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MOODY'S
INVESTORS SERVICE

Credit Opinion: FortisBC Energy Inc.

Global Credit Research - 21 Jul 2011

Vancouver, British Columbia, Canada

Ratings

Category	Moody's Rating
Outlook	Stable
Senior Secured -Dom Curr	A1
Senior Unsecured -Dom Curr	A3
Parent: FortisBC Holdings Inc.	
Outlook	Stable
Senior Unsecured -Dom Curr	Baa2
FortisBC Energy (Vancouver Island) Inc.	
Outlook	Stable
Senior Unsecured -Dom Curr	A3

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Key Indicators

[1]**FortisBC Energy Inc.**

	[2]LTM	2010	2009	2008	2007	2006
(CFO Pre-W/C + Interest) / Interest Expense	2.7x	2.7x	2.6x	2.5x	2.4x	2.5x
(CFO Pre-W/C) / Debt	11.3%	10.6%	10.2%	9.8%	8.8%	10.1%
(CFO Pre-W/C - Dividends) / Debt	5.4%	5.9%	6.5%	4.2%	2.5%	7.7%
Debt / Book Capitalization	57.3%	59.1%	61.8%	68.4%	66.8%	65.2%

[1] All ratios calculated in accordance with Moody's Regulated Electric and Gas Utilities Rating Methodology using Moody's standard adjustments. In addition, Moody's adjusts for one-time items. [2] Last twelve months ended March 31, 2011

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

Low-risk, cost-of-service regulated gas transmission and distribution utility

Weak financial metrics balanced by a supportive regulatory environment

Strong regulatory ring-fencing mechanisms insulate company from its weaker parent

Sufficient liquidity resources

Corporate Profile

FortisBC Energy Inc. (FEI) is the largest distributor of natural gas in British Columbia and one of the largest gas local distribution companies (LDC) in Canada. FEI is regulated on a cost-of-service basis by the British Columbia Utilities Commission (BCUC).

FEI is a wholly-owned subsidiary of FortisBC Holdings Inc. (FHI) which, in turn, is a wholly-owned subsidiary of Fortis Inc. (FTS, not rated), a diversified electric and gas utility holding company. FHI is a holding company which also holds 100% of FortisBC Energy (Vancouver Island) Inc. (FEVI) and FortisBC Energy (Whistler) Inc. (FEW) as well as a 30% interest in CustomerWorks, L.P.

SUMMARY RATING RATIONALE

FEI's A3 senior unsecured rating and stable outlook reflect its low-risk LDC business model and supportive regulatory environment which are

balanced by its weak financial metrics. We recognize that the weakness of FEI's financial metrics relative to similarly rated U.S. peers is largely a function of the relatively lower deemed equity and allowed ROE permitted by the BCUC. We believe that FEI's weak financial profile is balanced by its relatively low business risk as a gas LDC and the by the supportiveness of the business and regulatory environments in Canada generally and in British Columbia specifically. We expect FEI's financial profile to strengthen modestly in 2012 and 2013. Regulatory ring-fencing mechanisms effectively insulate FEI from its weaker parent companies, FHI and FTS. Growth in FEI's franchise area tends to be predictable and capital spending is not expected to tax the company's resources. FEI maintains sufficient liquidity resources.

DETAILED RATING CONSIDERATIONS

LOW-RISK REGULATED GAS DISTRIBUTION UTILITY OPERATING IN A SUPPORTIVE ENVIRONMENT

In general, we consider gas LDCs to be at the low end of the risk spectrum within the universe of regulated utilities. Similarly, we believe that regulated utilities, which are permitted the opportunity to recover their costs and earn an allowed return, have lower business risk than unregulated companies that do not benefit from cost of service regulation. Accordingly, we consider regulated gas LDCs like FEI to be among the lowest risk corporate entities.

We consider Canada to have more supportive regulatory and business environments than other jurisdictions globally. Furthermore, the regulatory environment in the Province of British Columbia (BC) is considered one of the most supportive in Canada reflecting the fact that regulatory proceedings in BC tend to be less adversarial than those in other jurisdictions and decisions tend to be timely and balanced. The supportiveness of the BC regulatory environment is also evidenced by the fact that FEI benefits from the existence of a number of BCUC-approved deferral, or true up, mechanisms. These mechanisms limit FEI's exposure to forecast error with respect to commodity price and volume, pension funding costs, insurance costs and short-term interest rates. In addition, FEI is required to obtain a certificate of public convenience and necessity (CPCN) from the BCUC prior to undertaking any capital project in excess of $5 million. In our view, this process reduces the risk that FEI would be denied the opportunity to recover the cost of its capital investments. We believe these qualitative factors balance FEI's weak financial profile.

