

**FORTISBC Inc.****INTERIM MANAGEMENT DISCUSSION & ANALYSIS****For the Three Months and Six Months Ended June 30, 2009**

Dated August 5, 2009

*The following material which is unaudited, should be read in conjunction with FortisBC Inc.'s ("the Company" or "FortisBC") unaudited consolidated financial statements and notes thereto for the three months and six months ended June 30, 2009 and the Management Discussion & Analysis and the audited consolidated financial statements and notes thereto for the year ended December 31, 2008.*

*Certain statements contained in this Management Discussion & Analysis contain forward-looking information within the meaning of applicable securities laws in Canada ("forward-looking information"). The words "anticipates", "assumes", "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 Management Discussion & Analysis includes, but is not limited to, statements regarding the Company's expectation of earnings growth in future years given the assumption of a consistently applied regulated capital structure and return on equity, recovery of its cost-of-service components in rates, and growth in rate base assets as a result of its annual capital expenditures.*

*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; continued electricity demand; absence of adverse weather conditions, natural disasters and equipment breakdown; no significant decline in interest rates; the ability to arrange sufficient and cost effective financing; the ability to maintain and renew collective bargaining agreements on acceptable terms; absence of environmental damage; the First Nations' settlement process does not adversely affect the Company; the adequacy of the Company's existing insurance arrangements; that counterparties do not default on power supply contracts; no weather related demand loss; ability to maintain and obtain applicable permits; climate change does not reduce water flows; and, no material adverse increase in employee future benefit costs.*

*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; electricity demand risk; weather and natural disasters, equipment breakdown, operating and maintenance risk; interest rates risk; capital resources risk; labour relations risk; environmental matters risk; First Nations' land matters risk; underinsured and uninsured losses; power supply contracts risk; weather related demand loss; permits risk; climate change risk; employee future benefits risk; and, other risks described in the Company'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 the Company's Management Discussion & Analysis for the year ended December 31, 2008.*

*All forward-looking information in this Management Discussion & Analysis is qualified in its entirety by this cautionary statement and, except as required by law, the Company 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**

FortisBC is an integrated, regulated utility operating in the southern interior of British Columbia, serving approximately 158,000 customers directly and indirectly, focusing on the safe delivery of reliable and cost effective electricity.

The Company's regulated business includes four hydroelectric generating plants with an aggregate capacity of 223 megawatts ("MW"), approximately 7,000 kilometers of transmission and distribution power lines, and a peak demand of 746 MW. Included in FortisBC's non-regulated assets is a 16 MW run-of-river hydroelectric power plant near Lillooet, British Columbia. FortisBC generates approximately 45% of its electricity requirements with the balance met through power purchase agreements.

The Company is regulated by the British Columbia Utilities Commission ("BCUC"). The BCUC administers acts and regulations, pursuant to the *Utilities Commission Act* (British Columbia) covering such matters as tariffs, rates, construction, operations, financing and accounting.

FortisBC operates primarily under a cost of service regulation as prescribed by the BCUC. The Company applies to the BCUC for annual revenue requirements based on estimated costs of service, including, but not limited to, operating expenses, power purchases, depreciation and amortization, income taxes, interest on debt and a return on equity ("ROE"). In addition, the regulatory framework includes some performance-based rate setting ("PBR") attributes. PBR is subject to change as the Company's regulatory framework evolves.

The Company is an indirect, wholly-owned subsidiary of Fortis Inc. ("Fortis"), a diversified, international utility holding company having investments in distribution, transmission and generation utilities, as well as commercial real estate and hotel operations.

## **REVENUE REQUIREMENTS**

### **PBR**

On April 19, 2006, FortisBC and a group of intervenors concluded negotiations on the Company's 2006 Revenue Requirement application. In addition to an agreement on the increase to customer rates required for 2006, the settlement agreement set 2006 as the base year for a PBR term from 2006 to 2008, with an option to extend the term to 2009. The settlement agreement was approved by the BCUC on May 23, 2006.

The significant terms of the PBR agreement are as follows:

- annual gross operating and maintenance expenses before capitalized overhead will be set by formula incorporating customer growth and inflation (CPI for British Columbia) minus a productivity improvement factor ("PIF") of 2% in 2007, 2% in 2008 and, if applicable, 3% in 2009;
- annual capitalized overhead will be set at 20% of the BCUC approved gross operating and maintenance expense;
- other components of revenue requirements will be forecast annually; and

- a 2% collar has been set around the allowed ROE whereby variances (adjusted for certain revenue and cost variances which flow through to customers) as a result of actual financial performance, positive or negative, will be shared equally between customers and the shareholder. If the variance exceeds the 2% collar, the excess will be placed in a deferral account for review and disposition during the next rate setting process. The Company's portion of the incentive is subject to the Company meeting certain performance standards and BCUC approval.

As part of the approval of 2009 Revenue Requirements on December 11, 2008, the PBR agreement was extended for 2009 to 2011. The terms of the settlement are consistent with the May 23, 2006 PBR agreement except that annual gross operating and maintenance expenses before capitalized overhead will be set by formula incorporating customer growth and inflation (CPI for British Columbia) minus a PIF of 3% in 2009, 1.5% in 2010 and 1.5% in 2011. Should inflation be in excess of 3%, the excess is added to the PIF which effectively caps the CPI at 3%.

### 2009 Revenue Requirements

FortisBC filed its Preliminary 2009 Revenue Requirements Application on September 26, 2008 which was updated by the Company on November 3, 2008. Following a negotiated settlement process with intervenors, the BCUC approved the settlement agreement on December 11, 2008 resulting in a rate increase of 4.6% effective January 1, 2009.

The 4.6% rate increase is primarily the result of the Company's ongoing investment in infrastructure and increasing power purchases driven by customer growth and increased demand for electricity. Rates for 2009 reflect an allowed ROE of 8.87%.

Further information on the terms of the PBR agreement and the 2009 Revenue Requirements can be found on the BCUC website ([www.bcuc.com](http://www.bcuc.com)).

## FINANCIAL RESULTS

### Consolidated Financial Results (Unaudited)

Period Ended June 30	Quarter		Year to Date	
	2009	2008 <sup>2</sup>	2009	2008 <sup>2</sup>
<b>Electricity Sales (GWh)</b>	<b>687</b>	685	<b>1,592</b>	1,563
(\$000s)				
Electricity Revenue	<b>51,609</b>	48,547	<b>120,101</b>	111,555
Other Revenue	<b>1,302</b>	1,974	<b>2,776</b>	3,329
Power Purchases	<b>12,322</b>	12,264	<b>34,668</b>	33,243
Operating Expenses <sup>1</sup>	<b>14,978</b>	14,639	<b>30,504</b>	29,402
Depreciation and Amortization	<b>9,142</b>	8,505	<b>18,782</b>	17,044
Interest Expense	<b>8,317</b>	7,453	<b>15,648</b>	14,677
Income Taxes	<b>754</b>	1,314	<b>2,717</b>	2,564
<b>Net Earnings</b>	<b>7,398</b>	6,346	<b>20,558</b>	17,954

<sup>1</sup> Includes operating and maintenance, property taxes, water fees and wheeling.

<sup>2</sup> Certain comparative figures have been reclassified to comply with the current period's classification.

