrease)<br/>(\$ millions)</b> | <b>Explanation</b>  |
|--|--|---|
| Credit facility                                | <b>(60)</b>                                      | The decrease was primarily a result of net repayment of credit facilities with seasonal cash flows provided by operations.  |
| Accounts payable and other current liabilities | <b>(45)</b>                                      | The decrease was primarily due to a decrease in accruals for natural gas for transportation incentives as well as lower credit balances related to customer payment plan arrangements.  |
| Income taxes payable and receivable            | <b>27</b>  | The change from income taxes receivable to payable was primarily due to current income tax expense incurred in the first quarter of 2017 and a decrease in taxes related to regulatory assets treated on a net of tax basis, partially offset by income tax installments made for 2017. |

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Summary of Consolidated Cash Flows**

| <b>Quarter Ended March 31</b>                        | <b>2017</b>  | <b>2016</b> | <b>Variance</b> |
|--|--------------|-------------|-----------------|
| (\$ millions)  |              |             |                 |
| Cash flows provided by (used for)                    |              |             |                 |
| Operating activities                                 | <b>189</b>   | 158         | 31              |
| Investing activities                                 | <b>(83)</b>  | (84)        | 1               |
| Financing activities                                 | <b>(104)</b> | (75)        | (29)            |
| Net increase (decrease) in cash and cash equivalents | <b>2</b>     | (1)         | 3               |

#### **Operating Activities**

Cash flows provided by operating activities were \$31 million higher compared to the same period in 2016. The increase was primarily due to an increase in net earnings and changes in long-term regulatory assets and liabilities.

#### **Investing Activities**

Cash used for investing activities was \$1 million lower compared to the same period in 2016. The decrease is primarily due to changes in other assets and liabilities and a decrease in restricted cash, offset by increased property, plant and equipment expenditures.

#### **Financing Activities**

Cash used for financing activities was \$29 million higher compared to the same period in 2016 primarily due to higher net repayments of credit facilities in the first quarter of 2017.

During the three months ended March 31, 2017, the Corporation paid a common share dividend of \$42 million (2016 - \$40 million) 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 March 31, 2017<br>(\$ millions)  | Total        | Due<br>Within<br>1 Year | Due in<br>Year 2 | Due in<br>Year 3 | Due in<br>Year 4 | Due in<br>Year 5 | Due<br>After<br>5 Years |
|--|--------------|-------------------------|------------------|------------------|------------------|------------------|-------------------------|
| Interest obligations on long-term debt | 2,423        | 116                     | 116              | 116              | 116              | 116              | 1,843                   |
| Long-term debt <sup>1</sup>            | 2,220        | -                       | -                | -                | -                | -                | 2,220                   |
| Gas purchase obligations               | 1,037        | 309                     | 205              | 152              | 128              | 89               | 154                     |
| Capital lease and finance obligations  | 116          | 12                      | 38               | 20               | 10               | 33               | 3                       |
| Power purchase obligations             | 484          | 4                       | 6                | 7                | 9                | 10               | 448                     |
| Other                                  | 17           | 11                      | 3                | 2                | 1                | -                | -                       |
| <b>Totals</b>                          | <b>6,297</b> | <b>452</b>              | <b>368</b>       | <b>297</b>       | <b>264</b>       | <b>248</b>       | <b>4,668</b>            |

<sup>1</sup> Excludes unamortized debt issuance costs of \$15 million.

The gas purchase obligations are based on gas commodity indices that vary with market prices. The amounts disclosed reflect index prices that were in effect at March 31, 2017.

## 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 2016 annual MD&A.

## Projected Capital Expenditures

The 2017 projected capital expenditures in excess of approximately \$460 million remain substantially unchanged from the description outlined in the Corporation's 2016 annual MD&A.

Capital expenditures include forecast 2017 costs associated with the CTS project of approximately \$130 million, LMIPSU project of approximately \$20 million and the Tilbury Expansion Project Phase 1A of approximately \$50 million.

### *CTS Project*

The CTS project, approved in the 2014 OIC, is estimated to cost approximately \$170 million and involves the installation of 11 kilometers of pipeline in the cities of Surrey and Coquitlam. The project is intended to increase security of supply by reducing the number of single points of failure. Construction is expected to be completed at the end of 2017.

### *LMIPSU Project*

In December 2014, the Corporation filed a CPCN application to replace certain sections of intermediate pressure pipeline segments within the Greater Vancouver area. In October 2015, the BCUC approved the CPCN substantially as filed. The anticipated cost of the project is approximately \$250 million with an expected in-service date of 2018.

