Diane Roy
Vice President, Regulatory Affairs

Gas Regulatory Affairs Correspondence
Email: gas.regulatory.affairs@fortisbc.com

Electric Regulatory Affairs Correspondence
Email: electricity.regulatory.affairs@fortisbc.com

FortisBC
16705 Fraser Highway
Surrey, B.C. V4N 0E8
Tel: (604) 576-7349
Cell: (604) 908-2790
Fax: (604) 576-7074
www.fortisbc.com

December 12, 2022

British Columbia Utilities Commission
Suite 410, 900 Howe Street
Vancouver, BC
V6Z 2N3

Attention: Ms. Sara Hardgrave, Acting Commission Secretary

Dear Ms. Hardgrave:

Re: British Columbia Utilities Commission (BCUC) 2022 Generic Cost of Capital (GCOC) Proceeding

FortisBC Energy Inc. (FEI) and FortisBC Inc. (FBC) (collectively FortisBC) Responses to Undertakings

On November 23, 2022, in compliance with BCUC Order G-237-22, FortisBC filed its responses to undertakings from the Oral Hearing of November 7, 2022 to November 9, 2022 in the above referenced proceeding.

In FortisBC's response to Undertaking No. 3 (filed as part of Exhibit B1-50), FortisBC stated that it would file Moody's credit rating reports for FEI and FBC in this proceeding if they became available prior to close of the evidentiary record on December 9, 2022. Moody's credit rating report for FEI was published in late hours of Friday, December 9, 2022 and is attached to this letter.

FortisBC notes that Moody's published its credit rating report for FBC on December 12, 2022, after the close of the evidentiary record. FortisBC is prepared to file FBC's credit rating report in this proceeding if requested by the BCUC.

If further information is required, please contact the undersigned.

Sincerely,

on behalf of FORTISBC

Original signed:

Diane Roy

Attachments

cc (email only): Registered Interveners

MOODY'S INVESTORS SERVICE

CREDIT OPINION
9 December 2022

Update

Send Your Feedback

RATINGS

FortisBC Energy Inc.

Domicile	Vancouver, British Columbia, Canada
Long Term Rating	A3
Type	Senior Unsecured - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Gavin MacFarlane +1.416.214.3864
VP-Sr Credit Officer
gavin.macfarlane@moodys.com

Yifei Qin +1.647.417.6291
Associate Analyst
yifei.qin@moodys.com

Michael G. Haggarty +1.212.553.7172
Associate Managing Director
michael.haggarty@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

FortisBC Energy Inc.

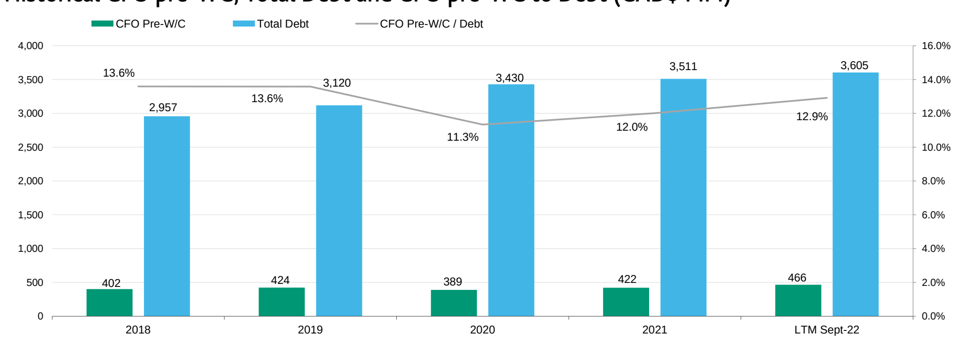
Update to credit analysis

Summary

FortisBC Energy Inc.'s (FEI) credit profile is driven by its low business risk gas transmission and distribution assets that operate in the credit supportive regulatory environment of British Columbia and its monopoly position in its service territory. The company has a long track record of earning its allowed return on equity and its cash flow continues to be highly predictable. These strengths are offset by the company's weak financial metrics that we forecast will be in the range of 11-13% CFO pre-W/C to debt. These financial metrics are primarily a product of a low allowed equity component of its capital structure, a relatively low return on equity, and depreciation rates. The credit profile also reflects FEI's independence from lower rated and heavily levered parent company Fortis Inc. (FTS, Baa3 stable) that does not constrain the utility's stand alone credit quality.