**Net Earnings**

Net earnings for the second quarter of 2009 were \$7.4 million, an increase of \$1.1 million over the same period last year. The higher earnings were attributable to an increase in electricity revenue and a decrease in income taxes, partially offset by a decrease in other revenue and increases in power purchases, operating expenses, depreciation and amortization, and interest expense.

Year to date, net earnings of \$20.6 million for 2009 were \$2.6 million higher than the same period last year. The increase in net earnings was attributable to increased electricity revenue, partially offset by a decrease in other revenue and increases in power purchases, operating expenses, depreciation and amortization, interest expense and income taxes.

**Electricity Sales**

Electricity sales in the second quarter of 2009 were 687 gigawatt hours (“GWh”), an increase of 2 GWh compared to 685 GWh in the second quarter of 2008. On a year-to-date basis, electricity sales were 1,592 GWh, an increase of 29 GWh compared to 1,563 GWh for the same period last year. The increase in electricity sales for both comparable periods was primarily due to growth in residential and general service customers, partially offset by a decrease in industrial customers.

**Electricity Revenue**

Electricity revenue for the second quarter of 2009 was \$51.6 million, an increase of \$3.1 million over the \$48.5 million in the second quarter of 2008. On a year-to-date basis, electricity revenue was \$120.1 million, an increase of \$8.5 million over the \$111.6 million in the first six months of 2008. The increase in revenue for both comparable periods was primarily due to:

- a 4.6% rate increase effective January 1, 2009 which was approved by the BCUC on December 11, 2008,
- a 0.8% rate increase effective May 1, 2008 which was approved by the BCUC on April 18, 2008 to recover the increased power purchases charged by BC Hydro to the Company, and
- an increase in electricity sales.

**Other Revenue**

Other revenue includes incentive adjustments associated with the PBR framework under which FortisBC operates. Under the terms of the PBR agreement, variances in certain revenues and costs as compared to the forecast will be recovered from (refunded to) customers. In addition, the ROE resulting from actual financial performance is compared to the Company’s allowed ROE and variances, positive or negative (adjusting for certain revenue and cost variances which flow through to customers), up to a 2% collar, will be shared equally between customers and FortisBC. The remainder of other revenue consists of management fees for third party contract work, pole attachment revenue, interest income, surplus electricity sales and other miscellaneous rental revenues.

Other revenues for the second quarter of 2009 were \$1.3 million compared to \$2.0 million for the same period of 2008. The decrease of \$0.7 million was primarily due to an increase in the PBR incentive adjustment owing to customers and a decrease in surplus electricity sales, partially offset by an increase in pole attachment revenue compared to the same quarter in 2008.

Year to date, other revenues were \$2.8 million compared to \$3.3 million for the same period last year. The decrease of \$0.5 million was attributable to an increase in the PBR incentive adjustment owing to customers and decreases in surplus electricity sales and management fees, partially offset by an increase in pole attachment revenue compared to the same period in 2008.

**Power Purchases**

Power purchases represent the cost of purchasing energy and capacity from third parties. Hydroelectric generating facilities owned by FortisBC generate approximately 45% of the energy and 30% of the capacity necessary to meet existing customer demand. The majority of the additional energy and capacity required to meet existing customer demand is purchased under firm, long-term power purchase contracts. Any remaining energy and capacity required to meet customer needs is purchased on the open market and is subject to fluctuations in market rates.

Power purchases of \$12.3 million for the second quarter of 2009 were comparable to the same period in 2008. The comparable results were primarily attributable to:

- increased electricity sales,
- a higher proportion of purchased power versus generated power, and
- the receipt of \$0.6 million of insurance proceeds in the second quarter of 2008 in excess of amounts accrued relating to power purchase costs incurred in 2006 due to a turbine failure at the Lower Bonnington generation plant,
- offset by lower average power purchase prices.

Year to date, power purchases were \$34.7 million compared to \$33.2 million for the first six months of 2008. The \$1.5 million increase in power purchases was primarily attributable to:

- increased electricity sales,
- a higher proportion of purchased power versus generated power, and
- the receipt of insurance proceeds in 2008 described above,
- partially offset by lower average power purchase prices.

**Operating Expenses**

Operating expenses consist of operating and maintenance expenses, property taxes, water fees and wheeling.

Operating expenses were \$15.0 million in the second quarter of 2009, an increase of \$0.4 million compared to \$14.6 million for the same period of 2008. The \$0.4 million increase in operating expenses was primarily a result of:

- a \$0.1 million increase in property taxes due to a larger assessment base,
- a \$0.2 million increase in water fees, and
- a \$0.2 million increase in wheeling fees,
- partially offset by a \$0.1 million increase in capitalized overhead.

Year to date, operating expenses of \$30.5 million have increased \$1.1 million over \$29.4 million recorded in the same period last year. The \$1.1 million increase in operating expenses was primarily a result of:

- a \$0.5 million increase in operating and maintenance costs due to timing of certain 2009 maintenance projects and their related expenditures, as well as labour escalation and general inflationary increases,
- a \$0.2 million increase in property taxes due to a larger assessment base,
- a \$0.3 million increase in water fees, and
- a \$0.2 million increase in wheeling fees,

- partially offset by a \$0.1 million increase in capitalized overhead.

**Depreciation and Amortization**

Depreciation and amortization expense for the second quarter of 2009 was \$9.1 million, an increase of \$0.6 million compared to \$8.5 million for the same period in 2008. Year to date, depreciation and amortization expense was \$18.8 million, an increase of \$1.8 million compared to \$17.0 million for the same period last year. These increases were due to increases in the depreciable asset base resulting from the Company's capital expenditure program.

**Interest Expense**

Interest expense, net of allowance for funds used during construction (capitalized financing costs) in the second quarter of 2009 was \$8.3 million, an increase of \$0.9 million compared to \$7.4 million for the same period in 2008. Year to date, interest expense net of capitalized interest was \$15.6 million, an increase of \$0.9 million over the \$14.7 million recorded in the same period last year. The increase of \$0.9 million for both comparable periods was primarily due to an increase in gross interest expense resulting from increased borrowings to finance the capital expenditure program and increased bank operating credit facility renewal fees, partially offset by lower borrowing interest rates on bank operating credit facilities and increased capitalized financing costs relating to more assets under construction compared to the same period in 2008.

**Income Taxes**

Prior to January 1, 2009, the Company used the taxes payable method of accounting for income taxes on regulated earnings as ordered by the BCUC. Effective January 1, 2009, Canadian Generally Accepted Accounting Principles ("GAAP") for rate-regulated operations has been amended to require the recognition of future income tax liabilities and assets as well as a regulatory asset or liability for the amount of future income taxes expected to be recovered from or returned to customers in future rates. In addition, certain regulatory assets and deferred charges are recorded net of their income tax impact, with the offset charged to income tax expense.

The Company follows the asset and liability method of accounting for income taxes on its non-regulated earnings which results in future income taxes expensed or recovered in the period that the temporary differences are incurred or reversed.

For the three months ended June 30, 2009, income tax expense was \$0.8 million, a \$0.5 million decrease compared to \$1.3 million for the same period in the prior year. The decrease was primarily due to an increase in income tax timing differences and a reduction in the Federal and Provincial income tax rates, partially offset by an increase in earnings before income taxes.

Year to date, income tax expense was \$2.7 million, an increase of \$0.1 million compared to \$2.6 million for the same period last year. The increase was primarily due to an increase in earnings before income taxes partially offset by an increase in timing differences and a reduction in the Federal and Provincial income tax rates.

