Attachment A

S&P Global
Ratings

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Research Update:

Hydro One Ltd. And Sub Ratings Affirmed As Regulator Rejects M&A Deal With Avista, Off Watch; Outlook Negative

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Table Of Contents

Table Of Contents (cont.)

Research Update:

Hydro One Ltd. And Sub Ratings Affirmed As Regulator Rejects M&A Deal With Avista, Off Watch; Outlook Negative

Rating Action Overview

- The Washington Utilities and Transportation Commission (WUTC) has denied the merger petition between Hydro One Ltd. (HOL) and Avista Corp.
- The WUTC's decision, in our view, significantly increases the likelihood that the transaction will not close as expected, reducing the possibility of an imminent ratings downgrade on HOL.
- However, in our assessment, the WUTC's decision weakens HOL's ability to track, adjust, and control the execution of its strategy, and raises broader concerns regarding HOL's governance and strategic direction as it seeks a permanent CEO.
- On Dec. 10, 2018, S&P Global Ratings affirmed its 'A-' issuer credit ratings on HOL and subsidiary Hydro One Inc. (HOI) and removed the ratings from CreditWatch, where they were placed with negative implications on June 15, 2018. The outlook on both entities is negative.
- We also affirmed our issue-level ratings on HOI, including the 'A-' rating on its senior unsecured debt, and the 'A-2' global and 'A-1 (LOW)' Canadian National Scale ratings on its commercial paper program. We removed the ratings from CreditWatch with negative implications.
- The negative outlooks reflect uncertainty about HOL's ability to convert its strategy into constructive actions that support the company's financial performance. In addition, the negative outlook incorporates broader concerns related to HOL's governance, uncertainty regarding the company's strategic direction, and our revised base-case assumption that the Avista transaction is unlikely to close as expected, the effect of which results in weaker stand-alone financial measures for HOL through 2019.

Rating Action Rationale

The removal of our CreditWatch negative listing reflects the decreased likelihood for a one-notch downgrade, incorporating our revised assumption that the pending transaction with Avista Corp. is unlikely to close as expected. As a result we forecast HOL's funds from operations (FFO) to debt, without Avista, to be about 12% during our 2019-2020 outlook period. However, the WUTC's decision weakens our view of HOL's ability to track, adjust, and control the execution of its strategy, and raises broader concerns related to

HOL's governance and strategic direction. Moreover, our revised base-case assumptions suggest weaker stand-alone financial measures for the company through 2019, collectively warranting a negative outlook for HOL and HOI.

Our assessment of HOL's business risk is unchanged and continues to reflect the utility's large electricity distribution and transmission operations that serve about 1.3 million electricity customers covering approximately 75% of the province of Ontario. The company has historically benefited from supportive regulation in Ontario that enables utilities to earn close to their authorized return on equity. This is done through the use of a forward-looking test year, multiyear rate-setting that adjusts to keep costs and rates aligned, decoupling, and variance accounts that foster full cost recovery. Our base-case assumes the regulatory framework in Ontario remains transparent, stable, and independent from government or political influence.

We assess HOL's financial risk using our low volatility financial benchmark table, reflecting the company's low-risk regulated utility operations, and management of regulatory risk. Under our revised base-case scenario, which assumes merger termination fees, redemption of the first installment of the convertible debentures of about C$500 million and accrued interest, and transaction fees incurred thus far, we expect FFO to debt of about 11.5% in 2019.

Historically, the rationale for the positive ratings analysis modifier reflects our view that the consolidated credit profile of HOL was incrementally stronger than other peers with similar business profiles, which is no longer the case. Currently, our assessment of the positive ratings analysis modifier reflects our expectation of robust financial measures for HOL at its current financial risk profile category. Any material deterioration in HOL's financial performance from our base case scenario could warrant a revision of this modifier, possibly resulting in a one-notch downgrade.

Outlook

The negative outlooks reflect uncertainty about HOL's ability to convert its strategy into constructive actions that support the company's financial performance. In addition, the negative outlook incorporates broader concerns related to HOI's governance, uncertainty regarding the company's strategic direction, and our revised base-case assumption that the Avista transaction is unlikely to close as expected, the effect of which, results in weaker stand-alone financial measures for HOL through 2019.