### *Tilbury Phase 1A Expansion Project*

In October 2014, FEI began construction on the expansion of its Tilbury LNG Facility in Delta, BC as approved in the 2013 OIC and the subsequent amendments made to the OIC by the BC Provincial government in December 2014 and March 2017. The cost of the project scope currently under construction for the Tilbury Phase 1A Expansion Project is approximately \$400 million, prior to including AFUDC and development costs, and will include a new LNG storage tank and liquefier, both expected to be in service in mid-2017. During the first quarter of 2017 progress on the project included the commissioning of the LNG storage tank and the continued installation of the liquefaction process area piping insulation, electrical and instrumentation cable and terminations.

### Additional Investment Opportunities

In addition to the Corporation's base consolidated capital expenditure forecast, management is pursuing additional investment opportunities, as discussed below, which are not included in the Corporation's base capital expenditures forecast.

The Corporation continues to pursue additional LNG infrastructure investment opportunities in British Columbia, including a pipeline expansion to the proposed Eagle Mountain Woodfibre LNG ("Woodfibre LNG") site near Squamish, BC, and a further expansion of Tilbury. The 2014 OIC and 2017 OIC grant FEI exemptions from the requirement to seek BCUC Certificate of Public Convenience and Necessity approvals for the pipeline expansion to the Woodfibre LNG site and certain further expansions at the Tilbury site, subject to certain conditions.

FEI's potential pipeline expansion is conditional on Woodfibre LNG proceeding with its LNG export facility. Woodfibre LNG has obtained an export license from the National Energy Board and received environmental assessment approvals from the Squamish First Nation, the British Columbia Environmental Assessment Office and the Canadian Environmental Assessment Agency. In November 2016, Woodfibre LNG's parent company announced they had authorized the funds necessary for the Woodfibre LNG Project to proceed. This project may move forward pending additional approvals and final investment decision by Woodfibre LNG but is not expected to be in service earlier than 2020.

FEI has received the necessary environmental assessment approvals for the pipeline expansion from the Squamish First Nation and provincial environmental assessment office. The capital cost for FEI's pipeline expansion was initially estimated at approximately \$600 million, however this estimate will be updated to take into account final scoping, detailed construction estimates and scheduling.

### 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

As at March 31, 2017, the Corporation had a \$700 million syndicated credit facility available, of which \$514 million (December 31, 2016 - \$454 million) was unused. The \$700 million credit facility matures in August 2021.

The following summary outlines the Corporation's credit facility:

| (\$ millions)                 | <b>March 31, 2017</b> | December 31, 2016 |
|-------------------------------|-----------------------|-------------------|
| Credit facility               | <b>700</b>            | 700               |
| Draws on credit facility      | <b>(134)</b>          | (194)             |
| Letters of credit outstanding | <b>(52)</b>           | (52)              |
| Credit facility available     | <b>514</b>            | 454               |

### OFF-BALANCE SHEET ARRANGEMENTS

As at March 31, 2017 the Corporation had no material off-balance sheet arrangements, with the exception of letters of credit outstanding of \$52 million (December 31, 2016 - \$52 million) primarily to support the Corporation's unfunded supplemental pension benefit plans.



## 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 FBC and 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 months ended March 31 were as follows:

| (\$ millions)  | 2017     | 2016     |
|--|----------|----------|
| Operation and maintenance expense charged to FBC (a) | 1        | 1        |
| Other income received from FHI (b)                   | 8        | -        |
|  | <b>9</b> | <b>1</b> |

- (a) The Corporation charged FBC for natural gas sales, office rent, management services and other labour.
- (b) As part of the TLUP, the Corporation received dividend income from FHI relating to a \$2,500 million (2016 - nil) 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 months ended March 31 were as follows:

| (\$ millions)  | 2017      | 2016     |
|--|-----------|----------|
| Operation and maintenance expense charged by FBC (a) | 2         | 1        |
| Operation and maintenance expense charged by FHI (b) | 3         | 3        |
| Finance charges paid to FHI (c)                      | 8         | -        |
| Gas storage and purchases charged by ACGS (d)        | 8         | -        |
|  | <b>21</b> | <b>4</b> |

- (a) FBC charged the Corporation for electricity purchases, management services and other labour.
- (b) FHI charged the Corporation for Board of Director costs, management services, labour and materials.
- (c) As part of a TLUP, the Corporation paid FHI interest on \$2,500 million (2016 - nil) of intercompany subordinated debt.
- (d) ACGS charged the Corporation for the lease of natural gas storage capacity and natural gas purchases.

### 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) | March 31, 2017  |               | December 31, 2016 |               |
|---------------|-----------------|---------------|-------------------|---------------|
|               | Amount Due From | Amount Due To | Amount Due From   | Amount Due To |
| FBC           | -               | 1             | -                 | 1             |
| ACGS          | -               | 3             | -                 | 3             |
|               | -               | <b>4</b>      | -                 | <b>4</b>      |

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## **BUSINESS RISK MANAGEMENT**

The business risks of the Corporation remain substantially unchanged from those outlined in the Corporation's 2016 annual MD&A.