Included in the income tax expense for the three and six months ended June 30, 2009 are future income tax expenses of \$2.6 million and \$1.1 million respectively. Both future income tax expenses are offset by the expected amounts to be recovered from customers in the future, resulting in no earnings impact for the three and six months ended June 30, 2009.

## FINANCIAL POSITION

The following table outlines the significant changes in the consolidated balance sheets as at June 30, 2009 as compared to December 31, 2008.

### Significant Changes in Consolidated Balance Sheets (Unaudited)

As at June 30, 2009 compared to December 31, 2008

<b>Balance Sheet Item</b>	<b>Increase (Decrease)</b>
(\$ millions)	
Cash	39.8
Accounts receivable	(5.6)
Prepaid expenses	5.5
Regulatory assets	76.0
Property, plant and equipment	41.4
Accounts payable and accrued liabilities	(11.2)
Current and long-term debt	65.6
Regulatory liabilities	14.7
Future income taxes <sup>1</sup>	74.9
Retained earnings	13.6

<sup>1</sup> Net of future income tax assets.

### Explanation of Significant Changes

#### Cash

The increase of \$39.8 million in cash from December 31, 2008 was due to the June 2, 2009 issuance of \$105.0 million of senior unsecured Medium Term Note Debentures (“MTN Debentures”). The net proceeds of \$104.5 million were used to repay existing indebtedness and finance the capital expenditure program and working capital requirements. The remaining cash proceeds are expected to be used to repay in part the maturing Series J - \$50.0 million unsecured debenture due July 31, 2009.

#### Accounts receivable

The decrease in accounts receivable of \$5.6 million from December 31, 2008 was primarily due to the seasonal reduction in sales and the corresponding reduction to receivables, partially offset by the increase in receivables relating to pole attachment revenue.

#### Prepaid expenses

The increase in prepaid expenses of \$5.5 million from December 31, 2008 was due to the timing of the payment for property taxes.

#### Regulatory assets

The increase of \$76.0 million in regulatory assets from December 31, 2008 was primarily due to the amendments to GAAP for rate-regulated operations effective on January 1, 2009 which required the recognition at June 30, 2009 of \$74.9 million in future income taxes (net of future income tax assets), offset by a regulatory asset of the same amount.

**Property, plant and equipment**

The increase of \$41.4 million in property, plant and equipment from December 31, 2008 was comprised of additions to property, plant and equipment of \$42.5 million less depreciation expense of \$13.0 million (total depreciation expense of \$15.5 million includes a provision for future removal and site restoration of \$2.5 million) and depreciation expense of \$0.4 million relating to the Brilliant Terminal Station (“BTS”) asset under a capital lease, the offset of which has been recognized in regulatory assets. Due to amendments to GAAP for rate-regulated operations effective January 1, 2009, the Company reclassified future removal and site restoration costs of \$12.3 million from accumulated depreciation to regulatory liabilities at January 1, 2009.

**Accounts Payable and accrued liabilities**

The decrease in accounts payable and accrued liabilities of \$11.2 million from December 31, 2008 was primarily due to lower outstanding accounts payable relating to power purchases and capital expenditures.

**Current and long-term debt**

The \$65.6 million increase in debt from December 31, 2008 was due to the June 2, 2009 issuance of \$105.0 million of senior unsecured MTN Debentures. The net proceeds of \$104.5 million were used to repay existing indebtedness and finance the capital expenditure program and working capital requirements. Approximately \$40.0 million of the proceeds remain as cash as at June 30, 2009 and is expected to be used to repay in part the maturing Series J - \$50.0 million unsecured debenture due July 31, 2009.

**Regulatory liabilities**

The increase of \$14.7 million in regulatory liabilities from December 31, 2008 was primarily due to the amendments to GAAP for rate-regulated operations effective January 1, 2009 which required the reclassification of \$12.3 million in future removal and site restoration costs from accumulated depreciation to regulatory liabilities at January 1, 2009.

**Future income taxes**

The increase of \$74.9 million in future income taxes (net of future income tax assets) from December 31, 2008 was primarily due to the amendments to GAAP for rate-regulated operations effective January 1, 2009 which required the recognition at June 30, 2009 of \$74.9 million in future income taxes (net of future income tax assets), offset by a regulatory asset of the same amount.

**Retained earnings**

The increase of \$13.6 million in retained earnings from December 31, 2008 was due to net earnings in the period of \$20.6 million less dividends paid of \$7.0 million.

## CAPITAL RESOURCES & LIQUIDITY

### Summary of Consolidated Cash Flows (Unaudited)

Period Ended June 30	Quarter		Year to Date	
	2009	2008	2009	2008
(\$000s)				
<b>Cash, Beginning of Period</b>	<b>91</b>	166	<b>40</b>	-
<b>Cash Provided From (Used in)</b>				
Operating activities	<b>5,487</b>	17,596	<b>32,828</b>	48,197
Investing activities	<b>(26,156)</b>	(22,633)	<b>(51,207)</b>	(50,268)
Financing activities	<b>60,449</b>	5,322	<b>58,210</b>	2,522
<b>Cash, End of Period</b>	<b>39,871</b>	451	<b>39,871</b>	451

### Sources of Capital Resources and Liquidity

FortisBC's primary sources of liquidity and capital resources are the following:

- funds generated from operations;
- issuances of long-term debt;
- bank financing and operating lines of credit; and
- equity contributions from its parent.

### Operating Activities

Cash provided from operating activities was \$5.5 million in the second quarter of 2009, a decrease of \$12.1 million compared to \$17.6 million provided by operating activities in the second quarter of 2008. Year to date, cash provided from operating activities was \$32.8 million, a decrease of \$15.4 million compared to \$48.2 million provided by operating activities for the same period last year. The decrease in both periods was primarily due to increases in cash used for non-cash operating working capital partially offset by increases in net earnings and depreciation.

### Investing Activities

Cash used for investing activities in the second quarter of 2009 was \$26.2 million, a \$3.6 million increase compared to \$22.6 million invested in the second quarter of 2008. Year to date, cash used in investing activities was \$51.2 million, \$0.9 million higher than the \$50.3 million invested during the same period last year. The increased cash used in investing activities for both periods was primarily due to an increase in property, plant and equipment expenditures compared to the same periods in 2008.

### Financing Activities

Cash from financing activities was \$60.4 million in the second quarter of 2009, an increase of \$55.1 million, compared to \$5.3 million in cash from financing activities in the second quarter of 2008. Year to date, cash provided by financing activities was \$58.2 million, an increase of \$55.7 million compared to \$2.5 million provided by financing activities during the same period last year.

The increase in cash provided by financing activities for the three and six months ended June 30, 2009 was primarily due to the June 2, 2009 issuance of \$105.0 million of senior unsecured MTN Debentures, offset by the repayment of bank debt.

The increased cash provided from financing activities for both the three and six months ended June 30, 2009 was primarily used to fund the increase in investing activities, fund the decrease in cash provided by operating activities and provide for the \$39.4 million increase in cash as at June 30, 2009.

During the three and six months ended June 30, 2009, the Company paid common share dividends of \$3.5 million (three months ended June 30, 2008 - \$3.2 million) and \$7.0 million (six months ended June 30, 2008 - \$6.4 million) respectively to its parent, Fortis Pacific Holdings Inc. ("Fortis Pacific").

