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**FORTIS INC.**

Consolidated Financial Statements  
As at and for the years ended December 31, 2014 and 2013

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

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## Management's Report

The accompanying Annual Consolidated Financial Statements of Fortis Inc. have been prepared by management, who are responsible for the integrity of the information presented including the amounts that must, of necessity, be based on estimates and informed judgments. These Annual Consolidated Financial Statements were prepared in accordance with accounting principles generally accepted in the United States.

In meeting its responsibility for the reliability and integrity of the Annual Consolidated Financial Statements, management has developed and maintains a system of accounting and reporting which provides for the necessary internal controls to ensure transactions are properly authorized and recorded, assets are safeguarded and liabilities are recognized. The systems of the Corporation and its subsidiaries focus on the need for training of qualified and professional staff and the effective communication of management guidelines and policies. The effectiveness of the internal controls of Fortis Inc. is evaluated on an ongoing basis.

The Board of Directors oversees management's responsibilities for financial reporting through an Audit Committee which is composed entirely of outside independent directors. The Audit Committee oversees the external audit of the Corporation's Annual Consolidated Financial Statements and the accounting and financial reporting and disclosure processes and policies of the Corporation. The Audit Committee meets with management, the shareholders' auditors and the internal auditor to discuss the results of the external audit, the adequacy of the internal accounting controls and the quality and integrity of financial reporting. The Corporation's Annual Consolidated Financial Statements are reviewed by the Audit Committee with each of management and the shareholders' auditors before the statements are recommended to the Board of Directors for approval. The shareholders' auditors have full and free access to the Audit Committee. The Audit Committee has the duty to review the adoption of, and changes in, accounting principles and practices which have a material effect on the Corporation's Annual Consolidated Financial Statements and to review and report to the Board of Directors on policies relating to the accounting and financial reporting and disclosure processes.

The Audit Committee has the duty to review financial reports requiring Board of Directors' approval prior to the submission to securities commissions or other regulatory authorities, to assess and review management judgments material to reported financial information and to review shareholders' auditors' independence and auditors' fees. The 2014 Annual Consolidated Financial Statements were reviewed by the Audit Committee and, on their recommendation, were approved by the Board of Directors of Fortis Inc. Ernst & Young LLP, independent auditors appointed by the shareholders of Fortis Inc. upon recommendation of the Audit Committee, have performed an audit of the 2014 Annual Consolidated Financial Statements and their report follows.



**Barry V. Perry**  
President and Chief Executive Officer, Fortis Inc.



**Karl W. Smith**  
Executive Vice President, Chief Financial Officer, Fortis Inc.

St. John's, Canada

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## Independent Auditors' Report

To the Shareholders of Fortis Inc.

We have audited the accompanying consolidated financial statements of Fortis Inc., which comprise the consolidated balance sheets as at December 31, 2014 and 2013, and the consolidated statements of earnings, comprehensive income, cash flows and changes in equity for the years then ended, and a summary of significant accounting policies and other explanatory information.

### Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Fortis Inc. as at December 31, 2014 and 2013 and its financial performance and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States.

St. John's, Canada  
February 18, 2015

*Ernst + Young LLP*

Chartered Professional Accountants

**Fortis Inc.**  
**Consolidated Balance Sheets**  
**As at December 31**  
(in millions of Canadian dollars)

	2014	2013
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 230	\$ 72
Accounts receivable and other current assets (Note 5)	900	732
Prepaid expenses	59	45
Inventories (Note 6)	321	143
Regulatory assets (Note 7)	295	150
Assets held for sale (Note 26)	-	112
Deferred income taxes (Note 25)	158	42
	<b>1,963</b>	<b>1,296</b>
<b>Other assets</b> (Note 8)	<b>337</b>	<b>246</b>
<b>Regulatory assets</b> (Note 7)	<b>2,230</b>	<b>1,672</b>
<b>Deferred income taxes</b> (Note 25)	<b>62</b>	<b>7</b>
<b>Utility capital assets</b> (Note 9)	<b>17,152</b>	<b>11,618</b>
<b>Non-utility capital assets</b> (Note 10)	<b>664</b>	<b>649</b>
<b>Intangible assets</b> (Note 11)	<b>488</b>	<b>345</b>
<b>Goodwill</b> (Note 12)	<b>3,732</b>	<b>2,075</b>
	<b>\$ 26,628</b>	<b>\$ 17,908</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Short-term borrowings (Note 33)	\$ 330	\$ 160
Accounts payable and other current liabilities (Note 13)	1,440	957
Regulatory liabilities (Note 7)	192	140
Current installments of long-term debt (Note 14)	505	780
Current installments of capital lease and finance obligations (Note 15)	208	7
Liabilities associated with assets held for sale (Note 26)	-	32
Deferred income taxes (Note 25)	9	8
	<b>2,684</b>	<b>2,084</b>
<b>Other liabilities</b> (Note 16)	<b>1,141</b>	<b>627</b>
<b>Regulatory liabilities</b> (Note 7)	<b>1,363</b>	<b>902</b>
<b>Deferred income taxes</b> (Note 25)	<b>1,837</b>	<b>1,078</b>
<b>Long-term debt</b> (Note 14)	<b>9,996</b>	<b>6,424</b>
<b>Capital lease and finance obligations</b> (Note 15)	<b>495</b>	<b>417</b>
	<b>17,516</b>	<b>11,532</b>
<b>Shareholders' equity</b>		
Common shares <sup>(1)</sup> (Note 17)	5,667	3,783
Preference shares (Note 19)	1,820	1,229
Additional paid-in capital	15	17
Accumulated other comprehensive income (loss) (Note 20)	129	(72)
Retained earnings	1,060	1,044
	<b>8,691</b>	<b>6,001</b>
Non-controlling interests (Note 21)	421	375
	<b>9,112</b>	<b>6,376</b>
	<b>\$ 26,628</b>	<b>\$ 17,908</b>

<sup>(1)</sup> No par value. Unlimited authorized shares; 276.0 million and 213.2 million issued and outstanding as at December 31, 2014 and 2013, respectively


Commitments (Note 34)  
Contingencies (Note 36)

See accompanying Notes to Consolidated Financial Statements

Approved on Behalf of the Board



David G. Norris,  
Director



Peter E. Case,  
Director

**Fortis Inc.**  
**Consolidated Statements of Earnings**  
**For the years ended December 31**  
(in millions of Canadian dollars, except per share amounts)

	2014	2013
<b>Revenue</b>	<b>\$ 5,401</b>	\$ 4,047
<b>Expenses</b>		
Energy supply costs	2,197	1,617
Operating	1,493	1,037
Depreciation and amortization	688	541
	<b>4,378</b>	<b>3,195</b>
<b>Operating income</b>	<b>1,023</b>	852
Other income (expenses), net (Note 23)	(25)	(31)
Finance charges (Note 24)	547	389
<b>Earnings before income taxes, discontinued operations and extraordinary item</b>	<b>451</b>	432
Income tax expense (Note 25)	66	32
<b>Earnings from continuing operations</b>	<b>385</b>	400
Earnings from discontinued operations, net of tax (Note 26)	5	-
<b>Earnings before extraordinary item</b>	<b>390</b>	400
Extraordinary gain, net of tax (Note 27)	-	20
<b>Net earnings</b>	<b>\$ 390</b>	\$ 420
<b>Net earnings attributable to:</b>		
Non-controlling interests	\$ 11	\$ 10
Preference equity shareholders	62	57
Common equity shareholders	317	353
	<b>\$ 390</b>	<b>\$ 420</b>
<b>Earnings per common share from continuing operations</b> (Note 18)		
Basic	\$ 1.39	\$ 1.64
Diluted	\$ 1.38	\$ 1.63
<b>Earnings per common share</b> (Note 18)		
Basic	\$ 1.41	\$ 1.74
Diluted	\$ 1.40	\$ 1.73

See accompanying Notes to Consolidated Financial Statements

**Fortis Inc.**  
**Consolidated Statements of Comprehensive Income**  
**For the years ended December 31**  
(in millions of Canadian dollars)

	2014	2013
<b>Net earnings</b>	<b>\$ 390</b>	\$ 420
<b>Other comprehensive income (loss)</b>		
Unrealized foreign currency translation gains, net of hedging activities and tax (Note 20)	204	16
Net change in fair value of cash flow hedges, net of tax (Notes 20 and 32)	1	-
Reclassification to earnings of net losses on derivative instruments discontinued as cash flow hedges, net of tax (Note 20)	1	1
Unrealized employee future benefits (losses) gains, net of tax (Notes 20 and 28)	(5)	7
	<b>201</b>	<b>24</b>
<b>Comprehensive income</b>	<b>\$ 591</b>	\$ 444
<b>Comprehensive income attributable to:</b>		
Non-controlling interests	\$ 11	\$ 10
Preference equity shareholders	62	57
Common equity shareholders	518	377
	<b>\$ 591</b>	<b>\$ 444</b>

See accompanying Notes to Consolidated Financial Statements

**Fortis Inc.**  
**Consolidated Statements of Cash Flows**  
**For the years ended December 31**  
(in millions of Canadian dollars)

	2014	2013
<b>Operating activities</b>		
Net earnings	\$ 390	\$ 420
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation - capital assets	597	475
Amortization - intangible assets	60	49
Amortization - other	31	17
Deferred income tax expense (recovery) (Note 25)	23	(6)
Accrued employee future benefits	25	17
Equity component of allowance for funds used during construction (Note 23)	(11)	(8)
Other	71	(34)
Change in long-term regulatory assets and liabilities	(80)	14
Change in non-cash operating working capital (Note 31)	(124)	(45)
	<b>982</b>	<b>899</b>
<b>Investing activities</b>		
Change in other assets and other liabilities	(4)	(8)
Capital expenditures - utility capital assets	(1,617)	(1,089)
Capital expenditures - non-utility capital assets	(39)	(46)
Capital expenditures - intangible assets	(69)	(40)
Contributions in aid of construction	69	54
Proceeds on disposal and settlement of assets (Notes 26 and 27)	109	20
Business acquisitions, net of cash acquired (Note 29)	(2,648)	(1,055)
	<b>(4,199)</b>	<b>(2,164)</b>
<b>Financing activities</b>		
Change in short-term borrowings	167	(6)
Proceeds from convertible debentures, net of issue costs (Note 17)	1,725	-
Proceeds from long-term debt, net of issue costs	1,193	653
Repayments of long-term debt and capital lease and finance obligations	(743)	(173)
Net borrowings under committed credit facilities	610	184
Advances from non-controlling interests	38	63
Issue of common shares, net of costs and dividends reinvested (Note 17)	51	596
Issue of preference shares, net of costs (Note 19)	586	242
Redemption of preference shares (Note 19)	-	(125)
Dividends		
Common shares, net of dividends reinvested	(194)	(181)
Preference shares	(62)	(56)
Subsidiary dividends paid to non-controlling interests	(10)	(11)
	<b>3,361</b>	<b>1,186</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>14</b>	<b>-</b>
<b>Change in cash and cash equivalents</b>	<b>158</b>	<b>(79)</b>
<b>Less cash at discontinued operations</b> (Note 26)	<b>-</b>	<b>(3)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>72</b>	<b>154</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 230</b>	<b>\$ 72</b>

Supplementary Information to Consolidated Statements of Cash Flows (Note 31)

See accompanying Notes to Consolidated Financial Statements

**Fortis Inc.**  
**Consolidated Statements of Changes in Equity**  
**For the years ended December 31, 2014 and 2013**  
(in millions of Canadian dollars)

	Common Shares	Preference Shares	Additional Paid-in Capital	Accumulated Other Comprehensive (Loss) Income	Retained Earnings	Non- Controlling Interests	Total Equity
	(Note 17)	(Note 19)		(Note 20)		(Note 21)	
<b>As at January 1, 2014</b>	<b>\$ 3,783</b>	<b>\$ 1,229</b>	<b>\$ 17</b>	<b>\$ (72)</b>	<b>\$ 1,044</b>	<b>\$ 375</b>	<b>\$ 6,376</b>
Net earnings	-	-	-	-	379	11	390
Other comprehensive income	-	-	-	201	-	-	201
Preference share issue	-	591	-	-	-	-	591
Common share issues	1,884	-	(5)	-	-	-	1,879
Stock-based compensation	-	-	3	-	-	-	3
Advances from non-controlling interests	-	-	-	-	-	38	38
Foreign currency translation impacts	-	-	-	-	-	7	7
Subsidiary dividends paid to non-controlling interests	-	-	-	-	-	(10)	(10)
Dividends declared on common shares (\$1.30 per share)	-	-	-	-	(301)	-	(301)
Dividends declared on preference shares	-	-	-	-	(62)	-	(62)
<b>As at December 31, 2014</b>	<b>\$ 5,667</b>	<b>\$ 1,820</b>	<b>\$ 15</b>	<b>\$ 129</b>	<b>\$ 1,060</b>	<b>\$ 421</b>	<b>\$ 9,112</b>
<b>As at January 1, 2013</b>	<b>\$ 3,121</b>	<b>\$ 1,108</b>	<b>\$ 15</b>	<b>\$ (96)</b>	<b>\$ 952</b>	<b>\$ 310</b>	<b>\$ 5,410</b>
Net earnings	-	-	-	-	410	10	420
Other comprehensive income	-	-	-	24	-	-	24
Preference share issue	-	244	-	-	-	-	244
Preference share redemption	-	(123)	-	-	-	-	(123)
Common share issues	662	-	(1)	-	-	-	661
Stock-based compensation	-	-	3	-	-	-	3
Advances from non-controlling interests	-	-	-	-	-	63	63
Foreign currency translation impacts	-	-	-	-	-	3	3
Subsidiary dividends paid to non-controlling interests	-	-	-	-	-	(11)	(11)
Dividends declared on common shares (\$1.25 per share)	-	-	-	-	(261)	-	(261)
Dividends declared on preference shares	-	-	-	-	(57)	-	(57)
<b>As at December 31, 2013</b>	<b>\$ 3,783</b>	<b>\$ 1,229</b>	<b>\$ 17</b>	<b>\$ (72)</b>	<b>\$ 1,044</b>	<b>\$ 375</b>	<b>\$ 6,376</b>

See accompanying Notes to Consolidated Financial Statements

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
For the years ended December 31, 2014 and 2013

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**1. DESCRIPTION OF THE BUSINESS**

**Nature of Operations**

Fortis Inc. ("Fortis" or the "Corporation") is principally an international electric and gas 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 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 with substantial autonomy, assumes profit and loss responsibility and is accountable for its own resource allocation.

The following summary describes the operations included in each of the Corporation's reportable segments.

**REGULATED UTILITIES**

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

**Regulated Electric & Gas Utilities - United States**

- a. *UNS Energy*: Primarily comprised of Tucson Electric Power Company ("TEP"), UNS Electric, Inc. ("UNS Electric") and UNS Gas, Inc. ("UNS Gas"), (collectively, the "UNS Utilities"), acquired by Fortis in August 2014 (Note 29).

TEP, UNS Energy's largest operating subsidiary, is a vertically integrated regulated electric utility. TEP generates, transmits and distributes electricity to retail customers in southeastern Arizona, including the greater Tucson metropolitan area in Pima County, as well as parts of Cochise County. TEP also sells wholesale electricity to other entities in the western United States.

UNS Electric is a vertically integrated regulated electric utility, which generates, transmits and distributes electricity to retail customers in Arizona's Mohave and Santa Cruz counties.

TEP and UNS Electric currently own or lease generation resources with an aggregate capacity of 2,746 megawatts ("MW"), including 53 MW of solar capacity. Several of the generating assets in which TEP and UNS Electric have an interest are jointly owned. As at January 1, 2015, approximately 48% of the generating capacity is fuelled by coal.

UNS Gas is a regulated gas distribution company. The Company serves retail customers in Arizona's Mohave, Yavapai, Coconino, Navajo and Santa Cruz counties.

- b. *Central Hudson*: Central Hudson Gas & Electric Corporation ("Central Hudson") is a regulated transmission and distribution ("T&D") utility, serving eight counties of New York State's Mid-Hudson River Valley. The Company owns minimal gas-fired and hydroelectric generating capacity totalling 64 MW. Central Hudson was acquired by Fortis in June 2013 (Note 29).

**Regulated Gas Utilities - Canadian**

*FortisBC Energy Companies*: Primarily includes FortisBC Energy Inc. ("FEI"), FortisBC Energy (Vancouver Island) Inc. ("FEVI") and FortisBC Energy (Whistler) Inc. ("FEWI"), (collectively, the "FortisBC Energy companies"). On December 31, 2014, FEI, FEVI and FEWI were amalgamated and FEI is the resulting Company.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2014 and 2013

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

**Regulated Gas Utilities – Canadian (cont'd)**

FEI is the largest distributor of natural gas in British Columbia, serving more than 125 communities. Major areas served by the Company are the Lower Mainland, Vancouver Island, Sunshine Coast, Whistler and Interior of British Columbia.

FEI provides T&D services to customers, and obtains natural gas supplies on behalf of most residential, commercial and industrial customers. Gas supplies are sourced primarily from northeastern British Columbia and, through FEI's Southern Crossing pipeline, from Alberta.

**Regulated Electric Utilities - Canadian**

- a. *FortisAlberta*: FortisAlberta Inc. ("FortisAlberta") owns and operates the electricity distribution system in a substantial portion of southern and central Alberta. The Company does not own or operate generation or transmission assets and is not involved in the direct sale of electricity.
- b. *FortisBC Electric*: Includes FortisBC Inc., an integrated electric utility operating in the southern interior of British Columbia. FortisBC Inc. owns four hydroelectric generating facilities with a combined capacity of 225 MW. Also included in the FortisBC Electric segment are the operating, maintenance and management services relating to the 493-MW Waneta hydroelectric generating facility owned by Teck Metals Ltd. and BC Hydro, the 149-MW Brilliant hydroelectric plant ("Brilliant Plant") and the 120-MW Brilliant hydroelectric expansion plant, both owned by Columbia Power Corporation and Columbia Basin Trust ("CPC/CBT"), and the 185-MW Arrow Lakes hydroelectric plant owned by CPC/CBT. In March 2013 FortisBC Inc. acquired the City of Kelowna's electric utility assets (Note 29).
- c. *Eastern Canadian*: Comprised of Newfoundland Power Inc. ("Newfoundland Power"), Maritime Electric Company, Limited ("Maritime Electric") and FortisOntario Inc. ("FortisOntario"). Newfoundland Power is an integrated electric utility and the principal distributor of electricity on the island portion of Newfoundland and Labrador. Newfoundland Power has an installed generating capacity of 139 MW, of which 97 MW is hydroelectric generation. Maritime Electric is an integrated electric utility and the principal distributor of electricity on Prince Edward Island ("PEI"). Maritime Electric also maintains on-Island generating facilities with a combined capacity of 150 MW. FortisOntario provides integrated electric utility service to customers in Fort Erie, Cornwall, Gananoque, Port Colborne and the District of Algoma in Ontario. FortisOntario's operations are primarily comprised of Canadian Niagara Power Inc. ("Canadian Niagara Power"), Cornwall Street Railway, Light and Power Company, Limited ("Cornwall Electric") and Algoma Power Inc. ("Algoma Power").

**Regulated Electric Utilities – Caribbean**

The Regulated Electric Utilities – Caribbean segment includes Caribbean Utilities Company, Ltd. ("Caribbean Utilities") and Fortis Turks and Caicos. Caribbean Utilities is an integrated electric utility and the sole provider of electricity on Grand Cayman, Cayman Islands. The Company has an installed diesel-powered generating capacity of 132 MW. Fortis holds an approximate 60% controlling ownership interest in Caribbean Utilities (December 31, 2013 - 60%). Caribbean Utilities is a public company traded on the Toronto Stock Exchange ("TSX") (TSX:CUP.U). Fortis Turks and Caicos is comprised of two integrated electric utilities that provide electricity to certain islands in Turks and Caicos. The utilities have a combined diesel-powered generating capacity of 76 MW.

**NON-REGULATED - FORTIS GENERATION**

Fortis Generation includes the financial results of non-regulated generation assets in Belize, British Columbia, Upstate New York and Ontario.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2014 and 2013

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

**NON-REGULATED - FORTIS GENERATION (cont'd)**

Generating assets in Belize are comprised of three hydroelectric generating facilities with a combined capacity of 51 MW. All of the output of these facilities is sold to Belize Electricity Limited ("Belize Electricity") under 50-year power purchase agreements ("PPAs") expiring in 2055 and 2060. The hydroelectric generation operations in Belize are conducted through the Corporation's indirectly wholly owned subsidiary Belize Electric Company Limited ("BECOL") under a franchise agreement with the Government of Belize ("GOB").

In British Columbia, generating assets include the 16-MW run-of-river Walden hydroelectric generating facility ("Walden") and the Corporation's 51% controlling ownership interest in the 335-MW Waneta Expansion hydroelectric generating facility ("Waneta Expansion"). All of the output of Walden is sold to BC Hydro under a long-term contract that cannot be terminated prior to 2024. Construction of the Waneta Expansion, which is adjacent to the Waneta Dam and powerhouse facilities on the Pend d'Oreille River, south of Trail, British Columbia, commenced late in 2010 and the facility is expected to come into service in spring 2015. The output of the Waneta Expansion will be sold to BC Hydro and FortisBC Electric under 40-year contracts. The Corporation's 51% controlling ownership interest in the Waneta Expansion is conducted through the Waneta Expansion Limited Partnership ("Waneta Partnership"), with CPC/CBT holding the remaining 49% interest.

Generating assets in Upstate New York are comprised of four hydroelectric generating facilities with a combined capacity of approximately 23 MW, operating under licences from the U.S. Federal Energy Regulatory Commission ("FERC"). Hydroelectric generation operations in Upstate New York are conducted through the Corporation's indirectly wholly owned subsidiary FortisUS Energy Corporation ("FortisUS Energy").

In Ontario, generating assets include six small hydroelectric generating facilities with a combined capacity of 8 MW and a 5-MW gas-powered cogeneration plant in Cornwall.

**NON-REGULATED - NON-UTILITY**

The Non-Utility segment includes Fortis Properties Corporation ("Fortis Properties") and, from June 2013 through March 2014, Griffith Energy Services, Inc. ("Griffith"). Fortis Properties owns and operates 23 hotels, comprised of more than 4,400 rooms, in eight Canadian provinces, and owns and operates approximately 2.8 million square feet of commercial office and retail space, primarily in Atlantic Canada. In September 2014 the Corporation announced that it would engage in a review of strategic options for its hotel and commercial real estate business. Strategic options may include, but are not limited to, a sale of all or a portion of the assets, a sale of shares of Fortis Properties or an initial public offering.

Griffith was acquired by Fortis as part of the acquisition of Central Hudson in June 2013 and was sold in March 2014 (Notes 26 and 29).

**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 net corporate expenses of Fortis and non-regulated holding company expenses of FortisBC Holdings Inc. ("FHI"), CH Energy Group, Inc. ("CH Energy Group") and UNS Energy Corporation. Net Corporate expenses include finance charges; dividends on preference shares; other corporate expenses, including corporate operating costs, net of recoveries from subsidiaries; acquisition-related expenses; interest and miscellaneous revenue; and related income taxes.

Also included in the Corporate and Other segment are the financial results of FortisBC Alternative Energy Services Inc. ("FAES"). FAES is a wholly owned subsidiary of FHI that provides alternative energy solutions, including thermal-energy and geo-exchange systems.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2014 and 2013

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**2. NATURE OF REGULATION**

The Corporation's regulated utilities are primarily determined under cost of service ("COS") regulation and, in certain circumstances, performance-based rate-setting ("PBR") mechanisms. Generally, under COS regulation the respective regulatory authority sets customer electricity and/or gas 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. When 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.

When future 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 (Note 7).

The nature of regulation at the Corporation's utilities is as follows.

*UNS Energy*

The UNS Utilities are regulated by the Arizona Corporation Commission ("ACC") regarding such matters as retail electric and gas rates, construction, operations, financing, accounting, transactions with affiliated parties and issuance of securities. Certain activities of the utilities are subject to regulation by FERC under the *Federal Power Act* (United States), including such matters as the terms and prices of transmission services and wholesale electricity sales.

The UNS Utilities operate under COS regulation as administered by the ACC. The ACC provides for the use of a historical test year in the establishment of retail electric and gas rates for the utilities. Retail electric and gas rates are set to provide the utilities with an opportunity to recover their costs of service and earn a reasonable rate of return on rate base, including an adjustment for the fair value of rate base as required under the laws of the State of Arizona.

TEP's allowed ROE is set at 10.0% on a capital structure of 43.5% common equity, effective from July 1, 2013. UNS Electric's allowed ROE is set at 9.50% on a capital structure of 52.6% common equity, effective from January 1, 2014. UNS Gas' allowed ROE is set at 9.75% on a capital structure of 50.8% common equity, effective from May 1, 2012.

*Central Hudson*

Central Hudson is regulated by the New York State Public Service Commission ("PSC") regarding such matters as rates, construction, operations, financing, accounting and issuance of securities. Certain activities of the Company are subject to regulation by FERC 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 with the use of a future test year in the establishment of rates for the utility.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

*Central Hudson (cont'd)*

Central Hudson's allowed ROE is set at 10.0% 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 was extended for two years, through June 30, 2015, as a condition required to close the acquisition (Note 29). Effective July 1, 2013, Central Hudson is also subject to an 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.

*FortisBC Energy Companies and FortisBC Electric*

The FortisBC Energy companies and FortisBC Electric are regulated by the British Columbia Utilities Commission ("BCUC"). The BCUC administers acts and regulations pursuant to the *Utilities Commission Act* (British Columbia), covering such matters as tariffs, rates, construction, operations, financing and accounting. FEI, FEVI, FEWI and FortisBC Electric primarily operate under COS regulation and, from time to time, PBR mechanisms for establishing customer rates.