Exhibit 1

Historical CFO pre-WC, Total Debt and CFO pre-WC to Debt (CAD$ MM)



Source: Moody's Financial Metrics

Credit strengths

» Low risk gas transmission and distribution business

» Credit supportive regulatory environment

» Predictable and growing cash flow

Credit challenges

» High leverage and weak financial metrics

» Performance based regulation (PBR) marginally increases risk compared to cost of service regulation

» Although independent of FTS, parent is heavily levered

Rating outlook

The stable outlook for FEI is based on our expectation of a continuing supportive regulatory environment and consistent, albeit weak, financial metrics that provide limited cushion at the current rating level.

Factors that could lead to an upgrade

Given the ongoing forecast weakness in credit metrics, an upgrade is unlikely over the near term. We could upgrade the company with a material, sustained improvement in financial metrics, including a ratio of CFO pre W/C to debt in the mid to high teens

Factors that could lead to a downgrade

While we do not expect it, an adverse regulatory decision or a forecast of a sustained deterioration in credit metrics including CFO pre-W/C to debt of less than 11%

Key indicators

Exhibit 2

FortisBC Energy Inc. [1]

	Dec-18	Dec-19	Dec-20	Dec-21	LTM Sept-22
CFO Pre-W/C + Interest / Interest	2.5x	3.0x	2.9x	3.9x	3.1x
CFO Pre-W/C / Debt	13.6%	13.6%	11.3%	12.0%	12.9%
CFO Pre-W/C – Dividends / Debt	8.8%	8.7%	6.6%	7.3%	8.2%
Debt / Capitalization	47.8%	47.5%	48.8%	48.2%	47.6%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
Source: Moody's Financial Metrics

Profile

FEI, headquartered in Vancouver, is the largest gas transmission and distribution company in British Columbia serving about 1,069,300 customers, around 91% of which are residential. FEI is regulated by the British Columbia Utilities Commission (BCUC) under performance based regulation (PBR). FEI is a wholly-owned subsidiary of FortisBC Holdings Inc. (FHI, not rated) which, in turn, is wholly owned by FTS, a diversified electric and gas utility holding company. Another FTS subsidiary, FortisBC Inc (Baa1 stable) is a vertically integrated regulated hydro-electric utility that also operates in BC.

Exhibit 3
FBC's and FEI's service area

Source: Fortis Investor Presentation

Detailed credit considerations

Credit supportive regulatory environment

FEI's credit quality continues to be driven by its credit supportive regulatory environment and its monopoly position. The legislative and judicial underpinnings of the regulatory framework are stable and we expect them to remain so, with a strong rule of law and the province providing the legislative framework. Legislation is not prescriptive in terms of rate-setting methodology, although the company has been able to earn its allowed ROE under both Performance Based Regulation and traditional Cost of Service. Both frameworks have been used for establishing tariffs in the past.

Generally, when the utility or other stakeholders materially disagree with some aspects of regulatory decisions, they have been successful in asking the regulator to review and adjust those decisions with final outcomes that have been generally acceptable to all parties as evidenced by a lack of court proceedings. The company is able to challenge regulatory decisions in the courts, although this has not happened since the utility was acquired by FTS in 2007.

Decisions from the regulator tend to be predictable, consistent and transparent with a consultative approach to regulation. The regulatory framework established by the BCUC has a long track record of enabling the company to generate predictable cash flow and earn its allowed returns, supporting our view that regulation is consistent and predictable.

The company has a track record of passing through its commodity costs in rates, has no direct exposure to commodity price risk and negligible volume risk, a credit positive. To the extent that these or other costs deviate from forecasted values, deferral or true up mechanisms limit exposure to forecast differentials. Commodity price risk is addressed through the commodity cost reconciliation account (CCRA) and delivery costs to FEI are recovered through a midstream cost reconciliation account (MCRA). Volume risk is addressed by the revenue stabilization and adjustment mechanism (RSAM) that captures weather related and volume variances for residential and commercial customers. The CCRA is reviewed quarterly and amortized over 12 months. The MCRA and RSAM variances are reviewed annually and amortized over two years. A separate flow through deferral captures other variances, including industrial volume variances, is reviewed annually and amortized over 1 year.

