

1        **Association of Major Power Consumers in Ontario Interrogatory # 52**

2  
3        **Issue:**

4        Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

5  
6        **Reference:**

7        D1-01-02 In Service Additions

8  
9        **Interrogatory:**

10       a) Please update Tables 1 and 2.

11  
12       **Response:**

13       a) 2017 Actuals are not available at the time of writing, but Table 1 will be updated when 2017  
14       Actuals are available.

15  
16       Please refer to Exhibit Q, Tab 1, Schedule 1 Table 6 (filed 2017-12-21) for an updated In-  
17       Service Capital Addition forecast.

**Consumers Council of Canada Interrogatory # 28**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

A-03-01 Page 31

**Interrogatory:**

Rate base in 2017 is expected to be \$161.5 million higher than the OEB-approved level. The explanation provided in the evidence is that the variance is related to higher than forecast spending on trouble calls and storm damage, as well as joint use and relocation projects. Please provide the original forecast of capital expenditures for each of these items (trouble calls, storm damage, joint use and relocation projects).

**Response:**

On June 7, 2017, Hydro One filed Blue Page updates to this application which included an update for 2016 actuals. This resulted in a revision to Exhibit A, Tab 3, Schedule 1, which shows that rate base is expected to be \$158.3 million higher than the OEB-approved level, a slight change from the \$161.5 million previously quoted.

Please find below the 2017 amounts that were filed as part of the 2015-2017 approved rate application:

	Capital Expenditures
	OEB Approved – 2017
Trouble Calls & Storm Damage	\$62 million
Joint Use & Relocation Projects	\$28 million

**Consumers Council of Canada Interrogatory # 29**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

A-03-01 Page 26

A-03-01-01 Page 15

**Interrogatory:**

Re: Capital Expenditures – Please reconcile the Distribution Capital Expenditures set out in the two referenced exhibits. Does HON prepare its budgets using the OEB-compliant asset investment categories, or the categories set out at p. 15 of the Business Plan (Sustaining, Development, Operations and Corporate Common Costs)?

**Response:**

Table 9 of Exhibit A, Tab 3, Schedule 1 on page 26 includes capital expenditures for the acquired LDCs in 2021 and 2022. In the Distribution Business Plan Exhibit A, Tab 3, Schedule 1, Attachment 1, the capital expenditures for the acquired LDCs can be found on page 25.

With respect to asset investment categories, the business plan, and associated budget, was prepared using both the OEB-compliant investment categories as well as the categories set out at page 15 of the Business Plan (Sustaining, Development, Operations and Corporate Common Costs & Other Capital).

**Consumers Council of Canada Interrogatory # 30**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D1-01-02 Page 2

**Interrogatory:**

In-service additions are forecast to be \$44.2 million lower than the OEB-approved level primarily due to lower demand for distribution generation connections as a result of changes make to IESO program rules and more efficient completion of wood pole replacements. Please provide a detailed break-down of the \$44.2 million.

**Response:**

A breakdown of variances between approved and forecast ISA for 2017 is as follows:

**Sustaining:** \$25.1 million lower than OEB approved mostly due to lower spending on Wood Pole Replacement, Join Use and Relocations, PCB Transformer Replacement, and Lines and Stations Sustainment. This is partially offset by higher spending on Trouble Calls and Storm Damage.

**Development:** \$32.1 million lower than OEB approved mostly due to lower spending on System Capacity Reinforcement, and Distribution Generation Connections.

**Operations:** \$3.8 million lower than OEB approved due to lower spending on Common Operating Infrastructure and Control Facilities. This is partially offset by higher spending on Operating Infrastructure.

**Customer Service:** \$14.9 million lower than OEB approved due to lower spending on Smart Grid.

**Common & Other:** \$31.7 million higher than OEB approved mostly due to higher spending on Real Estate and Facilities and IT.



**Consumers Council of Canada Interrogatory # 31**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

B1-01-01 Appendix A

**Interrogatory:**

HON is planning on spending between \$7.8 million and \$8.1 million on Capital in the years 2018-2020 for the Acquired Utilities. Has HON completed Business Cases for this spending? If not, why not?

**Response:**

The majority of spend planned for the acquired utilities is classified as Program Work. Hydro One's process and policy is to prepare business cases only for material project related work. Hydro One's Distribution program work is approved within the overall annual business plan by the Hydro One Board of Directors. Refer to Exhibit I-3-SEC-4 for the 2016 Board of Directors material, and Exhibit Q, Tab 1, Schedule 1, Attachment 1, for the 2017 Board of Directors material.

**Canadian Manufacturers & Exporters Interrogatory # 43**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

C1-07-02-04 Updated

D2-01-02-01

**Interrogatory:**

- a) Please explain why the net additions shown in the first reference for each of 2014, 2015 and 2016 are less than the additions less disposals (excluding non-regulated utility assets) shown in the fixed asset continuity schedules provided in the second reference.
- b) Please explain why the figures shown in the CCA schedule by CCA class do not match the corresponding figures shown in the fixed asset continuity schedules. For example, the 2015 CCA schedule shows net additions to Class 12 of \$13.3, while the sum for this class on the 2015 fixed asset continuity schedule is \$28.3 (or \$33.6 if computer software is included).

**Response:**

- a) The fixed asset additions for regulatory income taxes differs from the net additions in the fixed asset continuity schedules due to adjustments made to the fixed assets additions used for rate base purposes. See below for the reconciliation for 2014, 2015 and 2016. Further, fixed asset disposals have not been included in this reconciliation as disposals are treated differently for accounting versus for tax purposes. For accounting, disposals include asset retirements and for tax purposes, disposals represent the proceeds (the lower of original cost or actual proceeds) that were received from the sale.

<b>Calculation of Fixed Asset Additions for Regulatory Income Tax</b>				
<b>2014 to 2016</b>				
		<b><u>2014</u></b>	<b><u>2015</u></b>	<b><u>2016</u></b>
Fixed asset additions per Exhibit D2-1-2, Attachment 1 Appendix 2-BA		623.7	755.3	654.8
<u>Adjustments:</u>				
Asset removal		45.4	57.6	80.1
Capital equipment expensed		8.0	5.3	3.3
Land		(6.2)	(0.7)	(2.3)
Future use inventory		(3.7)	(5.0)	3.5
Interest capitalized		(16.5)	(16.3)	(20.4)
Overhead capitalized		(22.1)	(25.4)	(40.3)
Depreciation capitalized		(16.8)	(18.8)	(28.2)
OPEB capitalized		(33.1)	(38.6)	(55.1)
Pension capitalized		(42.3)	(49.0)	(57.2)
SR&ED capitalized		(3.2)	(2.4)	-
Intercompany capital contributions		(4.2)	(17.7)	(0.9)
Other		(2.3)	1.6	(2.3)
Tax additions to UCC		526.7	645.9	534.9
Fixed asset disposals for tax		(0.4)	(2.4)	(1.9)
Net additions per Exhibit C1-7-2, Attachment 4 Updated (Sum of CCA and CEC additions)		526.3	643.5	533.0

- b) The figures shown in the CCA schedule by class does not match the corresponding figures in the fixed asset schedule for the reasons itemized in the reconciliation in (a) that was adjusted to various CCA classes.

**Canadian Manufacturers & Exporters Interrogatory # 44**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

C1-07-02-02 Updated

D2-01-02-01

**Interrogatory:**

- a) Please explain why the net additions shown in the first reference for 2017 is lower than the additions less disposals (excluding non-regulated utility assets) shown in the fixed asset continuity schedule provided in the second reference.
- b) Please explain why the net additions shown in the first reference for 2018 is higher than the additions less disposals (excluding non-regulated utility assets) shown in the fixed asset continuity schedule provided in the second reference.
- c) Please explain why the net additions shown in the CCA schedule by class do not correspond to the net of the additions and disposals shown in the fixed asset continuity schedules. For example, the net additions shown for 2018 CCA purposes in Class 8 is \$30.6, while the net figure from the fixed asset continuity schedule is about \$21 based on the individual line items shown as Class 8 assets.
- d) Has Hydro One provide fixed asset continuity schedules (Appendix 2-BA) for each of 2019 through 2022? If not, why not, and how has Hydro One determined the appropriate level of additions for each CCA class in 2019 through 2022?
- e) Please provide a table that shows for each of 2014 through 2022, the net additions for CCA purposes and the net of in-service additions less disposals used for rate base purposes, along with a third line that shows the difference by year.

**Response:**

- a) Refer to part e) below for a reconciliation of the net in-service adjustments used for rate base purposes to the tax additions for the purpose of calculating CCA for regulatory income taxes. Further, the disposals captured in the fixed asset continuity schedule relate to asset

retirements with no proceeds. As such, no adjustment to the UCC schedule will be required for disposals for tax purposes.

b) Refer to response in a).

c) Net additions in the CCA schedule by class do not correspond to the net additions and disposals shown in the fixed asset continuity schedules due to the adjustments made to net additions for CCA purposes as referenced in a). In general, these adjustments are consistently applied to each class.

d) Appendix 2-BA that reflects the changes presented in Exhibit Q filing for 2019 to 2022 has been provided in Exhibit I-33-CME-47, attachment 1.

e) See the reconciliation provided below for the adjustments made to fixed asset additions per the fixed asset continuity schedules provided in Exhibit I-33-CME-47 attachment 1 to arrive to tax net additions to UCC that was reported in Exhibit I-3-Staff-10 for the 2017 to 2022 years. The same reconciliation for the historical years is provided in Exhibit I-33-CME-43.

<b>Calculation of Fixed Asset Additions for Regulatory Income Tax</b>							
<b>2017 to 2022</b>							
	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	
Fixed asset additions per Appendix 2-BA	651.8	635.1	755.2	748.5	880.2	784.4	
<u>Adjustments:</u>							
Transferred from amalgamation					(175.6)		
Asset Removal	66.0	53.6	64.5	65.1	64.2	65.1	
Capital Equipment Expensed	6.2	6.2	6.2	6.2	6.2	6.2	
Land	-	(0.1)	(0.5)	(0.3)	(0.4)	(0.5)	
Share Compensation	(4.6)	(6.3)	(7.0)	(7.0)	(6.8)	(6.8)	
Interest Capitalized	(19.0)	(14.4)	(13.9)	(13.9)	(13.9)	(13.9)	
Overhead capitalized	(29.0)	(22.1)	(23.1)	(22.9)	(23.1)	(24.2)	
Depreciation capitalized	(23.1)	(19.3)	(20.1)	(20.8)	(20.8)	(20.8)	
OPEB capitalized	(41.4)	(29.2)	(30.8)	(31.6)	(32.1)	(34.9)	
Pension capitalized	(39.6)	(19.8)	(19.7)	(19.6)	(19.8)	(20.8)	
Tax net additions to UCC	567.4	583.7	710.8	703.7	658.1	733.8	

**Canadian Manufacturers & Exporters Interrogatory # 45**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

Q-01-01

C1-07-02

**Interrogatory:**

a) Please provide a version of Attachments 1 & 2 of Exhibit C1, Tab 7, Schedule 2 that reflects the corporate income taxes shown in Table 10 of Exhibit Q, Tab 1.

**Response:**

Please refer to Exhibit I-3-Staff-10 for the updated corporate income tax calculations for the test period.

**Canadian Manufacturers & Exporters Interrogatory # 47**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D1-01-01 Updated

Q-01-01

**Interrogatory:**

Hydro One has filed Appendix 2-BA Fixed Asset Continuity Schedules in the D2-01-02-01 Excel spreadsheet for the 2014 through 2018 period.

(a) Please provide Appendix 2-BA Fixed Asset Continuity scheduled for the 2014 through 2018 period that reflect the distribution rate base shown in Table 7 in Exhibit Q.

(b) Has Hydro One filed a similar spreadsheet for the remaining test years 2019 through 2022 that corresponds to the mid-year net plant figure shown in Table 7 of Exhibit Q, Tab 1, Schedule 1? If not, please explain why not and provide the fixed asset continuity schedules for the 2019 through 2022 years based on the figures provided in Table 6 and 7 in Exhibit Q.

**Response:**

a) Please refer to the filed MS Excel I-33-CME-47-01 which includes asset continuity schedule for 2014-2022.

b) Please refer to part (a)

**Energy Probe Research Foundation Interrogatory # 53**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D1-01-01 Page: 3 Table 3

**Interrogatory:**

- a) Please explain the reason for the significantly higher 2016 actual retirements amount.
- b) Please explain the reason for the growth in Provincial Funded Assets from 2014 to 2017.

**Response:**

- a) Asset retirements in 2016 are higher than prior years as a result of \$67 million worth of retirements associated with defective smart meters.
- b) The growth in Provincial Funded Assets from 2014 to 2017 relates to capital expenditures and subsequent in-service additions associated with investments in distributed generation connections. These amounts are not to be collected from Hydro One Networks Distributions customers, thus are backed out of rate base.



**School Energy Coalition Interrogatory # 66**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D1-01-02 Page: 1

**Interrogatory:**

Please explain how Hydro One forecasts its in-service additions

**Response:**

On a monthly basis Hydro One reviews its in-service addition actuals and forecasts for both programs and projects. At the time of review, adjustments to both program and project forecasts may need to be made in response to changing circumstances and/or execution constraints. These may include responding to new customer requests, weather related incidents, or project delivery constraints. At an aggregate level, once all program and projects are reviewed, tactical adjustments may be made by senior management.

During the Investment Planning process, as Hydro One collects the various investment details including estimated capital expenditure and the associated in-service assumptions to create the future year forecasts.

**School Energy Coalition Interrogatory # 67**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D1-01-01 Tables 1-4

Appendix 2-BA

**Interrogatory:**

Please provide an update to the following tables and appendices to reflect 2017 actuals:

a) [D1-1-1] Tables 1-4

b) Appendix 2-BA

**Response:**

a) 2017 actuals are not available at this time.

b) See response to a) above.

**OEB Staff Interrogatory # 176**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D1-01-01 Page: 2 Table 1

**Interrogatory:**

Table 1 provides a comparison of the 2017 Board-approved versus 2017 Bridge Year Forecast Rate Bases. In the text below Table 1, Hydro One states:

*“Total rate base in 2017 is expected to be \$158.3 million above the OEB-approved amount. This variance of 2.2% is explained by higher in-service additions due to higher than forecast replacement of assets due to trouble calls and storm damage, as well as joint use and relocation projects. In addition, a higher cash working capital requirement also contributes to the higher rate base. This is partially offset by lower demand for distribution generation connections and reduced spending on wood pole replacements.”*

- a) Does Table 1 reflect the impacts of the Fair Hydro Plan which came into effect on July 1, 2017, particularly with respect to cost of power costs applicable to Residential, remote and First Nations ratepayers served by Hydro One?
- b) If not, please update Table 1 to reflect the impact of the Fair Hydro Plan. Please provide Hydro One’s analysis on the variance between the OEB-approved 2017 forecast and Hydro One’s updated budget forecast.

**Response:**

- a) Table 1 does not reflect the impacts of the Fair Hydro Plan.
- b) Please see below for the update to Table 1, reflecting the impact of the Fair Hydro Plan. The decrease in working capital requirement of approximately \$24 million relates to a reduction in the cost of power, largely a result of a decrease to the Global Adjustment rate. In order to estimate the working capital reduction of approximately \$24 million, Navigant’s Study -

Working Capital Requirements of Hydro One Networks was utilized, as filed in Exhibit D1,  
Tab 1, Schedule 3, Attachment 1.

(\$ Millions)

<b>Rate Base Component</b>	<b>2017 Bridge Year (Forecast)</b>	<b>2017 Board- approved</b>	<b>Variance</b>
Mid-Year Gross Plant	11,332.1	11,239.1	92.9
Less: Mid-Year Accumulated Depreciation	(4,298.1)	(4,311.7)	13.6
<b>Mid-Year Net Utility Plant</b>	7,034.0	6,927.4	106.5
Cash Working Capital	285.8	255.7	30.1
Materials & Supply Inventory	4.0	6.8	(2.7)
<b>Total Rate Base</b>	<b>7,323.8</b>	<b>7,189.9</b>	<b>133.9</b>

**OEB Staff Interrogatory # 177**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D1-02-01 Page: 5 Table 1 – Cost of Capital Summary

**Interrogatory:**

Please update Table 1 of this exhibit, based on the updates to the working capital allowance requested for Exhibit D1-1-1/Tables 1, 2, 3 and 4 reflecting the Fair Hydro Plan which came into effect on July 1, 2017, and any other changes to the rate base for the test year period from 2018 to 2022.

**Response:**

Table 1 in Exhibit D1, Tab 2, Schedule 1 was previously updated and provided as part of Exhibit Q, Tab 1, Schedule 1 submission in table 8 on page 10. The table below is an update to the previously provided table 8 from Exhibit Q, Tab 1, Schedule 1 to incorporate the impact of the Fair Hydro Plan.

**2018 Cost of Capital**

<b>Amount of Deemed</b>	<b>(\$M)</b>	<b>%</b>	<b>Cost Rate (%)</b>	<b>Return (\$M)</b>
<b>Long-term debt</b>	3,768.1	49.4	4.47	168.4
<b>Short-term debt</b>	305.0	4.0	2.29	7.0
<b>Deemed Long-Term debt</b>	502.6	6.6	4.47	22.5
<b>Common equity</b>	3,050.5	40.0	9.00	274.5
<b>Total</b>	7,626.2	100.0	6.20	472.4

**OEB Staff Interrogatory # 178**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D2-01-01 – Statement of Utility Rate Base

D2-01-02 - Continuity of Property, Plant and Equipment

D2-01-03 – Continuity of Property, Plant and Equipment - Accumulated Depreciation

D2-01-04 - Continuity of Property, Plant and Equipment - Construction Work in Progress

D2-01-05 - Statement of Working Capital

**Interrogatory:**

Please update these tables to reflect the Fair Hydro Plan which came into effect on July 1, 2017 and any other changes to the components of rate base changed as a result of budget updates or responses to interrogatories.

**Response:**

Please see the provided tables below.

**Table updated for Exhibit Q and Fair Hydro Plan:**

**D2-01-01 – Statement of Utility Rate Base**

**HYDRO ONE NETWORKS INC.  
DISTRIBUTION**

**Statement of Utility Rate Base**  
Bridge Year (2017) and Test Years (2018 to 2022)  
Year Ending December 31  
(\$ Millions)

<b>Particulars</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
<u>Electric Utility Plant</u>						
Gross plant at cost	\$ 11,699.2	\$ 12,245.5	\$ 12,866.9	13,570.4	\$ 14,387.4	\$ 15,109.1
Less: non-regulatory	(64.6)	(69.8)	(73.9)	(77.3)	(80.1)	(82.7)
Gross plant at cost for rate base	11,634.6	12,175.7	12,793.1	13,493.2	14,307.2	15,026.3
Less: accumulated depreciation	(4,448.1)	(4,703.3)	(4,925.9)	(5,250.0)	(5,600.6)	(5,942.1)
Less: non-regulatory	9.5	13.7	18.2	22.9	27.7	32.7
Accumulated depreciation for rate base	(4,438.5)	(4,689.6)	(4,907.7)	(5,227.1)	(5,572.8)	(5,909.3)
Net plant for rate base	7,196.0	7,486.1	7,885.3	8,266.1	8,734.4	9,117.0
Average net plant for rate base		7,341.1	7,685.7	8,075.7	8,575.8	8,925.7
Construction work in progress		0.0	0.0	0.0	0.0	0.0
Average net utility plant		\$ 7,341.1	\$ 7,685.7	\$ 8,075.7	\$ 8,575.8	\$ 8,925.7
<u>Working Capital</u>						
Cash working capital		281.0	295.8	308.5	338.8	355.6
Materials and Supplies Inventory		4.1	5.5	6.5	5.9	5.5
Total working capital		285.1	301.3	315.0	344.6	361.1
Total rate base		\$ 7,626.2	\$ 7,987.0	\$ 8,390.7	\$ 8,920.4	\$ 9,286.8

Witness: JODOIN Joel

**Tables updated for Exhibit Q only:**

**D2-01-02 - Continuity of Property, Plant and Equipment**

**HYDRO ONE NETWORKS INC.**

**DISTRIBUTION**

**Continuity of Property, Plant and Equipment**

Historical (2013 to 2016), Bridge (2017) & Test (2018 to 2022) Years

Year Ending December 31

Total - Gross Balances

(\$ Millions)

<b>Line No.</b>	<b>Year</b>	<b>Opening Balance</b>	<b>Additions</b>	<b>Retirement s</b>	<b>Sales</b>	<b>Transfers In/Out</b>	<b>Closing Balance</b>
		(a)	(b)	(c)	(d)	(e)	(f)
<u>Historical</u>							
1	2013	8,636.2	729.3	(93.8)	(15.6)	0.0	9,256.2
2	2014	9,256.2	623.7	(38.7)	(10.2)	1.0	9,832.0
3	2015	9,832.0	755.3	(36.1)	(18.5)	0.4	10,533.1
4	2016	10,533.1	654.8	(87.6)	(15.2)	2.1	11,087.3
<u>Bridge</u>							
5	2017	11,087.3	651.8	(40.5)	0.0	0.6	11,699.2
<u>Test</u>							
6	2018	11,699.2	635.1	(89.4)	-	0.6	12,245.5
7	2019	12,245.5	755.2	(134.4)	-	0.6	12,866.9
8	2020	12,866.9	748.5	(45.6)	-	0.6	13,570.4
9	2021	13,570.4	880.2	(63.9)	-	0.6	14,387.4
10	2022	14,387.4	784.4	(62.7)	-	0.0	15,109.1

Witness: JODOIN Joel



**D2-01-03 – Continuity of Property, Plant and Equipment - Accumulated Depreciation**

**HYDRO ONE NETWORKS INC.  
 DISTRIBUTION**

**Continuity of Property, Plant and Equipment - Accumulated Depreciation**

Historical (2013 to 2016), Bridge (2017) & Test (2018 to 2022) Years

Year Ending December 31

(\$ Millions)

<u>Line No.</u>	<u>Year</u>	<u>Opening Balance</u>	<u>Provision</u>	<u>Retirements</u>	<u>Sales</u>	<u>Transfers In/Out and Other</u>	<u>Closing Balance</u>
		(a)	(b)	(c)	(d)	(e)	(f)
<u>Historical</u>							
1	2013	3,254.0	277.7	(93.8)	(14.3)	0.0	3,423.6
2	2014	3,423.6	301.1	(33.2)	(9.5)	0.0	3,682.0
3 <sup>(1)</sup>	2015	3,682.0	308.0	(35.6)	(20.4)	4.7	3,938.6
4	2016	3,938.6	322.7	(83.7)	(14.6)	0.4	4,163.5
<u>Bridge</u>							
5	2017	4,163.5	325.0	(40.5)	-	-	4,448.1
<u>Test</u>							
6	2018	4,448.1	344.6	(89.4)	-	-	4,703.3
7	2019	4,703.3	357.0	(134.4)	-	-	4,925.9
8	2020	4,925.9	369.6	(45.6)	-	-	5,250.0
9	2021	5,250.0	414.5	(63.9)	-	-	5,600.6
10	2022	5,600.6	404.2	(62.7)	-	-	5,942.1

<sup>(1)</sup> \$4.7M in 2015 under Transfers In/Out and Other represents DSC Exemption and reserve redistribution.

Witness: JODOIN Joel

**D2-01-04 - Continuity of Property, Plant and Equipment - Construction Work in Progress**

**HYDRO ONE NETWORKS INC.**

**DISTRIBUTION**

**Continuity of Property, Plant and Equipment - Construction Work in Progress**

Historical (2013 to 2016), Bridge (2017) & Test (2018 to 2022) Years

Year Ending December 31

(\$ Millions)

<u>Line No.</u>	<u>Year</u>	<u>Opening Balance</u>	<u>Capital Expenditures</u>	<u>Transfers To Plant</u>	<u>Closing Balance</u>
		(a)	(b)	(c)	(d)
<u>Historical</u>					
1	2013	420.7	583.6	(680.2)	324.1
2	2014	324.1	581.8	(560.9)	345.0
3	2015	345.0	630.0	(705.0)	269.9
4	2016	269.9	692.6	(659.3)	303.2
<u>Bridge</u>					
5	2017	303.2	633.5	(651.8)	285.0
<u>Test</u>					
6	2018	285.0	628.1	(635.1)	278.0
7	2019	278.0	736.4	(755.2)	259.2
8	2020	259.2	699.3	(748.5)	210.0
9	2021	210.0	711.0	(704.6)	216.4
10	2022	216.4	796.5	(784.4)	228.4

Witness: JODOIN Joel

**Table updated for Fair Hydro Plan only:**

**D2-01-05 - Statement of Working Capital**

**HYDRO ONE NETWORKS INC.  
DISTRIBUTION  
Statement of Working Capital  
Annual Average  
Test Years (2018 to 2022)  
(\$ Millions)**

<b>Line No.</b>	<b>Particulars</b>	<b>2018 (a)</b>	<b>2019 (b)</b>	<b>2020 (c)</b>	<b>2021 (d)</b>	<b>2022 (e)</b>
1	Cash Working Capital	\$ 281.0	\$ 295.8	308.5	\$ 338.8	355.6
2	Materials and Supply Inventory	4.1	5.5	6.5	5.9	5.5
3	<b>Total</b>	<b>\$ 285.1</b>	<b>\$ 301.3</b>	<b>315.0</b>	<b>\$ 344.6</b>	<b>361.1</b>

**OEB Staff Interrogatory # 179**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

E1-01-01 - Revenue Requirement, Determination of Net Utility Income

**Interrogatory:**

Please update tables in this exhibit to reflect the Fair Hydro Plan which came into effect on July 1, 2017 and any other changes to the components of rate base changed as a result of budget updates or responses to interrogatories.

**Response:**

Please find below updated tables from Exhibit E1, Tab 1, Schedule 1, reflecting updates as a result of the Fair Hydro Plan including cash working capital impact and a reduction to OM&A as a result of lower bad debt expense by \$2.9 million and the changes described in Exhibit Q, Tab 1, Schedule 1 filed on December 21, 2017.

**Table 1 (updated): Revenue Requirement (\$ Millions)**

<b>Components</b>	<b>2017<sup>1</sup></b>	<b>2018</b>
OM&A	593.0	576.7
Depreciation and Amortization	390.2	397.1
Income Taxes	48.7	64.9
Return on Capital	435.8	472.5
<b>Total Revenue Requirement</b>	<b>1,467.6</b>	<b>1,511.2</b>
Deduct External Revenues and Other	(52.7)	(53.6)
<b>Rates Revenue Requirement</b>	<b>1,414.9</b>	<b>1,457.6</b>
Regulatory Deferral and Variance Accounts Disposition	11.1	6.2
<b>Rates Revenue Requirement (with Deferral and Variance Accounts)</b>	<b>1,426.0</b>	<b>1,463.8</b>

**Table 2 (updated): OM&A Expense (\$ Millions)**

	<b>2018</b>
Sustaining	346.7
Development	11.0
Operations	36.7
Customer Service	128.7
Common Corporate Costs and Other Costs	48.7
Property Taxes & Rights Payments	4.9
<b>Total OM&amp;A</b>	<b>576.7</b>

**Table 3 (updated): Depreciation and Amortization Expense (\$ Millions)**

	<b>2018</b>
Depreciation	383.9
Amortization (Excluding Other Reg. Amortization)	13.1
<b>Total Expense</b>	<b>397.1</b>

**Table 4 (updated): Corporate Income Taxes (\$ Millions)**

	<b>2018</b>
Regulatory Taxable Income	249.5
Tax Rate	26.5%
<b>Subtotal</b>	<b>66.1</b>
Less: Credits	(1.2)
<b>Total Income Taxes</b>	<b>64.9</b>

**Table 5 (updated): Return on Capital (\$ Millions)**

	<b>2018</b>
Return on Debt	198.0
Return on Equity	274.5
<b>Return on Capital</b>	<b>472.5</b>

**Table 6 (updated): Comparison of Revenue Requirement: 2018 vs. 2017 (\$ Millions)**

<b>Description</b>	<b>2018 vs. 2017</b>
OM&A	(16.2)
Depreciation and Amortization	6.9
Income Taxes	16.2
Return on Capital	36.8
<b>Total Revenue Requirement</b>	<b>43.7</b>
Less External Revenues	(0.9)
<b>Rates Revenue Requirement</b>	<b>42.8</b>
Regulatory Deferral and Variance Accounts Disposition	(4.9)
<b>Rates Revenue Requirement (with Deferral and Variance Accounts)</b>	<b>37.9</b>

**OEB Staff Interrogatory # 180**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D2-01-02-01

**Interrogatory:**

- a) Please reconcile the asset continuity schedule to Note 10 of the applicant's December 31, 2016 audited financial statements (by total cost and total accumulated depreciation).
- b) Please update the test period asset continuity schedule such that it reflects the impacts of the updates to the application as filed in Exhibit Q.

**Response:**

- a) See reconciliation below:

		<b><u>Cost</u></b>		<b><u>Accumulated Depreciation</u></b>	
Per Financials					
	Property, Plant & Equipment - Note 10	10,810.0		3,986.0	
	Intangibles - Note 11	421.0		186.0	
<b>Total Per Financials</b>			11,231.0		4,172.0
Less:	Norfolk, Haldimand & Woodstock PP & E	140.7		8.4	
	Intercompany Intangibles	3.0		0.2	
			143.7		8.5
<b>Subtotal</b>			<b>11,087.3</b>		<b>4,163.5</b>
Per OEB Continuity Filing (App.2-BA_Fixed Asset Cont 2016)			<b>11,087.3</b>		<b>4,163.5</b>

- b) Please refer to Exhibit I-33-Staff-178

Witness: CHHELAVDA Samir

**Vulnerable Energy Consumers Coalition Interrogatory # 28**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D1-01-02

**Interrogatory:**

a) Please breakout the \$104.6 million in higher than approved capital spending in 2015 as between the three listed categories – storm damage, in-service additions, and relocation projects.

b) Please provide the actual and forecast (Board approved) amounts for each category in 2015.

**Response:**

a) Note that the referenced section states that the higher than approved in-service additions are primarily due to overspending in “joint use and relocations”, which is one category, and “trouble calls and storm damage” is another category. These are part of the Sustaining line item. “Trouble calls and storm damage” contributes \$14.7 million to the higher spend and “joint use and relocations” contributes \$29 million to the higher spend in 2015.

b)

	<b>2015</b>		
<b>Program</b>	<b>OEB Approved</b>	<b>Actual</b>	<b>Variance</b>
Joint Use and Relocations	27.9	56.9	29.0
Trouble Calls & Storm Damage	59.4	74.1	14.7



**Vulnerable Energy Consumers Coalition Interrogatory # 29**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D1-01-02

**Interrogatory:**

a) For the period 2012-2018 please provide the forecast and actual budgets for storm damage capital works.

**Response:**

a) Trouble calls and Storm Damage are part of the “Sustaining” line item within Table 1 in Exhibit D1, Tab 1, Schedule 2, page 1.  
The portion relating to this work is as follows for 2012 to 2018:

	Historic									Bridge			Test
	2012	2013	2014	2015			2016			2017			2018
	Actual			OEB Approved	Actual	Variance	OEB Approved	Actual	Variance	OEB Approved	Forecast	Variance	Forecast
Trouble Calls & Storm Damage	61.7	97.8	76.7	59.4	74.1	14.7	60.7	80.8	20.1	61.5	83.7	22.2	82.8

Witness: BOWNESS Brad

**Vulnerable Energy Consumers Coalition Interrogatory # 30**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D1-01-04

**Interrogatory:**

- a) In her 2015 Report the Auditor General criticized Hydro One for keeping higher than necessary spare transformers (2015 Annual report Section 4.3, page 274).
- b) Please explain how Hydro One has addressed this criticism.
- c) Please provide a table showing the number of (distribution related) transformers in inventory for each of the years 2013 through 2022.
- d) In the same table please include separately the maintenance expense in each related to spare transformers.

**Response:**

- a) This interrogatory poses no question.
- b) Please refer to interrogatory response Exhibit I-25-Staff-156 part (d) for explanation on how Hydro One has addressed the AG's recommendation.
- c) & d) The following table shows the actual number of spare transformers in inventory and associated maintenance expense for the period 2013 to 2017 and forecast for 2018 to 2022.

	Actual					Forecast*				
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Total Spares in Inventory</b> (including Operating Spares & units available for project usage)	213	198	167	164	139	134	129	125	122	119
<b>Maintenance Expenditures</b>	\$0.5M	\$0.2M	\$0.2M	\$0.2M	\$0.3M	\$0.2M	\$0.2M	\$0.2M	\$0.2M	\$0.2M

\* Note: Hydro One achieved greater reductions in the spare inventory in 2017 than originally forecasted in SR-03. Therefore a revised forecast for number of transformers in inventory from 2018 to 2022 has been provided.

Witness: GARZOUZI Lyla

**Vulnerable Energy Consumers Coalition Interrogatory # 31**

**Issue:**

Issue 33: Are the amounts proposed for the rate base from 2018 to 2022 appropriate?

**Reference:**

D1-01-05 Page: - Table 1

**Interrogatory:**

a) Please explain how the rate for interest capitalized shown in Table 1 is calculated.

**Response:**

a) The rate of interest capitalization is derived based on the embedded cost of debt used to finance the capital expenditures. The bridge and test years represent the effective rate of Hydro One Distribution's average debt portfolio for a given year. For example, the 2018 year includes the actual cost of debt up to 2017 and the forecasted cost of debt in 2018 to finance the capital expenditures embedded in its forecast.

**Consumers Council of Canada Interrogatory # 32**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

None

**Interrogatory:**

Please explain how the implementation of the Fair Hydro Plan has impacted HON's working capital requirements?

**Response:**

Please refer to the following responses:

- Exhibit I-33-Staff-176
- Exhibit I-33-Staff-177
- Exhibit I-33-Staff-178
- Exhibit I-33-Staff-179
- Exhibit I-33-Staff-181

**Canadian Manufacturers & Exporters Interrogatory # 48**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

- a) With respect to the service lag description on page 7, please provide the calculation that turns the percentages of monthly, bi-monthly, quarterly and unassigned billing frequencies into the service lag of 17.25 days.
- b) Please explain the increase in the service lag to 17.25 days from the approved figure of 16.40 days in the Navigant study filed in EB-2013-0416.
- c) Please explain the reduction in the percentage of monthly billed customers from 96% in EB-2013-0416 to 90.3% in the current study.
- d) Please explain in detail the determination of the lag days associated with the 6.9% revenue weighting of customers that do not have an assigned billing schedule, including why a customer would not have an assigned billing schedule.
- e) Please explain why no such category for customers that do not have an assigned billing schedule existed in the study filed in EB-2013-0416.

**Response:**

- a) The 17.25 days is calculated by taking the average service lag days of each month, shown in table 1 below. These days are calculated by the revenue % by month outlined in table 2, and multiplying the applicable the mid-point number of days for each category in table 3.

**Table 1**

<b>Weighted Service Lag Days</b>												
	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14
A	B	C	D	E	F	G	H	I	J	K	L	M
Bi-Monthly	0.08	0.03	0.07	0.07	0.17	0.11	0.11	0.10	0.11	0.11	0.09	0.09
Monthly	14.05	14.06	13.89	13.66	13.52	13.56	13.77	13.74	13.55	13.50	13.58	13.74
Quarterly	1.19	1.36	1.71	2.40	2.10	1.55	1.60	1.83	1.48	1.90	1.75	1.12
Not Assigned	1.46	1.36	1.44	1.42	1.81	2.15	1.70	1.61	2.21	2.03	2.01	2.10
<b>Total</b>	<b>16.77</b>	<b>16.81</b>	<b>17.10</b>	<b>17.55</b>	<b>17.59</b>	<b>17.38</b>	<b>17.18</b>	<b>17.29</b>	<b>17.36</b>	<b>17.55</b>	<b>17.42</b>	<b>17.05</b>
												<b>17.25</b>

**Table 2**

<b>Dx Revenues %</b>												
%	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14
A	B	C	D	E	F	G	H	I	J	K	L	M
Bi-Monthly	0.25%	0.09%	0.22%	0.22%	0.55%	0.38%	0.37%	0.34%	0.37%	0.37%	0.29%	0.29%
Monthly	92.36%	92.45%	91.32%	89.85%	88.92%	89.14%	90.53%	90.36%	89.10%	88.79%	89.27%	90.35%
Quarterly	2.60%	2.98%	3.74%	5.27%	4.60%	3.40%	3.51%	4.02%	3.25%	4.17%	3.83%	2.45%
Not Assigned	4.79%	4.48%	4.73%	4.66%	5.94%	7.08%	5.59%	5.28%	7.28%	6.67%	6.61%	6.92%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

**Table 3**

<b>2014</b>	<b>Mid-Point</b>
A	B
Bi-Monthly	30.42
Monthly	15.21
Quarterly	45.63
Not Assigned (Average from above)	30.42

- b) The change in service lag from 16.40 days to 17.25 in the current study is a result of the “Not Assigned” accounts being treated separately in this study as compared to the prior study. Had the “Not Assigned” been allocated monthly, the service lag would be 16.37, similar to that of the prior study. The service lag for “Not Assigned” accounts are based on the average mid-point from all billing frequencies as opposed to the prior study where it was grouped into monthly.
- c) The change is mainly as a result of the “Not Assigned” category no longer being captured into the monthly category as in the prior study. The “Not Assigned” accounts for approximately 5.8% in the current study. Adding the “Not Assigned” and the “Monthly” percentages (90.3% +5.8% = approximately 96%) will yield a percentage similar to that of the 96% in the prior study. The “Not Assigned” category was carved out from the “Monthly” category in the current study, as it was not representative of monthly billing category.
- d) The 6.9% is derived by the percentage of revenues associated with the not assigned category out of the total revenue. The customers that do not have a set billing frequency within the

1 system are captured within the “Not assigned” category. The primary reason for this is that  
2 some customer invoices are handled manually in which their billing frequencies vary.

- 3  
4 e) Navigant held interviews with internal subject matter experts in which it was determined that  
5 the “Not assigned” category is no longer representative of the monthly billing frequency.  
6 Therefore, Navigant treated this category separately within this study.

**Canadian Manufacturers & Exporters Interrogatory # 49**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

The evidence notes that Hydro One has reduced its average collection lag to 25.90 days (page 7). The previous collection lag was 28.77 days (EB-2013-0416). In the OEB's June 3, 2015 letter to all licensed electricity distributors and other interested parties re "Allowance for Working Capital for Electricity Distribution Rate Applications", the OEB set a default collection period of 22.0 days that was based on the minimum payment period plus allowances for payments by mail as specified in s. 2.6 of the Distribution System Code and noted that the observed sample range was 21.8 days to 29.1 days.

- a) Please explain why the Hydro One collection lag remains significantly higher than the 22.0 days used by the OEB.
- b) Please explain why the statutory approach described by Navigant on page 4 is not used for the collection lag, given the length that customers have to pay is set out in the Distribution System Code, as noted above.
- c) Does Hydro One have any plans to improve (i.e. shorten) the collection lag over the 2018 through 2022 period? If not, why not?
- d) The Navigant report is based on actual 2014 information. What has Hydro One done to reduce the collection lag in 2015, 2016 and 2017?

**Response:**

- a) The 22.0 days set out in the OEB's June 3, 2015 letter is the proxy for which the OEB used for collections lag, in calculating the working capital requirements for those distributors who opt for the 7.5% default working capital percentage. Utilities that do not opt for the 7.5% default working capital percentage will have to conduct a lead-lag study to determine what the collections lag is, based upon actual distributor data. Hydro One's collections lag of



1 25.90 days falls within the range of what the OEB observed for collections lag (21.8-29.1).  
2 Furthermore, Hydro One's collections lag includes payment lag, for which the OEB allows  
3 for an additional 1.4 days.  
4

5 b) As mentioned in part (a) above, the 22.0 days is only used when calculating the 7.5% default  
6 working capital percentage, and is not used as Hydro One is using a lead-lag study to  
7 determine its working capital percentage.  
8

9 c) Hydro One redesigned its collections process in 2017 and can now reach out customers  
10 earlier in the collections cycle to prevent significant arrears build-up. Hydro One has also  
11 doubled the number of touch points with its customers; previously Hydro One had 4 touch  
12 points up to the point of disconnection. As of 2017, the number of touch points has increased  
13 to 8. Hydro One has seen a positive outcome from these changes and as a result, it does not  
14 plan to make changes to the Collections Process over the 2018-2022 period.  
15

16 d) Please see response to part (c) above.

**Canadian Manufacturers & Exporters Interrogatory # 50**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

As a result of the introduction of distribution rate protected residential customers and the delivery credit for on-reserve customers in Bill 132, Fair Hydro Act, 2017, a portion of Hydro One's retail revenue will come from a party other than the residential customers.

- a) Please confirm that this means that in Table 2, there would be less revenue coming through the retail revenue line and a corresponding increase in revenue coming from the government via a third party (such as the IESO). If this cannot be confirmed, please explain fully.
- b) Please provide an estimate for each of 2018 through 2022 of the amount of revenue from customers that will be shifted from distribution revenues to government funded revenues as a result of the distribution rate protected residential customer and delivery credit for on-reserve customers provisions of the Fair Hydro Act. For each year, please also indicate what percent this revenue is of the total retail revenue (i.e. including the government funded portion of the retail revenue).
- c) The Fair Hydro Act indicates requires that the IESO receive payments to and from the Minister and to make payments to distributors in respect of the distribution rate protection and on-reserve delivery credits that result from the Fair Hydro Plan. Has the IESO or the government indicated the timing of these payments to Hydro One or, for example, will the revenue due to Hydro One be used as a credit on the monthly cost of power invoice sent by the IESO each month?
- d) In Table 2, the lag days shown for the RRRP revenues is 32.72 days, the same figure as the lead time for the cost of power expense in Table 4. Is this because the RRRP revenue received by Hydro One is an offset to the cost of power on the monthly invoices received from Hydro One? If not, please explain why the figures are same in both the current and previous Navigant studies.

1 e) If the response to part (d) is yes, and in the absence of any information to the contrary, would  
2 it be reasonable to assume that the on-reserve delivery credits and distribution rate protection  
3 amounts will be shown as credits, similar to the RRP revenue, on the monthly cost of power  
4 invoices from the IESO? If not, please explain fully why not.  
5

6 **Response:**

7 a) The retail revenue line would not change. The collection of the outlined portion of revenue  
8 would shift from the customer to a third party which does not impact the retail revenues line  
9 in table 2.  
10

11 b) Based on 2017 data, it could be estimated that approximately 5% of total retail revenues are  
12 funded through the IESO for the distribution rate protected residential customers (DRP) and  
13 the delivery credit for on-reserve customers (FNDC). Since the total retail revenue will not  
14 change for the purpose of working capital set out in table 2, and given the time required to  
15 provide an accurate estimate of the impact for 2018-2022, it is prudent to extrapolate the  
16 2017 actual impact of 5% to be used for any estimated impacts.  
17

18 c) Yes, the payments are included in the monthly IESO invoice as a separate charge type which  
19 differs from Cost of Power line items.  
20

21 d) Yes, the RRRP Credit was previously funded by IESO through its monthly invoice.  
22

23 e) Assuming the question is to compare RRRP revenue instead of RPP revenue, the answer is  
24 no. Although the funding of RRRP, DRP, and FNDC are all shown as a credit on the IESO  
25 invoice, the different line items have different funding periods in which Hydro One is  
26 reimbursed. The RRRP credit is based on a calendar month whereas the DRP, and FNDC  
27 credits will only be reimbursed after they are applied to a customer's invoice which is based  
28 on the billing period for each individual customer.

**Canadian Manufacturers & Exporters Interrogatory # 51**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

- a) The description in section 3.2.5 on page 11 for the Payments to Inergi appears to be identical to that in the EB-2013-0416 study but the dollar-weighted expense lead time has dropped from 44.40 days to 32.82 days. Please explain this significant reduction in days.
- b) Please provide all the assumptions, data and calculations used to generate both the current estimate of 32.82 days and the corresponding information that resulted in the 44.40 days in the EB-2013-0416 study.

**Response:**

- a) The reduction in days is related to the payment date, in the current study this occurs primarily in the middle of the month whereas in the prior study it occurred closer to the end of the month. The explanation in the Navigant Report stated in Exhibit D1-1-3, Attachment 1, on page 11 in section 3.2.5, is incorrect and should reflect the middle of the month.
- b) Please refer to the filed MS Excel I-34-CME-51-01 for detailed information.

**Canadian Manufacturers & Exporters Interrogatory # 52**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

- a) The description in section 3.2.6 on page 11 for the Consulting and Contract Staff appears to be identical to that in the EB-2013-0416 study but the dollar-weighted expense lead time has dropped from 80.15 days to 1.91 days. Please explain this significant reduction in days.
- b) Please provide all the assumptions, data and calculations used to generate both the current estimate of 1.91 days and the corresponding information that resulted in the 80.15 days in the EB-2013-0416 study.

**Response:**

- a) The major change is as a result of the period beginning field being updated to reflect the clearing date rather than the year of the invoice date. In this study, some of the invoice dates were from the prior year which have skewed the outcome and resulted in a significantly higher payment lag time. The current study sets the period beginning to use the year of the clearing date, which more accurately reflects the service period to which Consulting and Contract staff are billed (typically billed on a monthly basis).
- b) The request in this interrogatory is unreasonable based on the immateriality of the impact to revenue requirement, relative to effort involved to gather and present the tremendous database of records within the time allowed.

**Canadian Manufacturers & Exporters Interrogatory # 53**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

- a) The description in section 3.2.7 on page 11 for the Miscellaneous OM&A appears to be identical to that in the EB-2013-0416 study but the dollar-weighted expense lead time has dropped from 63.60 days to 28.09 days. Please explain this significant reduction in days.
- b) Please provide all the assumptions, data and calculations used to generate both the current estimate of 28.09 days and the corresponding information that resulted in the 63.60 days in the EB-2013-0416 study.

**Response:**

- a) The major reduction is due to more detailed and descriptive data which allowed Navigant to develop more precise assumptions for service periods and payment terms. For example, the information computer and telecom category includes prepaid software licenses which is now visible and can be treated appropriately. This has the effect of decreasing the days. In addition, the most recent study was able to obtain a more precise split for Misc. OM&A expenses between distribution and transmission. Service period and payment term assumptions were developed in consultation with Hydro One subject matter experts by Misc. OM&A category and applied to the transaction level data. At the transaction level, by category, the service period is calculated relative to the invoice date. Most transactions have a monthly service period.
- b) The request in this interrogatory is unreasonable based on the immateriality of the impact to revenue requirement, relative to effort involved to gather and present the tremendous amount of records from the database within the time allowed.

**Canadian Manufacturers & Exporters Interrogatory # 54**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

a) For each of sections 3.25, 3.26 and 3.27, please explain why the results based on 2014 data is expected to be more in line with projections for the 2018 through 2022 period than those based on 2012 data filed in EB-2013-0416.

**Response:**

a) Based on Navigant's discussions with subject matter experts at Hydro One, it was determined that 2014 actuals are more closely aligned with 2018-2022 forecast for Payments to Inergi, Consulting and Contract Staff and Miscellaneous OM&A expenses. For example, in 2012 the consulting costs included costs related to large IT projects such as CIS which are not in 2014 actuals and are aligned closer to the forecast for 2018-2022 expenses.

**Canadian Manufacturers & Exporters Interrogatory # 55**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

- a) Please provide all the data, assumptions and calculations that result in the interest expense lead days of -1.93 noted in Section 3.4 on page 12.
- b) Please provide all the data, assumptions and calculations that result in the PILS expense lead time of 13.67 days noted in Section 3.5 on page 12.

