



**FORTIS**<sub>INC.</sub>

**Second Quarter 2013**

*Dear Shareholder:*

Fortis achieved second quarter net earnings attributable to common equity shareholders of \$54 million, or \$0.28 per common share, compared to \$62 million, or \$0.33 per common share, for the second quarter of 2012. For the first half of 2013, net earnings attributable to common equity shareholders were \$205 million, or \$1.06 per common share, compared to \$183 million, or \$0.97 per common share, for the first half of last year.



On June 27, 2013, Fortis closed the acquisition of CH Energy Group, Inc. (“CH Energy Group”) for approximately US\$1.5 billion, including the assumption of US\$518 million of debt on closing. The net purchase price of the acquisition was financed using proceeds from a \$601 million common equity offering and drawings under the Corporation’s committed credit facility. Central Hudson Gas & Electric Corporation (“Central Hudson”), the main business of CH Energy Group, is a regulated transmission and distribution utility that serves 377,000 electric and gas customers in New York State’s Mid-Hudson River Valley. Earnings for the quarter were reduced by \$32 million, or \$0.17 per common share, due to acquisition-related expenses and customer and community benefits offered to obtain regulatory approval of the acquisition compared to \$3 million of acquisition-related expenses for the same period last year.

Earnings for the quarter were favourably impacted by an income tax recovery of \$25 million, or \$0.13 per common share, due to the enactment of higher deductions associated with Part VI.1 tax on the Corporation’s preference share dividends. In the second quarter of 2012, earnings were reduced by income tax expenses of \$3 million associated with Part VI.1 tax.

Excluding the above-noted acquisition-related and Part VI.1 tax impacts, net earnings attributable to common equity shareholders for the second quarter of 2013 were \$61 million, or \$0.32 per common share, compared to \$68 million, or \$0.36 per common share, for the second quarter of 2012.

The integration of Central Hudson into the Fortis Group is progressing well. The acquisition is expected to be accretive to earnings per common share of Fortis beginning in 2015.

Regulated utilities, including Central Hudson, comprise approximately 90% of total assets and serve approximately 2.4 million gas and electricity customers across Canada and in New York State and the Caribbean. Regulated rate base assets of Fortis exceed \$10 billion.

Canadian Regulated Gas Utilities contributed earnings of \$6 million compared to \$13 million for the second quarter of 2012. The \$7 million decrease in earnings reflects the \$8 million unfavourable impact for the first half of 2013 of the regulatory decision related to the first phase of the Generic Cost of Capital (“GCOC”) Proceeding in British Columbia, described more fully below, which was recognized in the second quarter of 2013 when the decision was received. Earnings contribution from growth in energy infrastructure investment was largely offset by lower gas transportation volumes to industrial customers and lower-than-expected customer additions.

Canadian Regulated Electric Utilities contributed earnings of \$66 million, up \$15 million from the second quarter of 2012. For the second quarter, earnings at Newfoundland Power and Maritime Electric were favourably impacted by income tax recoveries of \$13 million and \$4 million, respectively, associated with Part VI.1 tax. FortisAlberta's earnings decreased \$1 million, due to lower net transmission revenue and timing of the recognition of a regulatory decision in 2012 impacting depreciation, partially offset by timing of operating expenses, growth in energy infrastructure investment and customer growth. The utility's depreciation rates were reduced, effective January 1, 2012, as a result of the decision related to FortisAlberta's 2012 revenue requirements, the impact of which was not recognized until the second quarter of 2012 when the decision was received. FortisBC Electric's earnings were \$1 million lower quarter over quarter, due to the \$2 million unfavourable impact for the first half of 2013 of the regulatory decision related to the first phase of the GCOC Proceeding, which was recognized in the second quarter of 2013 when the decision was received, partially offset by lower-than-expected finance charges, growth in energy infrastructure investment and higher capitalized allowance for funds used during construction.

In May 2013 the British Columbia Utilities Commission issued its decision on the first phase of its GCOC Proceeding. As a result, the allowed rate of return on common shareholders' equity ("ROE") for FortisBC Energy Inc. has been set at 8.75%, as compared to 9.50% for 2012, and the common equity component of capital structure has been reduced from 40.0% to 38.5% for 2013 through 2015. The interim allowed ROEs for the other FortisBC Energy companies, FortisBC Energy (Vancouver Island) Inc. ("FEVI") and FortisBC Energy (Whistler) Inc. ("FEWI"), and for FortisBC Electric were also reduced by 75 basis points for 2013 as a result of the first phase of the GCOC Proceeding, while the common equity components of the capital structures remain unchanged. Final allowed ROEs and capital structures for FEVI, FEWI and FortisBC Electric will be determined in the second phase of the GCOC Proceeding, which is currently underway.

In April 2013 Newfoundland Power received a cost of capital decision maintaining the utility's allowed ROE and common equity component of capital structure at 8.8% and 45%, respectively, for 2013 through 2015. FortisAlberta's allowed ROE and capital structure for 2013 remain to be determined.

Caribbean Regulated Electric Utilities contributed \$6 million of earnings, comparable with the second quarter of 2012.

Non-Regulated Fortis Generation contributed \$3 million of earnings compared to \$6 million for the second quarter of 2012. The \$3 million decrease in earnings is mainly related to lower production in Belize due to lower rainfall.

Non-Utility operations contributed earnings of \$9 million, \$1 million higher than earnings for the second quarter of 2012, largely related to performance at Fortis Properties' hotels in western Canada.

Corporate and other expenses were \$36 million compared to \$22 million for the second quarter of 2012. Corporate and other expenses for the second quarter of 2013 included \$32 million in CH Energy Group transaction expenses, compared to \$3 million for the same quarter last year. An approximate \$8 million income tax recovery, associated with Part VI.1 tax, reduced Corporate and other expenses in the second quarter of 2013, compared to income tax expense of

\$3 million associated with Part VI.1 tax for the same quarter last year. Excluding the above-noted impacts, Corporate and other expenses were \$4 million lower, quarter over quarter, mainly due to the favourable impact of the release of income tax provisions in the second quarter of 2013, a higher foreign exchange gain and lower finance charges, partially offset by higher preference share dividends.

Consolidated capital expenditures, before customer contributions, were approximately \$548 million for the first half of 2013 and are expected to total approximately \$1.3 billion for the year. Construction of the \$900 million, 335-megawatt Waneta Expansion hydroelectric generating facility (“Waneta Expansion”) in British Columbia continues on time and on budget, with completion of the facility expected in spring 2015. Approximately \$513 million in total has been invested in the Waneta Expansion since construction began in late 2010.

Cash flow from operating activities was \$571 million for the first half of 2013 compared to \$583 million for the first half of 2012.

Fortis has consolidated credit facilities of \$2.7 billion, of which \$1.7 billion was unused as at June 30, 2013. Credit facility borrowings as at June 30, 2013 include \$605 million in drawings under the Corporation’s committed credit facility. In July 2013 Fortis issued 10 million Cumulative Redeemable Fixed Rate Reset First Preference Shares, Series K for gross proceeds of \$250 million, the proceeds of which were used to redeem all of the Corporation’s First Preference Shares, Series C in July 2013 for \$125 million, to repay a portion of credit facility borrowings and for other general corporate purposes. In July 2013 the Corporation also priced a private placement of 10-year US\$285 million unsecured notes at 3.84% and 30-year US\$40 million unsecured notes at 5.08%. The offering is scheduled to close on October 1, 2013. Proceeds from the offering will be used to repay a portion of US dollar-denominated committed credit facility borrowings incurred to initially finance a portion of the CH Energy Group acquisition.

The second half of 2013 will continue to be very busy for Fortis, with significant regulatory proceedings in British Columbia and Alberta and with work continuing on capital projects for the year to ensure we continue to meet our customers’ energy needs. Our five-year capital program, including Central Hudson, is projected to total \$6 billion, which is expected to drive growth in earnings and dividends.

We welcome the employees of Central Hudson to the Fortis team, now some 8,400 individuals strong. The addition of this well-run U.S. utility and its proven track record for providing customers with quality service will further enhance the positioning of Fortis as a leader in the North American utility industry.



*H. Stanley Marshall*  
*President and Chief Executive Officer*  
*Fortis Inc.*

# Interim Management Discussion and Analysis

For the three and six months ended June 30, 2013

Dated August 1, 2013

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## FORWARD-LOOKING INFORMATION

The following Fortis Inc. ("Fortis" or the "Corporation") Management Discussion and Analysis ("MD&A") has been prepared in accordance with National Instrument 51-102 - *Continuous Disclosure Obligations*. The MD&A should be read in conjunction with the interim unaudited consolidated financial statements and notes thereto for the three and six months ended June 30, 2013 and the MD&A and audited consolidated financial statements for the year ended December 31, 2012 included in the Corporation's 2012 Annual Report. Financial information contained in the MD&A has been prepared in accordance with accounting principles generally accepted in the United States ("US GAAP") and is presented in Canadian dollars unless otherwise specified.

*Fortis includes forward-looking information in the Management Discussion and Analysis ("MD&A") within the meaning of applicable securities laws in Canada ("forward-looking information"). The purpose of the forward-looking information is to provide management's expectations regarding the Corporation's future growth, results of operations, performance, business prospects and opportunities, and it may not be appropriate for other purposes. All forward-looking information is given pursuant to the safe harbour provisions of applicable Canadian securities legislation. 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 reflects management's current beliefs and is based on information currently available to the Corporation's management. The forward-looking information in the MD&A includes, but is not limited to, statements regarding: the Corporation's forecasted gross consolidated capital expenditures for 2013 and total capital spending over the five-year period 2013 through 2017; the expectation that capital investment over the above-noted five-year period will allow utility rate base and hydroelectric investment to increase at a combined compound annual growth rate of approximately 6%; the expected nature, timing and capital cost related to the construction of the Waneta Expansion hydroelectric generating facility ("Waneta Expansion"); the expectation that, based on current tax legislation, future earnings will not be materially impacted by Part VI.1 tax; the expectation that cash required to complete subsidiary capital expenditure programs will be sourced from a combination of cash from operations, borrowings under credit facilities, equity injections from Fortis and long-term debt offerings; the expectation that the combination of available credit facilities and relatively low annual debt maturities and repayments will provide the Corporation and its subsidiaries with flexibility in the timing of access to capital markets; the expected consolidated long-term debt maturities and repayments on average annually over the next five years; the expectation that the Corporation and its subsidiaries will remain compliant with debt covenants during 2013; the expected timing of filing of regulatory applications and of receipt of regulatory decisions; the expectation that the acquisition of CH Energy Group, Inc. ("CH Energy Group") will be accretive to earnings per common share of Fortis beginning in 2015; and the expectation that the Corporation's capital expenditure program will support continuing growth in earnings and dividends.*

*The forecasts and projections that make up the forward-looking information are based on assumptions which include, but are not limited to: the receipt of applicable regulatory approvals and requested rate orders, no material adverse regulatory decisions being received and the expectation of regulatory stability; FortisAlberta continues to recover its cost of service and earn its allowed rate of return on common shareholders' equity ("ROE") under performance-based rate-setting, which commenced for a five-year term effective January 1, 2013; no significant variability in interest rates; no significant operational disruptions or environmental liability due to a catastrophic event or environmental upset caused by severe weather, other acts of nature or other major events; the continued ability to maintain the gas and electricity systems to ensure their continued performance; no severe and prolonged*

downturn in economic conditions; no significant decline in capital spending; no material capital project and financing cost overrun related to the construction of the Waneta Expansion; sufficient liquidity and capital resources; the expectation that the Corporation will receive appropriate compensation from the Government of Belize ("GOB") for the fair value of the Corporation's investment in Belize Electricity that was expropriated by the GOB; the expectation that Belize Electric Company Limited will not be expropriated by the GOB; the continuation of regulator-approved mechanisms to flow through the commodity cost of natural gas and energy supply costs in customer rates; the ability to hedge exposures to fluctuations in foreign exchange rates, natural gas commodity prices, electricity prices and fuel prices; no significant counterparty defaults; the continued competitiveness of natural gas pricing when compared with electricity and other alternative sources of energy; the continued availability of natural gas, fuel and electricity supply; continuation and regulatory approval of power supply and capacity purchase contracts; the ability to fund defined benefit pension plans, earn the assumed long-term rates of return on the related assets and recover net pension costs in customer rates; no significant changes in government energy plans and environmental laws that may materially negatively affect the operations and cash flows of the Corporation and its subsidiaries; no material change in public policies and directions by governments that could materially negatively affect the Corporation and its subsidiaries; maintenance of adequate insurance coverage; the ability to obtain and maintain licences and permits; retention of existing service areas; the ability to report under accounting principles generally accepted in the United States beyond 2014 or the adoption of International Financial Reporting Standards after 2014 that allows for the recognition of regulatory assets and liabilities; the continued tax-deferred treatment of earnings from the Corporation's Caribbean operations; continued maintenance of information technology infrastructure; continued favourable relations with First Nations; favourable labour relations; and sufficient human resources to deliver service and execute the capital program.

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. Risk factors which could cause results or events to differ from current expectations are detailed under the heading "Business Risk Management" in this MD&A, the Corporation's MD&A for the year ended December 31, 2012 and in continuous disclosure materials filed from time to time with Canadian securities regulatory authorities. Key risk factors for 2013 include, but are not limited to: uncertainty of the impact a continuation of a low interest rate environment may have on the allowed ROE at each of the Corporation's regulated utilities in western Canada; risk associated with the amount of compensation to be paid to Fortis for its investment in Belize Electricity that was expropriated by the GOB; and the timeliness of the receipt of compensation and the ability of the GOB to pay the compensation owing to Fortis.

All forward-looking information in the MD&A is qualified in its entirety by the above cautionary statements 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

Fortis is the largest investor-owned gas and electric distribution utility in Canada. Its regulated utilities account for 90% of total assets and serve approximately 2.4 million gas and electricity customers across Canada and in New York State and the Caribbean. Fortis owns non-regulated hydroelectric generation assets in Canada, Belize and Upstate New York. The Corporation's non-utility investments are comprised of hotels and commercial real estate in Canada and petroleum supply operations in the Mid-Atlantic Region of the United States.

Year-to-date June 30, 2013, the Corporation's electricity distribution systems met a combined peak demand of approximately 5,159 megawatts ("MW") and its gas distribution system met a peak day demand of 1,113 terajoules ("TJ"). For additional information on the Corporation's business segments, refer to Note 1 to the Corporation's interim unaudited consolidated financial statements for the three and six months ended June 30, 2013 and to the "Corporate Overview" section of the 2012 Annual MD&A.

The Corporation's main business, utility operations, is highly regulated and the earnings of the Corporation's regulated utilities are primarily determined under cost of service ("COS") regulation. Generally under COS regulation, the respective regulatory authority sets customer gas and/or electricity rates to permit a reasonable opportunity for the utility to recover, on a timely basis, estimated costs of providing service to customers, including a fair rate of return on a regulatory deemed or targeted capital structure applied to an approved regulatory asset value ("rate base"). The ability of a regulated utility to recover prudently incurred costs of providing service and earn the regulator-approved rate of return on common shareholders' equity ("ROE") and/or rate of return on rate base assets ("ROA") depends on the utility achieving the forecasts established in the rate-setting processes. As such, earnings of regulated utilities are generally impacted by: (i) changes in the regulator-approved allowed ROE and/or ROA and equity component of capital structure; (ii) changes in rate base; (iii) changes in energy sales or gas delivery volumes; (iv) changes in the number and composition of customers; (v) variances between actual expenses incurred and forecasted expenses used to determine revenue requirements and set customer rates; and (vi) timing differences within an annual financial reporting period between when actual expenses are incurred and when they are recovered from customers in rates. When forward test years are used to establish revenue requirements and set base customer rates, these rates are not adjusted as a result of actual COS being different from that which is estimated, other than for certain prescribed costs that are eligible to

be deferred on the balance sheet. In addition, the Corporation's regulated utilities, where applicable, are permitted by their respective regulatory authority to flow through to customers, without markup, the cost of natural gas, fuel and/or purchased power through base customer rates and/or the use of rate stabilization and other mechanisms.

When performance-based rate-setting ("PBR") mechanisms are utilized in determining annual revenue requirements and resulting customer rates, a formula is generally applied that incorporates inflation and assumed productivity improvements. The use of PBR mechanisms should allow a utility a reasonable opportunity to recover prudent COS and earn its allowed ROE.

## SIGNIFICANT ITEMS

**Acquisition of CH Energy Group, Inc.:** On June 27, 2013, Fortis acquired all of the outstanding common shares of CH Energy Group, Inc. ("CH Energy Group") for US\$65.00 per common share in cash, for an aggregate purchase price of approximately US\$1.5 billion, including the assumption of US\$518 million of debt on closing. The net purchase price of approximately \$1,019 million (US\$972 million) was financed through proceeds from the issuance of 18.5 million common shares of Fortis pursuant to the conversion of Subscription Receipts on closing of the acquisition for proceeds of approximately \$567 million, net of after-tax expenses, with the balance being initially funded through drawings under the Corporation's \$1 billion committed credit facility.

CH Energy Group is an energy delivery company headquartered in Poughkeepsie, New York. Its main business, Central Hudson Gas & Electric Corporation ("Central Hudson"), is a regulated transmission and distribution ("T&D") utility serving approximately 300,000 electric and 77,000 natural gas customers in eight counties of New York State's Mid-Hudson River Valley. Central Hudson accounts for approximately 93% of the total assets of CH Energy Group and is subject to regulation by the New York State Public Service Commission ("PSC") under a traditional COS model. CH Energy Group's non-regulated operations mainly consist of Griffith Energy Services, Inc. ("Griffith"), which is primarily a fuel delivery business serving approximately 56,000 customers in the Mid-Atlantic Region of the United States.

To obtain regulatory approval of the acquisition, Fortis committed to provide Central Hudson's customers and community with approximately US\$50 million in financial benefits. These incremental benefits outlined in the PSC order approving the acquisition include: (i) US\$35 million to cover expenses that would normally be recovered in customer rates, including certain storm-restoration expenses; (ii) guaranteed savings to customers of more than US\$9 million over five years resulting from the elimination of costs CH Energy Group would otherwise incur as a public company; and (iii) the establishment of a US\$5 million Community Benefit Fund to be used for low-income customer and economic development programs for communities and residents of the Mid-Hudson River Valley. In addition, electric and natural gas customers of Central Hudson will benefit from a delivery rate freeze through to June 30, 2015. The Company is committed to invest US\$215 million in capital expenditures over the same two-year period, including an estimated US\$50 million which will have a "storm-hardening" effect on its infrastructure.

The above-noted commitments of US\$35 million and US\$5 million, together with acquisition-related expenses of approximately US\$8 million, have been recognized in the Corporation's earnings for the second quarter of 2013. The acquisition is expected to be accretive to earnings per common share of Fortis beginning in 2015.

For further information on Central Hudson, refer to the "Segmented Results of Operation - Regulated Gas & Electric Utility - United States" section of this MD&A.

**Part VI.1 Tax:** In June 2013 the Government of Canada enacted changes associated with Part VI.1 tax on the Corporation's preference share dividends. In accordance with US GAAP, income taxes are required to be recognized based on enacted tax legislation. In the second quarter of 2013, the Corporation recognized an approximate \$25 million income tax recovery due to the enactment of higher deductions associated with Part VI.1 tax. The income tax recovery impacted earnings at Newfoundland Power, Maritime Electric and the Corporation as a result of the allocation of Part VI.1 tax in previous years. Currently, all legislative changes associated with Part VI.1 tax are enacted and, as a result, future earnings are not expected to be materially impacted by Part VI.1 tax.

**Receipt of Regulatory Decisions:** In March 2013 FortisAlberta received a decision from its regulator approving an interim increase in customer distribution rates, effective January 1, 2013.

In April 2013 Newfoundland Power received a cost of capital decision maintaining the utility's allowed ROE and common equity component of capital structure at 8.8% and 45%, respectively, for 2013 through 2015.

In May 2013 the British Columbia Utilities Commission ("BCUC") issued its decision on the first phase of its Generic Cost of Capital ("GCOC") Proceeding for British Columbia utilities. As a result, the allowed ROE for FortisBC Energy Inc. ("FEI"), which is the benchmark utility for calculating the allowed ROE for certain utilities in British Columbia, has been set at 8.75%, as compared to 9.50% for 2012, and the common equity component of capital structure has been reduced from 40.0% to 38.5% for 2013 through 2015. The interim allowed ROEs for the other FortisBC Energy companies, FortisBC Energy (Vancouver Island) Inc. ("FEVI") and FortisBC Energy (Whistler) Inc. ("FEWI"), and FortisBC Electric were also reduced by 75 basis points for 2013 as a result of the first phase of the GCOC Proceeding, while the common equity components of the capital structures remain unchanged. Final allowed ROEs and capital structures for FEVI, FEWI and FortisBC Electric will be determined in the second phase of the GCOC Proceeding, which is currently underway.

For a further discussion on the nature of the above regulatory decisions, refer to the "Material Regulatory Decisions and Applications" section of this MD&A.

**Settlement of Expropriation Matters - Exploits River Hydro Partnership:** In March 2013 the Corporation and the Government of Newfoundland and Labrador ("Government") settled all matters, including release from all debt obligations, pertaining to the Government's December 2008 expropriation of non-regulated hydroelectric generating assets and water rights in central Newfoundland, then owned by Exploits River Hydro Partnership ("Exploits Partnership"), in which Fortis held an indirect 51% interest. As a result of the settlement, an extraordinary after-tax gain of approximately \$22 million was recognized in the first quarter of 2013.

**Acquisition of the Electrical Utility Assets from the City of Kelowna:** FortisBC Electric acquired the electrical utility assets of the City of Kelowna (the "City") for approximately \$55 million in March 2013, which now allows FortisBC Electric to directly serve some 15,000 customers formerly served by the City. FortisBC Electric had provided the City with electricity under a wholesale tariff and had operated and maintained the City's electrical utility assets under contract since 2000.



## FINANCIAL HIGHLIGHTS

Fortis has adopted a strategy of profitable growth with earnings per common share as the primary measure of performance. The Corporation's business is segmented by franchise area and, depending on regulatory requirements, by the nature of the assets. Key financial highlights for the second quarter and year-to-date periods ended June 30, 2013 and June 30, 2012 are provided in the following table.

<b>Consolidated Financial Highlights (Unaudited)</b>						
Periods Ended June 30	<b>Quarter</b>			<b>Year-to-Date</b>		
<i>(\$ millions, except for common share data)</i>	<b>2013</b>	2012	Variance	<b>2013</b>	2012	Variance
Revenue	<b>790</b>	792	(2)	<b>1,903</b>	1,941	(38)
Energy Supply Costs	<b>282</b>	291	(9)	<b>787</b>	857	(70)
Operating Expenses	<b>206</b>	204	2	<b>427</b>	418	9
Depreciation and Amortization	<b>130</b>	114	16	<b>259</b>	233	26
Other Income (Expenses), Net	<b>(44)</b>	-	(44)	<b>(38)</b>	(3)	(35)
Finance Charges	<b>92</b>	92	-	<b>181</b>	183	(2)
Income Tax (Recovery) Expense	<b>(34)</b>	14	(48)	<b>(4)</b>	37	(41)
Earnings Before Extraordinary Item	<b>70</b>	77	(7)	<b>215</b>	210	5
Extraordinary Gain, Net of Tax	-	-	-	<b>22</b>	-	22
<b>Net Earnings</b>	<b>70</b>	77	(7)	<b>237</b>	210	27
Net Earnings Attributable to:						
Non-Controlling Interests	<b>2</b>	3	(1)	<b>4</b>	4	-
Preference Equity Shareholders	<b>14</b>	12	2	<b>28</b>	23	5
Common Equity Shareholders	<b>54</b>	62	(8)	<b>205</b>	183	22
<b>Net Earnings</b>	<b>70</b>	77	(7)	<b>237</b>	210	27
Earnings per Common Share Before Extraordinary Item						
Basic (\$)	<b>0.28</b>	0.33	(0.05)	<b>0.95</b>	0.97	(0.02)
Diluted (\$)	<b>0.28</b>	0.33	(0.05)	<b>0.94</b>	0.95	(0.01)
Earnings per Common Share						
Basic (\$)	<b>0.28</b>	0.33	(0.05)	<b>1.06</b>	0.97	0.09
Diluted (\$)	<b>0.28</b>	0.33	(0.05)	<b>1.05</b>	0.95	0.10
Weighted Average Common Shares Outstanding (# millions)	<b>193.4</b>	189.6	3.8	<b>192.7</b>	189.3	3.4
Cash Flow from Operating Activities	<b>291</b>	255	36	<b>571</b>	583	(12)

### Factors Contributing to Quarterly and Year-to-Date Revenue Variances

#### Unfavourable

- Lower commodity cost of natural gas charged to customers at the FortisBC Energy companies
- Decreases in the allowed ROEs at the FortisBC Energy companies and FortisBC Electric, and a decrease in the equity component of capital structure at FEI as a result of the BCUC decision in May 2013 on the first phase of its GCOC Proceeding
- Lower average gas consumption by residential and commercial customers and lower gas transportation volumes to industrial customers at the FortisBC Energy companies
- Decreased non-regulated hydroelectric production in Belize, due to lower rainfall
- Lower net transmission revenue at FortisAlberta

#### Favourable

- An increase in gas delivery rates at the FortisBC Energy companies and the base component of electricity rates at most of the regulated electric utilities, consistent with rate decisions, reflecting ongoing investment in energy infrastructure and forecasted certain higher expenses recoverable from customers
- Growth in the number of customers, driven by FortisAlberta
- Increased electricity sales at Newfoundland Power, Maritime Electric, Fortis Turks and Caicos and Caribbean Utilities

**Factors Contributing to Quarterly and Year-to-Date  
Energy Supply Costs Variances**

*Favourable*

- Lower commodity cost of natural gas
- Lower average gas consumption by residential and commercial customers and lower gas transportation volumes to industrial customers at the FortisBC Energy companies, which reduced natural gas purchases

*Unfavourable*

- Increased electricity sales at Newfoundland Power, Maritime Electric, Fortis Turks and Caicos and Caribbean Utilities, which increased fuel and power purchases
- Increased costs at Maritime Electric associated with energy supply costs expensed in the first half of 2013 related to the New Brunswick Power Point Lepreau nuclear generating station ("Point Lepreau"), which returned to service in the fourth quarter of 2012

**Factor Contributing to Quarterly and Year-to-Date  
Operating Expenses Variances**

*Unfavourable*

- General inflationary and employee-related cost increases at most of the Corporation's regulated utilities

**Factors Contributing to Quarterly and Year-to-Date  
Depreciation and Amortization Expense Variances**

*Unfavourable*

- Continued investment in energy infrastructure at the Corporation's regulated utilities
- Lower depreciation rates at FortisAlberta, effective January 1, 2012, as a result of the 2012 distribution revenue requirements decision received in April 2012. The cumulative impact of the overall decrease in depreciation rates was recognized in the second quarter of 2012, when the decision was received. Approximately \$3 million of decreased depreciation expense related to the first quarter of 2012.

**Factors Contributing to Quarterly and Year-to-Date  
Other Income (Expenses), Net Variances**

*Unfavourable*

- Approximately \$41 million (US\$40 million), or \$26 million (US\$26 million) after tax, in expenses associated with customer and community benefits offered by the Corporation to close the acquisition of CH Energy Group in June 2013
- Approximately \$8 million (\$6 million after tax) in costs incurred in the second quarter of 2013 related to the acquisition of CH Energy Group, compared to approximately \$4 million (\$3 million after tax) and \$8 million (\$7 million after tax) for the second quarter and first half of 2012, respectively

*Favourable*

- Foreign exchange gains of approximately \$3 million and \$5 million for the second quarter and the first half of 2013, respectively, associated with the translation of the US dollar-denominated long-term other asset representing the book value of the Corporation's expropriated investment in Belize Electricity, compared to approximately \$2 million and \$0.5 million, respectively, for the same periods in 2012

### **Factors Contributing to Quarterly and Year-to-Date Finance Charges Variances**

#### *Favourable*

- Higher capitalized interest associated with the financing of the construction of the Corporation's 51% controlling ownership interest in the Waneta Expansion hydroelectric generating facility ("Waneta Expansion")
- Higher capitalized allowance for funds used during construction ("AFUDC"), mainly at FortisBC Electric

#### *Unfavourable*

- Higher long-term debt levels in support of the utilities' capital expenditure programs

### **Factors Contributing to Quarterly and Year-to-Date Income Tax (Recovery) Expense Variances**

#### *Favourable*

- An approximate \$25 million income tax recovery in the second quarter of 2013, due to the enactment of higher deductions associated with Part VI.1 tax, compared to income tax expense of \$3 million associated with Part VI.1 tax for the same quarter last year. In the first quarter of 2013, income tax expense included \$2 million associated with Part VI.1 tax.
- An approximate \$5 million income tax recovery associated with the release of income tax provisions in the second quarter of 2013

#### *Unfavourable*

- Higher effective income taxes, due to differences in the deductions for income tax purposes compared to accounting purpose, mainly at the FortisBC Energy companies and FortisBC Electric

### **Factor Contributing to Year-to-Date Extraordinary Gain, Net of Tax Variance**

#### *Favourable*

- An approximate \$25 million (\$22 million after-tax) extraordinary gain recognized in the first quarter of 2013 on the settlement of expropriation matters associated with Exploits Partnership

### **Factors Contributing to Quarterly Earnings Variance**

#### *Unfavourable*

- Higher corporate expenses due to \$32 million in CH Energy Group transaction expenses and higher preference share dividends, due to the issuance of First Preference Shares, Series J in November 2012. The increases were partially offset by: (i) income tax recoveries of approximately \$13 million, comprised of \$8 million associated with Part VI.1 tax and \$5 million associated with the release of income tax provisions in the second quarter of 2013; (ii) a higher foreign exchange gain associated with the translation of the US dollar-denominated long-term other asset representing the book value of the Corporation's expropriated investment in Belize Electricity; and (iii) lower finance charges. In the first quarter of 2013, income tax expense included \$2 million associated with Part VI.1 tax.
- Decreased earnings at the FortisBC Energy companies primarily due to: (i) the \$8 million unfavourable impact for the first half of 2013 of the regulatory decision in May 2013 related to the first phase of the GCOC Proceeding; (ii) lower gas transportation volumes to industrial customers; and (iii) lower-than-expected customer additions. The decreases were partially offset by earnings contribution from growth in energy infrastructure investment.
- Decreased earnings at FortisBC Electric mainly due to the \$2 million unfavourable impact for the first half of 2013 of the regulatory decision in May 2013 related to first phase of the GCOC Proceeding, partially offset by lower-than-expected finance charges, growth in energy infrastructure investment and higher capitalized AFUDC
- Decreased non-regulated hydroelectric production in Belize, due to lower rainfall
- Decreased earnings at FortisAlberta due to lower net transmission revenue and timing of the recognition of a regulatory decision in 2012 impacting depreciation, partially offset by timing of operating expenses, growth in energy infrastructure investment and customer growth

*Favourable*

- Increased earnings at Newfoundland Power and Maritime Electric due to income tax recoveries of \$13 million and \$4 million, respectively, associated with Part VI.1 tax

**Factors Contributing to Year-to-Date Earnings Variance**

*Favourable*

- An approximate \$22 million after-tax extraordinary gain recognized in the first quarter of 2013 on the settlement of expropriation matters associated with the Exploits Partnership
- Increased earnings at Newfoundland Power and Maritime Electric due to income tax recoveries associated with Part VI.1 tax, as discussed above
- Increased earnings at FortisAlberta, due to timing of operating expenses, growth in energy infrastructure investment and customer growth, partially offset by lower net transmission revenue

*Unfavourable*

- Higher corporate expenses, for the same reasons discussed above for the quarter
- Decreased earnings at the FortisBC Energy companies, for the same reasons discussed above for the quarter, as well as higher effective income taxes
- Decreased non-regulated hydroelectric production in Belize, due to lower rainfall

**SEGMENTED RESULTS OF OPERATIONS**

The basis of segmentation of the Corporation's reportable segments is consistent with that disclosed in the 2012 Annual MD&A, except as follows as a result of the acquisition of CH Energy Group. Central Hudson is reported in a new segment "Regulated Gas & Electric Utility - United States"; and the former "Non-Regulated - Fortis Properties" segment is now "Non Regulated - Non-Utility" and is comprised of Fortis Properties and Griffith, the non-regulated operations of CH Energy Group.