Downside scenario

We could take a negative rating action on HOL over the next 12 months if the WUTC reverses its decision on the HOL-Avista merger. We could also lower the rating if the company's strategic decisions result in weaker business or financial risk assessments, including FFO to debt that consistently remains below 12%.

Alternatively, we could downgrade HOL if the Ontario government intervenes further in HOL's business or operating decisions, resulting in additional governance deficiencies that we consider severe.

Upside scenario

We could revise the outlook on HOL to stable if the company continues its historic focus on low-risk regulated utility operations and the company's forward strategy does not weaken its business risk and financial measures, maintaining FFO to debt above 12%, consistently.

Company Description

Hydro One, through its subsidiaries, operates as an electrical transmission and distribution (T&D) company in Ontario. It operates through three segments: transmission, distribution, and other business. The company owns and operates approximately 30,000 circuit kilometers of high-voltage transmission network, 123,000 circuit kilometers of low-voltage distribution network, and 308 transmission stations. It serves approximately 1.3 million residential and business customers across the province of Ontario, as well as large industrial customers and local distribution companies.

Our Base-Case Scenario

- Assessment of HOL on a stand-alone basis without Avista.
- Merger termination fees per the terms of the merger agreement.
- Redemption of the first installment of the convertible debentures of about C$500 million, plus accrued interest, issued in 2017.
- No structural change to the utility regulatory framework in Ontario.
- The Ontario utility regulator, the Ontario Energy Board (OEB) remains independent from government interference.
- No adverse regulatory decisions from the OEB.

Liquidity

We assess HOL's liquidity as adequate. We expect liquidity sources to exceed uses by more than 1.1x over the next 12 months. In the event of a 10% decline in EBITDA, we also expect liquidity sources will cover uses. In our view, the company has sound relationships with banks and a 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 its liquidity position.

Principal liquidity sources:

- About C$615 million cash as of Sept. 30, 2018;
- Committed credit facilities availability of about C$2.55 billion as of Sept. 30, 2018; and
- Cash FFO of about C$1.6 billion over the next 12 months.

Principal liquidity uses:

- Debt maturities of about C$1.9 billion over the next 12 months, including long-term, short-term, commercial paper, and redemption of the convertible debentures;
- Capital spending of about C$1.6 billion over the next 12 months;
- Dividend payments of about C$600 million over the next 12 months; and
- About C$105 million for the acquisition of Peterborough Distribution Inc.

Environmental, Social, And Governance

HOL's exposure to environmental risk is quite manageable compared with its electric utility peer group, since T&D companies are more favorably positioned than their counterparts with owned power generation assets.

From a social perspective, high power prices and consumer electricity bills are highly politicized in Ontario. We view this negatively in terms of regulatory advantage, since political interference is a potential negative credit factor. However, the primary goal of the company's critics is focused on reducing power costs, not T&D rates. These objectives can reduce social risks in the short term, but excessive political interference could constraint management's effectiveness over time and hinder long-term credit quality.

From a management and governance standpoint, the Ontario government recently passed an amendment to the Ontario Energy Board Act (OEBA) to exclude any compensation paid to HOL's CEO and other senior executives from consumer rates. We view this legislative action as a governance deficiency related to HOL's ownership structure since the Ontario Province exercised 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 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 Hydro One's entire previous board of directors. Additional interferences in HOL's business or operating decisions could result in a weaker assessment of the company's governance, reflecting severe deficiencies.

With respect to HOL's strategic positioning, the WUTC's rejection of its merger petition with Avista suggests that HOL may be unable to convert strategic decisions into constructive actions, which in our assessment weakens the company's overall ability to track, adjust and control the execution of its strategy.

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 is issued by HOI. There is no senior unsecured debt at the HOL level.

Analytical conclusions

We consider HOI as a qualifying investment-grade regulated utility under our criteria. As such, we rate its senior unsecured debt the same as our issuer credit rating on HOI.

Ratings Score Snapshot(Hydro One Ltd.)

Issuer Credit Rating: A-/Negative/--

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-/Negative/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)

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

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Hydro One Limited		
Issuer Credit Rating	A-/Negative/--	A-/Watch Neg/--
Hydro One Inc.		
Issuer Credit Rating	A-/Negative/A-2	A-/Watch Neg/A-2
Hydro One Inc.		
Senior Unsecured	A-	A-/Watch Neg
Commercial Paper	A-1(LOW)	A-1(LOW)/Watch Neg
Commercial Paper	A-2	A-2/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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.