**Response:**

Please see the response below:



1 a)

**INTEREST (Dx Only Amounts)**

Period Beginning	Period Ending	Payment Date	Payment Amount (\$M) Dx Only	Service Lead Time Days	Payment Lead Time Days	Total Lead Time Days	Weighting Factor	Weighted Lead Time
A	B	C	D	F	G	H	I	J
1/1/2014	12/31/2014	1/9/2014	\$ 4,176,000	182.50	(356.00)	(173.50)	2.80%	(4.86)
1/1/2014	12/31/2014	1/14/2014	\$ 4,666,500	182.50	(351.00)	(168.50)	3.13%	(5.27)
1/1/2014	12/31/2014	1/22/2014	\$ 85,447	182.50	(343.00)	(160.50)	0.06%	(0.09)
1/1/2014	12/31/2014	1/29/2014	\$ 4,699,000	182.50	(336.00)	(153.50)	3.15%	(4.83)
1/1/2014	12/31/2014	1/29/2014	\$ 2,207,675	182.50	(336.00)	(153.50)	1.48%	(2.27)
1/1/2014	12/31/2014	1/29/2014	\$ 429,000	182.50	(336.00)	(153.50)	0.29%	(0.44)
1/1/2014	12/31/2014	2/27/2014	\$ 4,176,000	182.50	(307.00)	(124.50)	2.80%	(3.48)
1/1/2014	12/31/2014	2/27/2014	\$ 3,165,750	182.50	(307.00)	(124.50)	2.12%	(2.64)
1/1/2014	12/31/2014	2/27/2014	\$ 82,274	182.50	(307.00)	(124.50)	0.06%	(0.07)
1/1/2014	12/31/2014	3/7/2014	\$ 2,950,000	182.50	(299.00)	(116.50)	1.98%	(2.30)
1/1/2014	12/31/2014	3/11/2014	\$ 3,912,000	182.50	(295.00)	(112.50)	2.62%	(2.95)
1/1/2014	12/31/2014	3/24/2014	\$ 1,646,250	182.50	(282.00)	(99.50)	1.10%	(1.10)
1/1/2014	12/31/2014	4/7/2014	\$ 4,691,250	182.50	(268.00)	(85.50)	3.14%	(2.69)
1/1/2014	12/31/2014	4/7/2014	\$ 4,316,450	182.50	(268.00)	(85.50)	2.89%	(2.47)
1/1/2014	12/31/2014	4/16/2014	\$ 5,050,500	182.50	(259.00)	(76.50)	3.38%	(2.59)
1/1/2014	12/31/2014	4/16/2014	\$ 3,625,000	182.50	(259.00)	(76.50)	2.43%	(1.86)
1/1/2014	12/31/2014	4/17/2014	\$ 4,316,450	182.50	(258.00)	(75.50)	2.89%	(2.18)
1/1/2014	12/31/2014	4/22/2014	\$ 82,110	182.50	(253.00)	(70.50)	0.06%	(0.04)
1/1/2014	12/31/2014	5/15/2014	\$ 4,304,080	182.50	(230.00)	(47.50)	2.88%	(1.37)
1/1/2014	12/31/2014	5/29/2014	\$ 2,640,000	182.50	(216.00)	(33.50)	1.77%	(0.59)
1/1/2014	12/31/2014	5/29/2014	\$ 6,574,075	182.50	(216.00)	(33.50)	4.41%	(1.48)
1/1/2014	12/31/2014	5/30/2014	\$ 4,519,159	182.50	(215.00)	(32.50)	3.03%	(0.98)
1/1/2014	12/31/2014	5/30/2014	\$ 82,372	182.50	(215.00)	(32.50)	0.06%	(0.02)
1/1/2014	12/31/2014	6/19/2014	\$ 1,725,000	182.50	(195.00)	(12.50)	1.16%	(0.14)
1/1/2014	12/31/2014	6/19/2014	\$ 290,962	182.50	(195.00)	(12.50)	0.19%	(0.02)
1/1/2014	12/31/2014	7/10/2014	\$ 4,176,000	182.50	(174.00)	8.50	2.80%	0.24
1/1/2014	12/31/2014	7/14/2014	\$ 4,666,500	182.50	(170.00)	12.50	3.13%	0.39
1/1/2014	12/31/2014	7/22/2014	\$ 83,172	182.50	(162.00)	20.50	0.06%	0.01
1/1/2014	12/31/2014	7/25/2014	\$ 429,000	182.50	(159.00)	23.50	0.29%	0.07
1/1/2014	12/31/2014	7/29/2014	\$ 4,699,000	182.50	(155.00)	27.50	3.15%	0.87
1/1/2014	12/31/2014	7/29/2014	\$ 2,207,675	182.50	(155.00)	27.50	1.48%	0.41
1/1/2014	12/31/2014	8/29/2014	\$ 4,176,000	182.50	(124.00)	58.50	2.80%	1.64
1/1/2014	12/31/2014	8/29/2014	\$ 3,165,750	182.50	(124.00)	58.50	2.12%	1.24
1/1/2014	12/31/2014	8/29/2014	\$ 82,573	182.50	(124.00)	58.50	0.06%	0.03
1/1/2014	12/31/2014	9/9/2014	\$ 2,950,000	182.50	(113.00)	69.50	1.98%	1.37
1/1/2014	12/31/2014	9/11/2014	\$ 3,912,000	182.50	(111.00)	71.50	2.62%	1.87
1/1/2014	12/31/2014	9/18/2014	\$ 368,803	182.50	(104.00)	78.50	0.25%	0.19
1/1/2014	12/31/2014	9/24/2014	\$ 1,646,250	182.50	(98.00)	84.50	1.10%	0.93
1/1/2014	12/31/2014	10/7/2014	\$ 4,691,250	182.50	(85.00)	97.50	3.14%	3.07
1/1/2014	12/31/2014	10/7/2014	\$ 4,316,450	182.50	(85.00)	97.50	2.89%	2.82
1/1/2014	12/31/2014	10/16/2014	\$ 5,050,500	182.50	(76.00)	106.50	3.38%	3.60
1/1/2014	12/31/2014	10/16/2014	\$ 3,625,000	182.50	(76.00)	106.50	2.43%	2.59
1/1/2014	12/31/2014	10/20/2014	\$ 4,316,450	182.50	(72.00)	110.50	2.89%	3.20
1/1/2014	12/31/2014	10/22/2014	\$ 84,338	182.50	(70.00)	112.50	0.06%	0.06
1/1/2014	12/31/2014	11/18/2014	\$ 4,304,080	182.50	(43.00)	139.50	2.88%	4.02
1/1/2014	12/31/2014	11/27/2014	\$ 2,640,000	182.50	(34.00)	148.50	1.77%	2.63
1/1/2014	12/31/2014	11/27/2014	\$ 6,574,075	182.50	(34.00)	148.50	4.41%	6.54
1/1/2014	12/31/2014	12/1/2014	\$ 4,543,306	182.50	(30.00)	152.50	3.04%	4.64
1/1/2014	12/31/2014	12/18/2014	\$ 1,725,000	182.50	(13.00)	169.50	1.16%	1.96
1/1/2014	12/31/2014	12/18/2014	\$ 369,030	182.50	(13.00)	169.50	0.25%	0.42
<b>Total</b>			<b>\$ 149,215,504</b>				<b>100.00%</b>	<b>-1.93</b>

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1 b)

**PAYMENTS IN LIEU OF TAXES (Dx Only Amounts)**

Month	Period Beginning	Period Ending	Payment date	Payment Amount (\$M)	Service Lead Time	Payment Lead Time	Total Lead Time	Weighting Factor	Weighted Lead Time
A	B	C	D	E	F	G	H	I	J
Jan-14	1/1/2014	12/31/2014	1/31/2014	\$ 1,286,454	182.50	-334.00	-151.50	8.33%	-12.63
Feb-14	1/1/2014	12/31/2014	2/28/2014	\$ 1,286,454	182.50	-306.00	-123.50	8.33%	-10.29
Mar-14	1/1/2014	12/31/2014	3/30/2014	\$ 1,286,454	182.50	-276.00	-93.50	8.33%	-7.79
Apr-14	1/1/2014	12/31/2014	4/30/2014	\$ 1,286,454	182.50	-245.00	-62.50	8.33%	-5.21
May-14	1/1/2014	12/31/2014	5/30/2014	\$ 1,286,454	182.50	-215.00	-32.50	8.33%	-2.71
Jun-14	1/1/2014	12/31/2014	6/29/2014	\$ 1,286,454	182.50	-185.00	-2.50	8.33%	-0.21
Jul-14	1/1/2014	12/31/2014	7/31/2014	\$ 1,286,454	182.50	-153.00	29.50	8.33%	2.46
Aug-14	1/1/2014	12/31/2014	8/29/2014	\$ 1,286,454	182.50	-124.00	58.50	8.33%	4.88
Sep-14	1/1/2014	12/31/2014	9/28/2014	\$ 1,286,454	182.50	-94.00	88.50	8.33%	7.38
Oct-14	1/1/2014	12/31/2014	10/31/2014	\$ 1,286,454	182.50	-61.00	121.50	8.33%	10.13
Nov-14	1/1/2014	12/31/2014	11/28/2014	\$ 1,286,454	182.50	-33.00	149.50	8.33%	12.46
Dec-14	1/1/2014	12/31/2014	12/31/2014	\$ 1,286,454	182.50	0.00	182.50	8.33%	15.21
<b>Total</b>				<b>\$15,437,448</b>				<b>100.00%</b>	<b>13.67</b>

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Witness: JODOIN Joel

**Canadian Manufacturers & Exporters Interrogatory # 56**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

- a) Please provide the expense lead days calculation based on the long-term debt issuance and amounts forecast for 2018, as shown in Exhibit D2, Tab 2, Schedule 6, Updated, page 6. Please show all calculations used to arrive the expense lead days.

**Response:**

- b) The table below reflects the expense lead days calculation based upon the long-term debt issuance amounts forecasts in 2018 embedded in Exhibit Q1, Tab 1, Schedule 1.

Period Beginning	Period Ending	Payment Date	Payment Amount (\$M) Dx Only	Service Lead Time Days	Payment Lead Time Days	Total Lead Time Days	Weightin g Factor	Weighted Lead Time
A	B	C	D	F	G	H	I	J
1/1/2018	12/31/2018	1/9/2018	\$ 4,176,000	182.50	(356.00)	(173.50)	2.58%	(4.47)
1/1/2018	12/31/2018	1/14/2018	\$ 4,666,500	182.50	(351.00)	(168.50)	2.88%	(4.85)
1/1/2018	12/31/2018	1/22/2018	\$ 85,447	182.50	(343.00)	(160.50)	0.05%	(0.08)
1/1/2018	12/31/2018	1/29/2018	\$ 4,699,000	182.50	(336.00)	(153.50)	2.90%	(4.45)
1/1/2018	12/31/2018	1/29/2018	\$ 2,207,675	182.50	(336.00)	(153.50)	1.36%	(2.09)
1/1/2018	12/31/2018	1/29/2018	\$ 429,000	182.50	(336.00)	(153.50)	0.26%	(0.41)
1/1/2018	12/31/2018	2/27/2018	\$ 3,165,750	182.50	(307.00)	(124.50)	1.95%	(2.43)
1/1/2018	12/31/2018	2/27/2018	\$ 82,274	182.50	(307.00)	(124.50)	0.05%	(0.06)
1/1/2018	12/31/2018	3/11/2018	\$ 3,912,000	182.50	(295.00)	(112.50)	2.41%	(2.71)
1/1/2018	12/31/2018	3/24/2018	\$ 1,646,250	182.50	(282.00)	(99.50)	1.02%	(1.01)
1/1/2018	12/31/2018	4/7/2018	\$ 4,691,250	182.50	(268.00)	(85.50)	2.89%	(2.47)
1/1/2018	12/31/2018	4/7/2018	\$ 4,316,450	182.50	(268.00)	(85.50)	2.66%	(2.28)
1/1/2018	12/31/2018	4/16/2018	\$ 3,625,000	182.50	(259.00)	(76.50)	2.24%	(1.71)
1/1/2018	12/31/2018	4/17/2018	\$ 4,316,450	182.50	(258.00)	(75.50)	2.66%	(2.01)
1/1/2018	12/31/2018	4/22/2018	\$ 82,110	182.50	(253.00)	(70.50)	0.05%	(0.04)
1/1/2018	12/31/2018	5/15/2018	\$ 4,304,080	182.50	(230.00)	(47.50)	2.65%	(1.26)
1/1/2018	12/31/2018	5/29/2018	\$ 2,640,000	182.50	(216.00)	(33.50)	1.63%	(0.55)
1/1/2018	12/31/2018	5/29/2018	\$ 6,574,075	182.50	(216.00)	(33.50)	4.05%	(1.36)
1/1/2018	12/31/2018	5/30/2018	\$ 4,519,159	182.50	(215.00)	(32.50)	2.79%	(0.91)
1/1/2018	12/31/2018	5/30/2018	\$ 82,372	182.50	(215.00)	(32.50)	0.05%	(0.02)
1/1/2018	12/31/2018	6/19/2018	\$ 1,725,000	182.50	(195.00)	(12.50)	1.06%	(0.13)
1/1/2018	12/31/2018	6/19/2018	\$ 290,962	182.50	(195.00)	(12.50)	0.18%	(0.02)
1/1/2018	12/31/2018	7/10/2018	\$ 4,176,000	182.50	(174.00)	8.50	2.58%	0.22
1/1/2018	12/31/2018	7/14/2018	\$ 4,666,500	182.50	(170.00)	12.50	2.88%	0.36
1/1/2018	12/31/2018	7/22/2018	\$ 83,172	182.50	(162.00)	20.50	0.05%	0.01
1/1/2018	12/31/2018	7/25/2018	\$ 429,000	182.50	(159.00)	23.50	0.26%	0.06
1/1/2018	12/31/2018	7/29/2018	\$ 4,699,000	182.50	(155.00)	27.50	2.90%	0.80
1/1/2018	12/31/2018	7/29/2018	\$ 2,207,675	182.50	(155.00)	27.50	1.36%	0.37
1/1/2018	12/31/2018	8/29/2018	\$ 3,165,750	182.50	(124.00)	58.50	1.95%	1.14
1/1/2018	12/31/2018	8/29/2018	\$ 82,573	182.50	(124.00)	58.50	0.05%	0.03
1/1/2018	12/31/2018	9/11/2018	\$ 3,912,000	182.50	(111.00)	71.50	2.41%	1.73
1/1/2018	12/31/2018	9/18/2018	\$ 368,803	182.50	(104.00)	78.50	0.23%	0.18
1/1/2018	12/31/2018	9/24/2018	\$ 1,646,250	182.50	(98.00)	84.50	1.02%	0.86
1/1/2018	12/31/2018	10/7/2018	\$ 4,691,250	182.50	(85.00)	97.50	2.89%	2.82
1/1/2018	12/31/2018	10/7/2018	\$ 4,316,450	182.50	(85.00)	97.50	2.66%	2.60
1/1/2018	12/31/2018	10/16/2018	\$ 3,625,000	182.50	(76.00)	106.50	2.24%	2.38

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Period Beginning	Period Ending	Payment Date	Payment Amount (\$M) Dx Only	Service Lead Time Days	Payment Lead Time Days	Total Lead Time Days	Weightin g Factor	Weighted Lead Time
A	B	C	D	F	G	H	I	J
1/1/2018	12/31/2018	10/20/2018	\$ 4,316,450	182.50	(72.00)	110.50	2.66%	2.94
1/1/2018	12/31/2018	10/22/2018	\$ 84,338	182.50	(70.00)	112.50	0.05%	0.06
1/1/2018	12/31/2018	11/18/2018	\$ 4,304,080	182.50	(43.00)	139.50	2.65%	3.70
1/1/2018	12/31/2018	11/27/2018	\$ 2,640,000	182.50	(34.00)	148.50	1.63%	2.42
1/1/2018	12/31/2018	11/27/2018	\$ 6,574,075	182.50	(34.00)	148.50	4.05%	6.02
1/1/2018	12/31/2018	12/1/2018	\$ 4,543,306	182.50	(30.00)	152.50	2.80%	4.27
1/1/2018	12/31/2018	12/18/2018	\$ 1,725,000	182.50	(13.00)	169.50	1.06%	1.80
1/1/2018	12/31/2018	12/18/2018	\$ 369,030	182.50	(13.00)	169.50	0.23%	0.39
1/1/2018	12/31/2018	2/24/2018	\$ 3,453,262	182.50	(310.00)	(127.50)	2.13%	(2.72)
1/1/2018	12/31/2018	2/24/2018	\$ 3,456,036	182.50	(310.00)	(127.50)	2.13%	(2.72)
1/1/2018	12/31/2018	2/24/2018	\$ 2,397,185	182.50	(310.00)	(127.50)	1.48%	(1.89)
1/1/2018	12/31/2018	5/20/2018	\$ 3,372,666	182.50	(225.00)	(42.50)	2.08%	(0.88)
1/1/2018	12/31/2018	3/15/2018	\$ 3,221,628	182.50	(291.00)	(108.50)	1.99%	(2.16)
1/1/2018	12/31/2018	6/15/2018	\$ 1,838,883	182.50	(199.00)	(16.50)	1.13%	(0.19)
1/1/2018	12/31/2018	3/16/2018	\$ 896,691	182.50	(290.00)	(107.50)	0.55%	(0.59)
1/1/2018	12/31/2018	8/26/2018	\$ 3,453,262	182.50	(127.00)	55.50	2.13%	1.18
1/1/2018	12/31/2018	8/26/2018	\$ 3,456,036	182.50	(127.00)	55.50	2.13%	1.18
1/1/2018	12/31/2018	8/26/2018	\$ 2,397,185	182.50	(127.00)	55.50	1.48%	0.82
1/1/2018	12/31/2018	11/19/2018	\$ 3,372,666	182.50	(42.00)	140.50	2.08%	2.92
1/1/2018	12/31/2018	9/14/2018	\$ 3,221,628	182.50	(108.00)	74.50	1.99%	1.48
1/1/2018	12/31/2018	12/15/2018	\$ 1,838,883	182.50	(16.00)	166.50	1.13%	1.89
1/1/2018	12/31/2018	9/15/2018	\$ 896,691	182.50	(107.00)	75.50	0.55%	0.42
<b>Total</b>			<b>\$162,135,207</b>				<b>100.00%</b>	<b>(1.40)</b>

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**Canadian Manufacturers & Exporters Interrogatory # 57**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

- a) Please confirm that Hydro One is required to pay corporate income taxes on a monthly basis. If this cannot be confirmed, what is the frequency of payment required?
- b) Please confirm that the monthly payments from Hydro One are due on the last day of the month. If this cannot be confirmed, please explain when payment is due.
- c) Was the statutory approach used to determine the corporate tax lag? If not, why not?

**Response:**

- a) Confirmed, Hydro One is required to pay corporate income tax instalments on a monthly basis.
- b) Confirmed, instalment payments are due at the end of the month.
- c) The actual payment dates made by HONI to the relevant tax authorities were used. The availability of actual payment dates means the statutory approach does not need to be used to determine the corporate tax lag.

**Canadian Manufacturers & Exporters Interrogatory # 58**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

a) Please provide all the data, assumptions and calculations that were used to determine each of the HST lead times shown in Table 8.

**Response:**

a) The requested response above is unreasonable, based on the immateriality of the impact on revenue requirement, and the effort involved to provide the detailed information and analysis requested within the time allowed.

**Canadian Manufacturers & Exporters Interrogatory # 59**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

a) Is Hydro One proposing to calculate the working capital requirement as 7.70% of the sum of the cost of power and OM&A in each of 2018 through 2022, or is Hydro One proposing to calculate the working capital requirement based on the forecast costs shown in each line applied to the net lag days for each year as shown in Tables 9 through 13?

**Response:**

a) As outlined in Exhibit D1, Tab 1, Schedule 3, page 1, the determination of working capital relies on a lead lag study. The finalized lead lag study supporting this application is included in Exhibit D1, Tab 1, Schedule 3, Attachment 1. The 7.7% is an output as a result of applying the lead lag study.



**Canadian Manufacturers & Exporters Interrogatory # 60**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01

**Interrogatory:**

a) Section 5.1.4 PILS on page 17 states that the PILS lead time (13.67) days is consistent with the PILS lead time calculations for other utilities across Ontario. Please provide the most recent PILS lead time calculations for other utilities across Ontario to which this refers.

**Response:**

a) As shown below, the PILS lead time calculated for HONI is not unusual as the range of lead times seen by other large distribution utilities in Ontario vary. Note that the method of calculation is consistent. The variations are a result of the different PILS payment dates.

- Hydro Ottawa – 2015 Dx Study: 3.75 PILS lead days<sup>1</sup>
- London Hydro – 2015 Dx Study: 24.79 PILS lead days<sup>2</sup>
- Toronto Hydro – 2013 Dx Study: -48.95 PILS lead days<sup>3</sup>

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<sup>1</sup> Source: EB-2015-0004, Amendment to the September 18, 2015 Settlement Proposal

<sup>2</sup> Source: EB-2016-0091, Exhibit 2, Tab 3, Schedule 1

<sup>3</sup> Source: EB-2014-0116 Exhibit 2A, Tab 3, Schedule 2

**Canadian Manufacturers & Exporters Interrogatory # 61**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03

**Interrogatory:**

Table 1 shows a forecast of the cost of power for each of 2018 through 2022.

- a) Where in the evidence has Hydro One provided the calculation of the cost of power figures shown in this table for each of the years broken down into the various components of the charges (cost of electricity, transmission rates, RRRP, etc.)?
- b) If Hydro One has not provided live Excel spreadsheets that show the calculation of the cost power, please provide such spreadsheets that show the billed energy consumption, the adjustment to purchased energy and the costs broken out into each of the components in the cost of power including power purchased (split between RPP and non-RPP volumes), wholesale market service charges, transmission network charges, transmission connection charges, rural rate assistance, smart meter entity charges and any other components of the cost of power that may be included. Please show the volumes and rates used in the various calculations.
- c) Please provided updated live Excel spreadsheets that reflect current power purchased rates (for RPP and non-RPP) for electricity, transmission network and connection rates, rural rate assistance, etc. that reflect changes are now included in rates post July 1, 2017, including the transmission rates that result from the EB-2016-0160 decision. Please also include all assumptions used to forecast rates for each of 2018 through 2022 based on the now current 2017 rates, including assumptions for transmission rates and any other rates that are expected to change before 2018.
- d) Based on the response to part (c) above, please provide updated versions of Tables 1, 2, 3 and 4. Please also include any other updates, such as to OM&A, cost of long-term debt, PILs, etc. that reflect the updated blue page evidence and the reduction in OM&A costs provided in Exhibit Q.

**Response:**

a) Hydro One has not provided the calculation of cost of power in evidence as it is a flow through cost.

b) The wholesale cost of power breakdown is provided in the below table:

<b>Cost of Power Flow Through Dollars in \$M</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
RPP Customers Commodity	1,818	1,893	1,988	2,083	2,188
Non-RPP Customers Commodity	267	278	291	305	321
Global Adjustment	872	908	953	998	1,049
WMSC (Incl RRRP)	143	142	142	142	142
Tx Network	239	261	273	288	306
Tx Line Connection	53	58	61	64	68
Tx Transf Connection	147	160	167	176	187
OESP	27	27	27	27	27
SME Charge	12	12	12	12	12
<b>Total</b>	<b>3,578</b>	<b>3,738</b>	<b>3,915</b>	<b>4,097</b>	<b>4,300</b>

The estimated rates and the high level summary of the Demand and Consumption are provided in the following tables.

<b>Cost of Power Flow Through Rates</b>		<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
RPP Commodity	c/kWh	11.83	12.43	13.06	13.72	14.42
Non- RPP Commodity	c/kWh	2.77	2.91	3.06	3.21	3.38
Global Adjustment	c/kWh	9.06	9.52	10.00	10.51	11.04
WMSC	c/kWh	0.36	0.36	0.36	0.36	0.36
RRRP Funding Adder	c/kWh	0.21	0.21	0.21	0.21	0.21
Tx Network	\$/kW	3.79	4.17	4.37	4.62	4.91
Tx Line Connection	\$/kW	0.96	1.06	1.11	1.17	1.24
Tx Transformation Connection	\$/kW	2.29	2.52	2.64	2.79	2.97
OESP Funding Adder	c/kWh	0.11	0.11	0.11	0.11	0.11

<b>Summary of Demand and Consumption</b>		<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Total Wholesale Volume	GWh	24,987	24,763	24,750	24,682	24,679
Tx Network	MW	63,166	62,568	62,557	62,388	62,219
Tx Line Connection	MW	55,639	55,114	55,107	54,958	54,809
Tx Transformation Connection	MW	63,977	63,372	63,363	63,191	63,108

Please refer to filed MS Excel I-34-CME-61-01.

1 c) A detailed update to the cost of power forecast calculation requested in this interrogatory is  
2 unreasonable based on the immateriality of the impact to the overall revenue requirement,  
3 relative to effort involved to conduct the update within the time allowed.

4  
5 Please refer to Exhibit I-33-Staff-176 for Fair Hydro Plan impact on working capital.

6  
7 d) The relevant exhibits that reflect the fair hydro impact have been updated in Exhibit I-33-  
8 Staff-179.

**School Energy Coalition Interrogatory # 68**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03

**Interrogatory:**

Please provide all impacts on the working capital requirements of Hydro One as a result of the implementation of the Fair Hydro Plan

**Response:**

Please refer to the following responses:

- Exhibit I-33-Staff-176
- Exhibit I-33-Staff-177
- Exhibit I-33-Staff-178
- Exhibit I-33-Staff-179
- Exhibit I-34-Staff-181

**OEB Staff Interrogatory # 181**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-01 Page: 4 – Cash Working Capital

**Interrogatory:**

Please update Hydro One's forecast of its Cash Working Capital for each of the test years to reflect the Fair Hydro Plan which came into effect on July 1, 2017, including the Tables in this exhibit.

**Response:**

Table 1: Please refer to Exhibit I-33-Staff-176 for an update to Table 1, reflecting the Fair Hydro Plan.

For tables 2, 4 and 5: please see the updated tables below, reflecting updates for the Fair Hydro Plan as well as rate base aligning with Exhibit Q, filed with the OEB on December 21, 2017.

There is no update required for Table 3.

**Table 2 (updated): Distribution Rate Base (\$ Millions)**

Description	Test				
	2018	2019	2020	2021	2022
Mid-Year Gross Plant	11,905.1	12,484.4	13,143.1	13,988.0	14,666.8
Mid-Year Accumulated Depreciation	(4,564.1)	(4,798.7)	(5,067.4)	(5,412.3)	(5,741.1)
<b>Mid-Year Net Plant</b>	<b>7,341.1</b>	<b>7,685.7</b>	<b>8,075.7</b>	<b>8,575.8</b>	<b>8,925.7</b>
Cash Working Capital	281.0	295.8	308.5	338.8	355.6
Materials and Supply Inventory	4.1	5.5	6.5	5.9	5.5
<b>Distribution Rate Base</b>	<b>7,626.2</b>	<b>7,987.0</b>	<b>8,390.7</b>	<b>8,920.4</b>	<b>9,286.8</b>

**Table 4 (updated): Forecast of Fixed Assets Summary - Rate Base (\$ Millions)**

Description	Test	Forecast			
	2018	2019	2020	2021	2022
Opening Gross Asset Balance	11,699.2	12,245.5	12,866.9	13,570.4	14,387.4
Integration of Acquired Utilities				175.6	
In-Service Additions	635.1	755.2	748.5	704.6	784.4
Retirements	(89.4)	(134.4)	(45.6)	(63.9)	(62.7)
Sales	0.0	0.0	0.0	0.0	0.0
Transfers	0.6	0.6	0.6	0.6	0.0
<b>Closing Gross Asset Balance</b>	<b>12,245.5</b>	<b>12,866.9</b>	<b>13,570.4</b>	<b>14,387.4</b>	<b>15,109.1</b>
Less Future Use Land	(1.3)	(1.3)	(1.3)	(1.3)	(1.3)
Less Provincial Funded Assets	(68.5)	(72.5)	(76.0)	(78.8)	(81.4)
<b>Gross Assets for Mid-Year Rate Base</b>	<b>12,175.7</b>	<b>12,793.1</b>	<b>13,493.2</b>	<b>14,307.2</b>	<b>15,026.3</b>
<b>Mid-Year Gross Asset Balance</b>	<b>11,905.1</b>	<b>12,484.4</b>	<b>13,143.1</b>	<b>13,988.0</b>	<b>14,666.8</b>

**Table 5 (updated): Total Cash Working Capital Allowance (\$ Millions)**

	Test years				
	2018	2019	2020	2021	2022
Cash Working Capital	281.0	295.8	308.5	338.8	355.6

**Vulnerable Energy Consumers Coalition Interrogatory # 32**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03

**Interrogatory:**

- a) Have the billing period for any customer classes changed since the last lead-lag study undertaken by Hydro One.
- b) If yes, please explain how this change was incorporated into the new study.

**Response:**

- a) No, the billing period has not changed for any customer classes since the last study was undertaken.
- b) Please see the response to part a) above.



**Vulnerable Energy Consumers Coalition Interrogatory # 33**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03

**Interrogatory:**

a) What is the revenue requirement impact of the working capital difference 7.7% and the Board default rate of 7.5%

**Response:**

a) By applying the Board default rate of 7.5%, revenue requirement would be reduced by approximately \$0.7 million per year.

**Vulnerable Energy Consumers Coalition Interrogatory # 34**

**Issue:**

Issue 34: Are the inputs used to determine the working capital component of the rate base and the methodology used appropriate?

**Reference:**

D1-01-03-01 Page: 3 - Table 1

**Interrogatory:**

a) Table 1 shows varying working capital requirements for the years 2018 through 2022. Please confirm that Hydro One does not intend to adjust the revenue requirement for changes in working capital for the duration of the rate plan.

**Response:**

a) The working capital requirement outlined in Table 1 in Exhibit D1, Tab 1, Schedule 3, Attachment 1 represent the requested working capital requirements. Hydro One has included these requirements in the calculation of its revenue requirement and does not intend further adjustment for the duration of the rate plan.

**Building Owners and Managers Association Toronto Interrogatory # 31**

**Issue:**

Issue 35: Is the proposed capital structure appropriate?

Issue 16: Are the proposed Z-factors and Off-Ramps appropriate?

Issue 24: Does Hydro One's investment planning process consider appropriate planning criteria? Does it adequately address the condition of distribution assets, service quality and system reliability?

**Reference:**

A-03-01-01 Distribution Business Plan

*"Three Competing But Equally Important Factors... responsible stewardship of the distribution system..."*

**Interrogatory:**

- a) What legislature mandate does the Company have OSC regulated, OBCA?
- b) p5 – Please confirm that Hydro One's goal is to achieve the ROE allowed by the OEB, but not to exceed it. Please discuss.
- c) p8 – Given the results of the customer engagement summarized here, please provide an analysis of why Plan C was not chosen.
- d) Please provide reference in the IPSOS Report Appendices to support the assertion made in the third bullet on p8.
- e) p9 – Please identify the cost savings that will result from each productivity initiative.
- f) To what extent will the power quality program (an audit of 200,000 OM&A per year) meet the current large distribution customer demand for the service?

**Response:**

- a) HONI is an OBCA company. Its direct and indirect parent companies (HOI and HOL) are public companies which must comply with the *Securities Act* and are regulated by the OSC. (Please see Exhibit I-3-CCC-9 for the corporate organizational chart.)

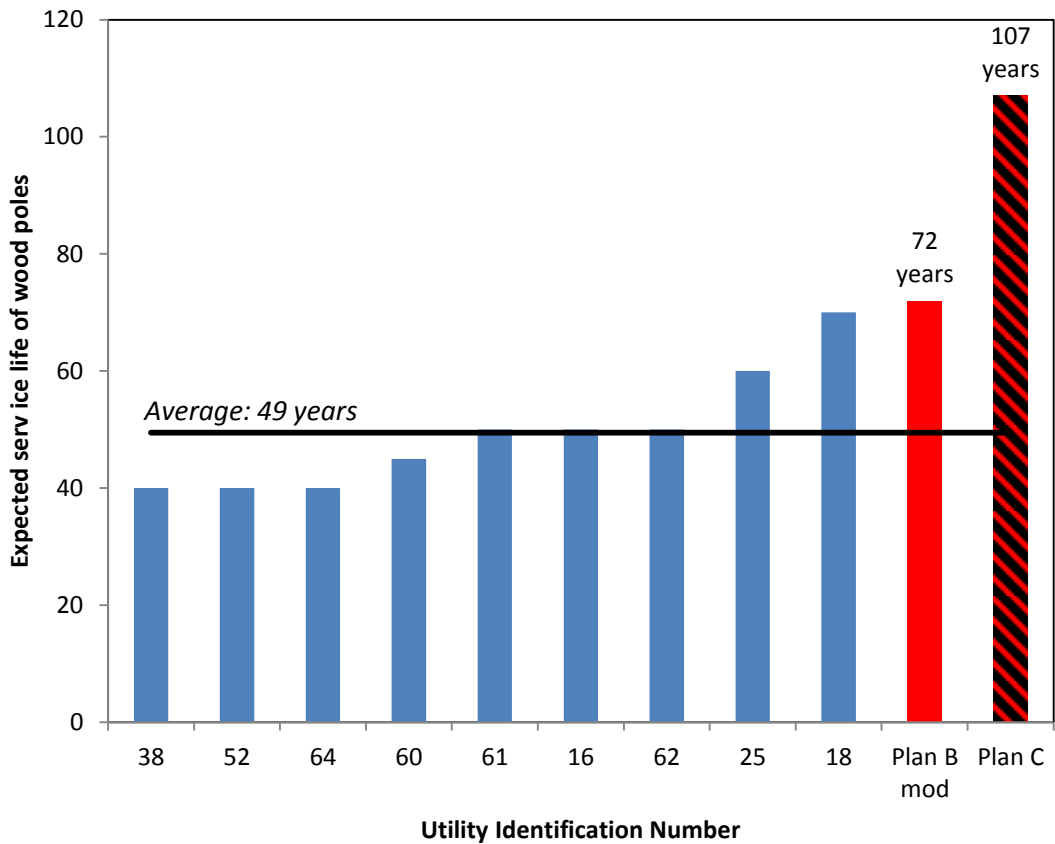
Witness: LOPEZ Chris and BRADLEY Darlene

- 1  
2 b) Hydro One will strive to achieve the ROE allowed by the OEB. Hydro One will share  
3 earnings with ratepayers through the ESM mechanism proposed in the Application.  
4  
5 c) Please refer to Attachment 2 of Exhibit I-3-SEC-4. Management concluded that Plan C was  
6 not a viable option due to material and reliability system impacts. Key shortcomings to Plan  
7 C are:  
8 i. Replacement levels resulting in an unprecedented service life for poles;  
9 ii. An increasing number of stations in poor condition; and  
10 iii. Unacceptable reliability for specific Hydro One customers.  
11

12 From Hydro One's perspective, Plan C maintains an asset base that poses unacceptable risks  
13 to reliability and safety, which will necessitate significantly higher investment levels beyond  
14 the term of this Application that are challenging to resource for Hydro One and challenging  
15 to fund for ratepayers. Relative to other utilities, Hydro One's reliability performance is  
16 poor. Plan C does the least to improve it, constraining Hydro One's ability to meaningful  
17 improve service for all its customers.  
18

19 *Unprecedented service life for poles*

20 Plan C replaces poles at a rate that results in an unjustifiably long service life. As Navigant  
21 concludes in its pole benchmarking study (Attachment 1 to section 1.6 of the DSP, Exhibit  
22 B1-1-1), Hydro One's wood pole inventory is the oldest (37 years), averaging eight years  
23 older than the other sampled utilities, which matches the planned life of poles which is ten  
24 years older for Hydro One (62 years). As Figure 1 demonstrates, Plan C lowers the pole  
25 replacement rate to a level which assumes a planned life for poles of approximately 107  
26 years. This is an unprecedented and unjustified assumed service life for these assets. For  
27 comparison purposes, Figure 1 also shows the expected impact of Plan B modified. Pole  
28 investments contribute to reliability outcomes, and they are essential for public safety.

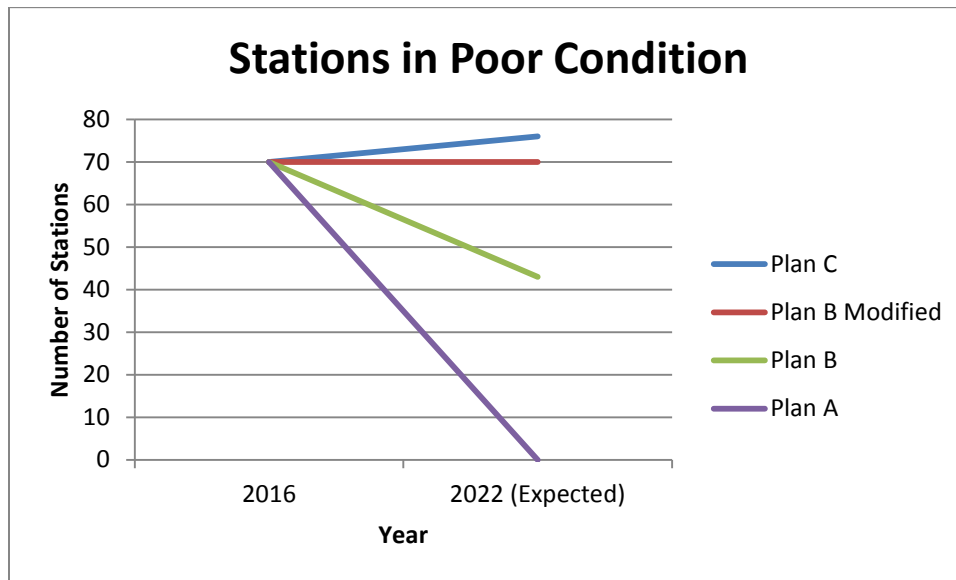


**Figure 1: Average Profile of Wood Poles (Navigant)<sup>1</sup>**

*Stations in poor condition*

As compared to Plans A, B, or B-modified, Plan C limits the number of stations refurbishments that are planned for the rate term. Figure 2 shows the expected number of stations in poor condition based on the replacement rates put forward in each of the four plan alternatives. Plan C is the only plan which increases the number of stations in poor condition by 2022.

<sup>1</sup> Figure 1 presents the information from Figure 14 of the Navigant Study in bar chart format.



**Figure 2: Impacts of Plan Alternatives on Distribution Station Population**

*Unacceptable reliability for specific Hydro One customers*

Plan C would result in unacceptable reliability for specific customers. Figure 3 shows a breakdown of the number of customers that experienced a total of 15 or more hours of interruptions in 2017. Figure 4 shows a breakdown of the number of customers that experienced a total of 5 or more interruptions in 2017.

Figure 3 shows, approximately 87,000 customers were interrupted for over 50 hours in 2017. Figure 4 shows, approximately 44,000 customers were interrupted 15 times or more in 2017. Through the Worst Performing Feeder program (ISD SS-06) and associated investments, Hydro One plans to significantly improve reliability for customers supplied by poorly performing feeders. Plan C significantly curtails these activities, meaning unacceptable reliability levels will persist for many of these customers.

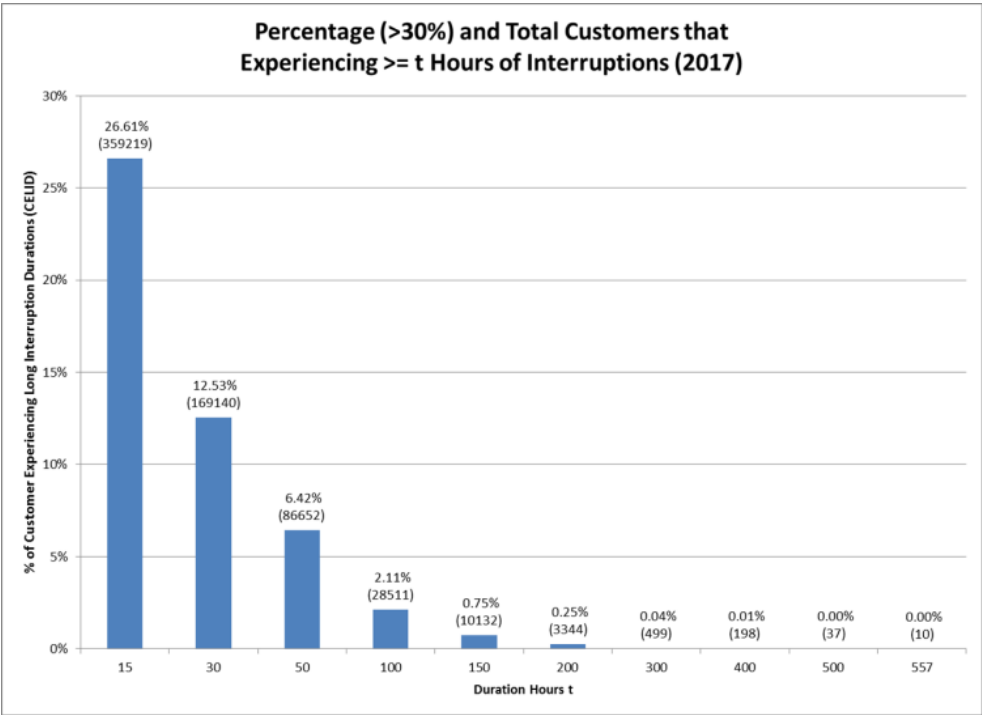


Figure 3: Breakdown of Customers Experiencing Long Interruptions (over 15 hours cumulatively) in 2017

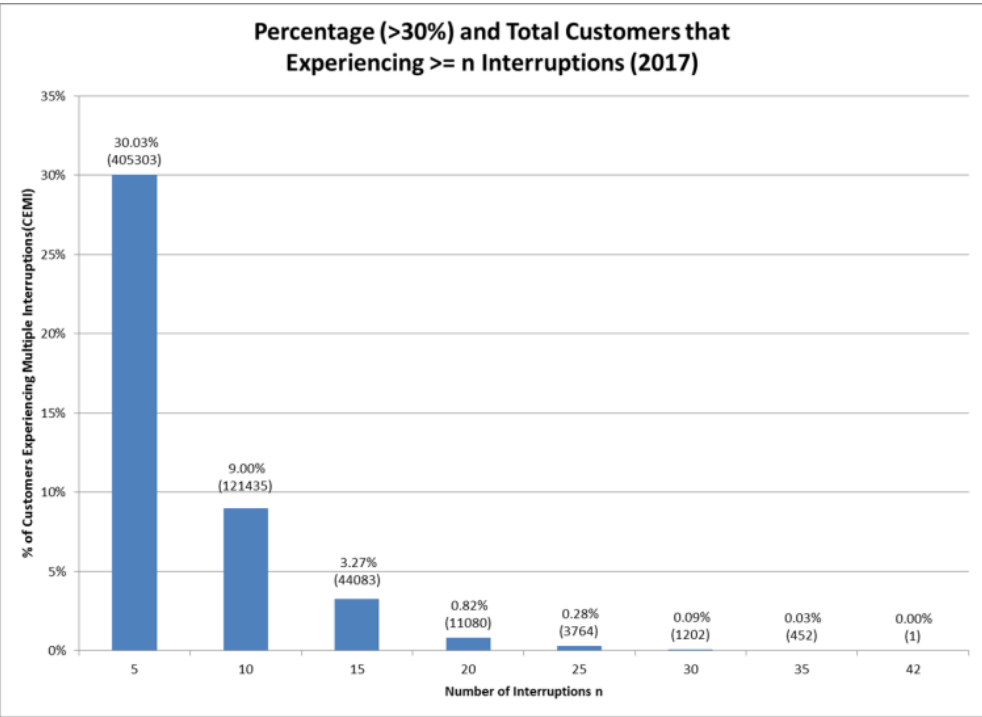
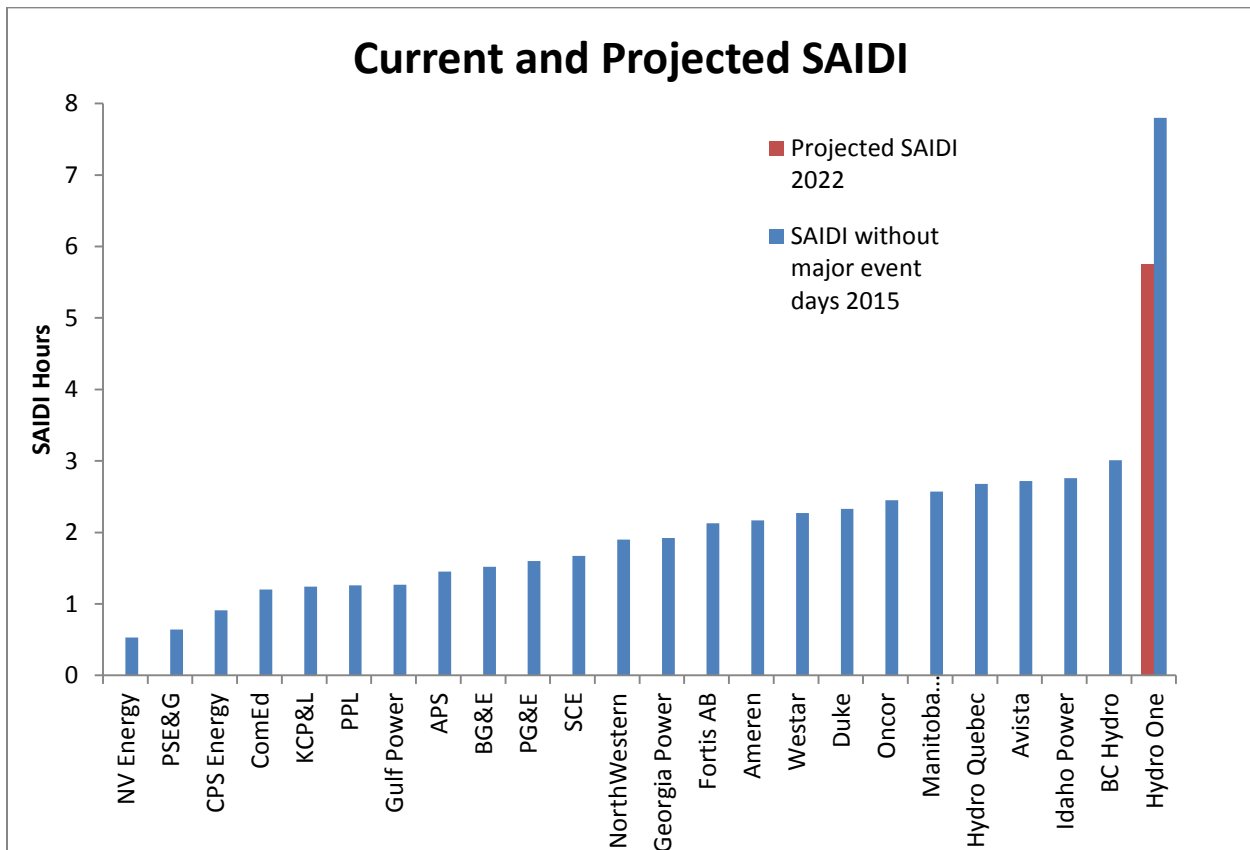


Figure 4: Breakdown of Customers Experiencing Multiple Interruptions in 2017

Plan B-modified allows Hydro One to improve reliability for these customers as well as Hydro One's overall system reliability metrics considerably. Plan C does not.

Figure 5 compares Hydro One's current reliability to other utilities (2015 non-major event reliability). As Figure 5 highlights, Hydro One's reliability performance is significantly worse, and Plan C would do the least to address it.



**Figure 5: Hydro One's Reliability Relative to Other Utilities and Projected SAIDI**

For the reasons explained, Hydro One does not support Plan C. It would lead to a substantial deterioration of asset condition within the short term, and an unacceptable degradation of safety and reliability beyond the term of this Application. Based on an expected increase in failure rates, sustained funding at Plan C levels will eventually lead to significantly higher investment levels that Hydro One will be challenged to resource and are counterproductive to any objective of smoothing rates through prudent investment pacing.



1 d) Please refer to pages 10 and 121 of the referenced Exhibit.

2  
3 e) Please refer to Exhibit I-25-Staff-123 response a) for productivity savings that have been  
4 embedded in the Dx Business Plan.

5  
6 f) This program has been budgeted to complete one audit per year. It is expected that this will  
7 meet large customer demand for this service. However, the program will be monitored to  
8 determine how demand develops overtime.

**Building Owners and Managers Association Toronto Interrogatory # 81**

**Issue:**

Issue 35: Is the proposed capital structure appropriate?