<b>Segmented Net Earnings Attributable to Common Equity Shareholders (Unaudited)</b>						
Periods Ended June 30	<b>Quarter</b>			<b>Year-to-Date</b>		
<i>(\$ millions)</i>	<b>2013</b>	2012	Variance	<b>2013</b>	2012	Variance
<b>Regulated Gas Utilities - Canadian</b>						
FortisBC Energy Companies	<b>6</b>	13	(7)	<b>91</b>	95	(4)
<b>Regulated Gas &amp; Electric Utility - United States</b>						
Central Hudson	-	-	-	-	-	-
<b>Regulated Electric Utilities - Canadian</b>						
FortisAlberta	<b>25</b>	26	(1)	<b>51</b>	47	4
FortisBC Electric	<b>8</b>	9	(1)	<b>26</b>	25	1
Newfoundland Power	<b>24</b>	11	13	<b>31</b>	18	13
Other Canadian Electric Utilities	<b>9</b>	5	4	<b>15</b>	12	3
	<b>66</b>	51	15	<b>123</b>	102	21
Regulated Electric Utilities - Caribbean	<b>6</b>	6	-	<b>9</b>	9	-
Non-Regulated - Fortis Generation	<b>3</b>	6	(3)	<b>27</b>	11	16
Non-Regulated - Non-Utility	<b>9</b>	8	1	<b>9</b>	9	-
Corporate and Other	<b>(36)</b>	(22)	(14)	<b>(54)</b>	(43)	(11)
<b>Net Earnings Attributable to Common Equity Shareholders</b>	<b>54</b>	62	(8)	<b>205</b>	183	22

For a discussion of the nature of regulation and material regulatory decisions and applications pertaining to the Corporation's regulated utilities, refer to the "Regulatory Highlights" section of this MD&A. A discussion of the financial results of the Corporation's reporting segments follows.

## REGULATED GAS UTILITIES - CANADIAN

### FORTISBC ENERGY COMPANIES <sup>(1)</sup>

Financial Highlights (Unaudited) Periods Ended June 30	Quarter			Year-to-Date		
	2013	2012	Variance	2013	2012	Variance
Gas Volumes ( <i>petajoules ("PJ")</i> )	36	40	(4)	107	112	(5)
Revenue ( <i>\$ millions</i> )	246	264	(18)	738	812	(74)
Earnings ( <i>\$ millions</i> )	6	13	(7)	91	95	(4)

<sup>(1)</sup> Includes FEI, FEVI and FEWI

#### Factors Contributing to Quarterly and Year-to-Date Gas Volumes Variances

##### Unfavourable

- Lower average gas consumption by residential and commercial customers, due to warmer temperatures
- Lower gas transportation volumes to industrial customers

As at June 30, 2013, the total number of customers served by the FortisBC Energy companies was approximately 947,000. Net customer additions for the first half of 2013 were approximately 2,000, comparable to the first half of 2012.

The FortisBC Energy companies earn approximately the same margin regardless of whether a customer contracts for the purchase and delivery of natural gas or only for the delivery of natural gas. As a result of the operation of regulator-approved deferral mechanisms, changes in consumption levels and the commodity cost of natural gas from those forecast to set residential and commercial customer gas rates do not materially affect earnings.

Seasonality has a material impact on the earnings of the FortisBC Energy companies as a major portion of the gas distributed is used for space heating. Most of the annual earnings of the FortisBC Energy companies are realized in the first and fourth quarters.

#### Factors Contributing to Quarterly and Year-to-Date Revenue Variances

##### Unfavourable

- Lower commodity cost of natural gas charged to customers
- Decreases in the allowed ROE and the equity component of capital structure, as a result of the regulatory decision in May 2013 related to the first phase of the GCOC Proceeding in British Columbia
- Lower average gas consumption by residential and commercial customers and lower gas transportation volumes to industrial customers

##### Favourable

- An increase in the delivery component of customer rates, effective January 1, 2013, mainly due to ongoing investment in energy infrastructure and forecasted higher expenses recoverable from customers as reflected in the 2012/2013 revenue requirements decision received in April 2012

#### Factors Contributing to Quarterly and Year-to-Date Earnings Variances

##### Unfavourable

- Decreases in the allowed ROE and the equity component of the capital structure, as discussed above. The cumulative impact of the decision, effective January 1, 2013, of approximately \$8 million was recognized in the second quarter when the decision was received.
- Lower gas transportation volumes to industrial customers
- Lower-than-expected customer additions
- Higher effective income taxes, due to differences in the deductions for income tax purposes compared to accounting purposes

##### Favourable

- Rate base growth, due to continued investment in energy infrastructure

## REGULATED GAS & ELECTRIC UTILITY - UNITED STATES

### CENTRAL HUDSON

Central Hudson is a regulated T&D utility serving approximately 300,000 electric and 77,000 natural gas customers in eight counties of New York State's Mid-Hudson River Valley. The Company's electric assets, which comprise approximately 77% of its total assets as at June 30, 2013, include over 11,700 kilometres of distribution lines and approximately 2,300 kilometres of transmission lines. The electric business met a peak demand of 1,168 MW in 2012. Central Hudson's natural gas assets, which comprise the remaining 23% of its total assets as at June 30, 2013, include approximately 1,900 kilometres of distribution pipelines and more than 264 kilometres of transmission pipelines. The gas business met a peak day demand of 115 TJ in 2012.

Central Hudson primarily relies on electricity purchases from third-party providers and the New York Independent System Operator ("NYISO")-administered energy and capacity markets to meet the demands of its full-service electricity customers. It also generates a small portion of its electricity requirements. Central Hudson purchases its gas supply requirements from a number of suppliers at various receipt points on pipelines that it has contracted with for firm transport capacity.

### Regulation

Central Hudson is regulated by the PSC regarding such matters as rates, construction, operations, financing and accounting. Certain activities of the Company are subject to regulation by the U.S. Federal Energy Regulatory Commission under the *Federal Power Act* (United States). Central Hudson is also subject to regulation by the North American Electric Reliability Corporation.

Central Hudson operates under COS regulation as administered by the PSC. The PSC provides for the use of a future test year in the establishment of rates for the utility and, pursuant to this method, the determination of the approved rate of return on forecast rate base and deemed capital structure, together with the forecast of all reasonable and prudent costs, establishes the revenue requirement upon which the Company's customer rates are determined. Once rates are approved, they are not adjusted as a result of actual COS being different from that which was applied for, other than for certain prescribed costs that are eligible for deferral account treatment.

Central Hudson's allowed ROE is set at 10% on a deemed capital structure of 48% common equity. The Company began operating under a three-year rate order issued by the PSC effective July 1, 2010. As approved by the PSC in June 2013, the original three-year rate order has been extended for two years, through June 30, 2015, as a condition required to close the acquisition of CH Energy Group by Fortis. Effective July 1, 2013, Central Hudson is also subject to a modified earnings sharing mechanism, whereby the Company and customers share equally earnings in excess of the allowed ROE up to an achieved ROE that is 50 basis points above the allowed ROE, and share 10%/90% (Company/customers) earnings in excess of 50 basis points above the allowed ROE.

Central Hudson's approved regulatory regime also allows for full recovery of purchased electricity and natural gas costs. The Company's rates also include Revenue Decoupling Mechanisms ("RDMS") which are intended to minimize the earnings impact resulting from reduced energy consumption as energy-efficiency programs are implemented. The RDMS allow the Company to recognize electric delivery revenue and gas revenue at the levels approved in rates for most of Central Hudson's customer base. Deferral account treatment is approved for certain other specified costs, including provisions for manufactured gas plant ("MGP") site remediation, pension and other post-employment benefit ("OPEB") costs.

## Financial Highlights

The financial statements of Central Hudson have been included in the consolidated financial statements of Fortis commencing June 27, 2013, the date of acquisition. Other than expenses associated with customer and community benefits offered by the Corporation to close the acquisition of CH Energy Group reported in the Corporate and Other segment, financial performance for Central Hudson from the date of acquisition through June 30, 2013 did not have a material impact on the Corporation's consolidated statement of earnings.

Seasonality impacts the delivery revenues of Central Hudson, as sales of electricity are highest during the summer months, primarily due to the use of air conditioning and other cooling equipment, and sales of natural gas are highest during the winter months, primarily due to space heating usage.

## REGULATED ELECTRIC UTILITIES - CANADIAN

### FORTISALBERTA

Financial Highlights (Unaudited) Periods Ended June 30	Quarter			Year-to-Date		
	2013	2012	Variance	2013	2012	Variance
Energy Deliveries ( <i>gigawatt hours ("GWh")</i> )	<b>3,995</b>	3,853	142	<b>8,486</b>	8,335	151
Revenue ( <i>\$ millions</i> )	<b>117</b>	110	7	<b>235</b>	218	17
Earnings ( <i>\$ millions</i> )	<b>25</b>	26	(1)	<b>51</b>	47	4

### Factors Contributing to Quarterly and Year-to-Date Energy Deliveries Variances

#### *Favourable*

- Growth in the number of customers, with the total number of customers increasing by approximately 10,000 year over year as at June 30, 2013, driven by favourable economic conditions and a high commodity price for oil
- Higher average consumption by commercial and residential customers, due to cooler temperatures

#### *Unfavourable*

- Lower average consumption by oil and gas customers, mainly in the first quarter of 2013, due to decreased activity associated with a low commodity price for natural gas
- Lower average consumption by farm and irrigation customers, primarily due to increased rainfall in the second quarter of 2013

As a significant portion of FortisAlberta's distribution revenue is derived from fixed or largely fixed billing determinants, changes in quantities of energy delivered are not entirely correlated with changes in revenue. Revenue is a function of numerous variables, many of which are independent of actual energy deliveries.

### Factors Contributing to Quarterly and Year-to-Date Revenue Variances

#### *Favourable*

- An interim increase in customer electricity distribution rates, effective January 1, 2013, associated with the regulator's interim decision received in March 2013 related to FortisAlberta's PBR Compliance Application
- Growth in the number of customers

#### *Unfavourable*

- Lower net transmission revenue, due to approximately \$3 million of favourable volume variances recognized in the second quarter of 2012. As approved by the regulator in April 2012, FortisAlberta assumed the risk of volume variances related to net transmission costs during 2012. The deferral of transmission volume variances, however, was reinstated by the regulator effective January 1, 2013. Year-to-date 2013, lower net transmission revenue was partially offset by approximately \$2 million recognized in the first quarter of 2013 associated with the finalization of the 2012 net transmission volume variances.

**Factors Contributing to Quarterly Earnings Variance**

*Unfavourable*

- Lower net transmission revenue of approximately \$3 million, as discussed above
- Lower depreciation rates, effective January 1, 2012, as a result of the 2012 distribution revenue requirements decision received in April 2012. The cumulative impact of the overall decrease in depreciation rates was recognized in the second quarter of 2012, when the decision was received. Approximately \$3 million of decreased depreciation expense related to the first quarter of 2012.

*Favourable*

- Timing of operating expenses
- Rate base growth, due to continued investment in energy infrastructure
- Growth in the number of customers

**Factors Contributing to Year-to-Date Earnings Variance**

*Favourable*

- The same factors discussed above for the quarter

*Unfavourable*

- Lower net transmission revenue of approximately \$1 million, as discussed above

In June 2013 parts of FortisAlberta’s service territory were impacted by the flooding in southern Alberta. Restoration efforts related to the flood did not have a material impact on the consolidated financial statements for the three and six months ended June 30, 2013. Restoration efforts are ongoing and the final impact on FortisAlberta’s operations, assets, earnings and cash flow is not fully determinable at this time.

**FORTISBC ELECTRIC <sup>(1)</sup>**

Financial Highlights (Unaudited) Periods Ended June 30	Quarter			Year-to-Date		
	2013	2012	Variance	2013	2012	Variance
Electricity Sales (GWh)	681	676	5	1,572	1,585	(13)
Revenue (\$ millions)	68	67	1	156	154	2
Earnings (\$ millions)	8	9	(1)	26	25	1

<sup>(1)</sup> Includes the regulated operations of FortisBC Inc. and operating, maintenance and management services related to the Waneta, Brilliant and Arrow Lakes hydroelectric generating plants. Excludes the non-regulated generation operations of FortisBC Inc.’s wholly owned partnership, Walden Power Partnership. In March 2013 FortisBC Inc. acquired the City of Kelowna’s electrical utility assets for approximately \$55 million. For further information, refer to the “Significant Items” section of this MD&A.

**Factor Contributing to Quarterly Electricity Sales Variance**

*Favourable*

- Higher average consumption, due to cooler temperatures in the second quarter of 2012

**Factor Contributing to Year-to-Date Electricity Sales Variance**

*Unfavourable*

- Lower average consumption, due to warmer temperatures in the first quarter of 2013

**Factors Contributing to Quarterly and Year-to-Date Revenue Variances**

*Favourable*

- An increase in customer electricity rates, effective January 1, 2013, mainly due to ongoing investment in energy infrastructure and forecasted certain higher expenses recoverable from customers as reflected in the 2012/2013 revenue requirements decision received in August 2012
- Revenue associated with the acquisition of the City of Kelowna’s electrical utility assets in March 2013



*Unfavourable*

- Differences in the amortization to revenue of flow-through adjustments owing to customers period over period
- A decrease in the interim allowed ROE, as a result of the regulatory decision in May 2013 related to the first phase of the GCOC Proceeding
- Lower contribution from non-regulated operating, maintenance and management services

**Factors Contributing to Quarterly and Year-to-Date Earnings Variances**

*Unfavourable*

- A decrease in the interim allowed ROE, as discussed above. The cumulative impact of the decision, effective January 1, 2013, of approximately \$2 million was recognized in the second quarter when the decision was received.
- Higher effective income taxes, due to lower deductions for income tax purposes

*Favourable*

- Lower-than-expected finance charges
- Rate base growth, due to continued investment in energy infrastructure, including the acquisition of the City of Kelowna's electrical utility assets in March 2013
- Higher capitalized AFUDC, as approved by the regulator

**NEWFOUNDLAND POWER**

Financial Highlights (Unaudited) Periods Ended June 30	Quarter			Year-to-Date		
	2013	2012	Variance	2013	2012	Variance
Electricity Sales (GWh)	1,288	1,259	29	3,230	3,173	57
Revenue (\$ millions)	132	130	2	329	322	7
Earnings (\$ millions)	24	11	13	31	18	13

**Factors Contributing to Quarterly and Year-to-Date Electricity Sales Variances**

*Favourable*

- Growth in the number of customers
- Higher average consumption, reflecting the higher use of electric-versus-oil heating in new home construction combined with economic growth

**Factors Contributing to Quarterly and Year-to-Date Revenue Variances**

*Favourable*

- The 2.3% and 1.8% increase in electricity sales for the quarter and year to date, respectively

*Unfavourable*

- Lower amortization to revenue of regulatory liabilities and deferrals, as approved by the regulator

**Factors Contributing to Quarterly and Year-to-Date Earnings Variances**

*Favourable*

- An approximate \$13 million income tax recovery in the second quarter of 2013, due to the enactment of higher deductions associated with Part VI.1 tax
- Rate base growth, due to continued investment in energy infrastructure
- Electricity sales growth

**OTHER CANADIAN ELECTRIC UTILITIES <sup>(1)</sup>**

<b>Financial Highlights (Unaudited)</b> Periods Ended June 30	<b>Quarter</b>			<b>Year-to-Date</b>		
	<b>2013</b>	2012	Variance	<b>2013</b>	2012	Variance
Electricity Sales (GWh)	<b>558</b>	563	(5)	<b>1,229</b>	1,208	21
Revenue (\$ millions)	<b>87</b>	82	5	<b>183</b>	173	10
Earnings (\$ millions)	<b>9</b>	5	4	<b>15</b>	12	3

<sup>(1)</sup> Comprised of Maritime Electric and FortisOntario. FortisOntario mainly includes Canadian Niagara Power, Cornwall Electric and Algoma Power.

**Factors Contributing to Quarterly and Year-to-Date Electricity Sales Variances**

*Unfavourable*

- Lower average consumption by customers in Ontario in the second quarter of 2013, reflecting more moderate temperatures, energy conservation and continued weak economic conditions in the region

*Favourable*

- Higher average consumption by residential customers on Prince Edward Island ("PEI"), due to cooler temperatures and an increase in the number of customers using electricity for home heating
- Higher average consumption by commercial customers in the agricultural processing sector on PEI, primarily during the second quarter of 2013

**Factors Contributing to Quarterly and Year-to-Date Revenue Variances**

*Favourable*

- Higher electricity sales on PEI combined with an increase in the basic component of customer rates at Maritime Electric, effective March 1, 2013
- The flow through in customer electricity rates of higher energy supply costs at FortisOntario

*Unfavourable*

- Lower electricity sales in Ontario in the second quarter of 2013

**Factors Contributing to Quarterly and Year-to-Date Earnings Variances**

*Favourable*

- An approximate \$4 million income tax recovery at Maritime Electric in the second quarter of 2013, due to the enactment of higher deductions associated with Part VI.1 tax
- Electricity sales growth at Maritime Electric

*Unfavourable*

- Timing of the recognition of a regulatory rate of return adjustment at Maritime Electric in 2013 as compared to 2012

**REGULATED ELECTRIC UTILITIES - CARIBBEAN <sup>(1)</sup>**

<b>Financial Highlights (Unaudited)</b> Periods Ended June 30	<b>Quarter</b>			<b>Year-to-Date</b>		
	<b>2013</b>	2012	Variance	<b>2013</b>	2012	Variance
Average US:CDN Exchange Rate <sup>(2)</sup>	<b>1.02</b>	1.01	0.01	<b>1.01</b>	1.01	-
Electricity Sales (GWh)	<b>193</b>	184	9	<b>363</b>	350	13
Revenue (\$ millions)	<b>70</b>	67	3	<b>136</b>	130	6
Earnings (\$ millions)	<b>6</b>	6	-	<b>9</b>	9	-

<sup>(1)</sup> Comprised of Caribbean Utilities on Grand Cayman, Cayman Islands, in which Fortis holds an approximate 60% controlling interest and two wholly owned utilities in the Turks and Caicos Islands, FortisTCI Limited ("FortisTCI") and Turks and Caicos Utilities Limited ("TCU"), acquired in August 2012, (collectively "Fortis Turks and Caicos"). In June 2013 Atlantic Equipment & Power (Turks and Caicos) Ltd. was amalgamated with FortisTCI.

<sup>(2)</sup> The reporting currency of Caribbean Utilities and Fortis Turks and Caicos is the US dollar.

**Factors Contributing to Quarterly and Year-to-Date Electricity Sales Variances**

*Favourable*

- Increased electricity sales at Fortis Turks and Caicos due to approximately 5 GWh and 10 GWh of electricity sales in the second quarter and first half of 2013, respectively, at TCU, which was acquired in August 2012, partially offset by lower average consumption by commercial customers at FortisTCI, mainly due to higher fuel costs and resulting energy conservation
- Growth in the number of customers at Caribbean Utilities and lower rainfall experienced on Grand Cayman, which increased air conditioning load

**Factors Contributing to Quarterly and Year-to-Date Revenue Variances**

*Favourable*

- The 4.9% and 3.7% increase in electricity sales for the quarter and year to date, respectively
- An increase in electricity rates for FortisTCI's large hotel customers, effective April 1, 2012
- A 1.8% increase in base customer electricity rates at Caribbean Utilities, effective June 1, 2013

**Factors Contributing to Quarterly and Year-to-Date Earnings Variances**

*Favourable*

- Increased electricity sales at Caribbean Utilities
- Decreased operating expenses at Caribbean Utilities, mainly due to lower employee-related costs and maintenance costs

*Unfavourable*

- Overall higher depreciation expense, due to continued investment in energy infrastructure
- Decreased electricity sales at FortisTCI

**NON-REGULATED - FORTIS GENERATION <sup>(1)</sup>**

Financial Highlights (Unaudited) Periods Ended June 30	Quarter			Year-to-Date		
	2013	2012	Variance	2013	2012	Variance
Energy Sales (GWh)	83	87	(4)	138	175	(37)
Revenue (\$ millions)	7	9	(2)	12	18	(6)
Earnings (\$ millions)	3	6	(3)	27	11	16

<sup>(1)</sup> Comprised of the financial results of non-regulated generation assets in Belize, Ontario, British Columbia and Upstate New York, with a combined generating capacity of 103 MW, mainly hydroelectric

**Factors Contributing to Quarterly and Year-to-Date  
Energy Sales Variances**

*Unfavourable*

- Decreased production in Belize, due to lower rainfall

*Favourable*

- Increased production in Ontario, Upstate New York and British Columbia, due to higher rainfall, and a generating unit in New York State being returned to service for part of the second quarter of 2013

**Factor Contributing to Quarterly and Year-to-Date  
Revenue Variances**

*Unfavourable*

- Decreased production in Belize

**Factors Contributing to Quarterly and Year-to-Date  
Earnings Variances**

*Unfavourable*

- Decreased production in Belize

*Favourable*

- An approximate \$22 million after-tax extraordinary gain recognized in the first quarter of 2013 on the settlement of expropriation matters associated with Exploits Partnership. For further information refer to the "Significant Items" section of this MD&A.

Since the end of the second quarter of 2013, a tropical depression that passed over Belize provided enough precipitation to fill the Chalillo reservoir. The hydroelectric generating facilities in Belize are currently running at full capacity.

**NON-REGULATED - NON-UTILITY**

The Non-Utility segment is comprised of Fortis Properties and Griffith. Fortis Properties owns and operates 23 hotels, comprised of more than 4,400 rooms, in eight Canadian provinces, and owns and operates approximately 2.7 million square feet of commercial office and retail space, primarily in Atlantic Canada. Non-regulated operations of CH Energy Group mainly consist of Griffith, which is primarily a fuel delivery business serving approximately 56,000 customers in the Mid-Atlantic Region of the United States.

**Fortis Properties**

Financial Highlights (Unaudited) Periods Ended June 30	Quarter			Year-to-Date		
	2013	2012	Variance	2013	2012	Variance
Hospitality - Revenue per Available Room ("RevPar")	\$ 87.76	\$ 85.56	2.6%	\$ 76.96	\$ 76.05	1.2%
Real Estate - Occupancy Rate ( <i>as at</i> )	92.3%	91.7%	0.7%	92.3%	91.7%	0.7%
Revenue (\$ millions)	65	64	1	118	116	2
Earnings (\$ millions)	9	8	1	9	9	-

**Factors Contributing to Quarterly RevPar Variance**

*Favourable*

- A 1.6% increase in occupancy, driven by hotel operations in western Canada
- A 1.0% increase in the average daily room rate, mainly in western Canada

**Factor Contributing to Year-to-Date RevPar Variance**

*Favourable*

- A 1.5% increase in the average daily room rate, mainly in western Canada, partially offset by a 0.3% decrease in occupancy, mainly at hotel operations in central Canada

**Factor Contributing to Quarterly and Year-to-Date Revenue Variances**

*Favourable*

- Increased revenue at the Hospitality Division, mainly due to contribution from the StationPark All Suite Hotel, which was acquired in October 2012, and hotel operations in western Canada

**Factors Contributing to Quarterly and Year-to-Date Earnings Variances**

*Favourable*

- Improved performance at the Hospitality Division, primarily due to hotel operations in western Canada

*Unfavourable*

- Increased depreciation, due to capital additions and improvements

**Griffith**

Griffith is an indirect wholly owned subsidiary of CH Energy Group, which supplies heating oil, gasoline, diesel fuel, kerosene and propane to approximately 56,000 customers in Maryland, Delaware, Washington D.C. and Virginia in the United States. Griffith also installs and maintains heating, ventilating and air conditioning equipment in these markets, which includes a customer base of an additional 12,000.

The financial statements of Griffith have been included in the consolidated financial statements of Fortis commencing June 27, 2013, the date of acquisition. Financial performance for Griffith from the date of acquisition through June 30, 2013 did not have a material impact on the Corporation's consolidated statement of earnings.

A considerable portion of the sales volume for Griffith is derived directly or indirectly from usage in space heating and air conditioning and, as a result, seasonality impacts Griffith's earnings.

**CORPORATE AND OTHER** <sup>(1)</sup>

<b>Financial Highlights (Unaudited)</b>						
Periods Ended June 30	<b>Quarter</b>			<b>Year-to-Date</b>		
(\$ millions)	<b>2013</b>	2012	Variance	<b>2013</b>	2012	Variance
Revenue	<b>7</b>	7	-	<b>13</b>	13	-
Operating Expenses	<b>3</b>	3	-	<b>6</b>	6	-
Depreciation and Amortization	-	-	-	<b>1</b>	1	-
Other Income (Expenses), Net	<b>(46)</b>	(3)	(43)	<b>(44)</b>	(8)	(36)
Finance Charges	<b>11</b>	12	(1)	<b>21</b>	23	(2)
Income Tax Recovery	<b>(31)</b>	(1)	(30)	<b>(33)</b>	(5)	(28)
	<b>(22)</b>	(10)	(12)	<b>(26)</b>	(20)	(6)
Preference Share Dividends	<b>14</b>	12	2	<b>28</b>	23	5
<b>Net Corporate and Other Expenses</b>	<b>(36)</b>	(22)	(14)	<b>(54)</b>	(43)	(11)

<sup>(1)</sup> Includes Fortis net corporate expenses, net expenses of non-regulated FortisBC Holdings Inc. ("FHI") corporate-related activities, and the financial results of FHI's wholly owned subsidiary FortisBC Alternative Energy Services Inc. and FHI's 30% ownership interest in CustomerWorks Limited Partnership

**Factors Contributing to Quarterly and Year-to-Date Net Corporate and Other Expenses Variances**

*Unfavourable*

- Increased other expenses primarily due to: (i) approximately \$41 million (US\$40 million), \$26 million (US\$26 million) after tax, in expenses associated with customer and community benefits offered by the Corporation to close the acquisition of CH Energy Group in June 2013; and (ii) approximately \$8 million (\$6 million after tax) in costs incurred in the second quarter of 2013 related to the acquisition of CH Energy Group, compared to approximately \$4 million (\$3 million after tax) and \$8 million (\$7 million after tax) for the second quarter and first half of 2012, respectively. For additional information on the acquisition of CH Energy Group, refer to the "Significant Items" section of this MD&A. The above-noted increases were partially offset by foreign exchange gains of approximately \$3 million and \$5 million for the second quarter and the first half of 2013, respectively, associated with the translation of the US dollar-denominated long-term other asset representing the book value of the Corporation's expropriated investment in Belize Electricity, compared to approximately \$2 million and \$0.5 million, respectively, for the same periods in 2012.
- Higher preference share dividends, due to the issuance of First Preference Shares, Series J in November 2012

*Favourable*

- An approximate \$8 million income tax recovery in the second quarter of 2013, due to the enactment of higher deductions associated with Part VI.1 tax, compared to income tax expense of \$3 million associated with Part VI.1 tax for the same quarter last year. In the first quarter of 2013, income tax expense included \$2 million associated with Part VI.1 tax.
- An approximate \$5 million income tax recovery associated with the release of income tax provisions in the second quarter of 2013
- Lower finance charges, primarily due to higher capitalized interest associated with the financing of the construction of the Corporation's 51% controlling ownership interest in the Waneta Expansion

## REGULATORY HIGHLIGHTS

The nature of regulation and material regulatory decisions and applications associated with each of the Corporation's regulated gas and electric utilities for the first half of 2013 are summarized as follows.