In 2013 the BCUC issued its decision on the first stage of the Generic Cost of Capital ("GCOC") Proceeding in British Columbia. Effective January 1, 2013, the decision set the allowed ROE of the benchmark utility, FEI, at 8.75% with a 38.5% common equity component of capital structure. The common equity component of capital structure will remain in effect until December 31, 2015. Effective January 1, 2014 through December 31, 2015, the BCUC has also introduced an Automatic Adjustment Mechanism ("AAM") to set the allowed 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%. In January 2014 the BCUC confirmed that the necessary conditions for the AAM to be triggered for the 2014 allowed ROE have not been met; therefore, the benchmark allowed ROE remained at 8.75% for 2014. FEVI, FEWI and FortisBC Electric's allowed ROEs and common equity component of capital structures were determined in the second stage of the GCOC Proceeding. However, as a result of the decision on the first stage 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 common equity component of capital structures remained unchanged.

In March 2014 the BCUC issued its decision on the second stage of the GCOC Proceeding. Effective January 1, 2013, the decision set the common equity component of capital structure for FEVI and FEWI at 41.5%, and reaffirmed the common equity component of capital structure for FortisBC Electric at 40%. The BCUC reaffirmed for FEVI and FortisBC Electric a risk premium over the benchmark utility of 50 basis points and 40 basis points, respectively, and set FEWI's equity risk premium at 75 basis points, which represented an increase of 25 basis points. The resulting allowed ROEs, effective January 1, 2013, for FEVI, FEWI and FortisBC Electric are 9.25%, 9.50% and 9.15%, respectively. The cumulative impact of the outcome of the second stage of the GCOC Proceeding was recognized in 2014 and did not have a material impact on earnings.

In September 2014 the BCUC issued its decisions on FEI's and FortisBC Electric's Multi-Year PBR Plans for 2014 through 2018. As part of the PBR decisions, the terms were extended to 2019. The approved PBR Plans incorporate incentive mechanisms for improving operating and capital expenditure efficiencies. Operation and maintenance expenses and base capital expenditures during the PBR period are subject to an incentive formula reflecting incremental costs for inflation and half of customer growth, less a fixed productivity adjustment factor of 1.1% for FEI and 1.03% for FortisBC Electric each year. The approved PBR Plans also include a 50%/50% sharing of variances from the formula-driven operation and maintenance expenses and capital expenditures over the PBR period, and a number of service quality measures designed to ensure FEI and FortisBC Electric maintain service levels. It also sets out the requirements for an annual review process which will provide a forum for discussion between the utilities and interested parties regarding current performance and future activities.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

*FortisAlberta*

FortisAlberta is regulated by the Alberta Utilities Commission ("AUC") pursuant to the *Electric Utilities Act* (Alberta), the *Public Utilities Act* (Alberta), the *Hydro and Electric Energy Act* (Alberta) and the *Alberta Utilities Commission Act* (Alberta). The AUC administers these acts and regulations, covering such matters as tariffs, rates, construction, operations and financing.

Effective January 1, 2013, the AUC prescribed that distribution utilities in Alberta, including FortisAlberta, move to PBR for a five-year term. Under PBR, each year this formula is applied to the preceding year's distribution rates and for 2013 and 2014 the formula was applied to the 2012 distribution rates. For 2013 and 2014, an allowed ROE of 8.75% was established by the AUC on an interim basis on a deemed capital structure of 41% common equity, pending the outcome of a GCOC Proceeding in Alberta.

The PBR plan includes mechanisms for the recovery or settlement of items determined to flow through directly to customers ("Y factor") and the recovery of costs related to capital expenditures that are not being recovered through the inflationary factor of the formula ("K factor" or "capital tracker"). The AUC also approved a Z factor, a PBR re-opener and an ROE efficiency carry-over mechanism. The Z factor permits an application for recovery of costs related to significant unforeseen events. The PBR re-opener permits an application to re-open and review the PBR plan to address specific problems with the design or operation of the PBR plan. The use of the Z factor and PBR re-opener mechanisms is associated with certain thresholds. The ROE efficiency carry-over mechanism provides an efficiency incentive by permitting a utility to continue to benefit from any efficiency gains achieved during the PBR term for two years following the end of that term.

A hearing related to the GCOC Proceeding in Alberta concluded in June 2014, with supplemental submissions filed in November 2014. As a result of this proceeding, the AUC is expected to set the allowed ROE and capital structure for utilities in Alberta for 2013, 2014 and possibly 2015. The AUC will also consider re-establishing a formula-based approach to setting the allowed ROE going forward. A decision on this proceeding is expected from the AUC in the first quarter of 2015.

A hearing related to the combined capital tracker application for 2013 and 2014 was held in October 2014 with an AUC decision expected during the first quarter of 2015. FortisAlberta's 2013 and 2014 capital tracker revenue was based on a placeholder equal to 60% of the then applied for capital tracker amounts. Any adjustment to the 60% capital tracker placeholder for 2013 and 2014 will result in an adjustment to revenue. Such an adjustment would be recognized in the consolidated financial statements when the regulatory decision is received, or when sufficient information is available to reasonably estimate the required adjustment in accordance with US GAAP.

*Eastern Canadian Electric Utilities*

Newfoundland Power operates under COS regulation and is regulated by the Newfoundland and Labrador Board of Commissioners of Public Utilities ("PUB") under the *Public Utilities Act* (Newfoundland and Labrador). The *Public Utilities Act* (Newfoundland and Labrador) provides for the PUB's general supervision of the Company's utility operations and requires the PUB to approve, among other things, customer rates, capital expenditures and the issuance of securities of Newfoundland Power. Newfoundland Power uses a future test year in the establishment of rates. The PUB has set the allowed ROE at 8.8% and the common equity component of capital structure at 45% for 2013 and 2014.

Maritime Electric operates under COS regulation as prescribed by the Island Regulatory and Appeals Commission ("IRAC") under the provisions of the *Electric Power Act* (PEI), the *Renewable Energy Act* (PEI), the *Electric Power (Electricity Rate-Reduction) Amendment Act* (PEI), which covers the period March 1, 2011 to February 28, 2013, and the *Electric Power (Energy Accord Continuation) Amendment Act* (PEI) ("Accord Continuation Act"), which covers the period March 1, 2013 to February 29, 2016. IRAC uses a future test year for the establishment of rates for the utility. Maritime Electric's allowed ROE was set at 9.75% on a targeted minimum capital structure of 40% common equity for 2013 and 2014.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2014 and 2013

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

*Eastern Canadian Electric Utilities (cont'd)*

At FortisOntario, Canadian Niagara Power, Algoma Power and Cornwall Electric operate under the *Electricity Act* (Ontario) and the *Ontario Energy Board Act* (Ontario), as administered by the Ontario Energy Board ("OEB"). Canadian Niagara Power and Algoma Power operate under COS regulation and earnings are regulated on the basis of rate of return on rate base, plus a recovery of allowable distribution costs. In non-rebasing years, customer electricity distribution rates are set using inflationary factors less an efficiency target under the Fourth-Generation Incentive Regulation Mechanism as prescribed by the OEB. Algoma Power is also subject to the use and implementation of the Rural and Remote Rate Protection ("RRRP") Program. The RRRP Program is calculated as the deficiency between the approved revenue requirement from the OEB and current customer electricity distribution rates, adjusted for the average rate increase across the province of Ontario. Canadian Niagara Power and Algoma Power use a future test year in the establishment of rates. Canadian Niagara Power's allowed ROE was set at 8.93% on a deemed capital structure of 40% common equity for 2013 and 2014. Algoma Power's allowed ROE was set at 9.85% on a deemed capital structure of 40% common equity for 2013 and 2014.

Cornwall Electric is subject to a rate-setting mechanism under a 35-year Franchise Agreement with the City of Cornwall expiring in 2033 and, therefore, is exempt from many aspects of the above Acts. The rate-setting mechanism is based on a price cap with commodity cost flow through. The base revenue requirement is adjusted annually for inflation, load growth, customer growth and premises vacancies.

*Regulated Electric Utilities - Caribbean*

Caribbean Utilities operates under T&D and generation licences from the Government of the Cayman Islands. The exclusive T&D licence is for an initial period of 20 years, expiring April 2028, with a provision for automatic renewal. As a result of a successful generation bid for new generation capacity, in November 2014 a new non-exclusive generation licence was issued for a term of 25 years, expiring in November 2039. The licences detail the role of the Electricity Regulatory Authority, which oversees all licences, establishes and enforces licence standards, reviews the rate-cap adjustment mechanism ("RCAM"), and annually approves capital expenditures. The licences contain the provision for an RCAM based on published consumer price indices. Caribbean Utilities' targeted allowed ROA for 2014 was in the range of 7.00% to 9.00%, as compared to a range of 6.50% to 8.50% for 2013.

Fortis Turks and Caicos operates under two 50-year licences expiring in 2037 and 2036. Among other matters, the licences describe how electricity rates are set by the Government of the Turks and Caicos Islands, using a historical test year, in order to provide the utilities with an allowed ROA of between 15.0% and 17.50% (the "Allowable Operating Profit"), based on a calculated rate base and including interest on the amounts by which actual operating profits fall short of the Allowable Operating Profits on a cumulative basis (the "Cumulative Shortfall"). Annual submissions are made to the Government of the Turks and Caicos Islands calculating the amount of the Allowable Operating Profit and the Cumulative Shortfall. The submissions for 2014 calculated the Allowable Operating Profit for 2014 to be \$42 million (US\$38 million) and the Cumulative Shortfall as at December 31, 2014 to be \$190 million (US\$164 million). The recovery of the Cumulative Shortfall is, however, dependent on future sales volumes and expenses. The achieved ROAs at the utilities have been significantly lower than those allowed under the 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.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
For the years ended December 31, 2014 and 2013

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

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“US GAAP”), which for regulated utilities include specific accounting guidance for regulated operations, as outlined in Note 2 and the following summary of significant accounting policies.

All amounts presented are in Canadian dollars unless otherwise stated.

#### **Basis of Presentation**

The consolidated financial statements reflect the Corporation's investments in its subsidiaries on a consolidated basis, with the equity method used for entities in which Fortis has significant influence, but not control, and proportionate consolidation for generation and transmission assets that are jointly owned with non-affiliated entities. All material intercompany transactions have been eliminated in the consolidated financial statements.

An evaluation of subsequent events through to February 18, 2015, the date these consolidated financial statements were approved by the Board of Directors of Fortis (“Board of Directors”), was completed to determine whether the circumstances warranted recognition and disclosure of events or transactions in the consolidated financial statements as at December 31, 2014.

#### **Cash and Cash Equivalents**

Cash and cash equivalents include cash and short-term deposits with initial maturities of three months or less from the date of deposit.

#### **Allowance for Doubtful Accounts**

The allowance for doubtful accounts reflects management's best estimate of uncollectible accounts receivable balances. Fortis and each of its subsidiaries maintain an allowance for doubtful accounts that is estimated based on a variety of factors including accounts receivable aging, historical experience and other currently available information, including events such as customer bankruptcy and economic conditions. Interest is charged on accounts receivable balances that have been outstanding for more than 21 to 30 days. Accounts receivable are charged-off in the period in which the receivable is deemed uncollectible.

#### **Regulatory Assets and Liabilities**

Regulatory assets and liabilities arise as a result of the rate-setting process at the Corporation's regulated utilities. Regulatory assets represent future revenues and/or receivables associated with certain costs incurred that will be, or are expected to be, recovered from customers in future periods through the rate-setting process. Regulatory liabilities represent future reductions or limitations of increases in revenue associated with amounts that will be, or are expected to be, refunded to customers through the rate-setting process.

All amounts deferred as regulatory assets and liabilities are subject to regulatory approval. As such, the regulatory authorities could alter the amounts subject to deferral, at which time the change would be reflected in the consolidated financial statements. Certain remaining recovery and settlement periods are those expected by management and the actual recovery or settlement periods could differ based on regulatory approval.

#### **Inventories**

Inventories, consisting of materials and supplies, gas and fuel in storage and coal, are measured at the lower of average cost and market value.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
For the years ended December 31, 2014 and 2013

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

**Utility Capital Assets**

Utility capital assets are recorded at cost less accumulated depreciation. Contributions in aid of construction represent amounts contributed by customers and governments for the cost of utility capital assets. These contributions are recorded as a reduction in the cost of utility capital assets and are being amortized annually by an amount equal to the charge for depreciation provided on the related assets.

Each of UNS Energy, Central Hudson, the FortisBC Energy companies, FortisAlberta, Newfoundland Power and Maritime Electric accrue estimated non-ARO removal costs in depreciation, as required by their respective regulator, with the amount provided for in depreciation recorded as a long-term regulatory liability (Note 7 (xvii)). Actual non-ARO removal costs, net of salvage proceeds, are recorded against the regulatory liability when incurred. During 2014 non-ARO removal costs of \$88 million (2013 - \$73 million) were accrued by the above-noted utilities as part of depreciation and actual non-ARO removal costs of \$16 million (2013 - \$14 million), net of salvage proceeds, were incurred and recognized against the long-term regulatory liability (Note 7 (xvii)).

As permitted by the regulator, FortisBC Electric records actual non-ARO removal costs, net of salvage proceeds, against accumulated depreciation as incurred. During 2014 actual non-ARO removal costs of approximately \$8 million (2013 - \$1 million), net of salvage proceeds of less than \$1 million (2013 - less than \$1 million), were incurred at FortisBC Electric.

FortisOntario and Fortis Turks and Caicos recognize non-ARO removal costs, net of salvage proceeds, in earnings in the period incurred. Caribbean Utilities recognizes non-ARO removal costs in utility capital assets.

Utility capital assets are derecognized on disposal or when no future economic benefits are expected from their use. Upon retirement or disposal of utility capital assets, any difference between the cost and accumulated depreciation of the asset, net of salvage proceeds, is charged to accumulated depreciation by UNS Energy, Central Hudson, FortisAlberta, FortisBC Electric, Newfoundland Power, Maritime Electric, Caribbean Utilities and the FortisBC Energy companies effective January 1, 2014, as required by their respective regulator, with no gain or loss, if any, recognized in earnings. It is expected that any gains or losses charged to accumulated depreciation will be reflected in future depreciation expense when they are refunded or collected in customer electricity and gas rates. Prior to January 1, 2014, the FortisBC Energy companies recorded any remaining net book value, net of salvage proceeds, upon retirement or disposal of utility capital assets in a regulatory deferral account for recovery from customers in future rates, subject to regulatory approval (Note 7 (ix)).

At FortisOntario and Fortis Turks and Caicos, the regulators require that any remaining net book value, net of salvage proceeds, upon retirement or disposal of utility capital assets be recognized immediately in earnings.

As required by their respective regulator, UNS Energy, Central Hudson, the FortisBC Energy companies, FortisBC Electric, Newfoundland Power, Maritime Electric, Caribbean Utilities and Fortis Turks and Caicos, capitalize overhead costs that are not directly attributable to specific utility capital assets but relate to the overall capital expenditure program. The methodology for calculating and allocating capitalized general overhead costs to utility capital assets is established by the respective regulator.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**Utility Capital Assets (cont'd)**

As required by their respective regulator, UNS Energy, Central Hudson, the FortisBC Energy companies, FortisAlberta, FortisBC Electric, Newfoundland Power, Maritime Electric and Caribbean Utilities include in the cost of utility capital assets both a debt and an equity component in the allowance for funds used during construction ("AFUDC"). The debt component of AFUDC is reported as a reduction of finance charges (Note 24) and the equity component of AFUDC is reported as other income (Note 23). Both components of AFUDC are charged to earnings through depreciation expense over the estimated service lives of the applicable utility capital assets. AFUDC is calculated in a manner as prescribed by the respective regulator.

At FortisAlberta, the cost of utility capital assets also includes Alberta Electric System Operator ("AESO") contributions, which are investments required by FortisAlberta to partially fund the construction of transmission facilities.

As approved by the regulator, FEVI has reduced the amounts reported for utility capital assets by the amount of government loans received in connection with the construction and operation of the Vancouver Island natural gas pipeline. As the loans are repaid and replaced with non-government loans, FEVI increases both utility capital assets and long-term debt (Note 14).

Utility capital assets include inventories held for the development, construction and betterment of other utility capital assets, with the exception of UNS Energy. As required by its regulator, UNS Energy recognizes inventories held for the development and construction of other utility capital assets in inventories until consumed. When put into service, the inventories are reclassified to utility capital assets (Note 6).

Maintenance and repairs of utility capital assets are charged to earnings in the period incurred, while replacements and betterments which extend the useful lives are capitalized.

Utility capital assets are depreciated using the straight-line method based on the estimated service lives of the utility capital assets. Depreciation rates for 2014 ranged from 1.3% to 43.2% (2013 - 1.3% to 43.2%). The weighted average composite rate of depreciation, before reduction for amortization of contributions in aid of construction, for 2014 was 3.2% (2013 - 3.3%).

The service life ranges and weighted average remaining service life of the Corporation's distribution, transmission, generation and other assets as at December 31 were as follows:

<i>(Years)</i>	2014		2013	
	Service Life Ranges	Weighted Average Remaining Service Life	Service Life Ranges	Weighted Average Remaining Service Life
Distribution				
Electric	5-80	28	5-80	31
Gas	4-85	39	7-85	39
Transmission				
Electric	20-70	27	20-70	31
Gas	4-71	38	8-70	38
Generation	4-75	24	4-75	30
Other	3-70	8	3-70	8

**FORTIS INC.**  
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**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

**Non-Utility Capital Assets**

Non-utility capital assets, which include office buildings, shopping malls, hotels, land, construction in progress, and related equipment and tenant inducements, are recorded at cost less accumulated depreciation, where applicable. Buildings are depreciated using the straight-line method over an estimated useful life of 60 years. Tenant inducements are depreciated over the initial terms of the leases to which they relate, except where a write-down is required to reflect permanent impairment. The lease terms vary to a maximum of 20 years. Equipment is depreciated on a straight-line basis over a range of 2 to 25 years.

Maintenance and repairs are charged to earnings in the period incurred, while replacements and betterments which extend the useful lives are capitalized.

**Leases**

Leases that transfer to the Corporation substantially all of the risks and benefits incidental to ownership of the leased item are capitalized at the present value of the minimum lease payments. Included as capital leases are any arrangements that qualify as leases by conveying the right to use a specific asset.

Capital leases are depreciated over the lease term, except where ownership of the asset is transferred at the end of the lease term, in which case capital leases are depreciated over the estimated service life of the underlying asset. Where the regulator has approved recovery of the arrangements as operating leases for rate-setting purposes that would otherwise qualify as capital leases for financial reporting purposes, the timing of the expense recognition related to the lease is modified to conform with the rate-setting process.

Operating lease payments are recognized as an expense in earnings on a straight-line basis over the lease term.

**Intangible Assets**

Intangible assets are recorded at cost less accumulated amortization. The cost of intangible assets at the Corporation's regulated subsidiaries includes amounts for AFUDC and allocated overhead, where permitted by the respective regulators. Costs incurred to renew or extend the term of an intangible asset are capitalized and amortized over the new term of the intangible asset. Intangible assets are comprised of computer software costs; land, transmission and water rights; and franchise fees.

The useful lives of intangible assets are assessed to be either indefinite or finite. Intangible assets with indefinite useful lives are tested for impairment annually, either individually or at the operating unit level, if they are held in a regulated utility. Such intangible assets are not amortized. Indefinite-lived intangible assets, not subject to amortization, consist of certain land, transmission and water rights at the FortisBC Energy companies and FortisBC Electric. An intangible asset with an indefinite useful life is reviewed annually to determine whether the indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

In testing indefinite-lived intangible assets for impairment, the Corporation has the option, on an annual basis, of performing a qualitative assessment before calculating fair value. If the qualitative factors indicate that fair value is 50% or more likely to be greater than the carrying value, calculation of fair value would not be required.

**FORTIS INC.**  
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**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

**Intangible Assets (cont'd)**

Impairment testing for indefinite-lived intangible assets is carried out at the operating unit level at the regulated utilities. A fair rate of return on the indefinite-lived intangible assets is provided through customer electricity and gas rates, as approved by the respective regulatory authority. The net cash flows for regulated enterprises are not asset-specific but are pooled for the entire regulated utility.

Fortis performs the annual impairment test as at October 1. In addition, the Corporation also performs an impairment test if any event occurs or if circumstances change that would indicate that the fair value of the indefinite-lived intangible assets is below its carrying value. No such event or change in circumstances occurred during 2014 or 2013 and there were no impairment provisions required in either year. For its annual testing of impairment for indefinite-lived intangible assets, Fortis uses the approach for the annual testing for goodwill impairment as disclosed in this Note under "Goodwill".

Intangible assets with finite lives are amortized using the straight-line method based on the estimated service lives of the assets and are assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortization rates for regulated intangible assets are approved by the respective regulator.

Amortization rates for 2014 ranged from 1.0% to 43.0% (2013 – 1.6% to 51.0%). The service life ranges and weighted average remaining service life of finite-life intangible assets as at December 31 were as follows:

<i>(Years)</i>	2014		2013	
	Service Life Ranges	Weighted Average Remaining Service Life	Service Life Ranges	Weighted Average Remaining Service Life
Computer software	3-10	4	5-10	5
Land, transmission and water rights	30-75	32	31-75	38
Franchise fees and other	10-100	19	10-100	25

Intangible assets are derecognized on disposal or when no future economic benefits are expected from their use. Upon retirement or disposal of intangible assets, any difference between the cost and accumulated amortization of the asset, net of salvage proceeds, is charged to accumulated amortization by UNS Energy, Central Hudson, FortisAlberta, FortisBC Electric, Newfoundland Power, Maritime Electric, Caribbean Utilities and the FortisBC Energy companies, effective January 1, 2014, as required by their respective regulator, with no gain or loss, if any, recognized in earnings. It is expected that any gains or losses charged to accumulated amortization will be reflected in future amortization costs when they are refunded or collected in customer electricity and gas rates. Prior to January 1, 2014, the FortisBC Energy companies recorded any remaining net book value, net of salvage proceeds, upon retirement or disposal of intangible assets in a regulatory deferral account for recovery from customers in future rates, subject to regulatory approval (Note 7 (ix)).

At FortisOntario and Fortis Turks and Caicos, the regulators require that any remaining net book value, net of salvage proceeds, upon retirement or disposal of intangible assets be recognized immediately in earnings.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

**Impairment of Long-Lived Assets**

The Corporation reviews the valuation of utility and non-utility capital assets, intangible assets with finite lives and other long-term assets when events or changes in circumstances indicate that the assets' carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. An impairment loss, calculated as the difference between the assets' carrying value and their fair value, which is determined using present value techniques, is recognized in earnings in the period in which it is identified. There was no impact on the consolidated financial statements as a result of asset impairments for the years ended December 31, 2014 and 2013.

The process for asset-impairment testing differs for non-regulated generation assets compared to regulated utility assets. Since each non-regulated generating facility provides an individual cash flow stream, such an asset is tested individually and impairment is recorded if the future net cash flows are no longer sufficient to recover the carrying value of the generating facility.

Asset-impairment testing at the regulated utilities is carried out at the enterprise level to determine if assets are impaired. The recovery of regulated assets' carrying value, including a fair rate of return, is provided through customer electricity and gas rates approved by the respective regulatory authority. The net cash flows for regulated enterprises are not asset-specific but are pooled for the entire regulated utility.

**Goodwill**

Goodwill represents the excess, at the dates of acquisition, of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired and liabilities assumed relating to business acquisitions. Goodwill is carried at initial cost less any write-down for impairment.

Fortis performs an annual internal quantitative assessment for each operating unit. For those operating units where: (i) management's assessment of quantitative and qualitative factors indicates that fair value is not 50% or more likely to be greater than carrying value; or (ii) where the excess of estimated fair value over carrying value, as determined by an independent external consultant as of the date of the immediately preceding impairment test, was not significant, then fair value of the operating unit will be estimated by an independent external consultant in the current year. Irrespective of the above-noted approach, an operating unit to which goodwill has been allocated may have its fair value estimated by an independent external consultant as at the annual impairment date, as Fortis will, at a minimum, have fair value for each operating unit estimated by an independent external consultant once every three years.

Fortis performs the annual impairment test as at October 1. In addition, the Corporation also performs an impairment test if any event occurs or if circumstances change that would indicate that the fair value of an operating unit is below its carrying value. No such event or change in circumstances occurred during 2014 or 2013 and no impairment provisions were required in either year.

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

**Goodwill (cont'd)**

In calculating goodwill impairment, Fortis determines those operating units that will have fair value estimated by an independent external consultant, as described above, and such estimated fair value is then compared to the book value of the applicable operating units. If the fair value of the operating unit is less than the book value, then a second measurement step is performed to determine the amount of the impairment. The amount of the impairment is determined by deducting the fair value of the operating unit's assets and liabilities from the fair value of the operating unit to determine the implied fair value of goodwill, and then comparing that amount to the book value of the operating unit's goodwill. Any excess of the book value of the goodwill over the implied fair value is the impairment amount recognized.

The primary method for estimating fair value of the operating units is the income approach, whereby net cash flow projections for the operating units are discounted using an enterprise value approach. Under the enterprise value approach, sustainable cash flow is determined on an after-tax basis, prior to the deduction of interest expense, and is then discounted at the weighted average cost of capital to yield the value of the enterprise. An enterprise value approach does not assess the appropriateness of the operating unit's existing debt level. The estimated fair value of the operating unit is then determined by subtracting the fair value of the operating unit's interest-bearing debt from the enterprise value of the operating unit. A secondary valuation method, the market approach, is also performed by an independent external consultant as a check on the conclusions reached under the income approach. The market approach includes comparing various valuation multiples underlying the discounted cash flow analysis of the applicable operating units to trading multiples of guideline entities and recent transactions involving guideline entities, recognizing differences in growth expectations, product mix and risks of those guideline entities with the applicable operating units.