### Capital Structure

FortisBC's business requires the Company to have ongoing access to capital to allow it to build and maintain the electrical systems in its service territory. In accordance with the BCUC's directives and to support investment grade credit ratings, the Company targets a long-term capital structure of 40% equity and 60% debt.

#### Consolidated Capital Structure (Unaudited)

	June 30, 2009		December 31, 2008	
	(\$ millions)	Percent	(\$ millions)	Percent
Total Debt	597.9 <sup>1</sup>	61.2	531.5 <sup>2</sup>	59.3
Shareholder's Equity	378.7	38.8	365.2	40.7
<b>Total</b>	<b>976.6</b>	<b>100.0</b>	<b>896.7</b>	<b>100.0</b>

<sup>1</sup> Excludes debt issue costs of \$5.0 million.

<sup>2</sup> Excludes debt issue costs of \$4.2 million.

The following table discloses the Company's debenture ratings as of June 30, 2009.

Rating Agency	Rating	Debt Rated
<b>DBRS Limited</b>	BBB (high), Stable Trend	Secured and Unsecured Debentures
<b>Moody's Investors Service</b>	Baa2, Stable Outlook	Unsecured Debentures

### Servicing and Repayment of Debt

FortisBC has authorized bank credit facilities of \$160.0 million, comprised of a \$150.0 million operating credit facility and a \$10.0 million demand overdraft facility. As of June 30, 2009, \$nil was drawn against these facilities (December 31, 2008 - \$38.2 million) and \$3.0 million (December 31, 2008 - \$3.0 million) was used to support outstanding letters of credit.

On April 30, 2009, the Company amended its operating credit facility provided by a syndicate of Canadian Chartered Banks. The amended operating credit facility is comprised of a \$50.0 million three-year revolving facility maturing on May 9, 2012 ("Facility A") and a \$100.0 million, 364-day revolving facility maturing on May 6, 2010 ("Facility B"). Two years prior to the current Facility A maturity date, the Company may request an extension of the maturity date for Facility A for a further period of 364 days and if the request for extension is not granted, all amounts outstanding under Facility A become due on the Facility A maturity date. Similarly, prior to the current Facility B maturity date, the Company may request the lenders to extend the term for an additional 364 days and if the request for extension is not granted, Facility B will automatically convert into a non-revolving term credit facility that will mature six months from that date. The operating credit facility also allows the Company to request that the lenders provide up to \$50.0 million of additional financing under Facility A or Facility B or a combination of the two facilities.

Borrowings under the Company's operating credit facilities bear interest at prime plus a margin or the certificate of deposit offered rate for bankers' acceptances plus a margin. The margin applied is based on FortisBC's debt ratings provided by its credit rating agencies. Borrowings under the overdraft facility bear interest at prime.

On May 22, 2009 the Company filed a short form base shelf prospectus to establish a MTN Debentures Program and entered into a Dealers Agreement with certain affiliates of a group of Canadian Chartered Banks. Upon filing the shelf prospectus, the Company may time to time during the 25 month life of the shelf prospectus, issue MTN Debentures in an aggregate principal amount of up to \$300.0 million.

On May 28, 2009, FortisBC entered into an agreement with the dealers listed in the Dealers Agreement to sell \$105.0 million of senior unsecured MTN Debentures. The MTN Debentures bear interest at a rate of 6.10% to be paid semi-annually and mature on June 2, 2039. The closing of the issuance occurred on June 2, 2009, with net proceeds of \$104.5 million being used to repay existing indebtedness and finance the capital expenditure program and working capital requirements.

FortisBC expects to meet interest payments on outstanding indebtedness from internally generated funds, but may have to rely upon the proceeds of new financings to meet its principal debt obligations when due.

### **Capital Program**

FortisBC's business is capital intensive and is focused on responding to customer growth and enhancing system reliability and safety through its capital program. Due to the size of the forecast capital program relative to the size of the Company, its implementation, financing and customer rate impacts present key challenges to the Company.

It is expected that capital expenditures in 2009 and beyond will be financed by drawing on the revolving lines of credit, utilizing the proceeds from future debt issues, equity contributions from the parent and from funds generated by operating activities.

On June 27, 2008, FortisBC applied to the BCUC for approval of its 2009-2010 Capital Expenditure Plan ("2009-2010 CEP"). On February 27, 2009, the BCUC approved 2009 capital expenditures of approximately \$151.0 million (net of \$14.0 million in customer contributions) and 2010 capital expenditures of approximately \$141.0 million (net of \$15.0 million in customer contributions). An additional \$16.0 million is subject to further regulatory processes. The capital expenditures are necessary to ensure the ability to provide service, public and employee safety and reliability of supply to the Company's growing customer base. The most significant areas of expenditure are those required to expand and upgrade the bulk transmission and distribution system to keep pace with load growth, and to continue the life extension program at FortisBC's generating plants.

FortisBC has forecast 2009 capital expenditures of approximately \$110.2 million, net of \$6.5 million in customer contributions. These capital expenditures estimates, as well as the estimates supporting the 2009-2010 CEP, are based upon detailed forecasts which include assumptions such as customer demand, cost of labour and materials, timing of project implementation, as well as other factors which could change and cause actual capital expenditures to differ from forecast capital expenditures.

During the six months ended June 30, 2009, FortisBC spent \$46.3 million on the capital program (net of \$3.0 million in customer contributions). The significant capital projects and related expenditures for the six months ended June 30, 2009 are as follows: \$5.1 million for the Black Mountain Substation Project, \$4.6 million for the Generation Unit Life Extension program, \$4.5 million relating to new distribution line extensions for customers, \$3.8 million for the Okanagan Transmission Reinforcement Project, and \$2.2 million for the Ellison Substation Project.

FortisBC recovers capital costs through depreciation which is approved by the BCUC on an annual basis. The BCUC also approves the Capital Plans of the Company; therefore, the majority of capital expenditures receive approval prior to the expenditures being made. The BCUC may order a review of cost variances for individual projects prior to inclusion in rate base or certain major projects may be subject to a “cost collar”. Also, the Company is generally required to provide a report to the BCUC upon completion of projects that were subject to the Certificate of Public Convenience and Necessity approval process. In these situations, any variance in costs disallowed by the BCUC would be to the account of the shareholder.

Further information relating to the 2009-2010 Capital Expenditure Plan can be found on the BCUC website ([www.bcuc.com](http://www.bcuc.com)).

## SHARE CAPITAL

FortisBC has issued and outstanding 1,818,510 common shares, all of which are owned by Fortis through its indirect wholly owned subsidiary, Fortis Pacific.

There were no changes to share capital during the three and six months ended June 30, 2009 and June 30, 2008.

During the three and six months ended June 30, 2009, FortisBC paid dividends of \$3.5 million (2008 - \$3.2 million) and \$7.0 million (2008 - \$6.4 million) respectively to its parent company, Fortis Pacific.