### NATURE OF REGULATION

Regulated Utility	Regulatory Authority	Allowed Common Equity (%)	Allowed Returns (%)			Supportive Features Future or Historical Test Year Used to Set Customer Rates
			2011	2012 ROE	2013	
FEI	BCUC	38.5 <sup>(1)</sup>	9.50	9.50	8.75	COS/ROE FEI: Prior to January 1, 2010, 50%/50% sharing of earnings above or below the allowed ROE under a PBR mechanism that expired on December 31, 2009 with a two-year phase-out
FEVI	BCUC	40 <sup>(2)</sup>	10.00	10.00	9.25 <sup>(2)</sup>	ROEs established by the BCUC - 2013 ROEs are under review Future Test Year
FEWI	BCUC	40 <sup>(2)</sup>	10.00	10.00	9.25 <sup>(2)</sup>	
FortisBC Electric	BCUC	40 <sup>(2)</sup>	9.90	9.90	9.15 <sup>(2)</sup>	COS/ROE  PBR mechanism for 2009 through 2011: 50%/50% sharing of earnings above or below the allowed ROE up to an achieved ROE that is 200 basis points above or below the allowed ROE – excess to deferral account  ROE established by the BCUC - 2013 ROE is under review Future Test Year
Central Hudson	PSC	48 <sup>(3)</sup>	10.00	10.00	10.00 <sup>(3)</sup>	COS/ROE  Earnings sharing mechanism effective July 1, 2013: 50%/50% sharing of earnings above the allowed ROE up to 50 basis points above the allowed ROE; and 10%/90% sharing of earnings in excess of 50 basis points above the allowed ROE  ROE established by PSC Future Test Year
FortisAlberta	Alberta Utilities Commission ("AUC")	41 <sup>(4)</sup>	8.75	8.75	8.75 <sup>(4)</sup>	COS/ROE  PBR mechanism for 2013 through 2017 with capital tracker account and other supportive features  ROE established by the AUC - 2013 ROE is under review 2012 test year with 2013 through 2017 rates set using PBR mechanism Future Test Year
Newfoundland Power	Newfoundland and Labrador Board of Commissioners of Public Utilities ("PUB")	45	8.38 +/- 50 bps	8.80 +/- 50 bps	8.80 +/- 50 bps	COS/ROE  The allowed ROE was set using an automatic adjustment formula tied to long-term Canada bond yields for 2011. ROE established by the PUB for 2012 through 2015 Future Test Year
Maritime Electric	Island Regulatory and Appeals Commission	40	9.75	9.75	9.75	COS/ROE  Future Test Year

**NATURE OF REGULATION (cont'd)**

Regulated Utility	Regulatory Authority	Allowed Common Equity (%)	Allowed Returns (%)			Supportive Features Future or Historical Test Year Used to Set Customer Rates
			2011	2012	2013	
<b>ROE</b>						
FortisOntario	Ontario Energy Board ("OEB")	40	8.01	8.01	8.93 <sup>(5)</sup>	Canadian Niagara Power - COS/ROE
	Canadian Niagara Power	40	9.85	9.85	9.85 <sup>(5)</sup>	Algoma Power - COS/ROE and subject to Rural and Remote Rate Protection ("RRRP") program
	Franchise Agreement Cornwall Electric					Cornwall Electric - Price cap with commodity cost flow through
<b>ROA</b>						
Caribbean Utilities	Electricity Regulatory Authority ("ERA")	N/A	7.75 - 9.75	7.25 - 9.25	6.50 - 8.50	COS/ROA Rate-cap adjustment mechanism based on published consumer price indices  The Company may apply for a special additional rate to customers in the event of a disaster, including a hurricane. Historical Test Year
Fortis Turks and Caicos	Utilities make annual filings to the Government of the Turks and Caicos Islands	N/A	17.50 <sup>(6)</sup>	17.50 <sup>(6)</sup>	17.50 <sup>(6)</sup>	COS/ROA  If the actual ROA is lower than the allowed ROA, due to additional costs resulting from a hurricane or other event, the utilities may apply for an increase in customer rates in the following year. Future Test Year

<sup>(1)</sup> Effective January 1, 2013. For 2011 and 2012, the allowed deemed equity component of the capital structure was 40%.

<sup>(2)</sup> Capital structures and allowed ROEs for 2013 are interim and are subject to change based on the outcome of the second phase of the GCOC Proceeding. The allowed ROEs for 2013 reflect the benchmark 8.75% allowed ROE for FEI, as set by the BCUC, and risk premiums associated with each of these utilities.

<sup>(3)</sup> Effective until June 30, 2015

<sup>(4)</sup> Capital structure and allowed ROE for 2013 are interim and are subject to change based on the outcome of the cost of capital proceeding.

<sup>(5)</sup> Based on the ROE automatic adjustment formula, the allowed ROE for regulated electric utilities in Ontario is 8.93% for 2013. This ROE is not applicable to the regulated electric utilities until they are scheduled to file full COS rate applications. As a result, the allowed ROE of 8.93% is not applicable to Algoma Power for 2013.

<sup>(6)</sup> Amount provided under licences as it relates to FortisTCI. Amount provided under licence for TCU is 15%. Achieved ROAs at the utilities were significantly lower than those allowed under licences as a result of the inability, due to economic and political factors, to increase base electricity rates associated with significant capital investment in recent years.

**MATERIAL REGULATORY DECISIONS AND APPLICATIONS**

Regulated Utility	Summary Description
FEI/FEVI/FEWI	<ul style="list-style-type: none"> <li>Effective January 1, 2013, rates increased by approximately 1.6% for typical residential customers at FEI in the Lower Mainland, as a result of an increase in delivery rates in accordance with the BCUC's decision in April 2012 pertaining to the FortisBC Energy companies' 2012/2013 Revenue Requirements Application ("RRA"), partially offset by a decrease in midstream rates. Natural gas commodity rates effective January 1, 2013 remained unchanged for customers at FEI.</li> <li>In February 2012 the BCUC approved FEI's amended application for a general tariff for the provision of compressed natural gas and liquefied natural gas ("LNG") refuelling services for transportation vehicles. FEI has received either permanent or interim rate approval for three refuelling projects. In June 2013 FEI received a decision on changing its LNG sales and dispensing service rate schedule from a pilot program to a permanent program. The decision did not approve the program as permanent, but extended the pilot program until the end of 2020, and set out the rate to be charged. In addition, FEI received BCUC approval for rate treatment of expenditures under the Greenhouse Gas Reductions (Clean Energy) Regulation ("GGRR") under the <i>Clean Energy Act</i> that was announced in May 2012. In May 2013 FEI filed an application for approval of its first refuelling station under the GGRR and a decision on the rate to be charged to customers is expected in the third quarter of 2013.</li> </ul>



**MATERIAL REGULATORY DECISIONS AND APPLICATIONS (cont'd)**

<b>Regulated Utility</b>	<b>Summary Description</b>
<b>FEI/FEVI/FEWI (cont'd)</b>	<ul style="list-style-type: none"> <li>• In August 2011 FEI received a BCUC decision on the use of Energy Efficiency and Conservation ("EEC") funds as incentives for natural gas-fuelled vehicles ("NGVs"). FEI had made these funds available to assist large customers in purchasing NGVs in lieu of vehicles fuelled by diesel. The decision determined that it was not appropriate to use EEC funds for the above-noted purpose and the BCUC requested that FEI provide further submissions to determine the prudence of the EEC incentives. In August 2012 an application was filed with the BCUC to review the prudence of the EEC incentives totalling approximately \$6 million. A decision was received in April 2013 in which the BCUC determined that the EEC incentives for NGVs were prudently incurred and can be recovered from customers in rates.</li> <li>• During the first quarter of 2013, the BCUC approved the capital expenditures for the Telus Garden project at FortisBC Alternative Energy Services Inc. ("FAES"); however, approval of revisions to the rate design and rates is pending. In July 2013 the BCUC approved the capital expenditures for the Kelowna District Energy System project; however, approval of revisions to the rate design and rates is also pending. In May 2013 the BCUC initiated a process to review a proposal for a streamlined regulatory framework for thermal energy system utilities in British Columbia. The process is ongoing with a decision expected in the third quarter of 2013.</li> <li>• In April 2012 the FortisBC Energy companies applied to the BCUC for the necessary approvals to amalgamate the three utilities and implement common rates across the service territories served by the amalgamated entity, effective January 1, 2014. The BCUC issued its decision in February 2013 denying the request to implement common rates. The FortisBC Energy companies filed a leave to appeal the decision to the British Columbia Court of Appeal in March 2013 and filed an Application for Reconsideration with the BCUC in April 2013. In June 2013 the BCUC determined that the reconsideration application will be heard and has set out a regulatory timetable for filing of evidence.</li> <li>• The public oral hearing for the first phase of a GCOC Proceeding to determine the allowed ROE and appropriate capital structure for FEI, the designated low-risk benchmark utility in British Columbia, occurred in December 2012. In May 2013 the BCUC issued its decision on the first phase of the GCOC Proceeding. Effective January 1, 2013, the decision set the ROE of the benchmark utility at 8.75%, compared to 9.50% for 2012, with a 38.5% equity component of capital structure, compared to 40% for 2012. The equity component of capital structure will remain in effect until December 31, 2015. Effective January 1, 2014 through December 31, 2015, the BCUC is also introducing an Automatic Adjustment Mechanism ("AAM") to set the ROE for the benchmark utility on an annual basis. The AAM will take effect when the long-term Government of Canada bond yield exceeds 3.8%. FEVI, FEWI and FortisBC Electric will have their allowed ROEs and capital structures determined in the second phase of the GCOC Proceeding. As a result of the BCUC's decision on the first phase of the GCOC Proceeding, which reduced the allowed ROE of the benchmark utility by 75 basis points, the interim allowed ROEs for FEVI, FEWI and FortisBC Electric decreased to 9.25%, 9.25% and 9.15%, respectively, effective January 1, 2013, while the deemed equity component of capital structures remained unchanged. The allowed ROEs and equity component of capital structures for FEVI, FEWI and FortisBC Electric could change further as a result of the outcome of the second phase of the GCOC Proceeding. In March 2013 the BCUC initiated the second phase of the GCOC Proceeding. The review process for the second phase is underway and in July 2013 FEVI, FEWI and FortisBC Electric filed evidence in accordance with the review. A decision on the second phase of the GCOC Proceeding is expected in the first half of 2014. For further discussion on the nature of the GCOC Proceeding, refer to the "Material Regulatory Decisions and Applications" section of the Corporation's 2012 Annual MD&amp;A.</li> <li>• In June 2013 FEI filed an application for a Multi-Year Performance-Based Ratemaking Plan for 2014 through 2018. The application assumes a forecast average rate base for 2014 of approximately \$2,789 million. The application requests approval of a delivery rate increase of approximately 1% for 2014 determined under a formula approach for operating and capital costs, and a continuation of this rate-setting methodology for a further four years. The review process for the application will continue throughout 2013.</li> </ul>

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**MATERIAL REGULATORY DECISIONS AND APPLICATIONS (cont'd)**


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<b>Regulated Utility</b>	<b>Summary Description</b>
<b>FortisBC Electric</b>	<ul style="list-style-type: none"> <li>• Effective January 1, 2013, as approved by the BCUC in its August 2012 decision pertaining to FortisBC Electric's 2012/2013 RRA, customer electricity rates increased 4.2%.</li> <li>• In July 2012 FortisBC Electric filed its Advanced Metering Infrastructure ("AMI") Application, which was updated in early 2013. A regulatory review by the BCUC and various interveners concluded with an oral hearing in March 2013. In July 2013 the BCUC approved the AMI project for a total cost of approximately \$51 million. The AMI project proposes to improve and modernize FortisBC Electric's grid by exchanging its manually read meters with advanced meters. As a condition of the BCUC decision, FortisBC Electric has confirmed that it will file, by November 2013, an application for an opt-out provision which would require the incremental cost of opting-out of AMI to be borne by customers who choose to opt-out.</li> <li>• In March 2013 the BCUC approved the acquisition by FortisBC Electric of the City of Kelowna's electrical utility assets and allowed for approximately \$38 million of the \$55 million purchase price to be included in FortisBC Electric's rate base, resulting in the recognition of approximately \$14 million of goodwill and a \$3 million deferred income tax asset. The transaction closed in March 2013, which allows FortisBC Electric to directly serve approximately 15,000 customers formerly served by the City. Prior to the acquisition, FortisBC Electric had provided the City with electricity under a wholesale tariff and had operated and maintained the City's electrical utility assets under contract since 2000.</li> <li>• In March 2012 the BCUC ordered a written hearing process to review the prudence of approximately \$29 million in capital expenditures already incurred related to the Kettle Valley Distribution Source Project, which was substantially completed in 2009. In April 2013 the BCUC issued a decision approving substantially all of the \$29 million to be included in rate base, effective from January 1, 2012.</li> <li>• In July 2013 FortisBC Electric filed an application for a Multi-Year Performance-Based Ratemaking Plan for 2014 through 2018. The application assumes a forecast midyear rate base for 2014 of approximately \$1,227 million. The application requests approval of a basic customer rate increase for 2014 of approximately 3.3%, determined under a formula approach for operating and capital costs, and a continuation of this rate-setting methodology for a further four years. <u>The review process for the application will continue throughout 2013.</u></li> </ul>
<b>FortisAlberta</b>	<ul style="list-style-type: none"> <li>• In September 2012 the AUC issued a generic PBR Decision outlining the PBR framework applicable to distribution utilities in Alberta, including FortisAlberta, for a five-year term, which commenced January 1, 2013. In the PBR Decision, a formula that estimates inflation annually and assumes productivity improvements is to be used by the distribution utilities to determine customer rates on an annual basis. The PBR framework also includes mechanisms for the recovery or settlement of items determined to flow through directly to customers and the recovery of costs related to capital expenditures that are not being recovered through the inflationary factor of the formula. The AUC also approved: (i) a Z factor permitting an application for recovery of costs related to significant unforeseen events; (ii) a PBR re-opener mechanism permitting an application to re-open and review the PBR plan to address specific problems with the design or operation of the PBR plan; and (iii) an ROE efficiency carry-over mechanism permitting an efficiency incentive by allowing the utility to continue to benefit from any efficiency gains achieved during the PBR term for two years following the end of the term. The PBR formula does, however, raise some concern and uncertainty for FortisAlberta regarding the treatment of certain capital expenditures. While the PBR Decision did provide for a capital tracker mechanism for the recovery of costs related to certain capital expenditures, FortisAlberta sought further clarification regarding this mechanism in a Review and Variance ("R&amp;V") Application and a Capital Tracker Application and sought leave to appeal the issue to the Alberta Court of Appeal.</li> <li>• In March 2013 the AUC issued a decision denying the R&amp;V Application. FortisAlberta has filed a leave to appeal the decision on similar grounds as the leave to appeal the 2012 PBR Decision. Both appeals have been adjourned pending further determinations in outstanding PBR-related proceedings.</li> <li>• In January 2013 FortisAlberta filed a Phase II Distribution Tariff Application ("Phase II DTA"), which proposed rates by customer class based on a cost allocation study and requested that the 2012 interim distribution rates by customer class be made final for 2012 and 2013, subject to further adjustments as a result of the PBR decision. The Phase II DTA will continue as a written proceeding with a decision expected in the third quarter of 2013. The outcome of the proceeding is not expected to have a material impact on FortisAlberta's 2013 financial results.</li> </ul>

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**MATERIAL REGULATORY DECISIONS AND APPLICATIONS (cont'd)**

<b>Regulated Utility</b>	<b>Summary Description</b>
<b>FortisAlberta (cont'd)</b>	<ul style="list-style-type: none"> <li>• In March 2013 the AUC issued an interim decision regarding the Compliance Applications filed by the distribution utilities in Alberta. The interim decision approved a combined inflation and productivity factor of 1.71%, certain adjustments to the Company's going-in rates, including specific flow-through amounts, and the recovery, on an interim basis, of 60% of the revenue requirement associated with the 2013 capital tracker expenditures applied for by FortisAlberta. For FortisAlberta, the AUC approved approximately \$14.5 million of the \$24 million in revenue requested in the utility's 2013 Capital Tracker Application. The decision resulted in an interim increase in FortisAlberta's distribution rates of approximately 4%, effective January 1, 2013, with collection from customers commencing April 1, 2013. A final decision on the Compliance Application was received in July 2013 directing the Company to continue to use interim rates until all remaining 2013 placeholders have been determined. A hearing on the Capital Tracker Application commenced in June 2013, with a decision expected in the second half of 2013.</li> <li>• In October 2012 the AUC initiated a 2013 GCOC Proceeding to establish the final allowed ROE for 2013 and determine whether a formulaic ROE automatic adjustment mechanism should be re-established. In November 2012 the 2013 GCOC Proceeding was suspended until other regulatory matters were resolved. In April 2013 the AUC recommenced the 2013 GCOC Proceeding to set the allowed ROE and capital structure for distribution utilities in Alberta for 2013, as well as the allowed ROE for 2014. In addition, an interim allowed ROE for 2015 will be established. The AUC may consider the possibility of re-establishing a formulaic ROE automatic adjustment mechanism at this time. The process for the 2013 GCOC Proceeding commenced in the second quarter of 2013 and a hearing is scheduled for early 2014. The expected outcome of this proceeding is currently unknown.</li> <li>• In its 2011 GCOC Decision, the AUC made statements regarding cost responsibility for stranded assets, which FortisAlberta and other utilities challenged as being incorrectly made. As a result, FortisAlberta, together with other Alberta utilities, filed an R&amp;V Application with the AUC. In June 2012 the AUC decided it would not permit an R&amp;V of the decision in question but would examine the issue in the Utility Asset Disposition ("UAD") Proceeding, which was reinitiated in November 2012. FortisAlberta and the other Alberta utilities had also sought leave to appeal the stranded asset pronouncements to the Alberta Court of Appeal and temporarily adjourned that court process pending the AUC's follow-up proceeding. Any decision by the AUC regarding the treatment of stranded assets does not alter a utility's right to a reasonable opportunity to recover prudent COS and the right to earn a reasonable ROE. In July 2013 FortisAlberta, together with other Alberta utilities, filed reply arguments in the UAD Proceeding, after which the AUC will commence deliberations with a decision expected in the fourth quarter of 2013.</li> </ul>
<b>Newfoundland Power</b>	<ul style="list-style-type: none"> <li>• In April 2013 the PUB issued its decision related to Newfoundland Power's 2013/2014 General Rate Application ("GRA"), which was filed in September 2012, to establish the Company's cost of capital for rate-making purposes. In its decision, the PUB ordered that the allowed ROE and common equity component of capital structure remain at 8.8% and 45%, respectively, for 2013 through 2015. The PUB also ordered: (i) the recognition of pension expense for regulatory purposes in accordance with US GAAP and the related regulatory asset to be recovered from customers over 15 years; (ii) a decrease in the overall composite depreciation rate to 3.42% from 3.47%; (iii) the deferral of annual customer energy conservation program costs to be recovered from customers over the subsequent seven-year period; and (iv) the approval of various regulatory amortizations over a three-year period, including cost-recovery deferrals recognized in 2011 and 2012, costs associated with the GRA and the December 31, 2011 balance in the Weather Normalization Account. The impact of the decision resulted in an overall average increase in customer electricity rates of approximately 4.8% effective July 1, 2013 and the deferral of approximately \$4 million of costs incurred in 2013 but not recovered from customers, due to the timing of collection in customer rates. The cumulative impact of the decision was recorded in the second quarter of 2013, when the decision was received. Newfoundland Power is required to file its GRA for 2016 on or before June 1, 2015.</li> </ul>

**MATERIAL REGULATORY DECISIONS AND APPLICATIONS (cont'd)**

<b>Regulated Utility</b>	<b>Summary Description</b>
<b>Newfoundland Power (cont'd)</b>	<ul style="list-style-type: none"> <li>Effective July 1, 2013, the PUB approved an overall average decrease in Newfoundland Power's customer electricity rates of approximately 3.1% to reflect the combined impact of the annual operation of Newfoundland Power's Rate Stabilization Account ("RSA") and the above-noted GRA decision. Through the annual operation of Newfoundland Hydro's Rate Stabilization Plan, variances in the cost of fuel used to generate electricity that Newfoundland Hydro sells to Newfoundland Power are captured and flowed through to customers through the operation of the Company's RSA. As a result of a decrease in the forecast cost of oil to be used to generate electricity at Newfoundland Hydro, customer electricity rates decreased approximately 7.9% effective July 1, 2013. The RSA also captures variances in certain of Newfoundland Power's costs, such as pension and energy supply costs. The decrease in customer rates as a result of the operation of the RSA is not expected to impact Newfoundland Power's earnings in 2013.</li> <li>In June 2013 Newfoundland Power filed an application with the PUB requesting approval for its 2014 Capital Expenditure Plan totalling approximately \$85 million, before customer contributions.</li> </ul>
<b>Maritime Electric</b>	<ul style="list-style-type: none"> <li>In December 2012 the <i>Electric Power (Energy Accord Continuation) Amendment Act ("Accord Continuation Act")</i> was enacted, which sets out the inputs, rates and other terms for the continuation of the PEI Energy Accord for an additional three years covering the period March 1, 2013 through February 29, 2016. Under the terms of the <i>Accord Continuation Act</i>, Maritime Electric received, in March 2013, proceeds of approximately \$47 million from the Government of PEI upon its assumption of Maritime Electric's \$47 million regulatory asset related to certain deferred incremental replacement energy costs during the refurbishment of Point Lepreau. Over the above-noted three-year period, increases in electricity costs for a typical residential customer have been set at 2.2%, effective March 1 annually, and Maritime Electric's allowed ROE has been capped at 9.75% each year. The resulting customer rate increases are due to the collection from customers by Maritime Electric, acting as an agent on behalf of the Government of PEI, of Point Lepreau-related costs assumed by the Government of PEI and higher COS. The proceeds were used by Maritime Electric to repay short-term borrowings, to pay a special dividend to Fortis to maintain the utility's capital structure and to finance its capital expenditure program.</li> <li>In July 2013 Maritime Electric filed its 2014 Capital Budget Application totalling approximately \$28 million, before customer contributions.</li> </ul>
<b>FortisOntario</b>	<ul style="list-style-type: none"> <li>Effective January 1, 2013, residential customer rates in Fort Erie, Gananoque and Port Colborne increased by an average of 6.8%, 5.9% and 7.4%, respectively. The rate increases were the result of the OEB's decision pertaining to FortisOntario's 2013 COS Application using a 2013 forward test year and the recovery of smart meter costs and stranded assets related to conventional meters and reflect an allowed ROE of 8.93%.</li> <li>In March 2013 the OEB issued its decision on Algoma Power's Third-Generation Incentive-Rate Mechanism Application for customer electricity distribution rates and smart meter cost recovery, effective January 1, 2013, resulting in an overall increase in residential and commercial customer distribution rates of 3.75%. Residential and commercial customer distribution rates are adjusted by the average increase in customer rates of all other distributor rate changes in Ontario in the most recent rate year. The difference in the recovery of COS in residential and commercial customer distribution rates and the revenue requirement is compensated from RRRP program funding. Recovery of smart meter costs allocated to residential customers will also be recovered from RRRP program funding as ordered by the OEB. Total RRRP program funding for 2013 is expected to be approximately \$12 million.</li> </ul>
<b>Caribbean Utilities</b>	<ul style="list-style-type: none"> <li>In June 2013 the ERA approved Caribbean Utilities' 2013-2017 Capital Investment Plan for US\$123 million related to non-generation installation capital expenditures. Capital expenditures relating to additional generation installation are subject to ERA approval through a competitive bid process.</li> <li>A Certificate of Need was filed with the ERA by Caribbean Utilities in November 2011, due to the upcoming retirements of some of the Company's generating units due to begin in mid-2014. In March 2012 proposals for the installation of new generation units from six qualified bidders, including Caribbean Utilities, was requested by the ERA and the Company's proposal was submitted in July 2012. In February 2013 the ERA awarded the bid to develop, install and operate two new 18-MW generation units to a third party. In April 2013 the ERA announced that it would be engaging an independent party to conduct an investigation of irregularities in the bid process. In July 2013 the ERA announced that it has cancelled the solicitation process as a result of unavoidable and unforeseen delays. The need for additional firm generating capacity for mid-2014 remains. In light of the ERA's decision to cancel the solicitation process, Caribbean Utilities will explore all cost-effective options with the ERA to ensure that there is sufficient installed generating capacity to serve the needs of its customers until the firm capacity needs can be met.</li> </ul>

**MATERIAL REGULATORY DECISIONS AND APPLICATIONS (cont'd)**

<b>Regulated Utility</b>	<b>Summary Description</b>
<b>Caribbean Utilities (cont'd)</b>	<ul style="list-style-type: none"> <li>Effective June 1, 2013, following review and approval by the ERA, Caribbean Utilities' base customer electricity rates increased by 1.8% as a result of changes in the applicable consumer price indices and the utility's targeted allowed ROA for 2013.</li> </ul>
<b>Fortis Turks and Caicos</b>	<ul style="list-style-type: none"> <li>In March 2013 the Fortis Turks and Caicos utilities submitted their 2012 annual regulatory filings outlining performance in 2012. Included in the filings were the calculations, in accordance with the utilities' licences, of rate base of US\$195 million for 2012 and cumulative shortfall in achieving allowable profits of US\$105 million as at December 31, 2012.</li> </ul>

**CONSOLIDATED FINANCIAL POSITION**

The following table outlines the significant changes in the consolidated balance sheet between June 30, 2013 and December 31, 2012. The changes in the consolidated balance sheet as at June 30, 2013 associated with the acquisition of CH Energy Group are itemized separately below.

**Significant Changes in the Consolidated Balance Sheet (Unaudited) between June 30, 2013 and December 31, 2012**

<b>Balance Sheet Account</b>	<b>Increase Due to CH Energy Group (\$ millions)</b>	<b>Other Increase/ (Decrease) (\$ millions)</b>	<b>Explanation for Other Increase/ (Decrease)</b>
Cash and cash equivalents	81	32	The increase in cash and cash equivalents was not significant.
Accounts receivable	118	(114)	The decrease was primarily due to the impact of a seasonal decrease in sales at the FortisBC Energy companies, partially offset by an increase due to the operation of equal payment plans.
Regulatory assets – current and long-term	271	(3)	The decrease was mainly due to: (i) proceeds of approximately \$47 million received from the Government of PEI in March 2013 upon its assumption of Maritime Electric's replacement energy deferral associated with Point Lepreau; and (ii) the \$26 million change in the deferral of the fair market value of the natural gas commodity derivatives at the FortisBC Energy companies. The above decreases were partially offset by an increase in the rate stabilization deferrals at the FortisBC Energy companies, an increase in regulatory deferred income taxes, and the deferral of various other costs, as permitted by the regulators, mainly at the FortisBC utilities and FortisAlberta.
Other assets	41	(3)	The decrease in other assets was not significant.
Utility capital assets	1,286	363	The increase primarily related to: (i) \$508 million invested in electricity and gas systems; (ii) the impact of foreign exchange on the translation of US dollar-denominated utility capital assets; and (iii) the acquisition of the City of Kelowna's electrical utility assets by FortisBC Electric. The above increases were partially offset by depreciation and customer contributions.
Intangible assets	45	(9)	The decrease in intangible assets was not significant.
Goodwill	486	23	The increase in goodwill was not significant.
Short-term borrowings	39	(76)	The decrease was primarily due to: (i) a reduction in borrowings at the FortisBC Energy companies due to the seasonality of operations; (ii) the repayment of short-term borrowings at Caribbean Utilities using proceeds from the issuance of long-term debt; and (iii) the repayment of borrowings at Maritime Electric with a portion of proceeds received from the Government of PEI in March 2013.

**Significant Changes in the Consolidated Balance Sheet (Unaudited) between June 30, 2013 and December 31, 2012 (cont'd)**

<b>Balance Sheet Account</b>	<b>Increase Due to CH Energy Group (\$ millions)</b>	<b>Other Increase/ (Decrease) (\$ millions)</b>	<b>Explanation for Other Increase/(Decrease)</b>
Accounts payable and other current liabilities	122	(126)	The decrease was mainly due to: (i) the timing of Alberta Electric System Operator ("AESO") payments for 2012 transmission costs and lower accounts payable associated with transmission-connected projects at FortisAlberta; (ii) the \$26 million change in the fair market value of the natural gas commodity derivatives at the FortisBC Energy companies; (iii) the enactment of higher deductions associated with Part VI.1 tax, resulting in the reversal of approximately \$23 million in income tax liabilities; (iv) lower amounts owing for purchased power at Newfoundland Power, associated with seasonality of operations; and (v) timing of payments for trade accounts payable at the FortisBC Energy companies. The decrease was partially offset by an increase in income and other taxes payable at the FortisBC Energy companies.
Regulatory liabilities – current and long-term	155	39	The increase was mainly due to: (i) a higher AESO charges deferral at FortisAlberta; (ii) an increase in non-ARO site removal cost provisions, primarily at FortisAlberta and the FortisBC Energy companies; and (iii) an increase in rate stabilization accounts at the FortisBC Energy companies.
Deferred income tax liabilities – current and long-term	279	40	The increase was driven by tax timing differences related mainly to capital expenditures at the regulated utilities.
Long-term debt (including current portion)	544	742	The increase was driven by higher committed credit facility borrowings at the Corporation to finance a portion of the acquisition of CH Energy Group, advances to the Waneta Expansion Limited Partnership ("Waneta Partnership"), and an equity injection into FortisAlberta in support of energy infrastructure investment. Higher committed credit facility borrowings at the regulated utilities were largely in support of energy infrastructure investment, including the acquisition of the City of Kelowna's electrical utility assets by FortisBC Electric. In addition, Caribbean Utilities issued US\$50 million in senior unsecured debentures in May 2013 to repay short-term borrowings and to finance capital expenditures. The translation of US-dollar denominated debt also resulted in an increase for the period. The above-noted increases were partially offset by regularly scheduled debt repayments at the FortisBC Energy companies and Fortis Properties.
Other Liabilities	185	(12)	The decrease in other liabilities was not significant.