Performance based regulation (PBR) marginally increases risk

PBR marginally increases risk because of the potential for higher cash flow volatility compared to Cost of Service regulation, particularly toward the latter years of the 5 year period. We believe that management will be successful in managing the challenges inherent in its PBR plan and continue to earn the allowed return on equity established by the regulator. In addition, the PBR plan offers downside protection that limits risk to the utility.

Rates had previously been set using performance, or incentive based, regulation for the period 2014-2019. The utility applied for a multiyear ratemaking plan for the period 2020-2024 at the end of the preceding period. A decision on the application was published on June 22, 2020 and we continue to refer to the rate-setting mechanism as PBR. We note that there was regulatory lag with this decision, but the company received interim rates as requested, mitigating this lag.

The company's controllable operating and maintenance (O&M) expenses are established by formula for the 2020-2024 period. We expect the utility to perform broadly in line with the O&M allowances over the period. O&M costs are increased annually by inflation minus a 0.5% productivity factor reducing risk in an inflationary environment. The earning sharing mechanism (ESM) remains unchanged, so any over/underspend is shared with customers in the subsequent year on a 50/50 basis. Non-controllable opex is a flow through to customers. Some other controllable costs are based on forecast and subject to the ESM.

FEI has a strong track record of recovering capital expenditures in rates in a timely fashion, a key credit strength and we expect the utility to recover its capex in the current period. The ESM applies to the WACC, depreciation and tax related to certain types of capex over or underspend during the period. For example, a $10 million underspend in capex that is subject to the ESM would result in half of the WACC, depreciation and tax related amounts associated with the $10 million underspend being subject to the ESM in the next year. This would similarly apply to a $10 million overspend. This represents the only portion of depreciation, interest and income tax variances that are shared with customers, the rest of these amounts are a pass through to customers. The table below shows the different types of capital expenditures, how each type of capex is recovered in rates, the ESM that applies, if any, and key details. We expect the company will likely continue a trend of overspending its growth capex over the current period.

Exhibit 4
Capital expenditures summary

	Recovery in Rates	Under/Overspend	How amounts are determined
Capex - Sustainment	Forecast basis, cash WACC and depreciation	ROE variances driven by actual rate base differences from forecast rate base levels, and ROE variances stemming from interest expense, tax and depreciation, all subject to ESM	Forecast for 2020-2022. 2023-2024 forecast submitted in annual review for 2023 rates. Forecast WACC and depreciation recovered in rates.
Capex - Growth	Formula driven amounts in rates, cash WACC and depreciation	ROE variances driven by actual rate base differences from forecast rate base levels, and ROE variances stemming from interest expense, tax and depreciation, all subject to ESM	Formula relates to prior unit cost of growth capital X inflation -0.5% productivitiy factor *100% of forecast customer additions with a true up for actual customer additions in the next year.
Capex - Major Projects (CPCN)	When project complete	Capex subject to prudency test	CPCN capital is based on project specific forecast. WACC capitalized during construction. Depreciation and cash WACC begins when project complete.
Capex - Other Capital	On a forecast basis, cash WACC and depreciation	Capex subject to prudency test	Smaller items that fall outside the other categories. This is forecast on an annual basis and is subject to a true up and prudency review

Source: BCUC Decision, Orders G-165-20 and G-166-20

The use of forecasts and formulas for the PBR period provides long term visibility of capex allowances and recovery. For capital projects in excess of $15 million, the company requires a certificate of public convenience and necessity (CPCN) that reduces the probability of cost disallowances, a credit positive. The company capitalizes its weighted average cost of capital during construction, which may cause large, multi-year projects to put some downward pressure on financial metrics, a credit negative. The company has not experienced any material cost disallowances.

There are two important components of the PBR plan that limit risk to the utility. Financial off ramps are triggered if, in any one year, FEI's ROE differs by more than 150 bps (post ESM) from the allowed return, up or down. Secondly, the Z-factor is designed to address non-controllable and unforeseen costs that flow through in rates. The materiality threshold for FEI is set at $500,000 which reduces the utility's risk. The company can file a Z-factor application to recover non-controllable and unforeseen costs that exceed the materiality threshold. The annual review process also provides an avenue to review FEI's performance on an annual basis.