**Reference:**

2016 Sector-Wide Consolidated Scorecards of Electricity Distributors Page: 41

**Interrogatory:**

- a) For each of the last six years, ending in 2016, please provide Hydro One Distribution's allowed ROE and its achieved ROE.
- b) Does the Board provide a single allowed ROE for HONI, or does it permit the HONI Transmission and HONI Distribution to have different ROEs?
- c) Does Hydro One Distribution aspire or target to achieve rates of returns above Board allowed rates, or to meet Board allowed rates, with perhaps a few basis points over to ensure they meet the allowed rate?
- d) In 2015, was the Board's allowed rate of return on equity 9.30%? Was the actual average return on equity for the industry also 9.30%?
- e) The filed distribution evidence (Exhibit A, Tab 5, Schedule 1, p7) shows Hydro One Distribution underleveraged with debt/equity ratio of 1.19. What was the rate in 2016, and the anticipated D/E ratio over the term of the plan? Why does HONI Distribution operate with an actual debt/equity ratio different from its deemed capital structure, with a much higher percentage of equity? How do these numbers compare with HONI Transmission?

**Response:**

- a) Please refer to Exhibit I-18-SEC-029.
- b) The OEB determines the values for the allowed return on equity, including deemed long-term and short-term debt rates to be used in cost of service customer incentive rate-setting application for regulated electricity distributors and transmitters.
- c) Hydro One works within the allowable envelope provided by the OEB which is  $\pm$  300 basis points from the allowed ROE.

Witness: LOPEZ Chris

d) In reference to Exhibit A, Tab 5, Schedule 1, p.52, Figure 21 – Achieved Regulatory Return on Equity, the industry average (as defined on p.3 of the same Exhibit), yes, the industry average ROE was 9.30 per cent. The table below provides the data used:

Profitability: Regulatory Return on Equity: Achieved	2015	2014	2013	2012	2011	Industry (OEB) Target	Industry Average
Algoma Power Inc.	11.07	8.38	7.06	11.44	10.50		9.30
Enersource Hydro Mississauga Inc.	7.54	9.43	9.46	6.58	8.65		9.30
Horizon Utilities Corporation	10.00	7.50	9.72	11.89	8.83		9.30
Hydro One Brampton Networks Inc.	7.66	9.45	10.64	10.72	11.16		9.30
Hydro One Networks Inc.	8.77	6.26	8.00	8.72	8.80		9.30
Hydro Ottawa Limited	7.92	8.06	7.80	9.41	7.86		9.30
Kitchener-Wilmot Hydro Inc.	11.47	10.87	8.94	10.91	11.02		9.30
London Hydro Inc.	7.52	9.10	11.22	4.90	6.80		9.30
PowerStream Inc.	6.65	9.49	9.98	8.55	10.09		9.30
Toronto Hydro-Electric System Limited	10.71	7.41	7.10	7.62	9.73		9.30
Veridian Connections Inc.	9.31	10.61	12.39	8.60	8.01		9.30
West Coast Huron Energy Inc.	6.91	14.84	9.40	10.79	17.62		9.30

e) For the 2016 D-E ratio, please refer to Exhibit I-18-SEC-029. Consistent with the filed evidence, Exhibit A, Tab 5, Schedule 1, s.6 Financial Performance, due to the forward-looking nature of the measures found in the Financial Ratios Performance Category of the Electricity Distributor Scorecard, the Company does not provide forecasts or targets outlining future financial expectations or performance. A discussion of the D-E results can be found on p.49 of Exhibit A, Tab 5, Schedule 1. Comparisons to Transmission financial ratios are out of scope.

**Building Owners and Managers Association Toronto Interrogatory # 156**

**Issue:**

Issue 36: Are the proposed timing and methodology for determining the return on equity and short-term debt prior to the effective date of rate implementation appropriate?

**Reference:**

Financial Statements

**Interrogatory:**

- a) Please provide copies of any rating agency reports by Moody's S&P, on DBRS, filed since those included in the prefiled evidence.
- b) Please provide details on the spare transformers purchases in the first three quarters of 2017, including the purpose for the purchase, the relationship to the existing spares pool, the total amount spent.

**Response:**

- a) Please see Attachments 1 to 7 for rating agency reports by DBRS, Moody's and S&P, released since those included in the prefiled evidence.
- b) Two spare transformers were purchased within the first three quarters of 2017. As per the following table, one Item A3 transformer and one Item B10 transformer were purchased as spares. These spares were purchased to keep our spares population at the levels prescribed by the distribution spare transformer strategy.

Item No.	MVA Ratings	Voltage Ratings (kV)	DETC in HV	ULTC in LV
A3	7.5	44-13.2	No	±15% , ±12 steps
B10	12	44-29.3	YES	N/A



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Insight beyond the rating.

## Ratings

Debt	Rating	Rating Action	Trend
Issuer Rating	A (high)	Confirmed	Stable
Senior Unsecured Debentures	A (high)	Confirmed	Stable
Commercial Paper	R-1 (low)	Confirmed	Stable

## Rating Update

On April 7, 2017, DBRS Limited (DBRS) confirmed the Issuer Rating and the Senior Unsecured Debentures rating of Hydro One Inc. (HOI or the Company) at A (high) and the Commercial Paper rating at R-1 (low). All trends are Stable. The rating confirmations reflect the Company's relatively low risk business profile supported by a transparent regulatory framework, a strong franchise in electric power transmission and distribution services and a reasonable financial profile sustained by predictable earnings and cash flow. The Stable trend assumes that the quality of the regulatory regime will continue to remain supportive, allowing the Company to earn a fair rate of return while recovering costs on a timely basis. DBRS rates HOI as a stand-alone entity and does not assume any credit support from its owner, Hydro One Limited (HOL), which is approximately 70% owned by the Province of Ontario (the Province; rated AA (low) with a Stable trend by DBRS).

The Company's transmission business (approximately 61% of 2016 EBIT) owns and operates approximately 98% of the transmission network in the Province while the distribution business (approximately 39% of 2016 EBIT) serves nearly 26% of the Province's customers. HOI's transmission (for 2015–2016) and distribution (for 2015–2017) businesses currently operate under a cost-of-service (COS) model. HOI filed a COS transmission rate application for 2017–2018 in May 2016 with the Ontario Energy Board (OEB) and an approval is expected in Q2 2017. HOI's next

transmission rate application for the period 2019–2023 is expected to be filed under a Custom Incentive Rate-Setting (CIR) approach. The Company also filed its CIR distribution rate application with the OEB in March 2017 for the 2018–2022 term requesting a 2018 revenue requirement increase of 3.5% over 2017. DBRS views the CIR model as suitable for HOI, as it provides greater clarity with respect to the Company's ability to recover high and variable capital expenditure (capex) requirements. However, utilities are required to operate under the CIR framework for a longer period (five years), which modestly increases forecasting risk and regulatory lag.

HOI's capex program is expected to be approximately \$9.75 billion in the 2017–2021 term (transmission: \$6.2 billion; distribution: \$3.55 billion) largely to replace and upgrade aging infrastructure. HOI's dividend payout ratio is expected to remain high in order to meet HOL's dividend objectives to pay out approximately 70% to 80% of its consolidated net income. DBRS expects HOI's credit metrics to be pressured in the medium term because of the high capex (averaging approximately \$2.0 billion annually) and dividends resulting in free cash flow deficits, which are likely to be funded with incremental debt. However, the incremental cash flows are expected to ease the pressure on metrics as projects are placed in service and added to rate base. HOI's ratings could be impacted should its cash flow-to-debt ratio weaken below 13% and its DBRS adjusted debt-to-capital exceeds 60%

Continued on P.2

## Financial Information

### Hydro One Inc.

(CAD\$ millions where applicable)

For the year ended December 31

	2016	2015	2014	2013	2012
Cash flow/Total debt	13.6%	13.3%	15.5%	15.3%	15.4%
Total debt in capital structure <sup>1</sup>	53.0%	51.1%	53.0%	55.2%	55.6%
Total debt in capital structure <sup>1, 2</sup>	57.3%	55.5%	53.0%	55.2%	55.6%
EBIT gross interest coverage (times) <sup>1</sup>	2.77	2.74	2.83	2.94	2.89

<sup>1</sup> Includes operating leases. <sup>2</sup> DBRS adjusted, excludes deferred tax assets related to departure tax.

## Issuer Description

HOI is the largest electricity transmission and distribution company in Ontario. The Company owns and operates over 30,000 circuit kilometres of high-voltage transmission lines and approximately 123,000 circuit kilometres of primary low-voltage distribution lines.

## Rating Updates (CONTINUED)

on a sustained basis. DBRS expects any potential acquisitions of unregulated businesses to be carried out at the HOL level. DBRS also notes that acquisitions by HOI of regulated utility assets in less supportive regulatory regimes or acquisition of regulated

assets with some exposure to unregulated operations could weaken the business profile of the Company and have an impact on ratings.

## Rating Considerations

### Strengths

#### 1. Reasonable regulatory environment

HOI's earnings are contributed by its low-risk regulated transmission and distribution businesses, which operate under a reasonable regulatory framework. The OEB rate approval framework permits HOI a reasonable opportunity to recover operating and capital costs and earn the approved rates of return. The Company's deemed capital structure (debt-to-equity of 60%:40%) has remained unchanged for several years. DBRS views the utility regulatory framework in Ontario as transparent and supportive for regulated transmission and distribution operators.

#### 2. Extensive franchise area

HOI owns the largest transmission and distribution businesses in Ontario. The Company operates approximately 98% of the Province's transmission capacity based on revenues approved by the OEB, is connected to more than 44 local distribution companies (including HOI's own distribution business) and 87 directly connected industrial customers and serves approximately five million customers. The Company's transmission system is also interconnected to systems in Manitoba, Michigan, Minnesota, New York and Québec through the use of interties. Load growth is expected to be modest and in line with economic growth in the Province. The distribution business spans approximately 75% of the Province, serving over 1.35 million customers, or approximately 26% of the total customers in Ontario.

#### 3. Reasonable financial profile

HOI continues to maintain a reasonably healthy balance sheet. Although credit metrics have been pressured in recent years, they have remained reasonable for the current rating category (DBRS-adjusted debt-to-capital ratio at 57.3%, EBIT interest coverage at 2.8 times (x) and cash flow-to-debt at 13.6% for 2016).

### Challenges

#### 1. High level of planned capex

The Company is currently in the midst of an aggressive build-out program that will continue over the next several years and pressure credit metrics. Capex was approximately \$1.7 billion for 2016 (approximately \$988 million for transmission and approximately \$703 million for distribution), with a plan for approximately \$9.75 billion in the next five years based on HOI's current regulatory filings.

#### 2. High dividend payouts

Compared with pre-2015 levels, DBRS expects the Company to pay out a higher portion of its earnings as dividends to support HOL's dividend policy (payout approximately 70% to 80% of consolidated net income). DBRS expects the Company's dividend payout ratio to remain high in order to meet HOL's dividend objectives, and consequently, HOI will need to access significant external funding to finance the potentially sizable free cash flow deficits because of the dividends and capex commitments expected over the medium term.

#### 3. Earnings sensitive to volume and costs

Earnings and cash flows for electricity distribution companies are partially dependent on the volume of electricity sold. Weather patterns, seasonality and economic conditions directly affect the volume of electricity sold and, therefore, earnings. The OEB approves the Company's transmission and distribution rates based on projected electricity load and consumption levels. If actual load or consumption materially falls below projected levels, earnings of these businesses could be adversely affected. Furthermore, current revenue requirements are approved based on cost assumptions that could materially differ from actual costs. There is no assurance that the OEB would allow rate increases sufficient to offset unfavourable financial impacts from unanticipated changes in electricity demand or in costs. However, this risk is expected to be gradually mitigated as the OEB implemented the new distribution rate design for all local distribution companies beginning in 2016 and HOI is allowed to phase in a higher fixed monthly rate and lower volumetric rate for its residential customers over the next eight years. Consequently, by 2023, all residential customers will be charged a fully fixed monthly fee for distribution services.

## Earnings and Outlook

### Hydro One Inc.

For the year ended December 31

(CAD millions where applicable)

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Net Revenue	3,075	3,079	3,129	3,054	2,954
EBITDA	2,016	1,949	1,985	1,905	1,883
EBIT	1,247	1,192	1,263	1,229	1,224
Gross interest expense	448	433	444	416	421
Earning before taxes	855	814	874	858	854
Income taxes	(131)	(113)	(86)	(106)	(118)
Minority interest	(6)	(10)	2	0	0
Net income before non-recurring items	718	691	790	752	736
Non-recurring items <sup>1</sup>	12	1	(41)	51	9
Reported net income	730	692	749	803	745
Return on equity	9.7%	9.0%	10.3%	10.6%	11.1%

<sup>1</sup> DBRS adjustment of \$48 million for customer service recovery project costs in 2014 and \$43 million property tax recovery in 2013.

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Transmission rate base (CAD billions)	10.78	10.17	9.93	9.35	8.80
Distribution rate base (CAD billions)	7.06	6.59	5.03	5.03	5.03
Allowed ROE - Transmission	9.19%	9.30%	9.36%	8.93%	9.42%
Allowed ROE - Distribution	9.19%	9.30%	9.66%	9.66%	9.66%
Deemed Equity (Transmission & Distribution)	40%	40%	40%	40%	40%

### 2016 Summary

- HOI's earnings are relatively stable and are supported by a reasonable regulatory environment, extensive franchise area and a diverse customer base that is growing at a steady rate.
- The Company's net earnings were slightly higher in 2016, compared with 2015, resulting from higher transmission rates and higher peak demand as a result of warmer weather and modestly lower OM&A expense. This was partly offset by higher financial costs caused by higher debt.

### 2017 Outlook

- Earnings before interest and tax (EBIT) for 2017 are expected to be slightly lower as the impact of the lower allowed ROE approved by the OEB (8.78% in 2017, versus 9.19% in 2016) for both the transmission and distribution segments is expected to be largely offset by the higher rate base.

## Financial Profile

### Hydro One Inc.

(CAD\$ millions where applicable)

	For the year ended December 31				
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Net income before non-recurring items	718	691	790	752	736
Depreciation & amortization	679	667	641	597	589
Deferred income taxes and other	119	(3)	(51)	41	(12)
<b>Cash flow from operations</b>	<b>1,516</b>	<b>1,355</b>	<b>1,380</b>	<b>1,390</b>	<b>1,313</b>
Dividends paid *	(611)	(888)	(287)	(218)	(370)
Capital expenditures	(1,634)	(1,569)	(1,504)	(1,387)	(1,454)
Free cash flow (bef. working cap. changes)	(729)	(1,102)	(411)	(215)	(511)
Changes in non-cash work. cap. items	168	187	(55)	11	(40)
Changes in regulatory assets	(16)	(3)	(69)	3	12
Deferred income tax asset <b>1</b>	0	(2,798)	0	0	0
Net Free Cash Flow	(577)	(3,716)	(535)	(201)	(539)
Acquisitions	(224)	(143)	(66)	0	0
Short-term investments	0	0	0	0	0
Long-term investments <b>2</b>	0	0	250	0	0
Amount to be financed	(801)	(3,859)	(351)	(201)	(539)
Net equity change	0	2,600	72	0	0
Net debt change	776	1,254	(177)	574	488
Other	(16)	(6)	(9)	(3)	18
Change in cash	(41)	(11)	(465)	370	(33)
Total debt	11,149	10,198	8,927	9,088	8,521
Cash and equivalents	48	89	100	565	195
Cash flow-to-total debt	13.6%	13.3%	15.5%	15.3%	15.4%
Total debt in capital structure <b>3</b>	53.0%	51.1%	53.0%	55.2%	55.6%
Total debt in capital structure <b>4</b>	57.3%	55.5%	53.0%	55.2%	55.6%
EBIT gross interest coverage (times)	2.78	2.75	2.84	2.95	2.91
Debt-to-rate base	62.5%	60.8%	59.7%	63.2%	61.6%
Dividend payout ratio <b>5</b>	85.1%	128.6%	36.3%	29.0%	50.3%

\* Dividend in 2016 includes \$609 million return of stated capital to HOL.

**1** Impact of deferred income tax asset that resulted as a consequence of leaving the PILs Regime and entering the Federal Tax Regime. **2** Proceeds of \$250 million Province of Ontario FRNs redeemed in 2014. **3** Includes operating leases. **4** Excludes deferred income tax assets. **5** 2015 dividends includes dividends paid for recapitalization; 2016 dividends include approximately \$77 million in dividends pertaining to 2015.

### 2016 Summary

- Overall, HOI's key credit metrics remained in line with the current rating category.
- Operating cash flow was higher because of the higher rate base and lower OM&A costs, however the Company's capex program and dividends to HOL resulted in free cash flow deficits that were largely funded with debt.
- HOI made capital investments of approximately \$1.7 billion and placed \$1.6 billion of new assets in-service in 2016.
- The debt-to-capital ratio weakened slightly, largely as a result of higher debt for the year that was used to fund the Company's capital program and for the acquisition of Hydro One Sault Ste. Marie LP (formerly Great Lakes Power Transmission LP) in October 2016. HOI paid a departure tax resulting from the

transition from the Payment in Lieu of Taxes Regime to the Federal Tax Regime in 2015. HOI expects that this will result in annual net cash savings over at least the next five years because of the reduction of cash income taxes payable. The balance in the deferred tax asset of \$1.6 billion is expected to act as a tax shield for HOI's future tax liabilities, reducing cash taxes payable by the Company. However, the Canada Revenue Agency may revisit the tax treatment of these assets and make adjustments to HOI's tax liability. There is also a risk that, in current or future rate applications, the OEB will reduce HOI's revenue requirement by the net cash savings, which could have a material impact on the Company. DBRS has therefore removed the balance of this asset from HOI's equity in calculating the debt-to-capital ratio.



## Financial Profile (CONTINUED)

### 2017 Outlook

- DBRS expects free cash flow deficits to continue in the medium term as the Company plans to incur high capex averaging approximately \$2.0 billion annually for the 2017–2021 term (approximately 64% for transmission and 36% for distribution) largely to sustain HOI's aging power systems and also to build critical infrastructure to meet growth in the customer base.
- DBRS expects the Company to support HOL's dividend policy (annual dividends of approximately 70% to 80% of consolidated net income) to the extent that such dividend payouts maintain HOI's regulatory capital structure. Consequently, DBRS expects the Company to pay a higher portion of its earnings as dividends compared with pre-2015 levels.
- Cash flow from operations is expected to grow over the medium to long term as capital projects are placed into service and included in the rate base. As a result, DBRS expects key credit metrics to gradually improve and continue to remain reasonable for the current rating.

## Debt and Liquidity

### Credit Facilities and Long-Term Debt

(CAD millions - As at December 31, 2016)

	Amount	Draw/LOCs	Available	Maturity
Cash & Cash Equivalents	48		48	
Revolving standby credit facility	2,300	469	1,831	June 2021
<b>Total</b>	<b>2,348</b>	<b>469</b>	<b>1,879</b>	

- The Company's liquidity profile remains reasonable and is adequate for its normal operating requirements.
- In August 2016, HOI terminated two credit facilities and entered into a new credit agreement for \$2.3 billion revolving credit

facility maturing in June 2021. The Company's \$1.5 billion commercial paper program is backstopped by this committed revolving credit facility. As of December 31, 2016, approximately \$469 million of commercial paper was outstanding.

### Long-term Debt Maturities

(CAD millions - As at December 31, 2016)

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>Thereafter</u>	<u>Total</u>
Principal Repayments	602	753	731	653	503	7,429	10,671
% of Total	6%	7%	7%	6%	5%	70%	100%

- HOI has adequate access to capital markets. In 2016, the Company issued an aggregate amount of \$2.3 billion under the medium-term note program to repay its maturing long-term and term out its short-term debt, as well as for other general corporate purposes.
- HOI's long-term debt and credit facilities covenants limit the permissible debt to 75% of its total capitalization and limit the

ability to sell assets and impose negative pledge provisions, subject to customary exceptions. As at December 31, 2016, the Company was in compliance with all of these covenants and limitations.

- HOI's refinancing risk remains manageable because maturities are well spread-out.

## Major Projects and Acquisitions

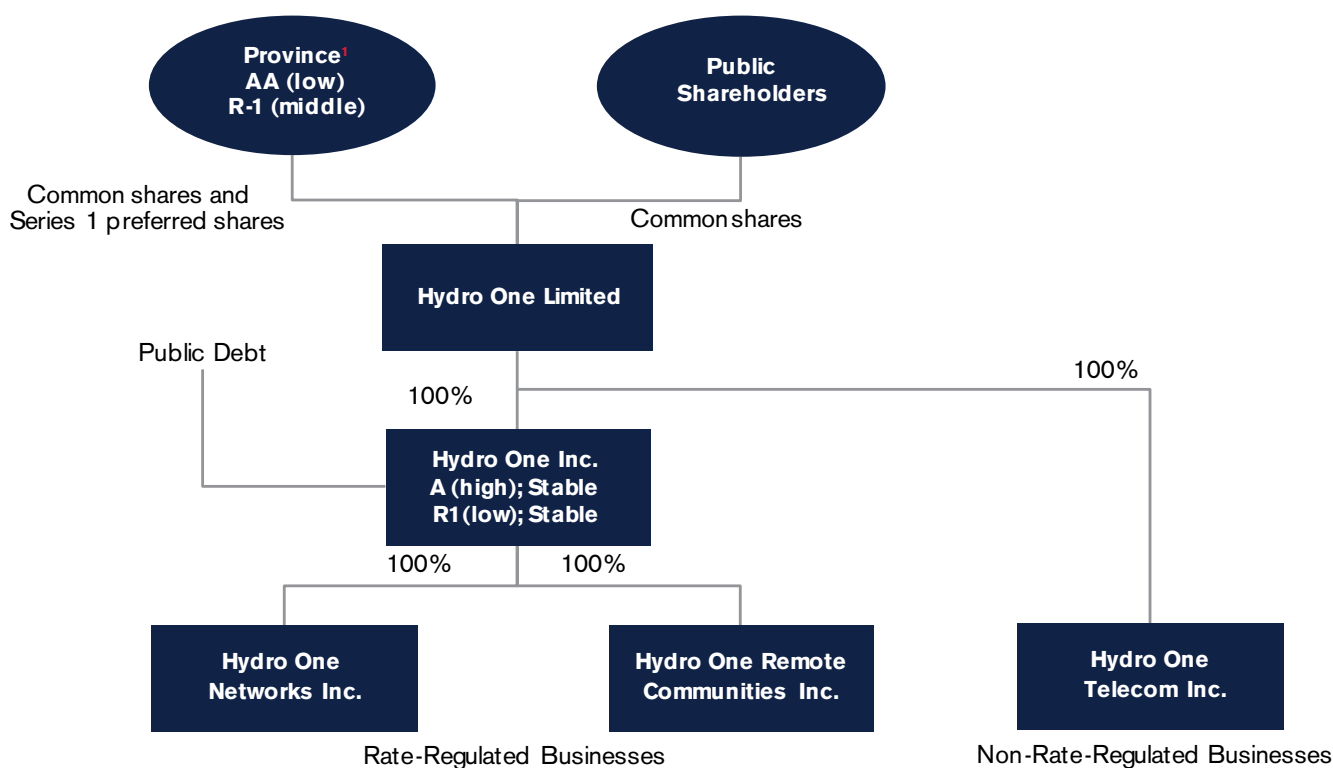
- Major transmission development projects include: (1) the \$87 million Guelph Area Transmission Refurbishment Project, an upgrade of a transmission line and transmission stations in south-central Guelph, major portions were placed in-service in September 2016; (2) the \$118 million Toronto Midtown Transmission Reinforcement Project, a new transmission line in midtown Toronto and the refurbishment of an underground

cable, a major portion has been put in-service in December 2016; (3) the \$267 million Clarington Transmission Station Project to install additional autotransformer capacity in the east Greater Toronto Area, expected to be in service in 2018; (4) the \$73 million Supply to Essex County Transmission Reinforcement Project, a new transmission line in the Windsor-Essex region, expected to be in service by 2018;

## Major Projects and Acquisitions (CONTINUED)

- (5) the Northwest Bulk Transmission Line Project, a new transmission line in the west Thunder Bay area (cost to be determined); and (6) the \$166 million East-West Tie Station Expansion Project, expected to be in service in 2020.
- In August 2016, HOI reached an agreement to acquire Orillia Power Distribution Corporation, an electricity distribution company located in Simcoe County, Ontario, for approximately \$41 million, including the assumption of \$15 million in outstanding indebtedness and regulatory liabilities and subject to other closing adjustments.
- In October 2016, the Company completed the acquisition of Hydro One Sault Ste. Marie LP (formerly Great Lakes Power Transmission LP) for \$226 million in cash and the assumption of approximately \$150 million in debt. The asset has a rate base of approximately \$218 million in 2017, with 15 transmission stations and 560 kilometres (km) of high- and medium-voltage 44-230 kilovolt transmission lines covering a service area of approximately 12,000 square km. Upon the completion of the transaction, HOI operates approximately 98% of Ontario's transmission capacity.

## Simplified Ownership Structure (as at December 31, 2016)



### Notes:

- 1 As of December 31, 2016, the Province owned approximately 70.1% of Hydro One Limited's common shares and 100% of the outstanding Series 1 preferred shares.

- In November 2015, HOL and the Province completed an initial public offering on the Toronto Stock Exchange of approximately 89.3 million common shares of HOL. In April 2016, the Province completed a secondary offering of 83.3 million common shares of HOL.
- HOI is 100% owned by HOL, which is in turn owned 70.1% by the Province and the remaining percentage by public shareholders.
- HOI is a regulated utility that owns Hydro One Networks Inc. and Hydro One Remote Communities Inc.
- Hydro One Networks Inc. carries on rate-regulated transmission and distribution businesses.
- Hydro One Remote Communities, Inc. generates and supplies electricity to remote communities in northern Ontario.

## Regulation

### Regulatory Overview

- HOI has a good track record of prudently managing its regulatory risk. The Company's transmission and distribution businesses are licensed and regulated by the OEB. DBRS has assessed the regulatory environment to be reasonable. (Refer to the Assessment of HOI's Regulatory Environment on page 8.)
- The OEB uses a deemed debt-to-common equity structure of 60% to 40% for both the transmission and distribution business segments.

### Transmission

- The Company's transmission business continues to operate under a COS framework. In January 2015, the OEB approved HOI's transmission rates revenue requirement of \$1,477 million for 2015 and the 2016 revenue requirement of \$1,516 million, subject to adjustments for the cost of capital parameters. In January 2016, the OEB revised the revenue requirement for 2016 to \$1,480 million, excluding Bruce to Milton LP transmission network on an allowed ROE of 9.19%.
- In May 2016, HOI submitted its 2017–2018 transmission rate application based on the COS model. The application seeks approval of a revenue requirement of \$1,505 million for 2017 and \$1,586 million for 2018, reflecting a required rate base of \$10,554 million for 2017 and \$11,226 million for 2018. In December 2016, HOI filed an application to update its revenue requirement to \$1,487 million for 2017 and to \$1,558 million for 2018, excluding Bruce to Milton LP (B2M LP) transmission network, based on OEB's updated 2017 cost of capital parameters.
- In 2015, the OEB initiated a discussion to develop a framework for the application of the Renewed Regulatory Framework for Electricity Distributions (RRFE) principles to transmitters. In February 2016, the OEB issued a new set of filing requirements with performance-based principles for transmission applications that will likely apply to HOI's transmission revenue application for 2019–2023.
- In December 2015, the Company updated the revenue requirement of the B2M LP transmission network for five years, from 2015 to 2019, with a revenue requirement range of \$36 million to \$41 million annually. In January 2016, the OEB issued its Decision and Rate Order approving the B2M LP revenue requirement recovery through the 2016 Uniform Transmission Rates. In December 2016, B2M LP's 2017 revenue requirement was updated to \$34 million, based on an updated 2017 cost of capital parameters issued by the OEB in October 2016.
- In December 2016, Great Lakes Power filed an application seeking approval of a revenue requirement of \$41 million for 2017.

### Distribution

- OEB's RRFE established a rate-setting policy that contains three performance-based rate-setting methods (PBR): 4th Generation Incentive Rate-setting (suitable for most distributors), Custom Incentive Rate-setting (CIR), suitable

for those distributors with large or highly variable capital requirements and the Annual Incentive Rate-setting Index (suitable for distributors with limited incremental capital requirements). Electricity distributors may select the rate-setting method that best meets their needs and circumstances and apply to the OEB accordingly.

- Under both COS and PBR, HOI can charge rates that allow it to recover the costs of providing its services and earn an allowed ROE. PBR encourages the Company to improve efficiency over time, resulting in lower costs to provide the same service.
- HOI's distribution business opted to use the CIR method under the RRFE. In December 2013, the Company filed a five-year distribution custom rate application (2015–2019) with the OEB customized to fit HOI's specific business circumstances, primarily servicing rural and remote areas of the province and significant multi-year capital programs. The OEB did not consider the Company's custom COS application as sufficiently aligned with its performance-based framework for setting rates and approved rates for a shorter three-year period (2015–2017) based on the COS methodology with the allowed ROE to be updated annually. However, the OEB approved the rate base and capex for 2015–2017, as applied for by HOI.
- In March 2015, the OEB approved the Company's distribution rates revenue requirement of \$1,326 million for 2015; \$1,430 million for 2016; and \$1,486 million for 2017. In January 2016, the OEB revised the revenue requirement for 2016 to \$1,410 million based on an updated 2016 allowed ROE of 9.19%. In December 2016, the OEB revised the revenue requirement for 2017 to \$1,415 million based on an updated 2017 allowed ROE of 8.78%.
- HOI submitted a distribution application for 2018–2022 rates based on the CIR approach on March 31, 2017. The application seeks approval of revenue requirement of \$1,505 million for 2018, reflecting an increase of 3.5% over 2017, OEB-approved levels and a required rate base of \$7,672 million in mid-2018. The revenue requirement for the first year (2018) is determined using a cost-of-service, forward test year approach. To establish the annual revenue requirements from 2019 to 2022, HOI has proposed a Revenue Cap Incentive-Rate, where the Company is subject to a revenue cap index that allows for an annual increase in distribution rates based on inflation, productivity, plus a custom capital factor to recover incremental revenue associated with its capex. Equity thickness at 40% remains unchanged, and the ROE of 8.78% for 2017 will be adjusted at end of the year for 2018 based on the OEB's formulaic approach. After adjustment for a reduced load forecast (3.0%), the resulting average impact on distribution rates is an increase of 6.5% in 2018, and an average of 3.7% per annum over the term. HOI would retain the first 100 basis points (bps) of any earnings that exceed the allowed ROE and will be required to share 50% of any excess over 100 bps in any year of the term with customers.

## DBRS Assessment of Regulatory Environment

The chart below reflects DBRS's assessment of the regulatory environment for HOI's transmission and distribution business segments.

Criteria	Score	Analysis
<b>1. Deemed Equity</b>	Excellent Good <b>Satisfactory</b> Below Average Poor	The OEB allows HOI's transmission and distribution business to have a deemed equity of 40%, which has been consistent historically.
<b>2. Allowed ROE</b>	Excellent Good <b>Satisfactory</b> Below Average Poor	The cost of capital parameters are updated annually by the OEB. The OEB has set ROE for the transmission and distribution business at 8.78% for 2017 (9.19% in 2016).
<b>3. Energy Cost Recovery</b>	<b>Excellent</b> Good Satisfactory Below Average Poor	There is no power price risk, as HOI is not responsible for purchasing power from generation facilities or the wholesale market. Power costs are passed on to ratepayers, and HOI collects the payments from its customers on a monthly basis.
<b>4. Capital and Operating Cost Recovery</b>	Excellent <b>Good</b> Satisfactory Below Average Poor	Major capital costs are pre-approved by the OEB and added to the rate base after project completion. In addition, the OEB can approve rate riders to allow for the recovery or disposition of specific regulatory accounts over specified time frames.
<b>5. COS versus IRM</b>	Excellent <b>Good</b> Satisfactory Below Average Poor	Hydro One's distribution business has opted to use the five-year CIR option under the RRFE. However, the distribution business has been allowed to operate under a COS rate-setting methodology by the OEB until 2017. Transmission rates are based on COS application rate orders approved by the OEB every two years.
<b>6. Political Interference</b>	Excellent Good Satisfactory <b>Below Average</b> Poor	After years of a relatively stable political and regulatory environment, the utility sector in Ontario could face growing challenges. As generation costs potentially rise above and ultimately test the political ceiling (10% increase in the total bill annually), it may be difficult for the utilities to pass costs onto ratepayers.
<b>7. Stranded Cost Recovery</b>	Excellent <b>Good</b> Satisfactory Below Average Poor	HOI has a limited history of stranded costs. Most prudently incurred or budgeted capex are approved by the OEB. DBRS notes that there can be some regulatory lag in the approval of capex.
<b>8. Rate Freeze</b>	Excellent Good <b>Satisfactory</b> Below Average Poor	From 2002 to 2005, because of rising rates during Ontario's experimental utility deregulation phase, a distribution rate freeze was imposed. There have been no subsequent province-wide rate freezes.

## Hydro One Inc.

## Balance Sheet

(CAD millions)

	Dec. 31				Dec. 31		
<b>Assets</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>Liabilities &amp; Equity</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Cash & equivalents	48	89	100	S.T. borrowings	469	1,491	2
Accounts receivable	833	772	1,016	Accounts payable	828	743	784
Inventories	19	21	23	Current portion L.T.D.	602	500	552
Prepaid expenses & other	302	263	311	Other current liab.	358	247	377
<b>Total Current Assets</b>	<b>1,202</b>	<b>1,145</b>	<b>1,450</b>	<b>Total Current Liab.</b>	<b>2,257</b>	<b>2,981</b>	<b>1,715</b>
Net fixed assets	19,068	17,893	17,401	Long-term debt	10,078	8,207	8,373
Future income tax assets	1,213	1,610	7	Deferred income taxes	60	206	1,313
Goodwill & intangibles	676	499	449	Pension and other liabilities	2,714	2,687	2,999
Regulatory assets	3,145	3,015	3,200	Regulatory liabilities	209	236	168
Investments & others	6	7	43	L.T. Payables & Other L.T. liab.	51	27	35
				Preferred shares	0	0	323
				Minority interest	72	75	70
				Common equity	5,391	6,000	3,314
				Retained earnings	4,487	3,759	4,249
				Accumulated OCI	(9)	(9)	(9)
<b>Total Assets</b>	<b>25,310</b>	<b>24,169</b>	<b>22,550</b>	<b>Total Liab &amp; SE</b>	<b>25,310</b>	<b>24,169</b>	<b>22,550</b>

## Balance Sheet &amp;

## Liquidity &amp; Capital Ratios

For the year ended December 31

	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Current ratio	0.53	0.38	0.85	1.03	0.73
Cash flow/Total debt	13.6%	13.3%	15.5%	15.3%	15.4%
Total debt in capital structure <sup>1</sup>	53.0%	51.1%	53.0%	55.2%	55.6%
(Cash flow-dividends)/Capex (times)	0.55	0.30	0.73	0.84	0.65
Dividend payout ratio <sup>2</sup>	85.1%	128.6%	36.3%	29.0%	50.3%

## Coverage Ratios (times)

EBIT gross interest coverage	2.78	2.75	2.84	2.95	2.91
EBITDA gross interest coverage	4.50	4.50	4.47	4.58	4.47
Fixed-charges coverage	2.77	2.74	2.83	2.94	2.89

## Profitability Ratios

EBITDA margin	65.6%	63.3%	63.4%	62.4%	63.7%
EBIT margin	40.6%	38.7%	40.4%	40.2%	41.4%
Profit margin	23.4%	22.4%	25.2%	24.6%	24.9%
Return on equity	9.7%	9.0%	10.3%	10.6%	11.1%
Return on capital	5.1%	5.1%	5.5%	5.6%	6.0%

<sup>1</sup> Including operating leases. <sup>2</sup> 2015 dividends includes dividends paid for recapitalization; 2016 dividends include approximately \$77 million in dividends pertaining to 2015.

## Rating History

	Current	2015	2014	2013	2012	2011
Issuer Rating	A (high)	A (high)	A (high)	A (high)	A (high)	A (high)
Senior Unsecured Debentures	A (high)	A (high)	A (high)	A (high)	A (high)	A (high)
Commercial Paper	R-1 (low)	R-1 (low)	R-1 (middle)	R-1 (middle)	R-1 (middle)	R-1 (middle)

## Previous Action

- DBRS Confirms Ratings of Hydro One Inc., April 7, 2016.

## Previous Report

- Hydro One Inc.: Rating Report, April 12, 2016.

### Notes:

All figures are in Canadian dollars unless otherwise noted.

For the definition of Issuer Rating, please refer to Rating Definitions under Rating Policy on [www.dbrs.com](http://www.dbrs.com).

Generally, Issuer Ratings apply to all senior unsecured obligations of an applicable issuer, except when an issuer has a significant or unique level of secured debt.

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*Insight beyond the rating.*

Date of Release: July 19, 2017

## **DBRS Comments on Hydro One Limited Acquiring Avista Corporation**

**Web: DBRS Comments on Hydro One acquiring Avista**  
**Bloomberg: DBRS Comments on Hydro One acquiring Avista**  
**Industry Group: Corporate**  
**Sub-Industry: Utilities & Independent Power**  
**Region: Canada**

DBRS Limited (DBRS) notes that Hydro One Limited (HOL) the parent company of Hydro One Inc. (HOI, rated A (high), Stable) has announced today that it has entered into a definitive merger agreement pursuant to which it will acquire Avista Corporation (Avista), a regulated electric and gas utilities holding company operating in the U.S. Pacific Northwest, for an all-cash purchase price of approximately US\$5.3 billion (C\$6.7 billion) including the assumption of approximately US\$1.9 billion (C\$2.7 billion) of debt (the Merger). The transaction was unanimously approved by the Boards of Directors of both companies and is expected to close in the second half of 2018, subject to Avista's common shareholder approval, regulatory and government approvals and clearances, and the satisfaction of customary closing conditions. Avista will continue to operate as a standalone utility following the closing of the transaction.

Avista is a Spokane, Washington headquartered utility serving 720,000 customers in five regulatory jurisdictions of Washington, Oregon, Idaho, Montana and Alaska. HOL plans to finance the acquisition through the issuance of US \$2.6 of debt and C\$1.4 billion of equity. HOL has concurrently executed a bought deal of C\$1.4 billion of contingent convertible debentures represented by instalment receipts to satisfy the equity component of the acquisition.

DBRS rates HOI as a stand-alone entity does not assume any credit support from its owner, HOL, which is approximately 50% owned by the Province of Ontario (the Province; rated AA (low) with a Stable trend by DBRS). DBRS notes that the acquisition provides HOL with both diversification and scale while expanding its regulated utility rate base to cover electricity transmission and distribution as well as natural gas local distribution businesses. While recognizing the possible synergistic benefits of the transaction, DBRS notes that HOI is insulated from the financing of this Merger as no debt is proposed to be issued at HOI and HOL's dividend payout guidance of 70-80% of earnings has not been

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revised upward as a result of today's announcement. Moreover, HOI's capital expenditure needs are largely met by the growing operating cash flow generated by its regulated utility operations in Ontario without the need for equity injections from HOL. DBRS expects that the quality of the regulatory regime in Ontario will continue to remain supportive, providing the regulatory ring-fencing for the utility and allowing the Company to earn a fair rate of return while recovering costs on a timely basis. DBRS views that should the acquisition be financed as contemplated in today's announcement, it will have no impact on HOI's credit profile. *Insight beyond the rating.*

#### Notes:

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## CREDIT OPINION

16 November 2016

### Update

Rate this Research &gt;&gt;

#### RATINGS

##### Hydro One Inc.

Domicile	Toronto, Ontario, 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.

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## Hydro One Inc.

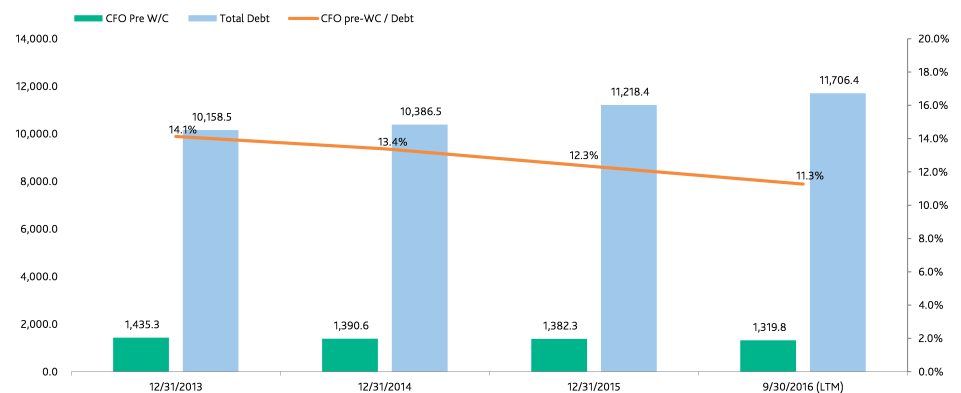
### Regulated Electric T&D Company

#### Summary Rating Rationale

As a government related issuer, Hydro One Inc.'s (HOI) A3 rating reflects its baseline credit assessment (BCA) of baa1 with a one notch uplift attributable to the moderate probability of extraordinary support from the Province of Ontario vs. our previous assumption of strong support prior to the partial privatization of HOI. HOI's BCA of baa1 is derived from our Regulated Electric and Gas Utilities rating methodology, and reflects its low business risk profile driven by its supportive regulatory environment. We expect cash flow from operations to remain predictable and financial metrics to remain weak for the ratings primarily as a result of the existing allowed return on equity and deemed capital structure established by the regulator. The one notch uplift attributed to HOI as a government related issuer incorporates our expectation of an enduring, albeit weaker link between HOI and the Province.

Exhibit 1

#### Historical CFO pre-W/C, Debt and CFO pre-W/C to Debt



Source: Moody's Investors Service

## Credit Strengths

- » Supportive regulatory environment
- » Predictable cash flow and stable financial metrics
- » Relationship with the Province of Ontario

## Credit Challenges

- » Reduced ownership by the province below 40% may impact support
- » High Leverage

## Rating Outlook

The outlook on Hydro One is stable, reflecting the expectation of a stable, ongoing relationship with the Province and a BCA that remains unchanged based on our favorable regulatory assessment and predictable cash flow generation.

## Factors that Could Lead to an Upgrade

Moody's could upgrade the ratings if we change the BCA of Hydro One to a3 from baa1. This could result from more favorable regulatory outcomes or a sustained improvement in financial metrics including CFO pre-W/C to debt in the high teens (11.3% at 9/30/2016). A one notch upgrade of the Province would not lead to an upgrade of Hydro One.

## Factors that Could Lead to a Downgrade

A downgrade of Hydro One's BCA would lead to a downgrade of the senior unsecured rating, so long as Moody's opinion of likely support from the Province remains unchanged or reduces. This could result from a deterioration in regulatory outcomes or a deterioration in financial metrics, including CFO pre-W/C to debt below 11% on a sustained basis (11.3% at 9/30/2016). A one notch downgrade of the Province would not lead to a downgrade of Hydro One. Further reductions in government ownership of Hydro One Limited down to 40% would not lead to further negative rating action all else being equal. A reduction in government ownership below 40% or a reduction in implied "moderate" support could also lead to a downgrade.

## Key Indicators

Exhibit 2

### Hydro One Inc.

	12/31/2012	12/31/2013	12/31/2014	12/31/2015	9/30/2016(LTM)
CFO pre-WC + Interest / Interest	4.0x	4.0x	3.9x	4.0x	3.9x
CFO pre-WC / Debt	13.6%	14.1%	13.4%	12.3%	11.3%
CFO pre-WC – Dividends / Debt	10.1%	12.1%	10.7%	4.4%	4.4%
Debt / Capitalization	57.6%	54.9%	53.4%	52.9%	54.1%

[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™

## Detailed Rating Considerations

### SUPPORTIVE REGULATORY ENVIRONMENT

The supportive regulatory environment is a key driver of HOI's credit quality and baa1 BCA. Supporting our view, HOI's monopoly position as a Transmission and Distribution (T&D) company with no commodity price risk underpins its credit strength. We expect the regulatory environment to remain relatively transparent, predictable and broadly credit supportive. The legislative and judicial underpinnings are well developed and we expect them to remain unchanged. Rates for the transmission business are established using cost of service principles with frequent cost of service rate resets. Distribution rates are established through an incentive rate

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

mechanism, with periodic cost of service rate resets. The company does not have any direct commodity risk exposure since commodity costs are a pass through for the distribution business. The company does have some exposure to volume risk that is typically driven by weather variability and the underlying performance of the economies in its service territories. The company has inherently lower business risk as a T&D business compared to the price, volume, operational or environmental risks typically associated with generation activities. The company does not have any supply obligations.

#### PREDICTABLE CASH FLOW AND STABLE, ALBEIT WEAK FINANCIAL METRICS

We expect the company to continue to generate stable cash flow, a key credit strength. Underpinning this stability, cash flow from operations is generally a function of the company's rate base, its deemed capital structure (established by the regulator), the allowed return on equity (currently about 9%) and depreciation. We have assumed that the company continues to perform broadly in line with the levels established by the regulator. While the company continues to move forward with a large capital program that could exceed a total of \$3 billion for 2016 and 2017. We believe that a combination of frequent cost of service rate resets in the transmission business and an approved rate base for 2015-2017 for the distribution business, mitigates the downward pressure the large capital program would otherwise place on financial metrics. We expect that HOI's CFO Pre-W/C to Debt will be maintained between 11-14% in 2016-2017.

#### RELATIONSHIP WITH THE PROVINCE OF ONTARIO

In accordance with Moody's Government Related Issuer (GRI) rating methodology, HOI's A3 rating reflects the following:

- » Aa2/Stable local currency rating of the Province of Ontario.
- » High default dependence as a result of HOI's exposure to virtually all facets of the provincial economy and its operational and financial proximity to the government.
- » Moderate probability of extraordinary support from the Province reflecting the strategic importance of HOI to the provincial economy as an essential service provider, the partial planned privatization of Hydro One and the medium to long term decline in political willingness to provide support. The Province's stated objective in the privatization of HOI was to improve corporate performance.

We believe the Province will continue to have effective control over Hydro One. Following a series of offerings, the government's nominations over the board of directors will decline to 40%, with an assumption that the province maintains a 40% equity interest in Hydro One Limited as broadly required by legislation. HOI is restricted from selling a large portion of its regulated transmission or distribution business and will continue to be regulated by the Ontario Energy Board (OEB). In addition, limitations have been placed on other shareholders that restrict their equity interest in Hydro One to less than 10%. Further, the government may seek to remove the board of directors at its discretion. However, since the government has stated its intent is to engage Hydro One as an investor, this has, in our view reduced the long term probability of "strong" support. Mitigating its control somewhat the government has implemented a pre-defined set of criteria to promote an independent, professional board with relevant expertise and a commercial orientation. These changes have been made in a stated attempt to improve the efficiency of Hydro One and they also reduce the government ties to the company. We do not believe any public policy mandates in the past several years have had a material negative affect on credit quality and the probability of further public policy initiatives has declined with the initial equity offering. Nonetheless, material acquisitions outside of Ontario could reduce the probability of extraordinary support from the Province.

#### Liquidity Analysis

Hydro One has adequate liquidity.

Hydro One has demonstrated its ability to readily access capital markets. Up to \$1.5 billion can be issued under its commercial paper (CP) program which is backstopped by a bank syndicated committed revolver of \$2.3 billion maturing in June 2021. At 30 September 2016, HOI had about \$1.1 billion in CP borrowings and no revolver borrowings outstanding. HOI terminated two of its credit facilities in the third quarter of 2016 and replaced them with a single facility for the same combined amount of \$2.3 billion. HOI has its own \$250 million committed credit facility that expires in November of 2021.

Hydro One relies in part on debt to finance its ongoing capex. The company has issued long-term debt of \$1.4 billion in the first three quarters of 2016 and had cash and cash equivalents balance of \$128 million as of September 30, 2016. Together with available credit facilities and estimated operating cash flows of around \$1.3-1.6 billion in the next 12 months these funds will be sufficient to finance around \$50 million long-term debt maturities, capex of around \$1.5 billion and dividends of about \$700 million.