**Significant Changes in the Consolidated Balance Sheet (Unaudited) between June 30, 2013 and December 31, 2012 (cont'd)**

<b>Balance Sheet Account</b>	<b>Increase Due to CH Energy Group</b> (\$ millions)	<b>Other Increase/ (Decrease)</b> (\$ millions)	<b>Explanation for Other Increase/ (Decrease)</b>
Shareholders' equity (before non-controlling interests)	-	707	The increase primarily related to: (i) the conversion of Subscription Receipts into common shares for \$567 million, net of after-tax expenses, in June 2013, to finance a portion of the acquisition of CH Energy Group; (ii) net earnings attributable to common equity shareholders for the six months ended June 30, 2013, less dividends declared on common shares; and (iii) the issuance of common shares under the Corporation's Dividend Reinvestment Plan.
Non-controlling interests	-	46	The increase was driven by advances from the 49% non-controlling interests in the Waneta Partnership.

**LIQUIDITY AND CAPITAL RESOURCES**

The table below outlines the Corporation's sources and uses of cash for the three and six months ended June 30, 2013, as compared to the same periods in 2012, followed by a discussion of the nature of the variances in cash flows.

<b>Summary of Consolidated Cash Flows (Unaudited)</b>						
Periods Ended June 30 (\$ millions)	Quarter			Year-to-Date		
	2013	2012	Variance	2013	2012	Variance
<b>Cash, Beginning of Period</b>	<b>168</b>	110	58	<b>154</b>	87	67
<b>Cash Provided by (Used in):</b>						
Operating Activities	<b>291</b>	255	36	<b>571</b>	583	(12)
Investing Activities	<b>(1,289)</b>	(273)	(1,016)	<b>(1,578)</b>	(484)	(1,094)
Financing Activities	<b>1,097</b>	139	958	<b>1,120</b>	45	1,075
<b>Cash, End of Period</b>	<b>267</b>	231	36	<b>267</b>	231	36

**Operating Activities:** Cash flow from operating activities was \$36 million higher quarter over quarter. The increase was primarily due to: (i) cash proceeds received, in the second quarter of 2013, as a result of the March 2013 settlement of the expropriation of the non-regulated hydroelectric generating assets and water rights of the Exploits Partnership; and (ii) favourable changes in working capital associated with accounts payable and other current liabilities.

Cash flow from operating activities was \$12 million lower year to date compared to the same period last year. The decrease was mainly due to unfavourable changes in working capital, primarily at FortisAlberta and the FortisBC Energy companies, partially offset by favourable changes in working capital at Maritime Electric. The decrease was partially offset by: (i) cash proceeds received, in the second quarter of 2013, as a result of the March 2013 settlement of expropriation matters of the Exploits Partnership; and (ii) the collection from customers of regulator-approved increases in depreciation and amortization expense.

**Investing Activities:** Cash used in investing activities was \$1,016 million higher for the quarter and \$1,094 million higher year to date compared to the same periods last year. The increases were primarily due to the acquisition of CH Energy Group on June 27, 2013 for a net cash purchase price of \$1,019 million and FortisBC Electric's acquisition of electrical utility assets of the City of Kelowna in March 2013 for approximately \$55 million.

Higher capital spending at FortisAlberta and the FortisBC Energy companies for the quarter and year to date was partially offset by lower capital spending related to the non-regulated Waneta Expansion.

**Financing Activities:** Cash provided by financing activities was \$958 million higher for the quarter and \$1,075 million higher year to date compared to the same periods last year. The increases were primarily due to the issuance of common shares and borrowings under the Corporation's committed credit facility in connection with the acquisition of CH Energy Group.

Net repayments of short-term borrowings were \$35 million higher quarter over quarter, driven by Caribbean Utilities, partially offset by the FortisBC Energy companies.

In May 2013 Caribbean Utilities issued 15-year US\$10 million 3.34% and 20-year US\$40 million 3.54% senior unsecured notes. The proceeds were used to repay short-term borrowings and to finance capital expenditures.

Repayments of long-term debt and capital lease and finance obligations and net borrowings under committed credit facilities for the quarter and year to date compared to the same periods last year are summarized in the following tables.

<b>Repayments of Long-Term Debt and Capital Lease and Finance Obligations (Unaudited)</b>						
Periods Ended June 30	<b>Quarter</b>			<b>Year-to-Date</b>		
(\$ millions)	<b>2013</b>	2012	Variance	<b>2013</b>	2012	Variance
FortisBC Energy Companies	<b>(5)</b>	(17)	12	<b>(26)</b>	(18)	(8)
Caribbean Utilities	<b>(17)</b>	(13)	(4)	<b>(17)</b>	(13)	(4)
Fortis Properties	<b>(2)</b>	(22)	20	<b>(20)</b>	(24)	4
Other	<b>(1)</b>	(1)	-	<b>(2)</b>	(2)	-
<b>Total</b>	<b>(25)</b>	(53)	28	<b>(65)</b>	(57)	(8)

<b>Net Borrowings Under Committed Credit Facilities (Unaudited)</b>						
Periods Ended June 30	<b>Quarter</b>			<b>Year-to-Date</b>		
(\$ millions)	<b>2013</b>	2012	Variance	<b>2013</b>	2012	Variance
FortisAlberta	<b>46</b>	38	8	<b>94</b>	9	85
FortisBC Electric	<b>1</b>	17	(16)	<b>33</b>	8	25
Newfoundland Power	<b>1</b>	14	(13)	<b>22</b>	28	(6)
Corporate	<b>514</b>	154	360	<b>549</b>	185	364
<b>Total</b>	<b>562</b>	223	339	<b>698</b>	230	468

Borrowings under credit facilities by the utilities are primarily in support of their capital expenditure programs and/or for working capital requirements. Repayments are primarily financed through the issuance of long-term debt, cash from operations and/or equity injections from Fortis. From time to time, proceeds from preference share, common share and long-term debt offerings are used to repay borrowings under the Corporation's committed credit facility. The borrowings under the Corporation's committed credit facility in 2013 were incurred to finance a portion of the acquisition of CH Energy Group, to support the construction of the Waneta Expansion and to finance an equity injection into FortisAlberta in support of energy infrastructure investment.

Advances of approximately \$20 million during the quarter and \$42 million year to date were received from non-controlling interests in the Waneta Partnership to finance capital spending related to the Waneta Expansion, compared to \$27 million received during the second quarter of 2012 and \$56 million received year-to-date 2012. In January 2012 advances of approximately \$12 million were received from two First Nations bands, representing their 15% equity investment in the LNG storage facility on Vancouver Island.

Proceeds from the issuance of common shares were \$575 million higher for the quarter and \$583 million higher year to date compared to the same periods in 2012. The increases were primarily due to the issuance of 18.5 million common shares, as a result of the conversion of the Subscription Receipts on closing of the CH Energy Group acquisition, for proceeds of approximately



\$567 million, net of after-tax expenses. Higher proceeds from the issuance of common shares for the quarter and year to date also reflected a higher number of common shares issued under the Corporation's stock option and employee share purchase plans.

Common share dividends paid during the second quarter of 2013 were \$44 million, net of \$15 million of dividends reinvested, compared to \$42 million, net of \$15 million of dividends reinvested, paid during the same quarter of 2012. Common share dividends paid in the first half of 2013 were \$85 million, net of \$34 million in dividends reinvested, compared to \$86 million, net of \$28 million in dividends reinvested, paid in the first half of 2012. The dividend paid per common share for the first and second quarters of 2013 was \$0.31 compared to \$0.30 for the first and second quarters of 2012. The weighted average number of common shares outstanding for the second quarter and year to date was 193.4 million and 192.7 million, respectively, compared to 189.6 million and 189.3 million, respectively, for the same periods in 2012.

## CONTRACTUAL OBLIGATIONS

The Corporation's consolidated contractual obligations with external third parties in each of the next five years and for periods thereafter, as at June 30, 2013, are outlined in the following table. A detailed description of the nature of the obligations is provided in the 2012 Annual MD&A and below, where applicable.

<b>Contractual Obligations (Unaudited) As at June 30, 2013</b> (\$ millions)	<b>Total</b>	Due					Due after 5 years
		within 1 year	Due in year 2	Due in year 3	Due in year 4	Due in year 5	
Long-term debt	<b>7,186</b>	201	699	836	329	80	5,041
Government loan obligations	<b>15</b>	-	10	5	-	-	-
Capital lease and finance obligations	<b>2,569</b>	48	49	50	51	51	2,320
Interest obligations on long-term debt	<b>6,996</b>	375	351	337	310	295	5,328
Gas purchase contract obligations <sup>(1)</sup>	<b>326</b>	217	55	19	10	6	19
Power purchase obligations:							
Central Hudson <sup>(2)</sup>	<b>50</b>	25	5	3	3	3	11
FortisBC Electric	<b>26</b>	9	7	6	3	1	-
FortisOntario	<b>334</b>	46	50	51	52	53	82
Maritime Electric	<b>121</b>	38	41	27	1	1	13
Capital cost <sup>(3)</sup>	<b>492</b>	12	18	18	18	17	409
Construction and maintenance projects <sup>(4)</sup>	<b>145</b>	49	48	29	6	5	8
Operating lease obligations	<b>37</b>	7	6	6	5	5	8
Waneta Partnership promissory note	<b>72</b>	-	-	-	-	-	72
Joint-use asset and shared service agreements	<b>62</b>	4	3	3	3	3	46
Defined benefit pension funding contributions	<b>66</b>	29	15	12	6	1	3
Performance Share Unit Plan obligations	<b>8</b>	1	2	5	-	-	-
Other	<b>12</b>	8	1	-	-	-	3
<b>Total</b>	<b>18,517</b>	1,069	1,360	1,407	797	521	13,363

<sup>(1)</sup> Gas purchase contract obligations at the FortisBC Energy companies are based on index prices as at June 30, 2013. Gas purchase contracts at Central Hudson are predominantly for long-term storage and interstate gas transportation contracts and are based on tariff rates as at June 30, 2013.

<sup>(2)</sup> Central Hudson has entered into agreements with Entergy Nuclear Power Marketing, LLC to purchase electricity, and not capacity, on a unit-contingent basis at defined prices from January 1, 2011 through December 31, 2013. In the event the counterparty is unable to fulfill the commitment to deliver under the terms of the agreement, Central Hudson would obtain required supply from the NYISO market, with cost recovery from customers. Central Hudson must also acquire sufficient peak load capacity to meet the peak load requirements of its full-service customers. This capacity is made up of contracts with capacity providers, purchases from the NYISO capacity market and its own generating capacity.

<sup>(3)</sup> Maritime Electric has entitlement to approximately 4.7% of the output from Point Lepreau for the life of the unit. As part of its entitlement, Maritime Electric is required to pay its share of the capital and operating costs of the unit. A major refurbishment of Point Lepreau that began in 2008 was completed and the facility returned to service in November 2012. The refurbishment is expected to extend the facility's estimated life an additional 27 years and, as a result, the total estimated capital cost obligation has increased approximately \$46 million from that disclosed in the 2012 Annual MD&A.

<sup>(4)</sup> Central Hudson has various purchase commitments and contracts related to ongoing projects and operating activities. Certain of these commitments are related to capital projects and are also included in Central Hudson's capital expenditure forecast.

Other contractual obligations, which are not reflected in the above table, did not materially change from those disclosed in the 2012 Annual MD&A, except as follows.

In May 2013 FortisBC Electric entered into a new PPA with BC Hydro to purchase up to 200 MW of capacity and 1,752 GWh of associated energy annually for a 20-year term beginning October 1, 2013. This new PPA does not change the basic parameters of the BC Hydro PPA, which expires on September 30, 2013. An executed version of the PPA was submitted by BC Hydro to the BCUC in May 2013 and is pending regulatory approval. Power purchases from the new PPA are expected to be recovered in customer rates.

For a discussion of the nature and amount of the Corporation's consolidated capital expenditure program, that is not included in the preceding Contractual Obligations table, refer to the "Capital Expenditure Program" section of this MD&A.

## CAPITAL STRUCTURE

The Corporation's principal businesses of regulated gas and electricity distribution require ongoing access to capital to enable the utilities to fund maintenance and expansion of infrastructure. Fortis raises debt at the subsidiary level to ensure regulatory transparency, tax efficiency and financing flexibility. Fortis generally finances a significant portion of acquisitions at the corporate level with proceeds from common share, preference share and long-term debt offerings. To help ensure access to capital, the Corporation targets a consolidated long-term capital structure containing approximately 40% equity, including preference shares, and 60% debt, as well as investment-grade credit ratings. Each of the Corporation's regulated utilities maintains its own capital structure in line with the deemed capital structure reflected in each of the utility's customer rates.

The consolidated capital structure of Fortis is presented in the following table.

Capital Structure (Unaudited)	As at			
	June 30, 2013		December 31, 2012	
	(\$ millions)	(%)	(\$ millions)	(%)
Total debt and capital lease and finance obligations (net of cash) <sup>(1)</sup>	7,452	56.2	6,317	55.3
Preference shares	1,108	8.4	1,108	9.7
Common shareholders' equity	4,699	35.4	3,992	35.0
<b>Total</b> <sup>(2)</sup>	<b>13,259</b>	<b>100.0</b>	<b>11,417</b>	<b>100.0</b>

<sup>(1)</sup> Includes long-term debt and capital lease and finance obligations, including current portion, and short-term borrowings, net of cash

<sup>(2)</sup> Excludes amounts related to non-controlling interests

The change in the capital structure was primarily due to the financing of the acquisition of CH Energy Group, including: (i) the conversion of Subscription Receipts into common shares for \$567 million, net of after-tax expenses; (ii) debt assumed upon acquisition; and (iii) higher borrowings under the Corporation's committed credit facility, to initially finance the remaining portion of the acquisition. The capital structure was also impacted by an increase in total debt, mainly in support of energy infrastructure investment, net earnings attributable to common equity shareholders for the six months ended June 30, 2013, less dividends declared on common shares, and the issuance of common shares under the Corporation's Dividend Reinvestment Plan.

Excluding capital lease and finance obligations, the Corporation's capital structure as at June 30, 2013 was 54.7% debt, 8.7% preference shares and 36.6% common shareholders' equity (December 31, 2012 - 53.6% debt, 10.1% preference shares and 36.3% common shareholders' equity).

## CREDIT RATINGS

The Corporation's credit ratings are as follows:

Standard & Poor's ("S&P")	A- (long-term corporate and unsecured debt credit rating)
DBRS	A(low) (unsecured debt credit rating)

In February 2013 S&P and DBRS affirmed the Corporation's debt credit ratings. The above-noted credit ratings reflect the Corporation's business-risk profile and diversity of its operations, the stand-alone nature and financial separation of each of the regulated subsidiaries of Fortis, management's commitment to maintaining low levels of debt at the holding company level, the Corporation's reasonable credit metrics and its demonstrated ability and continued focus on acquiring and integrating stable regulated utility businesses financed on a conservative basis. The credit ratings also reflect the Corporation's financing plans for the acquisition of CH Energy Group and the expected completion of the Waneta Expansion on time and on budget.

## CAPITAL EXPENDITURE PROGRAM

A breakdown of the \$548 million in gross consolidated capital expenditures by segment for the first half of 2013 is provided in the following table.

<b>Gross Consolidated Capital Expenditures (Unaudited) <sup>(1)</sup></b>									
<b>Year-to-Date June 30, 2013</b>									
<i>(\$ millions)</i>									
FortisBC Energy Companies	Fortis Alberta	FortisBC Electric	Newfoundland Power	Other Regulated Electric Utilities - Canadian	<b>Total Regulated Utilities - Canadian</b>	<b>Regulated Electric Utilities - Caribbean</b>	<b>Non- Regulated - Fortis Generation</b>	<b>Non- Regulated - Non- Utility</b>	<b>Total</b>
92	230	33	38	28	<b>421</b>	<b>24</b>	<b>79</b>	<b>24</b>	<b>548</b>

<sup>(1)</sup> Relates to cash payments to acquire or construct utility capital assets, income producing properties and intangible assets, as reflected on the consolidated statement of cash flows. Excludes capitalized depreciation and amortization and non-cash equity component of AFUDC.

Planned capital expenditures are based on detailed forecasts of energy demand, weather, cost of labour and materials, as well as other factors, including economic conditions, which could change and cause actual expenditures to differ from those forecast.

Gross consolidated capital expenditures for 2013 are forecast at approximately \$1.3 billion. There have been no material changes in the overall expected level, nature and timing of the Corporation's significant capital projects from those that were disclosed in the 2012 Annual MD&A, with the exception of those noted below for the Waneta Expansion, FAES and Central Hudson.

Capital expenditures related to the Waneta Expansion for 2013 are expected to be lower than the original forecast of \$227 million, primarily due to the timing of payments. Due to the uncertainty of the timing of alternative energy projects, capital expenditures for 2013 at FAES are delayed and are expected to be lower than the original forecast of \$43 million. Capital expenditures for 2013 now include approximately \$50 million in capital spending forecast at Central Hudson for the second half of 2013.

Construction of the \$900 million Waneta Expansion is ongoing, with an additional \$77 million invested in the first half of 2013. To date, approximately \$513 million has been invested in the Waneta Expansion since construction began late in 2010. Key construction activities in the first half of 2013 include the ongoing civil construction of the powerhouse and intake, installation of the turbine components, installation of ancillary mechanical and electrical powerhouse services, and most notably, the substantial completion of the intake channel excavation. The key offsite activity in the first half of 2013 was the successful completion of the factory acceptance testing of the generator step-up transformers.

Over the five-year period 2013 through 2017, gross consolidated capital expenditures are expected to be approximately \$6 billion. The approximate breakdown of the capital spending expected to be incurred is as follows: 55% at Canadian Regulated Electric Utilities, driven by FortisAlberta; 20% at Canadian Regulated Gas Utilities; 11% at Central Hudson; 4% at Caribbean Regulated Electric Utilities; and the remaining 10% at non-regulated operations. Capital expenditures at the regulated utilities are subject to regulatory approval. Over the five-year period, on average annually, the approximate breakdown of the total capital spending to be incurred is as follows: 36% to meet customer growth, 41% for sustaining capital expenditures, and 23% for facilities, equipment, vehicles, information technology and other assets.

## CASH FLOW REQUIREMENTS

At the subsidiary level, it is expected that operating expenses and interest costs will generally be paid out of subsidiary operating cash flows, with varying levels of residual cash flows available for subsidiary capital expenditures and/or dividend payments to Fortis. Borrowings under credit facilities may be required from time to time to support seasonal working capital requirements. Cash required to complete subsidiary capital expenditure programs is also expected to be financed from a combination of borrowings under credit facilities, equity injections from Fortis and long-term debt offerings.

The Corporation's ability to service its debt obligations and pay dividends on its common shares and preference shares is dependent on the financial results of the operating subsidiaries and the related cash payments from these subsidiaries. Certain regulated subsidiaries may be subject to restrictions that may limit their ability to distribute cash to Fortis.

Cash required of Fortis to support subsidiary capital expenditure programs and finance acquisitions is expected to be derived from a combination of borrowings under the Corporation's committed corporate credit facility and proceeds from the issuance of common shares, preference shares and long-term debt. Depending on the timing of cash payments from the subsidiaries, borrowings under the Corporation's committed corporate credit facility may be required from time to time to support the servicing of debt and payment of dividends.

As at June 30, 2013, management expects consolidated long-term debt maturities and repayments to average approximately \$310 million annually over the next five years, excluding borrowings under the Corporation's committed credit facility which are expected to be replaced with long-term financing. The combination of available credit facilities and relatively low annual debt maturities and repayments will provide the Corporation and its subsidiaries with flexibility in the timing of access to capital markets.

In May 2012 Fortis filed a short-form base shelf prospectus under which Fortis may offer, from time to time during the 25-month period from May 10, 2012, by way of a prospectus supplement, common shares, preference shares, subscription receipts and/or unsecured debentures in the aggregate amount of up to \$1.3 billion (or the equivalent in US dollars or other currencies). The base shelf prospectus provides the Corporation with flexibility to access securities markets in a timely manner.

Through prospectus supplements filed under its base shelf prospectus, Fortis offered and sold: (i) approximately \$601 million of Subscription Receipts in June 2012 (refer to the "Significant Items" section in this MD&A); (ii) \$200 million First Preference Shares, Series J in November 2012; and (iii) \$250 million First Preference Shares, Series K in July 2013 (refer to the "Subsequent Events" section in this MD&A). The remaining room under the base shelf prospectus is approximately \$250 million.

In July 2013 FortisBC Electric filed a short-form base shelf prospectus to establish a Medium-Term Note ("MTN") Debentures Program and entered into a dealer agreement with certain affiliates of a group of Canadian Chartered Banks. Upon filing the shelf prospectus, the Company may from time to time during the 25-month life of the base shelf prospectus, issue MTN Debentures in an aggregate principal amount of up to \$300 million. The establishment of the MTN Debentures Program has been approved by the BCUC.

Fortis and its subsidiaries were compliant with debt covenants as at June 30, 2013 and are expected to remain compliant throughout 2013.

## CREDIT FACILITIES

As at June 30, 2013, the Corporation and its subsidiaries had consolidated credit facilities of approximately \$2.7 billion, of which \$1.7 billion was unused, including \$395 million unused under the Corporation's \$1 billion committed revolving corporate credit facility. The credit facilities are syndicated mostly with the seven largest Canadian banks, with no one bank holding more than 20% of these facilities. Approximately \$2.6 billion of the total credit facilities are committed facilities with maturities ranging from 2013 through 2018.

The following summary outlines the credit facilities of the Corporation and its subsidiaries.

Credit Facilities (Unaudited) (\$ millions)	Regulated Utilities	Non- Regulated	Corporate and Other	As at	
				June 30, 2013	December 31, 2012
Total credit facilities	1,560	112	1,030	2,702	2,460
Credit facilities utilized:					
Short-term borrowings	(72)	(27)	-	(99)	(136)
Long-term debt (including current portion)	(226)	-	(603)	(829)	(150)
Letters of credit outstanding	(66)	-	(2)	(68)	(67)
Credit facilities unused	1,196	85	425	1,706	2,107

As at June 30, 2013 and December 31, 2012, certain borrowings under the Corporation's and subsidiaries' credit facilities were classified as long-term debt. These borrowings are under long-term committed credit facilities and management's intention is to refinance these borrowings with long-term permanent financing during future periods.

In January 2013 FEVI's \$20 million unsecured committed non-revolving credit facility matured and was not replaced.

In April 2013 FortisBC Electric renegotiated and amended its credit facility agreement, resulting in an extension to the maturity of the Company's \$150 million unsecured committed revolving credit facility with \$100 million now maturing in May 2016 and \$50 million now maturing in May 2014. The amended credit facility agreement contains substantially similar terms and conditions as the previous credit facility agreement.

In April 2013 FHI extended its \$30 million unsecured committed revolving credit facility to mature in May 2014 from May 2013.

In May 2013 FortisOntario extended its \$30 million unsecured revolving credit facility to mature in June 2014 from June 2013.

In June 2013 Fortis Turks and Caicos entered into new short-term unsecured demand credit facilities for US\$31 million (\$33 million), replacing its previous US\$21 million (\$22 million) facilities. The new facilities are comprised of a revolving operating credit facility of US\$12 million (\$13 million), a capital expenditure line of credit of US\$10 million (\$11 million) and a US\$9 million (\$9 million) emergency standby loan. The capital expenditure line of credit matures in December 2013. The remaining facilities mature in June 2014. The new credit facilities reflect a decrease in pricing but otherwise contain terms and conditions substantially similar to the previous facilities.

As at June 30, 2013, CH Energy Group had a US\$100 million (\$105 million) unsecured revolving credit facility maturing in October 2015, and Central Hudson had a US\$150 million (\$158 million) unsecured committed revolving credit facility maturing in October 2016.

In July 2013 FEI, FEVI and FortisAlberta amended their \$500 million, \$200 million and \$250 million committed revolving credit facilities, resulting in extensions to the maturity dates to August 2015, December 2015 and August 2018, respectively, from August 2014, December 2013 and August 2016, respectively. The new agreements contain substantially similar terms and conditions as the previous credit facility agreements.

## FINANCIAL INSTRUMENTS

The carrying values of the Corporation's consolidated financial instruments approximate their fair values, reflecting the short-term maturity, normal trade credit terms and/or nature of these instruments, except as follows.

Financial Instruments (Unaudited) <i>(\$ millions)</i>	As at			
	June 30, 2013		December 31, 2012	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Waneta Partnership promissory note	48	50	47	51
Long-term debt, including current portion	7,186	8,220	5,900	7,338

The fair value of long-term debt is calculated using quoted market prices when available. When quoted market prices are not available, as is the case with the Waneta Partnership promissory note and certain long-term debt, the fair value is determined by either: (i) discounting the future cash flows of the specific debt instrument at an estimated yield to maturity equivalent to benchmark government bonds or treasury bills, with similar terms to maturity, plus a credit risk premium equal to that of issuers of similar credit quality; or (ii) by obtaining from third parties indicative prices for the same or similarly rated issues of debt of the same remaining maturities. Since the Corporation does not intend to settle the long-term debt or promissory note prior to maturity, the excess of the estimated fair value above the carrying value does not represent an actual liability.

The Financial Instruments table above excludes the long-term other asset associated with the Corporation's expropriated investment in Belize Electricity. Due to uncertainty in the ultimate amount and ability of the Government of Belize ("GOB") to pay appropriate fair value compensation owing to Fortis for the expropriation of Belize Electricity, the Corporation has recorded the book value of the expropriated investment, including foreign exchange impacts, in long-term other assets, which totalled approximately \$109 million as at June 30, 2013 (December 31, 2012 - \$104 million).

**Risk Management:** The Corporation's earnings from, and net investments in, foreign subsidiaries are exposed to fluctuations in the US dollar-to-Canadian dollar exchange rate. The Corporation has effectively decreased the above-noted exposure through the use of US dollar-denominated borrowings at the corporate level. The foreign exchange gain or loss on the translation of US dollar-denominated interest expense partially offsets the foreign exchange loss or gain on the translation of the Corporation's foreign subsidiaries' earnings, which are denominated in US dollars. The reporting currency of Central Hudson, Caribbean Utilities, Fortis Turks and Caicos, FortisUS Energy Corporation, Belize Electric Company Limited ("BECOL") and Griffith is the US dollar.

As at June 30, 2013, the Corporation's corporately issued US\$1,052 million (December 31, 2012 - US\$557 million) long-term debt had been designated as an effective hedge of the Corporation's foreign net investments. As at June 30, 2013, the Corporation had approximately US\$534 million (December 31, 2012 - US\$17 million) in foreign net investments remaining to be hedged. Both the Corporation's US dollar-denominated long-term debt and foreign net investments as at June 30, 2013 were significantly impacted by the CH Energy Group acquisition. Foreign currency exchange rate fluctuations associated with the translation of the Corporation's corporately issued US dollar-denominated borrowings designated as effective hedges are recorded in other comprehensive income and serve to help offset unrealized foreign currency exchange gains and losses on the net investments in foreign subsidiaries, which gains and losses are also recorded in other comprehensive income.

Effective from June 20, 2011, the Corporation's asset associated with its expropriated investment in Belize Electricity does not qualify for hedge accounting as Belize Electricity is no longer a foreign subsidiary of Fortis. As a result, foreign exchange gains and losses on the translation of the long-term other asset associated with Belize Electricity are recognized in earnings. The Corporation recognized in earnings a foreign exchange gain of approximately \$3 million and \$5 million, for the three and six months ended June 30, 2013, respectively (\$2 million and \$0.5 million for the three and six months ended June 30, 2012, respectively).

From time to time, the Corporation and its subsidiaries hedge exposures to fluctuations in interest rates, foreign exchange rates and fuel, electricity and natural gas prices through the use of derivative instruments. The Corporation and its subsidiaries do not hold or issue derivative instruments for trading purposes. As at June 30, 2013, the Corporation's derivative contracts consisted of fuel option contracts, electricity swap contracts, natural gas swap and option contracts, and gas purchase contract premiums. The fuel option contracts are held by Caribbean Utilities. Electricity swap contracts are held by Central Hudson. Gas swaps and options and gas purchase contract premiums are held by the FortisBC Energy companies and Central Hudson.

The following table summarizes the Corporation's derivative instruments.

<b>Derivative Instruments (Unaudited)</b>	<b>As at</b>				
	<b>June 30, 2013</b>	<b>December 31, 2012</b>			
<b>Liability</b>	<b>Maturity</b>	<b>Number of Contracts</b>	<b>Volume<sup>(1)</sup></b>	<b>Carrying Value<sup>(2)</sup></b>	<b>Carrying Value<sup>(2)</sup></b>
				<b>(\$ millions)</b>	<b>(\$ millions)</b>
Fuel option contracts <sup>(3)</sup>	2013	2	4	-	(1)
Electricity swap contracts	2017	9	2,625	(1)	-
Natural gas commodity derivatives:					
Gas swaps and options	2014	42	15	(31)	(51)
Gas purchase contract premiums	2015	44	78	(2)	(8)

<sup>(1)</sup> The volume for fuel option contracts is reported in millions of imperial gallons; electricity swap contracts in GWh; and natural gas commodity derivatives in PJ.

<sup>(2)</sup> Carrying value is estimated fair value. The liability represents the gross derivatives balance.

