

**BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON**

**UM 1897**

In the Matter of the Application of Hydro )  
One Limited (acting through its indirect ) FIFTH SUPPLEMENTAL REPORT TO  
subsidiary Olympus Equity LLC) for an ) HYDRO ONE LIMITED'S RESPONSE TO  
Order Authorizing Hydro One Limited To ) JUNE 14, 2018 BENCH REQUEST  
Exercise Substantial Influence Over the )  
Policies and Actions of Avista Corporation )

1 Hydro One Limited (“Hydro One”) provides the following fifth supplemental report to  
Hydro One’s response, dated June 19, 2018, to Administrative Law Judge Patrick Power’s June  
14, 2018 Bench Request.

**I. BENCH REQUEST**

2 The Bench Request requires Hydro One to file a report on the following issues: (1)  
implications of the recent Ontario election for (a) the future management and plans of Hydro  
One, and (b) Hydro One’s acquisition of Avista; (2) a plan for keeping the Oregon Public Utility  
Commission (“OPUC” or “Commission”) informed on a timely basis as to new developments;  
and (3) what further measures might be necessary to fully develop the record if material changes  
are made in Hydro One’s management or Board of Directors (“Board”).

**II. S&P GLOBAL RATINGS REPORT**

3 On June 19, 2018, Hydro One filed its response to Administrative Law Judge Patrick  
Power’s June 14, 2018 Bench Request. Section V of that response outlines a plan for keeping  
the Commission informed on a timely basis as to new developments in Ontario in respect of the  
management of Hydro One.

4           On September 13, 2018, S&P Global Ratings (“S&P”) issued the attached report titled “Hydro One Ltd. And Subsidiary Downgraded To 'A-' On Lower Governance Assessment; Ratings Remain on Credit Watch.” S&P lowered its issuer credit ratings on Hydro One and its subsidiary Hydro One Inc. to ‘A-’ from ‘A’. It also lowered the issue-level rating on Hydro One Inc.’s senior unsecured debt to ‘A-’, the rating on its commercial paper program to ‘A-2’, and the global short-term and Canadian National Scale ratings to ‘A-1 (Low)’. All ratings remain on CreditWatch with negative implications.

5           S&P explained the one-notch downgrade as follows:

*The Government of Ontario recently implemented legislation, requiring Hydro One’s board of directors to establish a new executive compensation framework for the board, CEO, and other executives. The legislation also amends the current Ontario Energy Board Act, requiring the Ontario Energy Board to exclude any compensation paid to the CEO and other executives from consumer rates.*

*We consider such action as a governance deficiency related to Hydro One’s ownership structure and are lowering our management and governance (M&G) assessment on Hydro One Ltd. (HOL) and Hydro One Inc. (HOI) to fair from satisfactory.*

6           Hydro One’s credit rating remains investment grade. Further, the legislation cited by S&P as the reason for the downgrade, the *Hydro One Accountability Act, 2018*, applies only to Hydro One’s subsidiaries in Canada, and therefore, would not apply to Avista if the proposed merger is consummated.

### **III. CONCLUSION**

7           By filing this report, Hydro One and Avista continue to keep the Commission informed on a timely basis as to new developments in Ontario in respect of the management of Hydro One.

8           We trust that this information will prove helpful as the Commission deliberates in this matter.

DATED: September 14, 2018.

K&L GATES LLP on Behalf of Hydro One Limited and  
Olympus Equity LLC

A handwritten signature in blue ink that reads "Kari Vander Stoep". The signature is written in a cursive style with a large, sweeping flourish at the end.

By: \_\_\_\_\_  
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## Research Update:

# Hydro One Ltd. And Subsidiary Downgraded To 'A-' On Lower Governance Assessment; Ratings Remain On CreditWatch

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## Research Update:

# Hydro One Ltd. And Subsidiary Downgraded To 'A-' On Lower Governance Assessment; Ratings Remain On CreditWatch

## Overview

- The Government of Ontario recently implemented legislation, requiring Hydro One's board of directors to establish a new executive compensation framework for the board, CEO, and other executives. The legislation also amends the current Ontario Energy Board Act, requiring the Ontario Energy Board to exclude any compensation paid to the CEO and other executives from consumer rates.
- We consider such action as a governance deficiency related to Hydro One's ownership structure and are lowering our management and governance (M&G) assessment on Hydro One Ltd. (HOL) and Hydro One Inc. (HOI) to fair from satisfactory.
- At the same time, we are lowering the issuer credit ratings on both HOL and HOI by one notch to 'A-' from 'A', reflecting the change in our M&G assessment.
- We are also lowering the issue-level rating on HOI's senior unsecured debt to 'A-', the rating on its commercial paper program to 'A-2', and the global short-term and Canadian National Scale ratings to 'A-1 (Low)'.
- All ratings remain on CreditWatch with negative implications.

## Rating Action

On Sept. 13, 2018, S&P Global Ratings lowered its issuer credit ratings on Hydro One Ltd. (HOL) and subsidiary Hydro One Inc. (HOI) to 'A-' from 'A'. At the same time, we lowered the short-term issuer credit rating on HOI to 'A-2' from 'A-1'.

We also lowered the issue-level rating on HOI's senior unsecured debt by one notch to 'A-' from 'A' and lowered the rating on HOI's commercial paper program by one notch to 'A-2' from 'A-1' on the global scale and to 'A-1(Low)' from 'A-1(MID)' on the Canadian National Scale.

All ratings remain on CreditWatch where we placed them with negative implications on June 15, 2018.

## **Rationale**

The one-notch downgrade reflects our reassessment of HOL's management and governance structure, which has weakened following the government of Ontario's decision to exert its influence on the utility's compensation structure through legislation, potentially promoting the interests and priorities of one owner above those of other stakeholders.