Service Quality Indicators (SQI's) are used to monitor utility performance to ensure that any efficiencies or cost reductions do not result in a reduction in the quality of service to customers. The utility has not had any incremental incentives or penalties associated with performance on the SQI's, however a deterioration in performance would likely lead to more challenging regulatory outcomes and increased scrutiny in the future. We believe that FEI's customers, who are primarily residential, continue to have the capacity and willingness to pay their bills.

Predictable and growing cash flow but weak financial metrics

We expect the utility to continue to generate predictable cash flow and financial metrics, a key credit strength. Underpinning this predictability, cash flow from operations is generally a function of the company's rate base, the low allowed equity component in its capital structure (38.5% equity), a relatively low return on equity (8.75%), and depreciation rates. We forecast CFO pre-W/C to debt in the 11-13% range for the next several years, a level that provides limited cushion at its current rating. The utility has a long track record of earning its allowed return on equity and we have assumed that the company will continue to do so. A significant portion of the variability in CFO pre-W/C to debt stems from movements in working capital which represent changes in deferral accounts that are ultimately passed through in rates. This is evidenced by the FFO/debt ratio that has varied by less than 200 bps since 2016 based on fiscal year end results compared to CFO-pre W/C to debt that has been in a range of more than 400 bps over the same period. The financial off ramp at 150 bps (post ESM) and the low threshold on the Z-factor reduce the risk of significant variability in financial performance.

In January 2021, the BCUC announced that it was initiating a generic cost of capital proceeding that will revisit the capital structure and allowed ROE. We have assumed that there will be no changes stemming from this decision that would put downward pressure on financial metrics. We expect a decision in the first half of 2023 and the timing of any changes will be addressed in the decision. We expect the company's dividend policy, net of any equity injections, will continue to maintain the deemed capital structure.

Exhibit 5

Approved ROE, Equity thickness and Rate Base

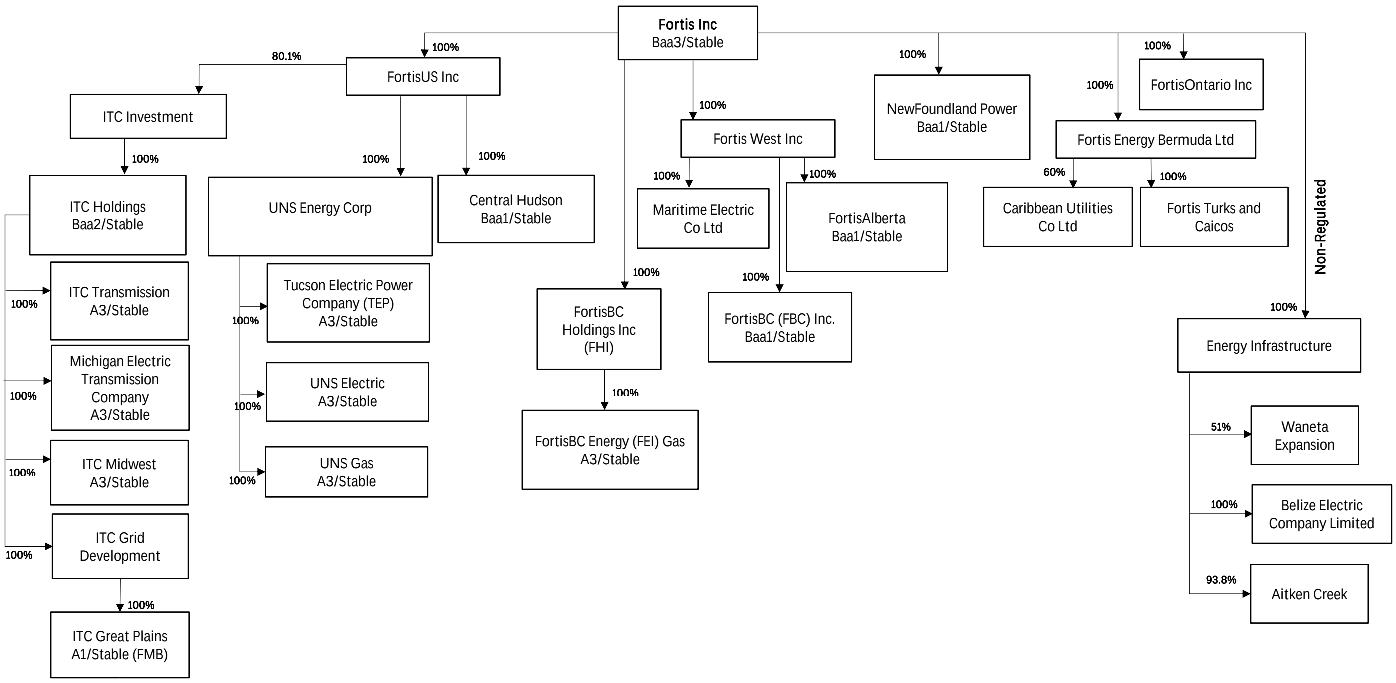
	2017	2018	2019	2020	2021	2022F
ROE	8.75%	8.75%	8.75%	8.75%	8.75%	8.75%
Equity thickness	38.50%	38.50%	38.50%	38.50%	38.50%	38.50%
Midyear Rate base, CAD billion	4.1	4.4	4.5	5.1	5.2	5.4