## Profile

Hydro One Inc. (HOI) is an electricity transmission and distribution company. HOI is about 70% indirectly owned by the Province of Ontario; however, its ownership position in Hydro One will likely decline to about 40% over the next several years. Hydro One Limited (HOL) is the publicly traded vehicle that owns 100% of HOI. HOI is regulated by the Ontario Energy Board (OEB) under cost-of-service and incentive rate frameworks. The transmission business owns and operates virtually all of Ontario's electricity transmission system representing 50% of HOI's total assets of \$24 billion as at 30 June 2016. The distribution business serves about 1.3 million customers and owns a substantial portion of the province's electricity distribution system representing 38% of HOI's total assets. HOI began operations in 1999, pursuant to the Electricity Act 1998, when the former Ontario Hydro was restructured into five entities: Ontario Power Generation Inc. (OPG), the Independent Electricity System Operator (IESO), Ontario Electricity Financial Corporation (OEF), the Electricity Safety Authority and HOI. The Province does not guarantee HOI's debt obligations.

## Rating Methodology and Scorecard Factors

Exhibit 3

Hydro One Inc.

Regulated Electric and Gas Utilities Industry Grid [1][2]			Current LTM 9/30/2016		Moody's 12-18 Month Forward View As of Date Published [3]	
Factor 1 : Regulatory Framework (25%)	Measure	Score	Measure	Score	Measure	Score
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A	A	A
b) Consistency and Predictability of Regulation	A	A	A	A	A	A
Factor 2 : Ability to Recover Costs and Earn Returns (25%)						
a) Timeliness of Recovery of Operating and Capital Costs	A	A	A	A	A	A
b) Sufficiency of Rates and Returns	Baa	Baa	Baa	Baa	Baa	Baa
Factor 3 : Diversification (10%)						
a) Market Position	A	A	A	A	A	A
b) Generation and Fuel Diversity	N/A	N/A	N/A	N/A	N/A	N/A
Factor 4 : Financial Strength (40%)						
a) CFO pre-WC + Interest / Interest (3 Year Avg)	4.0x	Baa	3.7x - 4.2x	Baa	3.7x - 4.2x	Baa
b) CFO pre-WC / Debt (3 Year Avg)	12.9%	Baa	11% - 14%	Baa	11% - 14%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	9.3%	Baa	7% - 10%	Baa	7% - 10%	Baa
d) Debt / Capitalization (3 Year Avg)	54.4%	Baa	50% - 55%	Baa	50% - 55%	Baa
Rating:						
Grid-Indicated Rating Before Notching Adjustment		Baa1		A3		A3
HoldCo Structural Subordination Notching	0	0	0	0	0	0
a) Indicated Rating from Grid		Baa1		A3		A3
b) Actual Rating Assigned		A3		A3		A3
Government-Related Issuer	Factor					
a) Baseline Credit Assessment	baa1					
b) Government Local Currency Rating	Aa2					
c) Default Dependence	High					
d) Support	Moderate					
e) Final Rating Outcome	A3					

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

[2] As of 9/30/2016(LTM);

[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™

## Ratings

Exhibit 4

Category	Moody's Rating
<b>HYDRO ONE INC.</b>	
Outlook	Stable
Senior Unsecured -Dom Curr	A3
Commercial Paper	P-2

Source: Moody's Investors Service

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REPORT NUMBER

1047412



## **Rating Action: Moody's Affirms Hydro One's senior unsecured A3 ratings; outlook changed to negative**

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Global Credit Research - 19 Jul 2017

### **Approximately \$11 billion of debt affected**

Toronto, July 19, 2017 -- Moody's Investors Service, ("Moody's") affirmed the ratings of Hydro One Inc. (HOI) A3 senior unsecured; (P)A3 MTN program; commercial paper P-2 and changed the outlook to negative.

### **RATINGS RATIONALE**

"The negative outlook on Hydro One Inc. reflects our view that the probability of extraordinary support from the Province of Ontario will be reduced," said Vice President and Senior Credit Officer Gavin MacFarlane. "This follows today's announcement that Hydro One Limited, the parent company of Hydro One Inc., plans to acquire Avista Corp., a U.S. based electric and gas utility company."

The government will retain control of Hydro One Limited (HOL: unrated), the holding company that owns 100% of HOI. The acquisition of Avista Corp. (Baa1 stable), the first major acquisition by the organization, will be financed with about C\$3.4 billion of holding company debt at the parent HOL level, which sits between HOI and the Province of Ontario (Aa2 Stable) in the overall corporate structure, reducing the probability of support to HOI from the Province. In addition, any provincial support would likely also provide indirect benefits to ratepayers in U.S. jurisdictions, which further reduces the probability of support from the Province. Following the completion of the Avista acquisition, we expect the government to continue to own between 40-50% of HOL.

Consistent with other Canadian regulated utilities acquiring US regulated utilities, the announced acquisition will rely on debt financing, a credit negative. The additional debt that Hydro One Limited plans to issue will not limit the ratings of Hydro One Inc.

As a government related issuer, HOI's A3 rating reflects its baseline credit assessment (BCA) of baa1 with a one notch uplift attributable to the historically moderate probability of extraordinary support from the Province of Ontario. HOI's BCA of baa1 reflects its low business risk profile driven by its supportive regulatory environment. We expect cash flow from operations to remain predictable and financial metrics to remain weak for the ratings primarily as a result of the existing allowed return on equity and deemed capital structure established by the regulator. The baseline credit assessment of baa1 remains unchanged following the acquisition announcement.

### **Rating Outlook**

The outlook on HOI is negative, reflecting the expectation of a declining probability of extraordinary support from the Province.

### **What could change the rating: up**

An upgrade at this time is unlikely given the negative outlook. The rating outlook could return to stable at the current rating level based on an upgrade to the baseline credit assessment of HOI offsetting the reduction in the probability of extraordinary support. This could result from more favorable regulatory outcomes or a sustained improvement in financial metrics including CFO pre-W/C to debt in the high teens (11.3% at 9/30/2016). A one notch upgrade of the Province would not lead to an upgrade of Hydro One.

### **What could change the rating: down**

The proposed acquisition of Avista Corp. could lead to a downgrade of HOI. A downgrade of HOI's BCA would lead to a downgrade of the senior unsecured rating, so long as Moody's opinion of likely support from the Province remains unchanged or is reduced. This could result from a deterioration in regulatory outcomes or financial metrics, including CFO pre-W/C to debt below 11% on a sustained basis (11.3% at 9/30/2016). A one notch downgrade of the Province would not lead to a downgrade of HOI.

The methodologies used in these ratings were Regulated Electric and Gas Utilities published in June 2017 and Government-Related Issuers published in October 2014. Please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of these methodologies.

Outlook Actions:

..Issuer: Hydro One Inc.

....Outlook, Changed To Negative From Stable

Affirmations:

..Issuer: Hydro One Inc.

....Senior Unsecured Commercial Paper, Affirmed P-2

....Senior Unsecured Medium-Term Note Program, Affirmed (P)A3

....Senior Unsecured Regular Bond/Debenture, Affirmed A3

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## CREDIT OPINION

27 November 2017

### Update

Rate this Research &gt;&gt;

#### RATINGS

##### Hydro One Inc.

Domicile	Toronto, Ontario, Canada
Long Term Rating	A3
Type	Senior Unsecured - Dom Curr
Outlook	Negative

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.

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## Hydro One Inc.

Update following affirmation and outlook change to negative

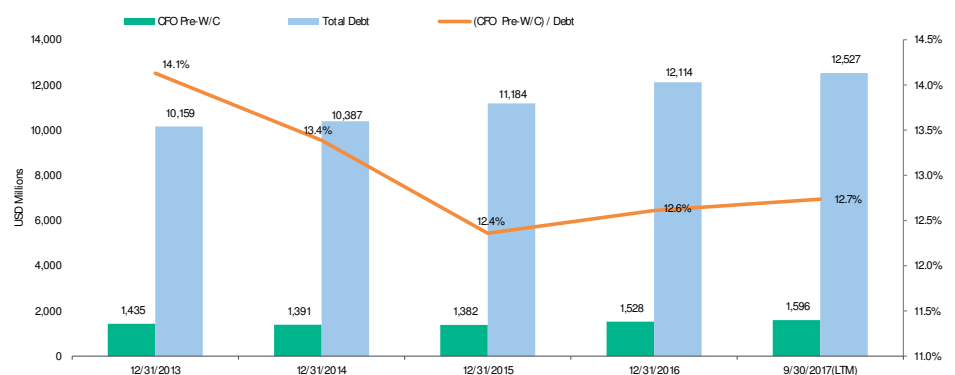
### Summary

Hydro One Inc.'s (HOI) credit profile reflects its baseline credit assessment (BCA) of baa1 with a one notch uplift attributable to the moderate probability of extraordinary support from the Province of Ontario (Aa2 stable). HOI's BCA of baa1 is derived from our Regulated Electric and Gas Utilities rating methodology, and reflects its low business risk profile driven by its supportive regulatory environment. We expect cash flow from operations to remain predictable and financial metrics to remain weak for the ratings primarily as a result of the existing allowed return on equity and deemed capital structure established by the regulator. The one notch uplift attributed to HOI as a government related issuer incorporates our expectation of an enduring, albeit weaker link between HOI and the Province.

On July 19, 2017 HOI's parent Hydro One Limited (HOL: unrated) announced that it plans to acquire Avista Corp., a U.S. based electric and gas utility company. HOI's negative outlook reflects our view that the probability of extraordinary support from the province will be reduced as a result of the acquisition.

Exhibit 1

#### Historical CFO pre-W/C, Debt and CFO pre-W/C to Debt



Source: Moody's Investors Service

## Credit Strengths

- » Supportive regulatory environment
- » Predictable cash flow and stable financial metrics
- » Relationship with the Province of Ontario

## Credit Challenges

- » Acquisition of Avista could reduce support from the province
- » High Leverage

## Rating Outlook

The outlook on HOI is negative, reflecting the expectation of a declining probability of extraordinary support from the Province.

## Factors that Could Lead to an Upgrade

An upgrade at this time is unlikely given the negative outlook. The rating outlook could return to stable at the current rating level based on an upgrade to the baseline credit assessment of HOI offsetting the reduction in the probability of extraordinary support. This could result from more favorable regulatory outcomes or a sustained improvement in financial metrics including CFO pre-W/C to debt in the high teens (12.7% at 9/30/2017). A one notch upgrade of the Province would not lead to an upgrade of Hydro One.

## Factors that Could Lead to a Downgrade

The proposed acquisition of Avista Corp. could lead to a downgrade of HOI. A downgrade of HOI's BCA would lead to a downgrade of the senior unsecured rating, so long as Moody's opinion of likely support from the Province does not increase. This could result from a deterioration in regulatory outcomes or financial metrics, including CFO pre-W/C to debt below 11% on a sustained basis. A one notch downgrade of the Province would not lead to a downgrade of HOI.

## Key Indicators

Exhibit 2

Hydro One Inc.

### KEY INDICATORS [1]

Hydro One Inc.

	12/31/2013	12/31/2014	12/31/2015	12/31/2016	9/30/2017(LTM)
CFO pre-WC + Interest / Interest	4.0x	3.9x	4.0x	4.3x	4.3x
CFO pre-WC / Debt	14.1%	13.4%	12.4%	12.6%	12.7%
CFO pre-WC – Dividends / Debt	12.1%	10.7%	4.4%	7.5%	8.3%
Debt / Capitalization	54.9%	53.4%	52.8%	55.0%	55.5%

[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

Hydro One Inc. (HOI) is an electricity transmission and distribution company. HOI is about 49.9% indirectly owned by the Province of Ontario; however, its ownership position in Hydro One Inc. will likely decline to about 40% over the next several years. Hydro One Limited (HOL) is the publicly traded vehicle that owns 100% of HOI. HOI is regulated by the Ontario Energy Board (OEB) under cost-of-service and incentive rate frameworks. The transmission business owns and operates virtually all of Ontario's electricity transmission system representing 52% of HOI's total assets of \$25.8 billion as at 30 September 2017. The distribution business serves about 1.4 million customers and owns a substantial portion of the province's electricity distribution system representing 37% of HOI's total

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assets. The remaining assets include the company's telecommunications business and other corporate activities that make a negligible contribution to revenue. HOI began operations in 1999, pursuant to the Electricity Act 1998, when the former Ontario Hydro was restructured into five entities: Ontario Power Generation Inc. (OPG), the Independent Electricity System Operator (IESO), Ontario Electricity Financial Corporation (OEFC), the Electricity Safety Authority and HOI. The Province does not guarantee HOI's debt obligations.

## Detailed Credit Considerations

### SUPPORTIVE REGULATORY ENVIRONMENT

The supportive regulatory environment is a key driver of HOI's credit quality and baa1 BCA. Supporting our view, HOI's monopoly position as a Transmission and Distribution (T&D) company with no commodity price risk underpins its credit strength. We expect the regulatory environment to remain relatively transparent, predictable and broadly credit supportive. The legislative and judicial underpinnings are well developed and we expect them to remain unchanged. Rates for the transmission business are established using cost of service principles with frequent cost of service rate resets. Distribution rates are currently established based on a cost of service methodology and are transitioning to an incentive rate mechanism, with periodic cost of service rate resets. The company does not have any direct commodity risk exposure since commodity costs are a pass through for the distribution business. However it does have some exposure to volume risk that is typically driven by weather variability and the underlying performance of the economies in its service territories. The company has inherently lower business risk as a T&D business compared to the price, volume, operational or environmental risks typically associated with generation activities. HOI does not have any supply obligations.

### PREDICTABLE CASH FLOW AND STABLE, ALBEIT WEAK FINANCIAL METRICS

We expect the company to continue to generate stable cash flow, a key credit strength. Underpinning this stability, cash flow from operations is generally a function of the company's rate base, its deemed capital structure of 40% equity that is established by the regulator, the allowed return on equity that is currently set at 8.78% for 2017 (increasing to 9% in 2018) and depreciation. We have assumed that the company continues to perform broadly in line with the levels established by the regulator. While the company continues to move forward with a large capital program of about \$5 billion over the period 2017-2019. We believe that a combination of frequent cost of service rate resets in the transmission business and a combination of an approved rate base for 2015-2017 and in subsequent periods support for the capital program under incentive based regulation for the distribution business, mitigates the downward pressure the large capital program would otherwise place on financial metrics. We expect that HOI's CFO Pre-W/C to Debt will be maintained between 11-14% in 2017-2018. A September 2017 transmission decision included a sharing mechanism for Hydro One's large deferred tax asset. While Hydro One is contesting this aspect of the decision, the financial implications are limited as the downside case, including a similar tax sharing mechanism in the distribution business, appears to be an annual reduction in cash flow in the C\$50-60 million range, or about 3% of cash flow.

### RELATIONSHIP WITH THE PROVINCE OF ONTARIO

In accordance with Moody's Government Related Issuer (GRI) rating methodology, HOI's A3 rating reflects the following:

- » Aa2/Stable local currency rating of the Province of Ontario.
- » High default dependence as a result of HOI's exposure to virtually all facets of the provincial economy and its operational and financial proximity to the government.
- » Moderate probability of extraordinary support from the Province reflecting the strategic importance of HOI to the provincial economy as an essential service provider, the partial planned privatization of Hydro One and the medium to long term decline in political willingness to provide support. The Province's stated objective in the privatization of HOI was to improve corporate performance.

Nonetheless, material acquisitions outside of Ontario such as that of Avista could reduce the probability of extraordinary support from the Province.

We believe the Province will continue to have effective control over Hydro One Inc. Following a series of offerings, the government's nominations over the board of directors will decline to 40%, with an assumption that the province maintains a 40% equity interest in Hydro One Limited as broadly required by legislation. HOI is restricted from selling a large portion of its regulated transmission or distribution business and will continue to be regulated by the Ontario Energy Board (OEB). In addition, limitations have been placed on other shareholders that restrict their equity interest in Hydro One to less than 10%. Further, the government may seek to remove the board of directors at its discretion. However, since the government has stated its intent is to engage Hydro One as an investor, this has, in our view reduced the long term probability of support. Mitigating its control somewhat the government has implemented a pre-defined set of criteria to promote an independent, professional board with relevant expertise and a commercial orientation. These changes have been made in a stated attempt to improve the efficiency of Hydro One and they also reduce the government ties to the company. We do not believe any public policy mandates in the past several years have had a material negative affect on credit quality and the probability of further public policy initiatives has declined with the initial equity offering.

### Liquidity Analysis

Hydro One has adequate liquidity.

Hydro One has demonstrated its ability to readily access capital markets. Up to \$1.5 billion can be issued under its commercial paper (CP) program which is backstopped by a bank syndicated committed revolver of \$2.3 billion maturing in June 2022. At 30 September 2017, HOI had \$894 million in CP borrowings and no revolver borrowings outstanding. HOL has its own \$250 million committed credit facility that expires in November of 2021.

Hydro One relies in part on debt to finance its ongoing capex. The company including parent HOL has cash and cash equivalents balance of \$622 million as of September 30, 2017. Together with available credit facilities and estimated operating cash flows of around \$1.5-1.7 billion in the next 12 months are sufficient to cover \$600 million long-term debt maturities, capex of around \$1.7 billion and dividends of about \$500 million.

## Rating Methodology and Scorecard Factors

Exhibit 3

Hydro One Inc.

Regulated Electric and Gas Utilities Industry Grid [1][2]			Current LTM 9/30/2017		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			A	A	A	A
Factor 2 : Ability to Recover Costs and Earn Returns (25%)						
a) Timeliness of Recovery of Operating and Capital Costs			A	A	A	A
b) Sufficiency of Rates and Returns			Baa	Baa	Baa	Baa
Factor 3 : Diversification (10%)						
a) Market Position			A	A	A	A
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)			4.2x	Baa	4.2x - 4.7x	Baa
b) CFO pre-WC / Debt (3 Year Avg)			13.0%	Baa	11% - 14%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)			7.4%	Baa	8% - 9%	Baa
d) Debt / Capitalization (3 Year Avg)			54.5%	Baa	53% - 58%	Baa
Rating:						
Grid-Indicated Rating Before Notching Adjustment				Baa1		Baa1
HoldCo Structural Subordination Notching						0
a) Indicated Rating from Grid				Baa1		Baa1
b) Actual Rating Assigned						A3
			Factor			
Government-Related Issuer			Factor			
a) Baseline Credit Assessment			baa1			
b) Government Local Currency Rating			Aa2			
c) Default Dependence			High			
d) Support			Moderate			
e) Final Rating Outcome			A3			

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

[2] As of 9/30/2017(LTM);

[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™

## Ratings

Exhibit 4

Category	Moody's Rating
<b>HYDRO ONE INC.</b>	
Outlook	Negative
Senior Unsecured -Dom Curr	A3
Commercial Paper	P-2

Source: Moody's Investors Service



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# S&P Global Ratings

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### Hydro One Ltd. And Hydro One Inc. Outlooks Revised To Negative From Stable On Proposed Avista Corp. Acquisition

**Primary Credit Analyst:**

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**Secondary Contact:**

Stephen R Goltz, Toronto (416) 507-2592; stephen.goltz@spglobal.com

- On July 19, 2017, Toronto-based Hydro One Ltd. (HOL) announced the C\$6.7 billion (US\$5.3 billion) proposed acquisition of Avista Corp., a U.S.-based electricity and gas utility.
- We are revising our outlook on HOL and subsidiary Hydro One Inc. (HOI) to negative from stable.
- We are also affirming our ratings on HOL and HOI, including our 'A' long-term corporate credit rating on both.
- The outlook revision reflects the shift in HOL's business strategy, as well as the slightly weakened business risk from the acquisition.

TORONTO (S&P Global Ratings) July 19, 2017--S&P Global Ratings today said it revised its outlook on Toronto-based Hydro One Ltd. (HOL) and subsidiary Hydro One Inc. (HOI) to negative from stable. At the same time, S&P Global Ratings affirmed its ratings on HOL and HOI, including its 'A' long-term corporate credit rating on both.

The outlook revision follows HOL's proposed acquisition of Avista Corp., a U.S. based-electricity and gas utility operator. Historically, HOL's focus on Ontario provided the company with incremental business strength based on a favorable market position, regulation, and operational history. With the Avista acquisition, we believe HOL's business risk has eroded slightly. Furthermore, the additional leverage that the transaction introduces also eroded HOL's credit metrics and financial risk.

The negative outlook on HOL reflects our view that the Avista acquisition signals a shift in HOL's business strategy, which will align the company with its global peers removing the historical rationale for a one-notch rating uplift. The negative outlook also reflects the execution and financing risk inherent in any large acquisition. We recognize that the use of the convertible debentures will create a temporary impact on credit metrics, with AFFO-to-debt forecast at about 9% until conversion. However, we expect the debentures will be converted to equity in full.

We could take a negative rating action on HOL if we expect that the transaction will conclude as expected. This would include a financing plan that relies on the equity issuance as anticipated, which will lead to AFFO-to-debt of about 10% after the debentures' conversion. In the meantime credit metrics are expected to be below 10%. If conversion of the debentures does not occur as expected and metrics remain below 10%, we could lower the ratings on HOL by more than one notch.

We could revise our outlook to stable within our outlook period in the unlikely event that the transaction does not close, the company continues its historic focus on Ontario regulated utilities and we expected HOL's consolidated AFFO-to-debt to be above 13%, on a consistent basis.

The negative outlook reflects our outlook on the parent, HOL, and our view that HOI is core to HOL under our group rating methodology.

We could take a negative rating action on HOI if we take a similar rating action on HOL.

We could revise the outlook on HOI to stable if we take a similar rating action on HOL.

#### RELATED CRITERIA

- 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: 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: Industry Risk, Nov. 19, 2013

*Hydro One Ltd. And Hydro One Inc. Outlooks Revised To Negative From Stable On Proposed Avista Corp.  
Acquisition*

- 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
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

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## Research

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### Research Update:

# Hydro One Ltd. And Hydro One Inc. Outlooks Revised To Negative From Stable On Proposed Avista Corp. Acquisition

#### Primary Credit Analyst:

Andrew Ng, Toronto (416) 507-2545; [andrew.ng@spglobal.com](mailto:andrew.ng@spglobal.com)

#### Secondary Contact:

Stephen R Goltz, Toronto (416) 507-2592; [stephen.goltz@spglobal.com](mailto:stephen.goltz@spglobal.com)

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## Research Update:

# Hydro One Ltd. And Hydro One Inc. Outlooks Revised To Negative From Stable On Proposed Avista Corp. Acquisition

## Overview

- On July 19, 2017, Toronto-based Hydro One Ltd. (HOL) announced the C\$6.7 billion (US\$5.3 billion) proposed acquisition of Avista Corp., a U.S.-based electricity and gas utility.
- We are revising our outlook on HOL and subsidiary Hydro One Inc. (HOI) to negative from stable.
- We are also affirming our ratings on HOL and HOI, including our 'A' long-term corporate credit rating on both.
- The outlook revision reflects the shift in HOL's business strategy, as well as the slightly weakened business risk from the acquisition.

## Rating Action

On July 19, 2017, S&P Global Ratings revised its outlook on Toronto-based Hydro One Ltd. (HOL) and subsidiary Hydro One Inc. (HOI) to negative from stable. At the same time, S&P Global Ratings affirmed its ratings on HOL and HOI, including its 'A' long-term corporate credit rating on both.

## Rationale

The outlook revision follows HOL's proposed acquisition of Avista Corp., a U.S. based-electricity and gas utility operator. Historically, HOL's focus on Ontario provided the company with incremental business strength based on a favorable market position, regulation, and operational history. With the Avista acquisition, we believe HOL's business risk has eroded slightly. Furthermore, the additional leverage that the transaction introduces also eroded HOL's credit metrics and financial risk.

Overall, we expect HOL's consolidated excellent business risk profile will continue with the Avista acquisition. We believe the jurisdictions in which Avista operates benefit from reasonably supportive regulatory environments. In addition, the purchase gives HOL some geographic diversity and entry into natural gas distribution. However, we believe that the overall weaker business risk profile of Avista offsets this to a certain degree.

From a financial risk perspective, we forecast consolidated adjusted funds from operations (AFFO)-to-total debt for HOL, when the transaction closes, at about 10% in 2018. This is consistent with a significant financial risk



profile, but does not allow for cushion in credit metrics.

The transaction's financing plan benefits from an equity issuance in the form of C\$1.4 billion in convertible debentures. While the form of these debentures has been used in the Canadian market with almost 100% conversion to equity, we treat this financing as debt until the conversion occurs. While the debentures are outstanding we forecast that AFFO-to-debt will be around 9%.

In addition, part of the financing plan for the acquisition includes HOL issuing debt, which would be structurally subordinated to the debt at each operating entities. As per our methodology, we expect to rate this new debt one notch below the corporate credit rating on the company.

We continue to believe the HOI is core to HOL, so we continue to equalize the corporate credit rating on HOI with that on HOL. We further consider Avista to be highly strategic to HOL under our criteria.

Our base-case assumptions include the following:

- HOL will continue focusing on its regulated utility business with no plans to expand into unregulated business segments
- The operating subsidiaries will not experience any adverse regulatory decisions from any of the respective jurisdictions that would impair predictable and steady cash flows

Based on these assumptions, we arrive at consolidated AFFO-to-debt of 10%-12% after closing.

## **Liquidity**

Our assessment of HOL and HOI's liquidity is 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 FFO of about C\$1.74 billion over the next 12 months
- Committed credit facilities availability of about C\$2.55 billion as of March 31, 2017, which mature in 2021

Principal liquidity uses include:

- Debt maturities of about C\$1.06 billion over the next 12 months, including short-term debt
- Capital spending of about C\$1.7 billion over the next 12 months
- Dividend payments of about C\$550 million over the next 12 months

## **Outlook (Hydro One Ltd.)**

The negative outlook on HOL reflects our view that the Avista acquisition signals a shift in HOL's business strategy, which will align the company with its global peers removing the historical rationale for a one-notch rating uplift. The negative outlook also reflects the execution and financing risk inherent in any large acquisition. We recognize that the use of the convertible debentures will create a temporary impact on credit metrics, with AFFO-to-debt forecast at about 9% until conversion. However, we expect the debentures will be converted to equity in full.

### **Downside scenario**

We could take a negative rating action on HOL if we expect that the transaction will conclude as expected. This would include a financing plan that relies on the equity issuance as anticipated, which will lead to AFFO-to-debt of about 10% after the debentures' conversion. In the meantime credit metrics are expected to be below 10%. If conversion of the debentures does not occur as expected and metrics remain below 10%, we could lower the ratings on HOL by more than one notch.

### **Upside scenario**

We could revise our outlook to stable within our outlook period in the unlikely event that the transaction does not close, the company continues its historic focus on Ontario regulated utilities and we expected HOL's consolidated AFFO-to-debt to be above 13%, on a consistent basis.

## **Outlook (Hydro One Inc.)**

The negative outlook reflects our outlook on the parent, HOL, and our view that HOI is core to HOL under our group rating methodology.

### **Downside scenario**

We could take a negative rating action on HOI if we take a similar rating action on HOL.

### **Upside scenario**

We could revise the outlook on HOI to stable if we take a similar rating action on HOL.

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

Corporate 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: Satisfactory (no impact)
- 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.)**

Corporate Credit Rating: A/Negative/A-1

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)
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- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: a

Group credit profile: a

- Status within group: core (no impact)

## Related Criteria

- 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
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- 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
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Ratings List

### Ratings Affirmed; Outlook Action

	To	From
Hydro One Limited Corporate Credit Rating	A/Negative/--	A/Stable/--
Hydro One Inc. Corporate Credit Rating	A/Negative/A-1	A/Stable/A-1

### Ratings Affirmed

Hydro One Inc. Senior Unsecured Commercial Paper	A
Global Scale	A-1
Canada Scale	A-1 (MID)

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Avista Corp. Acquisition*

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# Research

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## **Summary:** **Hydro One Inc.**

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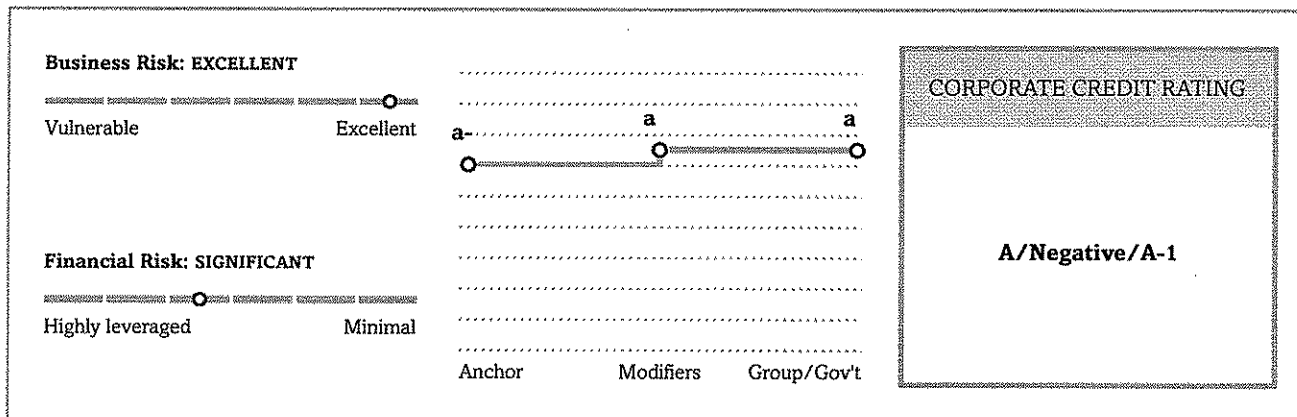
Ratings Score Snapshot

Issue Ratings--Subordination Risk Analysis

Related Criteria

## Summary:

# Hydro One Inc.



## Rationale

Business Risk: Excellent	Financial Risk: Significant
<ul style="list-style-type: none"> <li>• A relatively stable regulatory regime</li> <li>• Natural monopoly service provider</li> <li>• Limited commodity-price risk and low volume-risk exposure</li> </ul>	<ul style="list-style-type: none"> <li>• Stable regulated cash flow</li> <li>• Large capital program</li> </ul>



## Outlook: Negative

The negative outlook on Hydro One Inc. (HOI) reflects S&P Global Ratings' outlook on the parent, Hydro One Ltd. (HOL). The outlook on HOL reflects our view that the Avista Corp. acquisition signals a shift in the company's business strategy, which will align HOL with its global peers and remove the historical rationale for a one-notch rating uplift. The negative outlook also reflects the execution and financing risk inherent in any large acquisition. We recognize that the use of the convertible debentures will temporarily affect credit metrics, with adjusted funds from operations (AFFO)-to-debt forecast at about 9% until conversion. However, we expect the debentures will be converted to equity in full.

On a stand-alone basis, we expect HOI to continue generating stable, regulated cash flows, with AFFO-to-debt of about 12%-13% during the outlook period.

### Downside scenario

We could take a negative rating action on HOI if we take one on HOL. This could happen if we expect that the Avista transaction will conclude as expected. The transaction would include a financing plan that relies on the equity issuance as anticipated, which will lead to HOL's AFFO-to-debt of about 10% after the debentures' conversion. In the meantime, we expect AFFO-to-debt to be below 10%. If the debentures' conversion does not occur as expected and AFFO-to-debt remains below 10%, we could lower the ratings on HOL by more than one notch.

### Upside scenario

We could revise the outlook on HOI to stable if we did so to HOL. This could happen in the unlikely event that the transaction does not close, HOL continues its historical focus on Ontario regulated utilities and we expected HOL's consolidated AFFO-to-debt stays consistently above 13%.

## Our Base-Case Scenario

The key factor in our analysis continues to be the regulatory framework and the utility's performance within it.

Assumptions	Key Metrics			
<ul style="list-style-type: none"><li>• HOI will continue to focus on regulated electricity transmission and distribution businesses</li><li>• HOI will not experience any adverse regulatory decisions from the Ontario Energy Board (OEB), the regulator for the Province of Ontario, and that the OEB continues to operate transparently and stably</li><li>• HOI's operating performance and margins will be stable</li><li>• The company will continue to earn its allowed return on equity based on the deemed capital structure</li><li>• The strategic relationship between HOI and HOL will be stable</li><li>• Any additional leverage required for the financing of the Avista acquisition will happen at the HOL level</li></ul>				
		2016A	2017E	2018E
	FFO/debt	12%	11%-12%	12%-13%
	FFO cash interest coverage	5.1x	About 4.5x	About 4.5x
	Note: Fully S&P Global Ratings-adjusted. FFO--Funds from operations. A--Actual. E--Estimated.			

## Company Description

HOI is the operating subsidiary of HOL, the largest electricity transmission and distribution utility in Ontario.

HOI delivers electricity to approximately 1.3 million residential customers, as well as to industrial customers and municipal utilities, in the province. The utility operates through three segments: transmission, distribution, and other business. HOI owns and operates virtually all of Ontario's entire electricity transmission network, and approximately 123,000 circuit kilometers of primary low-voltage distribution lines.

## Business Risk: Excellent

Our view of HOI's business risk has not changed. The company continues to operate under a supportive regulatory regime. In our view, the OEB's regulatory framework for Ontario continues to support stable cash flow, a key credit strength. The framework allows for the recovery of prudent costs and the opportunity to earn a reasonable return. In addition, the regulatory framework limits HOI's exposure to commodity risk and associated cash flow volatility. Although the distribution business must bill customers for the commodity delivered, the cost is a flow-through. The company has no obligation to ensure an adequate supply of electricity and is not burdened with the procurement process or power purchase agreements, which reduces operating risk.

Further supporting the business risk profile is HOI's natural monopoly position in its service territories and the asset-intensive nature of electricity distribution, both of which limit competitive risk. We believe that the company's customer base supports the overall stability of revenues and greatly limits exposure to any particular customer or customer class. In the transmission business, municipally owned, investment-grade electricity distribution companies collect transmission revenues and forward them to HOI through the Independent Electricity System Operator. The

company's distribution business collects revenues from a relatively stable customer base that residential and commercial customers dominate. We view the economy of Ontario, which the transmission business services, as large, wealthy, and well-diversified. We do not expect the utility's customer composition to change materially over the next two years.

## Financial Risk: Significant

Our view on HOI's financial risk is also unchanged. We continue to assess the utility's financial measures against our most permissive leverage benchmarks because virtually all of HOI's cash flow is generated from the low end of the utility risk spectrum in electricity transmission and distribution under a highly supportive regulatory framework. We forecast AFFO-to-debt of 11%-12% for 2017 and 12%-13% in 2018-2019.

In July 2017, HOI announced the proposed acquisition of Avista. The company will require debt financing to fund this transaction and we do not expect this additional debt at the HOI operating level. We do not expect the transaction's financing to affect HOI's stand-alone credit metrics.

## Liquidity: Adequate

Our assessment of HOI's liquidity is adequate. We expect liquidity sources to exceed uses by 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, HOI has sound relationships with banks and generally satisfactory standing in the credit markets. In the unlikely event of liquidity distress, we expect HOI to scale back its capital spending to preserve credit metrics.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> <li>• Cash and equivalent of about C\$90 million as of Sept. 30, 2017</li> <li>• Cash FFO of C\$1.7 billion-C\$1.8 billion over the next 12 months</li> <li>• Committed credit facilities availability of about C\$2.3 billion as of Sept. 30, 2017; the facilities mature in 2022</li> </ul>	<ul style="list-style-type: none"> <li>• Debt maturities, including short-term debt, of about C\$1.5 billion over the next 12 months</li> <li>• Capital spending of about C\$1.7 billion in that time</li> <li>• Dividend payments of about C\$550 million over the next 12 months</li> </ul>

## Other Credit Considerations

We assign a positive comparable rating analysis modifier. This reflects HOI's credit metrics, which are at the high end of the financial risk profile, with FFO-to-debt of 12%-13% during our outlook period.

## Group Influence

We continue to view HOI as a core entity to the HOL group because HOI generates virtually all of the group's cash flow. In addition, we do not expect HOL to divest HOI in the foreseeable future. Furthermore, both HOL and HOI share the same name, reputation, operations and management team. As a result, we have equalized our ratings on HOI with the 'a' GCP on HOL, leading to the final 'A' rating.

## Government Influence

We believe there is a low likelihood that Ontario would provide timely and sufficient extraordinary support to HOI in the unlikely event of financial distress. In our view, HOL's recent IPO allows the utility to gain access to the equity capital market and does not need to rely on the government for financial support. Furthermore, HOL and HOI are no longer wholly owned by the province, although Ontario is still the largest single shareholder with about 47% ownership. Moreover, the OEB has oversight of electricity regulation and tariff setting, not the provincial government. As a result, we believe there is a low likelihood that Ontario would provide timely extraordinary support to HOI and HOL, which has no impact on our long-term corporate credit rating on HOI.

## Ratings Score Snapshot

### Corporate Credit Rating

A/Negative/A-1

### 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:** Satisfactory (no impact)
- **Comparable rating analysis:** Positive (+1 notch)

## Issue Ratings--Subordination Risk Analysis

### Capital structure

HOI, the operating subsidiary, has about C\$10.7 billion of senior unsecured debentures.

### Analytical conclusions

Given that HOI is an investment-grade regulated utility and all the senior unsecured debt is at the operating subsidiary level, we do not consider it as structurally subordinated. As a result, we equalize the issue-level rating on the unsecured debt with our 'A' long-term corporate credit rating on the utility.

## Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- 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

### Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

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**Building Owners and Managers Association Toronto Interrogatory # 157**

**Issue:**

Issue 36: Are the proposed timing and methodology for determining the return on equity and short-term debt prior to the effective date of rate implementation appropriate?

**Reference:**

Financial Statements Page: 13

**Interrogatory:**

a) Please provide the material from S&P dated July 19, 2017, in which it revised its outlook with Hydro One Limited from negative to stable.

b) Please provide the material from S&P and Moody's, in which they revised their outlook with Hydro One Inc. from negative to stable, affirming the existing debt rating.

**Response:**

a) Please refer to Exhibit I-36-BOMA-B156 Part (a), Attachments 6a and 6b for S&P material dated July 17, 2017.

b) Please refer to Exhibit I-36-BOMA-B156 Part (a), Attachments 3 to 7.

**Building Owners and Managers Association Toronto Interrogatory # 158**

**Issue:**

Issue 36: Are the proposed timing and methodology for determining the return on equity and short-term debt prior to the effective date of rate implementation appropriate?

**Reference:**

Financial Statements Page: 14, Summary of Contractual Obligations and Other Commercial Commitments

**Interrogatory:**

- a) For each of line items, please indicate where in the corporate chain Hydro One Limited, Hydro One Inc., Hydro One Networks, the liability or obligation is held.
- b) Please confirm that long-term debt, short-term rates payable, credit facility, and guarantees, are all obligations of Hydro One Inc.
- c) Does Hydro One Networks ("Networks") (the regulated entity) guarantee or support in any other manner, the debt incurred by Hydro One Inc., aside from required payments of dividends to Hydro One Inc.?

**Response:**

- a) Please see the following list from the Summary of Contractual Obligations and Other Commercial Commitments:
  - Long-term debt: Hydro One Inc. and Hydro One Sault-Ste-Marie
  - Short-term notes payable: Hydro One Inc.
  - Pension Contributions: Hydro One Inc.
  - Environmental and asset retirement obligations: Hydro One Networks and Hydro One Remote Communities.
  - Outsourcing agreements: Hydro One Networks.
  - Operating Lease Commitments: Hydro One Networks and Hydro One Telecom.
  - Long-term Software/meter agreement: Hydro One Networks.
  - Credit Facilities: Hydro One Limited (\$250M) and Hydro One Inc. (\$2.3B)
  - Letters of Credit: Hydro One Inc.
  - Guarantees: Hydro One Inc.
- b) All except the \$250 million credit facility for Hydro One Limited is associated with Hydro One Inc.



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Tab 36  
Schedule BOMA-158  
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- 1 c) Networks does not guarantee or support the debt issued by Hydro One Inc. Networks issues
- 2 debt to Hydro One Inc. to reflect debt issued by Hydro One Inc. to third-party public debt
- 3 investors, as stated in Exhibit D1, Tab 2, Schedule 2, line 5 to 8.

**Building Owners and Managers Association Toronto Interrogatory # 159**

**Issue:**

Issue 36: Are the proposed timing and methodology for determining the return on equity and short-term debt prior to the effective date of rate implementation appropriate?

**Reference:**

Financial Statements Page: 17

**Interrogatory:**

- a) Does Networks have any legal obligation to provide a minimum dividend?
- b) Please itemize the major covenants.
- c) Please provide a copy of any current prospectuses, shelf prospectus or other comparable documents under which Hydro One Limited or Hydro One Inc. raise debt or equity, including the Short Form Prospectus dated August 1, 2017 for the 4% \$1.4 billion convertible debenture in connection with the Arista acquisition.
- d) Please provide a copy of the agreement pursuant to which the Province of Ontario waived its pre-emptive right to participate in the debenture offer.
- e) Please provide a copy of the convertible debenture.

**Response:**

- a) No, Networks does not have any legal obligation to provide a minimum dividend.
- b) The convertible debenture offering has the following covenants: payment of debentures, reporting requirements, compliance certificates, further instruments and acts, maintenance of corporate existence, maintenance of office or agency and withholding matters.
- c) Please see Attachment 1 for a copy of the prospectus for the convertible debenture issued in connection with the Avista acquisition.
- d) Hydro One believes that the agreement is not relevant to this application.
- e) Please see Attachment 2 for a copy of the convertible debenture. Please note that the convertible debenture is currently registered in the name of Computershare, as security agent.

*No securities regulatory authority has expressed an opinion about these securities and it is an offence to claim otherwise.*

**Information has been incorporated by reference in this short form prospectus from documents filed with securities commissions or similar authorities in Canada.** Copies of the documents incorporated herein by reference may be obtained on request without charge from the Corporate Secretary of Hydro One Limited at 483 Bay Street, South Tower, 8<sup>th</sup> Floor, Toronto, Ontario, M5G 2P5 (telephone: (416) 345-6044) and are also available electronically at [www.sedar.com](http://www.sedar.com).

*This Prospectus constitutes a public offering of these securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such securities. **These securities may not be offered or sold in the United States.** The securities being offered under this Prospectus have not been and will not be registered under the 1933 Act (as defined in this Prospectus), or any state securities laws, and may not be offered or sold within the United States (as defined in Regulation S under the 1933 Act). See "Plan of Distribution".*

**Secondary Offering**

**August 1, 2017**

**SHORT FORM PROSPECTUS**



**HYDRO ONE LIMITED**

**\$1,400,000,000**

**4.00% Convertible Unsecured Subordinated Debentures  
represented by Instalment Receipts**

The 4.00% convertible unsecured subordinated debentures (the "Debentures") of Hydro One Limited ("Hydro One Limited", or the "Corporation") offered hereby (the "Offering") will be sold by 2587264 Ontario Inc. (the "Selling Debentureholder"), a direct wholly-owned subsidiary of Hydro One Limited, on an instalment basis at a price of \$1,000 per Debenture. See "Details of the Offering – The Selling Debentureholder". Prior to full payment, beneficial ownership of the Debentures will be represented by instalment receipts (the "Instalment Receipts"). The first instalment of \$333 is payable on the closing of the Offering. The final instalment of \$667 is payable following notification to holders of Instalment Receipts (the "Final Instalment Notice") that: (i) the Corporation has received all regulatory and governmental approvals required to finalize the direct or indirect acquisition (the "Merger") by Olympus Holding Corp. ("US Parent"), an indirect, wholly-owned subsidiary of the Corporation, of Avista Corporation, an investor-owned, regulated utility company whose common stock is listed on the New York Stock Exchange ("NYSE"); and (ii) US Parent and Avista Corporation have fulfilled or waived all other outstanding conditions precedent to closing the Merger, other than those which by their nature cannot be satisfied until the closing of the Merger (collectively, the "Approval Conditions"), in each case as set out in the agreement and plan of merger dated as of July 19, 2017 among Hydro One Limited, US Parent, Olympus Corp. ("Merger Sub"), a direct wholly-owned subsidiary of US Parent and, at the effective time of the closing of the Merger, will be collectively owned by US Parent and one or more direct or indirect wholly-owned subsidiaries of the Corporation, and Avista Corporation (the "Merger Agreement"). See "The Merger" and "The Merger Agreement". The Final Instalment Notice will set a date for payment of the final instalment (the "Final Instalment Date"), which shall not be less than 15 days nor more than 90 days following the date of such notice. **If a holder of an Instalment Receipt does not pay the final instalment on or before the Final Instalment Date, the Debenture represented by such Instalment Receipt may, at the option of the Selling Debentureholder, upon compliance with applicable law and the terms of the Instalment Receipt Agreement (as defined under "Details of the Offering – Instalment Receipts"), be forfeited to the Selling Debentureholder in full satisfaction of the holder's obligations or such**

**Debentures may be sold and the holder will remain liable for any deficiency in the proceeds of such sale. See “Details of the Offering”.**

The holders of Debentures will be entitled to interest at an annual rate of 4.00% per \$1,000 principal amount of Debentures, payable quarterly in arrears in equal instalments (other than the first interest payment and, depending on the Final Instalment Date, the final interest payment) on the last day of, December, March, June and September of each year (or the prior business day if the last day falls on a weekend or holiday) to and including the Final Instalment Date. The first interest payment will be made on December 29, 2017 in the amount of \$15.78082 per \$1,000 principal amount of Debentures and will include interest payable from and including the closing of the Offering, which is expected to take place on or about August 9, 2017 (the “Closing Date”). Subsequently, quarterly interest payments will be made in the amount of \$10.00 per \$1,000 principal amount of Debentures. **On the day following the Final Instalment Date, the interest rate payable on the Debentures will fall to an annual rate of 0% and interest will cease to accrue on the Debentures.** Based on a first instalment of \$333 per \$1,000 principal amount of Debentures, the effective annual yield to and including the Final Instalment Date is 12.0%, and the effective annual yield thereafter is 0%.

If the Final Instalment Date occurs on a day that is prior to the first anniversary of the Closing Date, holders of Debentures who have paid the final instalment on or before the Final Instalment Date will be entitled to receive, on the business day following the Final Instalment Date, in addition to the payment of accrued and unpaid interest to and including the Final Instalment Date, an amount equal to the interest that would have accrued from the day following the Final Instalment Date to and including the first anniversary of the Closing Date had the Debentures remained outstanding and continued to accrue interest until and including such date (the “Make-Whole Payment”). No Make-Whole Payment will be payable if the Final Instalment Date occurs on or after the first anniversary of the Closing Date.

#### **Conversion Privilege**

At the option of the holder of Debentures and provided that payment of the final instalment has been made, each Debenture will be convertible into common shares of Hydro One Limited (“Common Shares”) at any time on or after the Final Instalment Date, but prior to the earlier of the date that the Corporation redeems the Debentures or the Maturity Date (as defined in this Prospectus). The conversion price will be \$21.40 per Common Share (the “Conversion Price”), being a conversion rate of 46.7290 Common Shares per \$1,000 principal amount of Debentures, subject to adjustment in certain events. **A holder of Debentures who does not exercise its conversion privilege concurrently with the payment of the final instalment in order to convert its Debentures to Common Shares on the Final Instalment Date will hold a Debenture that pays 0% interest and may be redeemed by the Corporation in whole or in part on any trading day following the Final Instalment Date at a price equal to its principal amount plus any unpaid interest which accrued prior to and including the Final Instalment Date. See “Details of the Offering”.**

Prior to the Final Instalment Date, the Debentures may not be redeemed by the Corporation, except that the Debentures will be redeemed by the Corporation at a price equal to their principal amount plus accrued and unpaid interest (without any Make-Whole Payment) following the earlier of: (i) notification to holders that the Approval Conditions will not be satisfied; (ii) termination of the Merger Agreement in accordance with its terms; and (iii) May 1, 2019, if the Final Instalment Notice has not been given on or before April 30, 2019. Upon any such redemption, the Corporation will pay for each Debenture: (i) \$333 plus accrued and unpaid interest to the holder of the Instalment Receipt; and (ii) \$667 to the Selling Debentureholder on behalf of the holder of the Instalment Receipt in satisfaction of the final instalment. Under the terms of the Instalment Receipt Agreement, Hydro One Limited has agreed that until such time as the Debentures have been redeemed in accordance with the foregoing or the Final Instalment Date has occurred, the Corporation will at all times hold short-term interest bearing U.S. dollar securities with investment grade counterparties, maintain readily available capacity under the Operating Credit Facility (as defined in this Prospectus) or the revolving credit facilities of its subsidiaries, or have cash on hand together with such available capacity, in an amount at least equal to the net proceeds of the first instalment paid on the closing of the Offering and the exercise of the Over-Allotment Option (as defined in this Prospectus), if applicable. See “Details of the Offering — Debentures — Redemption”. After the Final Instalment Date, any Debentures not converted to Common Shares may be redeemed at the option of the Corporation at a price equal to

their principal amount plus any unpaid interest which accrued prior to and including the Final Instalment Date. See “Details of the Offering – Debentures – Redemption”.