## CONTRACTUAL OBLIGATIONS

### Contractual Obligations - Payments Due by Period (Unaudited)

As at June 30, 2009

	Total	Less than 1 Year	1-3 Years	4-5 Years	After 5 Years
(\$ millions)					
Building Leases <sup>1</sup>	21.2	2.0	3.9	2.9	12.4
Vehicle Leases <sup>2</sup>	1.0	0.5	0.5	-	-
Brilliant Terminal Station Agreement <sup>3</sup>	61.8	2.6	5.1	5.1	49.0
Power Purchase Obligations <sup>4</sup>	2,809.5	38.6	77.0	76.1	2,617.8
Debt Retirement <sup>5</sup>	597.9	54.6	1.9	16.4	525.0
<b>Totals</b>	<b>3,491.4</b>	<b>98.3</b>	<b>88.4</b>	<b>100.5</b>	<b>3,204.2</b>

<sup>1</sup> Under a sale-leaseback agreement, on September 29, 1993 the Company began leasing its Trail, BC office building for a term of 30 years. The terms of the agreement grant the Company repurchase options at approximately year 20 and approximately year 28 of the lease term. During the year ended December 31, 2007, the Company entered into an agreement to lease an office building owned by a related company, Terasen Gas Inc. During the initial five-year term of the lease commencing January 1, 2008, the Company will make annual payments of \$0.2 million. The Company has two options to renew the lease for additional five-year terms. In addition, the Company has entered into various leases within the Kelowna area for office and warehouse space with terms ranging from two to five years.

<sup>2</sup> These vehicle leases generally provide for the Company to pay the taxes, maintenance, insurance and certain other operating costs of the leased property, and typically have a lease term of two to five years.

<sup>3</sup> On July 15, 2003, the Company began operating the Brilliant Terminal Station ("BTS") under an agreement the term of which expires in 2056 (unless the Company has earlier terminated the agreement by exercising its right, at any time after the anniversary date of the agreement in 2029, to give 36 months' notice of termination). The BTS is jointly owned by the Columbia Power Corporation and the Columbia Basin Trust (the "Owners") and used by the Company on its own behalf and on behalf of the Owners. The agreement provides that FortisBC will pay the Owners a charge related to the recovery of the capital cost of the BTS and related operating costs.

<sup>4</sup> Power purchase obligations of FortisBC include the Brilliant Power Purchase Agreement (the "BPPA") and the Power Purchase Agreement with BC Hydro (the "PPA"). On May 3, 1996, an Order was granted by the BCUC approving the 60-year BPPA for the output of the Brilliant hydroelectric plant located near Castlegar, BC. The BPPA requires payments based on the operation and maintenance costs and a return on capital for the plant, in exchange for the specified take-or-pay amounts of power. The BPPA includes a market related price adjustment after 30 years of the 60-year term. The PPA, which expires in 2013, provides for any amount of supply up to a maximum of 200 MW but includes a take-or-pay provision based on a 5-year rolling nomination of the capacity requirements.

<sup>5</sup> Excludes debt issue costs.

**RELATED PARTY TRANSACTIONS**

In the normal course of business, the Company transacts with its parent and other related companies under common control. The following transactions were measured at the exchange amount.

**Inter-corporate Charges (Unaudited)**

Period Ended June 30	Quarter		Year to Date	
	2009	2008	2009	2008
(\$000s)				
Revenue charged to related parties	<b>120</b>	187	<b>258</b>	314
Operating costs charged by related parties	<b>449</b>	598	<b>960</b>	918
Operating costs recovered from related parties	<b>1,319</b>	1,783	<b>2,785</b>	3,196
Interest revenue on accounts receivable	<b>2</b>	8	<b>5</b>	14
Capital costs charged from related parties	-	159	-	159

The revenues charged represent electricity and services sold to related parties.

The operating costs charged consist of information technology expenses, contract and direct labour charges, meter shop charges, stock options, rent, natural gas utility charges consumed in operating the Company's facilities, and corporate governance costs.

The operating costs recovered consist of labour and materials charges to the Company's parent and other related parties.

Included in accounts receivable are amounts due from Fortis Pacific which bear interest at prime. Interest on the related party accounts receivable was recorded in other revenue.

Inter-corporate charges between FortisBC and other related companies under common control are included in accounts receivable and accounts payable and are unsecured and due on demand. Also included in accounts receivable are amounts due from officers of the Company for employee share purchase plan loans and stock option loans which are non-interest bearing and due within one to two years from the grant date.

Amounts due to and from the Company's parent, and other related companies under common control and officers of the Company are as follows:

**Inter-corporate Charges (Unaudited)**

	June 30, 2009	December 31, 2008
(\$000s)		
Included in accounts receivable	690	621
Included in accounts payable and accrued liabilities	357	344

**QUARTERLY RESULTS**

The following table sets forth unaudited quarterly information for each of the eight quarters ended September 30, 2007 through June 30, 2009. The information has been obtained from the Company's unaudited interim consolidated financial statements which, in the opinion of management, have been prepared in accordance with Canadian GAAP for rate-regulated entities. The timing of the recognition of certain assets, liabilities, revenues and expenses as a result of regulation may differ from that otherwise expected using Canadian GAAP for companies not subject to rate regulation. Past operating results are not necessarily indicative of results for any future period and should not be relied upon to predict future performance.

**Summary of Consolidated Quarterly Results (Unaudited)**

Quarter Ended	Electricity Revenue	Net Earnings
(\$000s)		
June 30, 2009	51,609	7,398
March 31, 2009	68,492	13,160
December 31, 2008	60,670	6,177
September 30, 2008	50,452	8,533
June 30, 2008	48,547	6,346
March 31, 2008	63,008	11,608
December 31, 2007	56,799	6,035
September 30, 2007	48,035	6,086

A summary of the past eight quarters reflects FortisBC's growth as well as the seasonality associated with the Company's business. The operations generally produce higher earnings in the first quarter of the fiscal year due to increased customer load as a result of cooler weather, while certain expenses such as depreciation, interest and operating expenses remain more evenly distributed throughout the fiscal year.

**September 2007/2008** – The increase in revenues and earnings was primarily due to a 2.9% rate increase effective January 1, 2008 and a 0.8% rate increase effective May 1, 2008. Net earnings also increased due to a decrease in power purchase costs, partially offset by increases in certain other expenses.

**December 2007/2008** – The increase in revenues was primarily due to a 2.9% rate increase effective January 1, 2008 and a 0.8% rate increase effective May 1, 2008. Despite the increase in electricity revenue, net earnings were relatively consistent due to increases in certain other costs during the fourth quarter of 2008 compared to the same period in 2007.

**March 2008/2009** – The increase in revenues and earnings was primarily due to a 4.6% rate increase effective January 1, 2009 and increased electricity sales resulting from customer growth and cooler temperatures.

**June 2008/2009** – The increase in revenues and earnings was primarily due to a 4.6% rate increase effective January 1, 2009, a 0.8% rate increase effective May 1, 2008 and increased electricity sales resulting from customer growth.

## **OFF-BALANCE SHEET ARRANGEMENTS**

Disclosure is required of all off-balance sheet arrangements such as transactions, agreements or contractual arrangements with unconsolidated entities, structured finance entities, special purpose entities or variable interest entities that are reasonably likely to materially affect liquidity or the availability of, or requirements for, capital resources. The Company has no such off-balance sheet arrangements.

## **CRITICAL ACCOUNTING ESTIMATES**

The preparation of the Company's financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the periods. Certain estimates are also necessary since the regulatory environment in which the Company operates often requires amounts to be recorded at estimated values until finalization and adjustment, if any, is determined pursuant to subsequent regulatory decisions or other regulatory proceedings. Due to the inherent uncertainty in making such estimates, actual results reported in future periods could differ materially from those estimated. Any such adjustments, which could be material, will be recorded in the period they become known.

There were no material changes to the Company's critical accounting estimates during the three and six months ended June 30, 2009 from those disclosed in the Management Discussion and Analysis for the year ended December 31, 2008 other than noted below.