Source: FortisBC Energy

Although independent of Fortis Inc., parent is heavily levered

We consider FEI to be operationally and financially independent of ultimate parent FTS. However, FTS has very high leverage and material holding company debt that adds financial risk across the entire FTS corporate family. FTS is dependent upon its many subsidiaries, including FEI, to make distributions to service its obligations. Despite this leverage, we view FTS ownership as generally credit positive for FEI since it benefits from access to a large and diversified parent that may facilitate streamlining operations and costs and provides strong access to capital markets. The company may periodically rely on its parent for equity injections to maintain its capital structure in line with the regulator's established parameters. We expect that FTS would provide extraordinary support to FEI, if required, provided that the parent had the economic incentive to do so. We believe that the parent will continue to have sufficient resources to provide support, if required. As of 30 September 2022, FTS had about CAD2.0 billion unused committed revolving credit facility at the FTS corporate level. Ring fencing provisions at FEI limit the ability of FTS to upstream cash, although we do not believe the parent would seek to increase leverage above the levels established by the regulator. Our view of parent FTS does not constrain the credit profile of FEI.

Exhibit 6
Fortis Inc's organizational structure



Source: Fortis Inc

ESG considerations

FortisBC Energy Inc.'s ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 7
ESG Credit Impact Score

CIS-3

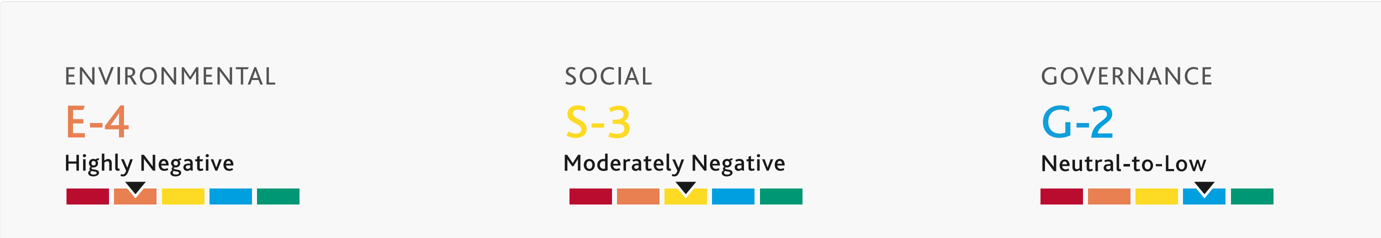
Moderately Negative

For an issuer scored CIS-3 (Moderately Negative), its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-2.

Source: Moody's Investors Service

FEI's ESG Credit Impact Score is moderately negative (**CIS-3**), indicating that its ESG attributes have an overall limited impact on the current rating, with potential for future negative impact over time. The scores reflect high environmental risks, moderate social risks and low governance risks.