<sup>(3)</sup> The carrying value of the fuel option contracts was less than \$1 million as at June 30, 2013.

The fuel option contracts are used by Caribbean Utilities to reduce the impact of volatility in fuel prices on customer rates, as approved by the regulator under the Company's Fuel Price Volatility Management Program. The fuel option contracts mature in October 2013. Approximately 30% of the Company's annual diesel fuel requirements are under fuel hedging arrangements.

The electricity swap contracts and natural gas commodity derivatives are used by Central Hudson to minimize commodity price volatility for electricity and natural gas purchases for the Company's full-service customers by fixing the effective purchase price for the defined commodities.

The natural gas commodity derivatives held by the FortisBC Energy companies are used to fix the effective purchase price of natural gas, as the majority of the natural gas supply contracts at the FortisBC Energy companies have floating, rather than fixed, prices. The price risk-management strategy of the FortisBC Energy companies aims to improve the likelihood that natural gas prices remain competitive, mitigate gas price volatility on customer rates and reduce the risk of regional price discrepancies. As directed by the regulator in 2011, the FortisBC Energy companies have suspended their commodity hedging activities with the exception of certain limited swaps as permitted by the regulator. The existing hedging contracts will continue in effect through to their maturity and the FortisBC Energy companies' ability to fully recover the commodity cost of gas in customer rates remains unchanged.

The changes in the fair values of the fuel option contracts, electricity swap contracts and natural gas commodity derivatives are deferred as a regulatory asset or liability for recovery from, or refund to, customers in future rates, as permitted by the regulators. The fair values of the derivative instruments were recorded in accounts payable and other current liabilities as at June 30, 2013 and December 31, 2012.

The fair value of the fuel option contracts reflects only the value of the heating oil derivative and not the offsetting change in the value of the underlying future purchases of heating oil and was calculated using published market prices for heating oil or similar commodities where appropriate. The fair values of the electricity swap contracts and natural gas commodity derivatives were calculated using forward pricing provided by independent third parties. The fair value of the natural gas commodity derivatives was calculated using the present value of cash flows based on market prices and forward curves for the commodity cost of natural gas. The fair values of the fuel option contracts, electricity swap

contracts, and natural gas commodity derivatives are estimates of the amounts that the utilities would receive or have to pay to terminate the outstanding contracts as at the balance sheet dates.

The fair values of the Corporation's financial instruments, including derivatives, reflect point-in-time estimates based on current and relevant market information about the instruments as at the balance sheet dates. The estimates cannot be determined with precision as they involve uncertainties and matters of judgment and, therefore, may not be relevant in predicting the Corporation's future consolidated earnings or cash flows.

## OFF-BALANCE SHEET ARRANGEMENTS

With the exception of letters of credit outstanding of \$68 million as at June 30, 2013 (December 31, 2012 - \$67 million), the Corporation had no 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.

## BUSINESS RISK MANAGEMENT

Year-to-date 2013, the business risks of the Corporation were generally consistent with those disclosed in the Corporation's 2012 Annual MD&A, including certain risks, as disclosed below, and an update to those risks, where applicable.

**Regulatory Risk:** The allowed ROE and capital structure at Newfoundland Power have been set for 2013 through 2015 and remain unchanged from 2012. At FEI, the allowed ROE and capital structure have been set for 2013, resulting in a decrease of 75 basis points in the allowed ROE and a reduction in the common equity component of capital structure to 38.5% from 40% as compared to 2012.

Final allowed ROEs and capital structures for 2013 remain outstanding for FortisAlberta, FortisBC Electric, FEVI and FEWI. The results of cost of capital proceedings could materially impact the earnings of the above-noted utilities.

PBR commenced at FortisAlberta for a five-year term, beginning January 1, 2013. In March 2013 interim distribution electricity rates under PBR were approved by the AUC, in addition to the recovery, on an interim basis, of 60% of the revenue requirement associated with 2013 capital tracker expenditures applied for by FortisAlberta. While the AUC's 2012 PBR decision provides for a capital tracker mechanism to address recovery of certain capital expenditures outside of the PBR formula, the mechanism has yet to be tested to confirm its applicability to FortisAlberta's capital program. Final decisions on FortisAlberta's rates are expected in the second half of 2013.

For further information, refer to the "Material Regulatory Decisions and Applications" section of this MD&A.

**Acquisition of CH Energy Group:** As a result of the closing of the CH Energy Group acquisition on June 27, 2013, the risks associated with the completion of the transaction are no longer applicable.

**Expropriation of Shares in Belize Electricity:** A decision is pending from the Belize Court of Appeal regarding the Corporation's appeal of the Belize Supreme Court's dismissal of the Corporation's claim filed in October 2011 challenging the constitutionality of the expropriation of the Corporation's investment in Belize Electricity.

Fortis believes it has a strong, well-positioned case before the Belize Courts supporting the unconstitutionality of the expropriation. There exists, however, a reasonable possibility that the outcome of the litigation may be unfavourable to the Corporation and the amount of compensation otherwise to be paid to Fortis under the legislation expropriating Belize Electricity could be lower than the book value of the Corporation's expropriated investment in Belize Electricity. The book value of the expropriated investment was approximately \$109 million, including foreign exchange impacts, as at



June 30, 2013 (December 31, 2012 - \$104 million). If the expropriation is held to be unconstitutional, it is not determinable at this time as to the nature of the relief that would be awarded to Fortis, for example: (i) the ordering of the return of the shares to Fortis and/or award of damages; or (ii) the ordering of compensation to be paid to Fortis for the unconstitutional expropriation of the shares. Based on presently available information, the \$109 million long-term other asset is not deemed impaired as at June 30, 2013. Fortis will continue to assess for impairment each reporting period based on evaluating the outcomes of court proceedings and/or compensation settlement negotiations. As well as continuing the constitutional challenge of the expropriation, Fortis is also pursuing alternative options for obtaining fair compensation, including compensation under the Belize/United Kingdom Bilateral Investment Treaty.

Fortis continues to control and consolidate the financial statements of BECOL, the Corporation's indirect wholly owned non-regulated hydroelectric generating subsidiary in Belize. As at July 31, 2013, Belize Electricity owed BECOL US\$3 million for overdue energy purchases, representing approximately 15% of BECOL's annual sales to Belize Electricity. In accordance with long-standing agreements, the GOB guarantees the payment of Belize Electricity's obligations to BECOL.

**Capital Resources and Liquidity Risk - Credit Ratings:** The Corporation's credit ratings were affirmed by S&P and DBRS in February 2013. Year-to-date 2013, the following changes were made to the credit ratings of the Corporation's utilities: (i) S&P updated Maritime Electric's debt credit rating from 'A- stable' to 'A stable' in February 2013; (ii) Moody's Investors Service ("Moody's"), in June 2013, affirmed the long-term credit ratings of FHI, FEI, FEVI and FortisBC Electric, and changed the rating outlooks to negative from stable; and (iii) Fitch Ratings and Moody's, in July 2013, affirmed Central Hudson's debt credit ratings at 'A stable' and 'A3 stable', respectively, and S&P also affirmed the Company's debt credit rating at 'A' and removed it from 'credit watch with negative implications'.

**Defined Benefit Pension and OPEB Plan Assets:** As at June 30, 2013, the fair value of the Corporation's consolidated defined benefit pension and OPEB plan assets was \$1,545 million, up \$677 million or 78%, from \$868 million as at December 31, 2012. Of the increase from December 31, 2012, approximately \$656 million, or 97% was due to the acquisition of CH Energy Group.

**Labour Relations:** The collective agreement between employees in specified occupations in the areas of administration and operations support at the FortisBC Energy companies and the Canadian Office and Professional Employees Union, Local 378, expired on March 31, 2012. A new three-year collective agreement, expiring on March 31, 2015, was reached in March 2013.

The collective agreement between FortisBC Electric and the International Brotherhood of Electrical Workers ("IBEW"), Local 213, expired on January 31, 2013. IBEW, Local 213, represents employees in specified occupations in the areas of generation and T&D. The parties have been unsuccessful in collective bargaining efforts to date. As a result, FortisBC Electric activated the essential services order issued in April 2013 by the Labour Relations Board of British Columbia. The IBEW is complying with the order and the Company continues to deliver safe and reliable electricity to its customers and is committed to reaching a fair and reasonable agreement that balances the needs of its employees and customers. Approximately 200 of FortisBC Electric's employees are members of the IBEW, Local 213.

## CHANGES IN ACCOUNTING POLICIES

The new US GAAP accounting pronouncements that are applicable to, and were adopted by, Fortis, effective January 1, 2013, are described as follows.

### *Disclosures About Offsetting Assets and Liabilities*

The Corporation adopted the amendments to Accounting Standards Codification ("ASC") Topic 210, *Balance Sheet – Disclosures About Offsetting Assets and Liabilities* as outlined in Accounting Standards Update ("ASU") No. 2011-11 and ASU No. 2013-01. The amendments improve the transparency of the effect or potential effect of netting arrangements on a company's financial position by expanding the level of disclosures required by entities for such arrangements. The amended disclosures are intended to assist financial statement users in understanding significant quantitative differences between balance sheets prepared under US GAAP and International Financial Reporting Standards. ASU No. 2013-01 limits the scope of the new offsetting disclosure requirements previously issued in ASU No. 2011-11 to certain derivative instruments, repurchase and reverse repurchase agreements, and securities borrowing and lending arrangements that are either offset on the balance sheet or subject to an enforceable master netting or similar arrangement. The above-noted amendments were applied retrospectively and did not materially impact the Corporation's interim consolidated financial statements for the three and six months ended June 30, 2013.

### *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*

The Corporation adopted the amendments to ASC Topic 220, *Other Comprehensive Income - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ("AOCI")* as outlined in ASU No. 2013-02. The amendments improve the reporting of reclassifications out of AOCI and require entities to report, in one place, information about reclassifications out of AOCI and to present details of the reclassifications in the disclosure for changes in AOCI balances. The effect of the reclassification of significant items to net income in their entirety during the reporting period must be reported in the respective line items in the statement where net income is presented. The effect of items not reclassified to net income in their entirety during the reporting period are to be presented in the notes to the consolidated financial statements. The amendments were applied by the Corporation prospectively commencing on January 1, 2013 and did not materially impact the Corporation's interim consolidated financial statements for the three and six months ended June 30, 2013.

## FUTURE ACCOUNTING PRONOUNCEMENTS

### *Obligations Resulting from Joint and Several Liability Arrangements*

In February 2013, the Financial Accounting Standards Board ("FASB") issued ASU No. 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date*. The objective of this update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. This accounting update is effective for annual and interim periods beginning on or after December 15, 2013 and is to be applied retrospectively. Fortis does not expect that the adoption of this update will have a material impact on its consolidated financial statements.

### *Parent's Accounting for the Cumulative Translation Adjustment*

In March 2013, FASB issued ASU No. 2013-5, *Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*. This update applies to the release of the cumulative translation adjustment into net earnings when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets within a foreign entity. This accounting update is effective for annual and interim periods beginning on or after December 15, 2013 and is to be applied prospectively. Fortis does not expect that the adoption of this update will have a material impact on its consolidated financial statements.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of the Corporation's interim unaudited consolidated financial statements in accordance with US GAAP requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Estimates and judgments are based on historical experience, current conditions and various other assumptions believed to be reasonable under the circumstances. Certain amounts are 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 earnings in the period in which they become known.

Interim financial statements may also employ a greater use of estimates than the annual financial statements. There were no material changes in the nature of the Corporation's critical accounting estimates year-to-date 2013 from those disclosed in the 2012 Annual MD&A.

**Contingencies:** The Corporation and its subsidiaries are subject to various legal proceedings and claims associated with the ordinary course of business operations. Management believes that the amount of liability, if any, from these actions would not have a material effect on the Corporation's consolidated financial position or results of operations.

The following describes the nature of the Corporation's contingent liabilities.

### Fortis

In May 2012 CH Energy Group and Fortis entered into a proposed settlement agreement with counsel to plaintiff shareholders pertaining to several complaints, which named Fortis and other defendants, which were filed in, or transferred to, the Supreme Court of the State of New York, County of New York, relating to the acquisition of CH Energy Group by Fortis. The complaints generally alleged that the directors of CH Energy Group breached their fiduciary duties in connection with the acquisition and that CH Energy Group, Fortis, FortisUS Inc. and Cascade Acquisition Sub Inc. aided and abetted that breach. The settlement agreement is subject to court approval.

### FHI

During 2007 and 2008, a non-regulated subsidiary of FHI received Notices of Assessment from Canada Revenue Agency ("CRA") for additional taxes related to the taxation years 1999 through 2003. The exposure has been fully provided for in the consolidated financial statements. A settlement was reached with CRA in the second quarter of 2013 resulting in the release of income tax provisions of approximately \$5 million.

In April 2013 FHI and Fortis were named as defendants in an action in the British Columbia Supreme Court by the Coldwater Indian Band ("Band"). The claim is in regard to interests in a pipeline right of way on reserve lands. The pipeline on the right of way was transferred by FHI (then Terasen Inc.) to Kinder Morgan Inc. in April 2007. The Band seeks orders cancelling the right of way and claims damages for wrongful interference with the Band's use and enjoyment of reserve lands. The outcome cannot be reasonably determined and estimated at this time and, accordingly, no amount has been accrued in the interim unaudited consolidated financial statements.

### FortisBC Electric

The Government of British Columbia has alleged breaches of the Forest Practices Code and negligence relating to a forest fire near Vaseux Lake in 2003, prior to the acquisition of FortisBC Electric by Fortis, and has filed and served a writ and statement of claim against FortisBC Electric dated August 2, 2005. The Government of British Columbia has now disclosed that its claim includes approximately \$15 million in damages as well as pre-judgment interest, but that it has not fully quantified its damages. FortisBC Electric and its insurers continue to defend the claim by the Government of British Columbia. The outcome cannot be reasonably determined and estimated at this time and, accordingly, no amount has been accrued in the interim unaudited consolidated financial statements.

The Government of British Columbia filed a claim in the British Columbia Supreme Court in June 2012 claiming on its behalf, and on behalf of approximately 17 homeowners, damages suffered as a result of a landslide caused by a dam failure in Oliver, British Columbia in 2010. The Government of British Columbia alleges in its claim that the dam failure was caused by the defendants', which includes FortisBC Electric, use of a road on top of the dam. The Government of British Columbia estimates its damages and the damages of the homeowners, on whose behalf it is claiming, to be approximately \$15 million. While FortisBC Electric has not been served, the utility has retained counsel and has notified its insurers. The outcome cannot be reasonably determined and estimated at this time and, accordingly, no amount has been accrued in the interim unaudited consolidated financial statements.

### **Central Hudson**

#### *Danskammer Point Steam Electric Generating Station*

In 1999, the New York State Attorney General alleged that Central Hudson may have constructed, and continued to operate, major modifications to the Danskammer Point Steam Electric Generating Station ("Danskammer Plant") without obtaining certain requisite pre-construction permits. In March 2000, the Environmental Protection Agency assumed responsibility for the investigation. Central Hudson believes any permits required for these projects were obtained in a timely manner. The Company sold the Danskammer Plant to Dynegy Inc. in January 2001. While Central Hudson could have retained liability after the sale, depending on the type of remedy, the Company believes that the statutes of limitation relating to any alleged violation of air emissions rules have lapsed.

#### *Former MGP Facilities*

Central Hudson and its predecessors owned and operated MGPs to serve their customers' heating and lighting needs. These plants manufactured gas from coal and oil beginning in the mid to late 1800s with all sites ceasing operations by the 1950s. This process produced certain by-products that may pose risks to human health and the environment.

The New York State Department of Environmental Conservation ("DEC"), which regulates the timing and extent of remediation of MGP sites in New York State, has notified Central Hudson that it believes the Company or its predecessors at one time owned and/or operated MGPs at seven sites in Central Hudson's franchise territory. The DEC has further requested that the Company investigate and, if necessary, remediate these sites under a Consent Order, Voluntary Clean-up Agreement, or Brownfield Clean-up Agreement. Central Hudson accrues for remediation costs based on the amounts that can be reasonably estimated. As at June 30, 2013, an obligation of US\$9 million was recognized in respect of MGPs remediation and, based upon cost model analysis completed in 2012, it is estimated, with a 90% confidence level, that total costs to remediate these sites over the next 30 years will not exceed US\$152 million.

Central Hudson has notified its insurers and intends to seek reimbursement from insurers for remediation, where coverage exists. Further, as authorized by the PSC, Central Hudson is currently permitted to defer, for future recovery from customers, the differences between actual costs for MGP site investigation and remediation and the associated rate allowances, with carrying charges to be accrued on the deferred balances at the authorized pre-tax rate of return.

#### *Etings Corners*

Central Hudson owns and operates a maintenance and warehouse facility. In the course of Central Hudson's hazardous waste permit renewal process for this facility, sediment contamination was discovered within the wetland area across the street from the main property. In cooperation with the DEC, Central Hudson continues to investigate the nature and extent of the contamination. The extent of the contamination, as well as the timing and costs for any future remediation efforts, cannot be reasonably estimated at this time and, accordingly, no amount has been accrued in the interim unaudited consolidated financial statements.

#### *Asbestos Litigation*

Prior to the acquisition of CH Energy Group, various asbestos lawsuits had been brought against Central Hudson. While a total of 3,340 asbestos cases have been raised, 1,168 remained pending as at June 30, 2013. Of the cases no longer pending against Central Hudson, 2,017 have been dismissed or discontinued without payment by the Company, and Central Hudson has settled the remaining 155 cases. The Company is presently unable to assess the validity of the remaining asbestos

lawsuits; however, based on information known to Central Hudson at this time, including the Company's experience in the settlement and/or dismissal of asbestos cases, Central Hudson believes that the costs which may be incurred in connection with the remaining lawsuits will not have a material effect on its financial position, results of operations or cash flows and, accordingly, no amount has been accrued in the interim unaudited consolidated financial statements.

## SUMMARY OF QUARTERLY RESULTS

The following table sets forth unaudited quarterly information for each of the eight quarters ended September 30, 2011 through June 30, 2013. The quarterly information has been obtained from the Corporation's interim unaudited consolidated financial statements. These financial results are not necessarily indicative of results for any future period and should not be relied upon to predict future performance.

Summary of Quarterly Results (Unaudited)	Net Earnings Attributable to Common Equity			
	Revenue (\$ millions)	Shareholders (\$ millions)	Earnings per Common Share	
Quarter Ended			Basic (\$)	Diluted (\$)
June 30, 2013	790	54	0.28	0.28
March 31, 2013	1,113	151	0.79	0.76
December 31, 2012	999	87	0.46	0.45
September 30, 2012	714	45	0.24	0.24
June 30, 2012	792	62	0.33	0.33
March 31, 2012	1,149	121	0.64	0.62
December 31, 2011	1,034	82	0.44	0.43
September 30, 2011	699	56	0.30	0.30

The summary of the past eight quarters reflects the Corporation's continued organic growth, growth from acquisitions, as well as the seasonality associated with its businesses. Interim results will fluctuate due to the seasonal nature of gas and electricity demand and water flows, as well as the timing and recognition of regulatory decisions. Revenue is also affected by the cost of fuel and purchased power and the commodity cost of natural gas, which are flowed through to customers without markup. Given the diversified nature of the Corporation's subsidiaries, seasonality may vary. Most of the annual earnings of the FortisBC Energy companies are realized in the first and fourth quarters.

**June 2013/June 2012:** Net earnings attributable to common equity shareholders were \$54 million, or \$0.28 per common share, for the second quarter of 2013 compared to earnings of \$62 million, or \$0.33 per common share, for the second quarter of 2012. A discussion of the quarter over quarter variance in financial results is provided in the "Financial Highlights" section of this MD&A.

**March 2013/March 2012:** Net earnings attributable to common equity shareholders were \$151 million, or \$0.79 per common share, for the first quarter of 2013 compared to earnings of \$121 million, or \$0.64 per common share, for the first quarter of 2012. Earnings for the first quarter of 2013 included an extraordinary gain of approximately \$22 million after tax upon the settlement of expropriation matters associated with Exploits Partnership. The remainder of the increase in earnings was primarily due to higher contribution from FortisAlberta, the FortisBC Energy companies and FortisBC Electric, and lower corporate expenses. Higher earnings at FortisAlberta were primarily due to lower depreciation and net transmission revenue of approximately \$2 million recognized in the first quarter of 2013 associated with the finalization of 2012 net transmission volume variances. At the FortisBC Energy companies, improved performance was mainly due to rate base growth and increased transportation volumes to industrial customers, partially offset by lower-than-expected customer additions and higher effective income taxes. Increased earnings at FortisBC Electric due to rate base growth, timing of operating expenses, lower-than-expected finance charges and depreciation, and higher capitalized AFUDC were partially offset by higher effective income taxes. Corporate expenses for the first quarter of 2013 were reduced by \$2 million related to foreign exchange, while corporate

expenses for the first quarter of 2012 were increased by \$1.5 million related to foreign exchange. Acquisition-related expenses in the first quarter of 2013 were approximately \$0.5 million after tax compared to \$4 million after tax in the first quarter of 2012. Excluding foreign exchange impacts and acquisition-related expenses noted above, corporate expenses increased quarter over quarter mainly due to higher preference share dividends, partially offset by lower finance charges. The increase in earnings was partially offset by decreased non-regulated hydroelectric production in Belize due to lower rainfall and lower earnings at Maritime Electric and Fortis Properties.

**December 2012/December 2011:** Net earnings attributable to common equity shareholders were \$87 million, or \$0.46 per common share, for the fourth quarter of 2012 compared to earnings of \$82 million, or \$0.44 per common share, for the fourth quarter of 2011. The increase in earnings was primarily due to higher contribution from FortisAlberta, Other Canadian Regulated Electric Utilities and FortisBC Electric, partially offset by decreased non-regulated hydroelectric production in Belize associated with lower rainfall, increased corporate expenses and decreased earnings at the FortisBC Energy companies. Higher earnings at FortisAlberta were driven by rate base growth, net transmission revenue of \$2 million recognized in the fourth quarter of 2012 and the rate revenue reduction accrual during the fourth quarter of 2011, reflecting the cumulative impact from January 1, 2011 of the decrease in the allowed ROE for 2011. At Other Canadian Regulated Electric Utilities, improved performance was mainly due to lower effective income taxes at Maritime Electric and the accrual of the cumulative return earned on FortisOntario's capital investment in smart meters. Increased earnings at FortisBC Electric were driven by rate base growth, lower-than-expected finance charges in 2012 and higher pole-attachment revenue, partially offset by the expiry of the PBR mechanism on December 31, 2011. The increase in corporate expenses was largely due to a \$3 million non-recurring provision recognized in the fourth quarter of 2012 and lower effective income tax recoveries, partially offset by a foreign exchange gain of \$1 million recognized in the fourth quarter of 2012, compared to a foreign exchange loss of \$1 million recognized in the fourth quarter of 2011, and lower finance charges. At the FortisBC Energy companies, the decrease in earnings was mainly due to the timing of certain operating and maintenance expenses during 2012, lower capitalized AFUDC and lower-than-expected customer additions in 2012, partially offset by rate base growth, higher gas transportation volumes to industrial customers and lower effective income taxes.

**September 2012/September 2011:** Net earnings attributable to common equity shareholders were \$45 million, or \$0.24 per common share, for the third quarter of 2012 compared to earnings of \$56 million, or \$0.30 per common share, for the third quarter of 2011. Earnings for the third quarter of 2012 were reduced by \$3.5 million related to foreign exchange and CH Energy Group acquisition-related expenses. Earnings for the third quarter of 2011 were favourably impacted by a one-time \$11 million after-tax merger termination fee paid to Fortis by Central Vermont Public Service Corporation and \$2.5 million of foreign exchange. Excluding the above impacts, higher earnings at FortisAlberta and FortisBC Electric for the quarter were partially offset by decreased non-regulated hydroelectric generation in Belize, due to lower rainfall, and a higher loss incurred at the FortisBC Energy companies. The improved performance at FortisAlberta was due to net transmission revenue of \$3.5 million recognized in the third quarter of 2012, rate base growth and the timing of operating expenses during 2012, partially offset by a lower allowed ROE. At FortisBC Electric, improved performance was driven by rate base growth, higher pole-attachment revenue and lower-than-expected finance charges. The higher loss at the FortisBC Energy companies related to the unfavourable impact of the difference in the timing of recognition of revenue associated with seasonal gas consumption and certain increased regulator-approved expenses in 2012, lower capitalized AFUDC and lower-than-expected customer additions in 2012. The above items were partially offset by higher gas transportation volumes to industrial customers and the timing of certain operating and maintenance expenses during 2012.

## OUTLOOK

Over the five years 2013 through 2017, the Corporation's consolidated capital expenditure program is expected to total approximately \$6 billion and will support continuing growth in non-regulated earnings and dividends. Capital investment over that period is expected to allow utility rate base and hydroelectric generation investment to increase at a combined compound annual growth rate of approximately 6%.

With the closing of the acquisition of CH Energy Group in June 2013, the Corporation's regulated midyear rate base has increased to more than \$10 billion. The acquisition is expected to be accretive to earnings per common share of Fortis beginning in 2015.

Fortis remains disciplined and patient in its pursuit of additional electric and gas utility acquisitions in the United States and Canada that will add value for its shareholders. Fortis will also pursue growth in its non-regulated businesses in support of its regulated utility growth strategy.

## SUBSEQUENT EVENTS

On July 10, 2013, the Corporation redeemed all of the issued and outstanding \$125 million 5.45% First Preference Shares, Series C at a redemption price of \$25.1456 per share, being equal to \$25.00 plus the amount of accrued and unpaid dividends per share.

On July 18, 2013, the Corporation issued 10 million Cumulative Redeemable Fixed Rate Reset First Preference Shares, Series K at \$25.00 per share for gross proceeds of \$250 million. The net proceeds of the offering were used to repay a portion of borrowings under the Corporation's \$1 billion committed corporate credit facility, including amounts borrowed in connection with the above-noted redemption of the Corporation's First Preference Shares, Series C, the construction of the Waneta Expansion and equity injections into certain of the Corporation's subsidiaries, and for general corporate purposes.

On July 19, 2013, the Corporation priced a private placement of 10-year US\$285 million unsecured notes at 3.84% and 30-year US\$40 million unsecured notes at 5.08%. The offering is scheduled to close on October 1, 2013. Proceeds from the offering will be used to repay a portion of the Corporation's US dollar-denominated committed credit facility borrowings incurred to initially finance a portion of the CH Energy Group acquisition.

On July 26, 2013, applications for rehearing of the approval of the CH Energy Group acquisition were filed with the PSC. In addition, the parties petitioned the PSC to designate Central Hudson's rates as temporary pending further review of certain matters, including the Company's allowed ROE. The Corporation is preparing a response to the applications, which it expects to file shortly.

**OUTSTANDING SHARE DATA**

As at July 31, 2013, the Corporation had issued and outstanding approximately 211.7 million common shares; 8.0 million First Preference Shares, Series E; 5.0 million First Preference Shares, Series F; 9.2 million First Preference Shares, Series G; 10.0 million First Preference Shares, Series H; 8.0 million First Preference Shares, Series J; and 10.0 million First Preference Shares, Series K. Only the common shares of the Corporation have voting rights. The Corporation's First Preference Shares do not have voting rights unless and until Fortis fails to pay eight quarterly dividends, whether or not consecutive and whether or not such dividends have been declared.

The number of common shares of Fortis that would be issued if all outstanding stock options and First Preference Shares, Series E were converted as at July 31, 2013 is as follows.

<b>Conversion of Securities into Common Shares (Unaudited)</b>	
<b>As at July 31, 2013</b>	
<b>Security</b>	<b>Number of Common Shares (millions)</b>
Stock Options	<b>5.2</b>
First Preference Shares, Series E	<b>6.5</b>
<b>Total</b>	<b>11.7</b>

Additional information, including the Fortis 2012 Annual Information Form, Management Information Circular and Annual Report, is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Corporation's website at [www.fortisinc.com](http://www.fortisinc.com).