Effective January 1, 2009, GAAP for rate-regulated operations has been amended to require the recognition of future income tax liabilities and assets. Future income taxes are recognized based upon temporary differences between the accounting and tax basis of existing assets and liabilities, the benefit of income tax reductions or tax losses available to be carried forward and the effects of changes in tax laws. The carrying amounts of assets and liabilities are based upon the amounts recorded in the financial statements and are therefore subject to accounting estimates that are inherent to those balances. The timing of the reversal of temporary differences is estimated based upon assumptions of expectations of future results of operations. The composition of future income tax liabilities is reasonably likely to change from period to period because of changes in the estimation of these uncertainties.

## **CHANGES IN ACCOUNTING POLICIES**

Effective January 1, 2009, FortisBC adopted the following new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA").

- a) Amendments to Section 1100, *Generally Accepted Accounting Principles* and Section 3465, *Income Taxes* which resulted from a Decision Summary issued by the Accounting Standards Board ("AcSB") in August 2007. The standards prior to the amendments were intended to reflect the unique characteristics of rate-regulated operations, specifically how rate regulation may result in assets and

liabilities which meet the asset and liability definitions of the CICA Handbook. The Decision Summary determined that prospectively for fiscal years beginning on or after January 1, 2009:

- The temporary exemption in Section 1100, *Generally Accepted Accounting Principles*, providing relief to entities subject to rate regulation from the requirement to apply Section 1100 to the recognition and measurement of assets and liabilities arising from rate regulation has been removed.
- Section 3465, *Income Taxes*, has been amended to require the recognition of future income tax liabilities and assets as well as a regulatory asset or liability for the amount of future income taxes expected to be recovered from or returned to customers in future rates.

The AcSB also decided that the current guidance pertaining to rate-regulated operations in Section 1600, *Consolidated Financial Statements*, Section 3061, *Property, Plant and Equipment*, Section 3475, *Disposal of Long Lived Assets and Discontinued Operations*, and AcG-19, *Disclosures by Entities Subject to Rate Regulation* be retained.

Effective January 1, 2009, the Company applied the amended Section 1100 to the recognition and measurement of assets and liabilities arising from rate regulation. Certain assets and liabilities arising from rate regulation continue to have specific guidance under a primary source of Canadian GAAP that applies only to the particular circumstances described therein, including those arising under Sections 1600, 3061 and 3475. Certain of the Company's assets and liabilities arising from rate regulation do not have specific guidance under a primary source of Canadian GAAP. In absence of primary sources of Canadian GAAP, Section 1100 directs the Company to adopt accounting policies that are developed through the exercise of professional judgment and the application of concepts described in Section 1000, *Financial Statement Concepts*. In developing these accounting policies, Section 1100 directs entities to consult other sources, including pronouncements issued by bodies authorized to issue accounting standards in other jurisdictions. In accordance with Section 1100, the Company has determined that certain of its assets and liabilities qualify for recognition under Canadian GAAP and this recognition is generally consistent with the accounting prescribed by the U.S. Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* ("FAS 71"). FAS 71 is the prevailing guidance to which the Company will refer to for the development of accounting policies and disclosures relating to certain of its assets and liabilities arising from rate regulation where there are no primary sources of Canadian GAAP available. The Company has determined that its regulatory assets and liabilities recognized in the financial statements prior and subsequent to January 1, 2009 comply with the recognition and presentation criteria under Section 1000 and FAS 71 and therefore will continue to exist under Canadian GAAP. Adoption of the amended Section 1100 standard resulted in the balance sheet changes discussed below.

#### *Future Removal and Site Restoration*

Included in FortisBC's depreciation rates is a provision for future removal and site restoration costs. Prior to January 1, 2009, actual costs of removal and site restoration incurred were recorded against accumulated depreciation as the assets were disposed of. In the absence of rate regulation, the removal and site restoration costs would be expensed in the period incurred. Effective January 1, 2009, the Company has prospectively applied the practice, consistent with other rate-regulated companies that follow FAS 71, of removing the net future site restoration provision from accumulated depreciation and reclassifying it as a long-term regulatory liability. Effective January 1, 2009, the Company reclassified \$12.3 million with no impact on earnings.

#### *Future Income Tax*

Effective January 1, 2009, the impact on FortisBC of the amendments to Section 3465, is the prospective recognition of future income taxes and a separate regulatory asset or liability for the

amount of future income taxes expected to be included in future rates and recovered from or returned to customers. Prior to January 1, 2009, the Company used the taxes payable method of accounting for income taxes on regulated earnings. As a result of the Company adopting the amendment to Section 3465, the Company has changed its accounting policy to account for income taxes using the asset and liability method. Under this method, future tax assets and liabilities are recognized for temporary differences between the accounting and tax basis of existing assets and liabilities, the benefit of income tax reductions or tax losses available to be carried forward and the effects of changes in tax laws and enacted or substantially enacted tax rates. The effect to the Company's June 30, 2009 interim financial statements is an increase to future income taxes (net of future income tax assets) of \$74.9 million (January 1, 2009 - \$73.8 million), including an amount associated with income taxes that will become payable on future revenues as they are collected from customers when the tax timing differences reverse. There is a corresponding increase in regulatory assets of \$74.9 million (January 1, 2009 - \$73.8 million) and no impact to earnings.

- b) Section 3064, *Goodwill and Intangible Assets*, converges Canadian GAAP for goodwill and intangible assets with International Financial Reporting Standards. The new standard provides more comprehensive guidance on intangible assets, particularly for internally developed intangible assets. Under Section 1506, *Changes in Accounting Policy*, the adoption of this new Section is to be applied retrospectively in the Company's financial statements. Effective January 1, 2009 and December 31, 2008, the Company reclassified \$14.9 million in software costs and \$20.5 million in right of way costs from property, plant and equipment to intangibles. The reclassification resulted in no impact on earnings.
- c) Emerging Issues Committee-173 ("EIC-173"), *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*, requires that the Company's own credit risk and the credit risk of its counterparties be taken into account in determining the fair value of a financial instrument. There was no effect on the Company's financial statements as a result of adopting EIC-173.

## FUTURE ACCOUNTING PRONOUNCEMENTS

### International Financial Reporting Standards ("IFRS")

In February 2008, the Accounting Standards Board ("AcSB") confirmed that the use of IFRS will be required in 2011 for publicly accountable enterprises in Canada. In March 2009, the AcSB issued a second IFRS Omnibus Exposure Draft confirming that publicly accountable enterprises be required to apply IFRS, in full and without modification, on January 1, 2011. The transition date of January 1, 2011 will require the restatement, for comparative purposes, of amounts reported by the Company for its year ended December 31, 2010, and of the opening balance sheet as at January 1, 2010.

The Company is continuing to assess the financial reporting impacts of adopting IFRS in 2011. The full impact on future financial position and results of operations is not reasonably determinable or estimable at this time, particularly in light of the recently released International Accounting Standards Board ("IASB") Exposure Draft on *Rate-regulated Activities*. The Company anticipates a significant increase in disclosure resulting from the adoption of IFRS and is continuing to assess the additional disclosure requirements as well as information systems changes that will be necessary to gather and compile the required disclosure.

**IFRS Conversion Project:** Fortis and its subsidiaries, including FortisBC, commenced an IFRS conversion project in 2007 and have established a formal project governance structure. Reporting on the IFRS conversion project occurs to senior executive management and the Audit and Risk Committee of the Board of Directors of FortisBC.