**Employee Future Benefits**

*Defined Benefit and Defined Contribution Pension Plans*

The Corporation and its subsidiaries each maintain one or a combination of defined benefit pension plans, including retirement allowances and supplemental retirement plans for certain executive employees, and defined contribution pension plans, including group Registered Retirement Savings Plans and group 401(k) plans for employees. The projected benefit obligation and the value of pension cost associated with the defined benefit pension plans are actuarially determined using the projected benefits method prorated on service and management's best estimate of expected plan investment performance, salary escalation and expected retirement ages of employees. Discount rates reflect market interest rates on high-quality bonds with cash flows that match the timing and amount of expected pension payments.

With the exception of the FortisBC Energy companies and Newfoundland Power, pension plan assets are valued at fair value for the purpose of determining pension cost. At the FortisBC Energy companies and Newfoundland Power, pension plan assets are valued using the market-related value for the purpose of determining pension cost, where investment returns in excess of, or below, expected returns are recognized in the asset value over a period of three years.

The excess of any cumulative net actuarial gain or loss over 10% of the greater of the projected benefit obligation and the fair value of plan assets (the market-related value of plan assets at the FortisBC Energy companies and Newfoundland Power) at the beginning of the fiscal year, along with unamortized past service costs, are deferred and amortized over the average remaining service period of active employees.

The net funded or unfunded status of defined benefit pension plans, measured as the difference between the fair value of the plan assets and the projected benefit obligation, is recognized on the Corporation's consolidated balance sheet.

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

**Employee Future Benefits (cont'd)**

As approved by the regulator, the cost of defined benefit pension plans at FortisAlberta is recovered in customer rates based on the cash payments made.

Any difference between pension cost recognized under US GAAP and that recovered from customers in current rates for defined benefit pension plans, which is expected to be recovered from, or refunded to, customers in future rates, is subject to deferral account treatment (Note 7 (ii)).

At UNS Energy, Central Hudson, the FortisBC Energy companies, FortisAlberta, FortisBC Electric, Newfoundland Power, Maritime Electric and FortisOntario, any unamortized balances related to net actuarial gains and losses, past service costs and transitional obligations associated with defined benefit pension plans, which would otherwise be recognized in accumulated other comprehensive income, are subject to deferral account treatment (Note 7 (ii)). At Fortis, FHI and Caribbean Utilities, any unamortized balances related to net actuarial gains and losses, past service costs and transitional obligations associated with defined benefit pension plans are recognized in accumulated other comprehensive income.

The costs of the defined contribution pension plans are expensed as incurred.

*Other Post-Employment Benefits Plans*

UNS Energy, the FortisBC Energy companies, Central Hudson, FortisAlberta, FortisBC Electric, Newfoundland Power, Maritime Electric, FortisOntario and the Corporation also offer other post-employment benefits ("OPEB") plans, including certain health and dental coverage and life insurance benefits, for qualifying members. The accumulated benefit obligation and the cost associated with OPEB plans are actuarially determined using the projected benefits method prorated on service and management's best estimate of expected plan performance, salary escalation, expected retirement ages of employees and health care costs. Discount rates reflect market interest rates on high-quality bonds with cash flows that match the timing and amount of expected OPEB payments.

The excess of any cumulative net actuarial gain or loss over 10% of the accumulated benefit obligation and the fair value of plan assets at the beginning of the fiscal year, along with unamortized past service costs, are deferred and amortized over the average remaining service period of active employees.

The net funded or unfunded status of OPEB plans, measured as the difference between the fair value of the plan assets and the benefit obligation, is recognized on the Corporation's consolidated balance sheet.

As approved by the regulator, the cost of OPEB plans at FortisAlberta is recovered in customer rates based on the cash payments made.

With the exception of FortisAlberta, as discussed below, any difference between the cost of OPEB plans recognized under US GAAP and that recovered from customers in current rates, which is expected to be recovered from, or refunded to, customers in future rates, is subject to deferral account treatment (Note 7 (ii)).

At FortisAlberta, the difference between the cost of OPEB plans recognized under US GAAP and that recovered from customers in current rates does not meet the criteria for deferral account treatment and, therefore, FortisAlberta recognizes in earnings the cost associated with its OPEB plan as actuarially determined, rather than as approved by the regulator. Unamortized OPEB plan balances at FortisAlberta related to net actuarial gains and losses and past service costs are recognized as a component of other comprehensive income.

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

**Stock-Based Compensation**

The Corporation records compensation expense related to stock options granted under its 2002 Stock Option Plan ("2002 Plan"), 2006 Stock Option Plan ("2006 Plan") and 2012 Stock Option Plan ("2012 Plan") (Note 22). Compensation expense is measured at the date of grant using the Black-Scholes fair value option-pricing model and each grant is amortized as a single award evenly over the four-year vesting period of the options granted. The offsetting entry is an increase to additional paid-in capital for an amount equal to the annual compensation expense related to the issuance of stock options. Upon exercise, the proceeds of the options are credited to capital stock at the option prices and the fair value of the options, as previously recognized, is reclassified from additional paid-in capital to capital stock. An exercise of options below the current market price of the Corporation's common shares has a dilutive effect on the Corporation's consolidated capital stock and shareholders' equity. Fortis satisfies stock option exercises by issuing common shares from treasury.

The Corporation also records the liabilities associated with its Directors' Deferred Share Unit ("DSU") and Performance Share Unit ("PSU") Plans at fair value at each reporting date until settlement, recognizing compensation expense over the vesting period on a straight-line basis. The fair value of the DSU and PSU liabilities is based on the Corporation's common share closing price at the end of each reporting period. The closing share price of the Corporation's common shares as at December 31, 2014 was \$38.96 (December 31, 2013 - \$30.45). The fair value of the PSU liability is also based on expected payout based on historical performance in accordance with defined metrics of each grant, where applicable, and management's best estimate.

**Foreign Currency Translation**

The assets and liabilities of the Corporation's foreign operations, UNS Energy, Central Hudson, Caribbean Utilities, Fortis Turks and Caicos, BECOL and FortisUS Energy, all of which have a US dollar functional currency, are translated at the exchange rate in effect as at the balance sheet date. The exchange rate in effect as at December 31, 2014 was US\$1.00=CDN\$1.16 (December 31, 2013 - US\$1.00=CDN\$1.06). The resulting unrealized translation gains and losses are excluded from the determination of earnings and are recognized in accumulated other comprehensive income until the foreign subsidiary is sold, substantially liquidated or evaluated for impairment in anticipation of disposal. Revenue and expenses of the Corporation's foreign operations are translated at the average exchange rate in effect during the reporting period.

Foreign exchange translation gains and losses on foreign currency-denominated long-term debt that is designated as an effective hedge of foreign net investments are accumulated as a separate component of shareholders' equity within accumulated other comprehensive income and the current period change is recorded in other comprehensive income.

Effective June 20, 2011, as a result of the expropriation of Belize Electricity by the GOB, the Corporation's asset associated with its previous investment in Belize Electricity (Notes 8, 33 and 35) 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.

Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate prevailing at the balance sheet date. Revenue and expenses denominated in foreign currencies are translated at the exchange rate prevailing at the transaction date. Gains and losses on translation are recognized in earnings.

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

**Derivative Instruments and Hedging Activities**

The Corporation and its subsidiaries use various physical and financial derivative instruments to meet forecast load and reserve requirements, to reduce exposure to fluctuations in commodity prices and foreign exchange rates, and to hedge interest rate risk exposure. The Corporation does not hold or issue derivative instruments for trading purposes and generally limits the use of derivative instruments to those that qualify as accounting, economic or cash flow hedges. As at December 31, 2014, the Corporation's derivative instruments primarily consisted of electricity swap contracts, gas swap and option contracts, electricity power purchase contracts and gas purchase contract premiums (Note 32).

All derivative instruments that do not meet the normal purchase or normal sale scope exception are recognized as assets or liabilities on the consolidated balance sheet and are measured at fair value. Changes in fair value are recognized in earnings unless the instruments qualify, and are designated, as an accounting or economic hedge.

As at December 31, 2014, the Corporation's hedging relationships primarily consisted of electricity swap contracts, gas swap option contracts, gas purchase contract premiums and US dollar-denominated borrowings.

UNS Energy, Central Hudson and the FortisBC Energy companies use derivative instruments to reduce energy price risk and are permitted by their respective regulators to record unrealized gains and losses on these derivative instruments as either a regulatory asset or regulatory liability, subject to regulatory approval.

UNS Energy hedges cash flow risk associated with variable interest rates and long-term power supply agreements. The effective portion of the change in fair value of cash flow hedges is recorded in accumulated other comprehensive income and the ineffective portion, if any, is recognized in earnings. When a hedging instrument is no longer effective in offsetting the changes in cash flow of a hedged item, the change in fair value is recognized in earnings. The unrealized gains and losses to that point remain in accumulated other comprehensive income and are reclassified into earnings as the underlying hedged transaction occurs.

Derivative instruments that meet the normal purchase or normal sale scope exemption are not measured at fair value and are accounted for on an accrual basis. Derivative contracts under master netting agreements and collateral positions are presented on a gross basis. The Corporation is required to bifurcate embedded derivatives from their host instruments and account for them as free-standing derivative instruments if they meet specified criteria.

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 decreased a portion of the above-noted exposure through the use of US dollar-denominated borrowings at the corporate level. The Corporation has designated its corporately issued US dollar long-term debt as a hedge of a portion of the foreign exchange risk related to its net investments in foreign subsidiaries. Foreign currency exchange rate fluctuations associated with the translation of the Corporation's corporately issued US dollar-denominated borrowings designated as hedges are recognized in other comprehensive income and help offset unrealized foreign currency exchange gains and losses on the foreign net investments, which gains and losses are also recognized in other comprehensive income.

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

**Income Taxes**

The Corporation and its subsidiaries follow the asset and liability method of accounting for income taxes. Under this method, deferred income tax assets and liabilities are recognized for temporary differences between the tax and accounting basis of assets and liabilities, as well as for the benefit of losses available to be carried forward to future years for tax purposes that are more likely than not to be realized. Valuation allowances are recognized against deferred tax assets when it is more likely than not that a portion of, or the entire amount of, the deferred income tax asset will not be realized. Deferred income tax assets and liabilities are measured using enacted income tax rates and laws in effect when the temporary differences are expected to be recovered or settled. The effect of a change in income tax rates on deferred income tax assets and liabilities is recognized in earnings in the period that the change occurs. Current income tax expense or recovery is recognized for the estimated income taxes payable or receivable in the current year.

As approved by the respective regulator, the FortisBC Energy companies, FortisAlberta, and FortisBC Electric recover income tax expense in customer rates based only on income taxes that are currently payable. Newfoundland Power and FortisOntario recover income tax expense in customer rates based only on income taxes that are currently payable, except for certain regulatory balances for which deferred income tax expense is recovered from, or refunded to, customers in current rates, as prescribed by the respective regulator. Therefore, with the exception of certain deferred tax balances of Newfoundland Power and FortisOntario, current customer rates do not include the recovery of deferred income taxes related to temporary differences between the tax basis of assets and liabilities and their carrying amounts for regulatory purposes, as these taxes are expected to be collected in customer rates when they become payable. These utilities recognize an offsetting regulatory asset or liability for the amount of deferred income taxes that are expected to be collected from or refunded to customers in rates once income taxes become payable or receivable (Note 7 (i)).

As approved by the respective regulator, UNS Energy, Central Hudson, and Maritime Electric recover current and deferred income tax expense in customer rates.

For regulatory reporting purposes, the capital cost allowance pool for certain utility capital assets at FortisAlberta is different from that for legal entity corporate income tax filing purposes. In a future reporting period, yet to be determined, the difference may result in higher income tax expense than that recognized for regulatory rate-setting purposes and collected in customer rates.

Caribbean Utilities and Fortis Turks and Caicos are not subject to income tax as they operate in tax-free jurisdictions. BECOL is not subject to income tax as it was granted tax-exempt status by the GOB for the terms of its 50-year PPAs.

Any difference between the income tax expense recognized under US GAAP and that recovered from customers in current rates that is expected to be recovered from customers in future rates, is subject to deferral account treatment (Note 7 (i)).

The Corporation intends to indefinitely reinvest earnings from certain foreign operations. Accordingly, the Corporation does not provide for deferred income taxes on temporary differences related to investments in foreign subsidiaries. As at December 31, 2014, temporary differences related to investments in foreign subsidiaries were approximately \$384 million (December 31, 2013 - \$334 million). It is impractical to estimate the amount of income tax that might be payable if a reversal of temporary differences occurred. Canada has entered into Tax Information Exchange Agreements ("TIEAs") with Bermuda, the Cayman Islands and the Turks and Caicos Islands. Consequently, earnings from the Corporation's foreign subsidiaries operating in these regions, subsequent to 2010, can be repatriated to Canada on a tax-free basis and, therefore, are not included in the amount of temporary differences noted above, as no taxes are payable on these earnings. When a TIEA is entered into with Belize, earnings from the Corporation's operations in Belize can also be repatriated to Canada on a tax-free basis. Negotiations between the Government of Canada and the GOB commenced in June 2010.

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

**Income Taxes (cont'd)**

Tax benefits associated with income tax positions taken, or expected to be taken, in an income tax return are recognized only when the more likely than not recognition threshold is met. The tax benefits are measured at the largest amount of benefit that is greater than 50% likely to be realized upon settlement. The difference between a tax position taken, or expected to be taken, and the benefit recognized and measured pursuant to this guidance represents an unrecognized tax benefit.

For the Corporation's subsidiaries in the United States, consolidated income tax liabilities are allocated to subsidiaries based on their taxable income as reported in their consolidated income tax return.

Income tax interest and penalties are expensed as incurred and included in income tax expense. At FortisAlberta, investment tax credits are deducted from the related assets and are recognized as a reduction of income tax expense as the Company becomes taxable for rate-setting purposes.

**Sales Taxes**

In the course of its operations, the Corporation's subsidiaries collect sales taxes from their customers. When customers are billed, a current liability is recognized for the sales taxes included on customers' bills. The liability is settled when the taxes are remitted to the appropriate government authority. The Corporation's revenue excludes sales taxes.

For regulatory reporting purposes, Central Hudson records receipt tax revenue and expenses collected on behalf of applicable government authorities on a gross basis. The amounts included in 2014 in both revenue and expenses was approximately \$22 million (December 31, 2013 - \$11 million).

**Revenue Recognition**

Revenue at the regulated utilities is billed at rates approved by the applicable regulatory authority and is generally bundled to include service associated with generation and T&D, except at FortisAlberta and FortisOntario.

Transmission is the conveyance of electricity at high voltages (generally at 69 kilovolts ("kV") and higher) and gas at high pressures (generally at 2,070 kilopascals ("kPa") and higher) or a hoop stress of 20% or more of standard minimum yield strength. Distribution is the conveyance of electricity at lower voltages (generally below 69 kV) and gas at lower pressures (generally below 2,070 kPa) or a hoop stress of less than 20% of standard minimum yield strength. Distribution networks convey electricity and gas from transmission systems to end-use customers.

Revenue from the sale of electricity and gas by the Corporation's regulated utilities is generally recognized on an accrual basis. Electricity and gas consumption is metered upon delivery to customers and is recognized as revenue using approved rates when consumed. Meters are read periodically and bills are issued to customers based on these readings. At the end of each reporting period, a certain amount of consumed electricity and gas will not have been billed. Electricity and gas that is consumed but not yet billed to customers is estimated and accrued as revenue at each period end, with the exception of certain electricity customers at Central Hudson, as approved by the regulator. As at December 31, 2014, approximately \$15 million (US\$13 million) (December 31, 2013 - \$14 million (US\$13 million)) in unbilled revenue at Central Hudson associated with these electricity customers was not accrued.

In certain circumstances, UNS Energy enters into purchased power and wholesale sales contracts that are not settled with energy. The net sales contracts and power purchase contracts are reflected at the net amount in revenue.

**FORTIS INC.**  
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**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

**Revenue Recognition (cont'd)**

As stipulated by the regulator, FortisAlberta is required to arrange and pay for transmission services with AESO and collect transmission revenue from its customers, which is achieved through invoicing the customers' retailers through FortisAlberta's transmission component of its regulator-approved rates. FortisAlberta is solely a distribution company and, as such, does not operate or provide any transmission or generation services. The Company is a conduit for the flow through of transmission costs to end-use customers, as the transmission provider does not have a direct relationship with these customers. As a result, FortisAlberta reports revenue and expenses related to transmission services on a net basis. The rates collected are based on forecast transmission expenses. FortisAlberta is not subject to any forecast risk with respect to transmission costs, as all differences between actual expenses related to transmission services and actual revenue collected from customers are deferred to be recovered from, or refunded to, customers in future rates (Note 7 (xix)).

All of the Corporation's non-regulated generation operations record revenue on an accrual basis and revenue is recognized on delivery of output at rates fixed under contract or based on observed market prices as stipulated in contractual arrangements.

Non-utility revenue is recognized when services are provided or products are delivered to customers. Specifically, real estate revenue is derived from leasing retail and office space to tenants for varying periods of time. Revenue is recognized in the month that it is earned at rates in accordance with lease agreements.

The leases are primarily of a net nature, with tenants paying basic rent plus a pro rata share of certain defined overhead expenses. Certain retail tenants pay additional rent based on a percentage of the tenants' sales. Expenses recovered from tenants are recorded as revenue on an accrual basis. Base rent and the escalation of lease rates included in long-term leases are recognized in earnings using the straight-line method over the term of the lease.

**Asset-Retirement Obligations**

Asset-retirement obligations ("AROs"), including conditional AROs, are recorded as a liability at fair value and are classified as long-term other liabilities, with a corresponding increase to utility or non-utility capital assets (Note 16). The Corporation recognizes AROs in the periods in which they are incurred if a reasonable estimate of fair value can be determined. The fair value of AROs is based on an estimate of the present value of expected future cash outlays reflecting a range of possible outcomes, discounted at a credit-adjusted risk-free interest rate. AROs are adjusted at the end of each reporting period to reflect the passage of time and any changes in the estimated future cash flows underlying the obligation. Actual costs incurred upon the settlement of AROs are recorded as a reduction in the liabilities. As permitted by the respective regulator, at UNS Energy, Central Hudson and FortisBC Electric, changes in the obligations due to the passage of time are recognized as a regulatory asset using the effective interest method.

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

#### **Asset-Retirement Obligations (cont'd)**

The Corporation has AROs associated with hydroelectric generation facilities, interconnection facilities and wholesale energy supply agreements. While each of the foregoing will have legal AROs, including land and environmental remediation and/or removal of assets, the final date and cost of remediation and/or removal of the related assets cannot be reasonably determined at this time. These assets are reasonably expected to operate in perpetuity due to the nature of their operation. The licences, permits, interconnection facilities agreements and wholesale energy supply agreements are reasonably expected to be renewed or extended indefinitely to maintain the integrity of the assets and ensure the continued provision of service to customers. In the event that environmental issues are identified, assets are decommissioned or the applicable licences, permits or agreements are terminated, AROs will be recorded at that time provided the costs can be reasonably estimated.

The Corporation also has AROs associated with the removal of certain electricity distribution system assets from rights-of-way at the end of the life of the system. As it is expected that the system will be in service indefinitely, an estimate of the fair value of asset removal costs cannot be reasonably determined at this time.

The Corporation has determined that AROs may exist regarding the remediation of certain land. Certain leased land contains assets integral to operations and it is reasonably expected that the land-lease agreement will be renewed indefinitely; therefore, an estimate of the fair value of remediation costs cannot be reasonably determined at this time. Certain other land may require environmental remediation but the amount and nature of the remediation is indeterminable at this time. AROs associated with land remediation will be recorded when the timing, nature and amount of costs can be reasonably estimated.

#### **New Accounting Policies**

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

Effective January 1, 2014, the Corporation adopted the amendments to Accounting Standards Codification ("ASC") Topic 405, *Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date*, as outlined in Accounting Standards Update ("ASU") No. 2013-04. The amendments were applied retrospectively and did not materially impact the Corporation's consolidated financial statements for 2014.

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

Effective January 1, 2014, the Corporation adopted the amendments to ASC Topic 830, *Foreign Currency Matters - 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*, as outlined in ASU No. 2013-05. The amendments were applied by the Corporation prospectively and did not materially impact the Corporation's consolidated financial statements for 2014.

##### *Presentation of an Unrecognized Tax Benefit*

Effective January 1, 2014, the Corporation adopted the amendments to ASC Topic 740, *Income Taxes - Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, as outlined in ASU No. 2013-11. The amendments were applied by the Corporation prospectively and did not materially impact the Corporation's consolidated financial statements for 2014.

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

#### **Use of Accounting Estimates**

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 recognized in earnings in the period in which they become known. In the event that a regulatory decision is received after the balance sheet date but before the consolidated financial statements are issued, the facts and circumstances are reviewed to determine whether or not it is a recognized subsequent event.

The Corporation's critical accounting estimates are described above in Note 3 under the headings Regulatory Assets and Liabilities, Utility and Non-Utility Capital Assets, Intangible Assets, Goodwill, Employee Future Benefits, Income Taxes, Revenue Recognition and Asset-Retirement Obligations, and in Notes 7 and 36.

### **4. FUTURE ACCOUNTING PRONOUNCEMENTS**

#### **Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity**

In April 2014 the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*. The amendments in this update change the requirements for reporting discontinued operations and require additional disclosures about discontinued operations. This update is effective for annual and interim periods beginning on or after December 15, 2014 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.

#### **Revenue from Contracts with Customers**

In May 2014 FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. The amendments in this update create ASC Topic 606, *Revenue from Contracts with Customers*, and supersede the revenue recognition requirements in ASC Topic 605, *Revenue Recognition*, including most industry-specific revenue recognition guidance throughout the codification. This standard completes a joint effort by FASB and the International Accounting Standards Board to improve financial reporting by creating common revenue recognition guidance for US GAAP and International Financial Reporting Standards that clarifies the principles for recognizing revenue and that can be applied consistently across various transactions, industries and capital markets. This standard is effective for annual and interim periods beginning on or after December 15, 2016 and is to be applied on a full retrospective or modified retrospective basis. Early adoption is not permitted. Fortis is assessing the impact that the adoption of this standard will have on its consolidated financial statements. The Corporation and its subsidiaries are in the process of identifying contracts with customers and performance obligations in the contracts.

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**4. FUTURE ACCOUNTING PRONOUNCEMENTS (cont'd)**

**Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period**

In June 2014 FASB issued ASU No. 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*. The amendments in this update are intended to resolve diversity in practice for employee share-based payments with performance targets that can entitle an employee to benefit from an award regardless of if they are rendering services at the date the performance target is achieved. This update is effective for annual and interim periods beginning on or after December 15, 2015 and may be applied prospectively or retrospectively. Fortis does not expect that the adoption of this update will have a material impact on its consolidated financial statements.

**Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern**

In August 2014 FASB issued ASU No. 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. The amendments in this update are intended to provide guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and provide related disclosures. This update is effective for annual and interim periods beginning on or after December 15, 2016. Early adoption is permitted. Fortis does not expect that the adoption of this update will have a material impact on its consolidated financial statements.

**5. ACCOUNTS RECEIVABLE AND OTHER CURRENT ASSETS**

<i>(in millions)</i>	2014	2013
Trade accounts receivable	\$ 479	\$ 352
Unbilled accounts receivable	365	341
Allowance for doubtful accounts	(31)	(19)
Income tax receivable	25	-
Other	62	58
	<b>\$ 900</b>	<b>\$ 732</b>

Other accounts receivable consisted of customer billings for non-core services, collateral deposits for gas purchases and residential tax credits at the FortisBC Energy companies. Other accounts receivable also included the fair value of derivative instruments (Note 32).

**6. INVENTORIES**

<i>(in millions)</i>	2014	2013
Materials and supplies	\$ 149	\$ 27
Gas and fuel in storage	134	116
Coal inventory	38	-
	<b>\$ 321</b>	<b>\$ 143</b>

Materials and supplies included approximately \$118 million at UNS Energy, and consisted of construction and repair materials for distribution, transmission and generation assets, as required by the regulator (Notes 3 and 9).

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**7. REGULATORY ASSETS AND LIABILITIES**

Based on previous, existing or expected regulatory orders or decisions, the Corporation's regulated utilities have recorded the following amounts that are expected to be recovered from, or refunded to, customers in future periods.