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**FORTIS INC.**

Interim Consolidated Financial Statements  
For the three and six months ended June 30, 2013 and 2012  
(Unaudited)

Prepared in accordance with accounting principles generally accepted in the United States

**Fortis Inc.**  
**Consolidated Balance Sheets (Unaudited)**  
**As at**  
(in millions of Canadian dollars)

	<b>June 30, 2013</b>	December 31, 2012
		(Note 24)
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 267	\$ 154
Accounts receivable	591	587
Prepaid expenses	33	18
Inventories	138	133
Regulatory assets (Note 4)	178	185
Deferred income taxes	30	16
	<b>1,237</b>	1,093
<b>Other assets</b>	<b>238</b>	200
<b>Regulatory assets</b> (Note 4)	<b>1,790</b>	1,515
<b>Deferred income taxes</b>	<b>7</b>	-
<b>Utility capital assets</b>	<b>11,272</b>	9,623
<b>Non-utility capital assets</b>	<b>651</b>	626
<b>Intangible assets</b>	<b>361</b>	325
<b>Goodwill</b> (Note 14)	<b>2,077</b>	1,568
	<b>\$ 17,633</b>	\$ 14,950
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Short-term borrowings (Note 19)	\$ 99	\$ 136
Accounts payable and other current liabilities	962	966
Regulatory liabilities (Note 4)	114	72
Current installments of long-term debt	201	159
Current installments of capital lease and finance obligations	7	7
Deferred income taxes	10	10
	<b>1,393</b>	1,350
<b>Other liabilities</b>	<b>811</b>	638
<b>Regulatory liabilities</b> (Note 4)	<b>833</b>	681
<b>Deferred income taxes</b>	<b>1,021</b>	702
<b>Long-term debt</b>	<b>6,985</b>	5,741
<b>Capital lease and finance obligations</b>	<b>427</b>	428
	<b>11,470</b>	9,540
<b>Shareholders' equity</b>		
Common shares <sup>(1)</sup> (Note 5)	3,739	3,121
Preference shares	1,108	1,108
Additional paid-in capital	16	15
Accumulated other comprehensive loss	(88)	(96)
Retained earnings	1,032	952
	<b>5,807</b>	5,100
Non-controlling interests (Note 6)	356	310
	<b>6,163</b>	5,410
	<b>\$ 17,633</b>	\$ 14,950

<sup>(1)</sup> No par value. Unlimited authorized shares; 211.7 million and 191.6 million issued and outstanding as at June 30, 2013 and December 31, 2012, respectively

Commitments and Contingent Liabilities (Notes 20 and 22, respectively)  
See accompanying Notes to Interim Consolidated Financial Statements

**Fortis Inc.**  
**Consolidated Statements of Earnings (Unaudited)**  
**For the periods ended June 30**  
(in millions of Canadian dollars, except per share amounts)

	Quarter Ended		Six Months Ended	
	2013	2012	2013	2012
<b>Revenue</b>	\$ 790	\$ 792	\$ 1,903	\$ 1,941
<b>Expenses</b>				
Energy supply costs	282	291	787	857
Operating	206	204	427	418
Depreciation and amortization	130	114	259	233
	<b>618</b>	<b>609</b>	<b>1,473</b>	<b>1,508</b>
<b>Operating income</b>	<b>172</b>	<b>183</b>	<b>430</b>	<b>433</b>
Other income (expenses), net (Note 9)	(44)	-	(38)	(3)
Finance charges (Note 10)	92	92	181	183
<b>Earnings before income taxes and extraordinary item</b>	<b>36</b>	<b>91</b>	<b>211</b>	<b>247</b>
Income tax (recovery) expense (Note 11)	(34)	14	(4)	37
<b>Earnings before extraordinary item</b>	<b>70</b>	<b>77</b>	<b>215</b>	<b>210</b>
Extraordinary gain, net of tax (Note 12)	-	-	22	-
<b>Net earnings</b>	<b>\$ 70</b>	<b>\$ 77</b>	<b>\$ 237</b>	<b>\$ 210</b>
<b>Net earnings attributable to:</b>				
Non-controlling interests	\$ 2	\$ 3	\$ 4	\$ 4
Preference equity shareholders	14	12	28	23
Common equity shareholders	54	62	205	183
	<b>\$ 70</b>	<b>\$ 77</b>	<b>\$ 237</b>	<b>\$ 210</b>
<b>Earnings per common share before extraordinary item</b> (Note 13)				
Basic	\$ 0.28	\$ 0.33	\$ 0.95	\$ 0.97
Diluted	\$ 0.28	\$ 0.33	\$ 0.94	\$ 0.95
<b>Earnings per common share</b> (Note 13)				
Basic	\$ 0.28	\$ 0.33	\$ 1.06	\$ 0.97
Diluted	\$ 0.28	\$ 0.33	\$ 1.05	\$ 0.95

See accompanying Notes to Interim Consolidated Financial Statements

**Fortis Inc.**  
**Consolidated Statements of Comprehensive Income (Unaudited)**  
**For the periods ended June 30**  
(in millions of Canadian dollars)

	Quarter Ended		Six Months Ended	
	2013	2012	2013	2012
<b>Net earnings</b>	\$ 70	\$ 77	\$ 237	\$ 210
<b>Other comprehensive income</b>				
Unrealized foreign currency translation gains, net of hedging activities and tax	5	2	7	-
Unrealized employee future benefits gains, net of tax	-	-	1	1
	<b>5</b>	<b>2</b>	<b>8</b>	<b>1</b>
<b>Comprehensive income</b>	<b>\$ 75</b>	<b>\$ 79</b>	<b>\$ 245</b>	<b>\$ 211</b>
<b>Comprehensive income attributable to:</b>				
Non-controlling interests	\$ 2	\$ 3	\$ 4	\$ 4
Preference equity shareholders	14	12	28	23
Common equity shareholders	59	64	213	184
	<b>\$ 75</b>	<b>\$ 79</b>	<b>\$ 245</b>	<b>\$ 211</b>

See accompanying Notes to Interim Consolidated Financial Statements

**Fortis Inc.**  
**Consolidated Statements of Cash Flows (Unaudited)**  
**For the periods ended June 30**  
(in millions of Canadian dollars)

	Quarter Ended		Six Months Ended	
	2013	2012	2013	2012
<b>Operating activities</b>				
Net earnings	\$ 70	\$ 77	\$ 237	\$ 210
Adjustments to reconcile net earnings to net cash provided by operating activities:				
Depreciation - capital assets	115	94	228	201
Amortization - intangible assets	11	10	23	21
Amortization - other	4	10	8	11
Deferred income tax (recovery) expense	(11)	3	(22)	8
Accrued employee future benefits	(4)	(11)	(5)	(7)
Equity component of allowance for funds used during construction (Note 9)	(1)	(1)	(4)	(3)
Other	(13)	3	(23)	(11)
Change in long-term regulatory assets and liabilities	-	(13)	(9)	(9)
Change in non-cash operating working capital (Note 16)	120	83	138	162
	<b>291</b>	<b>255</b>	<b>571</b>	<b>583</b>
<b>Investing activities</b>				
Change in other assets and other liabilities	(11)	-	(6)	4
Capital expenditures - utility capital assets	(278)	(262)	(508)	(473)
Capital expenditures - non-utility capital assets	(11)	(10)	(24)	(15)
Capital expenditures - intangible assets	(9)	(10)	(16)	(23)
Contributions in aid of construction	20	16	30	30
Proceeds on sale of capital assets	-	-	1	-
Business acquisitions, net of cash acquired (Note 14)	(1,000)	(7)	(1,055)	(7)
	<b>(1,289)</b>	<b>(273)</b>	<b>(1,578)</b>	<b>(484)</b>
<b>Financing activities</b>				
Change in short-term borrowings	(30)	5	(78)	(78)
Proceeds from long-term debt, net of issue costs	51	-	51	-
Repayments of long-term debt and capital lease and finance obligations	(25)	(53)	(65)	(57)
Net borrowings under committed credit facilities	562	223	698	230
Advances from non-controlling interests	21	28	43	69
Subscription Receipts issue costs (Note 5)	-	(12)	-	(12)
Issue of common shares, net of costs and dividends reinvested (Note 5)	579	4	589	6
Dividends				
Common shares, net of dividends reinvested	(44)	(42)	(85)	(86)
Preference shares	(14)	(12)	(28)	(23)
Subsidiary dividends paid to non-controlling interests	(3)	(2)	(5)	(4)
	<b>1,097</b>	<b>139</b>	<b>1,120</b>	<b>45</b>
<b>Change in cash and cash equivalents</b>	<b>99</b>	<b>121</b>	<b>113</b>	<b>144</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>168</b>	<b>110</b>	<b>154</b>	<b>87</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 267</b>	<b>\$ 231</b>	<b>\$ 267</b>	<b>\$ 231</b>

Supplementary Information to Consolidated Statements of Cash Flows (Note 16)  
See accompanying Notes to Interim Consolidated Financial Statements

**Fortis Inc.**  
**Consolidated Statements of Changes in Equity (Unaudited)**  
**For the periods ended June 30**  
(in millions of Canadian dollars)

	Common Shares	Preference Shares	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Non-Controlling Interests	Total Equity
<b>As at January 1, 2013</b>	\$ 3,121	\$ 1,108	\$ 15	\$ (96)	\$ 952	\$ 310	\$ 5,410
Net earnings	-	-	-	-	233	4	237
Other comprehensive income	-	-	-	8	-	-	8
Common share issues	618	-	(1)	-	-	-	617
Stock-based compensation	-	-	2	-	-	-	2
Advances from non-controlling interests	-	-	-	-	-	43	43
Foreign currency translation impacts	-	-	-	-	-	4	4
Subsidiary dividends paid to non-controlling interests	-	-	-	-	-	(5)	(5)
Dividends declared on common shares (\$0.62 per share)	-	-	-	-	(125)	-	(125)
Dividends declared on preference shares	-	-	-	-	(28)	-	(28)
<b>As at June 30, 2013</b>	\$ 3,739	\$ 1,108	\$ 16	\$ (88)	\$ 1,032	\$ 356	\$ 6,163
<b>As at January 1, 2012</b>	\$ 3,036	\$ 912	\$ 14	\$ (95)	\$ 868	\$ 208	\$ 4,943
Net earnings	-	-	-	-	206	4	210
Other comprehensive income	-	-	-	1	-	-	1
Common share issues	35	-	-	-	-	-	35
Stock-based compensation	-	-	1	-	-	-	1
Advances from non-controlling interests	-	-	-	-	-	69	69
Foreign currency translation impacts	-	-	-	-	-	(2)	(2)
Subsidiary dividends paid to non-controlling interests	-	-	-	-	-	(4)	(4)
Dividends declared on common shares (\$0.60 per share)	-	-	-	-	(114)	-	(114)
Dividends declared on preference shares	-	-	-	-	(23)	-	(23)
<b>As at June 30, 2012</b>	\$ 3,071	\$ 912	\$ 15	\$ (94)	\$ 937	\$ 275	\$ 5,116

See accompanying Notes to Interim Consolidated Financial Statements

# FORTIS INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
(Unaudited)

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### 1. DESCRIPTION OF THE BUSINESS

#### NATURE OF OPERATIONS

Fortis Inc. ("Fortis" or the "Corporation") is principally an international gas and electric distribution utility holding company. Fortis segments its utility operations by franchise area and, depending on regulatory requirements, by the nature of the assets. Fortis also holds investments in non-regulated generation assets and non-utility assets, which are treated as two separate segments. The Corporation's reporting segments allow senior management to evaluate the operational performance and assess the overall contribution of each segment to the long-term objectives of Fortis. Each entity within the reporting segments operates autonomously, assumes profit and loss responsibility and is accountable for its own resource allocation.

The following outlines each of the Corporation's reportable segments and is consistent with the basis of segmentation as disclosed in the Corporation's 2012 annual audited consolidated financial statements, with the exception of the acquisition of CH Energy Group, Inc. ("CH Energy Group") on June 27, 2013 (Note 14).

#### REGULATED UTILITIES

The Corporation's interests in regulated gas and electric utilities are as follows:

- a. *Regulated Gas Utilities - Canadian:* The FortisBC Energy companies, comprised of FortisBC Energy Inc., FortisBC Energy (Vancouver Island) Inc. ("FEVI") and FortisBC Energy (Whistler) Inc.
- b. *Regulated Gas & Electric Utility - United States:* Central Hudson Gas & Electric Corporation ("Central Hudson"), acquired by Fortis as part of the acquisition of CH Energy Group (Note 14).
- c. *Regulated Electric Utilities - Canadian:* Comprised of FortisAlberta, FortisBC Electric, Newfoundland Power, and Other Canadian Electric Utilities (Maritime Electric and FortisOntario). FortisOntario mainly includes Canadian Niagara Power Inc., Cornwall Street Railway, Light and Power Company, Limited and Algoma Power Inc.
- d. *Regulated Electric Utilities - Caribbean:* Comprised of Caribbean Utilities, in which Fortis holds an approximate 60% controlling interest; and two wholly owned utilities in the Turks and Caicos Islands, FortisTCI Limited ("FortisTCI") and Turks and Caicos Utilities Limited, acquired in August 2012, (collectively "Fortis Turks and Caicos"). In June 2013 Atlantic Equipment & Power (Turks and Caicos) Ltd. was amalgamated with FortisTCI.

#### NON-REGULATED - FORTIS GENERATION

Fortis Generation includes the financial results of non-regulated generation assets in Belize, Ontario, British Columbia and Upstate New York. In March 2013 the Corporation and the Government of Newfoundland and Labrador settled all matters, including release from all debt obligations, pertaining to the December 2008 expropriation of non-regulated hydroelectric generating assets and water rights in central Newfoundland, then owned by Exploits River Hydro Partnership ("Exploits Partnership") in which Fortis held an indirect 51% interest (Note 12).

#### NON-REGULATED - NON-UTILITY

- a. *Fortis Properties:* Fortis Properties owns and operates 23 hotels, comprised of more than 4,400 rooms, in eight Canadian provinces, and owns and operates approximately 2.7 million square feet of commercial office and retail space, primarily in Atlantic Canada.

## **FORTIS INC.**

### **NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
(Unaudited)

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#### **1. DESCRIPTION OF THE BUSINESS (cont'd)**

##### **NON-REGULATED - NON-UTILITY (cont'd)**

- b. Griffith:* Comprised primarily of Griffith Energy Services, Inc. ("Griffith"), acquired by Fortis as part of the acquisition of CH Energy Group (Note 14). Griffith supplies petroleum products and related services to approximately 56,000 customers in the Mid-Atlantic Region of the United States.

##### **CORPORATE AND OTHER**

The Corporate and Other segment captures expense and revenue items not specifically related to any reportable segment and those business operations that are below the required threshold for reporting as separate segments.

The Corporate and Other segment includes Fortis net corporate expenses and the net expenses of non-regulated FortisBC Holdings Inc. ("FHI") corporate-related activities. Also included in the Corporate and Other segment are the financial results of CustomerWorks Limited Partnership ("CWLP") and FortisBC Alternative Energy Services Inc. ("FAES"). CWLP is a non-regulated shared-services business in which FHI holds a 30% interest. CWLP provides billing and customer care services to utilities, municipalities and certain energy companies. CWLP's financial results are recorded using the equity method of accounting. FAES is a wholly owned subsidiary of FHI that provides alternative energy solutions, including thermal-energy and geo-exchange systems.

#### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

These interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("US GAAP") for interim financial statements. As a result, these interim consolidated financial statements do not include all of the information and disclosures required in the annual consolidated financial statements and should be read in conjunction with the Corporation's 2012 annual audited consolidated financial statements. In management's opinion, the interim consolidated financial statements include all adjustments that are of a recurring nature and necessary to present fairly the consolidated financial position of the Corporation.

Interim results will fluctuate due to the seasonal nature of gas and electricity demand and water flows, as well as the timing and recognition of regulatory decisions. As a result of natural gas consumption patterns, most of the annual earnings of the FortisBC Energy companies are realized in the first and fourth quarters. Given the diversified group of companies, seasonality may vary.

The preparation of the 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 environments in which the Corporation's utilities operate often require 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 reported in earnings in the period in which they become known.

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
(Unaudited)

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#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

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 the three and six months ended June 30, 2013.

An evaluation of subsequent events through to July 31, 2013, the date these interim consolidated financial statements were approved by the Audit Committee of the Board of Directors, was completed to determine whether circumstances warranted recognition and disclosure of events or transactions in the interim consolidated financial statements as at June 30, 2013 (Note 23).

All amounts are presented in Canadian dollars unless otherwise stated.

These interim consolidated financial statements are comprised of the accounts of Fortis and its wholly owned subsidiaries and controlling ownership interests, including the financial statements of CH Energy Group commencing June 27, 2013, the date of acquisition. Other than expenses associated with customer and community benefits offered by the Corporation to close the acquisition of CH Energy Group, which are reported in the Corporate and Other segment, financial performance for CH Energy Group from the date of acquisition through June 30, 2013 did not have a material impact on the Corporation's consolidated statement of earnings. All significant intercompany balances and transactions have been eliminated on consolidation.

These interim consolidated financial statements have been prepared following the same accounting policies and methods as those used to prepare the Corporation's 2012 annual audited consolidated financial statements, except as described below related to regulation at Central Hudson.

#### Regulation

Central Hudson is regulated by the New York State Public Service Commission ("PSC") regarding such matters as rates, construction, operations, financing and accounting. Certain activities of the Company are subject to regulation by the U.S. Federal Energy Regulatory Commission under the *Federal Power Act* (United States). Central Hudson is also subject to regulation by the North American Electric Reliability Corporation.

Central Hudson operates under cost of service ("COS") regulation as administered by the PSC. The PSC provides for the use of a future test year in the establishment of rates for the utility and, pursuant to this method, the determination of the approved rate of return on forecast rate base and deemed capital structure, together with the forecast of all reasonable and prudent costs, establishes the revenue requirement upon which the Company's customer rates are determined. Once rates are approved, they are not adjusted as a result of actual COS being different from that which was applied for, other than for certain prescribed costs that are eligible for deferral account treatment.

Central Hudson's allowed rate of return on common shareholders' equity ("ROE") is set at 10% on a deemed capital structure of 48% common equity. The Company began operating under a three-year rate order issued by the PSC effective July 1, 2010. As approved by the PSC in June 2013, the original three-year rate order has been extended for two years, through June 30, 2015, as a condition required to close the acquisition (Note 14). Effective July 1, 2013, Central Hudson is also subject to a modified earnings sharing mechanism, whereby the Company and customers share equally earnings in excess of the allowed ROE up to an achieved ROE that is 50 basis points above the allowed ROE, and share 10%/90% (Company/customers) earnings in excess of 50 basis points above the allowed ROE.

Central Hudson's approved regulatory regime also allows for full recovery of purchased electricity and natural gas costs. The Company's rates also include Revenue Decoupling Mechanisms ("RDMs"), which are intended to minimize the earnings impact resulting from reduced energy consumption as energy-efficiency programs are implemented. The RDMs allow the Company to recognize electric delivery revenue and gas revenue at the levels approved in rates for most of Central Hudson's customer base. Deferral account treatment is approved for certain other specified costs, including provisions for manufactured gas plant ("MGP") site remediation, pension and other post employment benefit ("OPEB") costs.



## **FORTIS INC.**

### **NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
(Unaudited)

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## **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

### **NEW ACCOUNTING POLICIES**

#### *Disclosures About Offsetting Assets and Liabilities*

Effective January 1, 2013, the Corporation adopted the amendments to Accounting Standards Codification ("ASC") Topic 210, *Balance Sheet - Disclosures About Offsetting Assets and Liabilities* as outlined in Accounting Standards Update ("ASU") No. 2011-11 and ASU No. 2013-01. The amendments improve the transparency of the effect or potential effect of netting arrangements on a company's financial position by expanding the level of disclosures required by entities for such arrangements. The amended disclosures are intended to assist financial statement users in understanding significant quantitative differences between balance sheets prepared under US GAAP and International Financial Reporting Standards. ASU No. 2013-01 limits the scope of the new offsetting disclosure requirements previously issued in ASU No. 2011-11 to certain derivative instruments, repurchase and reverse repurchase agreements, and securities borrowing and lending arrangements that are either offset on the balance sheet or subject to an enforceable master netting or similar arrangement. The above-noted amendments were applied retrospectively and did not materially impact the Corporation's interim consolidated financial statements for the three and six months ended June 30, 2013.

#### *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*

Effective January 1, 2013, the Corporation adopted the amendments to ASC Topic 220, *Other Comprehensive Income - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ("AOCI")* as outlined in ASU No. 2013-02. The amendments improve the reporting of reclassifications out of AOCI and require entities to report, in one place, information about reclassifications out of AOCI and to present details of the reclassifications in the disclosure for changes in AOCI balances. The effect of the reclassification of significant items to net income in their entirety during the reporting period must be reported in the respective line items in the statement where net income is presented. The effect of items not reclassified to net income in their entirety during the reporting period are to be presented in the notes to the consolidated financial statements. The amendments were applied by the Corporation prospectively commencing on January 1, 2013 and did not materially impact the Corporation's interim consolidated financial statements for the three and six months ended June 30, 2013.

## **3. FUTURE ACCOUNTING PRONOUNCEMENTS**

#### *Obligations Resulting from Joint and Several Liability Arrangements*

In February 2013, the Financial Accounting Standards Board ("FASB") issued ASU No. 2013-04, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date*. The objective of this update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. This accounting update is effective for annual and interim periods beginning on or after December 15, 2013 and is to be applied retrospectively. Fortis does not expect that the adoption of this update will have a material impact on its consolidated financial statements.

#### *Parent's Accounting for the Cumulative Translation Adjustment*

In March 2013, FASB issued ASU No. 2013-5, *Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*. This update applies to the release of the cumulative translation adjustment into net earnings when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets within a foreign entity. This accounting update is effective for annual and interim periods beginning on or after December 15, 2013 and is to be applied prospectively. Fortis does not expect that the adoption of this update will have a material impact on its consolidated financial statements.

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
(Unaudited)

#### 4. REGULATORY ASSETS AND LIABILITIES

A summary of the Corporation's regulatory assets and liabilities is provided below. For a detailed description of the nature of the Corporation's regulatory assets and liabilities, refer to Note 7 to the Corporation's 2012 annual audited consolidated financial statements.

(\$ millions)	As at	
	June 30, 2013	December 31, 2012
<b>Regulatory assets</b>		
Deferred income taxes <sup>(i)</sup>	786	713
Employee future benefits <sup>(i)</sup>	649	498
Deferred lease costs - FortisBC Electric	81	77
Rate stabilization accounts - electric utilities <sup>(i)</sup>	70	57
Deferred energy management costs <sup>(i)</sup>	60	50
Rate stabilization accounts - gas utilities <sup>(i)</sup>	45	48
Deferred operating overhead costs	38	32
Deferred net losses on disposal of utility capital assets and intangible assets	34	27
Customer Care Enhancement Project cost deferral	23	24
Income taxes recoverable on OPEB plans	23	23
Alternative energy projects cost deferral	14	18
MGP site remediation deferral <sup>(i)</sup>	14	-
Whistler pipeline contribution deferral	13	14
Deferred development costs for capital projects	10	10
Residual natural gas deferral <sup>(i)</sup>	8	-
Deferred costs - smart meters	1	9
Replacement energy deferral - Point Lepreau <sup>(ii)</sup>	-	47
Other regulatory assets <sup>(i)</sup>	99	53
<b>Total regulatory assets</b>	<b>1,968</b>	<b>1,700</b>
<b>Less: current portion</b>	<b>(178)</b>	<b>(185)</b>
<b>Long-term regulatory assets</b>	<b>1,790</b>	<b>1,515</b>

(\$ millions)	As at	
	June 30, 2013	December 31, 2012
<b>Regulatory liabilities</b>		
Non-asset retirement obligation removal cost provision <sup>(iii)</sup>	551	486
Rate stabilization accounts - gas utilities <sup>(iii)</sup>	131	117
Alberta Electric System Operator charges deferral	60	44
Rate stabilization accounts - electric utilities <sup>(iii)</sup>	38	46
Deferred income taxes <sup>(iii)</sup>	33	12
OPEB cost deferral <sup>(iii)</sup>	25	-
Customer and community benefits obligation <sup>(iii)</sup>	21	-
Meter reading and customer service variance deferral	12	6
Rate base impact of tax repair project <sup>(iii)</sup>	10	-
Deferred interest	8	9
Income tax variance deferral	3	7
Other regulatory liabilities <sup>(iii)</sup>	55	26
<b>Total regulatory liabilities</b>	<b>947</b>	<b>753</b>
<b>Less: current portion</b>	<b>(114)</b>	<b>(72)</b>
<b>Long-term regulatory liabilities</b>	<b>833</b>	<b>681</b>

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
(Unaudited)

#### 4. REGULATORY ASSETS AND LIABILITIES (cont'd)

##### Description of the Nature of Regulatory Assets and Liabilities

- (i) The respective regulatory assets as at June 30, 2013 include amounts related to Central Hudson. MGP site remediation and residual natural gas deferrals are being amortized and collected from customers over a two- and four-year period, respectively, as approved by the regulator.
- (ii) In March 2013 Maritime Electric received proceeds of approximately \$47 million from the Government of Prince Edward Island upon its assumption of the utility's replacement energy deferral during the refurbishment of the New Brunswick Power Point Lepreau nuclear generating station ("Point Lepreau").
- (iii) The respective regulatory liabilities as at June 30, 2013 include amounts related to Central Hudson. As approved by the regulator, the difference between Central Hudson's defined benefit pension and OPEB costs recognized under US GAAP and those which are expected to be refunded to, or recovered from, customers in future rates are subject to deferral account treatment. As a result, a regulatory liability has been recognized in relation to Central Hudson's OPEB plan.

As approved by the PSC, Fortis will provide Central Hudson's customers and community with approximately US\$50 million in financial benefits that would not have been realized in the absence of the acquisition (Note 14). These incremental benefits include: (i) US\$35 million to cover expenses that would normally be recovered in customer rates, including certain storm-restoration expenses; (ii) guaranteed savings to customers of more than US\$9 million over five years resulting from the elimination of costs CH Energy Group would otherwise incur as a public company; and (iii) the establishment of a US\$5 million Community Benefit Fund to be used for low-income customer and economic development programs for communities and residents of the Mid-Hudson River Valley. As a result, \$41 million (US\$40 million) in expenses were recognized in the second quarter of 2013 associated with the write-off of a \$20 million (US\$20 million) regulatory asset related to deferred storm costs and the recognition of a regulatory liability for customer and community benefits of \$21 million (US\$20 million) (Notes 9 and 14).

The tax-repair project regulatory liability represents accumulated tax refunds plus accrued carrying charges to be refunded to customers through future rates over a time period to be determined during Central Hudson's next rate hearing with the PSC.

#### 5. COMMON SHARES

Common shares issued during the period were as follows:

	Quarter Ended June 30, 2013		Year-to-Date June 30, 2013	
	Number of Shares (in thousands)	Amount (\$ millions)	Number of Shares (in thousands)	Amount (\$ millions)
Balance, beginning of period	192,476	3,149	191,566	3,121
Public offering - Conversion of Subscription Receipts	18,500	567	18,500	567
Dividend Reinvestment Plan	483	16	1,046	35
Consumer Share Purchase Plan	8	1	17	1
Employee Share Purchase Plan	71	2	217	7
Stock Option Plans	179	4	371	8
<b>Balance, end of period</b>	<b>211,717</b>	<b>3,739</b>	<b>211,717</b>	<b>3,739</b>

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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#### 5. COMMON SHARES (cont'd)

In June 2012, to finance a portion of the acquisition of CH Energy Group, the Corporation sold 18,500,000 Subscription Receipts at \$32.50 each, for gross proceeds of approximately \$601 million. On June 27, 2013, upon closing of the acquisition of CH Energy Group, each Subscription Receipt was exchanged, without payment of additional consideration, for one common share of Fortis. Each Subscription Receipt Holder also received a cash payment of \$1.22 per Subscription Receipt, which is an amount equal to the aggregate amount of dividends declared per common share of Fortis for which record dates have occurred since the issuance of the Subscription Receipts. The proceeds to the Corporation upon conversion of the Subscription Receipts were approximately \$567 million, net of after-tax expenses.

#### 6. NON-CONTROLLING INTERESTS

(\$ millions)	As at	
	June 30, 2013	December 31, 2012
Waneta Expansion Limited Partnership ("Waneta Partnership")	262	220
Caribbean Utilities	75	71
Mount Hayes Limited Partnership	12	12
Preference shares of Newfoundland Power	7	7
	<b>356</b>	<b>310</b>

#### 7. STOCK-BASED COMPENSATION PLANS

In January 2013, 8,497 Deferred Share Units ("DSUs") were granted to the Corporation's Board of Directors, representing the first quarter equity component of the Directors' annual compensation and, where opted, their first quarter component of annual retainers in lieu of cash. Each DSU represents a unit with an underlying value equivalent to the value of one common share of the Corporation.

In March 2013, 66,978 Performance Share Units ("PSUs") were paid out to the President and Chief Executive Officer ("CEO") of the Corporation at \$33.59 per PSU, for a total of approximately \$2 million. The payout was made upon the three-year maturation period in respect of the PSU grant made in March 2010 and the President and CEO satisfying the payment requirements, as determined by the Human Resources Committee of the Board of Directors of Fortis.

In March 2013 the Corporation granted 807,600 options to purchase common shares under its 2012 Stock Option Plan ("2012 Plan") at the five-day volume weighted average trading price immediately preceding the date of grant of \$33.58. The options granted under the 2012 Plan are exercisable for a period not to exceed ten years from the date of grant, expire no later than three years after the termination, death or retirement of the optionee and vest evenly over a four-year period on each anniversary of the date of grant. Directors are not eligible to receive grants of options under the 2012 Plan. The fair value of each option granted was \$3.91 per option.

The fair value was estimated at the date of grant using the Black-Scholes fair value option-pricing model and the following assumptions:

Dividend yield (%)	3.78
Expected volatility (%)	21.4
Risk-free interest rate (%)	1.31
Weighted average expected life (years)	5.3

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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#### 7. STOCK-BASED COMPENSATION PLANS (cont'd)

In March 2013 the Corporation's Board of Directors approved the 2013 PSU Plan, effective January 1, 2013. The 2013 PSU Plan represents a component of the long-term incentives awarded to senior management of the Corporation and its subsidiaries, including the President and CEO of Fortis. Each PSU represents a unit with an underlying value equivalent to the value of one common share of the Corporation and is subject to a three-year vesting period, at which time a cash payment may be made, as determined by the Human Resources Committee of the Board of Directors. Each PSU is entitled to accrue notional common share dividends equivalent to those declared by the Corporation's Board of Directors. In May 2013, 136,058 PSUs were granted to senior management of the Corporation and its subsidiaries.

In April 2013, 8,553 DSUs were granted to the Corporation's Board of Directors, representing the second quarter equity component of the Directors' annual compensation and, where opted, their second quarter component of annual retainers in lieu of cash.

For the three and six months ended June 30, 2013, stock-based compensation expense of approximately \$3 million and \$4 million, respectively, was recognized (\$1.5 million and \$3 million for the three and six months ended June 30, 2012, respectively).

#### 8. EMPLOYEE FUTURE BENEFITS

The Corporation and its subsidiaries each maintain one or a combination of defined benefit pension plans and defined contribution pension plans, including group registered retirement savings plans, for employees. The Corporation and certain subsidiaries also offer OPEB plans for qualifying employees. The net benefit cost of providing the defined benefit pension and OPEB plans is detailed in the following tables.