On September 30, 2027 (the “Maturity Date”), the Corporation will repay the principal amount of any Debentures not converted and remaining outstanding, in cash, provided that the Corporation may, at its option and without prior notice, satisfy the obligation to pay the principal amount of such Debentures on maturity by delivery of that number of freely tradable Common Shares obtained by dividing the aggregate principal amount of the Debentures then outstanding by 95% of the weighted average trading price of the Common Shares on the Toronto Stock Exchange (the “TSX”) for the 20 consecutive trading days ending five trading days preceding the Maturity Date (the “Market Price”).

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**Price: \$1,000 per Debenture to yield 4.00% per annum**  
**(each Debenture is convertible into Common Shares at a Conversion Price of \$21.40**  
**per Common Share)**

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	<b>Price to the Public</b>	<b>Underwriters’ Fee<sup>(1)</sup></b>	<b>Net Proceeds<sup>(2)</sup></b>
Per Debenture			
First Instalment .....	\$ 333.00	\$ 17.50	\$ 315.50
Final Instalment .....	\$ 667.00	\$ 17.50	\$ 649.50
Total Per Debenture .....	\$ 1,000.00	\$ 35.00	\$ 965.00
Total <sup>(3)</sup> .....	\$ 1,400,000,000	\$ 49,000,000	\$ 1,351,000,000

- (1) The Underwriters’ fee will be paid by the Corporation and is equal to 3.50% of the gross proceeds of the sale of the Debentures. One-half of the Underwriters’ fee is payable on the Closing Date and the remaining one-half is payable on the Final Instalment Date.
- (2) Net proceeds are calculated before deducting the expenses of the Offering, estimated at \$1,500,000, which will be paid by Hydro One Limited and the Selling Debentureholder.
- (3) The Selling Debentureholder has granted to the Underwriters (as defined in this Prospectus) an option (the “Over-Allotment Option”) to purchase additional Debentures represented by Instalment Receipts equal to up to 10% of the aggregate principal amount of Debentures represented by Instalment Receipts sold on the Closing Date, at a price of \$1,000 per Debenture payable on an instalment basis and on the same terms and conditions of the Offering to cover over-allotments, if any, and for market stabilization purposes. The Over-Allotment Option is exercisable in whole or in part at the Underwriters’ sole discretion and without obligation, on or prior to the 30<sup>th</sup> day following the closing of the Offering. If the Over-Allotment Option is exercised in full, the total “Price to the Public”, “Underwriters’ Fee” and “Net Proceeds” will be \$1,540,000,000, \$53,900,000 and \$1,486,100,000, respectively. This Prospectus qualifies the grant of the Over-Allotment Option and the sale of Debentures represented by Instalment Receipts pursuant to this Prospectus on the exercise of such option. A purchaser who acquires Debentures represented by Instalment Receipts forming part of the Underwriters’ over-allocation position acquires those securities under this Prospectus, regardless of whether the position is ultimately filled through the exercise of the Over-Allotment Option or secondary market purchases. Unless otherwise indicated, the disclosure in this Prospectus assumes that the Over-Allotment Option has not been exercised. See “Plan of Distribution”.

<b>Underwriters’ Position</b>	<b>Maximum Size or Number of Securities Held</b>	<b>Exercise Period</b>	<b>Exercise Price</b>
Over-Allotment Option	Option to purchase up to \$140,000,000 aggregate principal amount of Debentures (on an instalment basis)	At any time within 30 days following the closing of the Offering	\$1,000 per Debenture payable on an instalment basis of which \$333 is payable on the closing of the Over-Allotment Option and \$667 is payable on or before the Final Instalment Date

**There is currently no market through which the Debentures represented by Instalment Receipts may be sold and purchasers may not be able to resell securities purchased under this Prospectus. This may affect the pricing of the securities in the secondary market, the transparency and availability of trading prices, the liquidity of the securities and the extent of issuer regulation. See “Risk Factors”.**

This Prospectus qualifies for distribution the Debentures represented by the Instalment Receipts. Hydro One Limited has received conditional approval of the TSX to list the Instalment Receipts (representing the Debentures) and the Common Shares issuable on the conversion of the Debentures on the TSX. Listing will be subject to the Corporation fulfilling all of the requirements of the TSX. **The Corporation has no current intention to list the Debentures for trading on any exchange as it currently anticipates all Debentures will be converted to Common Shares on the Final Instalment Date.** The Corporation’s outstanding Common Shares are listed on the TSX under the symbol “H”, and, once listed, the Instalment Receipts will trade on the TSX under the symbol “H.IR”. On July 19, 2017, the last trading day prior to the announcement of the Merger and the Offering, the closing price of the Common Shares on the TSX was \$22.53.

The Debentures will be sold by the Selling Debentureholder on an instalment basis for a total of \$1,000 per Debenture as described in this Prospectus, which price and other terms of the Offering were determined by negotiation between the Corporation, the Selling Debentureholder and the Underwriters. **After a reasonable effort has been made to sell all of the Debentures represented by Instalment Receipts at the price specified above, the Underwriters may subsequently reduce the selling price to investors from time to time in order to sell any of the Debentures represented by Instalment Receipts remaining unsold. Any such reduction will not affect the proceeds received by the Selling Debentureholder. See “Plan of Distribution”.**

**An investment in the Debentures represented by Instalment Receipts, and the Common Shares issuable upon the conversion of Debentures, involves certain risks that should be considered by a prospective purchaser. See “Risk Factors – Risk Factors Relating to the Debentures”, “Risk Factors – Risk Factors Relating to the Instalment Receipts” and “Special Note Regarding Forward-Looking Statements”.**

Each of RBC Dominion Securities Inc., CIBC World Markets Inc., BMO Nesbitt Burns Inc., National Bank Financial Inc., Scotia Capital Inc., TD Securities Inc., Barclays Capital Canada Inc., Credit Suisse Securities (Canada), Inc., Canaccord Genuity Corp., Desjardins Securities Inc., Laurentian Bank Securities Inc., Raymond James Ltd., Industrial Alliance Securities Inc. and Wells Fargo Securities Canada, Ltd. (collectively, the “Underwriters”) are underwriters of the Offering. The Underwriters, as principals, conditionally offer the Debentures represented by Instalment Receipts, subject to prior sale, if, as and when issued by the Corporation and sold and delivered by the Selling Debentureholder to, and accepted by, the Underwriters in accordance with the terms and conditions contained in the Underwriting Agreement (as defined in this Prospectus) referred to under “Plan of Distribution” and subject to the approval of certain legal matters on behalf of the Corporation and the Selling Debentureholder by Osler, Hoskin & Harcourt LLP and on behalf of the Underwriters by Blake, Cassels & Graydon LLP. Subject to applicable laws, the Underwriters may, in connection with the Offering, effect transactions which stabilize or maintain the market price of the Instalment Receipts representing the Debentures or the Common Shares at levels above those which may prevail on the open market. Such transactions, if commenced, may be discontinued at any time. See “Plan of Distribution”.

RBC Dominion Securities Inc., CIBC World Market Inc., BMO Nesbitt Burns Inc., National Bank Financial Inc., Scotia Capital Inc. and TD Securities Inc. are subsidiaries or affiliates of lenders that have made a \$250 million operating credit facility (the “Operating Credit Facility”) available to Hydro One Limited. In addition, RBC Dominion Securities Inc., CIBC World Markets Inc., BMO Nesbitt Burns Inc., National Bank Financial Inc., Scotia Capital Inc., TD Securities Inc., Desjardins Securities Inc. and Laurentian Bank Securities Inc. are subsidiaries or affiliates of lenders that have made a \$2.3 billion unsecured revolving credit facility available to Hydro One Inc., a wholly-owned subsidiary of Hydro One Limited. **Consequently, the Corporation and/or the Selling Debentureholder may be considered a “connected issuer” of these Underwriters within the meaning of applicable securities legislation. See “Relationship between Hydro One Limited, the Selling Debentureholder and Certain Underwriters”.**

Subscriptions for the Debentures represented by Instalment Receipts will be received subject to rejection or allotment in whole or in part and the right is reserved to close the subscription books at any time without notice. It is expected that the Closing Date will take place on or about August 9, 2017, or such other date as may be agreed upon by the Corporation, the Selling Debentureholder and the Underwriters, but not later than August 23, 2017. The

Debentures represented by Instalment Receipts offered hereby are to be taken up by the Underwriters, if at all, on or before a date not later than 42 days after the date of the receipt for the final short form prospectus relating to the Offering.

A book-entry only certificate representing the Instalment Receipts (representing the Debentures) distributed hereunder will be issued in registered form only to CDS Clearing and Depository Services Inc. (“CDS”) or its nominee and will be deposited with CDS on the Closing Date. Subject to compliance with the provisions of the Instalment Receipt Agreement, as soon as practicable on or after the Final Instalment Date provided that payment of the final instalment has been made, the global certificate representing the Instalment Receipts will be cancelled and the global certificate representing the Debentures distributed hereunder, pledged to the Selling Debentureholder and held by Computershare Trust Company of Canada, as security agent, will be discharged and released and one or more new global certificates representing the Debentures will be delivered to CDS and registered in the name of CDS or its nominee (as adjusted for Debentures that have been converted into Common Shares on the Final Instalment Date). The Corporation understands that a purchaser of Debentures represented by Instalment Receipts will receive only a customer confirmation from the registered dealer (who is a participant in CDS) from or through whom the Debentures represented by Instalment Receipts are purchased. Except as otherwise stated herein, neither the holders of Instalment Receipts representing Debentures nor the holders of Debentures on or following the Final Instalment Date will be entitled to receive physical certificates representing their ownership thereof, as applicable. See “Details of the Offering”.

In this Prospectus, unless otherwise specified or the context otherwise requires, all dollar amounts are expressed in Canadian dollars.

Kathryn Jackson, a director of Hydro One Limited, resides outside of Canada. Ms. Jackson has appointed Hydro One Limited as her agent for service of process. Purchasers are advised that it may not be possible for investors to enforce judgments obtained in Canada against any person who resides outside of Canada, even if the party has appointed an agent for service of process. See “Enforceability of Certain Civil Liabilities”.

The registered and head office of the Corporation is located at 483 Bay Street, South Tower, 8<sup>th</sup> Floor, Toronto, Ontario, M5G 2P5.

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## **SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

*Please refer to the “Glossary of Terms” beginning on page 88 of this short form prospectus (the “Prospectus”) for a list of defined terms used herein.*

This Prospectus, including the documents incorporated herein by reference, contains forward-looking information within the meaning of applicable securities laws which reflects management’s current expectations regarding: (i) the future growth, results of operations, performance, business prospects and opportunities of Hydro One; (ii) the timing and completion of the contemplated Merger; (iii) the benefits and the impact of the Merger and the Offering on the financial position of the Corporation; and (iv) the future performance, business prospects and opportunities of Avista Corp. These expectations may not be appropriate for other purposes. All forward-looking information is given pursuant to the “safe harbour” provisions of applicable Canadian securities legislation. The words “anticipates”, “believes”, “budget”, “could”, “estimates”, “expects”, “forecasts”, “intends”, “may”, “might”, “plans”, “projects”, “schedule”, “should”, “will”, “would” and similar expressions are often intended to identify forward-looking information, although not all forward-looking information contains these identifying words. The forward-looking information reflects management’s current beliefs, expectations and intentions and is based on information currently available to the Corporation’s management.

The forward-looking information in this Prospectus, including the documents incorporated herein by reference, includes, but is not limited to, statements regarding: Hydro One’s business; Hydro One’s transmission and distribution rate applications, and resulting rates and impacts; expected impacts of changes to the electricity industry; Hydro One’s maturing debt and standby credit facilities; expectations regarding the Corporation’s financing activities; credit ratings; ongoing and planned projects and/or initiatives, including expected results and timing; expected future capital expenditures, the nature and timing of these expenditures, including the Hydro One’s plans for sustaining and development capital expenditures for its distribution and transmission systems; expectations regarding allowed ROE; the ability of Hydro One to recover expenditures in future rates; the Ontario Energy Board; future pension contributions, the pension plan and valuations; expectations regarding the ability to negotiate collective agreements consistent with rate orders and to maintain stable outsourcing arrangements; expectations related to work force demographics; expectations regarding taxes; occupational rights; expectations related to load growth; the regional planning process; expectation related to Hydro One’s CDM requirements and targets; Hydro One’s customer focus and related initiatives; Hydro One’s relationships with First Nations and Métis communities; expectations related to the effect of interest rates; environmental matters and Hydro One’s expected future environmental expenditures; Hydro One’s reputation; cyber and data security; Hydro One’s relationship with the Province; future sales of shares of Hydro One Limited; acquisitions, including the Merger and the Corporation’s acquisition of Orillia Power; expectations regarding the governance agreement and other agreements with the Province; the intentions of the Province with respect to future sales of Common Shares; and legal proceedings in which Hydro One is currently involved.

The forward-looking information contained herein pertaining to the Merger and the financing thereof and the future performance, business prospects and opportunities of Avista Corp. includes, but is not limited to, statements regarding: strength of credit metrics; the expectation that the Merger will increase Hydro One’s consolidated rate base and total customers; the expectation that the Merger will be accretive to Hydro One Limited’s earnings per Common Share; the impact of the Merger on the Corporation’s total assets, net income, growth, access to equity and debt capital markets, credit profile, economies of scale and ability to deploy capital; opportunities for costs savings and efficiency gains; the stability of the Corporation’s net income and overall quality of cash flows; the expectation that Hydro One will benefit from diversification of regulatory jurisdictions; the expectations regarding rate base growth; expectations regarding the economic outlook in Washington and in the U.S. generally; the complementary management teams and corporate cultures of Hydro One and Avista Corp.; Avista Corp’s labour relations; expectations regarding the nature, timing and costs of capital spending of Hydro One and Avista Corp.; the locations of the combined operations after completion of the Merger; the expectations with respect to the impact of costs and compliance as a result of new and existing laws, regulations and guidelines, including, but not limited to, environmental matters; the impact of legal proceedings; the financing of the Merger, including, but not limited to, the use of the net proceeds of the Offering, the impact of the Offering, the timing and closing of the Merger, the conversion of the Debentures into Common Shares, the issuance of Common Shares and the impact of changes to Hydro One’s long-term debt on the capital structure of Hydro One; the listing of securities on and approval of the TSX; the timing of payment of each of the first instalment and the final instalment payments; the plan of distribution pursuant to the Underwriting Agreement; the risk factors relating to the Merger, the post-Merger combined business

and operations of Hydro One and Avista Corp., the Instalment Receipts, the Debentures and the Common Shares; the Corporation's intention to declare and pay dividends and targeted dividend payout ratio; and market stabilization activities by the Underwriters.

The forecasts and projections that make up the forward-looking information included in this Prospectus are based on assumptions which include, but are not limited to: the timing and completion of the Merger; the receipt of Avista Shareholder Approval, the required regulatory approvals relating to the Merger and other conditions precedent to closing the Merger; the payment to the Selling Debentureholder of the aggregate amount of the final instalment; the conversion of all of the Debentures distributed pursuant to this Prospectus into Common Shares on the Final Instalment Date; the realization by Hydro One of the anticipated benefits of the Merger, including the expectation that the Merger will be accretive to Hydro One Limited's earnings per Common Share; the impact of the Merger on Hydro One's total assets, net income, growth, access to equity and debt capital markets, credit profile, economies of scale and ability to deploy capital; that Hydro One and Avista Corp. have complementary management teams and corporate cultures and that this will support a smooth combination of the two companies; the accuracy of the *pro forma* combined financial information, which does not purport to be indicative of the financial information that will result from the operations of Hydro One on a consolidated basis following the closing of the Merger and the completion of the Offering; relatively stable currency exchange rates between Canadian and U.S. dollars; the ability of Hydro One to successfully integrate the business and operations of Avista Corp. into the Hydro One group of companies; opportunities for cost savings and efficiency gains will arise; the ability of Hydro One to retain key personnel of Avista Corp., and the value of such key employees; the ability of Hydro One to satisfy its liabilities and meet its debt service obligations following completion of the Merger; the aggregate amount of the Merger-Related Expenses; the ability to maintain dividend payout ratios; the accuracy and completeness of Avista Corp.'s public and other disclosure reflected in this Prospectus; the absence of undisclosed liabilities of Avista Corp.; no unforeseen changes in the legislative and operating framework for Ontario's electricity market and the electricity and natural gas markets in which Avista Corp. operates; favourable decisions from the Ontario Energy Board and other regulatory bodies concerning outstanding and future rate and other applications; no unexpected delays in obtaining the required approvals; no unforeseen changes in rate orders or rate setting methodologies for any of Hydro One's or Avista Corp.'s rate-regulated businesses; no unfavourable changes in environmental regulation; continued use of U.S. GAAP; a stable regulatory environment; and no significant event occurring outside the ordinary course of business.

The forward-looking information is subject to risks, uncertainties and other factors that could cause actual results to differ materially from historical results or results anticipated by the forward-looking information. Factors which could cause results or events to differ from current expectations include, but are not limited to: inability to complete the Offering; inability to complete the Merger; an increase in the cash purchase price of the Merger; uncertainty regarding the length of time required to complete the Merger; failure to obtain Avista Shareholder Approval; the required shareholder, governmental or regulatory approvals may delay the proposed Merger or impose conditions; the effect and timing of changes in laws or in governmental regulations; disruption from the proposed Merger making it more difficult to maintain relationships with customers, employees, regulators or suppliers; the diversion of management time and attention on the Merger; the financing necessary to fund the Merger may not be obtained or may be more difficult and costly to obtain than anticipated; the ability to maintain an investment grade credit rating; the anticipated benefits of the Merger may not materialize or may not occur within the time periods anticipated by the Corporation; impact of significant demands placed on the Corporation as a result of the Merger; lack of control by the Corporation of Avista Corp. prior to the closing of the Merger; impact of the Merger-Related Expenses or increases in the Merger-Related Expenses; potential that the Corporation Termination Fee may need to be paid in certain circumstances; accuracy and completeness of Avista Corp.'s publicly disclosed information; increased indebtedness of Hydro One after the closing of the Merger; historical and *pro forma* combined financial information may not be representative of future performance; potential undisclosed liabilities of Avista Corp.; inability to retain key personnel of Avista Corp. following the Merger; indebtedness of Avista Corp.; risks relating to the Instalment Receipts, the Debentures and the Common Shares; risks associated with the Province's share ownership of Hydro One Limited and other relationships with the Province, including potential conflicts of interest that may arise between Hydro One, the Province and related parties; regulatory risks and risks relating to Hydro One's revenues, including risks relating to rate orders, actual performance against forecasts and capital expenditures; the risk that Hydro One may be unable to comply with regulatory and legislative requirements or that Hydro One may incur additional costs for compliance that are not recoverable through rates; the risk of exposure of Hydro One's facilities to the effects of severe weather conditions, natural disasters or other unexpected occurrences for which the Hydro One is uninsured or for which Hydro One could be subject to claims for damage; public opposition

to and delays or denials of the requisite approvals and accommodations for Hydro One's planned projects; the risk that Hydro One may incur significant costs associated with transferring assets located on reserves; the risks associated with information system security and with maintaining a complex information technology system infrastructure; the risks related to Hydro One's work force demographic and its potential inability to attract and retain qualified personnel; the risk of labour disputes and inability to negotiate appropriate collective agreements on acceptable terms consistent with Hydro One's rate decisions; the risk that Hydro One is not able to arrange sufficient cost-effective financing to repay maturing debt and to fund capital expenditures; risks associated with fluctuations in interest rates and failure to manage exposure to credit risk; the risk that Hydro One may not be able to execute plans for capital projects necessary to maintain the performance of Hydro One's assets or to carry out projects in a timely manner; the risk of non-compliance with environmental regulations or failure to mitigate significant health and safety risks and inability to recover environmental expenditures in rate applications; the risk that assumptions that form the basis of Hydro One's recorded environmental liabilities and related regulatory assets may change; the risk of not being able to recover Hydro One's pension expenditures in future rates and uncertainty regarding the future regulatory treatment of pension, other post-employment benefits and post-retirement benefits costs; the potential that Hydro One may incur significant expenses to replace functions currently outsourced if agreements are terminated or expire before a new service provider is selected; the risks associated with economic uncertainty and financial market volatility; the inability to prepare financial statements using U.S. GAAP; and the impact of the ownership by the Province of lands underlying Hydro One's transmission system.

All forward-looking information in this Prospectus and in the documents incorporated herein by reference is qualified in its entirety by the above cautionary statements and, except as required by law, the Corporation undertakes no obligation to revise or update any forward-looking information as a result of new information, future events or otherwise.

## DOCUMENTS INCORPORATED BY REFERENCE

The disclosure documents of the Corporation listed below and filed with the appropriate securities commissions or similar regulatory authorities in each of the provinces and territories of Canada are specifically incorporated by reference into and form an integral part of this Prospectus:

- (i) Hydro One Limited's annual information form dated March 27, 2017 for the year ended December 31, 2016 (the "**AIF**");
- (ii) Hydro One Limited's audited consolidated financial statements as at and for the years ended December 31, 2016 and December 31, 2015, together with the notes thereto and the independent auditors' report thereon dated February 9, 2017 (the "**2016 Annual Financial Statements**");
- (iii) Hydro One Limited's management's discussion and analysis in respect of the 2016 Annual Financial Statements (the "**Annual MD&A**");
- (iv) Hydro One Limited's unaudited condensed interim consolidated financial statements for the three months ended March 31, 2017 and 2016, together with the notes thereto (the "**Interim Financial Statements**");
- (v) Hydro One Limited's management's discussion and Analysis in respect of the Interim Financial Statements (the "**Interim MD&A**");
- (vi) Hydro One Limited's management information circular dated March 23, 2017 prepared in connection with Hydro One Limited's annual meeting of shareholders held on May 4, 2017;
- (vii) the template version of the term sheet dated July 19, 2017 and the template version of the investor presentation dated July 19, 2017 (a copy of which is attached as Appendix A to this Prospectus), each filed on SEDAR in connection with the Offering (collectively, the "**Marketing Materials**"); and
- (viii) the material change report dated July 20, 2017 announcing the Merger and the Offering.

Any documents of the type referred to above (other than confidential material change reports), any document filed by Hydro One Limited that specifically states that such document is incorporated by reference into this Prospectus and any other documents required under applicable securities laws to be incorporated by reference into this Prospectus, if filed by Hydro One Limited with the provincial securities commissions or similar authorities

in Canada after the date of this Prospectus and prior to the termination of the Offering, shall be deemed to be incorporated by reference into this Prospectus.

**Any statement contained in a document incorporated or deemed to be incorporated by reference in this Prospectus shall be deemed to be modified or superseded for purposes of this Prospectus to the extent that a statement contained herein, or in any other subsequently filed document which also is incorporated or is deemed to be incorporated herein by reference, modifies or supersedes such statement. The modifying or superseding statement need not state that it has modified or superseded a prior statement or include any other information set forth in the document that it modifies or supersedes. The making of a modifying or superseding statement will not be deemed to be an admission for any purpose that the modified or superseded statement, when made, constituted a misrepresentation, an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made. Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Prospectus.**

Copies of the documents incorporated herein by reference may be obtained on request without charge from the Corporate Secretary of the Corporation at 483 Bay Street, South Tower, 8<sup>th</sup> Floor, Toronto, Ontario, M5G 2P5, telephone (416) 345-6044, and are also available electronically at [www.sedar.com](http://www.sedar.com). The information contained on, or accessible through, any of these websites is not incorporated by reference into this Prospectus and is not, and should not be considered to be, a part of this Prospectus, unless it is explicitly so incorporated.

## MARKETING MATERIALS

The Marketing Materials (including the Investor Presentation) are not part of this Prospectus to the extent that the contents of the Marketing Materials have been modified or superseded by a statement contained elsewhere in this Prospectus. Any template version of “marketing materials” (as defined in National Instrument 41-101 – *General Prospectus Requirements*) filed after the date of this Prospectus and before the termination of the distribution under the Offering (including any amendments to, or an amended version of, the Marketing Materials) are deemed to be incorporated into this Prospectus. The template version of the investor presentation dated July 19, 2017, with the cautionary legend required by Section 7.6(5) of National Instrument 44-101 – Short Form Prospectus Distributions removed (the “**Investor Presentation**”), is attached as Appendix A to this Prospectus.

## ELIGIBILITY FOR INVESTMENT

In the opinion of Osler, Hoskin & Harcourt LLP, counsel to Hydro One Limited and the Selling Debentureholder, and Blake, Cassels & Graydon LLP, counsel to the Underwriters, provided that, on the date hereof, Hydro One Limited is a “public corporation” for the purposes of the Tax Act or the Common Shares are listed on a “designated stock exchange” for the purposes of the Tax Act (which currently includes the TSX), the Debentures represented by Instalment Receipts and the Common Shares issuable on the conversion or maturity of the Debentures, if issued on the date hereof, would be qualified investments under the Tax Act as of the date hereof for a trust governed by an RRSP, a RRIF, an RESP, a DPSP, an RDSP or a TFSA (collectively, “**Exempt Plans**”), except, in the case of the Debentures, a DPSP to which Hydro One Limited, or an employer that does not deal at arm’s length with Hydro One Limited, has made a contribution. Holders or annuitants of Exempt Plans should have regard to any restrictions (including restrictions on pledging plan assets) that may be included in the provisions of their particular Exempt Plan.

Notwithstanding the foregoing, if the Debentures or the Common Shares are a “prohibited investment” (as defined in the Tax Act) for a trust governed by a TFSA, RRSP or RRIF, the holder or annuitant thereof, as the case may be, will be subject to a penalty tax as set out in the Tax Act. The Debentures and Common Shares will not be a prohibited investment for a TFSA, RRSP or RRIF provided the holder or annuitant of such Exempt Plan, as the case may be, (i) deals at arm’s length with Hydro One Limited, for purposes of the Tax Act and (ii) does not have a “significant interest” (as defined in the prohibited investment rules in the Tax Act) in Hydro One Limited. In addition, Common Shares will not be a “prohibited investment” if the Common Shares are “excluded property” (as defined in the Tax Act for this purpose) for trusts governed by a TFSA, RRSP and RRIF. Based on certain Proposed Amendments (as defined herein) announced on March 22, 2017, it is proposed that the prohibited investment rules

described above (including the rules relating to “excluded property”) will be extended to cover trusts governed by RDSPs and RESPs.

A holder, annuitant or subscriber, as the case may be, should consult her own tax advisor with respect to whether the Instalment Receipts, Debentures or Common Shares would be a prohibited investment and whether the Instalment Receipts, Debentures or Common Shares otherwise comply with any restrictions that may apply to a particular Exempt Plan (including restrictions on the pledging of plan assets).

## **PRESENTATION OF FINANCIAL INFORMATION**

The financial statements of the Corporation included in this Prospectus are reported in Canadian dollars and have been prepared in accordance with U.S. GAAP. All financial information of Avista Corp. included in this Prospectus (other than *pro forma* financial statements) as at or for the periods ended December 31, 2016 and 2015 is reported in U.S. dollars and has been derived from audited historical financial statements of Avista Corporation that were prepared in accordance with U.S. GAAP. All financial information of Avista Corp. included in this Prospectus (other than *pro forma* financial statements) as at or for the periods ended March 31, 2017 and 2016 is reported in U.S. dollars and has been derived from unaudited historical financial statements of Avista Corporation that were prepared in accordance with U.S. GAAP. The assets and liabilities of Avista Corp. shown in the unaudited *pro forma* consolidated balance sheet of the Corporation as at March 31, 2017 are reported in Canadian dollars and reflect the U.S. dollar-to-Canadian dollar period-end closing exchange rate. The revenues and expenses of Avista Corp. shown in the unaudited *pro forma* consolidated statements of operations of the Corporation for the three month period ended March 31, 2017 and for the year ended December 31, 2016 are reported in Canadian dollars and reflect the average U.S. dollar-to-Canadian dollar exchange rates for such periods. Financial information in this Prospectus that has been derived from the unaudited *pro forma* consolidated financial statements has been translated to Canadian dollars on the same basis. Certain tables in this Prospectus may not add due to rounding.

Certain financial measures of Hydro One and Avista Corp. are used in this Prospectus that do not have standardized meanings under U.S. GAAP and may not be comparable to similar measures presented by other entities. Such non-U.S. GAAP measures are calculated by adjusting certain U.S. GAAP measures for specific items that Hydro One Limited and Avista Corporation believe are significant, but not reflective of the underlying operations of the Corporation.

### **Funds from Operations and Adjusted FFO**

Funds from Operations (“**FFO**”) is defined as net cash from operating activities, adjusted for (i) changes in non-cash balances related to operations, (ii) dividends paid on preferred shares, and (iii) distributions to non-controlling interest.

Adjusted FFO is defined as FFO, adjusted for the impact of the deferred income tax asset that resulted as a consequence of leaving the payment in lieu of corporate income taxes (“**PILs**”) regime (the “**PILs Regime**”) and entering the regular Canadian federal and Ontario income tax regime (the “**Federal Tax Regime**”).

Management believes that FFO and Adjusted FFO are helpful as supplemental measures of the Corporation’s operating cash flows as they exclude timing-related fluctuations in non-cash operating working capital and cash flows not attributable to common shareholders, and, in the case of Adjusted FFO, the impact of the IPO-related deferred income tax asset. As such, these measures provide consistent measures of the cash generating performance of the Corporation’s assets.

### **Adjusted Net Cash from Operating Activities**

Adjusted net cash from operating activities is defined as net cash from operating activities, adjusted for the impact of the deferred income tax asset that resulted as a consequence of leaving the PILs Regime and entering the Federal Tax Regime. Management believes that this measure is helpful as a supplemental measure of the Corporation’s net cash from operating activities as it excludes the impact of the IPO-related deferred income tax asset. As such, adjusted net cash from operating activities provides a consistent measure of the Corporation’s cash from operating activities compared to prior periods.

## Adjusted Earnings Per Share

The basic and diluted Adjusted EPS has been calculated by management on a supplementary basis which assumes that the total number of Common Shares outstanding was 595,000,000 in each of the periods presented. Adjusted EPS has been used internally by management subsequent to the IPO of the Corporation's Common Shares in November 2015 to assess the Corporation's performance and is considered useful because it eliminates the impact of a different and non-comparable number of shares outstanding and held by the Province prior to the IPO. EPS is considered an important measure and management believes that presenting it consistently for all periods based on the number of outstanding shares on, and subsequent to, the IPO provided users with a comparative basis to evaluate the operations of the Corporation.

Additional information regarding non-U.S. GAAP measures used by Hydro One Limited can be found in the Interim MD&A and the Annual MD&A.

## Electric Gross Margin and Natural Gas Gross Margin

The description in the Prospectus relating to Avista Utilities uses electric gross margin and natural gas gross margin, both of which are non-U.S. GAAP financial measures. The presentation of electric gross margin and natural gas gross margin is intended to supplement an understanding of operating performance. Avista Utilities uses these measures to determine whether the appropriate amount of revenue is being collected from customers to allow for the recovery of energy resource costs and operating costs, as well as to analyze how changes in loads (due to weather, economic or other conditions), rates, supply costs and other factors impact Avista Utilities' results of operations. In addition, Avista Utilities presents electric and natural gas gross margin separately for Avista Utilities since each business has different cost sources, cost recovery mechanisms and jurisdictions, such that separate analysis is beneficial. These measures are not intended to replace income from operations as determined in accordance with U.S. GAAP as an indicator of operating performance.

## CAUTION REGARDING UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

This Prospectus contains the unaudited *pro forma* consolidated balance sheet of the Corporation as at March 31, 2017 and consolidated statements of earnings of the Corporation for the three month period ended March 31, 2017 and for the year ended December 31, 2016, giving effect to: (i) the Offering, assuming no exercise of the Over-Allotment Option; (ii) the issuance of Common Shares upon the conversion of the Debentures (assuming no Make-Whole Payment); (iii) the proposed issuance by Hydro One Limited of U.S. dollar denominated debt to finance the Merger; and (iv) the completion of the Merger. Such unaudited *pro forma* consolidated financial statements have been prepared using certain of the Corporation's and Avista Corporation's respective financial statements as more particularly described in the notes to such unaudited *pro forma* consolidated financial statements. In preparing such unaudited *pro forma* consolidated financial statements, Hydro One Limited has had limited access to the non-public books and records of Avista Corp. and makes no representation or warranty as to the accuracy or completeness of such information provided by Avista Corp., including the financial statements of Avista Corporation that were used to prepare the unaudited *pro forma* consolidated financial statements. Such unaudited *pro forma* consolidated financial statements are not intended to be indicative of the results that would actually have occurred, or the results expected in future periods, had the events reflected therein occurred on the dates indicated. Actual amounts recorded upon the finalization of the purchase price allocation under the Merger may differ from such unaudited *pro forma* consolidated financial statements. At the date of preparation of the *pro forma* financial statements, the fair values of Avista Corp.'s identifiable assets and liabilities to be assumed and the full impact of applying acquisition accounting have not been fully determined. After reflecting the *pro forma* adjustments made in the *pro forma* financial statements, the excess of the purchase price consideration of the adjusted book values of Avista Corp.'s net assets has been presented as goodwill offset by an adjustment to eliminate Avista Corp.'s historical goodwill.

Since the unaudited *pro forma* consolidated financial statements have been developed to retroactively show the effect of a transaction that has or is expected to occur at a later date (even though this was accomplished by following generally accepted practice using assumptions that are considered to be reasonable), there are limitations inherent in the very nature of *pro forma* data. The data contained in the unaudited *pro forma* consolidated financial

statements represents only a simulation of the potential impact of the Merger. Undue reliance should not be placed on such unaudited *pro forma* consolidated financial statements. See “Special Note Regarding Forward-Looking Statements” and “Risk Factors”.

## CURRENCY

In this Prospectus, unless otherwise specified or the context otherwise requires, all dollar amounts are expressed in Canadian dollars. References to “dollars”, “\$” or “Cdn\$” are to lawful currency of Canada. References to “U.S. dollars” or “US\$” are to lawful currency of the United States of America.

The following table sets forth, for each of the periods indicated, the noon exchange rate, the average noon exchange rate and the high and low noon exchange rates of one U.S. dollar in exchange for Canadian dollars as reported by the Bank of Canada.

	<u>Year ended</u> <u>December 31,</u>			<u>Three months ended</u> <u>March 31,</u>	
	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2017</u>	<u>2016</u>
High .....	1.4589	1.3990	1.1643	1.3505	1.4589
Low .....	1.2544	1.1728	1.0614	1.3004	1.2962
Average .....	1.3248	1.2787	1.1045	1.3238	1.3732
Period End .....	1.3427	1.3840	1.1601	1.3322	1.2971

As of July 31, 2017, the daily average rate of exchange as reported by the Bank of Canada was US\$1.00 = Cdn\$1.2485.

## DEFINED TERMS

For an explanation of certain terms and abbreviations used in, and conversions applicable to, this Prospectus, reference is made to the “Glossary of Terms” beginning on page 88 of this Prospectus.

Unless otherwise indicated by the context, references to “Hydro One” refers to Hydro One Limited and its subsidiaries taken together as a whole. References to “Hydro One Inc.” refer only to Hydro One Inc. and references to “Hydro One Limited” or the “Corporation” refer only to Hydro One Limited.

Unless otherwise indicated by the context, “Avista Corp.” means Avista Corporation and its subsidiaries. References to individual subsidiaries of Avista Corp. refer to that subsidiary company and its respective subsidiaries and references to “Avista Corporation” refer only to Avista Corporation.

## THIRD PARTY SOURCES AND INDUSTRY DATA

This Prospectus contains information from publicly available third party sources as well as industry data prepared by the Corporation’s management on the basis of its knowledge of the electricity industry in which Hydro One operates (including management’s estimates and assumptions relating to the industry based on that knowledge). Management’s knowledge of the electricity industry has been developed through its experience and participation in the industry. Management believes that its industry data is accurate and that its estimates and assumptions are reasonable, but there can be no assurance as to the accuracy or completeness of this data. Third-party sources generally state that the information contained therein has been obtained from sources believed to be reliable, but there can be no assurance as to the accuracy or completeness of included information. Although management believes it to be reliable, none of Hydro One Limited, Hydro One Inc., the Selling Debentureholder or the Underwriters have independently verified any of the data from third-party sources referred to in this Prospectus or analyzed or verified the underlying studies or surveys relied upon or referred to by such sources, or ascertained the underlying economic assumptions relied upon or referred to by such sources.

## PROSPECTUS SUMMARY

*The following information is a summary only and is to be read in conjunction with, and is qualified in its entirety by, the more detailed information and financial data and statements appearing elsewhere in this Prospectus and in the documents incorporated herein by reference.*

### HYDRO ONE LIMITED

Hydro One is the largest electricity transmission and distribution company in Ontario. Through its wholly-owned subsidiary, Hydro One Inc., Hydro One owns and operates substantially all of Ontario's electricity transmission network with over 30,000 circuit km of high-voltage transmission lines, and an approximately 123,000 circuit km low-voltage distribution network.

Hydro One has three business segments: (i) transmission; (ii) distribution; and (iii) other business.

Hydro One's transmission business consists of owning, operating and maintaining its transmission system, which accounts for approximately 98% of Ontario's transmission capacity based on the revenues approved by the Ontario Energy Board. This includes Hydro One's 66% interest in B2M Limited Partnership, a limited partnership between Hydro One and the Saugeen Ojibway Nation in respect of the Bruce-to-Milton transmission line. Hydro One's transmission business is a rate-regulated business that earns revenues mainly from charging transmission rates that must be approved by the Ontario Energy Board. Hydro One's transmission business accounted for approximately 51% of the Corporation's total assets as at December 31, 2016, and approximately 51% of its total revenues, net of purchased power, in 2016. All of Hydro One's transmission business is carried out by its wholly-owned subsidiary Hydro One Inc., through its wholly-owned subsidiary Hydro One Networks Inc. and through other wholly-owned subsidiaries of Hydro One Inc. that own and control Hydro One Sault Ste. Marie LP, as well as the portion of Hydro One's transmission business held through B2M Limited Partnership, which Hydro One controls.

Hydro One's distribution business consists of owning, operating and maintaining its distribution system, which Hydro One, through Hydro One Inc., owns primarily through its wholly-owned subsidiary, Hydro One Networks Inc., the largest local distribution company in Ontario. Hydro One's distribution system is also the largest in Ontario, and principally serves rural communities. Hydro One's distribution business is a rate-regulated business that earns revenues mainly by charging distribution rates that are subject to approval by the Ontario Energy Board. Hydro One's distribution business accounted for approximately 37% of its total assets as at December 31, 2016 and approximately 47% of its total revenues, net of purchased power, in 2016.

Hydro One's other business segment consists principally of Hydro One's telecommunications business, as well as certain corporate activities. The telecommunications business provides telecommunications support for Hydro One's transmission and distribution businesses. The telecommunications business also offers communications and IT solutions to organizations with broadband network requirements. Hydro One's other business segment is not rate-regulated. The other business segment, which in addition to the telecommunications business also includes a deferred tax asset, accounted for approximately 12% of Hydro One's total assets as at December 31, 2016 and approximately 2% of its total revenues, net of purchased power, in 2016.

## THE MERGER

### Merger Overview

On July 19, 2017, Hydro One Limited, US Parent and Merger Sub entered into the Merger Agreement with Avista Corporation which provides for, among other things, the direct or indirect acquisition by US Parent of Avista Corporation. The aggregate purchase price for the Merger is approximately US\$5.3 billion, comprised of an equity purchase price of US\$3.4 billion and the assumption of approximately US\$1.9 billion of debt. The Merger is subject to receipt of Avista Shareholder Approval and certain regulatory and governmental approvals, including the expiration or termination of any applicable waiting period under the HSR Act, clearance of the Merger by CFIUS, the approval by each of IPUC, MPSC, OPUC, RCA, WUTC, FERC and the FCC, and the satisfaction of other customary closing conditions. The closing of the Merger is currently expected to occur in the second half of 2018.



Based on *pro forma* financial information as at March 31, 2017, following the Merger, Hydro One's total assets will increase from approximately \$25.4 billion to approximately \$34.9 billion.

Following completion of the Merger, Avista Corporation will maintain its existing corporate headquarters in Spokane and will continue to operate as a standalone utility in Washington, Oregon, Idaho, Montana and Alaska. Its management team will remain in place and it will operate with a board of directors that includes directors representing the interests of the Pacific Northwest and the communities it serves.

### **Avista Corp. Overview**

Avista Corporation, incorporated in the territory of Washington in 1889, is primarily an electric and natural gas utility with certain other business ventures. As of December 31, 2016, Avista Corp. employed 1,742 people in its Pacific Northwest utility operations (Avista Utilities) and 240 people in its subsidiary businesses (including in its Juneau, Alaska utility operations). Avista Corporation's corporate headquarters are in Spokane, Washington, the second-largest city in Washington. Spokane serves as the business, transportation, medical, industrial and cultural hub of the Inland Northwest region (eastern Washington and northern Idaho). Regional services include government and higher education, medical services, retail trade and finance. Through its subsidiary AEL&P, Avista Corporation also provides electric utility services in Juneau, Alaska. Avista Corporation is an operating public utility with its common stock listed on the NYSE under the ticker symbol "AVA".

As of March 31, 2017, Avista Corporation had two reportable business segments as follows:

- **Avista Utilities** – an operating division of Avista Corporation (not a subsidiary) that comprises its regulated utility operations in the Pacific Northwest. Avista Utilities generates, transmits and distributes electricity and distributes natural gas, serving electric and natural gas customers in eastern Washington and northern Idaho and natural gas customers in parts of Oregon. It also supplies electricity to a small number of customers in Montana, most of whom are its employees who operate its Noxon Rapids generating facility. Avista Utilities also engages in wholesale purchases and sales of electricity and natural gas as an integral part of energy resource management and its load-serving obligation. As of March 31, 2017, Avista Utilities supplied retail electric service to approximately 379,000 customers and retail natural gas service to approximately 342,000 customers across its service territory. Avista Utilities' service territory covers 30,000 square miles with a population of 1.6 million.
- **AEL&P** - a utility providing electric services in Juneau, Alaska that is a wholly-owned subsidiary and the primary operating subsidiary of AERC. Avista Corporation acquired AERC on July 1, 2014, and as of that date, AERC became a wholly-owned subsidiary of Avista Corporation. As of March 31, 2017, AEL&P served approximately 17,000 customers. Its primary customers include city, state and federal governmental entities located in Juneau, as well as a mine located in the Juneau area. Most of AEL&P's customers are served on a firm basis while certain of its customers, including its largest customer, are served on an interruptible sales basis. AEL&P maintains separate rate tariffs for each of its customer classes, as well as seasonal rates.

Avista Corporation has other businesses, including sheet metal fabrication, venture fund investments, real estate investments, a company that explores markets that could be served with LNG, as well as certain other investments of Avista Capital, which is a direct, wholly owned subsidiary of Avista Corporation. These activities do not represent a reportable business segment and are conducted by various direct and indirect subsidiaries of Avista Corporation, including AM&D, doing business as METALfx.

### **Merger Highlights**

#### ***Scale Reinforces Competitive Positioning and Improved Financial Flexibility***

As a result of the Merger, Hydro One's enterprise value will increase by over 25% (on a *pro forma* basis), making the combined entity one of North America's largest regulated utilities and a leader in regulated transmission as well as electricity and natural gas local distribution businesses. Post-Merger, on a *pro forma* basis as at March 31, 2017, Hydro One Limited's total assets would increase from approximately \$25.4 billion to approximately \$34.9 billion and Hydro One Limited's net income for the twelve months ended December 31, 2016 would increase from approximately \$746 million to approximately \$836 million. Management believes that the Merger will enhance

Hydro One's competitive positioning and provide Hydro One with opportunities for cost savings and non-headcount efficiency gains through enhanced innovation, shared IT systems and increased supply chain purchasing power.

***Diversification of Business Segments into Growing Natural Gas Local Distribution Companies and Regulated Primarily Clean Power Generation***

The Merger represents entry into complementary and synergistic regulatory assets and adds diversification for Hydro One across multiple geographies, economies, regulators and businesses. Management believes that Avista Corp.'s assets provide an opportunity to expand and diversify Hydro One's footprint to new regulatory jurisdictions (Washington, Idaho, Oregon, Montana and Alaska) with higher ROEs, favourable capital structures and growing economies, all of which will enhance Hydro One's stability and strategic positioning. Following the Merger, Hydro One's operations will have *pro forma* total assets of approximately \$34.9 billion (calculated as of March 31, 2017), operate regulated utilities across the Province of Ontario and five U.S. states and serve more than 2 million retail and industrial customers.

***Accretive to Earnings***

Management expects the Merger will be accretive to Hydro One's earnings per Common Share in the first full year following closing of the Merger. The Merger is expected to provide additional support to Hydro One's growing dividend, and its 70 per cent to 80 per cent targeted dividend payout ratio is expected to remain unchanged upon completion of the Merger.

***Experienced Management Teams and Shared Cultures and Values***

Hydro One's management believes that Hydro One and Avista Corp. have experienced management teams who share a common heritage with over 230 years of collective operational experience rooted in similar cultures and values. Both Hydro One and Avista Corp. take very seriously their responsibility to be good corporate citizens and community partners and share a common interest in preserving and increasing the philanthropy and economic development in the communities they serve. Additionally, both Hydro One and Avista Corp. share a strong commitment to safety, respect for the environment and the importance of engaging stakeholders in operations. Hydro One's management believes that this cultural fit will allow for a low risk transition and an increased ability to quickly find and implement areas of mutual benefit for the combined entity that do not compromise either company's values. Moreover, Hydro One believes it will benefit from Avista Corp's management team which consists of well-respected industry leaders who have consistently delivered shareholder value.

***Innovation and Knowledge Transfer***

Avista Corp. is a proven utility sector innovation leader, with a strong track record of progressive investments in sophisticated technologies and energy management solutions that address customers' increasing expectations. See page A-17 of the Investor Presentation attached as Appendix A to this Prospectus. Hydro One's management believes that sharing best practices in innovation and research and development will increase the ability for both Hydro One and Avista Corp. to effectively accelerate the deployment of new technology, to the benefit of the electricity system and its customers.

## **FINANCING THE MERGER**

The cash purchase price of the Merger and the Merger-Related Expenses will be financed at the closing of the Merger with a combination of some or all of the following: (i) net proceeds of the first instalment (to the extent available) and final instalment under the Offering; (ii) net proceeds of any subsequent bond or other debt offerings; (iii) amounts drawn under the existing \$250 million operating credit facility of Hydro One Limited (the "**Operating Credit Facility**"); and (iv) existing cash on hand and other sources available to the Corporation.

Prior to the closing of the Merger, Hydro One Limited intends to use the net proceeds of the first instalment under the Offering, which are expected to be \$441,700,000 (assuming no exercise of the Over-Allotment Option), to repay borrowings under the Operating Credit Facility or its subsidiaries' existing revolving credit facilities or other existing indebtedness (such indebtedness having been incurred for general corporate purposes), or for other general

corporate purposes, including investing in short-term interest bearing U.S. dollar securities with investment grade counterparties and in Hydro One Limited's wholly-owned subsidiaries. In the event that the net proceeds of the first instalment under the Offering are used to reduce outstanding indebtedness, or for other general corporate purposes, Hydro One Limited will maintain readily available capacity on its revolving credit facilities (on a consolidated basis), or have cash on hand together with such available capacity, in an amount at least equal to the net proceeds of the first instalment under the Offering. Upon the closing of the Merger, Hydro One Limited intends to use the net proceeds of the final instalment under the Offering, which are expected to be \$909,300,000 (assuming no exercise of the Over-Allotment Option), to finance, directly or indirectly, together with the net proceeds of the first instalment under the Offering to the extent available, part of the purchase price payable for the Merger and for other Merger-Related Expenses.