Ontario recently passed the Hydro One Accountability Act that allows the government to issue directives governing HOL's compensation of the board, CEO, and other executives. In addition, Ontario also amended the Ontario Energy Board Act (OEBA) to exclude any amount in respect of compensation paid to HOL's CEO and executives from consumer rates. Although the financial impact of the compensation disallowance is minimal, we think the legislative actions taken reflect a governance deficiency related to HOL's ownership structure because Ontario is exercising its legislative authority to lower electricity rates, consistent with the government's election campaign promises. In our view, the use of this legislative authority to influence HOL's compensation structure for some executives undermines the effectiveness of the company's governance structure, and potentially promotes the interests and priorities of the Ontario government above those of other stakeholders. We also note that these events followed the recent resignation of the entire previous board of Hydro One.

Our view of HOL's business and financial risks is unchanged. The business risk profile continues to reflect the utility's large electricity distribution and transmission operations that serves about 1.3 million electric customers covering approximately 75% of the geographic area of Ontario. The company historically benefited from supportive regulation in Ontario that has enabled utilities to earn close to their authorized return on equity through the use of a forward-looking test year, multiyear rate-setting that adjusts to keep costs and rates aligned, decoupling, and various variance accounts that foster full cost recovery. Furthermore, we expect HOL's consolidated business risk profile will not be affected because of the Avista Corp. acquisition. We believe the jurisdictions in which Avista operates benefit from reasonably supportive regulation. In addition, the purchase gives HOL some geographic diversity and entry into low-risk natural gas distribution operations.

From a financial risk perspective, we expect credit metrics to remain weak for 2018 due to timing of the closing of the Avista transaction. Under our base case scenario, which includes the current financing plan of Avista that comprises about C\$1.54 billion of equity and C\$3.4 billion (US\$2.6 billion) of new debt, capital spending of about C\$2 billion, and dividend payments of about C\$530 million, we forecast adjusted funds from operations (AFFO) to total debt for HOL, to consistently reflect about 10% for the 2019-2020 period, after the transaction closes. In addition, we do not expect the compensation disallowance to have any significant impact on HOL's cash flow. Our base case scenario also reflects the acquisition of Peterborough Distribution Inc. for about C\$105 million, incremental executive compensation

costs of about C\$20 million, and capital spending of about C\$2.5 billion each year.

### **Liquidity**

We assess HOL's liquidity as adequate. We expect liquidity sources to exceed uses more than 1.1x over the next 12 months. In the event of a 10% drop in the company's EBITDA, we also expect liquidity sources will cover uses. In our view, the company has sound relationships with banks and generally satisfactory standing in the credit markets. In the unlikely event of liquidity distress, we expect HOL to scale back its capital spending to preserve credit metrics.

Principal liquidity sources include:

- Cash of about C\$1.25 billion as of June 30, 2018.
- Committed credit facilities availability of about C\$7.43 billion as of June 30, 2018, including that of Avista and the committed bridge facilities for the Avista transaction.
- Cash FFO of about C\$1.9 billion over the next 12 months.

Principal liquidity uses include:

- Debt maturities of about C\$981 million over the next 12 months.
- Maintenance capital spending of about C\$1.3 billion over the next 12 months.
- Dividend payments of about C\$600 million over the next 12 months.
- Acquisitions of about C\$5 billion, including Avista and PDI.

### **CreditWatch**

We will resolve the CreditWatch placements of the ratings on HOL and HOI as we get closer to the transaction's closing, including final regulatory approvals from key states, including Washington, Avista's largest regulatory jurisdiction. In addition, the resolution of our CreditWatch placement will depend on our confirmation of the company's forward strategy after the board appoints a new permanent CEO for HOL.

### **Ratings Score Snapshot(Hydro One Ltd.)**

**Issuer Credit Rating: A-/Watch Neg/--**

**Business risk: Excellent**

- Country risk: Very low
- Industry risk: Very low

- Competitive position: Excellent

**Financial risk: Significant**

Cash flow/Leverage: Significant

**Anchor: a-**

**Modifiers**

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Fair (-1 notch)
- Comparable rating analysis: Positive (+1 notch)

**Stand-alone credit profile: a-**

**Group credit profile: a-**

Status within group: Parent

**Ratings Score Snapshot(Hydro One Inc.)**

Issuer Credit Rating: A-/Watch Neg/A-2

**Business risk: Excellent**

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Excellent

**Financial risk: Significant**

•Cash flow/Leverage: Significant

**Anchor: a-**

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Fair (-1 notch)
- Comparable rating analysis: Positive (+1 notch)



**Stand-alone credit profile: a-**

**Group credit profile: a-**

**Status within group: core (no impact)**

## **Issue Ratings--Subordination Risk Analysis**

### **Capital structure**

HOL's capital structure consists of about \$10.5 billion of senior unsecured long-term debt, all of which are issued by subsidiary HOI. There is currently no debt at the HOL level.

### **Analytical conclusions**

We consider HOI as a qualifying utility in accordance with our criteria. As such we rate the senior unsecured debt at HOI the same as our issuer credit rating on HOI.

## **Related Criteria**

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

### Downgraded

	To	From
Hydro One Limited Issuer Credit Rating	A-/Watch Neg/--	A/Watch Neg/--
Hydro One Inc. Issuer Credit Rating	A-/Watch Neg/A-2	A/Watch Neg/A-1
Hydro One Inc. Senior Unsecured Commercial Paper	A-/Watch Neg A-2/Watch Neg	A/Watch Neg A-1/Watch Neg
Commercial Paper	A-1(LOW)/Watch Neg	A-1(MID)/Watch Neg

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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