<i>(\$ millions)</i>	Quarter Ended June 30			
	Defined Benefit Pension Plans		OPEB Plans	
	2013	2012	2013	2012
Components of net benefit cost:				
Service costs	8	7	2	1
Interest costs	11	11	3	3
Expected return on plan assets	(14)	(13)	-	-
Amortization of actuarial losses	7	7	1	1
Amortization of past service credits/plan amendments	-	-	(1)	(1)
Amortization of transitional obligation	-	1	-	1
Regulatory adjustments	(4)	(5)	1	-
<b>Net benefit cost</b>	<b>8</b>	<b>8</b>	<b>6</b>	<b>5</b>

<i>(\$ millions)</i>	Year-to-Date June 30			
	Defined Benefit Pension Plans		OPEB Plans	
	2013	2012	2013	2012
Components of net benefit cost:				
Service costs	16	14	4	3
Interest costs	23	23	6	6
Expected return on plan assets	(27)	(25)	-	-
Amortization of actuarial losses	14	13	3	2
Amortization of past service credits/plan amendments	-	-	(2)	(2)
Amortization of transitional obligation	-	1	-	1
Regulatory adjustments	(7)	(6)	1	1
<b>Net benefit cost</b>	<b>19</b>	<b>20</b>	<b>12</b>	<b>11</b>

For the three and six months ended June 30, 2013, the Corporation expensed \$3 million and \$7 million, respectively (\$3 million and \$7 million for the three and six months ended June 30, 2012 respectively), related to defined contribution pension plans.

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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#### 9. OTHER INCOME (EXPENSES), NET

<i>(\$ millions)</i>	Quarter Ended June 30		Year-to-Date June 30	
	2013	2012	2013	2012
Equity component of allowance for funds used during construction ("AFUDC")	1	1	4	3
Net foreign exchange gain	3	2	5	-
Interest income	1	1	2	2
Acquisition-related expenses (Note 14)	(8)	(4)	(8)	(8)
Acquisition-related customer and community benefits (Notes 4 and 14)	(41)	-	(41)	-
	<b>(44)</b>	-	<b>(38)</b>	(3)

The net foreign exchange gain for the three and six months ended June 30, 2013 relates to approximately \$3 million and \$5 million, respectively (\$2 million and \$0.5 million for the three and six months ended June 30, 2012, respectively), associated with the translation into Canadian dollars of the Corporation's US dollar-denominated long-term other asset representing the book value of the Corporation's expropriated investment in Belize Electricity (Notes 19 and 21).

#### 10. FINANCE CHARGES

<i>(\$ millions)</i>	Quarter Ended June 30		Year-to-Date June 30	
	2013	2012	2013	2012
Interest:				
Long-term debt and capital lease and finance obligations	94	93	188	187
Short-term borrowings	2	2	4	3
Debt component of AFUDC	(4)	(3)	(11)	(7)
	<b>92</b>	92	<b>181</b>	183

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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#### 11. INCOME TAXES

Income taxes differ from the amount that would be expected to be generated by applying the enacted combined Canadian federal and provincial statutory income tax rate to earnings before income taxes. The following is a reconciliation of consolidated statutory income taxes to consolidated effective income taxes.

<i>(\$ millions, except as noted)</i>	Quarter Ended June 30		Year-to-Date June 30	
	2013	2012	2013	2012
Combined Canadian federal and provincial statutory income tax rate	<b>29.0%</b>	29.0%	<b>29.0%</b>	29.0%
Statutory income tax rate applied to earnings before income taxes and extraordinary item	<b>10</b>	26	<b>61</b>	72
Difference in Canadian provincial statutory rates applicable to subsidiaries in different Canadian jurisdictions	<b>(2)</b>	(2)	<b>(8)</b>	(8)
Difference between Canadian statutory rate and rates applicable to foreign subsidiaries	<b>(5)</b>	(5)	<b>(7)</b>	(7)
Items capitalized for accounting purposes but expensed for income tax purposes	<b>(10)</b>	(12)	<b>(26)</b>	(28)
Difference between capital cost allowance and amounts claimed for accounting purposes	-	1	<b>(2)</b>	4
Non-deductible expenses	<b>1</b>	3	<b>2</b>	3
Impacts associated with Part VI.1 tax	<b>(25)</b>	3	<b>(23)</b>	3
Difference between employee future benefits paid and amounts expensed for accounting purposes	-	1	<b>1</b>	1
Other	<b>(3)</b>	(1)	<b>(2)</b>	(3)
<b>Income tax (recovery) expense</b>	<b>(34)</b>	14	<b>(4)</b>	37
<b>Effective income tax rate</b>	<b>(94.4)%</b>	15.4%	<b>(1.9)%</b>	15.0%

In June 2013 the Government of Canada enacted changes associated with Part VI.1 tax on the Corporation's preference share dividends. In accordance with US GAAP, income taxes are required to be recognized based on enacted tax legislation. In the second quarter of 2013, the Corporation recognized an approximate \$25 million income tax recovery due to the enactment of higher deductions associated with Part VI.1 tax.

In June 2013 a settlement was reached with Canada Revenue Agency ("CRA") resulting in the release of income tax provisions of approximately \$5 million (Note 22).

As at June 30, 2013, the Corporation had non-capital and capital loss carryforwards of approximately \$87 million (December 31, 2012 - \$73 million), of which \$13 million (December 31, 2012 - \$13 million) has not been recognized in the consolidated financial statements. The non-capital loss carryforwards expire between 2013 and 2033.

#### 12. EXTRAORDINARY GAIN, NET OF TAX

Effective March 2013 the Corporation and the Government of Newfoundland and Labrador settled all matters, including release from all debt obligations, pertaining to the December 2008 expropriation of non-regulated hydroelectric generating assets and water rights in central Newfoundland, then owned by Exploits Partnership, in which Fortis held an indirect 51% interest. As a result of the settlement, an extraordinary gain of approximately \$25 million (\$22 million after tax) was recognized in the first quarter of 2013.

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
(Unaudited)

#### 13. EARNINGS PER COMMON SHARE

The Corporation calculates earnings per common share ("EPS") on the weighted average number of common shares outstanding. Diluted EPS is calculated using the treasury stock method for options and the "if-converted" method for convertible securities.

Quarter Ended	Earnings to Common Shareholders Before		Earnings to Common Shareholders	Weighted Average Shares	EPS Before		EPS
	Extraordinary Item	Extraordinary Gain			Extraordinary Item	Extraordinary Gain	
June 30, 2013	(\$ millions)	(\$ millions)	(\$ millions)	(millions)			EPS
<b>Basic EPS</b>	<b>54</b>	<b>-</b>	<b>54</b>	<b>193.4</b>	<b>\$ 0.28</b>	<b>\$ -</b>	<b>\$ 0.28</b>
Effect of potential dilutive securities:							
Stock Options	-	-	-	0.7			
Preference Shares	4	-	4	10.0			
	<b>58</b>	<b>-</b>	<b>58</b>	<b>204.1</b>			
Deduct anti-dilutive impacts:							
Preference Shares	(4)	-	(4)	(10.0)			
<b>Diluted EPS</b>	<b>54</b>	<b>-</b>	<b>54</b>	<b>194.1</b>	<b>\$ 0.28</b>	<b>\$ -</b>	<b>\$ 0.28</b>

Quarter Ended  
June 30, 2012

<b>Basic EPS</b>	62	-	62	189.6	\$ 0.33	\$ -	\$ 0.33
Effect of potential dilutive securities:							
Stock Options	-	-	-	0.9			
Preference Shares	4	-	4	10.3			
	66	-	66	200.8			
Deduct anti-dilutive impacts:							
Preference Shares	(4)	-	(4)	(10.3)			
<b>Diluted EPS</b>	<b>62</b>	<b>-</b>	<b>62</b>	<b>190.5</b>	<b>\$ 0.33</b>	<b>\$ -</b>	<b>\$ 0.33</b>

Year-to-Date	Earnings to Common Shareholders Before		Earnings to Common Shareholders	Weighted Average Shares	EPS Before		EPS
	Extraordinary Item	Extraordinary Gain			Extraordinary Item	Extraordinary Gain	
June 30, 2013	(\$ millions)	(\$ millions)	(\$ millions)	(millions)			EPS
<b>Basic EPS</b>	<b>183</b>	<b>22</b>	<b>205</b>	<b>192.7</b>	<b>\$ 0.95</b>	<b>\$ 0.11</b>	<b>\$ 1.06</b>
Effect of potential dilutive securities:							
Stock Options	-	-	-	0.7			
Preference Shares	8	-	8	10.0			
<b>Diluted EPS</b>	<b>191</b>	<b>22</b>	<b>213</b>	<b>203.4</b>	<b>\$ 0.94</b>	<b>\$ 0.11</b>	<b>\$ 1.05</b>

Year-to-Date  
June 30, 2012

<b>Basic EPS</b>	183	-	183	189.3	\$ 0.97	\$ -	\$ 0.97
Effect of potential dilutive securities:							
Stock Options	-	-	-	0.9			
Preference Shares	8	-	8	10.3			
<b>Diluted EPS</b>	<b>191</b>	<b>-</b>	<b>191</b>	<b>200.5</b>	<b>\$ 0.95</b>	<b>\$ -</b>	<b>\$ 0.95</b>



## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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#### 14. BUSINESS ACQUISITIONS

##### CH ENERGY GROUP

On June 27, 2013 Fortis acquired all of the outstanding common shares of CH Energy Group for US\$65.00 per common share in cash, for an aggregate purchase price of approximately US\$1.5 billion, including the assumption of US\$518 million of debt on closing. The net cash purchase price of approximately \$1,019 million (US\$972 million) was financed through proceeds from the issuance of 18.5 million common shares of Fortis, pursuant to the conversion of Subscription Receipts on the closing of the acquisition, for proceeds of approximately \$567 million, net of after-tax expenses (Note 5), with the balance being initially funded through drawings under the Corporation's \$1 billion committed credit facility.

CH Energy Group is an energy delivery company headquartered in Poughkeepsie, New York. Its main business, Central Hudson, is a regulated transmission and distribution utility serving approximately 300,000 electric and 77,000 natural gas customers in eight counties of New York State's Mid-Hudson River Valley. Central Hudson accounts for approximately 93% of the total assets of CH Energy Group and is subject to regulation by the PSC under a traditional COS model (Note 2). The determination of revenue and earnings is based on a regulated rate of return that is applied to historic values, which do not change with a change of ownership. Therefore, in determining the fair value of assets and liabilities of Central Hudson at the date of acquisition, fair value approximates book value. No fair value adjustments were recorded for the net assets acquired because all of the economic benefits and obligations associated with them beyond regulated rates of return accrue to the customers.

Non-regulated net assets acquired relate mainly to Griffith, which is primarily a fuel delivery business. Fair value approximates book value, with the exception of intangible assets associated with Griffith's customer relationships.

The following table summarizes the preliminary allocation of the purchase consideration to the assets and liabilities acquired as at June 27, 2013 based on their fair values, using an exchange rate of US\$1.00=CDN\$1.0484. The amount of the purchase price allocated to goodwill is entirely associated with the regulated gas and electric operations of Central Hudson.

<i>(\$ millions)</i>	<b>Total</b>
<b>Purchase consideration</b>	<b>1,019</b>
<b>Fair value assigned to net assets:</b>	
Current assets	215
Long-term regulatory assets	235
Utility capital assets	1,283
Non-utility capital assets	11
Intangible assets	45
Other long-term assets	33
Current liabilities	(133)
Assumed short-term borrowings	(39)
Assumed long-term debt (including current portion)	(543)
Long-term regulatory liabilities	(123)
Other long-term liabilities	(468)
	516
Cash and cash equivalents	19
<b>Fair value of net assets acquired</b>	<b>535</b>
<b>Goodwill</b>	<b>484</b>

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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#### 14. BUSINESS ACQUISITIONS (cont'd)

The acquisition has been accounted for using the acquisition method, whereby financial results of the business acquired have been consolidated in the financial statements of Fortis commencing on June 27, 2013. Other than acquisition-related expenses noted below, financial performance for CH Energy Group from the date of acquisition through June 30, 2013 did not have a material impact on the Corporation's consolidated statement of earnings.

Acquisition-related expenses totalled approximately \$8 million (\$6 million after tax) for the three and six months ended June 30, 2013 and have been recognized in other income (expenses), net on the consolidated statement of earnings (Note 9). In addition, approximately \$41 million (US\$40 million), or \$26 million (US\$26 million after tax), in customer and community benefits offered to obtain regulatory approval of the acquisition were expensed in the second quarter of 2013, as approved by the PSC, and were also recognized in other income (expenses), net on the consolidated statement of earnings (Notes 4 and 9).

#### Supplemental Pro Forma Data

The unaudited pro forma financial information below gives effect to the acquisition of CH Energy Group as if the transaction had occurred at the beginning of 2012. This pro forma data is presented for information purposes only, and does not necessarily represent the results that would have occurred had the acquisition taken place at the beginning of 2012, nor is it necessarily indicative of the results that may be expected in future periods.

(\$ millions)	Quarter Ended June 30		Year-to-Date June 30	
	2013	2012	2013	2012
Pro forma revenue	1,005	992	2,420	2,415
Pro forma net earnings <sup>(1)</sup>	106	82	290	258

<sup>(1)</sup> Pro forma net earnings exclude all acquisition-related expenses incurred by CH Energy Group and the Corporation, net of tax (Note 9). A pro forma adjustment has been made to net earnings for the respective periods presented to reflect the Corporation's after-tax financing costs associated with the acquisition.

#### CITY OF KELOWNA'S ELECTRICAL UTILITY ASSETS

In March 2013 FortisBC Electric acquired the electrical utility assets of the City of Kelowna (the "City") for approximately \$55 million, which now allows FortisBC Electric to directly serve some 15,000 customers formerly served by the City. FortisBC Electric had provided the City with electricity under a wholesale tariff and had operated and maintained the City's electrical utility assets under contract since 2000.

The acquisition was approved by the British Columbia Utilities Commission ("BCUC") in March 2013 and allowed for approximately \$38 million of the purchase price to be included in FortisBC Electric's rate base. Based on this regulatory decision, the book value of the assets acquired has been assigned as fair value in the purchase price allocation. FortisBC Electric is regulated under COS and the determination of revenue and earnings is based on a regulated rate of return that is applied to historic values, which do not change with a change in ownership. Therefore, in determining the fair value of assets at the date of acquisition, fair value approximates book value. No fair value adjustments were recorded for the assets acquired because all of the economic benefits and obligations associated with them beyond regulated rates of return accrue to the customers.

**FORTIS INC.**  
**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
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**14. BUSINESS ACQUISITIONS (cont'd)**

The following table summarizes the allocation of the purchase price to the assets acquired as at the date of acquisition based on their fair values.

<i>(\$ millions)</i>	<b>Total</b>
<b>Purchase consideration</b>	<b>55</b>
<b>Fair value assigned to assets:</b>	
Utility capital assets	<b>38</b>
Long-term deferred income tax asset	<b>3</b>
<b>Fair value of assets acquired</b>	<b>41</b>
<b>Goodwill</b>	<b>14</b>

The acquisition has been accounted for using the acquisition method, whereby financial results of the business acquired have been consolidated in the financial statements of Fortis commencing in March 2013.

# FORTIS INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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### 15. SEGMENTED INFORMATION

Information by reportable segment is as follows:

Quarter Ended June 30, 2013 (\$ millions)	REGULATED UTILITIES										NON-REGULATED			
	Gas & Electric			Electric										
	FortisBC Energy Canadian	Central Hudson US	Fortis Alberta	FortisBC Electric	Newfoundland Power	Other Canadian	Electric Caribbean	Generation	Fortis Generation	Non- Utility	Corporate and Other	Inter- segment eliminations	Total	
Revenue	246	-	117	68	132	87	404	70	7	65	7	(9)	790	
Energy supply costs	90	-	-	14	80	56	150	43	-	-	-	(1)	282	
Operating expenses	65	-	38	22	16	12	88	8	3	41	3	(2)	206	
Depreciation and amortization	46	-	36	12	13	7	68	9	1	6	-	-	130	
Operating income	45	-	43	20	23	12	98	10	3	18	4	(6)	172	
Other income (expenses), net	-	-	-	1	-	-	1	1	-	-	(46)	-	(44)	
Finance charges	36	-	18	10	9	5	42	3	-	6	11	(6)	92	
Income tax expense (recovery)	3	-	-	3	(10)	(2)	(9)	-	-	3	(31)	-	(34)	
Net earnings (loss)	6	-	25	8	24	9	66	8	3	9	(22)	-	70	
Non-controlling interests	-	-	-	-	-	-	-	2	-	-	-	-	2	
Preference share dividends	-	-	-	-	-	-	-	-	-	-	14	-	14	
Net earnings (loss) attributable to common equity shareholders	6	-	25	8	24	9	66	6	3	9	(36)	-	54	
Goodwill	913	486	227	235	-	67	529	149	-	-	-	-	2,077	
Identifiable assets	4,528	1,763	2,927	1,748	1,394	691	6,760	680	832	808	643	(458)	15,556	
Total assets	5,441	2,249	3,154	1,983	1,394	758	7,289	829	832	808	643	(458)	17,633	
Gross capital expenditures	54	-	135	16	23	15	189	13	31	11	-	-	298	
Revenue	264	-	110	67	130	82	389	67	9	64	7	(8)	792	
Energy supply costs	109	-	-	13	79	51	143	39	-	-	-	-	291	
Operating expenses	63	-	37	21	17	12	87	9	1	42	3	(1)	204	
Depreciation and amortization	40	-	30	12	11	6	59	9	1	5	-	-	114	
Operating income	52	-	43	21	23	13	100	10	7	17	4	(7)	183	
Other income (expenses), net	1	-	-	-	1	-	1	1	-	-	(3)	-	-	
Finance charges	36	-	17	10	9	6	42	3	-	6	12	(7)	92	
Income tax expense (recovery)	3	-	-	2	4	2	8	-	1	3	(1)	-	14	
Net earnings (loss)	14	-	26	9	11	5	51	8	6	8	(10)	-	77	
Non-controlling interests	1	-	-	-	-	-	-	2	-	-	-	-	3	
Preference share dividends	-	-	-	-	-	-	-	-	-	-	12	-	12	
Net earnings (loss) attributable to common equity shareholders	13	-	26	9	11	5	51	6	6	8	(22)	-	62	
Goodwill	913	-	227	221	-	67	515	142	-	-	-	-	1,570	
Identifiable assets	4,566	-	2,575	1,671	1,298	692	6,236	631	653	620	607	(412)	12,901	
Total assets	5,479	-	2,802	1,892	1,298	759	6,751	773	653	620	607	(412)	14,471	
Gross capital expenditures	32	-	121	16	21	13	171	12	57	10	-	-	282	

# FORTIS INC.

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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### 15. SEGMENTED INFORMATION (cont'd)

Year-to-Date June 30, 2013 (\$ millions)	REGULATED UTILITIES										NON-REGULATED			
	Gas & Electric			Electric										
	FortisBC Energy Canadian	Central Hudson US	Fortis Alberta	FortisBC Electric	Newfoundland Power	Other Canadian	Electric Canadian	Electric Caribbean	Fortis Generation	Fortis Utility	Non- Corporate Utility	Corporate and Other eliminations	Inter- segment	Total
Revenue	738	-	235	156	329	183	903	136	136	12	118	13	(17)	1,903
Energy supply costs	322	-	-	39	225	118	382	84	-	-	-	-	(1)	787
Operating expenses	137	-	78	42	39	25	184	16	16	5	83	6	(4)	427
Depreciation and amortization	92	-	72	25	25	14	136	17	17	2	11	1	-	259
Operating income	187	-	85	50	40	26	201	19	19	5	24	6	(12)	430
Other income (expenses), net	1	-	2	1	1	-	4	1	1	-	-	(44)	-	(38)
Finance charges	71	-	35	19	18	10	82	7	7	-	12	21	(12)	181
Income tax expense (recovery)	26	-	1	6	(8)	1	-	-	-	-	3	(33)	-	(4)
Net earnings (loss) before extraordinary item	91	-	51	26	31	15	123	13	13	5	9	(26)	-	215
Extraordinary gain, net of tax	-	-	-	-	-	-	-	-	-	22	-	-	-	22
Net earnings (loss)	91	-	51	26	31	15	123	13	13	27	9	(26)	-	237
Non-controlling interests	-	-	-	-	-	-	-	4	-	-	-	-	-	4
Preference share dividends	-	-	-	-	-	-	-	-	-	-	-	-	-	28
Net earnings (loss) attributable to common equity shareholders	91	-	51	26	31	15	123	9	9	27	9	(54)	-	205
Goodwill	913	486	227	235	-	67	529	149	149	-	-	-	-	2,077
Identifiable assets	4,528	1,763	2,927	1,748	1,394	691	6,760	680	680	832	808	643	(458)	15,556
Total assets	5,441	2,249	3,154	1,983	1,394	758	7,289	829	829	832	808	643	(458)	17,633
Gross capital expenditures	92	-	230	33	38	28	329	24	24	79	24	-	-	548
<b>Year-to-Date June 30, 2012</b> (\$ millions)														
Revenue	812	-	218	154	322	173	867	130	130	18	116	13	(15)	1,941
Energy supply costs	411	-	-	38	221	109	368	79	79	-	-	-	(1)	857
Operating expenses	133	-	76	42	37	24	179	17	17	4	82	6	(3)	418
Depreciation and amortization	80	-	65	24	22	13	124	16	16	2	10	1	-	233
Operating income	188	-	77	50	42	27	196	18	18	12	24	6	(11)	433
Other income (expenses), net	1	-	2	-	1	-	3	1	1	1	-	(8)	(1)	(3)
Finance charges	71	-	32	20	18	11	81	7	7	1	12	23	(12)	183
Income tax expense (recovery)	22	-	-	5	7	4	16	-	-	1	3	(5)	-	37
Net earnings (loss)	96	-	47	25	18	12	102	12	12	11	9	(20)	-	210
Non-controlling interests	1	-	-	-	-	-	-	3	-	-	-	-	-	4
Preference share dividends	-	-	-	-	-	-	-	-	-	-	-	-	-	23
Net earnings (loss) attributable to common equity shareholders	95	-	47	25	18	12	102	9	9	11	9	(43)	-	183
Goodwill	913	-	227	221	-	67	515	142	142	-	-	-	-	1,570
Identifiable assets	4,566	-	2,575	1,671	1,298	692	6,236	631	631	653	620	607	(412)	12,901
Total assets	5,479	-	2,802	1,892	1,298	759	6,751	773	773	653	620	607	(412)	14,471
Gross capital expenditures	78	-	200	33	36	22	291	22	22	105	15	-	-	511

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
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#### 15. SEGMENTED INFORMATION (cont'd)

Related party transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. The significant related party inter-segment transactions primarily related to: (i) electricity sales from Newfoundland Power to Non-Utility; and (ii) finance charges on related party borrowings. The significant related party inter-segment transactions for the three and six months ended June 30, 2013 and 2012 were as follows:

Significant Inter-Segment Transactions <i>(\$ millions)</i>	Quarter Ended June 30		Year-to-Date June 30	
	2013	2012	2013	2012
Sales from Fortis Generation to Other Canadian Electric Utilities	1	-	1	-
Sales from Newfoundland Power to Non-Utility	1	1	3	3
Inter-segment finance charges on lending from:				
Fortis Generation to Other Canadian Electric Utilities	-	1	-	1
Corporate to Regulated Electric Utilities - Caribbean	1	1	2	2
Corporate to Fortis Generation	-	1	-	1
Corporate to Non-Utility	4	4	9	8

The significant inter-segment asset balances were as follows:

<i>(\$ millions)</i>	As at June 30	
	2013	2012
Inter-segment lending from:		
Fortis Generation to Other Canadian Electric Utilities	20	20
Corporate to Regulated Electric Utilities - Caribbean	85	77
Corporate to Fortis Generation	6	14
Corporate to Non-Utility	325	281
Other inter-segment assets	22	20
Total inter-segment eliminations	458	412

#### 16. SUPPLEMENTARY INFORMATION TO CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(\$ millions)</i>	Quarter Ended June 30		Year-to-Date June 30	
	2013	2012	2013	2012
<b>Change in non-cash operating working capital:</b>				
Accounts receivable	205	187	126	128
Prepaid expenses	(1)	(8)	2	(6)
Inventories	(37)	(31)	18	27
Regulatory assets - current portion	6	5	40	48
Accounts payable and other current liabilities	(43)	(76)	(73)	(67)
Regulatory liabilities - current portion	(10)	6	25	32
	120	83	138	162
<b>Non-cash investing and financing activities:</b>				
Common share dividends reinvested	15	15	34	28
Additions to utility and non-utility capital assets, and intangible assets included in current liabilities	73	72	73	72
Contributions in aid of construction included in current assets	14	11	14	11
Exercise of stock options into common shares	1	1	1	1

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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#### 17. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Corporation generally limits the use of derivative instruments to those that qualify as accounting or economic hedges. As at June 30, 2013, the Corporation's derivative contracts consisted of fuel option contracts, electricity swap contracts, natural gas swap and option contracts and gas purchase contract premiums. The fuel option contracts are held by Caribbean Utilities. Electricity swap contracts are held by Central Hudson. Gas swaps and options and gas purchase contract premiums are held by the FortisBC Energy companies and Central Hudson.

#### Volume of Derivative Activity

As at June 30, 2013, the following notional volumes related to fuel option contracts and electricity and natural gas commodity derivatives that are expected to be settled are outlined below.

	2013	2014	2015	2016	2017
Fuel option contracts ( <i>millions of imperial gallons</i> )	4	-	-	-	-
Electricity swap contracts ( <i>gigawatt hours</i> )	653	876	657	220	219
Gas swaps and options ( <i>petajoules</i> )	7	8	-	-	-
Gas purchase contract premiums ( <i>petajoules</i> )	46	26	6	-	-

#### Presentation of Derivative Instruments in the Consolidated Financial Statements

On the Corporation's consolidated balance sheets, derivative instruments are presented on a net basis by counterparty, where the right of offset exists.

The Corporation's outstanding derivative balances were as follows:

(\$ millions)	As at	
	June 30, 2013	December 31, 2012
Gross derivatives balance <sup>(1)</sup>	34	60
Netting <sup>(2)</sup>	-	-
Cash collateral	-	-
<b>Total derivative balances <sup>(3)</sup></b>	<b>34</b>	<b>60</b>

<sup>(1)</sup> Refer to Note 18 for a discussion of the valuation techniques used to calculate the fair value of the derivative instruments.

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

<sup>(3)</sup> Unrealized losses of \$34 million on commodity risk-related derivative instruments as at June 30, 2013 were recognized in current regulatory assets (December 31, 2012 - \$60 million), which would otherwise be recognized on the consolidated statement of comprehensive income and in accumulated other comprehensive loss.

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

## FORTIS INC.

### NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

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#### 18. FAIR VALUE MEASUREMENTS

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

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

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

The fair values of the Corporation's financial instruments, including derivatives, reflect point-in-time estimates based on current and relevant market information about the instruments as at the balance sheet dates. The estimates cannot be determined with precision as they involve uncertainties and matters of judgment and, therefore, may not be relevant in predicting the Corporation's future consolidated earnings or cash flows.

The following table details the estimated fair value measurements of the Corporation's financial instruments, all of which were measured using Level 2 pricing inputs, except for other investments and certain long-term debt and derivative instruments as noted.

Asset (Liability) (\$ millions)	As at		December 31, 2012	
	June 30, 2013 Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Long-term other asset - Belize Electricity <sup>(1)</sup>	109	n/a <sup>(2)</sup>	104	n/a <sup>(2)</sup>
Other investments <sup>(1) (3)</sup>	9	9	-	-
Long-term debt, including current portion <sup>(4)</sup>	(7,186)	(8,220)	(5,900)	(7,338)
Waneta Partnership promissory note <sup>(5)</sup>	(48)	(50)	(47)	(51)
Fuel option contracts <sup>(6)</sup>	-	-	(1)	(1)
Electricity swap contracts <sup>(6)</sup>	(1)	(1)	-	-
Natural gas commodity derivatives: <sup>(6)</sup>				
Swaps and options	(31)	(31)	(51)	(51)
Gas purchase contract premiums	(2)	(2)	(8)	(8)

<sup>(1)</sup> Included in long-term other assets on the consolidated balance sheet

<sup>(2)</sup> The Corporation's expropriated investment in Belize Electricity is recognized at book value, including foreign exchange impacts. The actual amount of compensation that the Government of Belize may pay to Fortis is indeterminable at this time (Notes 19 and 21).

<sup>(3)</sup> Other investments represent a portion of the trust assets for the funding of CH Energy Group's Directors and Executives Deferred Compensation Plan. These investments were valued using Level 1 inputs.

<sup>(4)</sup> The Corporation's \$200 million unsecured debentures due 2039 and consolidated borrowings under credit facilities classified as long-term debt of \$829 million (December 31, 2012 - \$150 million) are valued using Level 1 inputs. All other long-term debt is valued using Level 2 inputs.

<sup>(5)</sup> Included in long-term other liabilities on the consolidated balance sheet

<sup>(6)</sup> The fair values of the derivatives were recorded in accounts payable and other current liabilities as at June 30, 2013 and December 31, 2012. The fair value of the fuel option contracts as at June 30, 2013 was less than \$1 million. The fair value of electricity swap contracts were determined using Level 3 inputs.