<i>(in millions)</i>	2014	2013	Remaining recovery period <i>(Years)</i>
<b>Regulatory assets</b>			
Deferred income taxes <i>(i)</i>	\$ 942	\$ 833	To be determined
Employee future benefits <i>(ii)</i>	680	440	Various
Manufactured gas plant ("MGP") site remediation deferral <i>(iii)</i>	123	47	To be determined
Rate stabilization accounts <i>(iv)</i>	119	70	Various
Deferred energy management costs <i>(v)</i>	111	76	1-10
Deferred lease costs <i>(vi)</i>	101	76	Various
Derivative instruments <i>(vii)</i>	69	15	Various
Deferred operating overhead costs <i>(viii)</i>	54	43	Various
Deferred net losses on disposal of utility capital assets and intangible assets <i>(ix)</i>	37	35	9
Final mine reclamation and retiree health care costs <i>(x)</i>	34	-	14-20
Property tax deferrals <i>(xi)</i>	29	-	Various
Natural gas for transportation incentives <i>(xii)</i>	24	8	10
Income taxes recoverable on OPEB plans <i>(xiii)</i>	24	24	Various
Carrying charges - employee future benefits <i>(xiv)</i>	20	14	Various
Customer Care Enhancement Project cost deferral <i>(xv)</i>	18	21	5-6
Other regulatory assets <i>(xvi)</i>	140	120	Various
<b>Total regulatory assets</b>	<b>2,525</b>	<b>1,822</b>	
<b>Less: current portion</b>	<b>(295)</b>	<b>(150)</b>	<b>1</b>
<b>Long-term regulatory assets</b>	<b>\$ 2,230</b>	<b>\$ 1,672</b>	
<b>Regulatory liabilities</b>			
Non-ARO removal cost provision <i>(xvii)</i>	\$ 951	\$ 563	To be determined
Rate stabilization accounts <i>(iv)</i>	142	167	Various
Deferred income taxes <i>(i)</i>	110	45	To be determined
Employee future benefits <i>(ii)</i>	58	55	Various
Customer and community benefits obligation <i>(xviii)</i>	55	23	To be determined
AESO charges deferral <i>(xix)</i>	49	73	1-5
Renewable energy surcharge <i>(xx)</i>	44	-	To be determined
Carrying charges - employee future benefits <i>(xiv)</i>	24	16	Various
Derivative instruments <i>(vii)</i>	-	10	Various
Other regulatory liabilities <i>(xxi)</i>	122	90	Various
<b>Total regulatory liabilities</b>	<b>1,555</b>	<b>1,042</b>	
<b>Less: current portion</b>	<b>(192)</b>	<b>(140)</b>	<b>1</b>
<b>Long-term regulatory liabilities</b>	<b>\$ 1,363</b>	<b>\$ 902</b>	

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**7. REGULATORY ASSETS AND LIABILITIES (cont'd)**

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

*(i) Deferred Income Taxes*

The Corporation's regulated utilities recognize deferred income tax assets and liabilities and related regulatory liabilities and assets for the amount of deferred income taxes expected to be refunded to, or recovered from, customers in future electricity and gas rates. Included in deferred income tax assets and liabilities are the future income tax effects of the subsequent settlement of the related regulatory liabilities and assets through customer rates. The deferred income taxes on regulatory assets and liabilities are the result of the application of ASC Topic 740, *Income Taxes*. The regulatory asset and liability balances are expected to be recovered from, or refunded to, customers in future rates when the income taxes become payable or receivable. As at December 31, 2014, \$359 million (December 31, 2013 - \$281 million) in regulatory assets for deferred income taxes was not subject to a regulatory return.

*(ii) Employee Future Benefits*

The regulatory asset and liability associated with employee future benefits includes the actuarially determined unamortized net actuarial losses, past service costs and credits, and transitional obligations associated with defined benefit pension and OPEB plans maintained by the Corporation's regulated utilities, which are expected to be recovered from, or refunded to, customers in future rates (Note 28).

At the Corporation's regulated utilities, as approved by the respective regulators, differences between defined benefit pension and OPEB plan costs recognized under US GAAP and those which are expected to be recovered from, or refunded to, customers in future rates are subject to deferral account treatment and have been recognized as a regulatory asset or liability. These amounts would otherwise be recognized in accumulated other comprehensive income on the consolidated balance sheet.

As at December 31, 2014, regulatory assets of approximately \$339 million associated with employee future benefits were not subject to a regulatory return (December 31, 2013 - \$130 million). As at December 31, 2014, regulatory liabilities of approximately \$55 million associated with employee future benefits were not subject to a regulatory return (December 31, 2013 - \$55 million).

*(iii) MGP Site Remediation Deferral*

As approved by the regulator, Central Hudson is permitted to defer for future recovery from its customers the difference between actual costs for MGP site investigation and remediation and the associated rate allowances (Notes 13, 16 and 36). Central Hudson's MGP site remediation costs are not subject to a regulatory return.

*(iv) Rate Stabilization Accounts*

Rate stabilization accounts associated with the Corporation's regulated electric and gas utilities are recovered from, or refunded to, customers in future rates, as approved by the respective regulatory authority. Electric rate stabilization accounts primarily mitigate the effect on earnings of variability in the cost of fuel and/or purchased power above or below a forecast or predetermined level and, at certain utilities, revenue decoupling mechanisms that minimize the earnings impact resulting from reduced energy consumption as energy-efficiency programs are implemented. Gas rate stabilization accounts primarily mitigate the effect on earnings of unpredictable and uncontrollable factors, namely volume volatility caused principally by weather, and natural gas cost volatility.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**7. REGULATORY ASSETS AND LIABILITIES (cont'd)**

**Description of the Nature of Regulatory Assets and Liabilities (cont'd)**

*(iv) Rate Stabilization Accounts (cont'd)*

As at December 31, 2014, approximately \$117 million and \$43 million of the rate stabilization accounts are expected to be recovered from, or refunded to, customers within one year and, as a result, are classified as current regulatory assets and liabilities, respectively (December 31, 2013 - approximately \$77 million and \$65 million, respectively).

As at December 31, 2014, \$104 million of the balance of rate stabilization accounts in a receivable position was not subject to a regulatory return (December 31, 2013 – \$67 million).

*(v) Deferred Energy Management Costs*

The FortisBC Energy companies, FortisBC Electric, Central Hudson, and Newfoundland Power provide energy management services to promote energy efficiency programs to their customers. As required by their respective regulator, these regulated utilities have capitalized related expenditures and are amortizing these expenditures on a straight-line basis over periods ranging from 1 to 10 years. This regulatory asset represents the unamortized balance of the energy management costs.

UNS Energy is required to implement cost-effective Demand-Side Management (“DSM”) programs to comply with the ACC’s energy efficiency standards. The energy efficiency standards provide for a DSM surcharge to recover from retail customers the costs of implementing DSM programs. The existing rate orders provide for a lost fixed cost recovery mechanism to recover certain non-fuel costs that were previously unrecoverable, due to reduced electricity sales as a result of energy efficiency programs and distributed generation. As at December 31, 2014, \$16 million of UNS Energy’s regulatory asset balance is not subject to a regulatory return.

*(vi) Deferred Lease Costs*

Deferred lease costs at FortisBC Electric primarily relate to the Brilliant Power Purchase Agreement (“BPPA”), which ends in 2056. The depreciation of the asset under capital lease and interest expense associated with the capital lease obligation are not being fully recovered by FortisBC Electric in current customer rates, since those rates include only the cash payments set out under the BPPA. The regulatory asset balance as at December 31, 2014 includes \$83 million (December 31, 2013 - \$76 million) of deferred lease costs that are expected to be recovered from customers in future rates over the term of the lease. In 2014, of the \$30 million (2013 - \$29 million) of interest expense related to the capital lease obligations and the \$6 million (2013 - \$6 million) of depreciation expense related to the assets under capital lease, a total of \$26 million (2013 - \$25 million) was recognized in energy supply costs and \$3 million (2013 - \$3 million) was recognized in operating expenses, respectively, as approved by the regulator, with the balance of \$7 million (2013 - \$7 million) deferred as a regulatory asset (Note 15).

Deferred lease costs at UNS Energy relate to the commitment to purchase 35.4% of the Springerville Unit 1 lease assets at the end of the lease and the purchase of 13.3% equity interest in the Springerville Coal Handling Facility. UNS Energy recognized an increase in capital lease obligation and a capital lease asset associated with Springerville Unit 1 at present value, resulting in an increase in interest expense over the remaining life of the lease. The Company deferred the increase in lease interest expense as a regulatory asset, as it expects to recover these costs in future customer rates. UNS Energy believes the purchase of the Springerville Coal Handling Facility is probable of recovery in future customer rates and, as a result the increase in lease expenses due to the commitment has been deferred as a regulatory asset (Note 15).

Deferred lease costs are not subject to a regulatory return.

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**7. REGULATORY ASSETS AND LIABILITIES (cont'd)**

**Description of the Nature of Regulatory Assets and Liabilities (cont'd)**

*(vii) Derivative Instruments*

As approved by the respective regulatory authority, unrealized gains or losses associated with changes in the fair value of certain derivative instruments at UNS Energy, Central Hudson and the FortisBC Energy companies are deferred as a regulatory asset or liability for recovery from, or refund to, customers in future rates. These unrealized losses and gains would otherwise be recognized in earnings (Note 32). UNS Energy and Central Hudson's deferred regulatory asset balance of \$57 million is not subject to a regulatory return.

*(viii) Deferred Operating Overhead Costs*

As approved by the regulator, FortisAlberta has deferred certain operating overhead costs. The deferred costs are expected to be collected in future customer rates over the lives of the related utility capital assets.

*(ix) Deferred Net Losses on Disposal of Utility Capital Assets and Intangible Assets*

As approved by the regulator, from 2010 through 2013 net losses on the retirement or disposal of utility capital assets and intangible assets at the FortisBC Energy companies are recorded in a regulatory deferral account to be recovered from customers in future rates. The regulator approved the recovery in customer rates of the resulting regulatory asset over a period of 10 years, which commenced in 2012.

*(x) Final Mine Reclamation and Retiree Health Care Costs*

Final mine reclamation and retiree health care costs are associated with TEP's jointly owned coal generating facilities at the San Juan, Four Corners and Navajo generating stations. TEP is required to recognize the present value of its liability associated with final mine reclamation and retiree health care obligations over the life of the coal supply agreements (Notes 16 and 36). TEP is permitted to fully recover these costs from customers when the costs are invoiced by the miners and expects to recover these costs over the remaining life of the mines, which is estimated to be between 14-20 years. These deferred costs are not subject to a regulatory return.

*(xi) Property Tax Deferrals*

Property taxes at UNS Energy and Central Hudson are deferred and are primarily collected from customers over a six-month to one-year period, as approved by the respective regulator. Property tax deferrals are not subject to a regulatory return.

*(xii) Natural Gas for Transportation Incentives*

The deferral for natural gas transportation incentives at the FortisBC Energy companies is comprised of subsidy payments to assist customers in purchasing natural gas vehicles in lieu of vehicles fueled by diesel as part of the incentive program funding pursuant to the greenhouse gas reductions regulation under the *Clean Energy Act*. The BCUC has approved recovery in rates over a 10-year period.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**7. REGULATORY ASSETS AND LIABILITIES (cont'd)**

**Description of the Nature of Regulatory Assets and Liabilities (cont'd)**

*(xiii) Income Taxes Recoverable on OPEB Plans*

At the FortisBC Energy companies and FortisBC Electric, the regulator allows OPEB plan costs to be collected in customer rates on an accrual basis, rather than on a cash basis, which creates timing differences for income tax purposes. As approved by the regulator, the tax effect of this timing difference is deferred as a separate regulatory asset and will be reduced as cash payments for OPEB plans exceed required accruals and amounts collected in customer rates. As at December 31, 2014, FortisBC Electric's deferred regulatory asset balance of \$5 million is not subject to a regulatory return.

*(xiv) Carrying Charges – Employee Future Benefits*

As approved by the regulator, the difference between Central Hudson's defined benefit pension and OPEB plan 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 asset and regulatory liability have been recognized related to the Company's defined benefit pension and OPEB plans, respectively. The regulator allows Central Hudson to accrue carrying charges on the regulatory asset and liability balances associated with defined benefit pension and OPEB plans. The balances are not subject to a regulatory return.

*(xv) Customer Care Enhancement Project Cost Deferral*

The Customer Care Enhancement Project cost deferral accumulated all incremental costs associated with the implementation of FEI's Customer Care Enhancement Project, which was substantially completed in January 2012. The regulatory asset is approved for recovery in customer rates over an eight-year period that commenced in 2012.

*(xvi) Other Regulatory Assets*

Other regulatory assets relate to all of the Corporation's regulated utilities and are comprised of various items, each individually less than \$20 million. As at December 31, 2014, \$91 million (December 31, 2013 - \$85 million) of the balance was approved to be recovered from customers in future rates, with the remaining balance expected to be approved. As at December 31, 2014, \$49 million (December 31, 2013 - \$44 million) of the balance was not subject to a regulatory return.

*(xvii) Non-ARO Removal Cost Provision*

As required by the respective regulator, depreciation rates at UNS Energy, Central Hudson, the FortisBC Energy companies, FortisAlberta, Newfoundland Power and Maritime Electric include an amount allowed for regulatory purposes to accrue for non-ARO removal costs. Actual non-ARO removal costs are recorded against the regulatory liability when incurred. This regulatory liability represents amounts collected in customer electricity rates at the respective utilities in excess of incurred non-ARO removal costs.

**FORTIS INC.**  
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**7. REGULATORY ASSETS AND LIABILITIES (cont'd)**

**Description of the Nature of Regulatory Assets and Liabilities (cont'd)**

*(xviii) Customer and Community Benefits Obligation*

As approved by the respective regulator for UNS Energy and Central Hudson, Fortis committed to provide their customers and community with financial benefits that would have not been realized in the absence of the acquisitions. In 2014 these incremental benefits for UNS Energy included US\$10 million in year one and US\$5 million in years two through five to cover credits in retail customer rates. In 2013 these incremental benefits for Central Hudson included: (i) US\$35 million to cover expenses that would normally be recovered in customer rates; (ii) guaranteed savings to customers of more than US\$9 million over five years resulting from the elimination of costs that 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, expenses of approximately \$33 million (US\$30 million) were recognized in 2014 related to the acquisition of UNS Energy for customer benefit obligations. In 2013 expenses of approximately \$41 million (US\$40 million) were recognized that were 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 23 and 29).

*(xix) AESO Charges Deferral*

FortisAlberta maintains an AESO charges deferral account that represents expenses incurred in excess of revenue collected for various items, such as transmission costs incurred and flowed through to customers, that are subject to deferral to be collected in future customer rates. To the extent that the amount of revenue collected in rates for these items exceeds actual costs incurred, the excess is deferred as a regulatory liability to be refunded in future customer rates. As at December 31, 2014, the regulatory liability primarily represented the over collection of the AESO charges deferral accounts for 2013 and 2014.

*(xx) Renewable Energy Surcharge*

As ordered by the regulator under its Renewable Energy Standard ("RES"), UNS Energy is required to increase its use of renewable energy each year until it represents at least 15% of its total annual retail energy requirements in 2025, with distributed generation accounting for 30% of the annual renewable energy requirement. The Company must file annual RES implementation plans for review and approval by the ACC. The approved cost of carrying out those plans is recovered from retail customers through the RES surcharge. The ACC has also approved recovery of operating costs, depreciation, property taxes and a return on investments on certain company-owned solar projects through the RES tariff until such costs are reflected in retail customer rates. Any RES surcharge collections above or below the costs incurred to implement the plans are deferred as a regulatory asset or liability.

The ACC measures compliance with its RES requirements through Renewable Energy Credits ("REC"), which represent one kilowatt hour generated from renewable resources. When UNS Energy purchases renewable energy, the premium paid above the market cost of conventional power equals the REC recoverable through the RES surcharge. When RECs are purchased, UNS Energy records the cost of the RECs as long-term other assets and a corresponding regulatory liability, to reflect the obligation to use the RECs for future RES compliance. When RECs are reported to the ACC for compliance with RES requirements, energy supply costs and revenue are recognized in an equal amount (Note 8).

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**7. REGULATORY ASSETS AND LIABILITIES (cont'd)**

**Description of the Nature of Regulatory Assets and Liabilities (cont'd)**

*(xxi) Other Regulatory Liabilities*

Other regulatory liabilities relate to all of the Corporation's regulated utilities and are comprised of various items, each individually less than \$20 million. As at December 31, 2014, \$116 million (December 31, 2013 - \$82 million) of the balance was approved for refund to customers or reduction in future rates, with the remaining balance expected to be approved. As at December 31, 2014, \$52 million (December 31, 2013 - \$23 million) of the balance was not subject to a regulatory return.

**8. OTHER ASSETS**

<i>(in millions)</i>	<b>2014</b>	2013
Other asset - Belize Electricity (Notes 33 and 35)	<b>\$ 116</b>	\$ 108
Deferred financing costs	<b>67</b>	51
Supplemental Executive Retirement Plan assets	<b>41</b>	14
Deferred compensation plan assets (Note 16)	<b>21</b>	15
Long-term income tax receivable	<b>13</b>	13
Renewable Energy Credits (Note 7 (xx))	<b>13</b>	-
Equity and cost investments	<b>12</b>	10
Other	<b>54</b>	35
	<b>\$ 337</b>	\$ 246

As a result of the expropriation of the Corporation's investment in Belize Electricity by the GOB and the consequential loss of control over the operations of the utility, Fortis discontinued the consolidation method of accounting for Belize Electricity, effective June 20, 2011. The book value of the Corporation's expropriated investment in Belize Electricity is classified as a long-term other asset. The asset is denominated in US dollars and has been translated into Canadian dollars at the exchange rate prevailing as at the balance sheet date. Effective June 20, 2011, the Corporation's asset associated with its expropriated investment in Belize Electricity does not qualify for hedge accounting and, as a result, a foreign exchange gain of approximately \$8 million was recognized in earnings in 2014 (2013 - \$6 million) (Note 23).

UNS Energy and Central Hudson provide additional post-employment benefits through both a deferred compensation plan for Directors and Officers of the Companies, as well as Supplemental Executive Retirement Plans ("SERP"). Since both plans are considered non-qualified plans under the *Employee Retirement Income Security Act of 1974*, the assets are reported separately from the related liabilities (Note 16). The assets of the plans are held in trust and funded mostly through the use of trust-owned life insurance policies and mutual funds. A portion of the SERP assets is invested in corporate-owned life insurance policies. Amounts held in mutual and money market funds are recorded at fair value (Note 32).

Other assets are recorded at cost and are recovered or amortized over the estimated period of future benefit, where applicable. Other assets also include the fair value of derivative instruments at UNS Energy and Central Hudson (Note 32).

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**9. UTILITY CAPITAL ASSETS**

<i>(in millions)</i>	2014		
	Cost	Accumulated Depreciation	Net Book Value
Distribution			
Electric	\$ 8,102	\$ (2,317)	\$ 5,785
Gas	3,475	(920)	2,555
Transmission			
Electric	2,562	(859)	1,703
Gas	1,649	(491)	1,158
Generation	5,296	(2,189)	3,107
Other	2,158	(731)	1,427
Assets under construction	1,250	-	1,250
Land	167	-	167
	<b>\$ 24,659</b>	<b>\$ (7,507)</b>	<b>\$ 17,152</b>
	2013		
<i>(in millions)</i>	Cost	Accumulated Depreciation	Net Book Value
Distribution			
Electric	\$ 5,716	\$ (1,526)	\$ 4,190
Gas	3,022	(805)	2,217
Transmission			
Electric	1,382	(390)	992
Gas	1,579	(462)	1,117
Generation	1,462	(432)	1,030
Other	1,594	(536)	1,058
Assets under construction	881	-	881
Land	133	-	133
	<b>\$ 15,769</b>	<b>\$ (4,151)</b>	<b>\$ 11,618</b>

Electric distribution assets are those used to distribute electricity at lower voltages (generally below 69 kV). These assets include poles, towers and fixtures, low-voltage wires, transformers, overhead and underground conductors, street lighting, meters, metering equipment and other related equipment. Gas distribution assets are those used to transport natural gas at low pressures (generally below 2,070 kPa) or a hoop stress of less than 20% of standard minimum yield strength. These assets include distribution stations, telemetry, distribution pipe for mains and services, meter sets and other related equipment.

Electric transmission assets are those used to transmit electricity at higher voltages (generally at 69 kV and higher). These assets include poles, wires, switching equipment, transformers, support structures and other related equipment. Gas transmission assets are those used to transport natural gas at higher pressures (generally at 2,070 kPa and higher) or a hoop stress of 20% or more of standard minimum yield strength. These assets include transmission stations, telemetry, transmission pipe and other related equipment.

Generation assets are those used to generate electricity. These assets include hydroelectric and thermal generation stations, gas and combustion turbines, coal-fired generating stations, dams, reservoirs, photovoltaic systems and other related equipment.

Other assets include buildings, equipment, vehicles, inventory and information technology assets.

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**9. UTILITY CAPITAL ASSETS (cont'd)**

As at December 31, 2014, assets under construction are primarily associated with the Waneta Expansion and other capital projects at the Corporation's regulated utilities.

The cost of utility capital assets under capital lease as at December 31, 2014 was \$1,088 million (December 31, 2013 - \$313 million) and related accumulated depreciation was \$627 million (December 31, 2013 - \$70 million). Utility assets under capital lease increased in 2014 due to the acquisition of UNS Energy (Notes 15 and 29).

**Jointly Owned Facilities**

As at December 31, 2014, UNS Energy's interests in jointly owned generating stations and transmission systems primarily consisted of the following:

<i>(in millions)</i>	Ownership %	2014		
		Cost	Accumulated Depreciation	Net Book Value
San Juan Units 1 and 2	50.0	\$ 535	\$ (281)	\$ 254
Navajo Units 1, 2 and 3	7.5	179	(130)	49
Four Corners Units 4 and 5	7.0	124	(89)	35
Luna Energy Facility	33.3	63	(2)	61
Gila River Common Facilities	25.0	65	(17)	48
Transmission Facilities	Various	455	(224)	231
		<b>\$ 1,421</b>	<b>\$ (743)</b>	<b>\$ 678</b>

UNS Energy holds an undivided interest in the above facilities and is entitled to its pro rata share of the utility capital assets. UNS Energy is proportionately liable for its share of operating costs and liabilities in respect of the jointly owned facilities, in particular financing obligations.

**10. NON-UTILITY CAPITAL ASSETS**

<i>(in millions)</i>	2014		
	Cost	Accumulated Depreciation	Net Book Value
Buildings	\$ 599	\$ (105)	\$ 494
Equipment	145	(73)	72
Tenant inducements	35	(27)	8
Land	72	-	72
Assets under construction	18	-	18
	<b>\$ 869</b>	<b>\$ (205)</b>	<b>\$ 664</b>

<i>(in millions)</i>	2013		
	Cost	Accumulated Depreciation	Net Book Value
Buildings	\$ 546	\$ (95)	\$ 451
Equipment	132	(62)	70
Tenant inducements	33	(25)	8
Land	72	-	72
Assets under construction	48	-	48
	<b>\$ 831</b>	<b>\$ (182)</b>	<b>\$ 649</b>

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**11. INTANGIBLE ASSETS**

<i>(in millions)</i>	2014		
	Cost	Accumulated Amortization	Net Book Value
Computer software	\$ 573	\$ (368)	\$ 205
Land, transmission and water rights	258	(66)	192
Franchise fees and other	16	(12)	4
Assets under construction	87	-	87
	<b>\$ 934</b>	<b>\$ (446)</b>	<b>\$ 488</b>

<i>(in millions)</i>	2013		
	Cost	Accumulated Amortization	Net Book Value
Computer software	\$ 361	\$ (193)	168
Land, transmission and water rights	165	(32)	133
Franchise fees and other	16	(12)	4
Assets under construction	40	-	40
	<b>\$ 582</b>	<b>\$ (237)</b>	<b>\$ 345</b>

Included in the cost of land, transmission and water rights as at December 31, 2014 was \$68 million (December 31, 2013 - \$66 million) not subject to amortization.

Amortization expense related to intangible assets was \$60 million for 2014 (2013 - \$49 million). Amortization is estimated to average approximately \$76 million annually for each of the next five years.

As at December 31, 2014, assets under construction primarily related to UNS Energy and the Waneta Expansion.

**12. GOODWILL**

<i>(in millions)</i>	2014	2013
Balance, beginning of year	\$ 2,075	\$ 1,568
Acquisition of UNS Energy (Note 29)	1,510	-
Acquisition of CH Energy Group (Note 29)	-	476
Acquisition of City of Kelowna's electric utility assets (Note 29)	-	14
Sale of Griffith (Notes 26 and 29)	(3)	-
Foreign currency translation impacts	150	17
Balance, end of year	<b>\$ 3,732</b>	<b>\$ 2,075</b>

Goodwill associated with the acquisitions of UNS Energy, CH Energy Group, Caribbean Utilities and Fortis Turks and Caicos is denominated in US dollars, as the reporting currency of these companies is the US dollar. Foreign currency translation impacts are the result of the translation of US dollar-denominated goodwill and the impact of the movement of the Canadian dollar relative to the US dollar.

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**13. ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES**

<i>(in millions)</i>	<b>2014</b>	2013
Trade accounts payable	\$ 612	\$ 423
Gas and fuel cost payable	195	135
Employee compensation and benefits payable	134	104
Interest payable	128	91
Dividends payable	101	73
Accrued taxes other than income taxes	96	41
Fair value of derivative instruments (Note 32)	66	15
MGP site remediation (Notes 7 (iii) and 36)	13	1
Defined benefit pension and OPEB plan liabilities (Note 28)	11	7
Income taxes payable	-	9
Other	84	58
	<b>\$ 1,440</b>	<b>\$ 957</b>

Accrued taxes other than income taxes as at December 31, 2014 and 2013 primarily consisted of property taxes at UNS Energy and the FortisBC Energy companies.