Growth in FEI's franchise area tends to be relatively predictable and capital spending is generally stable and modest in the context of FEI's asset base and depreciation expense. That said, we expect capital spending to be higher in 2011 than it has been in recent years. This reflects certain non-recurring or infrequently occurring projects such as the development of a new customer care system and the upgrading of a major river crossing. Notwithstanding higher capital spending in 2011, we anticipate that FEI will continue to finance its capital spending with a prudent combination of internally generated funds, additional term debt and equity injections from FTS as required.

FINANCIAL METRICS EXPECTED TO STRENGTHEN MODESTLY IN 2012 and 2013

FEI's financial metrics are materially weaker than those of its A3 rated global gas utility peers such as Piedmont Natural Gas Company, Inc., Northwest Natural Gas Company, UGI Utilities and its sister company, FEVI. We recognize that FEI's weaker financial metrics are largely a function of the deemed equity and allowed ROE approved by the BCUC. In general, Canadian deemed equity ratios and allowed ROEs are low relative to those of other jurisdictions.

We expect FEI's cash flow to increase in 2012 and 2103 due to higher levels of non-cash depreciation and amortization expense that will be collected in revenues. The largest driver of the higher depreciation will be FEI's customer care enhancement project which is slated to be placed into service in 2012. We anticipate that these changes will cause CFO pre-WC + Interest / Interest (Cash Flow Interest Coverage) to approach 3x in 2012 and 2013 versus the mid 2x range in recent years. Similarly, we anticipate CFO pre-WC / Debt will exceed 10% in the future versus its approximately 10% level in the past few years.

POTENTIAL AMALGAMATION OF FEI, FEVI AND FEW LIKELY CREDIT NEUTRAL

FEI has indicated that during 2011 it intends to apply to the BCUC to amalgamate FEI, FEVI and FEW and harmonize rates across the amalgamated utility. In an amalgamation scenario, the senior unsecured debt of FEI and FEVI would rank pari passu and be supported by the combined cash flow of the amalgamated utility. While the timing and outcome of the planned amalgamation application are unknown at this time, we expect that amalgamation and rate harmonization would be credit neutral to FEI provided that there are no reductions in deemed equity levels or allowed ROE or increases in the fundamental business risks borne by the amalgamated utility.

STRONG REGULATORY RING-FENCING INSULATES FEI FROM PARENT, FHI

We believe that FEI's ring-fencing is very good relative to that of its peers outside of BC. FEI is subject to a set of regulatory ring-fencing conditions imposed by the BCUC. The ring-fencing conditions provide that, unless otherwise approved by the BCUC, FEI shall: maintain a ratio of common equity to total capital at least as high as the deemed equity capitalization utilized by the BCUC for ratemaking purposes (currently 40%); not pay dividends if they would cause FEI's common equity to total capital to fall below the BCUC's deemed equity percentage; not invest in or financially support any non-regulated business; and not engage in affiliate transactions on anything other than an arm's length basis. We believe that the BCUC ring-fencing provisions effectively insulate FEI from the greater financial and business risks of its parents, FHI and FTS. The regulatory ring-fencing provisions, combined with FTS' philosophy of requiring its utility operating subsidiaries to be operationally and financially independent of FTS and other subsidiaries, allow us to evaluate FEI's credit profile on a stand-alone basis.

Liquidity Profile

We expect FEI's liquidity will be sufficient to meet its funding requirements over the next four quarters.

We expect FEI to generate approximately $215 million of CFO pre-WC during the 12 months ending June 30, 2012. After dividends in the range of $85 million and capital expenditures and working capital changes of approximately $255 million, we expect FEI to be free cash flow (FCF) negative by approximately $125 million. FEI has no material scheduled debt maturities during the twelve months ending June 30, 2012 resulting in a funding requirement of approximately $125 million.

We estimate availability under FEI's credit agreement to be roughly $380 million which exceeds our $125 million estimate of the company's funding requirement.