Hydro One Limited currently intends to fund the remainder of the purchase price for the Merger with a combination of bond or other debt financings, denominated principally in U.S. dollars in order to provide a significant natural currency hedge, drawdowns on the Operating Credit Facility and cash on hand.

Hydro One Limited's overall financing plan in respect of the Merger is structured and targeted to maintain Hydro One Limited's and Avista Corporation's strong investment grade status.

See "Risk Factors" for a discussion of certain risks relating to the financing of the Merger.

## THE OFFERING

<b>Issuer:</b>	Hydro One Limited
<b>Selling Debentureholder:</b>	2587264 Ontario Inc., a direct wholly-owned subsidiary of Hydro One Limited. See “Details of the Offering – The Selling Debentureholder”.
<b>Offering:</b>	4.00% convertible unsecured subordinated debentures, due September 30, 2027, represented by Instalment Receipts and convertible into Common Shares at a Conversion Price of \$21.40 per Common Share.
<b>Amount:</b>	\$1,400,000,000 (\$1,540,000,000 if the Over-Allotment Option is exercised in full) payable on an instalment basis.
<b>Price:</b>	\$1,000 per Debenture represented by an Instalment Receipt, of which the first instalment of \$333 is payable on the Closing Date and the final instalment of \$667 is payable on or before the Final Instalment Date.
<b>Closing Date:</b>	On or about August 9, 2017, or such other date as may be agreed upon by the Corporation, the Selling Debentureholder and the Underwriters, but not later than August 23, 2017.
<b>Over-Allotment Option:</b>	The Underwriters shall have the option, exercisable in whole or in part at any time on or prior to the 30th day following the Closing Date to purchase additional Debentures represented by Instalment Receipts equal to up to 10% of the aggregate principal amount of Debentures represented by Instalment Receipts issued at the Closing Date to cover over-allotments, if any, and for market stabilization purposes. See “Plan of Distribution”.
<b>Use of Proceeds:</b>	<p>The net proceeds from the Offering (including both the first instalment and final instalment) will be, in the aggregate, \$1,349,500,000 determined after deducting the Underwriters’ fee and the estimated expenses of the Offering. In the event that the Over-Allotment Option is exercised in full, the net proceeds will be, in the aggregate, \$1,484,600,000.</p> <p>Prior to the closing of the Merger, Hydro One Limited intends to use the net proceeds of the first instalment under the Offering, which are expected to be \$441,700,000 (assuming no exercise of the Over-Allotment Option), to repay borrowings under the Operating Credit Facility or its subsidiaries’ existing revolving credit facilities or other existing indebtedness (such indebtedness having been incurred for general corporate purposes), or for other general corporate purposes, including investing in short-term interest bearing U.S. dollar securities with investment grade counterparties and in Hydro One Limited’s wholly-owned subsidiaries. In the event that the net proceeds of the first instalment under the Offering are used to reduce outstanding indebtedness or for other general corporate purposes, Hydro One Limited will maintain readily available capacity on its revolving credit facilities (on a consolidated basis), or have cash on hand together with such available capacity, in an amount at least equal to the net proceeds of the first instalment under the Offering. Upon the closing of the Merger, Hydro One Limited intends to use the net proceeds of the final instalment under the Offering, which are expected to be \$909,300,000 (assuming no exercise of the Over-Allotment Option), to finance, directly or indirectly, together with the net proceeds of the first instalment under the Offering to the extent available, part of the purchase price payable for the Merger and for other Merger-Related Expenses. See “Use of Proceeds”.</p>

**Listing:** Conditional approval of the TSX has been received to list the Instalment Receipts (representing the Debentures) and the Common Shares to be issued upon conversion or maturity of the Debentures on the TSX. **The Debentures will not be listed.** The Common Shares are currently listed on the TSX under the symbol “H”, and, once listed, the Instalment Receipts will trade on the TSX under the symbol “H.IR”.

**Interest:** Annual rate of 4.00% per \$1,000 principal amount of Debentures will be payable quarterly in arrears in equal instalments (other than the first interest payment and, depending on the Final Instalment Date, the final interest payment) on the last day of December, March, June and September of each year (or the prior business day if the last day falls on a weekend or holiday) to and including the Final Instalment Date. The first interest payment in the amount of \$15.78082 per \$1,000 principal amount of Debentures will be made on December 29, 2017 and will include interest payable from and including the Closing Date. Subsequently, quarterly interest payments will be made in the amount of \$10.00 per \$1,000 principal amount of Debentures.

Based on a first instalment of \$333 per \$1,000 principal amount of Debentures, the effective yield per annum to and including the Final Instalment Date is 12.00%.

If the Final Instalment Date is prior to the first anniversary of the Closing Date, holders of Debentures who have paid the final instalment on or before the Final Instalment Date will be entitled to receive, on the business day following the Final Instalment Date, in addition to the payment of accrued and unpaid interest to and including the Final Instalment Date, an amount equal to the interest that would have accrued from the day following the Final Instalment Date to and including the first anniversary of the Closing Date had the Debentures remained outstanding and continued to accrue interest until and including such date (which is referred to in this Prospectus as the **“Make-Whole Payment”**). No Make-Whole Payment will be payable if the Final Instalment Date occurs on or after the first anniversary of the Closing Date.

No interest shall accrue on the Debentures following the Final Instalment Date.

See “Details of the Offering – Debentures”.

**Conversion:** At the option of the holder and provided that payment of the final instalment has been made, each Debenture will be convertible into Common Shares at any time on or after the Final Instalment Date, but prior to the earlier of the date that the Corporation redeems the Debentures or the Maturity Date.

The Conversion Price will be \$21.40 per Common Share, being a conversion rate of 46.7290 Common Shares per \$1,000 principal amount of Debentures, subject to adjustment in certain events.

A holder of Debentures who does not exercise its conversion privilege concurrently with the payment of the final instalment no later than the Final Instalment Date will hold a Debenture that pays 0% interest and may be redeemed by the Corporation in whole or in part on any trading day following the Final Instalment Date at a price equal to its principal amount plus any unpaid interest which accrued prior to and including the Final Instalment Date. No fractional Common Shares will be issued on any conversion, but in lieu thereof, the Corporation will satisfy such fractional interest by a cash payment equal to the fractional interest multiplied by the Conversion Price provided, however, the Corporation shall not be required to make any payment of less than \$10.00.

See “Details of the Offering – Debentures – Conversion Right”.

**Instalment Payment Arrangements:**

The price of \$1,000 per \$1,000 principal amount of Debentures is payable on an instalment basis. Prior to full payment, beneficial ownership of the Debentures will be represented by Instalment Receipts. The first instalment of \$333 per \$1,000 principal amount of Debentures is payable on the Closing Date. The final instalment of \$667 per \$1,000 principal amount of Debentures is payable by the holders of Instalment Receipts on or before the Final Instalment Date. The Final Instalment Notice will set the Final Instalment Date, which shall not be less than 15 days nor more than 90 days following the date of such notice. The Final Instalment Notice shall not be provided to holders until the Approval Conditions have been satisfied. The Final Instalment Date may occur up to 90 days following April 30, 2019. See “Details of the Offering”.

Each Debenture represented by an Instalment Receipt will be pledged to the Selling Debentureholder to secure the obligation of the holder of the Instalment Receipt to pay the final instalment in respect of such Debenture.

**If a holder of an Instalment Receipt does not pay the final instalment on or before the Final Instalment Date, the Debentures evidenced by such Instalment Receipt may, at the option of the Selling Debentureholder, upon compliance with applicable law and the terms of the Instalment Receipt Agreement governing the Instalment Receipts, be forfeited to the Selling Debentureholder in full satisfaction of the holder’s obligations or such Debentures may be sold and the holder of the Instalment Receipt shall remain liable for any deficiency if the proceeds of such sale are insufficient to cover the amount of the final instalment and the costs of such sale (such costs of sale not to exceed \$25 per Debenture). See “Details of the Offering – Instalment Receipts”.**

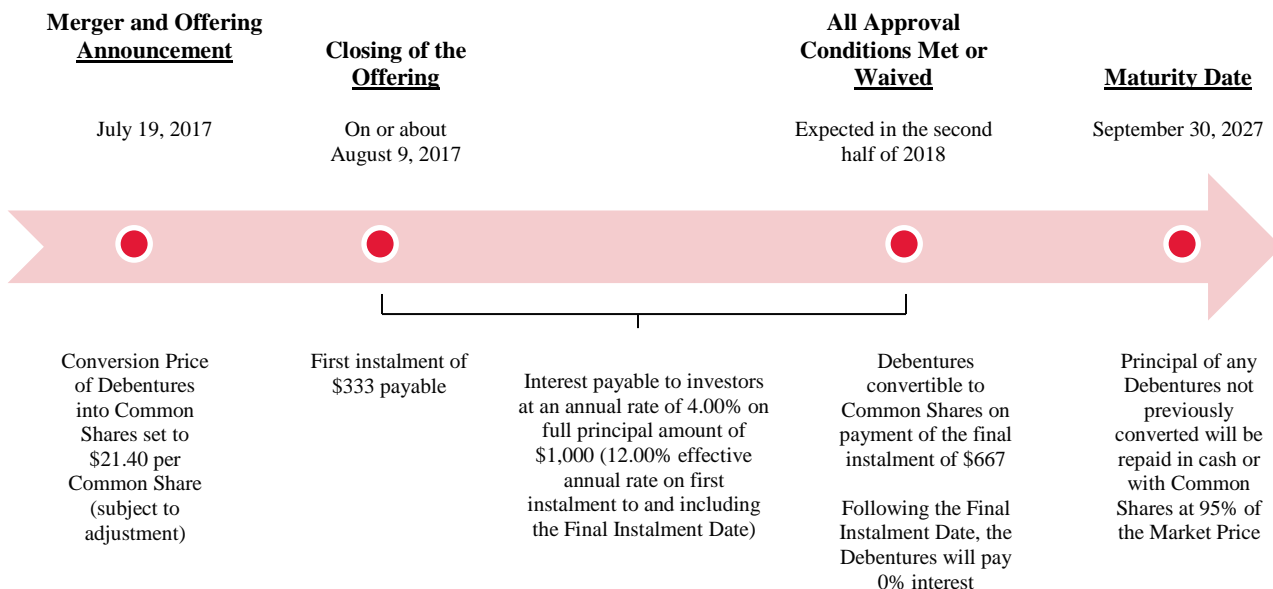
**Rights of Instalment Receipt Holders:**

Holders of Instalment Receipts will be entitled, in the manner set forth in the Instalment Receipt Agreement described herein, to fully receive payments of accrued interest and to exercise the rights of ownership attached to the Debentures represented by such Instalment Receipts unless they fail to pay the final instalment on or before the Final Instalment Date. See “Details of the Offering – Instalment Receipts – Rights and Privileges”.

<b>Redemption:</b>	<p>Prior to the Final Instalment Date, the Debentures may not be redeemed by the Corporation, except that the Debentures will be redeemed by the Corporation at a price equal to their principal amount plus accrued and unpaid interest (without any Make-Whole Payment) following the earlier of: (i) notification to holders that the Approval Conditions will not be satisfied; (ii) termination of the Merger Agreement in accordance with its terms; and (iii) May 1, 2019 if notice of the Final Instalment Date has not been given to holders of Instalment Receipts on or before April 30, 2019. Upon any such redemption, the Corporation will pay for each Debenture: (i) \$333 plus accrued and unpaid interest to the holder of the Instalment Receipt; and (ii) \$667 to the Selling Debentureholder on behalf of the holder of the Instalment Receipt in satisfaction of the final instalment.</p> <p>Until such time as the Debentures have been redeemed or the Final Instalment Date has occurred, the Corporation will at all times hold short-term interest bearing U.S. dollar securities with investment grade counterparties, maintain readily available capacity under the Operating Credit Facility or the revolving credit facilities of its subsidiaries, or have cash on hand together with such available capacity, in an amount at least equal to the net proceeds of the first instalment paid on the closing of the Offering and the exercise of the Over-Allotment Option, if applicable.</p> <p>In addition, after the Final Instalment Date, any Debentures not converted may be redeemed by the Corporation at a price equal to their principal amount plus any unpaid interest, which accrued prior to and including the Final Instalment Date.</p> <p>See “Details of the Offering – Debentures – Redemption”.</p>
<b>Maturity Date:</b>	September 30, 2027.
<b>Payment upon Maturity:</b>	<p>On the Maturity Date, the Corporation will repay the principal amount of any Debentures not converted and remaining outstanding, in cash, provided that the Corporation may, at its option and without prior notice, satisfy the obligation to pay the principal amount of such Debentures on maturity by delivery of that number of freely tradable Common Shares obtained by dividing the aggregate principal amount of the Debentures then outstanding by 95% of the Market Price. See “Details of the Offering – Debentures – Payment Upon Maturity”.</p>
<b>Subordination:</b>	<p>The Debentures will be direct unsecured obligations of Hydro One Limited. Payment of the principal of, interest on, any Make-Whole Payments and other amounts owing in respect of each Debenture will (i) be subordinated in right of payment to all present and future Senior Indebtedness of Hydro One Limited and (ii) rank pari passu with each other Debenture of the same series (regardless of their actual date or terms of issue) and, subject to statutory preferred exceptions, with all other present and future subordinated and unsecured indebtedness of Hydro One Limited. The trust indenture pursuant to which the Debentures will be issued does not limit the ability of the Corporation to incur additional indebtedness, including indebtedness that ranks senior to the Debentures, or from mortgaging, pledging, charging, hypothecating, granting a security interest in or otherwise encumbering any or all of its properties to secure any indebtedness. See “Details of the Offering – Debentures – Subordination”.</p>
<b>Ownership Restriction:</b>	<p>The <i>Electricity Act, 1998</i> (Ontario) precludes any person or company (or combination of persons or companies acting jointly or in concert), other than the Province, from beneficially owning, or exercising control or direction over, more than 10% of the Common Shares. <b>A potential purchaser of Debentures represented by Instalment Receipts should not subscribe for a number of such Debentures in this Offering that would, upon conversion of such Debentures into Common Shares, cause such purchaser to violate this prohibition.</b></p>

**Risk Factors:**

An investment in the Debentures represented by Instalment Receipts and the Common Shares issuable upon conversion thereof involves certain risks which should be carefully considered by prospective investors, including risks in respect of the Merger, the Instalment Receipts, the Debentures, the Common Shares and the post-Merger business and operations of Hydro One and Avista Corp. See “Risk Factors”.

**SUMMARY OF IMPORTANT DATES**



## **HYDRO ONE LIMITED**

### **Overview**

Hydro One is the largest electricity transmission and distribution company in Ontario. Through its wholly-owned subsidiary, Hydro One Inc., Hydro One owns and operates substantially all of Ontario's electricity transmission network with over 30,000 circuit km of high-voltage transmission lines, and an approximately 123,000 circuit km low-voltage distribution network.

Hydro One has three business segments: (i) transmission; (ii) distribution; and (iii) other business.

Hydro One's transmission business consists of owning, operating and maintaining its transmission system, which accounts for approximately 98% of Ontario's transmission capacity based on the revenues approved by the Ontario Energy Board. This includes Hydro One's 66% interest in B2M Limited Partnership, a limited partnership between Hydro One and the Saugeen Ojibway Nation in respect of the Bruce-to-Milton transmission line. Hydro One's transmission business is a rate-regulated business that earns revenues mainly from charging transmission rates that must be approved by the Ontario Energy Board. Hydro One's transmission business accounted for approximately 51% of the Corporation's total assets as at December 31, 2016, and approximately 51% of its total revenues, net of purchased power, in 2016. All of Hydro One's transmission business is carried out by its wholly-owned subsidiary Hydro One Inc., through its wholly-owned subsidiary Hydro One Networks Inc. and through other wholly-owned subsidiaries of Hydro One Inc. that own and control Hydro One Sault Ste. Marie LP, as well as the portion of Hydro One's transmission business held through B2M Limited Partnership, which Hydro One controls.

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Hydro One Limited was incorporated on August 31, 2015 under the OBCA. On October 31, 2015, Hydro One Limited acquired all of the issued and outstanding shares of Hydro One Inc. from the Province in exchange for the issuance of Common Shares and Series 1 Preferred Shares to the Province.

The address of the head and registered office of Hydro One is 483 Bay Street, South Tower, 8th Floor, Toronto, Ontario, M5G 2P5.

See the section entitled "Business of Hydro One" in the AIF for further details relating to the Corporation's business.

## **RECENT DEVELOPMENTS**

### **Credit Rating Reviews**

#### *Hydro One*

On July 19, 2017, S&P revised its outlook on Hydro One Limited and Hydro One Inc. to negative from stable while affirming the existing ratings, including its 'A' long-term corporate credit rating on both Hydro One

Limited and Hydro One Inc. S&P indicated that the negative outlook on Hydro One Limited reflects its view that the Merger signals a shift in Hydro One Limited's business strategy, which will align the company with its global peers removing the historical rationale for a one-notch rating uplift, and the execution and financing risk inherent in any large acquisition.

On July 19, 2017, DBRS issued a press release commenting on the Merger. DBRS' comments reflect DBRS' view that should the Merger be financed as contemplated in the announcement, it will have no impact on Hydro One Inc.'s credit profile.

On July 19, 2017, Moody's affirmed the ratings of Hydro One Inc.'s (i) senior unsecured regular bonds (A3); (ii) senior unsecured medium-term note program ((P)A3); and (iii) senior unsecured commercial paper (P-2), and changed the outlook to negative from stable. Moody's indicated that the negative outlook on Hydro One Inc. reflects its view that the Merger will reduce the probability of extraordinary support from the Province.

#### *Avista Corporation*

On July 19, 2017, S&P affirmed its ratings, including the 'BBB' issuer credit rating, on Avista Corporation and revised the outlook to positive from stable. The positive outlook reflects S&P's view of the potential for higher ratings on Avista Corporation if the Merger is completed as proposed based on its view that Avista Corporation will be an important member of the Hydro One group, highly unlikely to be sold and integral to overall group strategy and operations.

On July 19, 2017, Moody's affirmed the ratings of Avista Corporation's (i) issuer rating (Baa1); (ii) multiple seniority medium-term note program ((P)A2); (iii) senior secured medium-term notes (A2); (iv) senior secured first mortgage bonds (A2); (v) senior secured medium-term note program ((P)A2); and (vi) senior unsecured medium-term note program ((P)Baa1) and kept the outlook at stable. Moody's indicated that the stable rating outlook on Avista Corporation reflects its view that the Merger will not materially affect the credit quality of Avista Corporation.

#### **Outlook**

Milder weather in the first half of 2017 and a lower approved ROE for both Hydro One's transmission and distribution businesses have negatively impacted results of operations relative to the same period in 2016. A delay in approval of Hydro One's 2017-2018 transmission rates filing has also impacted revenues, however Hydro One anticipates a decision in the near term. Hydro One anticipates the revised rates will be effective from January 1, 2017 and as a result would book the increased revenue up to the date of decision at that time.

#### **Chief Financial Officer Accepted New Role**

On May 19, 2017, Michael Vels, former Chief Financial Officer of Hydro One, left Hydro One to assume the position of Executive Vice President and Chief Financial Officer of Empire Company Limited and its wholly-owned subsidiary Sobeys Inc.

### **THE MERGER**

#### **Merger Overview**

On July 19, 2017, Hydro One Limited, US Parent and Merger Sub entered into the Merger Agreement with Avista Corporation which provides for, among other things, the direct or indirect acquisition by US Parent of Avista Corporation. The aggregate purchase price for the Merger is approximately US\$5.3 billion, comprised of an equity purchase price of US\$3.4 billion and the assumption of approximately US\$1.9 billion of debt. The Merger is subject to receipt of Avista Shareholder Approval and certain regulatory and governmental approvals, including the expiration or termination of any applicable waiting period under the HSR Act, clearance of the Merger by CFIUS, the approval by each of IPUC, MPSC, OPUC, RCA, WUTC, FERC and the FCC, and the satisfaction of other customary closing conditions. The closing of the Merger is currently expected to occur in the second half of 2018.

Based on *pro forma* financial information as at March 31, 2017, following the Merger, Hydro One's total assets will increase from approximately \$25.4 billion to approximately \$34.9 billion.

Following completion of the Merger, Avista Corporation will maintain its existing corporate headquarters in Spokane and will continue to operate as a standalone utility in Washington, Oregon, Idaho, Montana and Alaska. Its management team will remain in place and it will operate with a board of directors that includes directors representing the interests of the Pacific Northwest and the communities it serves.

## **Merger Highlights**

### ***Scale Reinforces Competitive Positioning and Improved Financial Flexibility***

As a result of the Merger, Hydro One's enterprise value will increase by over 25% on a *pro forma* basis, making the combined entity one of North America's largest regulated utilities and a leader in regulated transmission as well as electricity and natural gas local distribution businesses. Post-Merger, on a *pro forma* basis as at March 31, 2017, Hydro One Limited's total assets would increase from approximately \$25.4 billion to approximately \$34.9 billion and Hydro One Limited's net income for the twelve months ended December 31, 2016 would increase from approximately \$746 million to approximately \$836 million. Management believes that the Merger will enhance Hydro One's competitive positioning and provide Hydro One with opportunities for cost savings and non-headcount efficiency gains through enhanced innovation, shared IT systems and increased supply chain purchasing power.

### ***Diversification of Business Segments into Growing Natural Gas Local Distribution Companies and Regulated Primarily Clean Power Generation***

The Merger represents entry into complementary and synergistic regulatory assets and adds diversification for Hydro One across multiple geographies, economies, regulators and businesses. Management believes that Avista Corp.'s assets provide an opportunity to expand and diversify Hydro One's footprint to new regulatory jurisdictions (Washington, Idaho, Oregon, Montana and Alaska) with higher ROEs, favourable capital structures and growing economies, all of which will enhance Hydro One's stability and strategic positioning. Following the Merger, Hydro One's operations will have *pro forma* total assets of approximately \$34.9 billion (calculated as of March 31, 2017), operate regulated utilities across the Province of Ontario and five U.S. states and serve more than 2 million retail and industrial customers.

### ***Accretive to Earnings***

Management expects the Merger will be accretive to Hydro One's earnings per Common Share in the first full year following closing of the Merger. The Merger is expected to provide additional support to Hydro One's growing dividend, and its 70 per cent to 80 per cent targeted dividend payout ratio is expected to remain unchanged upon completion of the Merger.

### ***Experienced Management Teams and Shared Cultures and Values***

Hydro One's management believes that Hydro One and Avista Corp. have experienced management teams who share a common heritage with over 230 years of collective operational experience rooted in similar cultures and values. Both Hydro One and Avista Corp. take very seriously their responsibility to be good corporate citizens and community partners and share a common interest in preserving and increasing the philanthropy and economic development in the communities they serve. Additionally, both Hydro One and Avista Corp. share a strong commitment to safety, respect for the environment and the importance of engaging stakeholders in operations. Hydro One's management believes that this cultural fit will allow for a low risk transition and an increased ability to quickly find and implement areas of mutual benefit for the combined entity that do not compromise either company's values. Moreover, Hydro One believes it will benefit from Avista Corp's management team which consists of well-respected industry leaders who have consistently delivered shareholder value.

### ***Innovation and Knowledge Transfer***

Avista Corp. is a proven utility sector innovation leader, with a strong track record of progressive investments in sophisticated technologies and energy management solutions that address customers' increasing

expectations. See page A-17 of the Investor Presentation attached as Appendix A to this Prospectus. Hydro One's management believes that sharing best practices in innovation and research and development will increase the ability for both Hydro One and Avista Corp. to effectively accelerate the deployment of new technology, to the benefit of the electricity system and its customers.

For additional information on the Merger, its expected benefits, its expected timing to completion and its strategic rationale, see pages A-6, A-7, A-11 and A-13 to A-19 of the Investor Presentation attached as Appendix A to this Prospectus.

## THE ACQUIRED BUSINESS

### **Avista Corp.**

Avista Corporation, incorporated in the territory of Washington in 1889, is primarily an electric and natural gas utility with certain other business ventures. As of December 31, 2016, Avista Corp. employed 1,742 people in its Pacific Northwest utility operations (Avista Utilities) and 240 people in its subsidiary businesses (including in its Juneau, Alaska utility operations). Avista Corporation's corporate headquarters are in Spokane, Washington, the second-largest city in Washington. Spokane serves as the business, transportation, medical, industrial and cultural hub of the Inland Northwest region (eastern Washington and northern Idaho). Regional services include government and higher education, medical services, retail trade and finance. Through its subsidiary AEL&P, Avista Corporation also provides electric utility services in Juneau, Alaska. Avista Corporation is an operating public utility with its common stock listed on the NYSE under the ticker symbol "AVA".

As of March 31, 2017, Avista Corporation had two reportable business segments as follows:

- **Avista Utilities** – an operating division of Avista Corporation (not a subsidiary) that comprises its regulated utility operations in the Pacific Northwest. Avista Utilities generates, transmits and distributes electricity and distributes natural gas, serving electric and natural gas customers in eastern Washington and northern Idaho and natural gas customers in parts of Oregon. It also supplies electricity to a small number of customers in Montana, most of whom are its employees who operate its Noxon Rapids generating facility. Avista Utilities also engages in wholesale purchases and sales of electricity and natural gas as an integral part of energy resource management and its load-serving obligation.
- **AEL&P** - a utility providing electric services in Juneau, Alaska that is a wholly-owned subsidiary and the primary operating subsidiary of AERC. Avista Corporation acquired AERC on July 1, 2014, and as of that date, AERC became a wholly-owned subsidiary of Avista Corporation.

Avista Corporation has other businesses, including sheet metal fabrication, venture fund investments, real estate investments, a company that explores markets that could be served with LNG, as well as certain other investments of Avista Capital, which is a direct, wholly owned subsidiary of Avista Corporation. These activities do not represent a reportable business segment and are conducted by various direct and indirect subsidiaries of Avista Corporation, including AM&D, doing business as METALfx.

### **Avista Utilities**

As of March 31, 2017, Avista Utilities supplied retail electric service to approximately 379,000 customers and retail natural gas service to approximately 342,000 customers across its service territory. Avista Utilities' service territory covers 30,000 square miles with a population of 1.6 million.

### ***Electric Resources***

#### ***Hydroelectric Resources***

Avista Utilities owns and operates six hydroelectric projects on the Spokane River and two hydroelectric projects on the Clark Fork River. Hydroelectric generation is typically Avista Utilities lowest cost source per MWh of electric energy and the availability of hydroelectric generation has a significant effect on total power supply costs. Under normal streamflow and operating conditions, Avista Utilities estimates that it would be able to meet approximately one-half of its total average electric requirements (both retail and long-term wholesale) with the

combination of its hydroelectric generation and long-term hydroelectric purchase contracts with certain PUDs in the state of Washington. Avista Utilities estimate of normal annual hydroelectric generation for 2017 (including resources purchased under long-term hydroelectric contracts with certain PUDs) is 538 average MW (or 4.7 million MWhs).

#### *Thermal Resources*

Avista Utilities owns the following thermal generating resources:

- the combined cycle CT natural gas-fired Coyote Springs 2 located near Boardman, Oregon, a 15 percent interest in a twin-unit, coal-fired boiler generating facility, Colstrip 3 & 4, located in southeastern Montana,
- a wood waste-fired boiler generating facility known as the Kettle Falls Generating Station (“**Kettle Falls GS**”) in northeastern Washington,
- a two-unit natural gas-fired CT generating facility, located in northeastern Spokane (“**Northeast CT**”),
- a two-unit natural gas-fired CT generating facility in northern Idaho (“**Rathdrum CT**”), and
- two small natural gas-fired generating facilities (“**Boulder Park GS**” and “**Kettle Falls CT**”).

Coyote Springs 2, which is operated by Portland General Electric Company, is supplied with natural gas under a combination of term contracts and spot market purchases, including transportation agreements with bilateral renewal rights.

Colstrip, which is operated by Talen Energy LLC, is supplied with fuel from adjacent coal reserves under coal supply and transportation agreements in effect through 2019. During 2016, Talen Energy LLC provided notice to the Colstrip owners that it no longer plans to operate units 3 & 4 after May 2018. The Colstrip owners are searching for a replacement operator for units 3 & 4.

The primary fuel for the Kettle Falls GS is wood waste generated as a by-product and delivered by trucks from forest industry operations within 100 miles of the plant. A combination of long-term contracts and spot purchases has provided, and is expected to meet, fuel requirements for the Kettle Falls GS.

The Northeast CT, Rathdrum CT, Boulder Park GS and Kettle Falls CT generating units are primarily used to meet peaking electric requirements. Avista Utilities also operate these facilities when marginal costs are below prevailing wholesale electric prices. These generating facilities have access to natural gas supplies that are adequate to meet their respective operating needs.

Avista Utilities has the exclusive rights to all the capacity of the Lancaster Plant, a 270 MW natural gas-fired combined cycle combustion turbine plant located in northern Idaho, owned by an unrelated third-party. All of the output from the Lancaster Plant is contracted to Avista Utilities through 2026 under a PPA. Under the terms of the PPA, Avista Utilities makes the dispatch decisions, provides all natural gas fuel and receives all of the electric energy output from the Lancaster Plant; as such, Avista Utilities considers this plant to be part of its baseload resources.

#### *Wind Resources*

Avista Utilities has the exclusive rights to all the capacity of Palouse Wind, a wind generation project developed, owned and managed by an unrelated third-party and located in Whitman County, Washington. Avista Utilities has a PPA that expires in 2042 and allows it to acquire all of the power and renewable attributes produced by the project at a fixed price per MWh with a fixed escalation of the price over the term of the agreement. The project has a nameplate capacity of 105 MW. Generation from Palouse Wind was 349,771 MWhs in 2016, 293,563 MWhs in 2015 and 335,291 MWhs in 2014. Avista Utilities has an annual option to purchase the wind project beginning in December 2022. The purchase price per the PPA is a fixed price per KW of in-service capacity with a fixed decline in the price per KW over the remaining 20-year term of the agreement. Under the terms of the PPA, Avista Utilities does not have any input into the day-to-day operation of the project, including maintenance decisions. All such rights are held by the owner.

### *Other Purchases, Exchanges and Sales*

In addition to the resources described above, Avista Utilities purchases and sells power under various long-term contracts, and also enters into short-term purchases and sales. Further, pursuant to PURPA, as amended, Avista Utilities is required to purchase generation from qualifying facilities. This includes, among other resources, hydroelectric projects, cogeneration projects and wind generation projects at rates approved by the WUTC and the IPUC.

### ***Hydroelectric Licenses***

Avista Corp. is a licensee under the FPA as administered by the FERC, which includes regulation of hydroelectric generation resources. Excluding Little Falls, its other seven hydroelectric plants are regulated by the FERC through two project licenses. The licensed projects are subject to the provisions of Part I of the FPA. These provisions include payment for headwater benefits, condemnation of licensed projects upon payment of just compensation, and take-over by the federal government of such projects after the expiration of the license upon payment of the lesser of “net investment” or “fair value” of the project, in either case, plus severance damages. In the unlikely event that a take-over occurs, it could lead to either the decommissioning of the hydroelectric project or offering the project to another party (likely through sale and transfer of the license).

Cabinet Gorge and Noxon Rapids are under one 45-year FERC license issued in March 2001.

Five of Avista Corp.’s six hydroelectric projects on the Spokane River (Long Lake, Nine Mile, Upper Falls, Monroe Street and Post Falls) are under one 50-year FERC license issued in June 2009 and are referred to collectively as the Spokane River Project. The sixth, Little Falls, is operated under separate Congressional authority and is not licensed by the FERC.

### ***Natural Gas Operations***

Avista Utilities provides natural gas distribution services to retail customers in parts of eastern Washington, northern Idaho, and northeastern and southwestern Oregon.

### ***Natural Gas Supply***

Avista Utilities purchases all of its natural gas in wholesale markets. Avista Utilities is connected to multiple supply basins in the western United States and Canada through firm capacity transportation rights on six different pipeline networks. Access to this diverse portfolio of natural gas resources allows it to make natural gas procurement decisions that benefit its natural gas customers. These interstate pipeline transportation rights provide the capacity to serve approximately 25 percent of peak natural gas customer demands from domestic sources and 75 percent from Canadian sourced supply. Natural gas prices in the Pacific Northwest are affected by global energy markets, as well as supply and demand factors in other regions of the United States and Canada. Future prices and delivery constraints may cause Avista Utilities resource mix to vary.

### ***Natural Gas Storage***

Avista Utilities owns a one-third interest in Jackson Prairie. Jackson Prairie has a total peak day deliverability of 12 million therms, with a total working natural gas capacity of 256 million therms. As an owner, Avista Utilities’ share is one-third of the peak day deliverability and total working capacity. Avista Utilities also contracts for additional storage capacity and delivery at Jackson Prairie from Northwest Pipeline for a portion of their one-third share of the storage project.

Avista Utilities optimizes its natural gas storage capacity throughout the year by executing transactions that capture favourable market price spreads. Natural gas buyers identify opportunities to purchase lower cost natural gas in the immediate term to inject into storage, and then sell the gas in a forward market to be withdrawn at a later time. The reverse of this type of transaction also occurs. These transactions lock in incremental value for customers. Jackson Prairie is also used as a variable peaking resource, and to protect from extreme daily price volatility during cold weather or other events affecting the market.

### ***Alaska Electric Light and Power Company***

AEL&P is the primary operating subsidiary of AERC. AEL&P is the sole utility providing electrical energy in Juneau, Alaska. Juneau is a geographically isolated community with no electric interconnections with the transmission facilities of other utilities and no pipeline access to natural gas or other fuels. Juneau’s economy is

primarily driven by government activities, tourism, commercial fishing, and mining, as well as activities as the commercial hub of southeast Alaska.

AEL&P owns and operates electric generation, transmission and distribution facilities located in Juneau. AEL&P operates five hydroelectric generation facilities with 102.7 MW of hydroelectric generation capacity as of December 31, 2016. AEL&P owns four of these generation facilities (totaling 24.5 MW of capacity) and has a PPA for the output of the Snettisham hydroelectric project (totaling 78.2 MW of capacity).

The Snettisham hydroelectric project is owned by the AIDEA, a public corporation of the State of Alaska. AEL&P has a PPA and operating and maintenance agreement with the AIDEA to operate and maintain the facility. This PPA is a take-or-pay obligation expiring in December 2038, to purchase all of the output of the project.

For accounting purposes, this PPA is treated as a capital lease and as of March 31, 2017 and December 31, 2016, the capital lease obligation was US\$61.6 million and US\$62.2 million, respectively. Snettisham Electric Company, a non-operating subsidiary of AERC, has the option to purchase the Snettisham project at any time for a price equal to the principal amount of the bonds outstanding at that time.

As of December 31, 2016, AEL&P also had 107.5 MW of diesel generating capacity from four facilities to provide back-up service to firm customers when necessary.

As of March 31, 2017, AEL&P served approximately 17,000 customers. Its primary customers include city, state and federal governmental entities located in Juneau, as well as a mine located in the Juneau area. Most of AEL&P's customers are served on a firm basis while certain of its customers, including its largest customer, are served on an interruptible sales basis. AEL&P maintains separate rate tariffs for each of its customer classes, as well as seasonal rates.

AEL&P's operations are subject to regulation by the RCA with respect to rates, standard of service, facilities, accounting and certain other matters, but not with respect to the issuance of securities. Rate adjustments for AEL&P's customers require approval by the RCA pursuant to RCA regulations. AEL&P filed an electric general rate case during 2016.

AEL&P is also subject to the jurisdiction of the FERC concerning the permits and licenses necessary to operate certain of its hydroelectric facilities. One of these licenses (for the Salmon Creek and Annex Creek hydroelectric projects) expires in 2018, but AEL&P plans to extend this license. Since AEL&P has no electric interconnection with other utilities and makes no wholesale sales, it is not subject to general FERC jurisdiction, other than the reporting and other requirements of the Public Utility Holding Company Act of 2005 as an Avista Corporation subsidiary.

The Snettisham hydroelectric project is subject to regulation by the State of Alaska with respect to dam safety and certain aspects of its operations. In addition, AEL&P is subject to regulation with respect to air and water quality, land use and other environmental matters under both federal and state laws.

## **Other Businesses**

As of March 31, 2017, Avista Corporation's other businesses had assets of approximately US\$58.4 million (excluding intracompany amounts) compared to assets of US\$55.3 million as of December 31, 2016. Avista Corporation's other businesses are described below.

### ***Avista Capital***

- Salix is a wholly-owned subsidiary of Avista Capital that explores markets that could be served with LNG.
- Equity investments are primarily in an emerging technology venture capital fund.

### ***Avista Development***

- Equity investments are primarily in emerging technology venture capital funds and companies, including an investment in a technology company that delivers scalable smart grid solutions to global partners and customers, and a predictive data science company.
- Real estate consists primarily of mixed use commercial and retail office space.

- Notes receivable and other assets are primarily long-term notes receivable made to a company focused on spurring economic development throughout the State of Washington.
- AM&D doing business as METALfx performs custom sheet metal fabrication of electronic enclosures, parts and systems for the computer, construction, telecom, renewable energy and medical industries. The asset balance above excludes an intercompany loan from METALfx to Avista Corporation. The loan balance was US\$4.3 million as of March 31, 2017 and US\$4.0 million as of December 31, 2016.

#### *Alaska companies*

- Includes AERC and AJT Mining, which is a wholly-owned subsidiary of AERC and is an inactive mining company holding certain properties.

Over time as opportunities arise, Avista Corp. disposes of investments and phases out operations that do not fit with its overall corporate strategy. However, Avista Corp. may invest incremental funds to protect its existing investments and invest in new businesses that it believes fit in with its overall corporate strategy.

### **Results of Operations**

#### *Avista Corporation*

The following table presents net income (loss) attributable to Avista Corporation for each of its business segments (and the other businesses) for the three months ended March 31, 2017 and years ended December 31, 2016 and December 31, 2015 (U.S. dollars in thousands):

<u>Period</u>	<u>Three Months ended March 31, 2017</u>	<u>Year ended December 31, 2016</u>	<u>Year ended December 31, 2015</u>
Avista Utilities	\$58,439	\$132,490	\$113,360
AEL&P	\$ 3,853	\$7,968	\$6,641
Ecova – Discontinued operations			\$5,147
Other	\$(176)	\$(3,230)	\$(1,921)
<b>Net income</b>	<u><b>\$62,116</b></u>	<u><b>\$137,228</b></u>	<u><b>\$123,227</b></u>

#### *Avista Utilities*

##### *Three months ended March 31, 2017 compared to the three months ended March 31, 2016*

The following table presents Avista Utilities' operating revenues, resource costs and resulting gross margin for the three months ended March 31, 2017 and three months ended March 31, 2016 (U.S. dollars in thousands):

	<u>Electric</u>		<u>Natural Gas</u>		<u>Intracompany</u>		<u>Total</u>	
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Operating revenues	\$ 263,718	\$ 262,802	\$ 170,212	\$ 155,410	\$ (18,549)	\$ (18,065)	\$ 415,381	\$ 400,147
Resource costs	90,875	94,351	90,287	82,792	(18,549)	(18,065)	162,613	159,078
Gross margin	<u>\$ 172,843</u>	<u>\$ 168,451</u>	<u>\$ 79,925</u>	<u>\$ 72,618</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 252,768</u>	<u>\$ 241,069</u>

##### *Year end 2016 compared to year end 2015*

The following table presents Avista Utilities' operating revenues, resource costs and resulting gross margin for the years ended December 31, 2016 and December 31, 2015 (U.S. dollars in thousands):



	Electric		Natural Gas		Intracompany		Total	
	2016	2015	2016	2015	2016	2015	2016	2015
Operating revenues	\$ 996,959	\$ 997,873	\$ 470,894	\$ 521,010	\$ (95,215)	\$ (107,020)	\$1,372,638	\$1,411,863
Resource costs	360,591	400,910	273,976	351,101	(95,215)	(107,020)	539,352	644,991
Gross margin	<u>\$ 636,368</u>	<u>\$ 596,963</u>	<u>\$ 196,918</u>	<u>\$ 169,909</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 833,286</u>	<u>\$ 766,872</u>

#### *Avista Utilities Electric Operations Statistics*

The following table presents Avista Utilities' operating revenues and energy sales for its electric operations for the three months ended March 31, 2017 and the years ended December 31, 2016 and December 31, 2015 (U.S. dollars in thousands):

#### **Avista Utilities Electric Operating Statistics**

	<i>Operating Revenues</i> (thousand US\$)			<i>Energy Sales</i> (thousands of MWhs)		
	<i>Three months ended March 31, 2017</i>	<i>Year ended December 31, 2016</i>	<i>Year ended December 31, 2015</i>	<i>Three months ended March 31, 2017</i>	<i>Year ended December 31, 2016</i>	<i>Year ended December 31, 2015</i>
Residential	\$ 120,101	\$ 339,210	\$ 335,552	1,213	3,528	3,571
Commercial	78,021	305,613	308,210	809	3,183	3,197
Industrial	25,973	107,296	111,770	424	1,763	1,812
Public street and highway lighting	1,895	7,662	7,277	5	23	23
Total Retail	<u>\$ 225,990</u>	<u>\$ 759,781</u>	<u>\$ 762,809</u>	<u>2,451</u>	<u>8,497</u>	<u>8,603</u>
Wholesale	21,883	112,071	127,253	721	2,998	3,145
Sale of fuel	14,940	78,334	82,853			
Other	7,985	28,492	25,839			
Decoupling	(7,080)	17,349	4,740			
Provisions for earnings share	-	932	(5,621)			
Total electric operating revenues	<u>\$ 263,718</u>	<u>\$ 996,959</u>	<u>\$ 997,873</u>			
Total electric energy sales				<u>3,172</u>	<u>11,495</u>	<u>11,748</u>

#### *Avista Utilities Natural Gas Operations Statistics*

The following table presents Avista Utilities' operating revenues and therms delivered for its natural gas operations for the three months ended March 31, 2017 and the years ended December 31, 2016 and December 31, 2015 (U.S. dollars in thousands):

#### **Avista Utilities Natural Gas Operating Statistics**

	<i>Operating Revenues</i> (thousand US\$)			<i>Therms Delivered</i> (thousands of therms)		
	<i>Three months ended March 31, 2017</i>	<i>Year ended December 31, 2016</i>	<i>Year ended December 31, 2015</i>	<i>Three months ended March 31, 2017</i>	<i>Year ended December 31, 2016</i>	<i>Year ended December 31, 2015</i>
Residential	\$ 91,425	\$ 195,275	\$ 193,825	96,748	186,565	176,613
Commercial	43,948	92,978	96,751	56,824	112,686	107,894
Interruptible	625	2,179	2,782	1,701	5,700	4,708
Industrial	1,313	3,348	3,792	2,149	5,234	5,070
Total Retail	<u>\$ 137,311</u>	<u>\$ 293,780</u>	<u>\$ 297,150</u>	<u>157,422</u>	<u>310,185</u>	<u>294,285</u>
Wholesale	36,610	153,446	204,289	128,422	684,317	809,132
Transportation	2,591	8,339	7,988	55,477	178,377	164,679
Other	1,657	5,787	5,578	238	378	335
Decoupling	(7,957)	12,309	6,004			
Provisions for earnings share	-	(2,767)	0			
Total natural gas operating revenues	<u>\$ 170,212</u>	<u>\$ 470,894</u>	<u>\$ 521,009</u>			
Total therms delivered				<u>341,559</u>	<u>1,173,257</u>	<u>1,268,431</u>

## ***Alaska Electric Light and Power Company***

### ***Three months ended March 31, 2017 compared to the three months ended March 31, 2016***

Net income for AEL&P was US\$3.9 million for the three months ended March 31, 2017 compared to US\$3.0 million for the three months ended March 31, 2016.

The increase in earnings was primarily due to an increase in gross margin, partially offset by an increase in operating expenses and a decrease in equity-related AFUDC due to the construction of an additional back-up generation plant in 2016.

The increase in gross margin was primarily related to an interim general rate increase, effective in November 2016, and an increase in electric heating loads due to weather that was colder than the prior year and colder than normal. This was partially offset by an increase in resource costs primarily due to purchased power expense and deferred power supply expenses.

While the cold weather did have some effect on AEL&P revenues during 2017, AEL&P has a relatively stable load profile as it does not have a large population of customers in its service territory with electric heating and cooling requirements; therefore, its revenues are not as sensitive to weather fluctuations as Avista Utilities. However, AEL&P does have higher winter rates for its customers during the peak period of November through May of each year, which drives higher revenues during those periods.

### ***Year end 2016 compared to year end 2015***

Net income for AEL&P was US\$8.0 million for the year ended December 31, 2016, compared to US\$6.6 million for 2015. The increase in earnings for 2016 was primarily due to an increase in gross margin and an increase in equity-related AFUDC (increased earnings) due to the construction of an additional back-up generation plant which was completed during the fourth quarter of 2016.

The increase in gross margin was primarily related to a decrease in costs associated with the Snettisham hydroelectric project (due to a refinancing transaction during the second half of 2015 which lowered interest costs under the take-or-pay power purchase agreement), as well as an interim rate increase effective in November 2016. These were partially offset by a slight decrease in sales volumes to commercial and government customers and an increase in other resource costs.

AEL&P has a relatively stable load profile as it does not have a large population of customers in its service territory with electric heating and cooling requirements; therefore, its revenues are not as sensitive to weather fluctuations as Avista Utilities. However, AEL&P does have higher winter rates for its customers during the peak period of November through May of each year, which drives higher revenues during those periods.

For further information on the financial condition and results of Avista Corp., reference is made to the audited comparative consolidated financial statements of Avista Corporation as at December 31, 2016 and 2015, including the consolidated balance sheets and the related consolidated statements of income, common stockholders' equity and cash flows, for each of the years ended December 31, 2016 and 2015, and the unaudited interim comparative consolidated financial statements of Avista Corporation for the three months ended March 31, 2017, each of which is included in this Prospectus.

## **Properties**

### ***Avista Utilities***

#### ***Generation Properties***

Substantially all of Avista Utilities' properties are subject to the lien of Avista Corporation's mortgage indenture.

Avista Corp.'s utility electric properties, located in the states of Washington, Idaho, Montana and Oregon, include the following:

	<b>No. of Units</b>	<b>Nameplate Rating (MW)<sup>(1)</sup></b>	<b>Present Capability (MW)<sup>(2)</sup></b>
<b>Hydroelectric Generating Stations (River)</b>			
Washington:			
Long Lake (Spokane)	4	70.0	88.0
Little Falls (Spokane)	4	32.0	35.6
Nine Mile (Spokane) <sup>(3)</sup>	4	36.8	29.0
Upper Falls (Spokane)	1	10.0	10.2
Monroe Street (Spokane)	1	14.8	15.0
Idaho:			
Cabinet Gorge (Clark Fork) <sup>(4)</sup>	4	265.0	273.0
Post Falls (Spokane)	6	14.8	15.4
Montana:			
Noxon Rapids (Clark Fork)	5	487.8	562.4
Total Hydroelectric		931.2	1,028.6
<b>Thermal Generating Stations (cycle, fuel source)</b>			
Washington:			
Kettle Falls GS (combined-cycle, wood waste) <sup>(5)</sup>	1	50.7	53.5
Kettle Falls CT (combined-cycle, natural gas) <sup>(5)</sup>	1	7.2	6.9
Northeast CT (simple-cycle, natural gas)	2	61.8	64.8
Boulder Park GS (simple-cycle, natural gas)	6	24.6	24.6
Idaho:			
Rathdrum CT (simple-cycle, natural gas)	2	166.5	166.5
Montana:			
Colstrip Units 3 & 4 (simple-cycle, coal) <sup>(6)</sup>	2	233.4	222.0
Oregon:			
Coyote Springs 2 (combined-cycle, natural gas)	1	295.0	295.0
Total Thermal		839.2	833.3
Total Generation Properties		1,770.4	1,861.9

- (1) Nameplate rating, also referred to as “installed capacity,” is the manufacturer’s assigned power capability under specified conditions.
- (2) Present capability is the maximum capacity of the plant under standard test conditions without exceeding specified limits of temperature, stress and environmental conditions. Information is provided as of December 31, 2016.
- (3) The project to replace Units 1 and 2 was completed during 2016. The present capability shown is the maximum plant generation Avista Utilities have seen given the water they have had available, because they have not yet had peak water conditions since Units 1 and 2 went into service. As conditions change, Avista Utilities will test plant capability and revise this number accordingly.
- (4) For Cabinet Gorge, Avista Utilities has water rights permitting generation up to 265 MW. However, if natural stream flows will allow for generation above Avista Utilities’ water rights, Avista Utilities is able to generate above its water rights. If natural stream flows only allow for generation at or below 265 MW, Avista Utilities is limited to generation of 265 MW. The present capability disclosed above represents the capability based on maximum stream flow conditions when Avista Utilities has been allowed to generate above its water rights.
- (5) These generating stations can operate as separate single-cycle plants or combined-cycle with the natural gas plant providing exhaust heat to the wood boiler to increase efficiency.
- (6) Jointly owned; data refers to Avista Utilities’ 15 percent interest.