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### **NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

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#### **18. FAIR VALUE MEASUREMENTS (cont'd)**

The fair value of long-term debt is calculated using quoted market prices when available. When quoted market prices are not available, as is the case with the Waneta Partnership promissory note and certain long-term debt, the fair value is determined by either: (i) discounting the future cash flows of the specific debt instrument at an estimated yield to maturity equivalent to benchmark government bonds or treasury bills, with similar terms to maturity, plus a credit risk premium equal to that of issuers of similar credit quality; or (ii) by obtaining from third parties indicative prices for the same or similarly rated issues of debt of the same remaining maturities. Since the Corporation does not intend to settle the long-term debt or promissory note prior to maturity, the excess of the estimated fair value above the carrying value does not represent an actual liability.

The fuel option contracts are used by Caribbean Utilities to reduce the impact of volatility in fuel prices on customer rates, as approved by the regulator under the Company's Fuel Price Volatility Management Program. The fair value of the fuel option contracts reflects only the value of the heating oil derivative and not the offsetting change in the value of the underlying future purchases of heating oil and was calculated using published market prices for heating oil or similar commodities where appropriate. The fuel option contracts mature in October 2013. Approximately 30% of the Company's annual diesel fuel requirements are under fuel hedging arrangements.

The electricity swap contracts and natural gas commodity derivatives are used by Central Hudson to minimize commodity price volatility for electricity and natural gas purchases for the Company's full-service customers by fixing the effective purchase price for the defined commodities. The fair values of the electricity swap contracts and natural gas commodity derivatives were calculated using forward pricing provided by independent third parties.

The natural gas commodity derivatives are used by the FortisBC Energy companies to fix the effective purchase price of natural gas, as the majority of the natural gas supply contracts have floating, rather than fixed, prices. The fair value of the natural gas commodity derivatives was calculated using the present value of cash flows based on market prices and forward curves for the commodity cost of natural gas.

The fair values of the fuel option contracts, electricity swap contracts and natural gas commodity derivatives are estimates of the amounts that the utilities would receive or have to pay to terminate the outstanding contracts as at the balance sheet dates. As at June 30, 2013, none of the fuel option contracts, electricity swap contracts and natural gas commodity derivatives were designated as hedges of fuel purchases or electricity and natural gas supply contracts. However, any gains or losses associated with changes in the fair value of the derivatives were deferred as a regulatory asset or liability for recovery from, or refund to, customers in future rates, as permitted by the regulators.

#### **19. FINANCIAL RISK MANAGEMENT**

The Corporation is primarily exposed to credit risk, liquidity risk and market risk as a result of holding financial instruments in the normal course of business.

<b>Credit Risk</b>	Risk that a counterparty to a financial instrument might fail to meet its obligations under the terms of the financial instrument.
<b>Liquidity Risk</b>	Risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments.
<b>Market Risk</b>	Risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market prices. The Corporation is exposed to foreign exchange risk, interest rate risk and commodity price risk.

## FORTIS INC.

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#### 19. FINANCIAL RISK MANAGEMENT (cont'd)

##### Credit Risk

For cash equivalents, trade and other accounts receivable, and long-term other receivables, the Corporation's credit risk is generally limited to the carrying value on the consolidated balance sheet. The Corporation generally has a large and diversified customer base, which minimizes the concentration of credit risk. The Corporation and its subsidiaries have various policies to minimize credit risk, which include requiring customer deposits, prepayments and/or credit checks for certain customers and performing disconnections and/or using third-party collection agencies for overdue accounts.

FortisAlberta has a concentration of credit risk as a result of its distribution service billings being to a relatively small group of retailers. As at June 30, 2013, FortisAlberta's gross credit risk exposure was approximately \$105 million, representing the projected value of retailer billings over a 37-day period. The Company has reduced its exposure to less than \$1 million by obtaining from the retailers either a cash deposit, bond, letter of credit or an investment-grade credit rating from a major rating agency, or by having the retailer obtain a financial guarantee from an entity with an investment-grade credit rating.

The FortisBC Energy companies may be exposed to credit risk in the event of non-performance by counterparties to derivative instruments. The Company uses netting arrangements to reduce credit risk and net settles payments with counterparties where net settlement provisions exist. The following table summarizes the FortisBC Energy companies' net credit risk exposure to its counterparties, as well as credit risk exposure to counterparties accounting for greater than 10% net credit exposure, as it relates to its natural gas swaps and options.

(\$ millions, except as noted)	As at	
	June 30, 2013	December 31, 2012
Gross credit exposure before credit collateral <sup>(1)</sup>	31	51
Credit collateral	-	-
Net credit exposure <sup>(2)</sup>	31	51
Number of counterparties > 10% (#)	4	4
Net exposure to counterparties > 10%	29	45

<sup>(1)</sup> Gross credit exposure equals mark-to-market value on physically and financially settled contracts, notes receivable and net receivables (payables) where netting is contractually allowed. Gross and net credit exposure amounts reported do not include adjustments for time value or liquidity.

<sup>(2)</sup> Net credit exposure is the gross credit exposure collateral minus credit collateral (cash deposits and letters of credit).

The Corporation is exposed to credit risk associated with the amount and timing of fair value compensation that Fortis is entitled to receive from the Government of Belize ("GOB") as a result of the expropriation of the Corporation's investment in Belize Electricity by the GOB on June 20, 2011. As at June 30, 2013, the Corporation had a long-term other asset of \$109 million (December 31, 2012 - \$104 million), including foreign exchange impacts, recognized on the consolidated balance sheet related to its expropriated investment in Belize Electricity (Notes 18 and 21).

Additionally, as at June 30, 2013, Belize Electricity owed Belize Electric Company Limited ("BECOL") approximately US\$7 million for energy purchases of which US\$3 million was overdue. In accordance with long-standing agreements, the GOB guarantees the payment of Belize Electricity's obligations to BECOL.

## FORTIS INC.

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#### 19. FINANCIAL RISK MANAGEMENT (cont'd)

##### Liquidity Risk

The Corporation's consolidated financial position could be adversely affected if it, or one of its subsidiaries, fails to arrange sufficient and cost-effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. The ability to arrange sufficient and cost-effective financing is subject to numerous factors, including the consolidated results of operations and financial position of the Corporation and its subsidiaries, conditions in capital and bank credit markets, ratings assigned by rating agencies and general economic conditions.

To help mitigate liquidity risk, the Corporation and its larger regulated utilities have secured committed credit facilities to support short-term financing of capital expenditures and seasonal working capital requirements.

The Corporation's committed corporate credit facility is available for interim financing of acquisitions and for general corporate purposes. Depending on the timing of cash payments from the subsidiaries, borrowings under the Corporation's committed corporate credit facility may be required from time to time to support the servicing of debt and payment of dividends. As at June 30, 2013, average annual consolidated long-term debt maturities and repayments over the next five years are expected to be approximately \$310 million, excluding borrowings under the Corporation's committed credit facility which are expected to be replaced with long-term financing. The combination of available credit facilities and relatively low annual debt maturities and repayments provide the Corporation and its subsidiaries with flexibility in the timing of access to capital markets.

As at June 30, 2013, the Corporation and its subsidiaries had consolidated credit facilities of approximately \$2.7 billion, of which \$1.7 billion was unused, including \$395 million unused under the Corporation's \$1 billion committed revolving corporate credit facility. The credit facilities are syndicated mostly with the seven largest Canadian banks, with no one bank holding more than 20% of these facilities. Approximately \$2.6 billion of the total credit facilities are committed facilities with maturities ranging from 2013 to 2018.

The following table outlines the credit facilities of the Corporation and its subsidiaries.

(\$ millions)	As at				December 31, 2012
	Regulated Utilities	Non-Regulated	Corporate and Other	June 30, 2013	
Total credit facilities	1,560	112	1,030	2,702	2,460
Credit facilities utilized:					
Short-term borrowings <sup>(1)</sup>	(72)	(27)	-	(99)	(136)
Long-term debt <sup>(2)</sup>	(226)	-	(603)	(829)	(150)
Letters of credit outstanding	(66)	-	(2)	(68)	(67)
Credit facilities unused	1,196	85	425	1,706	2,107

<sup>(1)</sup> The weighted average interest rate on short-term borrowings was approximately 1.7% as at June 30, 2013 (December 31, 2012 - 1.9%).

<sup>(2)</sup> As at June 30, 2013, credit facility borrowings classified as long term included \$65 million in current installments of long-term debt on the consolidated balance sheet (December 31, 2012 - \$62 million). The weighted average interest rate on credit facility borrowings classified as long-term debt was approximately 1.7% as at June 30, 2013 (December 31, 2012 - 2.1%).

As at June 30, 2013 and December 31, 2012, certain borrowings under the Corporation's and subsidiaries' credit facilities were classified as long-term debt. These borrowings are under long-term committed credit facilities and management's intention is to refinance these borrowings with long-term permanent financing during future periods.

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#### **19. FINANCIAL RISK MANAGEMENT (cont'd)**

##### **Liquidity Risk (cont'd)**

In January 2013 FEVI's \$20 million unsecured committed non-revolving credit facility matured and was not replaced.

In April 2013 FortisBC Electric renegotiated and amended its credit facility agreement, resulting in an extension to the maturity of the Company's \$150 million unsecured committed revolving credit facility with \$100 million now maturing in May 2016 and \$50 million now maturing in May 2014. The amended credit facility agreement contains substantially similar terms and conditions as the previous credit facility agreement.

In April 2013 FHI extended its \$30 million unsecured committed revolving credit facility to mature in May 2014 from May 2013.

In May 2013 FortisOntario extended its \$30 million unsecured revolving credit facility to mature in June 2014 from June 2013.

In June 2013 Fortis Turks and Caicos entered into new short-term unsecured demand credit facilities for US\$31 million (\$33 million), replacing its previous US\$21 million (\$22 million) facilities. The new facilities are comprised of a revolving operating credit facility of US\$12 million (\$13 million), a capital expenditure line of credit of US\$10 million (\$11 million) and a US\$9 million (\$9 million) emergency standby loan. The capital expenditure line of credit matures in December 2013. The remaining facilities mature in June 2014. The new credit facilities reflect a decrease in pricing but otherwise contain terms and conditions substantially similar to the previous facilities.

As at June 30, 2013, CH Energy Group had a US\$100 million (\$105 million) unsecured revolving credit facility maturing in October 2015, and Central Hudson had a US\$150 million (\$158 million) unsecured committed revolving credit facility maturing in October 2016.

In July 2013 FEI, FEVI and FortisAlberta amended their \$500 million, \$200 million and \$250 million committed revolving credit facilities, resulting in extensions to the maturity dates to August 2015, December 2015 and August 2018, respectively, from August 2014, December 2013 and August 2016, respectively. The new agreements contain substantially similar terms and conditions as the previous credit facility agreements.

The Corporation and its currently rated utilities target investment-grade credit ratings to maintain capital market access at reasonable interest rates. As at June 30, 2013, the Corporation's credit ratings were as follows:

Standard & Poor's ("S&P")	A- (long-term corporate and unsecured debt credit rating)
DBRS	A(low) (unsecured debt credit rating)

In February 2013 S&P and DBRS affirmed the Corporation's debt credit ratings. The above-noted credit ratings reflect the Corporation's business-risk profile and diversity of its operations, the stand-alone nature and financial separation of each of the regulated subsidiaries of Fortis, management's commitment to maintaining low levels of debt at the holding company level, the Corporation's reasonable credit metrics and its demonstrated ability and continued focus on acquiring and integrating stable regulated utility businesses financed on a conservative basis. The credit ratings also reflect the Corporation's financing plans for the acquisition of CH Energy Group and the expected completion of the Waneta Expansion hydroelectric generating facility on time and on budget.

## FORTIS INC.

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#### 19. FINANCIAL RISK MANAGEMENT (cont'd)

##### Market Risk

###### *Foreign Exchange Risk*

The Corporation's earnings from, and net investment in, foreign subsidiaries are exposed to fluctuations in the US dollar-to-Canadian dollar exchange rate. The Corporation has effectively decreased the above-noted exposure through the use of US dollar-denominated borrowings at the corporate level. The foreign exchange gain or loss on the translation of US dollar-denominated interest expense partially offsets the foreign exchange loss or gain on the translation of the Corporation's foreign subsidiaries' earnings, which are denominated in US dollars. The reporting currency of Central Hudson, Caribbean Utilities, Fortis Turks and Caicos, FortisUS Energy Corporation, BECOL and Griffith is the US dollar.

As at June 30, 2013, the Corporation's corporately issued US\$1,052 million (December 31, 2012 – US\$557 million) long-term debt had been designated as an effective hedge of the Corporation's foreign net investments. As at June 30, 2013, the Corporation had approximately US\$534 million (December 31, 2012 – US\$17 million) in foreign net investments remaining to be hedged. Both the Corporation's US dollar-denominated long-term debt and foreign net investments as at June 30, 2013 were significantly impacted by the CH Energy Group acquisition. Foreign currency exchange rate fluctuations associated with the translation of the Corporation's corporately issued US dollar-denominated borrowings designated as effective hedges are recorded in other comprehensive income and serve to help offset unrealized foreign currency exchange gains and losses on the net investments in foreign subsidiaries, which gains and losses are also recorded in other comprehensive income.

Effective from June 20, 2011, the Corporation's asset associated with its expropriated investment in Belize Electricity does not qualify for hedge accounting as Belize Electricity is no longer a foreign subsidiary of Fortis (Note 21). As a result, foreign exchange gains and losses on the translation of the long-term other asset associated with Belize Electricity are recognized in earnings. The Corporation recognized in earnings a foreign exchange gain of approximately \$3 million and \$5 million for the three and six months ended June 30 2013, respectively (\$2 million and \$0.5 million for the three and six months ended June 30 2012, respectively) (Note 9).

###### *Interest Rate Risk*

The Corporation and most of its subsidiaries are exposed to interest rate risk associated with credit facility borrowings. The Corporation and its subsidiaries may enter into interest rate swap agreements to help reduce this risk.

###### *Commodity Price Risk*

The FortisBC Energy companies are exposed to commodity price risk associated with changes in the market price of natural gas; Central Hudson is exposed to commodity price risk associated with changes in the market price of electricity and natural gas; and Caribbean Utilities is exposed to commodity price risk associated with changes in the market price for fuel (Notes 17 and 18). The risks have been reduced by entering into natural gas commodity derivatives, electricity derivatives and fuel option contracts that effectively fix the price of natural gas purchases, electricity purchases and fuel purchases, respectively. The natural gas and electricity derivatives and fuel option contracts are recorded on the consolidated balance sheet at fair value and any change in the fair value is deferred as a regulatory asset or liability, as permitted by the regulators, for recovery from, or refund to, customers in future rates.

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#### **19. FINANCIAL RISK MANAGEMENT (cont'd)**

##### **Market Risk (cont'd)**

###### *Commodity Price Risk (cont'd)*

The price risk-management strategy of the FortisBC Energy companies aims to improve the likelihood that natural gas prices remain competitive, mitigate gas price volatility on customer rates and reduce the risk of regional price discrepancies. As directed by the regulator in 2011, the FortisBC Energy companies have suspended their commodity hedging activities with the exception of certain limited swaps as permitted by the regulator. The existing hedging contracts will continue in effect through to their maturity and the FortisBC Energy companies' ability to fully recover the commodity cost of gas in customer rates remains unchanged. Any differences between the cost of natural gas purchased and the price of natural gas included in customer rates are recorded as regulatory deferrals and are recovered from, or refunded to, customers in future rates, subject to regulatory approval.

#### **20. COMMITMENTS**

There were no material changes in the nature and amount of the Corporation's commitments from the commitments disclosed in the Corporation's 2012 annual audited consolidated financial statements, except as follows.

Maritime Electric has entitlement to approximately 4.7% of the output from Point Lepreau for the life of the unit. As part of its entitlement, Maritime Electric is required to pay its share of the capital and operating costs of the unit. A major refurbishment of Point Lepreau that began in 2008 was completed and the station returned to service in November 2012. The refurbishment is expected to extend the facility's estimated life an additional 27 years and, as a result, the total estimated capital cost obligation has increased approximately \$46 million from that disclosed in the 2012 annual audited consolidated financial statements.

In May 2013 FortisBC Electric entered into a new Power Purchase Agreement ("PPA") with BC Hydro to purchase up to 200 megawatts of capacity and 1,752 gigawatt hours of associated energy annually for a 20-year term beginning October 1, 2013. This new PPA does not change the basic parameters of the BC Hydro PPA, which expires on September 30, 2013. An executed version of the new PPA was submitted by BC Hydro to the BCUC in May 2013 and is pending regulatory approval. Power purchases from the new PPA are expected to be recovered in customer rates.

Central Hudson is party to various gas purchase contracts with obligations totaling approximately \$85 million as at June 30, 2013. These obligations are predominately for long-term storage and interstate gas transportation contracts and are based on tariff rates as at June 30, 2013.

Central Hudson is also party to agreements with Entergy Nuclear Power Marketing, LLC to purchase electricity, and not capacity, on a unit-contingent basis at defined prices from January 1, 2011 through December 31, 2013. In the event the counterparty is unable to fulfill the commitment to deliver under the terms of the agreement, Central Hudson would obtain required supply from the New York Independent System Operator ("NYISO") market, with cost recovery from customers. Central Hudson must also acquire sufficient peak load capacity to meet the peak load requirements of its full-service customers. This capacity is made up of contracts with capacity providers, purchases from the NYISO capacity market and its own generating capacity. Obligations in respect of electricity purchase agreements totalled \$50 million as at June 30, 2013.

Central Hudson has various purchase commitments and contracts related to ongoing projects and operating activities with an obligation totalling approximately \$145 million as at June 30, 2013. Certain of these commitments are related to capital projects and are also included in Central Hudson's capital expenditure forecast.

## **FORTIS INC.**

### **NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
(Unaudited)

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#### **21. EXPROPRIATED ASSETS**

On June 20, 2011, the GOB enacted legislation leading to the expropriation of the Corporation's investment in Belize Electricity. Consequent to the deprivation of control over the operations of the utility, the Corporation discontinued the consolidation method of accounting for Belize Electricity, as of June 20, 2011, and classified the book value, including foreign exchange impacts, of the expropriated investment as a long-term other asset on the consolidated balance sheet.

In October 2011 Fortis commenced an action in the Belize Supreme Court with respect to challenging the constitutionality of the expropriation of the Corporation's investment in Belize Electricity. Fortis commissioned an independent valuation of its expropriated investment and submitted its claim for compensation to the GOB in November 2011. The book value of the long-term other asset is below fair value as at the date of expropriation as determined by independent valuers. The GOB also commissioned a valuation of Belize Electricity which is significantly lower than both the fair value determined under the Corporation's valuation and the book value of the long-term other asset.

In July 2012 the Belize Supreme Court dismissed the Corporation's claim of October 2011. Also in July 2012, Fortis filed its appeal of the above-noted trial judgment in the Belize Court of Appeal. The appeal was heard in October 2012 and a decision is pending. Any decision of the Belize Court of Appeal may be appealed to the Caribbean Court of Justice, the highest court of appeal available for judicial matters in Belize.

Fortis believes it has a strong, well-positioned case before the Belize Courts supporting the unconstitutionality of the expropriation. There exists, however, a reasonable possibility that the outcome of the litigation may be unfavourable to the Corporation and the amount of compensation otherwise to be paid to Fortis under the legislation expropriating Belize Electricity could be lower than the book value of the Corporation's expropriated investment in Belize Electricity. The book value was \$109 million, including foreign exchange impacts, as at June 30, 2013 (December 31, 2012 - \$104 million). If the expropriation is held to be unconstitutional, it is not determinable at this time as to the nature of the relief that would be awarded to Fortis, for example: (i) the ordering of the return of the shares to Fortis and/or award of damages; or (ii) the ordering of compensation to be paid to Fortis for the unconstitutional expropriation of the shares. Based on presently available information, the \$109 million long-term other asset is not deemed impaired as at June 30, 2013. Fortis will continue to assess for impairment each reporting period based on evaluating the outcomes of court proceedings and/or compensation settlement negotiations. As well as continuing the constitutional challenge of the expropriation, Fortis is also pursuing alternative options for obtaining fair compensation, including compensation under the Belize/United Kingdom Bilateral Investment Treaty.

## **FORTIS INC.**

### **NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
(Unaudited)

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#### **22. CONTINGENT LIABILITIES**

The Corporation and its subsidiaries are subject to various legal proceedings and claims associated with the ordinary course of business operations. Management believes that the amount of liability, if any, from these actions would not have a material effect on the Corporation's consolidated financial position or results of operations.

The following describes the nature of the Corporation's contingent liabilities.

##### **Fortis**

In May 2012 CH Energy Group and Fortis entered into a proposed settlement agreement with counsel to plaintiff shareholders pertaining to several complaints, which named Fortis and other defendants, which were filed in, or transferred to, the Supreme Court of the State of New York, County of New York, relating to the acquisition of CH Energy Group by Fortis. The complaints generally alleged that the directors of CH Energy Group breached their fiduciary duties in connection with the acquisition and that CH Energy Group, Fortis, FortisUS Inc. and Cascade Acquisition Sub Inc. aided and abetted that breach. The settlement agreement is subject to court approval.

##### **FHI**

During 2007 and 2008, a non-regulated subsidiary of FHI received Notices of Assessment from CRA for additional taxes related to the taxation years 1999 through 2003. The exposure has been fully provided for in the consolidated financial statements. A settlement was reached with CRA in the second quarter of 2013 resulting in the release of income tax provisions of approximately \$5 million (Note 11).

In April 2013 FHI and Fortis were named as defendants in an action in the British Columbia Supreme Court by the Coldwater Indian Band ("Band"). The claim is in regard to interests in a pipeline right of way on reserve lands. The pipeline on the right of way was transferred by FHI (then Terasen Inc.) to Kinder Morgan Inc. in April 2007. The Band seeks orders cancelling the right of way and claims damages for wrongful interference with the Band's use and enjoyment of reserve lands. The outcome cannot be reasonably determined and estimated at this time and, accordingly, no amount has been accrued in the interim unaudited consolidated financial statements.

##### **FortisBC Electric**

The Government of British Columbia has alleged breaches of the Forest Practices Code and negligence relating to a forest fire near Vaseux Lake in 2003, prior to the acquisition of FortisBC Electric by Fortis, and has filed and served a writ and statement of claim against FortisBC Electric dated August 2, 2005. The Government of British Columbia has now disclosed that its claim includes approximately \$15 million in damages as well as pre-judgment interest, but that it has not fully quantified its damages. FortisBC Electric and its insurers continue to defend the claim by the Government of British Columbia. The outcome cannot be reasonably determined and estimated at this time and, accordingly, no amount has been accrued in the interim unaudited consolidated financial statements.

The Government of British Columbia filed a claim in the British Columbia Supreme Court in June 2012 claiming on its behalf, and on behalf of approximately 17 homeowners, damages suffered as a result of a landslide caused by a dam failure in Oliver, British Columbia in 2010. The Government of British Columbia alleges in its claim that the dam failure was caused by the defendants', which includes FortisBC Electric, use of a road on top of the dam. The Government of British Columbia estimates its damages and the damages of the homeowners, on whose behalf it is claiming, to be approximately \$15 million. While FortisBC Electric has not been served, the utility has retained counsel and has notified its insurers. The outcome cannot be reasonably determined and estimated at this time and, accordingly, no amount has been accrued in the interim unaudited consolidated financial statements.



## **FORTIS INC.**

### **NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
(Unaudited)

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## **22. CONTINGENT LIABILITIES (cont'd)**

### **Central Hudson**

#### *Danskammer Point Steam Electric Generating Station*

In 1999, the New York State Attorney General alleged that Central Hudson may have constructed, and continued to operate, major modifications to the Danskammer Point Steam Electric Generating Station ("Danskammer Plant") without obtaining certain requisite pre-construction permits. In March 2000, the Environmental Protection Agency assumed responsibility for the investigation. Central Hudson believes any permits required for these projects were obtained in a timely manner. The Company sold the Danskammer Plant to Dynegy Inc. in January 2001. While Central Hudson could have retained liability after the sale, depending on the type of remedy, the Company believes that the statutes of limitation relating to any alleged violation of air emissions rules have lapsed.

#### *Former MGP Facilities*

Central Hudson and its predecessors owned and operated MGPs to serve their customers' heating and lighting needs. These plants manufactured gas from coal and oil beginning in the mid to late 1800s with all sites ceasing operations by the 1950s. This process produced certain by-products that may pose risks to human health and the environment.

The New York State Department of Environmental Conservation ("DEC"), which regulates the timing and extent of remediation of MGP sites in New York State, has notified Central Hudson that it believes the Company or its predecessors at one time owned and/or operated MGPs at seven sites in Central Hudson's franchise territory. The DEC has further requested that the Company investigate and, if necessary, remediate these sites under a Consent Order, Voluntary Clean-up Agreement, or Brownfield Clean-up Agreement. Central Hudson accrues for remediation costs based on the amounts that can be reasonably estimated. As at June 30, 2013, an obligation of US\$9 million was recognized in respect of MGPs remediation and, based upon cost model analysis completed in 2012, it is estimated, with a 90% confidence level, that total costs to remediate these sites over the next 30 years will not exceed US\$152 million.

Central Hudson has notified its insurers and intends to seek reimbursement from insurers for remediation, where coverage exists. Further, as authorized by the PSC, Central Hudson is currently permitted to defer, for future recovery from customers, the differences between actual costs for MGP site investigation and remediation and the associated rate allowances, with carrying charges to be accrued on the deferred balances at the authorized pre-tax rate of return (Note 4).

#### *Etings Corners*

Central Hudson owns and operates a maintenance and warehouse facility. In the course of Central Hudson's hazardous waste permit renewal process for this facility, sediment contamination was discovered within the wetland area across the street from the main property. In cooperation with the DEC, Central Hudson continues to investigate the nature and extent of the contamination. The extent of the contamination, as well as the timing and costs for any future remediation efforts, cannot be reasonably estimated at this time and, accordingly, no amount has been accrued in the interim unaudited consolidated financial statements.

#### *Asbestos Litigation*

Prior to the acquisition of CH Energy Group, various asbestos lawsuits had been brought against Central Hudson. While a total of 3,340 asbestos cases have been raised, 1,168 remained pending as at June 30, 2013. Of the cases no longer pending against Central Hudson, 2,017 have been dismissed or discontinued without payment by the Company, and Central Hudson has settled the remaining 155 cases. The Company is presently unable to assess the validity of the remaining asbestos lawsuits; however, based on information known to Central Hudson at this time, including the Company's experience in the settlement and/or dismissal of asbestos cases, Central Hudson believes that the costs which may be incurred in connection with the remaining lawsuits will not have a material effect on its financial position, results of operations or cash flows and, accordingly, no amount has been accrued in the interim unaudited consolidated financial statements.

## **FORTIS INC.**

### **NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

For the three and six months ended June 30, 2013 and 2012 (unless otherwise stated)  
(Unaudited)

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#### **23. SUBSEQUENT EVENTS**

On July 10, 2013, the Corporation redeemed all of the issued and outstanding \$125 million 5.45% First Preference Shares, Series C at a redemption price of \$25.1456 per share, being equal to \$25.00 plus the amount of accrued and unpaid dividends per share.

On July 18, 2013, the Corporation issued 10 million Cumulative Redeemable Fixed Rate Reset First Preference Shares, Series K at \$25.00 per share for gross proceeds of \$250 million. The net proceeds of the offering were used to repay a portion of borrowings under the Corporation's \$1 billion committed corporate credit facility, including amounts borrowed in connection with the above-noted redemption of the Corporation's First Preference Shares, Series C, the construction of the Waneta Expansion and equity injections into certain of the Corporation's subsidiaries, and for general corporate purposes.

On July 19, 2013, the Corporation priced a private placement of 10-year US\$285 million unsecured notes at 3.84% and 30-year US\$40 million unsecured notes at 5.08%. The offering is scheduled to close on October 1, 2013. Proceeds from the offering will be used to repay a portion of the Corporation's US dollar-denominated committed credit facility borrowings incurred to initially finance a portion of the CH Energy Group acquisition.

On July 26, 2013, applications for rehearing of the approval of the CH Energy Group acquisition were filed with the PSC. In addition, the parties petitioned the PSC to designate Central Hudson's rates as temporary pending further review of certain matters, including the Company's allowed ROE. The Corporation is preparing a response to the applications, which it expects to file shortly.

#### **24. COMPARATIVE FIGURES**

Certain comparative figures have been reclassified to comply with current period presentation.

## Dates – Dividends\* and Earnings

### Expected Earnings Release Dates

November 1, 2013                      February 6, 2014  
May 6, 2014                              July 31, 2014

### Dividend Record Dates

August 16, 2013                      November 15, 2013  
February 14, 2014                      May 16, 2014

### Dividend Payment Dates

September 1, 2013                      December 1, 2013  
March 1, 2014                              June 1, 2014

\* *The declaration and payment of dividends are subject to Board of Directors' approval.*

### Registrar and Transfer Agent

Computershare Trust Company of Canada  
9<sup>th</sup> Floor, 100 University Avenue  
Toronto, ON M5J 2Y1  
T: 514-982-7555 or 1-866-586-7638  
F: 416-263-9394 or 1-888-453-0330  
W: [www.investorcentre.com/fortisinc](http://www.investorcentre.com/fortisinc)

### Share Listings

The Common Shares, First Preference Shares, Series E; First Preference Shares, Series F; First Preference Shares, Series G; First Preference Shares, Series H; First Preference Shares, Series J; and First Preference Shares, Series K of Fortis are traded on the Toronto Stock Exchange under the symbols FTS, FTS.PR.E, FTS.PR.F, FTS.PR.G, FTS.PR.H, FTS.PR.J and FTS.PR.K, respectively.

<b>Fortis Common Shares (\$)</b>		
<b>Quarter Ended June 30</b>		
	<b>2013</b>	<b>2012</b>
<b>High</b>	<b>35.14</b>	<b>34.98</b>
<b>Low</b>	<b>30.70</b>	<b>31.88</b>
<b>Close</b>	<b>32.19</b>	<b>32.29</b>

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