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**14. LONG-TERM DEBT**

<i>(in millions)</i>	Maturity Date	2014	2013
<b>Regulated Utilities</b>			
<i>UNS Energy</i>			
Unsecured US Tax-Exempt Bonds - 3.92% weighted average fixed and variable rate	2020-2040	\$ 956	\$ -
Unsecured US Fixed Rate Notes - 4.75% weighted average fixed rate	2021-2044	638	-
Secured US Fixed Rate Notes 5.76% weighted average fixed and variable rate	2015-2026	267	-
<i>Central Hudson</i>			
Unsecured US Promissory Notes - 4.31% weighted average fixed and variable rate (2013 - 4.51%)	2016-2042	587	521
<i>FortisBC Energy Companies</i>			
Secured Purchase Money Mortgages - 10.71% weighted average fixed rate (2013 - 10.71%)	2015-2016	275	275
Unsecured Debentures - 5.95% weighted average fixed rate (2013 - 5.95%)	2029-2041	1,620	1,620
Government loan (Note 3)	2015	10	10
<i>FortisAlberta</i>			
Unsecured Debentures - 5.01% weighted average fixed rate (2013 - 5.31%)	2024-2052	1,534	1,459
<i>FortisBC Electric</i>			
Secured Debentures - 8.80% weighted average fixed rate (2013 - 8.80%)	2023	25	25
Unsecured Debentures - 5.36% weighted average fixed rate (2013 - 5.84%)	2016-2050	660	600
<i>Eastern Canadian</i>			
Secured First Mortgage Sinking Fund Bonds - 7.08% weighted average fixed rate (2013 - 7.28%)	2016-2043	484	518
Secured First Mortgage Bonds - 7.18% weighted average fixed rate (2013 - 7.18%)	2016-2061	167	167
Unsecured Senior Notes - 6.11% weighted average fixed rate (2013 - 6.11%)	2018-2041	104	104
<i>Caribbean Electric</i>			
Unsecured US Senior Loan Notes - 4.91% weighted average fixed rate (2013 - 5.23%)	2016-2046	400	251
<b>Non-Regulated - Non-Utility</b>			
Secured First Mortgages - 7.50% weighted average fixed rate (2013 - 7.03%)	2017	26	47
Secured Senior Notes - 7.32% fixed rate	2019	8	9
<b>Corporate</b>			
Unsecured US Senior Notes - 4.39% weighted average fixed rate (2013 - 4.93%)	2019-2044	1,421	931
Unsecured US Promissory Notes - 6.80% weighted average fixed rate (2013 - 6.75%)	2025	22	29
Unsecured Debentures 6.49% weighted average fixed rate (2013 - 6.14%)	2039	201	325
Long-term classification of credit facility borrowings (Note 33)		1,096	313
Total long-term debt (Note 32)		10,501	7,204
Less: Current installments of long-term debt		(505)	(780)
		<b>\$ 9,996</b>	<b>\$ 6,424</b>

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2014 and 2013

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**14. LONG-TERM DEBT (cont'd)**

As noted in the table above, certain long-term debt instruments issued by UNS Energy, the FortisBC Energy companies, FortisBC Electric, Newfoundland Power, Maritime Electric and Fortis Properties are secured. When security is provided, it is typically a fixed or floating first charge on the specific assets of the company to which the long-term debt is associated. The purchase money mortgages of the FortisBC Energy companies are secured equally and rateably by a first fixed and specific mortgage and charge on FEI's coastal division assets. The aggregate principal amount of the purchase money mortgages that may be issued is limited to \$425 million.

UNS Energy entered into a four-year US\$30 million variable rate term loan credit agreement. The interest rate currently in effect is three-month LIBOR plus 1.125%. At the same time, UNS Energy entered into a fixed-for-floating interest rate swap in which it will pay a fixed rate of 0.97% and receive a three-month LIBOR rate on a US\$30 million notional amount over a four-year period ending August 2015. The interest rate swap is recorded as a cash flow hedge (Note 32).

**Covenants**

Certain of the Corporation's long-term debt obligations have covenants restricting the issuance of additional debt such that consolidated debt cannot exceed 70% of the Corporation's consolidated capital structure, as defined by the long-term debt agreements. In addition, one of the Corporation's long-term debt obligations contains a covenant which provides that Fortis shall not declare or pay any dividends, other than stock dividends or cumulative preferred dividends on preference shares not issued as stock dividends, or make any other distribution on its shares or redeem any of its shares or prepay subordinated debt if, immediately thereafter, its consolidated funded obligations would be in excess of 75% of its total consolidated capitalization.

As at December 31, 2014, the Corporation and its subsidiaries were in compliance with their debt covenants.

**Regulated Utilities**

The majority of the long-term debt instruments at the Corporation's regulated utilities are redeemable at the option of the respective utilities, at any time, at the greater of par or a specified price as defined in the respective long-term debt agreements, together with accrued and unpaid interest.

In March 2014 Central Hudson issued 10-year US\$30 million unsecured notes with a floating interest rate of 3-month LIBOR plus 1%. The net proceeds were used to repay maturing long-term debt and for general corporate purposes.

In September 2014 FortisAlberta issued \$275 million senior unsecured debentures in two tranches of 10-year \$150 million at 3.30% and 30-year \$125 million at 4.11%. The net proceeds were used to repay long-term debt, to finance capital expenditures and for general corporate purposes.

In October 2014 FortisBC Electric issued 30-year \$200 million 4.00% unsecured debentures. The net proceeds were used to repay long-term debt and credit facility borrowings.

In November 2014 Caribbean Utilities issued a total of US\$50 million unsecured notes with terms to maturity ranging from 15 to 32 years and coupon rates ranging from 3.65% to 4.53%. The net proceeds will be used to finance capital expenditures.

In December 2014 Fortis Turks and Caicos issued 15-year US\$80 million 4.75% unsecured notes. The net proceeds were used to repay inter-company loans with a direct subsidiary of Fortis.

**FORTIS INC.**  
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**14. LONG-TERM DEBT (cont'd)**

**Corporate**

The unsecured debentures and US senior notes are redeemable at the option of Fortis at a price calculated as the greater of par or a specified price as defined in the respective long-term debt agreements, together with accrued and unpaid interest.

In June 2014 the Corporation issued US\$213 million unsecured notes with terms to maturity ranging from 5 to 30 years and coupon rates ranging from 2.92% to 4.88%. The weighted average term to maturity is approximately 9 years and the weighted average coupon rate is 3.51%. Net proceeds were used to repay US-dollar denominated borrowings on the Corporation's committed credit facility and for general corporate purposes. In September 2014 the Corporation issued US\$287 million unsecured notes with terms to maturity ranging from 7 to 30 years and coupon rates ranging from 3.64% to 5.03%. The weighted average term to maturity is approximately 12 years and the weighted average coupon rate is 4.11%. Net proceeds were used to repay long-term debt and for general corporate purposes.

**Repayment of Long-Term Debt**

The consolidated annual requirements to meet principal repayments and maturities in each of the next five years and thereafter are as follows:

<b>Year</b>	<b>Subsidiaries</b> <i>(in millions)</i>	<b>Corporate</b> <i>(in millions)</i>	<b>Total</b> <i>(in millions)</i>
2015	\$ 505	\$ -	\$ 505
2016	397	350	747
2017	101	2	103
2018	249	492	741
2019	95	106	201
Thereafter	6,672	1,532	8,204
	<u>\$ 8,019</u>	<u>\$ 2,482</u>	<u>\$ 10,501</u>

**15. CAPITAL LEASE AND FINANCE OBLIGATIONS**

**Capital Lease Obligations**

**UNS Energy**

*Springerville Unit 1 Capital Lease Purchases*

TEP leases Unit 1 of the Springerville Generating Station and an undivided one-half interest in certain Springerville Common Facilities (collectively, "Springerville Unit 1") under seven separate lease agreements, which are accounted for as capital leases. The leases expired in January 2015 and included fair market value renewal and purchase options.

In 2013 TEP agreed to purchase undivided ownership interests in Springerville Unit 1 totalling 35.4%, or 137 MW for a purchase price of approximately US\$66 million. As a result of the purchase commitment, TEP recorded an increase to utility capital assets and capital leases and finance obligations of approximately US\$55 million.

As scheduled, TEP purchased a 35.4% leased interest in Springerville Unit 1 in December 2014 and January 2015 for US\$20 million and US\$46 million, respectively. Upon the close of these lease option purchases, TEP owns 49.5% of Springerville Unit 1, or 192 MW of capacity. Furthermore, TEP is obligated to operate the unit for the third-party owners under an existing facility support agreement. The third-party owners are obligated to compensate TEP for their pro rata share of fixed operating and maintenance costs for the unit and their share of capital expenditures.

**FORTIS INC.**  
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**15. CAPITAL LEASE AND FINANCE OBLIGATIONS (cont'd)**

*Springerville Coal Handling Facilities Lease Purchase Commitment*

TEP is party to Springerville Coal Handling Facilities leases, which have an initial term to April 2015 and include a fixed-price purchase provision of US\$120 million. In April 2014 TEP elected to purchase an ownership interest in the Springerville Coal Handling Facilities upon the expiration of the lease term. Due to TEP's purchase commitment, TEP recorded an increase to utility capital assets and capital lease and finance obligations of US\$109 million, which represents the present value of the total purchase commitment. TEP has agreements with third parties to either purchase a portion of TEP's ownership in Springerville Coal Handling Facilities or to continue to make payments to TEP for the use of the facility.

*Springerville Common Facilities Leases*

TEP is party to three Springerville Common Facilities leases, which have an initial term to December 2017 for one lease and January 2021 for the other two leases, subject to optional renewal periods of two or more years through 2025 (Note 34). Instead of extending the leases, TEP may exercise a fixed-price purchase provision of US\$38 million in 2017 and US\$68 million in 2021. TEP has agreements with third parties that if the Springerville Coal Handling and Common Facilities leases are not renewed, TEP will exercise the purchase options under these contracts. The third parties would then either be obligated to buy a portion of these facilities or continue to make payments to TEP for the use of these facilities.

UNS Energy entered into an interest rate swap that hedges the floating interest rate risk associated with the Springerville Common Facilities lease debt. Interest on the lease debt is payable at six-month LIBOR plus a spread of 1.75%, as at December 31, 2014. The swap has the effect of fixing the interest rates on the amortizing principal balances of US\$33 million. The interest rate swap is recorded as a cash flow hedge (Note 32).

The capital lease obligations bear interest at a rate of 13.20%, 9.85% and 5.08% for the Springerville Unit 1, Springerville Coal Handling Facilities and Springerville Common Facilities, respectively. For the year ended December 31, 2014, \$2 million of interest expense on the Springerville capital lease obligations was recognized in finance charges and \$3 million and \$7 million of depreciation expense on the Springerville leased assets was recognized in energy supply costs and depreciation, respectively.

**FortisBC Electric**

FortisBC Electric has a capital lease obligation with respect to the operation of the Brilliant Plant located near Castlegar, British Columbia. FortisBC Electric operates and maintains the Brilliant Plant, under the BPPA which expires in 2056, in return for a management fee. In exchange for the specified take-or-pay amounts of power, the BPPA requires semi-annual payments based on a return on capital, comprised of the original plant capital charge and periodic upgrade capital charges, which are both subject to fixed annual escalators, as well as sustaining capital charges and operating expenses. The BPPA includes a market-related price adjustment in 2026. Due to the fixed annual escalators, the interest expense on the capital lease obligation presently exceeds the required payments. The capital lease obligation will continue to increase through to 2024, and subsequently decrease for the remainder of the term when the required payments exceed the interest expense on the capital lease obligation. Approximately 94% of the output from the Brilliant Plant is being purchased by FortisBC Electric through the BPPA.

The BPPA capital lease obligation bears interest at a composite rate of 5.00%. Included in energy supply costs for 2014 was \$26 million (2013 - \$25 million) recognized in accordance with the BPPA, as approved by the BCUC (Note 7 (vi)).

FortisBC Electric also has a capital lease obligation with respect to the operation of the Brilliant Terminal Station ("BTS"), under an agreement which expires in 2056. The agreement provides that FortisBC Electric will pay a charge related to the recovery of the capital cost of the BTS and related operating costs. The obligation bears interest at a composite rate of 9.00%. Included in operating expenses for 2014 was \$3 million (2013 - \$3 million) recognized in accordance with the BTS agreement, as approved by the BCUC (Note 7 (vi)).

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**15. CAPITAL LEASE AND FINANCE OBLIGATIONS (cont'd)**

**Finance Obligations**

Between 2000 and 2005 FEI entered into arrangements whereby certain natural gas distribution assets were leased to certain municipalities and then leased back by FEI from the municipalities. The natural gas distribution assets are considered to be integral equipment to real estate assets and, as such, the transactions have been accounted for as finance transactions. The proceeds from these transactions have been recognized as finance obligations on the consolidated balance sheet. Lease payments, net of the portion considered to be interest expense, reduce the finance obligations.

Obligations under the above-noted lease-in lease-out transactions at FEI have implicit interest at rates ranging from 7.17% to 8.76% and are being repaid over a 35-year period. Each of the lease-in lease-out arrangements allows FEI, at its option, to terminate the lease arrangements early, after 17 years. If the Company exercises this option, FEI would pay the municipality an early termination payment which is equal to the carrying value of the obligation at that point in time.

**Repayment of Capital Lease and Finance Obligations**

The present value of the minimum lease payments required for the capital lease and finance obligations over the next five years and thereafter are as follows:

<b>Year</b>	<b>Capital Leases (in millions)</b>	<b>Finance Obligations (in millions)</b>	<b>Total (in millions)</b>
2015	\$ 260	\$ 4	\$ 264
2016	63	4	67
2017	65	4	69
2018	58	4	62
2019	59	31	90
Thereafter	2,114	54	2,168
	<u>\$ 2,619</u>	<u>\$ 101</u>	<u>\$ 2,720</u>
Less: Amounts representing imputed interest and executory costs on capital lease and finance obligations			<u>(2,017)</u>
Total capital lease and finance obligations			703
Less: Current portion			<u>(208)</u>
			<u>\$ 495</u>

**16. OTHER LIABILITIES**

<i>(in millions)</i>	<b>2014</b>	<b>2013</b>
OPEB plan liabilities (Note 28)	<b>\$ 403</b>	\$ 290
Defined benefit pension plan liabilities (Note 28)	<b>390</b>	185
MGP site remediation (Notes 7 (iii) and 36)	<b>109</b>	42
Waneta Partnership promissory note (Notes 32 and 34)	<b>53</b>	50
Asset retirement obligations	<b>37</b>	3
Final mine reclamation and retiree health care liabilities (Notes 7(x) and 36)	<b>34</b>	-
Customer security deposits	<b>26</b>	6
Deferred compensation plan liabilities (Note 8)	<b>21</b>	16
DSU and PSU liabilities (Note 22)	<b>17</b>	10
Fair value of derivative instruments (Note 32)	<b>13</b>	-
Other	<b>38</b>	25
	<u><b>\$ 1,141</b></u>	<u>\$ 627</u>

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**16. OTHER LIABILITIES (cont'd)**

The Waneta Partnership promissory note is non-interest bearing with a face value of \$72 million. As at December 31, 2014, its discounted net present value was \$53 million (December 31, 2013 - \$50 million). The promissory note was incurred on the acquisition by the Waneta Partnership, from a company affiliated with CPC/CBT, of certain intangible assets and project design costs associated with the construction of the Waneta Expansion. The promissory note is payable on the fifth anniversary of the commercial operation date of the Waneta Expansion, which is projected to be in spring 2015.

As at December 31, 2014, UNS Energy, Central Hudson and FortisBC Electric recognized asset retirement obligations.

Other liabilities primarily include deferred lease revenue, funds received in advance of expenditures and unrecognized tax benefits.

**17. COMMON SHARES**

Common shares issued during the year were as follows:

	2014		2013	
	Number of Shares (in thousands)	Amount (in millions)	Number of Shares (in thousands)	Amount (in millions)
Balance, beginning of year	213,165	\$ 3,783	191,566	\$ 3,121
Conversion of Convertible Debentures	58,545	1,747	-	-
Public offering - Conversion of Subscription Receipts	-	-	18,500	567
Dividend Reinvestment Plan	2,495	82	2,263	72
Consumer Share Purchase Plan	33	1	36	1
Employee Share Purchase Plan	384	12	369	12
Stock Option Plans	1,375	42	431	10
Balance, end of year	<b>275,997</b>	<b>\$ 5,667</b>	213,165	\$ 3,783

**Convertible Debentures**

To finance a portion of the acquisition of UNS Energy, in January 2014, Fortis completed the sale of \$1.8 billion aggregate principal amount of 4% convertible unsecured subordinated debentures, represented by Installment Receipts ("Convertible Debentures"). The Convertible Debentures were sold on an installment basis at a price of \$1,000 per Convertible Debenture, of which \$333 was paid on closing in January 2014 and the remaining \$667 was paid on October 27, 2014 (the "Final Installment Date"). Prior to the Final Installment Date, the Convertible Debentures were represented by Installment Receipts, which were traded on the TSX under the symbol "FTS.IR". Since the Final Installment Date occurred prior to the first anniversary of the closing of the offering, holders of Convertible Debentures received, in addition to the payment of accrued and unpaid interest, a make-whole payment, representing interest that would have accrued from the day following the Final Installment Date to and including January 9, 2015. Approximately \$72 million (\$51 million after tax) in interest expense associated with the Convertible Debentures, including the make-whole payment, was recognized in 2014 (Note 24).

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**17. COMMON SHARES (cont'd)**

**Convertible Debentures (cont'd)**

At the option of the holders, each Convertible Debenture was convertible into common shares of Fortis at any time after the Final Installment Date but prior to maturity or redemption by the Corporation at a conversion price of \$30.72 per common share, being a conversion rate of 32.5521 common shares per \$1,000 principal amount of Convertible Debentures. On October 28, 2014, approximately 58.2 million common shares of Fortis were issued, representing conversion into common shares of more than 99% of the Convertible Debentures. As at December 31, 2014, a total of approximately 58.5 million common shares of Fortis were issued on the conversion of Convertible Debentures, for proceeds of \$1.747 billion, net of after-tax expenses. The net proceeds were used to finance a portion of the acquisition of UNS Energy (Note 29).

**Subscription Receipts**

In June 2012, to finance a portion of the acquisition of Central Hudson, the Corporation sold 18.5 million Subscription Receipts at \$32.50 each, for gross proceeds of approximately \$601 million. In June 2013, upon closing of the acquisition of Central Hudson, 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 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 (Note 29).

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**18. EARNINGS PER COMMON SHARE**

The Corporation calculates earnings per common share ("EPS") on the weighted average number of common shares outstanding. The weighted average number of common shares outstanding was 225.6 million for 2014 and 202.5 million for 2013.

Diluted EPS was calculated using the treasury stock method for options and the "if-converted" method for convertible securities.

EPS were as follows:

	2014									
	Net Earnings to Common Shareholders (in millions)				Weighted Average Number of Shares (millions)	EPS				
	Continuing Operations	Discontinued Operations	Extraordinary Item	Total		Continuing Operations	Discontinued Operations	Extraordinary Item	Total	
<b>Basic EPS</b>	\$312	\$5	\$-	\$317	225.6	\$1.39	\$0.02	\$-	\$1.41	
Effect of potential dilutive securities:										
Stock Options	-	-	-	-	0.5					
Preference Shares	10	-	-	10	6.9					
	322	5	-	327	233.0					
Deduct anti-dilutive impacts:										
Preference Shares	(10)	-	-	(10)	(6.9)					
<b>Diluted EPS</b>	\$312	\$5	\$-	\$317	226.1	\$1.38	\$0.02	\$-	\$1.40	

	2013									
	Net Earnings to Common Shareholders (in millions)				Weighted Average Number of Shares (millions)	EPS				
	Continuing Operations	Discontinued Operations	Extraordinary Item	Total		Continuing Operations	Discontinued Operations	Extraordinary Item	Total	
<b>Basic EPS</b>	\$333	\$-	\$20	\$353	202.5	\$1.64	\$-	\$0.10	\$1.74	
Effect of potential dilutive securities:										
Stock Options	-	-	-	-	0.6					
Preference Shares	13	-	-	13	8.2					
	346	-	20	366	211.3					
Deduct anti-dilutive impacts:										
Preference Shares	(4)	-	-	(4)	(2.0)					
<b>Diluted EPS</b>	\$342	\$-	\$20	\$362	209.3	\$1.63	\$-	\$0.10	\$1.73	

**FORTIS INC.**  
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**19. PREFERENCE SHARES**

Authorized

- (a) an unlimited number of First Preference Shares, without nominal or par value
- (b) an unlimited number of Second Preference Shares, without nominal or par value

Issued and Outstanding	Annual Dividend Per Share	2014		2013	
		Number of Shares	Amount (in millions)	Number of Shares	Amount (in millions)
First Preference Shares					
Series E <sup>(1)</sup>	\$ 1.2250	7,993,500	\$ 197	7,993,500	\$ 197
Series F <sup>(1)</sup>	\$ 1.2250	5,000,000	122	5,000,000	122
Series G <sup>(2)</sup>	\$ 0.9708	9,200,000	225	9,200,000	225
Series H <sup>(2)</sup>	\$ 1.0625	10,000,000	245	10,000,000	245
Series J <sup>(1)</sup>	\$ 1.1875	8,000,000	196	8,000,000	196
Series K <sup>(2)</sup>	\$ 1.0000	10,000,000	244	10,000,000	244
Series M <sup>(2)</sup>	\$ 1.0250	24,000,000	591	-	-
		<b>74,193,500</b>	<b>\$ 1,820</b>	50,193,500	\$ 1,229

<sup>(1)</sup> Cumulative Redeemable First Preference Shares

<sup>(2)</sup> Cumulative Redeemable Five-Year Fixed Rate Reset First Preference Shares. The annual fixed dividend per share for the First Preference Shares, Series G was reset from \$1.3125 to \$0.9708 for the five-year period from and including September 1, 2013 to but excluding September 1, 2018.

In September 2014 the Corporation issued 24 million Cumulative Redeemable Fixed Rate Reset First Preference Shares, Series M ("First Preference Shares, Series M") at a price of \$25.00 per share for net after-tax proceeds of \$591 million.

In July 2013 the Corporation issued 10 million Cumulative Redeemable Fixed Rate Reset First Preference Shares, Series K ("First Preference Shares, Series K") at a price of \$25.00 per share for net after-tax proceeds of \$244 million.

In July 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. Upon redemption, approximately \$2 million of after-tax issuance costs associated with First Preference Shares, Series C were recognized in net earnings attributable to preference equity shareholders.

Holders of the First Preference Shares, Series E, Series F and Series J are each entitled to receive a fixed cumulative quarterly cash dividend as and when declared by the Board of Directors of the Corporation, payable in equal quarterly installments on the first day of each quarter.

On or after September 1, 2016, each First Preference Share, Series E will be convertible at the option of the holder on the first day of September, December, March and June of each year into fully paid and freely tradeable common shares of the Corporation, determined by dividing \$25.00, together with all accrued and unpaid dividends, by the greater of \$1.00 or 95% of the then-current market price of the common shares at such time. If a holder of First Preference Shares, Series E elects to convert any such shares into common shares, the Corporation can redeem such First Preference Shares, Series E for cash or arrange for the sale of those shares to other purchasers.

The Corporation has the option to convert all, or from time to time any part, of the outstanding First Preference Shares, Series E into fully paid and freely tradeable common shares of the Corporation. The number of common shares into which each First Preference Share, Series E may be converted will be determined by dividing the then-applicable redemption price per First Preference Share, Series E, together with all accrued and unpaid dividends, by the greater of \$1.00 or 95% of the then-current market price of the common shares at such time.

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**19. PREFERENCE SHARES (cont'd)**

The First Preference Shares, Series G, Series H, Series K and Series M are entitled to receive fixed cumulative cash dividends as and when declared by the Board of Directors of the Corporation in the amounts of \$0.9708, \$1.0625, \$1.0000 and \$1.0250 per share per annum, respectively, for each year up to but excluding September 1, 2018, June 1, 2015, March 1, 2019, and December 1, 2019, respectively. The dividends are payable in equal quarterly installments on the first day of each quarter. As at September 1, 2018, June 1, 2015, March 1, 2019, and December 1, 2019, and each five-year period thereafter, the holders of First Preference Shares, Series G, Series H, Series K and Series M, respectively, are entitled to receive reset fixed cumulative cash dividends. The reset annual dividends per share will be determined by multiplying \$25.00 per share by the annual fixed dividend rate of the First Preference Shares, Series G, Series H, Series K and Series M, which is the sum of the five-year Government of Canada Bond Yield on the applicable reset date plus 2.13%, 1.45%, 2.05% and 2.48%, respectively.

On each First Preference Shares, Series H, Series K and Series M Conversion Date, the holders of First Preference Shares, Series H, Series K and Series M have the option to convert any or all of their First Preference Shares, Series H, Series K and Series M into an equal number of cumulative redeemable floating rate First Preference Shares, Series I, Series L and Series N, respectively. The holders of First Preference Shares, Series I, Series L and Series N will be entitled to receive floating rate cumulative cash dividends in the amount per share determined by multiplying the applicable floating quarterly dividend rate by \$25.00. The floating quarterly dividend rate of the First Preference Shares, Series I, Series L and Series N will be equal to the sum of the average yield expressed as a percentage per annum on three-month Government of Canada Treasury Bills plus 1.45%, 2.05% and 2.48%, respectively.

On or after specified dates, the Corporation has the option to redeem for cash the outstanding First Preference Shares, in whole at any time or in part from time to time, at specified fixed prices per share plus all accrued and unpaid dividends up to but excluding the dates fixed for redemption.

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**20. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

Other comprehensive income or loss results from items deferred from recognition in the consolidated statement of earnings. The change in accumulated other comprehensive income by category is provided as follows.