### *Electric Distribution and Transmission Plant*

Avista Utilities owns and operates approximately 19,000 miles of primary and secondary electric distribution lines providing service to retail customers. Avista Utilities has an electric transmission system of 685 miles of 230 KV line and 1,565 miles of 115 KV line. Avista Utilities also owns an 11 percent interest in approximately 500 miles of a 500 KV line between Colstrip, Montana and Townsend, Montana. Its transmission and distribution systems also include numerous substations with transformers, switches, monitoring and metering devices, and other equipment.

The 230 KV lines are the backbone of Avista Utilities' transmission grid and are used to transmit power from generation resources, including Noxon Rapids, Cabinet Gorge and the Mid-Columbia hydroelectric projects, to the major load centers in Avista Utilities service area, as well as to transfer power between points of interconnection with adjoining electric transmission systems. These lines interconnect at various locations with the BPA, Grant County PUD, PacifiCorp, NorthWestern Energy and Idaho Power Company and serve as points of delivery for power from generating facilities outside of Avista Utilities service area, including Colstrip, Coyote Springs 2 and the Lancaster Plant.

These lines also provide a means for Avista Utilities to optimize resources by entering into short-term purchases and sales of power with entities within and outside of the Pacific Northwest.

The 115 KV lines provide for transmission of energy and the integration of smaller generation facilities with Avista Utilities service-area load centers, including the Spokane River hydroelectric projects, the Kettle Falls projects, Rathdrum CT, Boulder Park GS and the Northeast CT. These lines interconnect with the BPA, Chelan County PUD, the Grand Coulee Project Hydroelectric Authority, Grant County PUD, NorthWestern Energy, PacifiCorp and Pend Oreille County PUD. Both the 115 KV and 230 KV interconnections with the BPA are used to transfer energy to facilitate service to each other's customers that are connected through the other's transmission system. Avista Utilities holds a long-term transmission agreement with the BPA that allows them to serve their native load customers that are connected through the BPA's transmission system.

### *Natural Gas Plant*

Avista Utilities has natural gas distribution mains of approximately 3,400 miles in Washington, 2,000 miles in Idaho and 2,300 miles in Oregon. It has natural gas transmission mains of approximately 75 miles in Washington and 50 miles in Oregon. Its natural gas system includes numerous regulator stations, service distribution lines, monitoring and metering devices, and other equipment.

Avista Utilities owns a one-third interest in Jackson Prairie.

### *Alaska Electric Light and Power Company*

#### *Generation Properties*

Substantially all of AEL&P's utility properties are subject to the lien of the AEL&P mortgage indenture.

AEL&P's utility electric properties, located in Alaska include the following:

	<b>No. of Units</b>	<b>Nameplate Rating (MW)<sup>(1)</sup></b>	<b>Present Capability (MW)<sup>(2)</sup></b>
<b>Hydroelectric Generating Stations</b>			
Snettisham <sup>(3)</sup>	3	78.2	78.2
Lake Dorothy	1	14.3	14.3
Salmon Creek	1	8.4	5.0
Annex Creek	2	4.1	3.6
Gold Creek	3	1.6	1.6
Total Hydroelectric		106.6	102.7
<b>Diesel Generating Stations</b>			
Lemon Creek	11	61.4	51.8
Auke Bay	3	28.4	25.2
Gold Creek	5	8.2	7.0
Industrial Blvd. Plant	1	23.5	23.5
Total Diesel		121.5	107.5
Total Generation Properties		228.1	210.2

- (1) Nameplate rating, also referred to as “installed capacity,” is the manufacturer’s assigned power capability under specified conditions.
- (2) Present capability is the maximum capacity of the plant under standard test conditions without exceeding specified limits of temperature, stress and environmental conditions. Information is provided as of December 31, 2016.
- (3) AEL&P does not own this generating facility but has a PPA under which it has the right to purchase, and the obligation to pay for (whether or not energy is received), all of the capacity and energy of this facility.

In addition to the generation properties above, AEL&P owns approximately 61 miles of transmission lines, which are primarily comprised of 69 KV line, and approximately 184 miles of distribution lines.

### **Legal Proceedings**

In the course of its business, Avista Corp. becomes involved in various claims, controversies, disputes and other contingent matters. Some of these claims, controversies, disputes and other contingent matters involve litigation or other contested proceedings. For all such matters, Avista Corp. intends to vigorously protect and defend its interests and pursue its rights. However, no assurance can be given as to the ultimate outcome of any particular matter because litigation and other contested proceedings are inherently subject to numerous uncertainties. For matters that affect Avista Utilities’ or AEL&P’s operations, Avista Corp. intends to seek, to the extent appropriate, recovery of incurred costs through the ratemaking process.

#### ***California Refund Proceeding***

In February 2016, APX, a market maker in the California Refund Proceedings in whose markets Avista Energy participated in the summer of 2000, asserted that Avista Energy and its other customer/participants may be responsible for a share of the disgorgement penalty APX may be found to owe to the California Parties. The penalty arises as a result of the FERC finding that APX committed violations in the California market in the summer of 2000. APX is making these assertions despite Avista Energy having been dismissed in FERC Opinion No. 536 from the on-going administrative proceeding at the FERC regarding potential wrongdoing in the California markets in the summer of 2000. APX has identified Avista Energy’s share of APX’s exposure to be as much as US\$16.0 million even though no wrongdoing allegations are specifically attributable to Avista Energy. Avista Energy believes its 2014 settlement with the California Parties insulates it from any such liability and that as a dismissed party it cannot be drawn back into the litigation. Avista Energy intends to vigorously dispute APX’s assertions of indirect liability, but cannot at this time predict the eventual outcome.

### ***Cabinet Gorge Total Dissolved Gas Abatement Plan***

Dissolved atmospheric gas levels (“**Total Dissolved Gas**” or “**TDG**”) in the Clark Fork River exceed state of Idaho and federal water quality numeric standards downstream of Cabinet Gorge particularly during periods when excess river flows must be diverted over the spillway. Under the terms of the CFSA as incorporated in Avista Corp.’s FERC license for the Clark Fork Project, Avista Corp. has worked in consultation with agencies, tribes and other stakeholders to address this issue. Under the terms of a gas supersaturation mitigation plan, Avista Corp. is reducing TDG by constructing spill crest modifications on spill gates at the dam, and Avista Corp. expects to continue spill crest modifications over the next several years, in ongoing consultation with key stakeholders. Avista Corp. cannot at this time predict the outcome or estimate a range of costs associated with this contingency; however, Avista Corp. will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to this issue.

### ***Fish Passage at Cabinet Gorge and Noxon Rapids***

In 1999, the USFWS listed bull trout as threatened under the *Endangered Species Act*. In 2010, the USFWS issued a revised designation of critical habitat for bull trout, which includes the lower Clark Fork River. The USFWS issued a final recovery plan in October 2015.

The CFSA describes programs intended to help restore bull trout populations in the project area. Using the concept of adaptive management and working closely with the USFWS, Avista Corp. evaluated the feasibility of fish passage at Cabinet Gorge and Noxon Rapids. The results of these studies led, in part, to the decision to move forward with development of permanent facilities, among other bull trout enhancement efforts. Parties to the CFSA are working to resolve several issues. Avista Corp. believes its ongoing efforts through the CFSA continue to effectively address issues related to bull trout. Avista Corp. cannot at this time predict the outcome or estimate a range of costs associated with this contingency; however, Avista Corp. will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to fish passage at Cabinet Gorge and Noxon Rapids.

### ***Other Contingencies***

In the normal course of business, Avista Corp. has various other legal claims and contingent matters outstanding. Avista Corp. believes that any ultimate liability arising from these actions will not have a material impact on its financial condition, results of operations or cash flows.

### **Environmental Issues and Contingencies**

Avista Corp. is subject to environmental regulation by federal, state and local authorities. The generation, transmission, distribution, service and storage facilities in which they have ownership interests are designed and operated in compliance with applicable environmental laws. Furthermore, Avista Corp. conducts periodic reviews and audits of pertinent facilities and operations to ensure compliance and to respond to or anticipate emerging environmental issues. Avista Corporation’s board of directors has established a committee to oversee environmental issues.

Avista Corp. monitors legislative and regulatory developments at all levels of government for environmental issues, particularly those with the potential to impact the operation and productivity of their generating plants and other assets.

Environmental laws and regulations may:

- increase the operating costs of generating plants;
- increase the lead time and capital costs for the construction of new generating plants;
- require modification of its existing generating plants;
- require existing generating plant operations to be curtailed or shut down;
- reduce the amount of energy available from its generating plants;
- restrict the types of generating plants that can be built or contracted with;

- require construction of specific types of generation plants at higher cost; and
- increase costs of distributing natural gas.

Compliance with environmental laws and regulations could result in increases to capital expenditures and operating expenses. Avista Corp. intends to seek recovery of any such costs through the ratemaking process.

### ***Clean Air Act***

Avista Corp. must comply with the requirements under the CAA in operating its thermal generating plants. The CAA currently requires a Title V operating permit for Colstrip (expires in 2017), Coyote Springs 2 (expires in 2018), the Kettle Falls GS (application has been made for a new permit), and the Rathdrum CT (application has been made for a new permit). Boulder Park GS, Northeast CT, and other activities only require minor source operating or registration permits based on their limited operation and emissions. The Title V operating permits are renewed every five years and updated to include newly applicable CAA requirements. Avista Corp. actively monitors legislative, regulatory and program developments within the CAA that may impact its facilities.

On March 6, 2013, the Sierra Club and Montana Environmental Information Center, filed a Complaint (“**Complaint**”) in the United States District Court for the District of Montana, Billings Division, against the owners of Colstrip. The Complaint alleged certain violations of the CAA. On July 12, 2016, all of the parties to this action filed a Consent Decree with the Court settling all claims contained in the Complaint.

### ***Hazardous Air Pollutants***

The EPA regulates HAPs from a published list of industrial sources referred to as “source categories” which must meet control technology requirements if they emit one or more of the pollutants in significant quantities. In 2012, the EPA finalized the MATS for the coal and oil-fired source category. At the time of issuance in 2012, Avista Corp. examined the existing emission control systems of Colstrip Units 3 & 4, the only units in which Avista Corp. are a minority owner, and concluded that the existing emission control systems should be sufficient to meet mercury limits. For the remaining portion of the rule that utilized Particulate Matter as a surrogate for air toxics (including metals and acid gases), the Colstrip owners reviewed recent stack testing data and expected that no additional emission control systems would be needed for Units 3 & 4 MATS compliance.

### ***Regional Haze Program***

The EPA set a national goal of eliminating man-made visibility degradation in Class I areas by the year 2064. States are expected to take actions to make “reasonable progress” through 10-year plans, including application of BART requirements. BART is a retrofit program applied to large emission sources, including electric generating units built between 1962 and 1977. In the case where a State opts out of implementing the Regional Haze program, the EPA may act directly. On September 18, 2012, the EPA finalized the Regional Haze federal implementation plan (“**FIP**”) for Montana. The FIP includes both emission limitations and pollution controls for Colstrip Units 1 & 2. Colstrip Units 3 & 4, the only units of which Avista Corp. are a minority owner, are not currently affected, but will be evaluated for Reasonable Progress at the next review period. Avista Corp. does not anticipate any material impacts on Units 3 & 4 at this time.

### ***Coal Ash Management/Disposal***

On April 17, 2015, the EPA published a final rule regarding CCRs, also termed coal combustion byproducts or coal ash in the Federal Register, and this rule became effective on October 15, 2015. Colstrip, of which Avista Corp. is a 15 percent owner of Units 3 & 4, produces this byproduct. The rule establishes technical requirements for CCR landfills and surface impoundments under Subtitle D of the *Resource Conservation and Recovery Act*, the primary law in the United States for regulating solid waste. Avista Corp., in conjunction with the other owners, are developing a multi-year compliance plan to strategically address the new CCR requirements and existing state obligations while maintaining operational stability. During 2015, the operator of Colstrip provided an initial cost estimate of the expected retirement costs associated with complying with the new CCR rule and based on the initial assessments, Avista Corp. recorded an increase to its asset retirement obligations of US\$12.5 million with a corresponding increase in the cost basis of the utility plant. During 2016, due to additional information and updated estimates, Avista Corp. increased the ARO to US\$13.6 million (including accretion of US\$0.7 million).

In addition to an increase to Avista Corp.'s ARO, it is expected that there will be significant compliance costs at Colstrip in the future, both operating and capital costs, due to a series of incremental infrastructure improvements which are separate from the ARO.

The actual asset retirement costs and future compliance costs related to the CCR rule requirements may vary substantially from the estimates used to record the increased ARO due to uncertainty about the compliance strategies that will be used and the preliminary nature of available data used to estimate costs, such as the quantity of coal ash present at certain sites and the volume of fill that will be needed to cap and cover certain impoundments. Avista Corp. will coordinate with the plant operators and continue to gather additional data in future periods to make decisions about compliance strategies and the timing of closure activities. As additional information becomes available, Avista Corp. will update the ARO and future nonretirement compliance costs for these changes in estimates, which could be material. Avista Corp. expects to seek recovery of any increased costs related to complying with the new rule through customer rates.

### *Climate Change*

Concerns about long-term global climate changes could have a significant effect on Avista Corp.'s business. Avista Corp.'s operations could also be affected by changes in laws and regulations intended to mitigate the risk of, or alter global climate changes, including restrictions on the operation of their power generation resources and obligations imposed on the sale of natural gas. Changing temperatures and precipitation, including snowpack conditions, affect the availability and timing of streamflows, which impact hydroelectric generation. Extreme weather events could increase service interruptions, outages and maintenance costs. Changing temperatures could also increase or decrease customer demand.

Avista Corp.'s Climate Policy Council (an interdisciplinary team of management and other employees):

- facilitates internal and external communications regarding climate change issues,
- analyzes policy effects, anticipates opportunities and evaluates strategies for Avista Corp., and
- develops recommendations on climate related policy positions and action plans.

### *Climate Change - Federal Regulatory Actions*

The EPA released the final rules for the Clean Power Plan ("**Final CPP**") and the Carbon Pollution Standards ("**Final CPS**") on August 3, 2015. The Final CPP and the Final CPS are both intended to reduce the CO2 emissions from certain coal-fired and natural gas electric generating units ("**EGUs**"). These rules were published in the Federal Register on October 23, 2015 and were immediately challenged via lawsuits by other parties.

In a separate but related rulemaking, the EPA finalized CO2 new source performance standards ("**NSPS**") for new, modified and reconstructed fossil fuel-fired EGUs under CAA section 111(b). These EGUs fall into the same two categories of sources regulated by the Final CPP: steam generating units (also known as "**utility boilers and IGCC units**"), which primarily burn coal, and stationary combustion turbines, which primarily burn natural gas.

The promulgated and proposed greenhouse gas rulemakings mentioned above have been legally challenged in multiple venues. On February 9, 2016, the U.S. Supreme Court granted a request for stay, halting implementation of the CPP. On March 28, 2017, the Department of Justice has filed a motion with the U.S. Court of Appeals for the District of Columbia Circuit ("**D.C. Circuit**") requesting that the Court hold the cases challenging the CPP in abeyance while the EPA reviews the final rules applicable to existing, as well as to new, modified, and reconstructed electric generating units pursuant to an Executive Order issued by President Trump. The Executive Order also instructed the EPA to review the CPP rule. On April 28, 2017 the D.C. Circuit issued orders to hold the litigation regarding the Clean Air Act §111(d) Clean Power Plan and the §111(b) New Source Performance Standards for power plants in abeyance for a period of 60 days with status reports due from EPA every 30 days. The D.C. Circuit ordered the parties to file supplemental briefs by May 15, 2017 on whether the rules should be remanded to EPA, rather than having the case held in abeyance. Given this development and related ongoing legal challenges, Avista Corp. cannot fully predict the outcome or estimate the extent to which its facilities may be impacted by these regulations at this time. Avista Corp. intends to seek recovery of any costs related to compliance with these requirements through the ratemaking process.



## ***Climate Change - State Legislation and State Regulatory Activities***

The states of Washington and Oregon have adopted non-binding targets to reduce GHG emissions. Both states enacted their targets with an expectation of reaching the targets through a combination of renewable energy standards, and assorted “complementary policies,” but no specific reductions are mandated.

Washington and Oregon apply a GHG emissions performance standard to electric generation facilities used to serve retail loads in their jurisdictions. The emissions performance standard prevents utilities from constructing or purchasing generation facilities, or entering into power purchase agreements of five years or longer duration to purchase energy produced by plants, that in any case, have emission levels higher than 1,100 pounds of GHG per MWh. Commerce initiated a process to adopt a lower emissions performance standard in 2012; any new standard will be applicable until at least 2017. Commerce published a supplemental notice of proposed rulemaking on January 16, 2013 with a new emissions performance standard of 970 pounds of GHG per MWh. Avista Corp. will engage in the next process to revise the emissions performance standard, which should occur in 2017.

### ***Washington***

#### ***Energy Independence Act***

The EIA in Washington requires electric utilities with over 25,000 customers to acquire qualified renewable energy resources and/or renewable energy credits equal to 15 percent of the utility's total retail load in Washington in 2020. I-937 also requires these utilities to meet biennial energy conservation targets beginning in 2012. The renewable energy standard increased from three percent in 2012 to nine percent in 2016. Failure to comply with renewable energy and efficiency standards could result in penalties of US\$50 per MWh or greater assessed against a utility for each MWh it is deficient in meeting a standard. Avista Corp. has met, and will continue to meet, the requirements of EIA through a variety of renewable energy generating means, including, but not limited to, some combination of hydro upgrades, wind, biomass and renewable energy credits. In 2012, EIA was amended in such a way that Avista Utilities' Kettle Falls GS and certain other biomass energy facilities, which commenced operation before March 31, 1999, are considered resources that may be used to meet the renewable energy standards.

#### ***Clean Air Rule***

In September 2016, Ecology adopted the CAR to cap and reduce GHG emissions across the State of Washington in pursuit of the State's GHG goals, which were enacted in 2008 by the Legislature. The CAR applies to sources of annual GHG emissions in excess of 100,000 tons for the first compliance period of 2017 through 2019; this threshold incrementally decreases to 70,000 metric tons beginning in 2035. The rule affects stationary sources and transportation fuel suppliers, as well as natural gas distribution companies. Ecology has identified approximately 30 entities that would be regulated under the CAR. Parties covered by the regulation must reduce emissions by 1.7 percent annually until 2035. Compliance can be demonstrated by achieving emission reductions and/or surrendering ERUs, which are generated by parties that achieve reductions greater than required by the rule. ERUs can also take the form of renewable energy credits from renewable resources located in Washington, carbon emission offsets, and allowances acquired from an organized cap and trade market, such as that operating in California. In addition to the CAR's applicability to their burning of fuel as an electric utility, the CAR applies to Avista Corp. as a natural gas distribution company, for the emissions associated with the use of the natural gas Avista Corp. provides its customers who are not already covered under the regulation.

In September 2016, the Petitioners jointly filed an action in the U.S. District Court for the Eastern District of Washington challenging Ecology's recently promulgated CAR. The four companies also filed litigation in Thurston County Superior Court.

Petitioners believe that the reduction of GHG emissions is a matter that needs to be addressed, but the CAR is not the solution. Each utility represented in this case provided feedback and public comment to improve the rule, but ideas put forward were not incorporated in the final rule. They are asking the U.S. District Court and the Thurston County Superior Court to find that the CAR is invalid.

In their State claim, Petitioners assert that:

- Ecology lacks statutory authority to regulate natural gas utilities because the CAR holds them responsible for the indirect emissions of their customers;

- Ecology does not have the authority to create an emission reduction trading program (“ERUs”);
- Ecology failed to comply with the requirements of the *State Environmental Policy Act*; and
- the CAR is arbitrary and capricious.

Petitioners' federal claim asserts that the CAR violates the dormant Commerce Clause of the U.S. Constitution by discriminating against interstate commerce, regulating extraterritorially and unduly burdening interstate commerce by restricting the use of ERU's (allowances) generated from outside the State of Washington for compliance purposes. The case in U.S. District Court has been tolled while the state court case proceeds, with oral arguments scheduled for the spring of 2017.

#### *Initiative I-732*

An Initiative to the Legislature (“I-732”) to impose a carbon tax on fossil-fueled generation and natural gas distribution, as well as on transportation fuels, was submitted to the Legislature in January 2016. The Legislature failed to act upon the measure and I-732 was referred to the November 2016 General Election ballot, where it failed to gain enough votes for enactment.

#### *Colstrip 3 & 4 Considerations*

On February 6, 2014, the WUTC issued a letter finding that PSE's 2013 Electric Integrated Resource Plan meets the requirements of the Revised Code of Washington and the Washington Administrative Code. In its letter, however, the WUTC expressed concern regarding the continued operation of the Colstrip plant as a resource to serve retail customers. Although the WUTC recognized that the results of the analyses presented by PSE “differed significantly between Colstrip Units 1 & 2 and Units 3 & 4,” the WUTC did not limit its concerns solely to Colstrip Units 1 & 2. The WUTC recommended that PSE “consult with WUTC staff to consider a Colstrip Proceeding to determine the prudence of any new investment in Colstrip before it is made or, alternatively, a closure or partial-closure plan.” As part of the Sierra Club litigation that was settled in 2016, Units 1 & 2 are scheduled to close by July 2022. As a 15 percent owner of Colstrip Units 3 & 4, Avista Corp. cannot estimate the effect of such proceeding, should it occur, on the future ownership, operation and operating costs of our share of Colstrip Units 3 & 4. Our remaining investment in Colstrip Units 3 & 4 as of December 31, 2016 was US\$131.0 million.

In Oregon, legislation was enacted in 2016 which requires Portland General Electric and PacifiCorp to remove coal-fired generation from their Oregon rate base by 2030. This legislation does not directly relate to Avista Corp. because Avista Corp. is not an electric utility in Oregon. However, because these two utilities, along with Avista Corp., hold minority interests in Colstrip, the legislation could indirectly impact Avista Corp., though specific impacts cannot be identified at this time. While the legislation requires Portland General Electric and PacifiCorp to eliminate Colstrip from their rates, they would be permitted to sell the output of their shares of Colstrip into the wholesale market or, as is the case with PacifiCorp, reallocate the plant to other states. Avista Corp. cannot predict the eventual outcome of actions arising from this legislation at this time or estimate the effect thereof on Avista Corp.; however, Avista Corp. will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to our generation assets.

#### *Threatened and Endangered Species and Wildlife*

A number of species of fish in the Northwest are listed as threatened or endangered under the ESA. Efforts to protect these and other species have not significantly impacted generation levels at any of our hydroelectric facilities, nor operations of our thermal plants or electrical distribution and transmission system. Avista Corp. is implementing fish protection measures at its hydroelectric project on the Clark Fork River under a 45-year FERC operating license for Cabinet Gorge and Noxon Rapids (issued March 2001) that incorporates a comprehensive settlement agreement. The restoration of native salmonid fish, including bull trout, is a key part of the agreement. The result is a collaborative native salmonid restoration program with the U.S. Fish and Wildlife Service, Native American tribes and the states of Idaho and Montana on the lower Clark Fork River, consistent with requirements of the FERC license. The U.S. Fish & Wildlife Service issued an updated Critical Habitat Designation for bull trout in 2010 that includes the lower Clark Fork River, as well as portions of the Coeur d'Alene basin within the Spokane River Project area, and issued a final Bull Trout Recovery Plan under the ESA. Issues related to these activities are expected to be resolved through the ongoing collaborative effort of our Clark Fork and Spokane River FERC licenses.

Various statutory authorities, including the *Migratory Bird Treaty Act*, have established penalties for the unauthorized take of migratory birds. Because Avista Corp. operates facilities that can pose risks to a variety of such birds, they have developed and follow an avian protection plan.

Avista Corp. is also aware of other threatened and endangered species and issues related to them that could be impacted by their operations and they make every effort to comply with all laws and regulations relating to these threatened and endangered species. Avista Corp. expects all costs associated with these compliance efforts to be recovered through the future ratemaking process.

## **Regulation and Regulatory Matters**

### ***General***

As a public utility, Avista Corp. is subject to regulation by state utility commissions for prices, accounting, the issuance of securities and other matters. The retail electric and natural gas operations are subject to the jurisdiction of the WUTC, IPUC, OPUC and MPSC. Approval of the issuance of securities is not required from the MPSC. Avista Corp. is also subject to the jurisdiction of the FERC for licensing of hydroelectric generation resources, and for electric transmission services and wholesale sales.

Since Avista Corp. is a “holding company” (in addition to being itself an operating utility), it is also subject to the jurisdiction of the FERC under the *Public Utility Holding Company Act of 2005*, which imposes certain reporting and other requirements. Avista Corporation, and all of its subsidiaries (whether or not engaged in any energy related business), are required to maintain books, accounts and other records in accordance with the FERC regulations and to make them available to the FERC and the state utility commissions. In addition, upon the request of any jurisdictional state utility commission, or of Avista Corp., the FERC would have the authority to review assignment of costs of non-power goods and administrative services among Avista Corp. The FERC has the authority generally to require that rates subject to its jurisdiction be just and reasonable and in this context would continue to be able to, among other things, review transactions of any affiliated company.

Avista Corp.’s rates for retail electric and natural gas services (other than specially negotiated retail rates for industrial or large commercial customers, which are subject to regulatory review and approval) are generally determined on a “cost of service” basis.

Rates are designed to provide an opportunity for Avista Corp. to recover allowable operating expenses and earn a return of and a reasonable return on “rate base.” Rate base is generally determined by reference to the original cost (net of accumulated depreciation) of utility plant in service, subject to various adjustments for deferred income taxes and other items. Over time, rate base is increased by additions to utility plant in service and reduced by depreciation and retirement of utility plant and write-offs as authorized by the utility commissions. Avista Corp.’s operating expenses and rate base are allocated or directly assigned to five regulatory jurisdictions: electric in Washington and Idaho, and natural gas in Washington, Idaho and Oregon. In general, requests for new retail rates are made on the basis of revenues, operating expenses and net investment for a test year that ended prior to the date of the request, subject to possible adjustments, which differ among the various jurisdictions, designed to reflect the expected revenues, operating expenses and net investment during the period new retail rates will be in effect. The retail rates approved by the state commissions in a rate proceeding may not provide sufficient revenues to provide recovery of costs and a reasonable return on investment for a number of reasons, including, but not limited to, unexpected changes in revenues, expenses and investment following the time new retail rates are requested in the rate proceeding, the denial by the commission of recovery, or timely recovery, of certain expenses or investment and the limitation by the commission of the authorized return on investment.

Avista Corp.’s rates for wholesale electric and natural gas transmission services are based on either “cost of service” principles or market-based rates as set forth by the FERC.

### ***Avista Utilities – Washington General Rate Cases***

#### ***2015 General Rate Cases***

In January 2016, Avista Utilities received an order (“**Order 05**”) that concluded its electric and natural gas general rate cases that were originally filed with the WUTC in February 2015. New electric and natural gas rates were effective on January 11, 2016. The WUTC-approved rates were designed to provide a 1.6 percent, or US\$8.1 million decrease in electric base revenue, and a 7.4 percent, or US\$10.8 million increase in natural gas base revenue. The WUTC also approved an ROR on rate base of 7.29 percent, with a common equity ratio of 48.5 percent and a

9.5 percent ROE. On January 19, 2016, the ICNU and the PC filed a Joint Motion for Clarification with the WUTC. On February 19, 2016, the WUTC issued an order (“**Order 06**”) denying the motions and affirming Order 05, including an US\$8.1 million decrease in electric base revenue. On March 18, 2016, PC filed in Thurston County Superior Court a Petition for Judicial Review of the WUTC’s Order 05 and Order 06 described above that concluded Avista Utilities’ 2015 electric and natural gas general rate cases. The new rates established by Order 05 will continue in effect while the Petition for Judicial Review is being considered. Avista Utilities believes the WUTC’s Order 05 and Order 06 finalizing the electric and natural gas general rate cases provide a reasonable end result for all parties. If the outcome of the judicial review were to result in an electric rate reduction greater than the decrease ordered by the WUTC, it may not provide us with a reasonable opportunity to earn the rate of return authorized by the WUTC.

#### *2016 General Rate Cases*

On December 15, 2016, the WUTC issued an order related to Avista Utilities’ Washington electric and natural gas general rate cases that were originally filed with the WUTC in February 2016. The WUTC order denied Avista Utilities’ proposed electric and natural gas rate increase requests of US\$38.6 million and US\$4.4 million, respectively. On December 23, 2016 Avista Utilities filed a Petition for Reconsideration or, in the alternative, Rehearing (“**Petition**”) with the WUTC related to its 2016 general rate cases. On February 27, 2017, Avista Utilities received an order from the WUTC denying our Petition and confirming its previous order in the case.

Avista Utilities determined that an appeal of the WUTC’s decision to the courts would involve a significant amount of uncertainty regarding the level of success of such an appeal, as well as the timing of any value that might come following a process that would take between one and two years. Avista Utilities believes greater long-term value can be achieved through focusing on the 2017 general rate cases rather than through appealing the recent decision in the courts.

#### *2017 General Rate Cases*

On May 26, 2017, Avista Utilities filed two requests with the WUTC to recover costs related to power supply as well as infrastructure, system maintenance, and technology.

The two filings are summarized as follows:

#### *Power Cost Rate Adjustment*

The first filing is an electric only power cost rate adjustment that would update and reset power supply costs, effective September 1, 2017. Avista Utilities requested an overall increase in billed electric rates of 2.9 percent (designed to increase annual electric revenues by US\$15.0 million). The key drivers behind this request are related to the expiration of a capacity sales agreement with another utility and an increase in the price of natural gas to fuel our generating plants. Any new rates resulting from the power cost rate adjustment would expire upon the conclusion of the electric general rate case (discussed in further detail below), if approved. Avista Utilities expects the WUTC to address the power cost rate adjustment by August 10, 2017, in which they will either approve or deny the request or indicate additional steps that may be necessary.

#### *General Rate Requests*

The second request relates to electric and natural gas general rate cases. Avista Utilities filed three-year rate plans for electric and natural gas and have requested the following for each year (U.S. dollars in millions):

Effective Date	Electric		Natural Gas	
	Proposed Revenue	Proposed Base	Proposed Revenue	Proposed Base
	Increase	Rate Increase	Increase	Rate Increase
May 1, 2018 <sup>(1)</sup>	\$ 61.4	12.5%	\$ 8.3	9.3%
May 1, 2019 <sup>(2)</sup>	\$ 14.0	2.5%	\$ 4.2	4.4%
May 1, 2020 <sup>(2)</sup>	\$ 14.4	2.5%	\$ 4.4	4.4%

- (1) The US\$61.4 million electric revenue increase includes the US\$15.0 million power cost rate adjustment discussed above.
- (2) As a part of the electric rate plan, Avista Utilities has proposed to update power supply costs through a Power Supply Update, the effects of which would also go into effect on May 1, 2019 and May 1, 2020. The requested revenue increases for 2019 and 2020 do not include any power supply adjustments.

Avista Utilities request is based on a proposed ROR of 7.76 percent with a common equity ratio of 50.0 percent and a 9.9 percent ROE. As a part of the three-year rate plan, if approved, Avista Utilities would not file another general rate case until June 1, 2020, with new rates effective no earlier than May 1, 2021. The WUTC has up to 11 months to review the general rate case filings and issue a decision.

### ***Idaho General Rate Cases***

#### ***2016 General Rate Cases***

In December 2016, the IPUC approved a settlement agreement between Avista Utilities and other parties in their electric general rate case, concluding the Idaho electric general rate case originally filed in May 2016. New rates took effect on January 1, 2017 under the settlement agreement. Avista Utilities did not file a natural gas general rate case in 2016. The settlement agreement increased annual electric base rates by 2.6 percent (designed to increase annual electric revenues by US\$6.3 million). The settlement revenue increase is based on a ROR of 7.58 percent with a common equity ratio of 50 percent and a 9.5 percent ROE.

#### ***2017 General Rate Cases***

On June 9, 2017, Avista Utilities filed electric and natural gas general rate requests with the IPUC to recover increased power supply costs and capital investments made since the last determination of Avista Utilities' rate base in the 2016 Idaho general rate case. Avista Utilities filed two-year rate plans for electric and natural gas and have requested the following for each year (U.S. dollars in millions):

Effective Date	Electric		Natural Gas	
	Proposed Revenue	Proposed Base	Proposed Revenue	Proposed Base
	Increase	Rate Increase	Increase	Rate Increase
January 1, 2018	\$ 18.6	7.5%	\$ 3.5	8.8%
January 1, 2019 <sup>(1)</sup>	\$ 9.9	3.7%	\$ 2.1	5.0%

- (1) Avista Utilities is not proposing to update base power supply costs for year two of the rate plan, but rather have any differences flow through the PCA mechanism.

Avista Utilities' requests are based on a proposed ROR of 7.81 percent with a common equity ratio of 50.0 percent and a 9.9 percent ROE. As a part of the two-year rate plan, if approved, Avista Utilities would not file a new general rate case for a new rate plan to be effective prior to January 1, 2020. The IPUC has up to nine months to review the general rate case filings and issue a decision.

### ***Oregon General Rate Cases***

#### ***2015 General Rate Case***

On February 29, 2016, the OPUC issued a preliminary order (and a final order on March 15, 2016) concluding Avista Utilities' natural gas general rate case, which was originally filed with OPUC in May 2015. The OPUC order approved rates designed to increase overall billed natural gas rates by 4.9 percent (designed to increase annual natural gas revenues by US\$4.5 million). New rates went into effect on March 1, 2016. The final OPUC order incorporated two partial settlement agreements which were entered into during November 2015 and January 2016.

### *2016 General Rate Case*

On May 17, 2017, Avista Utilities reached a settlement agreement with all parties involved in its natural gas general rate case and the settlement agreement was filed with the OPUC. If the settlement agreement is approved by the OPUC, new rates would take effect on October 1, 2017.

The settlement proposes that, effective October 1, 2017, Avista Utilities would receive an increase in rates designed to increase annual base revenues by 5.9 percent or US\$3.5 million. In addition, the order denied the recovery of certain utility plant expenditures, which resulted in a disallowance and write-off of approximately US\$0.8 million in the second quarter of 2017.

The proposed settlement agreement reflects a 7.35 ROR with a common equity ratio of 50 percent and a 9.4 percent ROE.

### ***Alaska Electric Light and Power Company***

#### *Alaska General Rate Case*

In September 2016, AEL&P filed an electric general rate case with the RCA. AEL&P was granted a refundable interim base rate increase of 3.86 percent (designed to increase electric revenues by US\$1.3 million), which took effect in November 2016. AEL&P has also requested a permanent base rate increase of an additional 4.24 percent (designed to increase electric revenues by US\$1.5 million), which, if approved, could take effect in February 2018. This represents a combined total rate increase of 8.1 percent (designed to increase electric revenues by US\$2.8 million).

The RCA must rule on permanent rate increase requests within 450 days (approximately 15 months) from the date of filing, unless otherwise extended by consent of the parties. The statutory timeline for the AEL&P general rate case, with the consent of the parties, has been extended to February 8, 2018.

### ***Avista Utilities***

#### *Purchased Gas Adjustments*

PGAs are designed to pass through changes in natural gas costs to Avista Utilities' customers with no change in gross margin (operating revenues less resource costs) or net income. In Oregon, Avista Utilities absorbs (cost or benefit) 10 percent of the difference between actual and projected natural gas costs included in retail rates for supply that is not hedged. Total net deferred natural gas costs among all jurisdictions were a liability of US\$31.0 million as of March 31, 2017 and a liability of US\$30.8 million as of December 31, 2016, and these deferred natural gas costs balances represent amounts due to customers.

#### *Power Cost Deferrals and Recovery Mechanisms*

The ERM is an accounting method used to track certain differences between Avista Utilities' actual power supply costs, net of wholesale sales and sales of fuel, and the amount included in base retail rates for our Washington customers. Total net deferred power costs under the ERM were a liability of US\$21.6 million as of March 31, 2017 compared to a liability of US\$21.3 million as of December 31, 2016, and these deferred power cost balances represent amounts due to customers.

The difference in net power supply costs under the ERM primarily results from changes in:

- short-term wholesale market prices and sales and purchase volumes,
- the level and availability of hydroelectric generation,
- the level and availability of thermal generation (including changes in fuel prices), and
- retail loads.

Under the ERM, Avista Utilities absorbs the cost or receives the benefit from the initial amount of power supply costs in excess of or below the level in retail rates, which is referred to as the deadband. The annual (calendar year) deadband amount is US\$4.0 million.

### ***Decoupling and Earnings Sharing Mechanisms***

Decoupling is a mechanism designed to sever the link between a utility's revenues and consumers' energy usage. In each of Avista Utilities' jurisdictions, each month Avista Utilities' electric and natural gas revenues are adjusted so as to be based on the number of customers in certain customer rate classes, rather than kilowatt hour and therm sales. The difference between revenues based on the number of customers and revenues based on actual usage is deferred and either surcharged or rebated to customers beginning in the following year.

#### ***Washington Decoupling and Earnings Sharing***

In Washington, the WUTC approved Avista Utilities' decoupling mechanisms for electric and natural gas for a five-year period beginning January 1, 2015. Electric and natural gas decoupling surcharge rate adjustments to customers are limited to 3 percent on an annual basis, with any remaining surcharge balance carried forward for recovery in a future period. There is no limit on the level of rebate rate adjustments.

The decoupling mechanisms each include an after-the-fact earnings test. At the end of each calendar year, separate electric and natural gas earnings calculations are made for the prior calendar year. These earnings tests reflect actual decoupled revenues, normalized power supply costs and other normalizing adjustments.

- If Avista Utilities has a decoupling rebate balance for the prior year and earns in excess of the authorized ROR (7.32 percent for 2015 and 7.29 percent for 2016), the rebate to customers would be increased by 50 percent of the earnings in excess of the authorized ROR.
- If Avista Utilities has a decoupling rebate balance for the prior year and its earnings are equal to or less than the authorized ROR, only the base amount of the rebate to customers would be made.
- If Avista Utilities has a decoupling surcharge balance for the prior year and earns in excess of the authorized ROR, the surcharge to customers would be reduced by 50 percent of the earnings in excess of the authorized ROR (or eliminated). If 50 percent of the earnings in excess of the authorized ROR exceeds the decoupling surcharge balance, the dollar amount that exceeds the surcharge balance would create a rebate balance for customers.
- If Avista Utilities has a decoupling surcharge balance for the prior year and its earnings are equal to or less than the authorized ROR, the base amount of the surcharge to customers would be made.

#### ***Idaho FCA and Earnings Sharing Mechanisms***

In Idaho, the IPUC approved the implementation of FCAs for electric and natural gas (similar in operation and effect to the Washington decoupling mechanisms) for an initial term of three years, beginning January 1, 2016.

For the period 2013 through 2015, Avista Corp. had an after-the-fact earnings test, such that if Avista Corp., on a consolidated basis for electric and natural gas operations in Idaho, earned more than a 9.8 percent ROE, it would be required to share with customers 50 percent of any earnings above the 9.8 percent. There was no provision for a surcharge to customers if its ROE was less than 9.8 percent. This after-the-fact earnings test was discontinued as part of the settlement of Avista Corp.'s 2015 Idaho electric and natural gas general rates cases.

#### ***Oregon Decoupling Mechanism***

In February 2016, the OPUC approved the implementation of a decoupling mechanism for natural gas, similar to the Washington and Idaho mechanisms described above. The decoupling mechanism became effective on March 1, 2016. There will be an opportunity for interested parties to review the mechanism and recommend changes, if any, by September 2019. An earnings review is conducted on an annual basis, which is filed by Avista Corp. with the OPUC on or before June 1 of each year for the prior calendar year. In the annual earnings review, if Avista Corp. earns more than 100 basis points above its allowed return on equity, one-third of the earnings above the 100 basis points would be deferred and later returned to customers.

### **Liquidity, Capital Resources and Financing Activities**

Avista Corporation's consolidated operating cash flows are primarily derived from the operations of Avista Utilities. The primary source of operating cash flows for Avista Utilities is revenues from sales of electricity and natural gas. Significant uses of cash flows from Avista Utilities include the purchase of power, fuel and natural gas,

and payment of other operating expenses, taxes and interest, with any excess being available for other corporate uses such as capital expenditures and dividends.

### **Committed Lines of Credit**

Avista Corporation has a committed line of credit with various financial institutions in the total amount of US\$400.0 million. Avista Corporation exercised a two-year option in May 2016 to extend the maturity of the credit facility agreement to April 2021. As of March 31, 2017, there were US\$105.0 million of cash borrowings and US\$42.1 million in letters of credit outstanding (which were primarily issued as collateral for Avista Corporation's energy commodity and interest rate swap derivatives), leaving US\$252.9 million of available liquidity under this line of credit.

The Avista Corporation credit facility contains customary covenants and default provisions, including a covenant which does not permit its ratio of "consolidated total debt" to "consolidated total capitalization" to be greater than 65 percent at any time. As of March 31, 2017, Avista Corporation is in compliance with this covenant with a ratio of 52.2 percent.

AEL&P has a US\$25.0 million committed line of credit that expires in November 2019. As of March 31, 2017, there were no borrowings or letters of credit outstanding under this committed line of credit.

The AEL&P credit facility contains customary covenants and default provisions including a covenant which does not permit the ratio of "consolidated total debt at AEL&P" to "consolidated total capitalization at AEL&P," (including the impact of the Snettisham obligation) to be greater than 67.5 percent at any time. As of March 31, 2017, AEL&P was in compliance with this covenant with a ratio of 54.6 percent.

### **Competition**

Avista Corp.'s utility electric and natural gas distribution business has historically been recognized as a natural monopoly. In each regulatory jurisdiction, its rates for retail electric and natural gas services (other than specially negotiated retail rates for industrial or large commercial customers, which are subject to regulatory review and approval) are generally determined on a "cost of service" basis. Rates are designed to provide, after recovery of allowable operating expenses and capital investments, an opportunity for it to earn a reasonable return on investment as allowed by its regulators.

In retail markets, Avista Corp. compete with various rural electric cooperatives and public utility districts in and adjacent to its service territories in the provision of service to new electric customers. Alternative energy technologies, including customer-sited solar, wind or geothermal generation, may also compete with it for sales to existing customers. While the risk is currently small in its service territory given the small numbers of customers utilizing these technologies, advances in power generation, energy efficiency, energy storage and other alternative energy technologies could lead to more wide-spread usage of these technologies, thereby reducing customer demand for the energy supplied by Avista Corp. This reduction in usage and demand would reduce Avista Corp.'s revenue and negatively impact its financial condition including possibly leading to its inability to fully recover its investments in generation, transmission and distribution assets. Similarly, Avista Corp.'s natural gas distribution operations compete with other energy sources including heating oil, propane and other fuels.

Certain natural gas customers could bypass Avista Corp.'s natural gas system, reducing both revenues and recovery of fixed costs. To reduce the potential for such bypass, Avista Corp. prices its natural gas services, including transportation contracts, competitively and have varying degrees of flexibility to price transportation and delivery rates by means of individual contracts. These individual contracts are subject to state regulatory review and approval. Avista Corp. has long-term transportation contracts with several of its largest industrial customers under which the customer acquires its own commodity while using Avista Corp.'s infrastructure for delivery. Such contracts reduce the risk of these customers bypassing Avista Corp.'s system in the foreseeable future and minimizes the impact on its earnings.

Also, non-utility businesses are developing new technologies and services to help energy consumers manage energy in new ways that may improve productivity and could alter demand for the energy Avista Corp. sells.

In wholesale markets, competition for available electric supply is influenced by the:

- localized and system-wide demand for energy,



- type, capacity, location and availability of generation resources, and
- variety and circumstances of market participants.

These wholesale markets are regulated by the FERC, which requires electric utilities to:

- transmit power and energy to or for wholesale purchasers and sellers,
- enlarge or construct additional transmission capacity for the purpose of providing these services, and
- transparently price and offer transmission services without favor to any party, including the merchant functions of the utility.

Participants in the wholesale energy markets include:

- other utilities,
- federal power marketing agencies,
- energy marketing and trading companies,
- independent power producers,
- financial institutions, and
- commodity brokers.

### Credit Ratings

Avista Corporation's corporate credit ratings and the ratings for its securities are as follows:

<u>Period</u>	<u>S&amp;P<sup>(1)</sup></u>	<u>Moody's<sup>(2)</sup></u>
Corporate/Issuer rating .....	BBB	Baa1
Senior secured debt.....	A-	A2
Senior unsecured debt.....	BBB	Baa1

(1) S&P's lowest "investment grade" credit rating is BBB-.

(2) Moody's lowest "investment grade" credit rating is Baa3.

A security rating is not a recommendation to buy, sell or hold securities. Each rating is subject to revision or withdrawal at any time by the assigning rating organization. Each security rating agency has its own methodology for assigning ratings, and, accordingly, each rating should be considered independently of all other ratings.

See "Recent Developments".

For additional information on Avista Corp. see pages A-9 and A-10 of the Investor Presentation attached as Appendix A to this Prospectus.

## THE MERGER AGREEMENT

Set forth below is a description of the material terms of the Merger Agreement. The description is a summary only and is qualified in its entirety by the full text of the Merger Agreement. A copy of the Merger Agreement has been filed on the Corporation's SEDAR profile at [www.sedar.com](http://www.sedar.com). This summary is not intended to

be, and should not be relied upon as disclosure of any facts and circumstances relating to Hydro One or Avista Corp. All capitalized terms used herein without definition will have the meanings assigned to them in the Merger Agreement, a copy of which will be available on the Corporation's SEDAR profile at [www.sedar.com](http://www.sedar.com).

## **The Merger**

On July 19, 2017, the Corporation, US Parent, Merger Sub and Avista Corporation entered into the Merger Agreement. Upon the terms and subject to the conditions set forth in the Merger Agreement, which has been approved by the board of directors of both Avista Corporation and Hydro One Limited, at the effective time upon the closing of the Merger, Merger Sub will merge with and into Avista Corporation with Avista Corporation continuing as the surviving corporation. US Parent is an indirect, wholly owned subsidiary of the Corporation, and Merger Sub is a direct, wholly-owned subsidiary of US Parent and, at the effective time of the closing of the Merger, will be collectively owned by US Parent and one or more direct or indirect wholly owned subsidiaries of the Corporation.

## **The Merger Consideration**

Pursuant to the Merger Agreement, upon the closing of the Merger, each issued and outstanding share of common stock, no par value, of Avista Corporation (other than shares held by shareholders exercising their dissenter's rights and shares owned by the Corporation, US Parent or Merger Sub or their respective subsidiaries to be cancelled in the Merger) will be converted automatically into the right to receive US\$53.00 in cash, without interest (the "**Merger Consideration**"). The aggregate amount of Merger Consideration to be paid, including with respect to the outstanding restricted stock units (the "**RSUs**") and performance awards granted under Avista Corporation's stock incentive plans, is approximately US\$3.4 billion in cash. Shareholders exercising their dissenter's rights and shares owned by the Corporation, US Parent or Merger Sub or their respective subsidiaries to be cancelled in the Merger will not be entitled to receive the Merger Consideration.