Exhibit 8
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

FEI's high environmental risk (**E-4** issuer profile score) reflects its elevated exposure to carbon transition risk given British Columbia's legislated commitments to reduce greenhouse gas emissions by 40% by 2030 and 80% by 2050 and that all of the company's network operations are gas.

Social

Exposure to social risks is moderately negative (**S-3** issuer profile score) reflecting the sector's fundamental risk that demographic and social trends could trigger public affordability concerns that could lead to adverse regulatory or political intervention. FEI, similar to peers, is also moderately exposed to responsible production risk because a gas leak or explosion, although unlikely, could have a significant negative impact on its reputation and financial profile.

Governance

FEI's governance is driven by that of its parent FTS. FEI's governance risk is broadly in line with other utilities and does not pose a particular risk (**G-2** issuer profile score). This is supported by a key financial policy to maintain the capital structure established by the regulator with any dividends paid to the parent offset by sufficient equity injections to maintain the target capital structure. FEI's management credibility and track record also support the low risk governance outcome.

ESG Issuer Profile Scores and Credit Impact Scores for FEI are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for FEI on MDC and view the ESG Scores section.

Liquidity analysis

FEI maintains adequate liquidity. It has a CAD700 million syndicated credit facility maturing in July 2026 that supports a commercial paper program, and a CAD55 million uncommitted letter of credit facility maturing in March 2023. The credit facility contains a material adverse event clause that requires notification to lenders, but does not prohibit new borrowings. The company is currently well below the single debt to total capitalization ratio covenant (maximum 75%) in the credit agreement. At September 30, 2021, CAD383 million was available under this facility.

For the twelve months ended September 2022, FEI reported negative free cash flow of CAD253 million as a result of CAD487 million of CFO, CAD169 million of dividends and CAD571 million of capex. We estimate that annual negative free cash flow will be around CAD300 million in 2022 on the basis of about CAD470 million of CFO, CAD600 million of capex and CAD170 million of annual dividends. We expect FEI to manage dividend payouts and parent equity injections, along with its capex spending and borrowing profile, to maintain an equity layer close to the approved level of 38.5%.

FEI's next debt maturity is CAD150 million of unsecured debentures due in 2026.

Rating methodology and scorecard factors

Exhibit 9

Rating Factors
FortisBC Energy Inc.

Regulated Electric and Gas Utilities Industry Scorecard [1][2]	Current LTM 9/30/2022		Moody's 12-18 Month Forward View As of Date Published [3]	
Factor 1 : Regulatory Framework (25%)	**Measure**	**Score**	**Measure**	**Score**
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A
b) Consistency and Predictability of Regulation	Aa	Aa	Aa	Aa
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	Aa	Aa	Aa	Aa
b) Sufficiency of Rates and Returns	Baa	Baa	Baa	Baa
Factor 3 : Diversification (10%)				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity	N/A	N/A	N/A	N/A
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	3.1x	Baa	3.5x - 4x	Baa
b) CFO pre-WC / Debt (3 Year Avg)	12.4%	Baa	11% - 13%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	7.6%	Baa	6% - 9%	Baa
d) Debt / Capitalization (3 Year Avg)	47.9%	A	46% - 49%	A
Rating:				
Scorecard-Indicated Outcome Before Notching Adjustment		A3		A3
HoldCo Structural Subordination Notching		0		0
a) Scorecard-Indicated Outcome		A3		A3
b) Actual Rating Assigned		A3		A3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] As of 9/30/2022(L)
[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.
Source: Moody's Financial Metrics

Appendix

Exhibit 10

Peer Comparison Table [1]