<i>(in millions)</i>	2014		
	Opening balance January 1	Net change	Ending balance December 31
<b>Net unrealized foreign currency translation (losses) gains:</b>			
Unrealized foreign currency translation (losses) gains on net investments in foreign operations	\$ (60)	\$ 333	\$ 273
Losses on hedges of net investments in foreign operations	-	(131)	(131)
Income tax recovery	-	2	2
	<u>(60)</u>	<u>204</u>	<u>144</u>
<b>Cash flow hedges:</b>			
Net change in fair value of cash flow hedges (Note 32)	-	1	1
<b>Discontinued cash flow hedges:</b>			
Net losses on derivative instruments discontinued as cash flow hedges	(1)	1	-
<b>Unrealized employee future benefits (losses) gains:</b> (Note 28)			
Unamortized past service (costs) credits	(3)	1	(2)
Unamortized net actuarial losses	(9)	(11)	(20)
Income tax recovery	1	5	6
	<u>(11)</u>	<u>(5)</u>	<u>(16)</u>
<b>Accumulated other comprehensive (loss) income</b>	<b>\$ (72)</b>	<b>\$ 201</b>	<b>\$ 129</b>
	2013		
	Opening balance January 1	Net change	Ending balance December 31
<b>Net unrealized foreign currency translation (losses) gains:</b>			
Unrealized foreign currency translation (losses) gains on net investments in foreign operations	\$ (115)	\$ 55	\$ (60)
Gains (losses) on hedges of net investments in foreign operations	45	(45)	-
Income tax (expense) recovery	(6)	6	-
	<u>(76)</u>	<u>16</u>	<u>(60)</u>
<b>Discontinued cash flow hedges:</b>			
Net losses on derivative instruments discontinued as cash flow hedges	(3)	2	(1)
Income tax recovery	1	(1)	-
	<u>(2)</u>	<u>1</u>	<u>(1)</u>
<b>Unrealized employee future benefits (losses) gains:</b> (Note 28)			
Unamortized past service costs	(1)	(2)	(3)
Unamortized net actuarial (losses) gains	(19)	10	(9)
Income tax recovery (expense)	2	(1)	1
	<u>(18)</u>	<u>7</u>	<u>(11)</u>
<b>Accumulated other comprehensive (loss) income</b>	<b>\$ (96)</b>	<b>\$ 24</b>	<b>\$ (72)</b>

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**21. NON-CONTROLLING INTERESTS**

<i>(in millions)</i>	<b>2014</b>		2013
Waneta Partnership	\$	<b>316</b>	\$ 280
Caribbean Utilities		<b>88</b>	78
Mount Hayes Limited Partnership		<b>11</b>	11
Preference shares of Newfoundland Power		<b>6</b>	6
	<b>\$</b>	<b>421</b>	<b>\$ 375</b>

**22. STOCK-BASED COMPENSATION PLANS**

**Stock Options**

The Corporation is authorized to grant officers and certain key employees of Fortis and its subsidiaries options to purchase common shares of the Corporation. As at December 31, 2014, the Corporation had the following stock option plans: the 2012 Plan, the 2006 Plan and the 2002 Plan. The 2012 Plan was approved at the May 4, 2012 Annual General Meeting and will ultimately replace the 2002 and 2006 Plans. The 2002 and 2006 Plans will cease to exist when all outstanding options are exercised or expire in or before 2016 and 2018, respectively. The Corporation has ceased the granting of options under the 2002 and 2006 Plans and all new options granted after 2011 are being made under the 2012 Plan. Directors are not eligible to receive grants of options under the 2012 Plan.

Options granted under the 2006 Plan are exercisable for a period not to exceed seven 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.

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.

The following options were granted in 2014 and 2013. The fair values of the options were estimated at the date of grant using the Black-Scholes fair value option-pricing model and the following assumptions:

	<b>2014</b>			2013
	<b>August</b>	<b>June</b>	<b>February</b>	March
Options granted (#)	<b>12,216</b>	<b>23,584</b>	<b>925,172</b>	807,600
Exercise price (\$) <sup>(1)</sup>	<b>33.44</b>	<b>32.23</b>	<b>30.73</b>	33.58
Grant date fair value (\$)	<b>2.47</b>	<b>2.69</b>	<b>3.53</b>	3.91
Assumptions:				
Dividend yield (%) <sup>(2)</sup>	<b>3.8</b>	<b>3.8</b>	<b>3.8</b>	3.8
Expected volatility (%) <sup>(3)</sup>	<b>15.7</b>	<b>15.9</b>	<b>20.3</b>	21.4
Risk-free interest rate (%) <sup>(4)</sup>	<b>1.45</b>	<b>1.52</b>	<b>1.69</b>	1.31
Weighted average expected life (years) <sup>(5)</sup>	<b>5.5</b>	<b>5.5</b>	<b>5.5</b>	5.3

<sup>(1)</sup> Five-day volume weighted average trading price immediately preceding the date of grant

<sup>(2)</sup> Based on average annual dividend yield up to the date of grant and the weighted average expected life of the options

<sup>(3)</sup> Based on historical experience over a period equal to the weighted average expected life of the options

<sup>(4)</sup> Government of Canada benchmark bond yield in effect at the date of grant that covers the weighted average expected life of the options

<sup>(5)</sup> Based on historical experience

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**22. STOCK-BASED COMPENSATION PLANS (cont'd)**

**Stock Options (cont'd)**

The Corporation records compensation expense upon the issuance of stock options granted under its 2002, 2006 and 2012 Plans. Using the fair value method, each grant is treated as a single award, the fair value of which is amortized to compensation expense evenly over the four-year vesting period of the options.

The following table summarizes information related to the stock options for 2014.

	<b>Total Options</b>		<b>Non-vested Options <sup>(1)</sup></b>	
	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>	<b>Number of Options</b>	<b>Weighted Average Grant Date Fair Value</b>
Options outstanding, January 1, 2014	5,119,738	\$29.13	1,990,042	\$4.18
Granted	960,972	\$30.80	960,972	\$3.50
Exercised	(1,374,775)	\$26.40	n/a	n/a
Vested	n/a	n/a	(802,634)	\$4.27
Options outstanding, December 31, 2014	<u>4,705,935</u>	<u>\$30.27</u>	<u>2,148,380</u>	<u>\$3.84</u>
Options vested, December 31, 2014 <sup>(2)</sup>	<u>2,557,555</u>	<u>\$28.47</u>		

<sup>(1)</sup> As at December 31, 2014, there was \$8 million of unrecognized compensation expense related to stock options not yet vested, which is expected to be recognized over a weighted average period of approximately four years.

<sup>(2)</sup> As at December 31, 2014, the weighted average remaining term of vested options was four years with an aggregate intrinsic value of \$27 million.

The following table summarizes additional 2014 and 2013 stock option information.

<i>(in millions)</i>	<b>2014</b>	2013
Stock option expense recognized	\$ 3	\$ 3
Stock options exercised:		
Cash received for exercise price	36	8
Intrinsic value realized by employees	12	6
Fair value of options that vested	3	4

**Directors' DSU Plan**

Under the Corporation's Directors' DSU Plan, directors who are not officers of the Corporation are eligible for grants of DSUs representing the equity portion of directors' annual compensation. In addition, directors can elect to receive credit for their annual cash retainer in a notional account of DSUs in lieu of cash. The Corporation may also determine from time to time that special circumstances exist that would reasonably justify the grant of DSUs to a director as compensation in addition to any regular retainer or fee to which the director is entitled.

Each DSU represents a unit with an underlying value equivalent to the value of one common share of the Corporation and is entitled to accrue notional common share dividends equivalent to those declared by the Corporation's Board of Directors.

<b>Number of DSUs</b>	<b>2014</b>	2013
DSUs outstanding, beginning of year	203,172	175,326
Granted	29,279	32,883
Granted - notional dividends reinvested	8,526	7,520
DSUs paid out	(64,853)	(12,557)
DSUs outstanding, end of year	<u>176,124</u>	<u>203,172</u>

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**22. STOCK-BASED COMPENSATION PLANS (cont'd)**

**Directors' DSU Plan (cont'd)**

For the year ended December 31, 2014, expense of \$3 million (2013 - less than \$1 million) was recognized in earnings with respect to the DSU Plan.

In 2014, 64,853 DSUs were paid out to retired directors at prices of \$36.06, \$38.68 and \$39.57 per DSU, for a total of approximately \$2 million.

As at December 31, 2014, the liability related to outstanding DSUs has been recorded at the closing price of the Corporation's common shares of \$38.96, for a total of \$7 million (December 31, 2013 - \$6 million), and is included in long-term other liabilities (Note 16).

**PSU Plans**

The Corporation's PSU Plans represent a component of long-term compensation awarded to senior management of the Corporation and its subsidiaries. Prior to 2013, the Corporation's PSU Plan was previously awarded only to the President and Chief Executive Officer ("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.

<b>Number of PSUs</b>	<b>2014</b>	2013
PSUs outstanding, beginning of year	<b>257,419</b>	178,012
Granted	<b>261,737</b>	136,058
Granted - notional dividends reinvested	<b>17,691</b>	10,327
PSUs paid out	<b>(33,559)</b>	(66,978)
PSUs cancelled/forfeited	<b>(21,588)</b>	-
PSUs outstanding, end of year	<b>481,700</b>	257,419

In January, June and August 2014, 155,133, 23,791 and 4,277 PSUs, respectively, were granted to senior management of the Corporation and its subsidiaries under the 2013 PSU Plan. In April 2014, 78,536 PSUs were granted to senior management of a U.S. subsidiary of the Corporation under a 2014 Share Unit Plan. The 2014 Share Unit Plan was modelled after the Corporation's 2013 PSU Plan, with differences in the payment criteria at the end of the three-year vesting period.

In March 2014, 33,559 PSUs, representing two-thirds of the vested PSUs, were paid out to the former President and CEO of the Corporation at \$30.67 per PSU, for a total of approximately \$1 million. The payout was made upon the three-year maturation period in respect of the PSU grant made in March 2011 and the former President and CEO satisfying two of the three payment requirements, as determined by the Human Resources Committee of the Board of Directors of Fortis.

For the year ended December 31, 2014, expense of approximately \$7 million (2013 - \$3 million) was recognized in earnings with respect to the PSU Plan.

As at December 31, 2014, the liability related to outstanding PSUs has been recorded at the closing price of the Corporation's common shares of \$38.96, for a total of \$10 million (December 31, 2013 - \$4 million), and is included in long-term other liabilities (Note 16).

**FORTIS INC.**  
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**23. OTHER INCOME (EXPENSES), NET**

<i>(in millions)</i>	<b>2014</b>	2013
Equity component of AFUDC (Note 3)	\$ <b>11</b>	\$ 8
Interest income	<b>13</b>	7
Net foreign exchange gain (Note 8)	<b>8</b>	6
Other income, net of expenses	<b>1</b>	1
Acquisition-related expenses (Note 29)	<b>(25)</b>	(12)
Acquisition-related customer and community benefits (Notes 7 <i>(xviii)</i> and 29)	<b>(33)</b>	(41)
	<b>\$ (25)</b>	\$ (31)

The foreign exchange gain is related to 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 8, 33 and 35).

The acquisition-related expenses and customer and community benefits were associated with the acquisition of UNS Energy in 2014 and the acquisition of Central Hudson in 2013 (Note 29).

**24. FINANCE CHARGES**

<i>(in millions)</i>	<b>2014</b>	2013
Interest - Long-term debt and capital lease and finance obligations	\$ <b>482</b>	\$ 403
- Short-term borrowings	<b>20</b>	9
- Convertible Debentures (Note 17)	<b>72</b>	-
Debt component of AFUDC (Note 3)	<b>(27)</b>	(23)
	<b>\$ 547</b>	\$ 389

**FORTIS INC.**  
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**25. INCOME TAXES**

**Deferred Income Taxes**

Deferred income taxes are provided for temporary differences. The significant components of deferred income tax assets and liabilities consist of the following.

<i>(in millions)</i>	2014	2013
<b>Gross deferred income tax assets</b>		
Tax loss and credit carryforwards	\$ 376	\$ 26
Regulatory liabilities	186	170
Employee future benefits	108	92
Share issue and debt financing costs	20	2
Unrealized foreign exchange gains (losses) on long-term debt	17	(2)
Other	70	12
	777	300
Deferred income tax assets valuation allowance	(24)	-
<b>Net deferred income tax assets</b>	<b>\$ 753</b>	<b>\$ 300</b>
<b>Gross deferred income tax liabilities</b>		
Utility capital assets	\$ (2,096)	\$ (1,082)
Regulatory assets	(204)	(153)
Non-utility capital assets	(40)	(37)
Intangible assets	(39)	(65)
	(2,379)	(1,337)
<b>Net deferred income tax liability</b>	<b>\$ (1,626)</b>	<b>\$ (1,037)</b>

The net deferred income tax liability is classified on the consolidated balance sheet as follows.

<i>(in millions)</i>	2014	2013
<b>Deferred income taxes</b>		
Current assets	\$ 158	\$ 42
Current liabilities	(9)	(8)
Long-term assets	62	7
Long-term liabilities	(1,837)	(1,078)
	\$ (1,626)	\$ (1,037)

**Unrecognized Tax Benefits**

The following table summarizes the change in unrecognized tax benefits during 2014 and 2013.

<i>(in millions)</i>	2014	2013
<b>Total unrecognized tax benefits, beginning of year</b>	<b>\$ 3</b>	<b>\$ 16</b>
Additions related to the current year	7	2
Adjustments related to prior years	1	(14)
Reductions related to the lapse of applicable statute of limitations	-	(1)
<b>Total unrecognized tax benefits, end of year</b>	<b>\$ 11</b>	<b>\$ 3</b>

If the total amount of unrecognized tax benefits as at December 31, 2014 of \$11 million (December 31, 2013 - \$3 million) was ultimately realized, total income tax expense for 2014 would not have changed.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2014 and 2013

**25. INCOME TAXES (cont'd)**

The components of the provision for income taxes were as follows.

<i>(in millions)</i>	2014	2013
<b>Canadian</b>		
Current income taxes	\$ 43	\$ 41
Deferred income taxes	64	78
Less: regulatory adjustments	(67)	(81)
	(3)	(3)
Total Canadian	\$ 40	\$ 38
<b>Foreign</b>		
Current income taxes	\$ -	\$ (3)
Deferred income taxes	26	(3)
Total Foreign	\$ 26	\$ (6)
<b>Income tax expense</b>	<b>\$ 66</b>	<b>\$ 32</b>

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 taxes to consolidated effective taxes.

<i>(in millions, except as noted)</i>	2014	2013
Combined Canadian federal and provincial statutory income tax rate	29.0%	29.0%
Statutory income tax rate applied to earnings before income taxes	\$ 131	\$ 125
Difference between Canadian statutory income tax rate and rates applicable to foreign subsidiaries	(13)	(16)
Difference in Canadian provincial statutory income tax rates applicable to subsidiaries in different Canadian jurisdictions	(11)	(11)
Items capitalized for accounting purposes but expensed for income tax purposes	(41)	(53)
Difference between capital cost allowance and amounts claimed for accounting purposes	(5)	7
Impacts associated with Part VI.1 tax	-	(23)
Release of income tax reserves	-	(7)
Other	5	10
<b>Income tax expense</b>	<b>\$ 66</b>	<b>\$ 32</b>
<b>Effective tax rate</b>	<b>14.6%</b>	<b>7.4%</b>

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 2013 the Corporation recognized a \$23 million income tax recovery due to the enactment of higher deductions associated with Part VI.1 tax.

In 2013 a settlement was reached with Canada Revenue Agency resulting in the release of income tax provisions of approximately \$5 million.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**25. INCOME TAXES (cont'd)**

As at December 31, 2014, the Corporation had the following tax carryforward amounts.

<i>(in millions)</i>	Expiring Year	Amount
<b>Canadian</b>		
Capital loss	N/A	\$ 8
Non-capital loss	2025-2034	201
Other tax credits	2026-2034	2
		<b>211</b>
Unrecognized in the consolidated financial statements		<b>(9)</b>
		<b>\$ 202</b>
<b>Foreign</b>		
Capital loss	2017	\$ 10
Federal and state net operating loss	2031-2034	794
Other tax credits	2016-2034	49
Alternative minimum tax credits	N/A	50
		<b>903</b>
Unrecognized in the consolidated financial statements		<b>(12)</b>
		<b>891</b>
<b>Total tax carryforwards</b>		<b>\$ 1,093</b>

As at December 31, 2014, the Corporation had approximately \$1,093 million in tax carryforward amounts recognized in the consolidated financial statements (December 31, 2013 - \$121 million). The increase reflects the acquisition of UNS Energy in 2014 which accounts for approximately \$870 million of the increase.

**26. DISCONTINUED OPERATIONS**

In March 2014 Griffith was sold for proceeds of approximately \$105 million (US\$95 million). The assets and liabilities of Griffith were classified as held for sale on the consolidated balance sheet as at December 31, 2013 and the results of operations to the date of sale are presented as discontinued operations on the consolidated statements of earnings.

The table below details the results of discontinued operations.

<i>(in millions)</i>	2014	2013
<b>Revenue</b>	<b>\$ 95</b>	\$ 143
Earnings from discontinued operations before income taxes	<b>8</b>	1
Income tax recovery	<b>(3)</b>	(1)
<b>Earnings from discontinued operations, net of tax</b>	<b>\$ 5</b>	\$ -

**27. 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 Government's 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 (\$20 million after tax) was recognized in 2013. In 2014 an extraordinary gain of approximately \$3 million (nil after tax) was recognized associated with additional settlement proceeds owing to the Corporation to recover the full income tax impact of the settlement of expropriation matters.

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**28. EMPLOYEE FUTURE BENEFITS**

The Corporation and its subsidiaries each maintain one or a combination of defined benefit pension plans, defined contribution pension plans, and OPEB plans. For the defined benefit pension and OPEB plan arrangements, the benefit obligation and the fair value of plan assets are measured for accounting purposes as at December 31 of each year.

For funding purposes, actuarial valuations are required for pension plans, at least, every three years for Fortis' Canadian and Caribbean subsidiaries. The most recent valuations were as of December 31, 2011 for the Corporation, Newfoundland Power and FortisOntario; as of July 1, 2012 for Algoma Power; as of December 31, 2012 for the FortisBC Energy companies (plans covering non-unionized employees), FortisAlberta, FortisBC Electric and Caribbean Utilities; and as of December 31, 2013 for the FortisBC Energy companies (plan covering unionized employees).

UNS Energy and Central Hudson perform annual actuarial valuations, as their funding requirements are based on maintaining annual target fund percentages. Both UNS Energy and Central Hudson have met the minimum funding requirements.

The Corporation's investment policy is to ensure that the defined benefit pension and OPEB plan assets, together with expected contributions, are invested in a prudent and cost-effective manner to optimally meet the liabilities of the plans for its members. The investment objective of the defined benefit pension and OPEB plans is to maximize return in order to manage the funded status of the plans and minimize the Corporation's cost over the long term, as measured by both cash contributions and defined benefit pension and OPEB expense for consolidated financial statement purposes.

The Corporation's consolidated defined benefit pension and OPEB plan weighted average asset allocations were as follows.

<b>Plan assets as at December 31</b> <i>(%)</i>	<b>2014 Target</b> <b>Allocation</b>	<b>2014</b>	<b>2013</b>
Equities	50	49	50
Fixed income	46	46	45
Real estate	4	4	4
Cash and other	-	1	1
	<b>100</b>	<b>100</b>	<b>100</b>

The fair value measurements of defined benefit pension and OPEB plan assets by fair value hierarchy, as defined in Note 32, were as follows.

<b>Fair value of plan assets as at December 31, 2014</b> <i>(in millions)</i>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Equities	\$ 352	\$ 806	\$ -	\$ 1,158
Fixed income	23	1,069	-	1,092
Real estate	-	11	85	96
Private equities	-	-	8	8
Cash and other	6	10	-	16
	<b>\$ 381</b>	<b>\$ 1,896</b>	<b>\$ 93</b>	<b>\$ 2,370</b>

<b>Fair value of plan assets as at December 31, 2013</b> <i>(in millions)</i>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Equities	\$ 289	\$ 546	\$ -	\$ 835
Fixed income	46	701	-	747
Real estate	-	-	62	62
Cash and other	2	16	-	18
	<b>\$ 337</b>	<b>\$ 1,263</b>	<b>\$ 62</b>	<b>\$ 1,662</b>

**FORTIS INC.**  
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**28. EMPLOYEE FUTURE BENEFITS (cont'd)**

The following table is a reconciliation of changes in the fair value of pension plan assets that have been measured using Level 3 inputs for the years ended December 31, 2014 and 2013.

<i>(in millions)</i>	2014	2013
<b>Balance, beginning of year</b>	\$ 62	\$ 53
Assets assumed on acquisition	24	-
Actual return on plan assets held at end of year	6	7
Purchases, sales and settlements	1	2
<b>Balance, end of year</b>	<b>\$ 93</b>	<b>\$ 62</b>

The following is a breakdown of the Corporation's and subsidiaries' defined benefit pension and OPEB plans and their respective funded status.

<i>(in millions)</i>	Defined Benefit Pension Plans		OPEB Plans	
	2014	2013	2014	2013
<b>Change in benefit obligation <sup>(1)</sup></b>				
Balance, beginning of year	\$ 1,724	\$ 1,132	\$ 417	\$ 285
Liabilities assumed on acquisition	403	638	83	169
Service costs	43	37	11	9
Employee contributions	17	14	1	-
Interest costs	90	59	21	15
Benefits paid	(101)	(60)	(15)	(9)
Actuarial losses (gains)	335	(99)	27	(55)
Past service (credits) costs/plan amendments	-	(4)	-	2
Foreign currency translation impacts	93	7	19	1
Balance, end of year <sup>(2)</sup>	<b>\$ 2,604</b>	<b>\$ 1,724</b>	<b>\$ 564</b>	<b>\$ 417</b>
<b>Change in value of plan assets</b>				
Balance, beginning of year	\$ 1,541	\$ 868	\$ 121	\$ -
Assets assumed on acquisition	373	544	13	110
Actual return on plan assets	236	124	11	12
Benefits paid	(101)	(60)	(15)	(9)
Employee contributions	17	14	1	-
Employer contributions	70	44	11	7
Foreign currency translation impacts	80	7	12	1
Balance, end of year	<b>\$ 2,216</b>	<b>\$ 1,541</b>	<b>\$ 154</b>	<b>\$ 121</b>
<b>Funded status</b>	<b>\$ (388)</b>	<b>\$ (183)</b>	<b>\$ (410)</b>	<b>\$ (296)</b>

<sup>(1)</sup> Amounts reflect projected benefit obligation for defined benefit pension plans and accumulated benefit obligation for OPEB plans

<sup>(2)</sup> The accumulated benefit obligation for defined benefit pension plans, excluding assumptions about future salary levels, was \$2,378 million as at December 31, 2014 (December 31, 2013 - \$1,559 million).

**FORTIS INC.**  
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**28. EMPLOYEE FUTURE BENEFITS (cont'd)**

The following table summarizes the employee future benefit assets and liabilities and their classifications on the consolidated balance sheet.

<i>(in millions)</i>	<b>Defined Benefit Pension Plans</b>		<b>OPEB Plans</b>	
	<b>2014</b>	2013	<b>2014</b>	2013
<b>Assets</b>				
Defined benefit pension assets:				
Long-term other assets	\$ 6	\$ 3	\$ -	\$ -
<b>Liabilities</b>				
Defined benefit pension liabilities:				
Current (Note 13)	4	1	-	-
Long-term other liabilities (Note 16)	390	185	-	-
OPEB plan liabilities:				
Current (Note 13)	-	-	7	6
Long-term other liabilities (Note 16)	-	-	403	290
<b>Net liabilities</b>	<b>\$ 388</b>	<b>\$ 183</b>	<b>\$ 410</b>	<b>\$ 296</b>

The net benefit cost for the Corporation's defined benefit pension plans and OPEB plans were as follows:

<i>(in millions)</i>	<b>Defined Benefit Pension Plans</b>		<b>OPEB Plans</b>	
	<b>2014</b>	2013	<b>2014</b>	2013
<b>Components of net benefit cost</b>				
Service costs	\$ 43	\$ 37	\$ 11	\$ 9
Interest costs	90	59	21	15
Expected return on plan assets	(106)	(70)	(9)	(4)
Amortization of actuarial losses	32	39	3	8
Amortization of past service (credits) costs/plan amendments	(1)	1	(3)	(7)
Amortization of transitional obligation	2	-	(6)	-
Regulatory adjustments	11	(12)	4	2
<b>Net benefit cost</b>	<b>\$ 71</b>	<b>\$ 54</b>	<b>\$ 21</b>	<b>\$ 23</b>

**FORTIS INC.**  
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**28. EMPLOYEE FUTURE BENEFITS (cont'd)**

The following tables provide the components of accumulated other comprehensive loss and regulatory assets and liabilities, which would otherwise have been recognized as accumulated other comprehensive loss, for the years ended December 31, 2014 and 2013 that have not been recognized as components of net benefit cost.

<i>(in millions)</i>	Defined Benefit Pension Plans		OPEB Plans	
	2014	2013	2014	2013
Unamortized net actuarial losses	\$ 16	\$ 8	\$ 4	\$ 1
Unamortized past service costs	-	-	2	3
Income tax recovery	(5)	(1)	(1)	-
<b>Accumulated other comprehensive loss (Note 20)</b>	<b>\$ 11</b>	<b>\$ 7</b>	<b>\$ 5</b>	<b>\$ 4</b>
Net actuarial losses	\$ 513	\$ 254	\$ 95	\$ 69
Past service credits	-	1	(43)	(49)
Amount deferred due to actions of regulators	18	55	39	55
	<b>\$ 531</b>	<b>\$ 310</b>	<b>\$ 91</b>	<b>\$ 75</b>
Regulatory assets (Note 7 (ii))	\$ 531	\$ 310	\$ 149	\$ 130
Regulatory liabilities (Note 7 (ii))	-	-	(58)	(55)
<b>Net regulatory assets</b>	<b>\$ 531</b>	<b>\$ 310</b>	<b>\$ 91</b>	<b>\$ 75</b>

The following tables provide the components recognized in comprehensive income or as regulatory assets, which would otherwise have been recognized in comprehensive income.

<i>(in millions)</i>	Defined Benefit Pension Plans		OPEB Plans	
	2014	2013	2014	2013
Current year net actuarial losses (gains)	\$ 9	\$ (5)	\$ 3	\$ (3)
Past service (credits) costs/plan amendments	-	-	(1)	2
Amortization of actuarial losses	(1)	(2)	-	-
Income tax (recovery) expense	(4)	1	(1)	-
<b>Total recognized in comprehensive income</b>	<b>\$ 4</b>	<b>\$ (6)</b>	<b>\$ 1</b>	<b>\$ (1)</b>
Assets assumed on acquisition	\$ 79	\$ 143	\$ 6	\$ (8)
Current year net actuarial losses (gains)	197	(150)	23	(60)
Past service credits/plan amendments	-	(4)	-	-
Amortization of actuarial losses	(31)	(36)	(5)	(7)
Amortization of past service (costs) credits	(1)	(1)	(3)	6
Foreign currency translation impacts	14	-	(4)	(1)
Regulatory adjustments	(37)	8	(1)	(3)
<b>Total recognized in regulatory assets</b>	<b>\$ 221</b>	<b>\$ (40)</b>	<b>\$ 16</b>	<b>\$ (73)</b>

Net actuarial losses of \$1 million are expected to be amortized from accumulated other comprehensive income into net benefit cost in 2015 related to defined benefit pension plans.