The IFRS conversion project consists of three phases: Scoping and Diagnostics, Analysis and Development, and Implementation and Review.

*Phase One: Scoping and Diagnostics*, which involved project planning and staffing and identification of differences between current Canadian GAAP and IFRS, has been completed. The resulting identified areas of accounting difference of highest potential impact to the Company, based on existing IFRS at the time, were identified to include rate-regulated accounting; property plant and equipment; provisions and contingent liabilities; employee benefits; impairment of assets; income taxes; and, initial adoption of IFRS under the provisions of IFRS 1, *First-Time Adoption of International Financial Reporting Standards*.

*Phase Two: Analysis and Development* is nearing completion, and involves detailed diagnostics and evaluation of the financial impacts of various options and alternative methodologies provided for under IFRS; identification and design of operational and financial business processes; initial staff training and audit committee orientation; analysis of IFRS 1 optional exemptions and mandatory exceptions to the general requirement for full retrospective application upon transition to IFRS; summarization of 2011 IFRS disclosure requirements; and development of required solutions to address identified issues.

*Phase Three: Implementation and Review* has recently commenced and involves the execution of changes to information systems and business processes; completion of formal authorization processes to approve recommended accounting policy changes; and further training programs across the Company's finance and other affected areas, as necessary. It will culminate in the collection of financial information necessary to compile IFRS-compliant financial statements and reconciliations; embedding of IFRS in business processes; and audit committee approval of IFRS-compliant interim and annual financial statements for 2011.

**Accounting for Rate-Regulated Activities under IFRS:** IFRS does not provide specific guidance with respect to accounting for rate-regulated activities. However, in December 2008, the IASB initiated a project on accounting for rate-regulated activities and whether or not rate-regulated entities could or should recognize assets or liabilities as a result of rate-regulation imposed by a regulatory body.

On July 23, 2009, the IASB issued an Exposure Draft on *Rate-regulated Activities*. Comments on the Exposure Draft are to be submitted for consideration by the IASB by November 20, 2009. Based on the current project timeline of the IASB, a final standard is expected to be issued in 2010.

Based on the Exposure Draft as it currently exists, regulatory assets and liabilities arising from activities subject to cost-of-service regulation may be recognized under IFRS when certain conditions are met. The ability to record regulatory assets and liabilities, as proposed in the Exposure Draft, could reduce the Company's earnings volatility that may have otherwise resulted under IFRS, however it will result in the requirement to provide enhanced balance sheet presentation and note disclosures. However, uncertainty as to the final outcome of this Exposure Draft, and the final standard on accounting for rate-regulated activities under IFRS, has resulted in FortisBC being unable to reasonably estimate and conclude on the impact on the Company's future financial position and results of operations with respect to differences, if any, in accounting for rate-regulated activities under IFRS versus Canadian GAAP.

Differences between IFRS and Canadian GAAP, in addition to those referred to below under "Accounting Policy Impacts and Decisions", may still be identified based on further detailed analysis by the Company, the outcome of a final standard on accounting for rate-regulated activities and other changes in IFRS prior to the Company's conversion to IFRS in 2011.

The Company will continue to work with the BCUC to identify IFRS transitional issues and suggest how the issues might be addressed.

**Accounting Policy Impacts and Decisions:** The Company has completed an initial assessment of the impacts of adopting IFRS, based on the standards as they currently exist, and has identified the following as having the greatest potential to impact the Company's accounting policies, financial reporting and information systems requirements upon conversion to IFRS. However, final conclusions cannot be reached at this time with respect to the Company's rate-regulated operations pending a final IFRS standard on accounting for rate-regulated activities.

(a) *Property Plant and Equipment*

IFRS and Canadian GAAP contain the same basic principles of accounting for property, plant and equipment; however, differences in application do exist. For example, capitalization of directly attributable costs in accordance with IAS 16, *Property Plant and Equipment* may require measurement of an item of property, plant and equipment upon initial recognition to include or exclude certain previously recognized amounts under Canadian GAAP. Specifically, there may be changes in accounting for:

- i) the amount of capitalized overheads;
- ii) the capitalization of major inspections that were previously expensed under Canadian GAAP;
- iii) the capitalization of depreciation for which the future economic benefits of that asset are absorbed in the production of another asset; and
- iv) the capitalization of borrowing costs in accordance with IAS 23, *Borrowing Costs*.

IAS 16 also requires an allocation of the amount initially recognized in respect of an item of property, plant and equipment to its significant parts and the depreciation of each such part separately. This method of componentizing property, plant and equipment may result in an increase in the number of component parts that are recorded and depreciated and, as a result, may impact the calculation of depreciation expense.

The final extent of the impact of applying IAS 16 by the Company, and elective options with respect to accounting for property, plant and equipment upon transition to IFRS, cannot be made at this time pending a final standard on accounting for rate-regulated activities.

(b) *Provisions and Contingent Liabilities*

IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* requires a provision to be recognized when (i) there is a present obligation as a result of a past transaction or event; (ii) it is probable that an outflow of resources will be required to settle the obligation; and (iii) a reliable estimate can be made of the obligation. Under Canadian GAAP the criterion for recognition is "likely", which is a higher threshold than "probable". It is possible, therefore, that some contingent liabilities which would meet the recognition criterion under IFRS would not have been recognized under Canadian GAAP.

(c) *Employee Benefits*

IAS 19, *Employee Benefits* requires the past service cost element of defined benefit plans to be expensed on an accelerated basis, with vested past service costs being expensed immediately and unvested past service costs being recognized on a straight-line basis until the benefits become vested. In addition, actuarial gains and losses are permitted under IAS 19 to be recognized directly in equity rather than through earnings, and IFRS 1 also provides an option to recognize immediately in retained earnings all cumulative actuarial gains and losses existing as at the date of transition to IFRS.

Under Canadian GAAP, past service costs are generally amortized on a straight-line basis over the expected average remaining service period of active employees in the defined benefit plan.

The Company maintains defined benefit pension plans, defined contribution pension plans and supplementary and other post-employment benefit plans which will be subject to different accounting treatment under IFRS as compared to Canadian GAAP. The full extent of the impact of applying IAS 19 cannot be made at this time, pending a final standard on accounting for rate-regulated activities.

(d) *Impairment of Assets*

IAS 36, *Impairment of Assets* uses a one-step approach for testing and measuring asset impairments, with asset carrying values being compared to the higher of value in use and fair value less costs to sell. Value in use is defined as being equal to the present value of future cash flows expected to be derived from the asset. In the absence of an active market, fair value less costs to sell may also be determined using discounted cash flows. The use of discounted cash flows under IFRS to test and measure asset impairment differs from Canadian GAAP where undiscounted future cash flows are used to compare against the asset's carrying value to determine if impairment exists. This may result in more frequent write-downs in the carrying value of assets under IFRS since asset carrying values that were previously supported under Canadian GAAP based on undiscounted cash flows may not be supported on a discounted cash flow basis under IFRS. However, under IAS 36, previous impairment losses may be reversed where circumstances change such that the impairment has reduced. This also differs from Canadian GAAP, which prohibits the reversal of previously recognized impairment losses.

The majority of the Company's assets are rate-regulated and the potential for and extent of impairment losses on these assets will be primarily subject to the continued ability of the Company to recover costs through the regulatory process.