	FortisBC Energy Inc. A3 (Stable)			FortisBC Inc. Baa1 (Stable)			FortisAlberta Inc. Baa1 (Stable)			Hydro One Inc. A3 (Stable)		
(In CAD millions)	FYE Dec-20	FYE Dec-21	LTM Sept-22	FYE Dec-20	FYE Dec-21	LTM Sept-22	FYE Dec-20	FYE Dec-21	LTM Sept-22	FYE Dec-20	FYE Dec-21	LTM Sept-22
Revenue	1,385	1,714	1,949	412	454	471	653	708	735	7,250	7,185	7,657
CFO Pre-W/C	389	422	466	107	127	137	394	366	376	1,874	2,039	2,230
Total Debt	3,430	3,511	3,605	1,249	1,267	1,310	2,391	2,409	2,525	15,644	15,010	14,911
CFO Pre-W/C + Interest / Interest	2.9x	3.9x	3.1x	2.5x	2.7x	2.8x	4.8x	4.4x	4.5x	4.5x	4.8x	5.1x
CFO Pre-W/C / Debt	11.3%	12.0%	12.9%	8.6%	10.0%	10.5%	16.5%	15.2%	14.9%	12.0%	13.6%	15.0%
CFO Pre-W/C – Dividends / Debt	6.6%	7.3%	8.2%	5.0%	6.3%	6.7%	13.1%	11.6%	11.2%	8.1%	9.4%	10.6%
Debt / Capitalization	48.8%	48.2%	47.6%	54.3%	53.4%	53.8%	55.4%	54.5%	54.8%	58.9%	56.5%	54.9%

[1] All figures & ratios calculated using Moody's estimates & standard adjustments. FYE = Financial Year-End. LTM = Last Twelve Months. RUR* = Ratings under Review, where UPG = for upgrade and DNG = for downgrade
Source: Moody's Financial Metrics

Exhibit 11

Cash Flow and Credit Metrics [1]

CF Metrics	Dec-18	Dec-19	Dec-20	Dec-21	LTM Sept-22
As Adjusted					
FFO	**407**	**417**	**412**	**479**	**491**
+/- Other	-5	7	-23	-57	-25
CFO Pre-WC	**402**	**424**	**389**	**422**	**466**
+/- ΔWC	-46	-13	-48	95	23
CFO	**356**	**411**	**341**	**517**	**489**
- Div	143	151	162	166	169
- Capex	486	483	477	513	609
FCF	**-273**	**-223**	**-298**	**-162**	**-289**
(CFO Pre-W/C) / Debt	13.6%	13.6%	11.3%	12.0%	12.9%
(CFO Pre-W/C - Dividends) / Debt	8.8%	8.7%	6.6%	7.3%	8.2%
FFO / Debt	13.8%	13.4%	12.0%	13.6%	13.6%
RCF / Debt	8.9%	8.5%	7.3%	8.9%	8.9%
Revenue	1,187	1,330	1,385	1,714	1,949
Interest Expense	275	216	209	147	218
Net Income	171	172	180	173	195
Total Assets	6,888	7,351	7,738	8,173	8,514
Total Liabilities	4,168	4,460	4,758	5,076	5,244
Total Equity	2,720	2,891	2,980	3,097	3,270

[1] All figures and ratios are calculated using Moody's estimates and standard adjustments. Periods are Financial Year-End unless indicated. LTM = Last Twelve Months
Source: Moody's Financial Metrics

Exhibit 12

FortisBC Energy Inc. Moody's - Adjusted Debt Breakdown

(CAN Millions)	FYE Dec-17	FYE Dec-18	FYE Dec-19	FYE Dec-20	FYE Dec-21	LTM Sept-22
As Reported Debt	2,578.0	2,832.0	2,952.0	3,269.0	3,368.0	3,462.0
Pensions	91.0	83.0	139.0	155.0	133.0	133.0
Operating Leases	19.2	22.4	8.0	6.0	10.0	10.0
Non-Standard Adjustments	19.0	20.0	21.0	0.0	0.0	0.0
Moody's Ajusted Debt	2,707.2	2,957.4	3,120.0	3,430.0	3,511.0	3,605.0

Based on consolidated financial data of FortisBC Energy Inc. All figures are calculated using Moody's estimates and standard adjustments
Source: Moody's Financial Metrics

Ratings

Exhibit 13

Category	Moody's Rating
FORTISBC ENERGY INC.	
Outlook	Stable
Senior Unsecured -Dom Curr	A3
ULT PARENT: FORTIS INC.	
Outlook	Stable
Issuer Rating -Dom Curr	Baa3
Senior Unsecured	Baa3

Source: Moody's Investors Service

REPORT NUMBER 1350010

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Moody's
INVESTORS SERVICE