Net actuarial losses of \$53 million, past service credits of \$1 million and regulatory adjustments of \$3 million are expected to be amortized from regulatory assets into net benefit cost in 2015 related to defined benefit pension plans. Net actuarial losses of \$4 million, past service credits of \$1 million and regulatory adjustments of \$5 million are expected to be amortized from regulatory assets into net benefit cost in 2015 related to OPEB plans.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**28. EMPLOYEE FUTURE BENEFITS (cont'd)**

Significant weighted average assumptions	Defined Benefit Pension Plans		OPEB Plans	
	2014	2013	2014	2013
Discount rate during the year (%)	4.81	4.14	4.72	4.20
Discount rate as at December 31 (%)	4.00	4.76	3.95	4.73
Expected long-term rate of return on plan assets (%) <sup>(1)</sup>	6.46	6.29	7.08	7.33
Rate of compensation increase (%)	3.48	3.60	-	-
Health care cost trend increase as at December 31 (%) <sup>(2)</sup>	-	-	4.67	4.69

<sup>(1)</sup> Developed by management with assistance from independent actuaries using best estimates of expected returns, volatilities and correlations for each class of asset. The best estimates are based on historical performance, future expectations and periodic portfolio rebalancing among the diversified asset classes.

<sup>(2)</sup> The projected 2015 weighted average health care cost trend rate is 7.06% for OPEB plans and is assumed to decrease over the next 12 years by 2026 to the weighted average ultimate health care cost trend rate of 4.67% and remain at that level thereafter.

For 2014 the effects of changing the health care cost trend rate by 1% were as follows.

<i>(in millions)</i>	1% increase in rate	1% decrease in rate
Increase (decrease) in accumulated benefit obligation	\$ 44	\$ (34)
Increase (decrease) in service and interest costs	4	(3)

The following table provides the amount of benefit payments expected to be made over the next 10 years.

Year	Defined Benefit Pension Payments		OPEB Payments	
	<i>(in millions)</i>		<i>(in millions)</i>	
2015	\$	104	\$	21
2016		108		23
2017		114		24
2018		118		26
2019		124		27
2020 - 2024		705		157

Refer to Note 34 for expected defined benefit pension and OPEB plan funding contributions.

During 2014 the Corporation expensed \$21 million (2013 - \$16 million) related to defined contribution pension plans.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**29. BUSINESS ACQUISITIONS**

**2014**

**UNS ENERGY**

On August 15, 2014, Fortis acquired all of the outstanding common shares of UNS Energy for US\$60.25 per common share in cash, for an aggregate purchase price of approximately US\$4.5 billion, including the assumption of US\$2.0 billion of debt on closing.

Financing of the net cash purchase price of approximately \$2.7 billion (US\$2.5 billion) is substantially complete. Fortis completed the sale of \$1.8 billion 4% Convertible Debentures. Proceeds from the first installment of approximately \$599 million were received in January 2014. A significant portion of these cash proceeds were used to finance a portion of the UNS Energy acquisition. Proceeds from the final installment of approximately \$1.2 billion were received on October 28, 2014 and were used to repay borrowings under acquisition credit facilities initially used to finance a portion of the UNS Energy acquisition. Following the receipt of the final installment, on October 28, 2014, approximately 58.2 million common shares of Fortis were issued on conversion of the Convertible Debentures (Note 17). In September 2014 Fortis issued 24 million 4.1% Cumulative Redeemable Fixed Rate Reset First Preference Shares, Series M for gross proceeds of \$600 million (Note 19). The net proceeds were also used to repay a portion of borrowings under the acquisition credit facilities. The remainder of the purchase price was financed through credit facility borrowings under a medium-term bridge facility and the Corporation's revolving credit facility (Note 33).

UNS Energy is a vertically integrated utility services holding company, headquartered in Tucson, Arizona, engaged through its primary subsidiaries in the regulated electric generation and energy delivery business, primarily in the State of Arizona, serving approximately 658,000 electricity and gas customers. UNS Energy has three regulated utility subsidiaries: TEP, UNS Electric and UNS Gas. TEP is a vertically integrated regulated electric utility and UNS Energy's largest operating subsidiary, representing approximately 84% of UNS Energy's total assets at December 31, 2014. The Company generates, transmits and distributes electricity to approximately 415,000 retail electric customers in southeastern Arizona. TEP's service territory covers 2,991 square kilometres and includes a population of approximately 1,000,000 people in the greater Tucson metropolitan area in Pima County, as well as parts of Cochise County. The Company has sufficient generating capacity which, together with existing power purchase agreements and expected generation plant additions, should satisfy the requirements of its customer base and meet expected future peak demand requirements. TEP also sells wholesale electricity to other entities in the western United States.

UNS Electric is a vertically integrated regulated electric utility, representing approximately 10% of UNS Energy's total assets at December 31, 2014. The Company generates, transmits and distributes electricity to approximately 93,000 retail electric customers in Arizona's Mohave and Santa Cruz counties, which have a combined population of approximately 250,000.

UNS Gas is a regulated gas distribution company, representing approximately 6% of UNS Energy's total assets at December 31, 2014. The company serves approximately 150,000 retail customers in Arizona's Mohave, Yavapai, Coconino, Navajo and Santa Cruz counties, which have a combined population of approximately 700,000.

TEP and UNS Electric currently own or lease generation resources with an aggregate capacity of 2,746 MW, including 53 MW of solar capacity. Several of the generating assets in which UNS Energy has an interest are jointly owned. As at January 1, 2015, approximately 48% of UNS Energy's generating capacity is fuelled by coal. UNS Energy has a long-term energy resource diversification strategy to provide long-term rate stability for customers, mitigate environmental impacts, comply with regulatory requirements and leverage existing utility infrastructure. TEP is reducing its reliance on coal over the next few years by replacing portions of existing coal generation with efficient combined-cycle gas turbines and renewables, particularly by adding solar generating capacity.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**29. BUSINESS ACQUISITIONS (cont'd)**

**UNS ENERGY (cont'd)**

UNS Energy's operations are regulated by the ACC and FERC (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. No fair value adjustments, other than goodwill, 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.

The following table summarizes the preliminary allocation of the purchase consideration to the assets and liabilities acquired as at August 15, 2014 based on their fair values, using an exchange rate of US\$1.00=CDN\$1.0925. The preliminary amounts recognized are subject to change in the event that additional information is obtained about facts and circumstances that existed as of the acquisition date.

<i>(in millions)</i>	<b>Total</b>
<b>Purchase consideration</b>	<b>\$ 2,745</b>
<b>Fair value assigned to net assets:</b>	
Current assets	539
Long-term regulatory assets	185
Utility capital assets	3,972
Intangible assets	116
Other long-term assets	108
Current liabilities	(458)
Assumed long-term debt and capital lease and finance obligations (including current portion)	(2,186)
Long-term regulatory liabilities	(341)
Other long-term liabilities	(797)
	<b>1,138</b>
Cash and cash equivalents	97
<b>Fair value of net assets acquired</b>	<b>1,235</b>
<b>Goodwill (Note 12)</b>	<b>\$ 1,510</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 on August 15, 2014.

Acquisition-related expenses totalled approximately \$25 million (\$19 million after tax) for the year ended December 31, 2014, and have been recognized in other income (expenses), net on the consolidated statement of earnings (Note 23). In addition, approximately \$33 million (US\$30 million), or \$20 million (US\$18 million) after tax, in customer benefits offered to obtain regulatory approval of the acquisition were expensed in 2014 and were also recognized in other income (expenses), net on the consolidated statement of earnings (Notes 7 (xviii) and 23).

**Supplemental Pro Forma Data**

The unaudited pro forma financial information below gives effect to the acquisition of UNS Energy as if the transaction had occurred at the beginning of 2013. 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 2013, nor is it necessarily indicative of the results that may be expected in future periods.

<i>(in millions)</i>	<b>2014</b>	2013
Pro forma revenue <sup>(1)</sup>	<b>\$ 6,440</b>	\$ 5,576
Pro forma net earnings <sup>(1)</sup>	<b>578</b>	553

<sup>(1)</sup> Pro forma net earnings exclude all acquisition-related expenses incurred by UNS Energy and the Corporation, net of tax (Note 23). A pro forma adjustment has been made to net earnings for the years presented to reflect the Corporation's after-tax financing costs associated with the acquisition.

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**29. BUSINESS ACQUISITIONS (cont'd)**

**2013**

**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 primarily 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 17), and a US\$325 million unsecured notes offering by the Corporation (Note 14).

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 customers and 77,000 natural gas customers in eight counties of New York State's Mid-Hudson River Valley. Central Hudson accounted 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. 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 customers.

Non-regulated net assets acquired related 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. Griffith was sold in March 2014, and resulted in a \$3 million adjustment to the purchase price allocation, including a \$3 million increase in the amount allocated to intangible assets and an offsetting reduction in goodwill (Notes 12 and 26).

The following table summarizes the final 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 electric and gas operations of Central Hudson.

<i>(in 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	56
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)
	<b>527</b>
Cash and cash equivalents	19
<b>Fair value of net assets acquired</b>	<b>546</b>
<b>Goodwill (Note 12)</b>	<b>\$ 473</b>

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

**CH ENERGY GROUP (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.

In 2013 acquisition-related expenses of approximately \$9 million (\$6 million after tax) were recognized in other income (expenses), net on the consolidated statement of earnings (Note 23). 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 as approved by the PSC, and were also recognized in other income (expenses), net on the consolidated statement of earnings (Notes 7 (xviii) and 23).

**CITY OF KELOWNA'S ELECTRIC UTILITY ASSETS**

In March 2013 FortisBC Electric acquired the electric utility assets of the City of Kelowna (the "City") for approximately \$55 million, which allowed 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 electric utility assets under contract since 2000.

The acquisition was approved by the 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 with PBR mechanisms 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 customers.

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>(in 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 (Note 12)</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 CONSOLIDATED FINANCIAL STATEMENTS**  
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**30. SEGMENTED INFORMATION**

Information by reportable segment is as follows:

Year Ended December 31, 2014 (\$ millions)	REGULATED								NON-REGULATED					Inter- segment eliminations	Total
	United States			Canada					Caribbean Electric	Fortis Generation	Non- Utility	Corporate and Other			
	Electric & Gas UNS Energy	Central Hudson	Total	Gas FortisBC Energy	Fortis Alberta	FortisBC Electric	Eastern Canadian	Total							
Revenue	684	821	1,505	1,435	518	334	1,008	3,295	321	38	249	31	(38)	5,401	
Energy supply costs	272	345	617	646	-	87	653	1,386	195	1	-	-	(2)	2,197	
Operating expenses	209	337	546	287	176	90	143	696	39	10	172	38	(8)	1,493	
Depreciation and amortization	80	49	129	190	164	59	79	492	38	5	22	2	-	688	
Operating income (loss)	123	90	213	312	178	98	133	721	49	22	55	(9)	(28)	1,023	
Other income (expenses), net	4	6	10	4	3	1	2	10	2	(1)	-	(45)	(1)	(25)	
Finance charges	34	35	69	139	79	41	56	315	14	-	24	154	(29)	547	
Income tax expense (recovery)	33	24	57	49	(1)	12	19	79	-	1	8	(79)	-	66	
Net earnings (loss) from continuing operations	60	37	97	128	103	46	60	337	37	20	23	(129)	-	385	
Earnings from discontinued operations, net of tax	-	-	-	-	-	-	-	-	-	-	5	-	-	5	
Net earnings (loss)	60	37	97	128	103	46	60	337	37	20	28	(129)	-	390	
Non-controlling interests	-	-	-	1	-	-	-	1	10	-	-	-	-	11	
Preference share dividends	-	-	-	-	-	-	-	-	-	-	-	62	-	62	
Net earnings (loss) attributable to common equity shareholders	60	37	97	127	103	46	60	336	27	20	28	(191)	-	317	
Goodwill	1,603	523	2,126	913	227	235	67	1,442	164	-	-	-	-	3,732	
Identifiable assets	5,849	2,174	8,023	4,876	3,257	1,812	2,174	12,119	810	961	696	727	(440)	22,896	
Total assets	7,452	2,697	10,149	5,789	3,484	2,047	2,241	13,561	974	961	696	727	(440)	26,628	
Gross capital expenditures	444	126	570	332	348	92	166	938	71	102	38	6	-	1,725	
<b>Year Ended December 31, 2013 (\$ millions)</b>															
Revenue	-	335	335	1,378	475	317	975	3,145	290	35	248	26	(32)	4,047	
Energy supply costs	-	116	116	600	-	84	638	1,322	179	1	-	-	(1)	1,617	
Operating expenses	-	148	148	295	161	84	131	671	33	10	170	13	(8)	1,037	
Depreciation and amortization	-	21	21	180	150	49	77	456	35	5	22	2	-	541	
Operating income (loss)	-	50	50	303	164	100	129	696	43	19	56	11	(23)	852	
Other income (expenses), net	-	2	2	3	4	1	4	12	2	1	(1)	(45)	(2)	(31)	
Finance charges	-	16	16	142	73	39	56	310	13	1	26	48	(25)	389	
Income tax expense (recovery)	-	13	13	36	1	12	2	51	-	-	11	(43)	-	32	
Net earnings (loss) from continuing operations	-	23	23	128	94	50	75	347	32	19	18	(39)	-	400	
Earnings from discontinued operations, net of tax	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Extraordinary gain, net of tax	-	-	-	-	-	-	-	-	-	20	-	-	-	20	
Net earnings (loss)	-	23	23	128	94	50	75	347	32	39	18	(39)	-	420	
Non-controlling interests	-	-	-	1	-	-	-	1	9	-	-	-	-	10	
Preference share dividends	-	-	-	-	-	-	-	-	-	-	-	57	-	57	
Net earnings (loss) attributable to common equity shareholders	-	23	23	127	94	50	75	346	23	39	18	(96)	-	353	
Goodwill	-	483	483	913	227	235	67	1,442	150	-	-	-	-	2,075	
Identifiable assets	-	1,770	1,770	4,618	3,061	1,764	2,099	11,542	694	873	801	636	(483)	15,833	
Total assets	-	2,253	2,253	5,531	3,288	1,999	2,166	12,984	844	873	801	636	(483)	17,908	
Gross capital expenditures	-	57	57	215	429	69	148	861	52	146	46	13	-	1,175	

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**30. 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 during the years ended December 31 were as follows.

**Significant Related Party Inter-Segment Transactions**

<i>(in millions)</i>	2014	2013
Sales from Eastern Canadian Electric Utilities to Non-Utility	\$ 6	\$ 5
Sales from Fortis Generation to Eastern Canadian Electric Utilities	2	1
Inter-segment finance charges on lending from:		
Fortis Generation to Eastern Canadian Electric Utilities	1	1
Corporate to Regulated Electric Utilities - Caribbean	5	4
Corporate to Non-Utility	22	18

The significant related party inter-segment asset balances as at December 31 were as follows.

**Significant Related Party Inter-Segment Assets**

<i>(in millions)</i>	2014	2013
Inter-segment borrowings from:		
Fortis Generation to Eastern Canadian Electric Utilities	\$ 20	\$ 20
Corporate to Regulated Electric Utilities - Caribbean	-	85
Corporate to Non-Utility	402	366
Other inter-segment assets	18	12
Total inter-segment eliminations	\$ 440	\$ 483

**31. SUPPLEMENTARY INFORMATION TO CONSOLIDATED STATEMENTS OF CASH FLOWS**

<i>(in millions)</i>	2014	2013
<b>Cash paid for:</b>		
Interest	\$ 538	\$ 411
Income taxes	83	57
<b>Change in non-cash operating working capital:</b>		
Accounts receivable and other current assets	\$ 53	\$ (44)
Prepaid expenses	2	(13)
Inventories	(11)	7
Regulatory assets - current portion	(16)	73
Accounts payable and other current liabilities	(123)	(96)
Regulatory liabilities - current portion	(29)	28
	\$ (124)	\$ (45)
<b>Non-cash investing and financing activities:</b>		
Common share dividends reinvested	\$ 81	\$ 70
Conversion of Convertible Debentures into common shares (Note 17)	1,747	-
Additions to utility capital assets, non-utility capital assets, and intangible assets included in current liabilities	200	107
Contributions in aid of construction included in current assets	7	16
Exercise of stock options into common shares	5	1

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
For the years ended December 31, 2014 and 2013

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**32. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS**

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 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.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**32. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS (cont'd)**

The following table presents, by level within the fair value hierarchy, the Corporation's assets and liabilities accounted for at fair value on a reoccurring basis. These assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement and there were no transfers between the levels in the periods presented. For derivative instruments, the Corporation has elected gross presentation for its derivative contracts under master netting agreements and collateral positions.

<i>(\$ millions)</i>	<b>Fair value hierarchy</b>	<b>As at December 31</b>	
		<b>2014</b>	<b>2013</b>
<b>Assets</b>			
Energy contracts subject to regulatory deferral <sup>(1) (2)</sup>	Level 3	3	10
Energy contracts not subject to regulatory deferral <sup>(1) (2)</sup>	Level 3	1	-
Other investments <sup>(3)</sup>	Levels 1/2	36	6
<b>Total gross assets</b>		<b>40</b>	16
Less: Counterparty netting not offset on the balance sheet <sup>(4)</sup>		<b>(3)</b>	-
<b>Total net assets</b>		<b>37</b>	16
<b>Liabilities</b>			
Energy contracts subject to regulatory deferral <sup>(1) (2) (5)</sup>	Levels 1/2/3	72	15
Energy contracts not subject to regulatory deferral <sup>(1) (2)</sup>	Level 3	1	-
Energy contracts - cash flow hedges <sup>(2) (6)</sup>	Level 3	1	-
Interest rate swaps - cash flow hedges <sup>(6)</sup>	Level 2	5	-
<b>Total gross liabilities</b>		<b>79</b>	15
Less: Counterparty netting not offset on the balance sheet <sup>(4)</sup>		<b>(3)</b>	-
<b>Total net liabilities</b>		<b>76</b>	15

<sup>(1)</sup> The fair value of the Corporation's energy contracts are recorded in accounts receivable and other current assets, long-term other assets, accounts payable and other current liabilities and long-term other liabilities. Unrealized gains and losses arising from changes in fair value of these contracts are deferred as a regulatory asset or liability for recovery from, or refund to, customers in rates as permitted by the regulators, with the exception of long-term energy sales contracts.

<sup>(2)</sup> Changes in one or more of the unobservable inputs could have a significant impact on the fair value measurement depending on the magnitude and direction of the change for each input. The impacts of changes in fair value are subject to regulatory recovery, with the exception of long-term energy sales contracts.

<sup>(3)</sup> Included in long-term other assets on the consolidated balance sheet and includes \$5 million - level 1 and \$31 million - level 2 (2013 - \$6 million - level 1)

<sup>(4)</sup> Certain energy contracts are subject to legally enforceable master netting arrangements to mitigate credit risk and netted by counterparty where the intent and legal right to offset exists.

<sup>(5)</sup> Includes \$2 million - level 1, \$35 million - level 2 and \$35 million - level 3 (2013 - \$15 million - level 2)

<sup>(6)</sup> The fair value of certain of the Corporation's energy contracts are recorded in accounts payable and other current liabilities and the fair value of the Corporation's interest rate swaps are recorded in accounts payable and other current liabilities and long-term other liabilities. Unrealized gains and losses arising from changes in fair value are recorded in other comprehensive income until they become realized and are reclassified to earnings.

**FORTIS INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**32. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS (cont'd)**

**Derivative Instruments**

The Corporation generally limits the use of derivative instruments to those that qualify as accounting, economic or cash flow hedges. The Corporation is required to record all derivative instruments at fair value, except for those that qualify for the normal purchase and normal sale exception. The fair value of derivative instruments 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.

*Energy Contracts Subject to Regulatory Deferral*

UNS Energy holds electricity power purchase contracts and gas swap and option contracts to reduce its exposure to energy price risk associated with purchased power and gas requirements. UNS Energy primarily applies the market approach for fair value measurements using independent third-party information, where possible. When published prices are not available, adjustments are applied based on historical price curve relationships and transmission and line losses. The fair value of gas swap and option contracts are estimated using a Black-Scholes option-pricing model, which includes inputs such as implied volatility, interest rates, and forward price curves. UNS Energy also considers the impact of counterparty credit risk using current and historical default and recovery rates, as well as its own credit risk using credit default swap data.

Central Hudson holds electricity swap contracts and gas swap and option contracts to minimize commodity price volatility for electricity and natural gas purchases by fixing the effective purchase price for the defined commodities. The fair value of the electricity swap contracts and gas swap and option contracts was calculated using forward pricing provided by independent third parties.

The FortisBC Energy companies hold gas swap and option contracts and gas purchase contract premiums 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 derivatives was calculated using the present value of cash flows based on market prices and forward curves for the cost of natural gas.

As at December 31, 2014, these energy contract derivatives were not designated as hedges; however, any unrealized gains or losses associated with changes in the fair value of the derivatives are deferred as a regulatory asset or liability for recovery from, or refund to, customers in future rates, as permitted by the regulators. These unrealized losses and gains would otherwise be recorded in earnings. As at December 31, 2014, unrealized losses of \$69 million (December 31, 2013 - \$15 million) were recognized in current regulatory assets and no unrealized gains were recognized in regulatory liabilities (December 31, 2013 - \$10 million) (Note 7 (vii)).

*Energy Contracts Not Subject to Regulatory Deferral*

From time to time, UNS Energy enters into forward contracts with long-term wholesale customers that qualify as derivative instruments. The fair value of power sales contracts is determined using observable market variables, regional power and gas prices, as well as the ratio between the two, and the prevailing market heat rate. The unrealized gains and losses on these derivative instruments are recorded in earnings, as they do not qualify for regulatory deferral. In December 2014 TEP entered into a three-year sales option contract and unrealized gains of less than \$1 million associated with this contract were recognized in 2014.

*Cash Flow Hedges*

UNS Energy holds interest rate swaps, expiring in 2020, to mitigate its exposure to volatility in variable interest rates on debt, and a power purchase swap, expiring in September 2015, to hedge the cash flow risk associated with a long-term power supply agreement. The after-tax unrealized gains and losses on cash flow hedges are recorded in other comprehensive income and reclassified to earnings as they become realized. The loss expected to be reclassified to earnings within the next twelve months is estimated to be approximately \$3 million.

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**32. FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS (cont'd)**

**Derivative Instruments (cont'd)**

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

**Volume of Derivative Activity**

As at December 31, 2014, the following notional volumes related to electricity and natural gas derivatives that are expected to be settled are outlined below.

<b>Volume</b>	Maturity (year)	Contracts (#)	2015	2016	2017
Energy contracts subject to regulatory deferral:					
Electricity swap contracts (GWh)	2017	7	1,200	659	219
Electricity power purchase contracts (GWh)	2017	33	1,206	457	145
Gas swap and option contracts (PJ)	2017	188	49	9	4
Gas purchase contract premiums (PJ)	2015	54	75	-	-
Energy contracts not subject to regulatory deferral:					
Long-term power sales contracts (GWh)	2017	1	536	586	634
Energy contracts - cash flow hedges (GWh)	2015	1	59	-	-

**Financial Instruments Not Carried At Fair Value**

The following table discloses the estimated fair value measurements of the Corporation's financial instruments not carried at fair value. The fair values were measured using Level 2 pricing inputs, except as noted. 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:

<b>Asset (Liability)</b> <i>(in millions)</i>	<b>As at</b>		December 31, 2013	
	December 31, 2014 Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Long-term other asset - Belize Electricity <sup>(1)</sup>	\$ 116	\$ n/a <sup>(2)</sup>	\$ 108	\$ n/a <sup>(2)</sup>
Long-term debt, including current portion <sup>(3)</sup>	(10,501)	(12,237)	(7,204)	(8,084)
Waneta Partnership promissory note <sup>(4)</sup>	(53)	(56)	(50)	(50)

<sup>(1)</sup> Included in long-term other assets on the consolidated balance sheet (Note 8).

<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 GOB may pay to Fortis is indeterminable at this time (Notes 33 and 35).

<sup>(3)</sup> The Corporation's \$200 million unsecured debentures due 2039 and consolidated borrowings under credit facilities classified as long-term debt of \$1,096 million (December 31, 2013 - \$313 million) are valued using Level 1 inputs. All other long-term debt is valued using Level 2 inputs.

<sup>(4)</sup> Included in long-term other liabilities on the consolidated balance sheet (Note 16).

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) 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.

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### **33. 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.

**Credit risk** Risk that a counterparty to a financial instrument might fail to meet its obligations under the terms of the financial instrument.

**Liquidity risk** Risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments.

**Market risk** 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.

#### **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 December 31, 2014, FortisAlberta's gross credit risk exposure was approximately \$111 million, representing the projected value of retailer billings over a 37-day period. The Company has reduced its exposure to \$2 million by obtaining from the retailers either a cash deposit, bond, letter of credit, an investment-grade credit rating from a major rating agency, or a financial guarantee from an entity with an investment-grade credit rating.

UNS Energy, Central Hudson and the FortisBC Energy companies may be exposed to credit risk in the event of non-performance by counterparties to derivative instruments. The Companies use netting arrangements to reduce credit risk and net settle payments with counterparties where net settlement provisions exist. They also limit credit risk by only dealing with counterparties that have investment-grade credit ratings. At UNS Energy, contractual arrangements also contain certain provisions requiring counterparties to derivative instruments to post collateral under certain circumstances.

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 GOB as a result of the expropriation of the Corporation's investment in Belize Electricity by the GOB on June 20, 2011. As at December 31, 2014, the Corporation had a long-term other asset of \$116 million (December 31, 2013 - \$108 million), including foreign exchange impacts, recognized on the consolidated balance sheet related to its expropriated investment in Belize Electricity (Notes 8, 32 and 35).