FEI's $500 million syndicated committed revolving facility matures August 2013 and is available to support its $500 million commercial paper (CP) program and for general corporate purposes. The company is currently well below the debt to total capitalization ratio covenant (maximum

75%) in the credit agreement. Further, the syndicated credit agreement does not contain language such as Material Adverse Change (MAC) clauses or ratings triggers that would inhibit access to the unutilized portion of the facility in situations of financial stress.

Although utilization of FEI's credit facility was limited to roughly $134 million at March 31, 2011, during the peak gas storage season the financing of gas inventory can significantly reduce the unutilized portion of FEI's credit facility. For instance, at the end of the third quarter of 2008, availability under FEI's $500 million credit facility was only about $175 million. We recognize that FEI's reliance on short-term debt to finance gas inventories is supported by the BCUC and that the BCUC has approved the use of an interest rate deferral account to limit FEI's exposure to short-term interest rate volatility. However, we believe that FEI's financial flexibility can become somewhat constrained, particularly, when material debt maturities fall within the peak storage season. Although FEI has no significant debt maturities until September 2015, the BCUC's July 2011 decision to eliminate the majority of FEI's commodity hedging activities is expected to increase the volatility of FEI's cash flow and increase FEI's liquidity requirements. This decision is directionally negative for credit but, at this time, not material enough to impact our rating or outlook.

Rating Outlook

The stable outlook is predicated on FEI's low business risk as a regulated gas LDC, our expectation that FEI's regulatory environment will continue to be supportive and our belief that FEI's financial profile will continue to improve modestly through 2013. The outlook also reflects our belief that if FEI, FEVI and FEW ultimately amalgamate, the amalgamation and rate harmonization would be credit neutral for FEI's credit profile.

What Could Change the Rating - Up

We consider an upward revision in FEI's rating to be unlikely in the near term due to its weak financial profile. However, the rating could be positively impacted if FEI could demonstrate a sustainable improvement in its credit metrics. All else being equal, at the A2 senior unsecured level, Moody's would expect FEI's Cash Flow Interest Coverage to exceed 4x and CFO pre-WC / Debt to be above 19%.

What Could Change the Rating - Down

Notwithstanding FEI's low risk business profile, its financial profile is considered weak at the A3, senior unsecured rating level. Accordingly, a sustained weakening of FEI's Cash Flow Interest Coverage below 2.3x and CFO pre-WC / Debt below 8% combined with a less supportive and predictable regulatory framework would likely result in a downgrade of FEI's rating. This could occur if gas were to lose its competitive advantage over electricity in British Columbia due Provincial policies favouring non-carbon emitting energy sources or other factors.

Rating Factors

FortisBC Energy Inc.

Regulated Electric and Gas Utilities Industry [1][2]	Current		[3]Moody's 12-18 month Forward View As of 07/20/2011	
Factor 1: Regulatory Framework (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Regulatory Framework		Aa		Aa
Factor 2: Ability To Recover Costs And Earn Returns (25%)				
a) Ability To Recover Costs And Earn Returns		A		A
Factor 3: Diversification (10%)				
a) Market Position (10%)		A		A
b) Generation and Fuel Diversity (0%)				
Factor 4: Fin. Strength, Liquidity And Key Fin. Metrics (40%)				
a) Liquidity (10%)		A		A
b) CFO pre-WC + Interest/ Interest (3 Year Avg) (7.5%)	2.6x	Ba1	2.6x-2.8x	Ba1/Baa3
c) CFO pre-WC / Debt (3 Year Avg) (7.5%)	10.2%	Ba2	9%-11%	Ba2/Ba1
d) CFO pre-WC - Dividends / Debt (3 Year Avg) (7.5%)	5.5%	Ba2	5%-7%	Ba2/Ba1
e) Debt/Capitalization (3 Year Avg) (7.5%)	62.9%	Ba3	57%-60%	Ba2/Ba1
Rating:				
a) Indicated Baseline Credit Assessment from Methodology Grid		A3		A3
b) Actual Baseline Credit Assessment Assigned		A3		A3

Source: Moody's Financial Metrics.

[1] All ratios calculated in accordance with Moody's Regulated Electric and Gas Utilities Rating Methodology using Moody's standard adjustments. In addition, Moody's adjusts for one-time items. [2] Financial ratios reflect three year averages for 2008, 2009 and 2010. [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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