### **NEW ACCOUNTING POLICIES**

#### **Simplifying the Test for Goodwill Impairment**

Effective January 1, 2017, the Corporation adopted Accounting Standards Update ("ASU") No. 2017-04, *Simplifying the Test for Goodwill Impairment*. The amendments in this update simplify the subsequent measurement of goodwill by eliminating step two in the current two-step goodwill impairment test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. The above-noted ASU was applied prospectively and did not impact the Corporation's interim unaudited consolidated financial statements for the three months ended March 31, 2017.

### **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 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. In 2016, a number of additional ASUs were issued that clarify implementation guidance in ASC Topic 606. This standard, and all related ASUs, is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted for annual and interim periods beginning after December 15, 2016. The Corporation has elected not to early adopt.

The new guidance permits two methods of adoption: (i) the full retrospective method, under which comparative periods would be restated, and the cumulative impact of applying the standard would be recognized as at January 1, 2017, the earliest period presented; and (ii) the modified retrospective method, under which comparative periods would not be restated and the cumulative impact of applying the standard would be recognized at the date of initial adoption, January 1, 2018. The Corporation expects to use the modified retrospective approach, however, it continues to monitor industry developments. Any significant industry developments could change the Corporation's expected method of adoption.

The majority of the Corporation's revenue is generated from natural gas sales to customers based on published tariff rates, as approved by the BCUC, and is considered to be in 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 recognition of revenue generated from natural gas sales to customers, or on its remaining material revenue streams; however, the Corporation does expect it will impact its required disclosures. Certain industry specific interpretative issues remain outstanding and the conclusions reached, if different than current practice, could have a material impact on the Corporation's consolidated financial statements and related disclosures. FEI continues to closely monitor industry developments related to the new standard.

#### **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

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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 ASC 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 inform credit loss estimates. This update is effective for annual and interim periods beginning after December 15, 2019 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.

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

ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, was issued in March 2017 and the amendments in this update require that an employer disaggregate the current service costs component of net benefit cost and present it in the same statement of earnings line item as other employee compensation costs arising from services rendered. The other components of net benefit cost are required to be presented separately from the service cost component and outside of operating income. Additionally, the amendments allow only the service cost component to be eligible for capitalization when applicable. This update is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted, however, early adoption must be within the first interim period of a reporting year. The amendments in this update should be applied retrospectively for the presentation of the net periodic benefit costs and prospectively, on and after the effective date, for the capitalization in assets of only the service cost component of net periodic benefit costs. 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 supply contracts and commodity swaps as of March 31, 2017 and December 31, 2016, 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)                             | March 31, 2017 |                      | December 31, 2016 |                      |
|---|----------------|----------------------|-------------------|----------------------|
|   | Carrying Value | Estimated Fair Value | Carrying Value    | Estimated Fair Value |
| <b>Assets</b>                             |                |                      |                   |                      |
| <i>Current</i>                            |                |                      |                   |                      |
| Natural gas commodity swaps <sup>1</sup>  | 3              | 3                    | -                 | -                    |
| <b>Liabilities</b>                        |                |                      |                   |                      |
| <i>Current</i>                            |                |                      |                   |                      |
| Natural gas supply contracts <sup>1</sup> | 8              | 8                    | 10                | 10                   |
| <i>Long-term</i>                          |                |                      |                   |                      |
| Long-term debt <sup>2</sup>               | 2,220          | 2,711                | 2,220             | 2,687                |
| Natural gas supply contracts <sup>1</sup> | 3              | 3                    | 4                 | 4                    |

<sup>1</sup> Natural gas supply contracts and commodity swaps 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.

<sup>2</sup> Carrying value excludes unamortized debt issuance costs of \$15 million (2016 - \$15 million).

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 March 31, 2017, the Corporation's outstanding derivative balances, which consisted of physically-settled natural gas supply contracts and financially-settled natural gas commodity swaps, were as follows:

| (\$millions)                                      | Gross Derivatives Balance <sup>1</sup> | Gross Amounts Not Offset in the Balance Sheet <sup>2</sup> | Margin                                   | Total Net Derivatives Balance |
|---|--|--|--|-------------------------------|
|   |  |  | Deposits Not Offset in the Balance Sheet |                               |
| Natural gas supply contracts and commodity swaps: |  |  |  |                               |
| Accounts receivable                               | 3                                      | -  | -  | 3                             |
| Accounts payable and other current liabilities    | 8                                      | -  | -  | 8                             |
| Other liabilities                                 | 3                                      | -  | -  | 3                             |

<sup>1</sup> See the March 31, 2017 unaudited interim consolidated financial statements for a discussion of the valuation techniques used to calculate the fair value of these instruments.

<sup>2</sup> Positions, by counterparty, are netted where the intent and legal right to offset exists.