#### **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.

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**33. FINANCIAL RISK MANAGEMENT (cont'd)**

**Liquidity Risk (cont'd)**

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 \$1 billion committed corporate credit facility is available for interim financing of acquisitions and for general corporate purposes. Depending on the timing of cash payments from 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 December 31, 2014, over the next five years, average annual consolidated long-term debt maturities and repayments are expected to be approximately \$240 million, excluding long-term credit facility borrowings. The combination of available credit facilities and relatively low annual debt maturities and repayments provides the Corporation and its subsidiaries with flexibility in the timing of access to capital markets.

As at December 31, 2014, the Corporation and its subsidiaries had consolidated credit facilities of approximately \$3.9 billion, of which approximately \$2.2 billion was unused, including \$509 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 \$3.7 billion of the total credit facilities are committed facilities with maturities ranging from 2015 through 2019.

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

<i>(in millions)</i>	Regulated Utilities	Non- Regulated	Corporate and Other	<b>Total as at December 31, 2014</b>	Total as at December 31, 2013
Total credit facilities	\$ 2,248	\$ 12	\$ 1,594	\$ <b>3,854</b>	\$ 2,695
Credit facilities utilized:					
Short-term borrowings <sup>(1)</sup>	(325)	(5)	-	<b>(330)</b>	(160)
Long-term debt (Note 14) <sup>(2)</sup>	(258)	-	(838)	<b>(1,096)</b>	(313)
Letters of credit outstanding	(161)	-	(31)	<b>(192)</b>	(66)
Credit facilities unused	\$ 1,504	\$ 7	\$ 725	\$ <b>2,236</b>	\$ 2,156

<sup>(1)</sup> The weighted average interest rate on short-term borrowings was approximately 1.3% as at December 31, 2014 (December 31, 2013 - 1.3%)

<sup>(2)</sup> As at December 31, 2014, credit facility borrowings classified as long term included \$237 million in current installments of long-term debt on the consolidated balance sheet (December 31, 2013 - \$43 million). The weighted average interest rate on credit facility borrowings classified as long-term debt was approximately 1.8% as at December 31, 2014 (December 31, 2013 - 1.8%).

As at December 31, 2014 and 2013, 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.

*Regulated Utilities*

The UNS Utilities have a total of US\$370 million (\$429 million) in unsecured committed revolving credit facilities, of which US\$300 million (\$348 million) matures in November 2016 and the remaining US\$70 million (\$81 million) matures in November 2015. The UNS Utilities also have a US\$130 million (\$151 million) term loan commitment and a US\$82 million (\$95 million) letter of credit facility, maturing in November 2015 and 2016, respectively.

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

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

##### *Regulated Utilities (cont'd)*

Central Hudson has a US\$150 million (\$174 million) unsecured committed revolving credit facility, maturing in October 2016, that is utilized to finance capital expenditures and for general corporate purposes.

FEI has a \$500 million unsecured committed revolving credit facility, maturing in August 2016, and a \$200 million unsecured committed revolving credit facility, maturing in December 2015. The facilities are utilized to finance working capital requirements and capital expenditures and for general corporate purposes.

FortisAlberta has a \$250 million unsecured committed revolving credit facility, maturing in August 2019, that is utilized to finance capital expenditures and for general corporate purposes.

FortisBC Electric has a \$150 million unsecured committed revolving credit facility, of which \$50 million matures in April 2015 and the remaining \$100 million matures in May 2017. This facility is utilized to finance capital expenditures and for general corporate purposes. FortisBC Electric also has a \$10 million unsecured demand overdraft facility.

Newfoundland Power has a \$100 million committed revolving credit facility, which matures in August 2019, and a \$20 million demand credit facility. Maritime Electric has a \$50 million unsecured committed revolving credit facility, maturing in February 2019, and a \$5 million unsecured demand credit facility. FortisOntario has a \$30 million unsecured committed revolving credit facility, maturing in June 2015.

Caribbean Utilities has unsecured credit facilities totalling approximately US\$47 million (\$54 million). Fortis Turks and Caicos has short-term unsecured demand credit facilities of US\$26 million (\$30 million), maturing in September 2015.

##### *Non-Regulated – Non-Utility*

Fortis Properties has a \$12 million secured revolving demand credit facility that can be utilized for general corporate purposes.

##### *Corporate and Other*

Fortis has a \$1 billion unsecured committed revolving credit facility, maturing in July 2018, that is available for general corporate purposes; a \$273 million medium-term bridge facility secured to initially finance a portion of the acquisition of UNS Energy, maturing in August 2016; and a \$30 million letter of credit facility, maturing in January 2016.

UNS Energy Corporation has a US\$125 million (\$145 million) unsecured committed revolving credit facility, maturing in November 2016.

CH Energy Group has a US\$100 million (\$116 million) unsecured committed revolving credit facility, maturing in October 2015, that can be utilized for general corporate purposes.

FHI has a \$30 million unsecured committed revolving credit facility, maturing in April 2015, that is available for general corporate purposes.

The Corporation and its currently rated utilities target investment-grade credit ratings to maintain capital market access at reasonable interest rates. As at December 31, 2014, the Corporation's credit ratings were as follows:

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

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

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

The above-noted credit ratings reflect the Corporation's low business-risk profile and diversity of its operations, the stand-alone nature and financial separation of each of the regulated subsidiaries of Fortis, and management's commitment to maintaining low levels of debt at the holding company level. In October 2014, following the completion of equity financing associated with the acquisition of UNS Energy, S&P confirmed the Corporation's credit rating and revised its outlook to Stable. Similarly, in December 2014 DBRS confirmed the Corporation's credit rating with a Stable outlook.

#### **Market Risk**

##### *Foreign Exchange Risk*

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 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 gain or loss on the translation of the Corporation's foreign subsidiaries' earnings, which are denominated in US dollars. The reporting currency of UNS Energy, Central Hudson, Caribbean Utilities, Fortis Turks and Caicos, BECOL and FortisUS Energy is the US dollar.

As at December 31, 2014, the Corporation's corporately issued US\$1,496 million (December 31, 2013 - US\$1,033 million) long-term debt had been designated as an effective hedge of the Corporation's foreign net investments. As at December 31, 2014, the Corporation had approximately US\$2,762 million (December 31, 2013 - US\$560 million) in foreign net investments remaining to be hedged. The Corporation's US dollar-denominated foreign net investments as at December 31, 2014 were significantly impacted by the UNS Energy acquisition, which was substantially financed through Convertible Debentures and preference shares denominated in Canadian dollars. 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 on the balance sheet in accumulated 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 on the balance sheet in accumulated other comprehensive income.

As a result of the acquisition of UNS Energy, consolidated earnings and cash flows of Fortis will be impacted to a greater extent by fluctuations in the US dollar-to-Canadian dollar exchange rate. On an annual basis, it is estimated that a 5 cent, or 5%, increase or decrease in the US dollar relative to the Canadian dollar exchange rate of US \$1.00=CDN \$1.16 as at December 31, 2014 would increase or decrease earnings per common share of Fortis by approximately 4 cents. Management will continue to hedge future exchange rate fluctuations related to the Corporation's foreign net investments and US dollar-denominated earnings streams, where possible, through future US dollar-denominated borrowings, and will continue to monitor the Corporation's exposure to foreign currency fluctuations on a regular basis.

Effective June 20, 2011, the Corporation's asset associated with its expropriated investment in Belize Electricity (Notes 8, 32 and 35) 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. In 2014 the Corporation recognized in earnings a foreign exchange gain of approximately \$8 million (2013 - \$6 million) (Note 23).

##### *Interest Rate Risk*

The Corporation and most of its subsidiaries are exposed to interest rate risk associated with borrowings under variable-rate credit facilities and the refinancing of long-term debt. The Corporation and its subsidiaries may enter into interest rate swap agreements to help reduce this risk (Notes 14 and 15).

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**33. FINANCIAL RISK MANAGEMENT (cont'd)**

**Market Risk (cont'd)**

*Commodity Price Risk*

UNS Energy is exposed to commodity price risk associated with changes in the market price of gas, purchased power and coal. Central Hudson is exposed to commodity price risk associated with changes in the market price of electricity and natural gas. The FortisBC Energy companies are exposed to commodity price risk associated with changes in the market price of natural gas. The risks have been reduced by entering into derivative contracts that effectively fix the price of natural gas, power and electricity, and coal purchases. These derivative instruments 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 (Note 32).

**34. COMMITMENTS**

As at December 31, 2014, the Corporation's consolidated commitments in each of the next five years and for periods thereafter, excluding repayments of long-term debt and capital lease and finance obligations separately disclosed in Notes 14 and 15, respectively, are as follows:

<i>(\$ in millions)</i>	<b>Total</b>	Due within 1 year	Due in year 2	Due in year 3	Due in year 4	Due in year 5	Due after 5 years
Interest obligations on long-term debt	<b>8,838</b>	497	475	449	444	432	6,541
Renewable power purchase obligations <sup>(1)</sup>	<b>1,031</b>	59	59	59	59	59	736
Long-term contracts - UNS Energy <sup>(2)</sup>	<b>929</b>	121	122	117	85	83	401
Power purchase obligations <sup>(3)</sup>	<b>891</b>	243	161	128	101	76	182
Capital cost <sup>(4)</sup>	<b>518</b>	19	22	19	21	19	418
Gas purchase obligations <sup>(5)</sup>	<b>314</b>	235	20	16	11	9	23
Renewable energy credit purchase agreements <sup>(6)</sup>	<b>146</b>	11	11	11	11	11	91
Purchase of Springerville Common facilities <sup>(7)</sup>	<b>123</b>	-	-	44	-	-	79
Defined benefit pension funding contributions <sup>(8)</sup>	<b>182</b>	77	36	7	8	8	46
Operating lease obligations <sup>(9)</sup>	<b>152</b>	11	10	9	8	8	106
Waneta Partnership promissory note <sup>(10)</sup>	<b>72</b>	-	-	-	-	-	72
Joint-use asset and shared service agreements <sup>(11)</sup>	<b>53</b>	3	3	3	3	3	38
Other <sup>(12)</sup>	<b>72</b>	12	11	10	-	3	36
<b>Total</b>	<b>13,321</b>	1,288	930	872	751	711	8,769

<sup>(1)</sup> UNS Energy is party to 20-year long-term renewable power purchase agreements totalling approximately US\$888 million as at December 31, 2014, which require UNS Energy to purchase 100% of the output of certain renewable energy generating facilities that have achieved commercial operation. These agreements have various expiry dates through 2034. UNS Energy has entered into additional long-term renewable power purchase agreements to comply with Renewable Energy Standards of the State of Arizona; however, the Company's obligation to purchase power under these agreements does not begin until the facilities are operational.

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**34. COMMITMENTS (cont'd)**

- (2) UNS Energy has entered into various long-term contracts for the purchase and delivery of coal to fuel its generating facilities, the purchase of gas transportation services to meet its load requirements, and the purchase of transmission services for purchased power, with obligations totalling US\$510 million, US\$215 million and US\$75 million, respectively, as at December 31, 2014. Amounts paid under contracts for the purchase and delivery of coal depends on actual quantities purchased and delivered. Certain of these contracts also have price adjustment clauses that will affect future costs under the contracts.
- (3) Power purchase obligations include various power purchase contracts held by certain of the Corporation's subsidiaries, mainly Central Hudson, FortisBC Electric and FortisOntario, with obligations totalling US\$162 million, \$311 million, and \$259 million, respectively.

*Central Hudson*

Central Hudson meets its capacity and electricity obligations through contracts with capacity and energy providers, purchases from the New York Independent System Operator energy and capacity markets, and its own generating capacity. In 2014 Central Hudson entered into two agreements to purchase electricity on a unit-contingent basis at defined prices from December 2014 through March 2015. These contracts replaced existing contracts which expired at the end of 2013.

In June 2014 Central Hudson entered into a contract to purchase available installed capacity from the Danskammer Generating Facility from October 2014 through August 2018 with approximately US\$91 million in purchase commitments remaining as at December 31, 2014. In November 2013 Central Hudson entered into a contract to purchase 200 MW of installed capacity from May 2014 through April 2017, with approximately US\$34 million in purchase commitments remaining as at December 31, 2014.

*FortisBC Electric*

Power purchase obligations for FortisBC Electric are mainly comprised of a 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 in October 2013. This PPA was approved by the BCUC in May 2014 and was effective July 2014. The capacity and energy to be purchased under this agreement do not relate to a specific plant.

In November 2011 FortisBC Electric executed the Waneta Expansion Capacity Agreement ("WECA"). The WECA allows FortisBC Electric to purchase capacity over 40 years upon completion of the Waneta Expansion, which is expected in spring 2015. In May 2012 the WECA was accepted for filing as an energy supply contract by the BCUC. Amounts associated with the WECA have not been included in the Commitments table as they are to be paid by FortisBC Electric to a related party and such a related-party transaction would be eliminated upon consolidation with Fortis.

FortisBC Electric is also party to various agreements to purchase fixed-price capacity and energy purchases through 2017. The purchases under these agreements do not relate to specific plants and/or the output being purchased does not constitute a significant portion of the output of a specific plant.

*FortisOntario*

Power purchase obligations for FortisOntario primarily include two long-term take-or-pay contracts between Cornwall Electric and Hydro-Québec Energy Marketing for the supply of energy and capacity. The first contract provides approximately 237 GWh of energy per year and up to 45 MW of capacity at any one time. The second contract, supplying the remainder of Cornwall Electric's energy requirements, provides 100 MW of capacity and energy and provides a minimum of 300 GWh of energy per contract year. Both contracts expire in December 2019.

**FORTIS INC.**  
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**34. COMMITMENTS (cont'd)**

- <sup>(4)</sup> Maritime Electric has entitlement to approximately 4.55% of the output from New Brunswick Power's Point Lepreau nuclear generating station 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.
- <sup>(5)</sup> Gas purchase obligations include various gas purchase contracts held by certain of the Corporation's subsidiaries, mainly the FortisBC Energy companies and Central Hudson. At the FortisBC Energy companies, the obligations include the gross cash payments associated with natural gas derivatives (Note 32) and are based on market prices as at December 31, 2014. At Central Hudson, the obligations are based on tariff rates, negotiated rates and market prices as at December 31, 2014.
- <sup>(6)</sup> UNS Energy is party to renewable energy credit purchase agreements, totalling approximately US\$126 million as at December 31, 2014, to purchase the environmental attributions from retail customers with solar installations. Payments for the renewable energy credit purchase agreements are paid in contractually agreed-upon intervals based on metered renewable energy production.
- <sup>(7)</sup> UNS Energy has entered into a commitment to exercise its fixed-price purchase provision to purchase an undivided 50% leased interest in the Springerville Common Facilities if the lease is not renewed, for a purchase price of US\$106 million, with one facility to be acquired in 2017 and the remaining two facilities to be acquired in 2021 (Note 15).
- <sup>(8)</sup> Consolidated defined benefit pension funding contributions include current service, solvency and special funding amounts. The contributions are based on estimates provided under the latest completed actuarial valuations. As a result, actual pension funding contributions may be higher than these estimated amounts, pending completion of the next actuarial valuations for funding purposes (Note 28).
- <sup>(9)</sup> Operating lease obligations include certain office, warehouse, natural gas T&D asset, rail car, land easement and rights-of-way, and vehicle and equipment leases.
- <sup>(10)</sup> Payment is expected to be made in 2020 and relates to certain intangible assets and project design costs acquired from a company affiliated with CPC/CBT related to the construction of the Waneta Expansion. The amount disclosed is on a gross cash flow basis. The promissory note was recorded in long-term other liabilities at its discounted net present value of \$53 million as at December 31, 2014 (Note 16).
- <sup>(11)</sup> FortisAlberta and an Alberta transmission service provider have entered into an agreement to allow for joint attachments of distribution facilities to the transmission system, as well as service agreements to ensure operational efficiencies are maintained through coordinated operations. The expiry terms of the joint attachment agreement state that the agreement remains in effect until FortisAlberta no longer has attachments to the transmission system. Due to the unlimited term of this agreement, the calculation of future payments after 2019 includes payments to the end of 20 years, however, payments under this agreement may continue for an indefinite period of time.
- <sup>(12)</sup> Other contractual obligations include various other commitments entered into by the Corporation and its subsidiaries including Performance Share Unit and Deferred Share Unit Plan obligations and asset retirement obligations.

**Other Commitments**

*Capital Expenditures:* The Corporation's regulated utilities are obligated to provide service to customers within their respective service territories. The regulated utilities' capital expenditures are largely driven by the need to ensure continued and enhanced performance, reliability and safety of the electricity and gas systems and to meet customer growth. The Corporation's consolidated capital expenditure program, including capital spending at its non-regulated operations, is forecast to be approximately \$2.2 billion for 2015. Over the five years 2015 through 2019, the Corporation's consolidated capital expenditure program is expected to approach \$9 billion, which has not been included in the Commitments table.

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### **34. COMMITMENTS (cont'd)**

#### **Other Commitments (cont'd)**

*Other:* CH Energy Group is party to an investment to develop, own and operate electric transmission projects in New York State. In December 2014 an application was filed with FERC for the recovery of the cost of and return on five high-voltage transmission projects totalling US\$1.7 billion, of which CH Energy Group's maximum commitment is US\$182 million.

In 2014 Caribbean Utilities renewed its primary and secondary fuel supply contracts and is committed to purchasing approximately 60% and 40%, respectively, of the Company's diesel fuel requirements under the contracts for the operation of its diesel-powered generating plant. The approximate combined quantity under the contracts for 2015 is 30 million imperial gallons.

Fortis Turks and Caicos has a renewable contract with a major supplier for all of its diesel fuel requirements associated with the generation of electricity. The approximate fuel requirements under this contract are 12 million imperial gallons per annum.

The Corporation's long-term regulatory liabilities of \$1,363 million as at December 31, 2014 have been excluded from the Commitments table, as the final timing of settlement of many of the liabilities is subject to further regulatory determination. The nature and amount of the long-term regulatory liabilities are detailed in Note 7.

### **35. 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. 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 was rendered by the Belize Court of Appeal in May 2014. The two Belizean judges found in favour of the GOB; however, the third judge delivered a strong dissenting opinion concluding that the expropriation was contrary to the Belize Constitution. An appeal of the decision to the Caribbean Court of Justice ("CCJ"), the final court for appeals arising in Belize, was filed in June 2014 and Fortis filed its written submission for appeal in October 2014. The case was brought before the CCJ for hearing in December 2014 and January 2015 and it is not known at this time when a judgment will be received.

Fortis believes it has a strong, well-positioned case supporting the unconstitutionality of the expropriation. There exists, however, a possibility that the outcome of the litigation may be unfavourable to the Corporation and the amount of compensation to be paid to Fortis could be lower than the book value of the Corporation's expropriated investment in Belize Electricity. The book value was \$116 million, including foreign exchange impacts, as at December 31, 2014 (December 31, 2013 - \$108 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) ordering return of the shares to Fortis and/or award of damages; or (ii) ordering compensation to be paid to Fortis for the unconstitutional expropriation of the shares and/or award of damages. Based on presently available information, the \$116 million long-term other asset is not deemed impaired as at December 31, 2014. Fortis will continue to assess for impairment each reporting period based on evaluating the outcomes of court proceedings and/or compensation settlement negotiations.

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### **36. 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 adverse effect on the Corporation's consolidated financial position or results of operations.

The following describes the nature of the Corporation's contingencies.

#### **UNS Energy**

##### *Springerville Unit 1*

In November 2014 the Springerville Unit 1 third-party owners filed a complaint ("FERC Action") against TEP with FERC alleging that TEP had not agreed to wheel power and energy for the third-party owners in the manner specified in the Springerville Unit 1 facility support agreement between TEP and the third-party owners and for the cost specified by the third-party owners. The third-party owners requested an order from FERC requiring such wheeling of the third-party owners' energy from their Springerville Unit 1 interests beginning on January 1, 2015 for the price specified by the third-party owners. In December 2014 TEP filed a response to the FERC Action denying the allegations and requesting that FERC dismiss the complaint.

In December 2014 the third-party owners filed a complaint ("New York Action") against TEP in the Supreme Court of the State of New York, New York County, alleging, among other things, that: TEP has refused to comply with the third-party owners' instructions to schedule their entitlement share of power and energy; that TEP failed to comply with their instructions to specify the level of fuel and fuel handling services; that TEP has failed to properly operate, maintain and make capital investments in Springerville Unit 1 during the term of the leases; that TEP has not agreed to wheel power and energy in the manner required as set forth in the FERC Action; and that TEP has breached fiduciary duties claimed to be owed to the third-party owners. The New York Action seeks declaratory judgments, injunctive relief, damages in an amount to be determined at trial, and the third-party owners' fees and expenses.

In December 2014 Wilmington Trust Company, as owner trustees and lessors under the leases of the third-party owners, sent a notice to TEP that alleges that TEP has defaulted under the third-party owners' leases. The notice states that the owner trustees, as lessors, are exercising their rights to keep the undivided interests idle and demanding that TEP pay, on January 1, 2015, liquidated damages totalling approximately US\$71 million. In a letter to Wilmington Trust Company in December 2014, TEP denied the allegations in the notice. In January 2015 Wilmington Trust Company sent a second notice to TEP that alleges that TEP has defaulted under the third-party owners' leases by not remediating the defaults alleged in the first notice. The second notice repeated the demand that TEP pay liquidated damages totalling approximately US\$71 million. In a letter to Wilmington Trust Company, TEP denied the allegations in the second notice.

TEP cannot predict the outcome of the claims relating to Springerville Unit 1 and, due to the general and non-specific scope and nature of the injunctive relief sought for these claims, TEP cannot determine estimates of the range of loss at this time and, accordingly, no amount has been accrued in the consolidated financial statements. TEP intends to vigorously defend itself against the claims asserted by the third-party owners.

##### *San Juan Generating Station*

San Juan Coal Company ("SJCC") operates an underground coal mine in an area where certain gas producers have oil and gas leases with the Government of the United States, the State of New Mexico, and private parties. These gas producers allege that SJCC's underground coal mine interferes with their operations, reducing the amount of natural gas they can recover. SJCC compensated certain gas producers for any remaining production from wells deemed close enough to the mine to warrant plugging and abandoning them. These settlements, however, do not resolve all potential claims by gas producers in the area. TEP owns 50% of Units 1 and 2 at San Juan generating station, which represents approximately 20% of the total generation capacity at San Juan, and is responsible for its share of any settlements. The Company cannot reasonably estimate the impact of any future claims by these gas producers and, accordingly, no amount has been accrued in the consolidated financial statements.

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**36. CONTINGENCIES (cont'd)**

**UNS Energy (cont'd)**

*Mine Reclamation Costs*

TEP pays ongoing reclamation costs related to coal mines that supply generating stations in which the Company has an ownership interest but does not operate. TEP is liable for a portion of final reclamation costs upon closure of the mines servicing the San Juan, Four Corners and Navajo generating stations. TEP's share of reclamation costs at all three mines is expected to be US\$49 million upon expiration of the coal supply agreements, which expire between 2017 and 2031. The mine reclamation liability recorded as at December 31, 2014 was US\$22 million, and represents the present value of the estimated future liability (Note 16).

Amounts recorded for final reclamation are subject to various assumptions, such as estimations of reclamation costs, the dates when final reclamation will occur, and the credit-adjusted risk-free interest rate to be used to discount future liabilities. As these assumptions change, TEP will prospectively adjust the expense amounts for final reclamation over the remaining coal supply agreements' terms.

TEP is permitted to fully recover these costs from retail customers and, accordingly, these costs are deferred as a regulatory asset (Note 7 (x)).

**Central Hudson**

*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 December 31, 2014, an obligation of US\$105 million was recognized in respect of MGP 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\$169 million (Notes 13 and 16).

Central Hudson has notified its insurers and intends to seek reimbursement from insurers for remediation, where coverage exists. Further, as authorized by the New York State Public Service Commission, Central Hudson is currently permitted to defer, for future recovery from customers, 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 7 (iii)).

*Asbestos Litigation*

Prior to and after the acquisition of CH Energy Group, various asbestos lawsuits have been brought against Central Hudson. While a total of 3,348 asbestos cases have been raised, 1,170 remained pending as at December 31, 2014. Of the cases no longer pending against Central Hudson, 2,022 have been dismissed or discontinued without payment by the Company, and Central Hudson has settled the remaining 156 cases. The Company is presently unable to assess the validity of the outstanding 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 consolidated financial statements.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**36. CONTINGENCIES (cont'd)**

**FortisBC Electric**

The Government of British Columbia filed a claim in the British Columbia Supreme Court ("B.C. 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 include 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 Company 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 consolidated financial statements.

**Fortis**

Following the announcement of the acquisition of UNS Energy on December 11, 2013, four complaints which named Fortis and other defendants were filed in the Superior Court of the State of Arizona ("Superior Court") in and for the County of Pima and one claim in the United States District Court in and for the District of Arizona, challenging the acquisition. The complaints generally allege that the directors of UNS Energy breached their fiduciary duties in connection with the acquisition and that UNS Energy, Fortis, FortisUS Inc., and Color Acquisition Sub Inc. aided and abetted that breach. In March 2014 two of the four complaints filed in the Superior Court were dismissed by the plaintiffs and counsel for the parties in the two actions remaining in the Superior Court executed a Memorandum of Understanding recording an agreement-in-principle on the structure of a settlement to be proposed to the Superior Court for approval following closing of the acquisition. In April 2014 the complaint filed in the United States District Court was dismissed by the plaintiff. The outcome of these lawsuits cannot be predicted with any certainty and, accordingly, no amount has been accrued in the consolidated financial statements.

**FHI**

In April 2013 FHI and Fortis were named as defendants in an action in the B.C. 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 consolidated financial statements.

**37. COMPARATIVE FIGURES**

Certain comparative figures have been reclassified to comply with current year presentation. The former "Other Canadian Electric Utilities" segment is now "Eastern Canadian Electric Utilities" and now includes Newfoundland Power, Maritime Electric and FortisOntario.