(e) *Income Taxes*

IAS 12, *Income Taxes* prescribes that an entity account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Therefore, where transactions and other events are recognized in earnings, the recognition of deferred tax assets or liabilities which arise from those transactions should also be recorded in earnings. For transactions that are recognized outside of the statement of earnings, either in other comprehensive income or directly in equity, any related tax effects should also be recognized outside of the statement of earnings.

The most significant impact of IAS 12 on the Company will be derived directly from the accounting policy decisions made under IAS 16. In addition, the Company currently accounts for income taxes based on regulatory decisions. Therefore, the impact on the Company of accounting for the tax consequences of transactions and other events under IFRS versus Canadian GAAP cannot be fully determined at this time pending a final IFRS standard on accounting for rate-regulated activities.

(f) *IFRS 1, First-Time Adoption of International Financial Reporting Standards*

IFRS 1 provides the framework for the first time adoption of IFRS and specifies that, in general, an entity shall apply the principles under IFRS retrospectively. IFRS 1 also specifies that the adjustments that arise on retrospective conversion to IFRS from other GAAP should be directly recognized in retained earnings. Certain optional exemptions and mandatory exceptions to retrospective application are provided for under IFRS 1.

The Company has completed an analysis of IFRS 1. While preliminary decisions have been made with respect to the elective exemptions available upon transition, final decisions cannot be made at this time pending a final IFRS standard on the accounting for rate-regulated activities.

(g) *Information Systems*

It is anticipated that the adoption of IFRS will have an impact on information systems requirements. The Company has assessed the need for systems upgrades or modifications to ensure an efficient conversion to IFRS. The extent of the impact on the Company's information systems is largely dependent upon the final IFRS standard on accounting for rate-regulated activities and is, therefore, not fully determinable at this time.

The IASB has a number of on-going projects on its agenda, in addition to the project on accounting for rate-regulated activities, that may result in changes to existing IFRS prior to the Company's conversion in 2011. The Company continues to monitor these projects and the impact that any resulting IFRS changes may have on its anticipated accounting policies, financial position or results of operations under IFRS for 2011 and beyond.

**Section 3862, *Financial Instruments - Disclosures***

This Section was amended in June 2009 to improve the disclosure surrounding fair value and liquidity risk. The amendment was a response to calls by users of financial statements and others for enhanced disclosures in light of current market conditions and concerns that the nature and extent of liquidity risk disclosure requirements were unclear and difficult to apply. The amended section clarifies that liquidity risk disclosures are required only for financial liabilities that result in the outflow of cash or another financial asset; require entities to provide quantitative disclosures based on how they manage liquidity risk for derivative financial liabilities; require entities to disclose the remaining expected maturities of non-derivative financial liabilities if they manage liquidity risk on the basis of expected maturities; and strengthen the relationship between qualitative and quantitative disclosures about liquidity risk. The amended section is to be applied prospectively and is effective for FortisBC's annual financial statements for the year ended December 31, 2009. This amended accounting policy is not expected to have a significant impact on FortisBC's annual financial statements.

**BUSINESS OUTLOOK**

**Regulatory**

The Company would expect earnings to grow in future years assuming a consistently applied regulated capital structure, no material reduction in the allowed return on equity, recovery of its cost-of-service components in rates, and growth in rate base assets as a result of its annual capital expenditures.

**The BC Energy Plan**

The British Columbia provincial government released its Energy Plan on February 27, 2007. The plan is a natural progression from the previous plan with consistent principles and a strong focus on environmental leadership, energy conservation and efficiency, and investing in innovation. This focus manifests itself by setting specific goals and timelines in these three areas. In particular, the Energy Plan outlines various measures to address the challenges of global warming including that all electricity produced in British Columbia will be required to have zero net greenhouse gas emissions by 2016. The plan places a great deal of responsibility on British Columbians to conserve energy by acquiring 50% of the province's incremental resource needs through conservation by 2020. The plan emphasizes efficiency by requiring BC Hydro to eliminate electricity imports and become fully self-sufficient by 2016. The Energy Plan also states that 90% of British Columbia's electricity will come from renewable resources and that British Columbia will become the first jurisdiction in North America to require 100% carbon sequestration for any coal-fired electricity project. FortisBC continues to assess the impacts and opportunities provided by the plan, and will consider which policy actions it may support. Many of the principles of the Energy Plan were adopted when Bill 15-2008, the *Utilities Commission Amendment Act, 2008*, received Royal Assent

by the Legislative Assembly of British Columbia on May 1, 2008. The Energy Plan is available on the following website: [www.energyplan.gov.bc.ca](http://www.energyplan.gov.bc.ca).

**Collective Agreements**

The Collective Agreement between the Company and Local 213 of the International Brotherhood of Electrical Workers (“IBEW”) expires on January 31, 2013. IBEW represents employees in specified occupations in the areas of generation, transmission and distribution. The Collective Agreement between the Company and Local 378 of the Canadian Office and Professional Employees Union expires January 31, 2011.

**Business Risk Management**

For more information with respect to risks and uncertainties, reference is made to the subsection entitled “Business Risk Management” in the Company’s Management Discussion and Analysis for the year ended December 31, 2008.

**Contingency**

The Province of British Columbia has alleged breaches of the Forest Practices Code and negligence relating to a forest fire near Vaseux Lake and has filed and served a Writ and Statement of Claim against FortisBC. In addition, private land owners have filed a separate Writ and Statement of Claim in relation to the same matter. FortisBC is communicating with its insurers and has filed a Statement of Defence in relation to both of the actions. The outcome cannot be reasonably determined and estimated at this time, and accordingly no amount has been accrued in the financial statements.

**STRATEGY AND VISION**

FortisBC is an electric utility company, generating, transmitting and distributing electricity to homes and businesses in the southern interior of British Columbia. FortisBC employees are committed to safety, providing excellent customer service, and conducting business in an environmentally responsible manner.

**CORPORATE INFORMATION**

All the common shares of FortisBC are owned by Fortis Inc. (“Fortis”) through its indirect wholly owned subsidiary, Fortis Pacific Holdings Inc. Fortis is the largest investor-owned distribution utility in Canada. Its regulated holdings include a natural gas utility in British Columbia and electric utilities in five Canadian provinces and three Caribbean countries. Fortis owns non-regulated hydroelectric generation assets across Canada and in Belize and upper New York State. It also owns hotels and commercial real estate in Canada. Fortis shares are listed on the Toronto Stock Exchange and trade under the symbol FTS. Additional information can be accessed at [www.fortisinc.com](http://www.fortisinc.com) or [www.sedar.com](http://www.sedar.com).

**Board of Directors:**

Beth Campbell, William J. (Bill) Daley, Walter Gray, R.L. (Randy) Jespersen, Stanley Marshall, Roger Mayer, John McCallum, Harry McWatters and John Walker.

**Executive Team:**

John Walker	<i>President and Chief Executive Officer</i>
Don Debiegne	<i>Vice President, Power Supply and Strategic Planning</i>
Doyle Sam	<i>Vice President, Engineering and Operations</i>
Michele Leeners	<i>Vice President, Finance and Chief Financial Officer</i>
Michael Mulcahy	<i>Vice President, Customer and Corporate Services</i>
David Bennett	<i>Vice President, Regulatory Affairs and General Counsel</i>

Additional information about FortisBC Inc. is available on Sedar at [www.sedar.com](http://www.sedar.com).

**For further information, please contact:**

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