At December 31, 2016, the Corporation's outstanding derivative balances, which consisted of physically-settled natural gas supply contracts, were as follows:

| (\$millions)                                   | Gross Derivatives Balance <sup>1</sup> | Gross Amounts Not Offset in the Balance Sheet <sup>2</sup> | Margin                                   | Total Net Derivatives Balance |
|--|--|--|--|-------------------------------|
|  |  |  | Deposits Not Offset in the Balance Sheet |                               |
| Natural gas supply contracts:                  |  |  |  |                               |
| Accounts payable and other current liabilities | 10                                     | -  | -  | 10                            |
| Other liabilities                              | 4                                      | -  | -  | 4                             |

<sup>1</sup> See the December 31, 2016 consolidated financial statements for a discussion of the valuation techniques used to calculate the fair value of these instruments.

<sup>2</sup> Positions, by counterparty, are netted where the intent and legal right to offset exists.

The following table shows the cumulative unrealized losses at March 31, 2017 and December 31, 2016, with respect to all natural gas supply contracts and commodity swaps:

| (\$ millions)  | <b>March 31, 2017</b> | December 31, 2016 |
|--|-----------------------|-------------------|
| Unrealized loss on natural gas supply contracts and commodity swaps <sup>1,2</sup> | <b>8</b>              | 14                |

<sup>1</sup> 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.

<sup>2</sup> 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 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 involved 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. The Corporation's critical accounting estimates are discussed as follows.

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 2017 from those disclosed in the Corporation's 2016 annual MD&A.

## SUMMARY OF QUARTERLY RESULTS

The following table sets forth unaudited quarterly information for each of the eight quarters ended June 30, 2015 through March 31, 2017. 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      | <b>Revenue</b> | <b>Net Earnings (Loss)</b> |
|--------------------|----------------|----------------------------|
| (\$ millions)      |                |                            |
| March 31, 2017     | 449            | 99                         |
| December 31, 2016  | 394            | 77                         |
| September 30, 2016 | 151            | (11)                       |
| June 30, 2016      | 200            | 13                         |
| March 31, 2016     | 406            | 91                         |
| December 31, 2015  | 411            | 76                         |
| September 30, 2015 | 168            | (19)                       |
| June 30, 2015      | 227            | 6                          |

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.

**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 investment in regulated assets, partially offset by lower operation and maintenance expense savings, net of the regulated Earnings Sharing Mechanism prescribed by the PBR Decision.

**September 2016/2015** - Net loss was lower primarily due to higher income tax recovery resulting from having a TLUP in place for the full duration of the third quarter of 2016 as compared to the third quarter of 2015 when the TLUP was implemented at the end of the period, higher investment in regulated assets, and higher operation and maintenance expense savings, net of the regulated Earnings Sharing Mechanism prescribed by the PBR Decision, partially offset by the timing of revenue versus the incurrence of the related expenses which was more pronounced in the third quarter of 2016 versus the same period in 2015.

**December 2016/2015** - Net earnings were higher primarily due to higher investment in regulated assets, higher operating and maintenance expense savings, net of the regulated Earnings Sharing Mechanism, and the timing of recognizing revenue versus the incurrence of the related expenses, which was more pronounced in the fourth quarter of 2016 versus the same period of 2015, partially offset by lower income tax recovery as a result of the Corporation having a TLUP in place for a shorter duration in the fourth quarter of 2016 as compared to the same period of 2015.

**March 2017/2016** - Net earnings were higher due to the timing of recognizing revenue versus the incurrence of the related expenses, which was more pronounced in the first quarter of 2017 compared to the same period of 2016, higher income tax recovery as a result of the Corporation having a TLUP in place in the first quarter of 2017 and higher investment in regulated assets, partially offset by lower operating and maintenance expense savings, net of the regulated Earnings Sharing Mechanism, as compared to the operating costs allowed in the rates under the PBR formula.

## **BUSINESS OUTLOOK**

### **Collective Agreements**

There are two collective agreements between the Corporation and Local 378 of the Canadian Office and Professional Employees Union ("COPE"). The first collective agreement representing customer service employees was ratified during the quarter and expires on March 31, 2022. The second collective agreement representing employees in specified occupations in the areas of administration and operations support was renewed for a three year term which expires on March 31, 2018.

## **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](http://www.sedar.com).

### **For further information, please contact:**

Ian Lorimer  
Vice President, Finance and Chief Financial Officer  
Tel: (250) 469-8013  
Email: [ian.lorimer@fortisbc.com](mailto:ian.lorimer@fortisbc.com)

FortisBC Energy Inc.  
10<sup>th</sup> Floor, 1111 West Georgia Street  
Vancouver, British Columbia V6E 4M3

**Website:** [www.fortisbc.com](http://www.fortisbc.com)