## **Treatment of Performance Awards and RSUs**

Upon the closing of the Merger, each outstanding performance award will be cancelled and converted into the right to receive a lump sum cash payment equal to the product of (i) the Merger Consideration multiplied by (ii)(A) for any outstanding performance award for which the performance period has ended as of immediately prior to the effective time of the Merger, (1) in the case of a share-settled performance award, the number of shares of Avista Corporation common stock that would be delivered to the holder of such performance award, or (2) in the case of a cash-settled performance award, the number of shares of Avista Corporation common stock that would be deemed deliverable to the holder for purposes of calculating the cash payment due under such performance award, in each case, based on the achievement of the applicable performance goals, as reasonably determined by the board of directors of Avista Corporation (or a committee thereof) prior to the effective time of the Merger, and assuming the satisfaction of all other applicable conditions, and (B) for any outstanding performance award for which the performance period has not ended as of immediately prior to the effective time of the Merger, (1) in the case of a share-settled performance award, the number of shares of Avista Corporation common stock subject to such performance award, or (2) in the case of a cash-settled performance award, the number of shares of Avista Corporation common stock that would be deemed deliverable to the holder for purposes of calculating the cash payment due thereunder, in each case, based on deemed satisfaction of the applicable performance goals at the target level, and in each case, assuming the satisfaction of all other applicable conditions. Upon the closing of the Merger, all accrued but unpaid dividends with respect to performance awards will become fully vested and be paid in connection with the Merger.

Upon the closing of the Merger, each outstanding RSU which by its terms would vest before the calendar year or in the calendar year in which the Merger occurs will be cancelled and converted into the right to receive a lump-sum cash payment equal to the product of (i) the number of shares of Avista Corporation common stock subject to the cancelled RSU and (ii) the Merger Consideration. Upon the closing of the Merger, all accrued but unpaid dividends with respect to cancelled RSUs will become fully vested and be paid in connection with the Merger.

Upon the closing of the Merger, each outstanding RSU which by its terms would vest in any calendar year following the calendar year in which the Merger occurs will be converted into a restricted stock unit award issued

under the Corporation's equity-based long-term incentive compensation plan, on the same terms and conditions as were applicable under the RSU immediately prior to the effective time of the Merger, with respect to a number of shares of common stock of the Corporation determined by multiplying (i) the number of shares of Avista Corporation common stock subject to the RSU by (ii) a fraction, the numerator of which is the Merger Consideration and the denominator of which is the closing price per share of common stock of the Corporation on the TSX on the closing date of the Merger, converted into U.S. dollars using the reported Bank of Canada noon spot exchange rate on the closing date of the Merger (or as reported by such other authoritative source mutually accepted by Avista Corporation and the Corporation), rounded up to the nearest whole share, and each such converted RSU will not be accelerated except as provided in the related RSU agreement. Upon the closing of the Merger, the Corporation will assume all obligations of Avista Corporation with respect to the Avista Corporation stock plans and each outstanding converted RSU and the original related grant agreements. The converted RSUs will be settled in shares of common stock of the Corporation or cash, as determined by the Corporation.

All amounts payable pursuant to the Merger Agreement are subject to reduction for applicable tax withholdings.

### **Representations and Warranties**

Under the Merger Agreement, the Corporation, US Parent, Merger Sub and Avista Corporation have made various customary representations and warranties.

Avista Corporation's representations and warranties relate to, among other things: organization, standing and corporate power of Avista Corporation and its subsidiaries; capitalization; authority and non-contravention; governmental approvals; Avista Corporation SEC reports and financial statements and undisclosed liabilities; absence of certain changes; legal proceedings; compliance with applicable laws and permits; tax matters; employee benefits matters; environmental matters; intellectual property; real property; material contracts; labour and employment matters; opinion of financial advisor; brokers and other advisors; and Avista Shareholder Approval.

The representations and warranties of the Corporation, US Parent and Merger Sub relate to, among other things: organization, standing and corporate power; authority and non-contravention; governmental approvals; brokers and other advisors; ownership and operations of Merger Sub; sufficient funds; share ownership; legal proceedings; and non-reliance.

### **Covenants**

Avista Corporation, the Corporation, US Parent and Merger Sub have made covenants regarding the conduct of the parties to the Merger Agreement during the period between the signing of the Merger Agreement and the closing of the Merger, at the closing of the Merger and after the closing of the Merger.

Except as set forth in the confidential disclosure schedules to the Merger Agreement, or otherwise contemplated or permitted by the Merger Agreement or as required by applicable law, or with the prior written consent of the Corporation (not to be unreasonably withheld, delayed or conditioned), (a) Avista Corporation has agreed, among other things, from the date of the Merger Agreement until the closing of the Merger to, and to cause each of its subsidiaries to, use its commercially reasonable efforts to conduct its business in all material respects in the ordinary course of business and to preserve intact its present lines of business, maintain its rights and franchises and preserve satisfactory relationships with governmental authorities, employees, customers and suppliers, and (b) Avista Corporation will not, and will not permit any of its subsidiaries to: (i) issue any shares of its capital stock, or any securities or rights convertible into shares of its capital stock except for (A) the issuance of any shares of Avista Corporation common stock in settlements of RSUs and performance awards or (B) the issuance of such number of shares of Avista Corporation capital stock as is equal to an equivalent value of up to US\$150,000,000 in net proceeds in the aggregate through the end of 2018, as disclosed in the related confidential disclosure schedules to the Merger Agreement; (ii) redeem, repurchase or otherwise acquire any of its capital stock, except in connection with withholding shares of Avista Corporation common stock to satisfy tax obligations with respect to RSUs and performance awards or acquisitions in connection with the forfeiture of RSUs and performance awards; (iii) declare any dividend on, or make any other distribution in respect of, any shares of capital stock other than (A) dividends paid by any subsidiary of Avista Corporation to Avista Corporation or a wholly owned subsidiary of Avista Corporation, (B) quarterly cash dividends with respect to the Avista Corporation common stock not to exceed the

current annual per share dividend rate by more than US\$0.06 per year, consistent with Avista Corporation's current dividend practice or (C) a "stub period" dividend to holders of record of Avista Corporation common stock as of immediately prior to the effective time of the Merger; (iv) incur any indebtedness in excess of US\$250,000,000 in the aggregate, except to replace existing indebtedness, pursuant to any existing contract relating to indebtedness or among Avista Corporation and any of its wholly-owned subsidiaries or among any of such wholly owned subsidiaries; (v) dispose of any of its properties or assets except (A) dispositions as to which the sales price is not in excess of US\$25,000,000 in the aggregate in any calendar year, (B) pursuant to a material contract in effect as of the date of the Merger Agreement, (C) dispositions of inventory or equipment that are no longer used or useful or (D) transfers among Avista Corporation and its wholly-owned subsidiaries; (vi) make capital expenditures, except for an aggregate amount of capital expenditures in any calendar year equal to the aggregate amount budgeted in Avista Corporation's current long term plan that was made available to the Corporation prior to the date of the Merger Agreement (plus a 10% variance), excluding any acquisition expenditures permitted pursuant to item (vii) below; (vii) make any acquisition (including by merger) of capital stock or assets of any other person for consideration in excess of US\$25,000,000 in the aggregate in any calendar year (not including certain capital expenditures); (viii) (A) increase the compensation or benefits of any of its directors, executive officers or employees (except in the ordinary course of business), (B) grant to any director or employee of Avista Corporation or any of its subsidiaries any increase in change-in-control, severance, retention or termination pay, or enter into or amend any change-in-control, severance, retention or termination agreement or (C) take any action to accelerate the time of vesting, funding or payment of any compensation or benefits under any Avista Corporation benefit plan, except, in each case, (X) as required pursuant to applicable law, (Y) pursuant to the terms of Avista Corporation benefit plans or collective bargaining agreements, or (Z) in the ordinary course of business consistent with past practice; (ix) establish, adopt, amend or terminate any company benefit plan except (A) as required by law or (B) for routine, immaterial or ministerial amendments; (x) make any material change to its methods of accounting, except as required by U.S. GAAP, Regulation S-X of the Exchange Act, a governmental authority or by applicable law; (xi) amend Avista Corporation's organizational documents or the organizational documents of any of its subsidiaries; (xii) adopt a plan or agreement of complete or partial liquidation or dissolution; (xiii) enter into, modify, or amend in any material respect or terminate or waive any material right under any material contracts of Avista Corp. except in the ordinary course of business or a termination without material penalty to Avista Corporation or any of its subsidiaries; (xiv) waive, settle or compromise any material claim except (A) with respect to the payment of monetary damages, a payment not exceeding US\$2,000,000 in the aggregate during any twelve-month period or (B) with respect to any nonmonetary terms, would not reasonably be expected to be material and adverse to Avista Corporation and its subsidiaries; (xv) make or change any material tax election, any material method of tax accounting, amend any material tax return or settle any material tax liability; (xvi) permit any material insurance policy to terminate or lapse without replacing such policy with substantially similar coverage; (xvii) enter into any derivative transactions other than in the ordinary course of business and in a manner consistent with and in compliance with hedging policies or materially change any of its energy price or interest rate risk management guidelines; (xviii) enter into any material new line of business; (xix) take any action that would reasonably be expected to materially impede, interfere with or delay the consummation by Avista Corporation of the Merger and the related transactions contemplated by the Merger Agreement; or (xx) agree in writing to do any of the foregoing.

Under the Merger Agreement, the Corporation, US Parent and Merger Sub agreed that they will not take any action that would reasonably be expected to prevent or materially impede the consummation by the Corporation, US Parent or Merger Sub of the Merger and the related transactions contemplated by the Merger Agreement.

Between the date of the Merger Agreement and the closing of the Merger, Avista Corporation is required to continue to make regulatory filings in the ordinary course of business consistent with past practice and is permitted to respond to regulatory filings made by other parties in which Avista Corporation or any of its subsidiaries is an interested party and take other actions contemplated by the state or federal filings or submissions made in connection with regulatory filings in the ordinary course of business. Avista Corporation is required to keep the Corporation promptly informed of any material communications or meetings with any governmental authority with respect to rate cases, consult with and give the Corporation a reasonable opportunity to comment on material written communications or submissions to governmental authorities, and provide the Corporation a reasonable opportunity to participate in any related material meeting or communication. The Corporation has the right to approve (not to be unreasonably withheld, conditioned or delayed) any settlement of any rate case and rate case filing if it would reasonably be expected to result in an outcome that would be materially adverse to Avista Corporation or any of its

subsidiaries after the closing of the Merger, taking into account the requests made by Avista Corp. in such rate case and the resolution of similar recent rate cases by Avista Corp.

Moreover, Avista Corporation has agreed to prepare and file with the SEC a preliminary proxy statement as promptly as reasonably practicable, but in any event within sixty days after the signing of the Merger Agreement, and the Corporation has agreed to cooperate in such preparation and filing.

Under the Merger Agreement, Avista Corporation, the Corporation, US Parent and Merger Sub are required to use reasonable best efforts to cause the Merger to be consummated as soon as practicable, make any required governmental submissions and filings and obtain all required governmental and regulatory approvals. In furtherance of the foregoing, the Corporation, US Parent and Merger Sub agreed to take all necessary steps to eliminate impediments to obtaining required regulatory approvals, except that neither the Corporation nor any of its affiliates is required to accept any term or condition in connection with obtaining the required regulatory approvals that would have or be reasonably likely to constitute a Burdensome Condition (as defined below). In the course of obtaining required regulatory approvals, Avista Corporation is not permitted to offer or agree to any concessions with regulators that would reasonably be expected to be material and adverse to the Corporation's ability to obtain required regulatory approvals on substantially the terms the Corporation reasonably expects unless Avista Corporation is so directed by the Corporation.

The Corporation has agreed that, for a period of six years after the Merger, it will cause to be maintained in effect policies of directors' and officers' liability insurance and fiduciary liability insurance no less favorable than the existing coverage, subject to a limit on the aggregate annual premiums payable of not more than 300% of the current premiums paid by Avista Corporation. In lieu of maintaining the foregoing coverage, Avista Corporation may purchase a "tail" insurance policy for a period of not less than six years, subject to the same aggregate cost limitation.

In addition, for a period of three years after the closing of the Merger, the Corporation will cause to be provided to each individual employed by Avista Corporation or its subsidiaries immediately prior to the closing of the Merger, cash compensation (including bonus and long-term incentive compensation opportunities) and employee benefits that are no less favourable than those provided to such employee, in the aggregate, immediately prior to the closing of the Merger. With respect to employees of Avista Corp. covered by a collective bargaining agreement, the Corporation will cause to be provided to such employees' terms and conditions of employment as required by the applicable collective bargaining agreement. Effective upon the closing of the Merger, the Corporation is required to cause Avista Corporation to implement a pre-agreed executive retention program.

Between the date of the Merger Agreement until the closing of the Merger, subject to certain limitations, Avista Corporation is required to use its commercially reasonable efforts to cooperate with the Corporation and its affiliates in connection with any financing transaction undertaken by the Corporation in connection with the Merger.

The Merger Agreement includes a series of governance and operational commitments and limitations, with respect to Avista Corporation that the Corporation intends to implement from and after the consummation of the Merger. From and after the closing of the Merger, the Corporation intends that the board of directors of Avista Corporation (the "**Subsidiary Board**") will consist of nine members in total, determined as follows: (i) two directors designated by the sole shareholder of Avista Corporation, who are executives of the Corporation or any of its subsidiaries, (ii) three directors who are not officers, employees or directors (other than an independent director of Avista Corporation) of the Corporation or any of its affiliates and who are residents of the Pacific Northwest region, to be designated by the sole shareholder of Avista Corporation, (iii) three directors who, as of immediately prior to the effective time of the Merger, were members of the board of directors of Avista Corporation, including the chairman of Avista Corporation's board of directors (if such person is different from the chief executive officer of Avista Corporation), and (iv) the chief executive officer of Avista Corporation. The initial chairman of the board of directors of Avista Corporation following the closing of the Merger will be the chief executive officer of Avista Corporation as of the time immediately prior to the effective time of the Merger for a one-year term. In addition, these provisions permit the Corporation to promptly remove and replace its designees to the Subsidiary Board, require prior notice of matters to be discussed at meetings of the Subsidiary Board and require that a quorum of the Subsidiary Board includes at least one member who is an executive of the Corporation and at least an equal number of members designated by the Corporation as other members of the board.

Furthermore, following the closing of the Merger, commitments with respect to certain operational, governance and related matters will be required to be administered by the Subsidiary Board, subject to the approval of the sole shareholder of Avista Corporation, which will be a wholly owned, indirect subsidiary of the Corporation, with respect to specified matters. The matters to be administered by the Subsidiary Board include, among others, social commitments, decisions with respect to maintaining existing levels of charitable giving and economic development investment, maintaining Avista Corporation's brand, and maintaining the location of Avista Corporation's headquarters in Spokane, Washington, maintaining service and reliability standards, negotiations with labour unions, maintenance of existing employee compensation and benefits practices, retention of the existing executive management team and the composition of the Subsidiary Board as described above. The approval of the sole shareholder of Avista Corporation will be required, however, for decisions with respect to fundamental operational, governance and organizational matters, including, among others, entering into a merger or other business combination transaction, materially changing the nature of the business of Avista Corporation or any of its subsidiaries, winding up or dissolving Avista Corporation or any of its subsidiaries, declaring or paying dividends, changing the number of directors on the board of directors, changing employee compensation in a manner that is inconsistent with current market standards and practices, hiring or dismissing the chief executive officer and amending the organizational documents of Avista Corporation or any of its subsidiaries.

### **Closing Conditions**

The Merger Agreement provides that the obligation of each of the Corporation, US Parent, Merger Sub and Avista Corporation to consummate the Merger is subject to the satisfaction or waiver of the following conditions:

(i) the Merger Agreement shall have been approved by the affirmative vote of the holders of a majority of the outstanding shares of Avista Corporation common stock entitled to vote at a duly convened meeting of Avista Corporation's shareholders ("**Avista Shareholder Approval**");

(ii) the governmental and regulatory consents and approvals specified in the Merger Agreement required to be obtained by the Corporation, US Parent, Merger Sub and Avista Corporation pursuant to the Merger shall have been obtained prior to the closing of the Merger, including: (A) clearance of the Merger by CFIUS and the expiration or termination of any applicable waiting period under the HSR Act and (B) the approval of the Merger by each of the IPUC, MPSC, OPUC, RCA, WUTC, the FERC and the FCC, and the required regulatory approvals and consents shall have become Final Orders; and

(iii) no law or judgment shall be in effect that prevent, prohibits or makes illegal the consummation of the Merger.

In addition, the Merger Agreement provides that the obligation of the Corporation, US Parent and Merger Sub to consummate the Merger is subject to the satisfaction or waiver of the following conditions:

(i) (A) the representations and warranties of Avista Corporation (except for the representations and warranties pertaining to capital structure and authority) shall be true and correct (without giving effect to any limitation as to "materiality" or "Avista Material Adverse Effect"), except where the failure to be true and correct has not had or would not reasonably be expected to have an Avista Material Adverse Effect; (B) the representations and warranties of Avista Corporation pertaining to capital structure shall be true and correct except where the failure of any such representation or warranty to be true and correct would be de minimis; and (C) the representations and warranties of Avista Corporation pertaining to authority and shareholder approval shall be true and correct in all material respects, in each case, as of the closing of the Merger as though made at and as of the closing of the Merger (except to the extent that such representation and warranty is expressly made as of a specified date, in which case such representation and warranty shall be true and correct as of such specific date);

(ii) Avista Corporation must have complied with all of its covenants in all material respects;

(iii) the Corporation shall have received a certificate signed by an executive officer of Avista Corporation certifying the satisfaction by Avista Corporation of the conditions set forth in items (i) and (ii) above;

(iv) no Avista Material Adverse Effect has occurred; and

(v) the Final Orders do not impose or require any obligations that would, individually or in the aggregate, constitute a Burdensome Condition.

The Merger Agreement also provides that the obligation of Avista Corporation to consummate the Merger is subject to the satisfaction or waiver of the following conditions:

(i) the representations and warranties of the Corporation, US Parent and Merger Sub shall be true and correct (without giving effect to any limitation as to “materiality” or “Corporation Material Adverse Effect”), as of the closing of the Merger with the same effect as though made on and as of the closing of the Merger (except to the extent that such representation and warranty is expressly made as of a specified date, in which case such representation and warranty shall be true and correct as of such specific date), except as would not cause a Corporation Material Adverse Effect;

(ii) the Corporation, US Parent and Merger Sub must have complied with all of their respective covenants in all material respects; and

(iii) Avista Corporation shall have received a certificate signed by an executive officer of the Corporation certifying the satisfaction by the Corporation and Merger Sub of the conditions set forth in items (i) and (ii) above.

#### **No Solicitation; Avista Corporation’s Board of Directors Recommendation**

Pursuant to the terms of the Merger Agreement, Avista Corporation will, and will cause its subsidiaries and its and their respective directors, officers, employees and professional (including financial) advisors, attorneys, accountants, consultants or other representatives (acting in such capacity) (“**Representatives**”) to, immediately terminate any ongoing negotiations with any person with respect to any Takeover Proposal. From and after the signing of the Merger Agreement, Avista Corporation will not and will cause its subsidiaries and Representatives not to, directly or indirectly, (i) solicit, initiate or knowingly encourage or facilitate any Takeover Proposal or (ii) enter into or participate in any discussions or negotiations with any person or furnish any nonpublic information to or cooperate with any person with respect to a Takeover Proposal. Notwithstanding the foregoing, Avista Corporation may, in response to an unsolicited Takeover Proposal made after the signing of the Merger Agreement and prior to the receipt of the Avista Shareholder Approval and that the board of directors of Avista Corporation determines in good faith could lead to a Superior Proposal, furnish information and participate in discussions with the persons making that Takeover Proposal. Avista Corporation must notify the Corporation promptly in writing of the receipt of the Takeover Proposal, its material terms and conditions, and the identity of the person making the Takeover Proposal.

Except as otherwise provided in the Merger Agreement, neither the Avista Corporation board of directors nor any committee thereof shall (i)(A) withdraw, change, qualify, withhold or modify in a manner adverse to the Corporation, or publicly propose to withdraw, change, qualify, withhold or modify in a manner adverse to the Corporation, its recommendation that Avista Corporation’s shareholders approve the Merger Agreement, (B) adopt, approve or recommend, or publicly propose to adopt, approve or recommend, any Takeover Proposal, (C) fail to include its recommendation that Avista Corporation’s shareholders approve the Merger Agreement in the proxy statement sent to its shareholders relating to the shareholder meeting to be held to vote on approval of the Merger Agreement or (D) in the event a tender offer that constitutes a Takeover Proposal subject to Regulation 14D under the Exchange Act is commenced, fail to recommend against such Takeover Proposal in any solicitation or recommendation statement made on Schedule 14D-9 within ten (10) business days after the Corporation so requests reaffirmation in writing (provided that the Corporation shall be entitled to make such a written request for reaffirmation only once for each Takeover Proposal and once for each material amendment to such Takeover Proposal) (any action described in this clause (i) being referred to herein as an “**Adverse Recommendation Change**”) or (ii) cause or permit Avista Corporation or any of its affiliates to execute or enter into, any letter of intent, memorandum of understanding, agreement in principle, agreement or commitment constituting, or that would reasonably be expected to lead to a Takeover Proposal.

At any time prior to obtaining the Avista Shareholder Approval, the Avista Corporation board of directors may make an Adverse Recommendation Change if (i) Avista Corporation has received a Superior Proposal that does not result from a breach of the Merger Agreement, or (ii) any circumstance, development, change, event, occurrence

or effect that (A) is unknown to or by Avista Corporation's board of directors as of the date of the Merger Agreement (or if known, the magnitude or material consequences of which are not known by Avista Corporation's board of directors as of the date of the Merger Agreement) and (B) becomes known to or by Avista Corporation's board of directors prior to obtaining the Avista Shareholder Approval (an "**Avista Intervening Event**"); provided, however, that neither a Takeover Proposal nor any consequence thereof shall constitute an Avista Intervening Event, in each case, if Avista Corporation's board of directors determines in good faith, after consultation with outside counsel, that the failure to make an Adverse Recommendation Change would reasonably be expected to be inconsistent with its fiduciary duties, and, provided that Avista Corporation's board of directors complies with the following requirements: (1) the Avista Corporation board of directors has provided prior written notice to the Corporation that it is prepared to change its board recommendation at least four business days prior to taking such action; (2) during the four business day period, the parties negotiate in good faith regarding any revisions to the Merger Agreement the other party proposes to make; and (3) at the end of the four business day period and taking into account any revisions of the Merger Agreement committed to in writing by the other party, the Avista Corporation board of directors determines in good faith (after consultation with outside legal counsel and a financial advisor) that the failure to make an adverse board recommendation change would be inconsistent with its fiduciary duties.

## Termination

The Merger Agreement may be terminated at any time prior to the closing of the Merger, by mutual written consent of Avista Corporation or the Corporation.

Additionally, the Merger Agreement may be terminated by either Avista Corporation or the Corporation at any time prior to the closing of the Merger, if:

(i) the closing of the Merger has not occurred by the End Date; provided that if, prior to the End Date, all of the conditions to the closing of the Merger have been satisfied or waived, as applicable, or shall then be capable of being satisfied (except for the conditions relating to receipt of the required governmental and regulatory consents and approvals, the absence of any law or judgment in effect that prevents or prohibits the closing of the Merger or makes the closing of the Merger illegal or the absence of a Burdensome Condition), either Avista Corporation or the Corporation may extend the End Date to a date that is not later than six months after the End Date; provided, further that neither Avista Corporation or the Corporation may terminate the Merger Agreement if it (or, in the case of the Corporation, US Parent or Merger Sub) is in breach of the Merger Agreement and such breach has primarily caused the failure to satisfy the conditions to the obligations of the terminating party to consummate the Merger prior to the End Date or the failure of the closing of the Merger to have occurred by the End Date.

If either Avista Corporation or the Corporation terminates the Merger Agreement pursuant to the above clause (i) and, at the time of such termination:

- (1) the governmental and regulatory consents and approvals required to be obtained by the Corporation, US Parent, Merger Sub and Avista Corporation have not been obtained, or any law or judgment is in effect that prevents or prohibits the consummation of the Merger or makes the consummation of the Merger illegal (but only if the applicable law or judgment giving rise to such termination arises in connection with the required governmental and regulatory consents and approvals), and at the time of such termination, the Avista Shareholder Approval has been obtained and the other closing conditions for the benefit of the Corporation (other than the receipt of the Avista Corporation officer's certificate and the absence of a Burdensome Condition) have been satisfied or waived (except for any conditions that have not been satisfied as a result of a breach of the Merger Agreement by the Corporation, US Parent or Merger Sub of its respective obligations), the Corporation will pay or cause to be paid to Avista Corporation a fee of US\$103,000,000 (the "**Corporation Termination Fee**") in cash; or
- (2) a Takeover Proposal was publicly disclosed or made to Avista Corporation and not publicly withdrawn prior to the date of termination and within twelve months of such termination, Avista Corporation enters into an agreement with respect to a competing transaction or consummates a Takeover Proposal, Avista Corporation will pay or cause to be paid to the Corporation a fee of US\$103,000,000 (the "**Avista Termination Fee**") in cash.



(ii) any law or judgment (each, a “**Restraint**”) is in effect that prevents, makes illegal or prohibits the consummation of the Merger, and, in the case of any judgment, shall have become final and non-appealable; provided, however that the right to terminate the Merger Agreement pursuant to this clause shall not be available to Avista Corporation or the Corporation if the issuance of such a final, non-appealable Restraint was primarily due to a breach by such party of any of its covenants or agreements under the Merger Agreement, including any failure to obtain the governmental and regulatory consents and approvals. If Avista Corporation or the Corporation terminates the Merger Agreement pursuant to this clause (but only if the applicable Restraint giving rise to such termination arises in connection with the governmental and regulatory consents and approvals), and at the time of any such termination, the Avista Shareholder Approval has been obtained and the other conditions of the closing for the benefit of the Corporation (other than the receipt of the Avista Corporation officer’s certificate and the absence of a Burdensome Condition) have been satisfied or waived (except for any conditions that have not been satisfied as a result of a breach of the Merger Agreement by the Corporation, US Parent or Merger Sub of its respective obligations), the Corporation will pay or cause to be paid to Avista Corporation the Corporation Termination Fee in cash; or

(iii) the Avista Shareholder Approval is not obtained at a duly convened meeting of Avista Corporation’s shareholders (the “**Avista Shareholders Meeting**”) (including any adjournments or postponements thereof). If either Avista Corporation or the Corporation terminates the Merger Agreement pursuant to this clause and (A) a Takeover Proposal was publicly disclosed or made to Avista Corporation and not publicly withdrawn prior to the date of the Avista Shareholders Meeting and (B) within twelve months of such termination, Avista Corporation enters into an agreement with respect to a competing transaction or consummates a Takeover Proposal, Avista Corporation will pay or cause to be paid to the Corporation the Avista Termination Fee in cash.

Moreover, the Merger Agreement may be terminated by Avista Corporation if:

(i) the Corporation, US Parent or Merger Sub has breached or failed to perform any of its respective representations, warranties, covenants or agreements set forth in the Merger Agreement, which breach or failure to perform (A) would give rise to the failure of one of the closing conditions for the benefit of Avista Corporation and (B) cannot be cured by the Corporation, US Parent or Merger Sub by the End Date or, if capable of being cured, has not have cured within 30 days following receipt of written notice from Avista Corporation stating Avista Corporation’s intention to terminate the Merger Agreement pursuant to this clause and the basis for such termination; provided that Avista Corporation will not have the right to terminate the Merger Agreement pursuant to this clause if Avista Corporation is then in material breach of the Merger Agreement. If Avista Corporation terminates the Merger Agreement pursuant to this clause because of a failure by the Corporation, US Parent or Merger Sub to comply with their obligations with respect to obtaining the governmental and regulatory consents and approvals; provided that, at the time of any such termination, the Avista Shareholder Approval has been obtained and the other conditions of the closing for the benefit of the Corporation (other than the receipt of the Avista Corporation officer’s certificate and the absence of a Burdensome Condition) have been satisfied or waived (except for any such conditions that have not been satisfied as a result of a breach of the Merger Agreement by the Corporation, US Parent or Merger Sub of its respective obligations), the Corporation will pay or cause to be paid to Avista Corporation the Corporation Termination Fee in cash; or

(ii) prior to the receipt of the Avista Shareholder Approval, the board of directors of Avista Corporation (or a duly authorized committee thereof) has effected an Adverse Recommendation Change with respect to a Superior Proposal and has approved, and substantially concurrently with such termination, has entered into an agreement with respect to a competing transaction with respect to such Superior Proposal; provided that such termination will not be effective and Avista Corporation will not enter into any such an agreement with respect to a competing transaction, unless Avista Corporation has paid the Avista Termination Fee to the Corporation or causes the Avista Termination Fee to be paid to the Corporation substantially concurrently with such termination. If Avista Corporation terminates the Merger Agreement pursuant to this clause, Avista Corporation will pay or cause to be paid, to the Corporation the Avista Termination Fee.

Furthermore, the Merger Agreement may be terminated by the Corporation if:

- (i) the board of directors of Avista Corporation (or a duly authorized committee thereof) has effected an Adverse Recommendation Change; provided that the Corporation will not have the right to such termination if the Avista Shareholder Approval has been obtained. If the Corporation terminates the Merger Agreement pursuant to this clause, Avista Corporation will pay or cause to be paid the Avista Termination Fee; or
- (ii) Avista Corporation has breached or failed to perform any of its representations, warranties, covenants or agreements set forth in the Merger Agreement, which breach or failure to perform (A) would give rise to the failure of a condition to certain closing conditions for the benefit of the Corporation, US Parent or Merger Sub, respectively, and (B) cannot be cured by Avista Corporation by the End Date or, if capable of being cured, has not been cured within 30 days following receipt of written notice from the Corporation stating the Corporation's intention to terminate the Merger Agreement pursuant to this clause and the basis for such termination; provided that the Corporation will not have the right to such termination if the Corporation, US Parent or Merger Sub is then in material breach of the Merger Agreement. If the Corporation terminates the Merger Agreement pursuant to this clause (solely with respect to a breach or failure to perform a covenant), a Takeover Proposal was publicly disclosed or made to Avista Corporation and not publicly withdrawn prior to the date of termination and within twelve months of such termination, Avista Corporation enters into an agreement with respect to a competing transaction or consummates a Takeover Proposal, Avista Corporation will pay or cause to be paid to the Corporation the Avista Termination Fee.

#### **Payment of Fees and Effect on Termination**

Neither Avista Corporation nor the Corporation shall be required to pay the Avista Termination Fee or the Corporation Termination Fee, respectively, on more than one occasion.

Moreover, Avista Corporation, on the one hand, and the Corporation, US Sub and Merger Sub, on the other hand, agree that payment of the Avista Termination Fee and the Corporation Termination Fee, as applicable, shall not constitute a penalty, but rather will constitute liquidated damages. If Avista Corporation fails to pay the Avista Termination Fee and the Corporation, in order to obtain such payment, commences a claim that results in a judgment against Avista Corporation, Avista Corporation will pay to the Corporation, in addition to the Avista Termination Fee, the Corporation's costs and expenses (including reasonable attorneys' fees) in connection with such claim, along with interest from the date such payment was required until the date of payment. If the Corporation fails to pay the Corporation Termination Fee and Avista Corporation, in order to obtain such payment, commences a claim that results in a judgment against the Corporation, the Corporation will pay to Avista Corporation, in addition to the Corporation Termination Fee, Avista Corporation's costs and expenses (including reasonable attorneys' fees) in connection with such claim, along with interest from the date such payment was required until the date of payment.

Furthermore, upon payment by Avista Corporation of the Avista Termination Fee to the Corporation, including any costs pursuant to the above paragraph, Avista Corporation will have no further liability to the Corporation, US Parent or Merger Sub. Upon payment by the Corporation of the Corporation Termination Fee to Avista Corporation, including any costs pursuant to the above paragraph, the Corporation, US Parent and Merger Sub will have no further liability to Avista Corporation.

#### **FINANCING THE MERGER**

The cash purchase price of the Merger and the Merger-Related Expenses will be financed at the closing of the Merger with a combination of some or all of the following: (i) net proceeds of the first instalment (to the extent available) and the final instalment under the Offering; (ii) net proceeds of any subsequent bond or other debt offerings; (iii) amounts drawn under the Operating Credit Facility; and; (iv) existing cash on hand and other sources available to the Corporation.

Prior to the closing of the Merger, Hydro One Limited intends to use the net proceeds of the first instalment under the Offering, which are expected to be \$441,700,000 (assuming no exercise of the Over-Allotment Option), to repay borrowings under the Operating Credit Facility or its subsidiaries' existing revolving credit facilities or other existing indebtedness (such indebtedness having been incurred for general corporate purposes), or for other general corporate purposes, including investing in short-term interest bearing U.S. dollar securities with investment grade counterparties and in Hydro One Limited's wholly-owned subsidiaries. In the event that the net proceeds of the first instalment under the Offering are used to reduce outstanding indebtedness or for other general corporate purposes, Hydro One Limited will maintain readily available capacity on its revolving credit facilities (on a consolidated basis), or have cash on hand together with such available capacity, in an amount at least equal to the net proceeds of the first instalment under the Offering. Upon the closing of the Merger, Hydro One Limited intends to use the net proceeds of the final instalment under the Offering, which are expected to be \$909,300,000 (assuming no exercise of the Over-Allotment Option), to finance, directly or indirectly, together with the net proceeds of the first instalment under the Offering to the extent available, part of the purchase price payable for the Merger and for other Merger-Related Expenses.

Hydro One Limited currently intends to fund the remainder of the purchase price for the Merger with a combination of bond or other debt financings, denominated principally in U.S. dollars in order to provide a significant natural currency hedge, drawdowns on the Operating Credit Facility and cash on hand.

Hydro One Limited's overall financing plan in respect of the Merger is structured and targeted to maintain Hydro One Limited's and Avista Corporation's strong investment grade status. For additional information on the proposed financing plan for the Merger, see page A-8 of the Investor Presentation attached as Appendix A to this Prospectus.

See "Risk Factors" for a discussion of certain risks relating to the financing of the Merger.

## CAPITALIZATION

Upon completion of the Offering, the closing of the Merger and assuming the payment of the final instalment and the conversion of all of the Debentures into Common Shares (based on the conversion price of \$21.40 per Common Share), the Corporation will have, on a *pro forma* basis, an aggregate of approximately 660,420,561 Common Shares outstanding (assuming no exercise of the Over-Allotment Option and based on the 595,000,000 Common Shares issued and outstanding on March 31, 2017), or approximately 666,962,617 Common Shares if the Over-Allotment Option is exercised in full and based on the 595,000,000 Common Shares issued and outstanding on March 31, 2017.

The following table sets out the consolidated capitalization of the Corporation as at March 31, 2017 and on a *pro forma* basis, as of such date after giving effect to (i) the net proceeds of the Offering (including the payment of both the first instalment and final instalment), assuming no exercise of the Over-Allotment Option and determined after deducting the Underwriters' fee and estimated expenses of the Offering on an after-tax basis, (ii) the anticipated net proceeds of subsequent U.S. dollar bond or other debt offerings to fund the balance of the purchase price, (iii) the Merger, including the assumption of approximately US\$1.9 billion of Avista Corporation's consolidated debt, (iv) the conversion of the Debentures into Common Shares and (v) the changes in Common Shares and long-term debt from April 1, 2017 up to and including July 31, 2017. See "Changes in Share and Loan Capital Structure" and "Financing the Merger". The financial information set out below has been compiled based on financial statements prepared in accordance with U.S. GAAP. See "Index to Financial Statements" and in particular, the *pro forma* financial statements beginning on page F-94 of this Prospectus.

	As at March 31, 2017 (unaudited)	Pro forma as at March 31, 2017 (unaudited) <sup>(1)</sup>
	(in millions of \$ dollars)	
Total Debt <sup>(2)</sup> .....	11,133	17,098
Shareholders' equity		
Securities offered hereby .....	-	1,351 <sup>(5)</sup>

Common Shares <sup>(3)</sup> .....	5,623	5,623
Series 1 Preferred Shares .....	418	418
Additional contributed surplus.....	40	40
Accumulated other comprehensive loss .....	(7)	(7)
Retained earnings.....	3,992	3,798
Total capitalization .....	<u>21,199</u>	<u>28,321</u>

- (1) After giving effect to (i) the net proceeds of the Offering (including the payment of both the first instalment and final instalment), assuming no exercise of the Over-Allotment Option and determined after deducting the Underwriters' fee and estimated expenses of the Offering on an after-tax basis, (ii) the anticipated net proceeds of subsequent U.S. dollar bond or other debt offerings to fund the balance of the purchase price, (iii) the Merger, including the assumption of approximately US\$1.9 billion of Avista Corporation's consolidated debt, and (iv) the conversion of the Debentures into Common Shares. See "Changes in Share and Loan Capital Structure", "Financing the Merger" and "Index to Financial Statements".
- (2) Includes long-term debt (including the current portion and short-term borrowings).
- (3) Does not include the Common Shares issuable upon the conversion of the Debentures, which are included as "Securities offered hereby".
- (4) Excludes non-controlling interests.
- (5) Excluding approximately \$13 million in deferred tax.

### EARNINGS COVERAGE RATIOS

The Corporation's interest requirements on all of its outstanding debt securities after giving effect to the issue of the Debentures distributed hereunder (assuming no exercise of the Over-Allotment Option and the issuance of such Debentures at the beginning of such period) amounted to \$449 million and \$456 million for the 12 months ended December 31, 2016 and the 12 months ended March 31, 2017, respectively. The Corporation's earnings before interest and income tax for the 12 months ended December 31, 2016 and 12 months ended March 31, 2017 were \$1.278 billion and \$1.237 billion, respectively, which is 2.8 times and 2.7 times, respectively, the Corporation's aggregate interest requirements for the periods.

The earnings coverage ratios of the Corporation calculated on a *pro forma* basis after giving effect to the Merger (including the assumption of approximately US\$1.9 billion of Avista Corporation's consolidated debt), the conversion of the Debentures into Common Shares (assuming no exercise of the Over-Allotment Option), and the anticipated net proceeds of subsequent U.S. dollar bond or other debt offerings to fund the balance of the purchase price (in each case as if they had occurred at the beginning of such period), are calculated as follows: (i) the Corporation's interest requirements on all of its outstanding debt securities amounted to \$639 million and \$167 million for each of the 12 months ended December 31, 2016 and the three months ended March 31, 2017, respectively; and (ii) the Corporation's earnings before interest and income tax for the 12 months ended December 31, 2016 and three months ended March 31, 2017 were \$1.674 billion and \$460 million, respectively, which is 2.6 times and 2.8 times, respectively, the Corporation's aggregate interest requirements for the periods.

### CHANGES IN SHARE AND LOAN CAPITAL STRUCTURE

There have been no material changes in Hydro One Limited's share and loan capital, on a consolidated basis, since the date of the Interim Financial Statements. As a result of the Offering, after giving effect to the assumed conversion of the Debentures into Common Shares, shareholders' equity in the Corporation will increase by approximately \$1.351 billion (assuming no exercise of the Over-Allotment Option).

## PRIOR SALES

The following table sets out the issuance of Common Shares and securities convertible into or exchangeable for Common Shares that occurred in the 12-month period before the date of this Prospectus:

<u>Date of Issue</u>	<u>Securities</u> <sup>(1)(2)</sup>	<u>Price per Security</u>	<u>Number of Common Shares Issuable or Issued, as applicable</u>
August 15, 2016	RSUs	\$25.49	1,690
August 15, 2016	PSUs	\$25.49	3,140
September 1, 2016	RSUs	\$26.19	17,180
September 1, 2016	PSUs	\$26.19	17,180
September 7, 2016	RSUs	\$26.49	16,990
September 7, 2016	PSUs	\$26.49	16,990
September 9, 2016	RSUs <sup>(3)</sup>	\$25.98	45,130
September 9, 2016	PSUs	\$25.98	45,130
September 12, 2016	RSUs	\$25.75	20,830
September 12, 2016	PSUs	\$25.75	20,830
November 14, 2016	RSUs	\$22.65	8,030
November 14, 2016	PSUs	\$22.65	8,030
March 31, 2017	RSUs	\$24.25	218,950
March 31, 2017	PSUs	\$24.25	267,450
April 1, 2017	Common Shares <sup>(4)</sup>	\$20.50	371,611
May 31, 2017	Common Shares <sup>(5)</sup>	\$25.98	13,714
July 21, 2017	Common Shares <sup>(6)</sup>	\$24.31	1,274

Notes:

- (1) Except as noted in footnote (3) below, each RSU granted in 2016 and 2017 vests in full on December 31, 2018 and December 31, 2019, respectively, assuming the individual has remained employed by Hydro One Limited or its subsidiaries through such date. Each vested RSU entitles the holder thereof to one Common Share. RSUs also earn dividend equivalents as dividends are paid on the Common Shares. Price per security represents the grant date price of the RSUs.
- (2) Each PSU granted in 2016 and 2017 vests on December 31, 2018 and December 31, 2019, respectively, subject to achieving certain performance thresholds for the three-year average earnings per share for the period from (i) January 1, 2016 to December 31, 2018, in the case of 2016 grants and (ii) January 1, 2017 to December 31, 2019, in the case of 2017 grants, and provided further that the dividend rate is not decreased during the period. In the event the dividend rate is decreased during the period, no PSUs will vest regardless of whether the performance thresholds are met. In respect of the performance thresholds, below a certain performance threshold, no PSUs will vest. At the target performance threshold (assuming the dividend rate is not reduced during the period), the PSUs vest at the target level of 100% and will entitle the holder thereof to one Common Share for each PSU granted. At or above the maximum performance threshold (assuming the dividend rate is not reduced during the period), the PSUs vest at the maximum level of 200% and will entitle the holder thereof to two Common Shares for each PSU granted. Between performance thresholds (assuming the dividend rate is not reduced during the period), PSUs will vest on an interpolated basis. PSUs also earn dividend equivalents as dividends are paid on the Common Shares. The number of Common Shares issuable pursuant to the PSUs assumes the PSUs vest at 100% of their target. Price per security represents the grant date price of the PSUs.
- (3) 13,470 of these RSUs vest on May 31, 2018. 13,470 of these RSUs vested on May 31, 2017 and 13,714 Common Shares (including related accrued dividend equivalents) were issued on that date. See footnote (5).
- (4) Upon terms and conditions previously agreed to, Hydro One Limited issued these Common Shares to eligible employees at the initial public offering price of the Common Shares in accordance with the provisions of the PWU Share Grant Plan.

- (5) A total of 13,714 Common Shares were issued from treasury on the vesting of 13,470 RSUs and 244 related accrued dividend equivalents on May 31, 2017. See footnote (3). Price per security represents the grant date price of the RSUs.
- (6) A total of 1,274 Common Shares were issued from treasury on July 21, 2017 from the vesting of 610 RSUs (and 27 related accrued dividend equivalents) and 610 PSUs (and 27 related accrued dividend equivalents) granted on March 31, 2016 arising from the death of the holder of the RSUs and PSUs. Price per security represents the grant date price of the RSUs and PSUs.

### TRADING PRICES AND VOLUMES

The outstanding Common Shares are traded on the TSX under the trading symbol “H”. The following table sets forth the high and low price for, and the volume of trading in, the Common Shares for the periods indicated, based on information obtained from the TSX.

<b><u>Month</u></b>	<b><u>High</u></b>	<b><u>Price (\$)</u></b>	<b><u>Low</u></b>	<b><u>Trading Volume</u></b>
<b>2016</b>				
August	26.48		25.10	7,138,631
September	26.54		25.36	7,031,417
October	26.02		24.02	6,765,511
November	24.58		22.06	11,932,522
December	23.65		22.59	9,719,103
<b>2017</b>				
January	24.49		23.49	8,368,116
February	24.17		23.22	8,477,586
March	24.28		23.04	11,764,543
April	24.66		23.84	6,292,356
May	24.15		22.63	42,296,289
June	23.98		22.73	19,011,705
July	23.25		21.32	17,158,684

### DESCRIPTION OF COMMON SHARES

Hydro One Limited’s authorized share capital consists of an unlimited number of Common Shares and an unlimited number of preferred shares, issuable in series, of which 595,386,599 Common Shares, 16,720,000 Series 1 preferred shares and no Series 2 preferred shares are issued and outstanding as of the date of this Prospectus.

Holders of Common Shares are entitled to receive notice of and to attend all meetings of shareholders, except meetings at which only the holders of another class or series of shares are entitled to vote separately as a class or series, and holders of Common Shares are entitled to one vote per share at all such meetings of shareholders. Hydro One Limited’s Common Shares are not redeemable or retractable. Subject to the rights, privileges, restrictions and conditions attaching to any other class or series of shares, including the Series 1 Preferred Shares and Series 2 Preferred Shares, holders of Common Shares are entitled to receive dividends if, as, and when declared by the Board of Directors. Subject to the rights, privileges, restrictions and conditions attaching to any other class or series of shares, including the Series 1 Preferred Shares and Series 2 Preferred Shares, holders of Common Shares are also entitled to receive the remaining assets of Hydro One Limited upon its liquidation, dissolution or winding-up or other distribution of Hydro One Limited’s assets for the purposes of winding-up its affairs.

Voting securities of Hydro One Limited, which include the Common Shares, are subject to share ownership restrictions under the *Electricity Act, 1998* (Ontario). The share ownership restrictions provide that no person or company (or combination of persons or companies acting jointly or in concert), other than the Province or an underwriter who holds voting securities of Hydro One Limited solely for the purposes of distributing them to purchasers who comply with the share ownership restrictions, may beneficially own or exercise control or direction over more than 10% of any class or series of voting securities of Hydro One Limited. The articles of Hydro One Limited provide for comprehensive enforcement mechanisms that are applicable in the event of a contravention of the share ownership requirements. **A potential purchaser of Debentures represented by Instalment Receipts should not subscribe for a number of such Debentures in this Offering that would, upon conversion of such Debentures into Common Shares, cause such purchaser to violate this prohibition.**

## DETAILS OF THE OFFERING

The Offering consists of \$1,400,000,000 aggregate principal amount of Debentures represented by Instalment Receipts at a price of \$1,000 per Debenture, which are being sold by the Selling Debentureholder on an instalment basis. The first instalment of \$333 per \$1,000 principal amount of Debentures is payable on the Closing Date. The final instalment of \$667 per \$1,000 principal amount of Debentures is payable following notification to holders of Instalment Receipts (the “**Final Instalment Notice**”) that the Corporation has received all regulatory and government approvals required to finalize the Merger and Hydro One Limited, US Parent, Merger Sub and Avista Corporation have fulfilled or waived all other outstanding conditions precedent to closing the Merger, other than those which by their nature cannot be satisfied until the closing of the Merger, in each case as set out in the Merger Agreement (collectively, the “**Approval Conditions**”). See “The Merger Agreement”. The Final Instalment Notice, which must be given by no later than April 30, 2019, will establish a date for payment of the final instalment (the “**Final Instalment Date**”), which shall not be less than 15 days nor more than 90 days following the date of such notice. Payment of the final instalment in full must be received by the Custodian (as defined in this Prospectus) by no later than 3:30 p.m. (Toronto time) on the Final Instalment Date. Holders should make arrangements with the securities broker, trust company or other financial institution through which they hold Instalment Receipts to pay the final instalment sufficiently in advance of the Final Instalment Date to ensure that such payment is received by the Custodian prior to this deadline.

### The Selling Debentureholder

The Selling Debentureholder is a direct wholly-owned subsidiary of Hydro One Limited organized under the OBCA. The Selling Debentureholder will acquire (both of record and beneficially) the Debentures offered pursuant to this Prospectus from Hydro One Limited for the purpose of participating in the Offering.

If the Over-Allotment Option is exercised by the Underwriters, the Selling Debentureholder will acquire the Debentures purchased in the Over-Allotment Option from Hydro One Limited and will sell them to the Underwriters on the terms and conditions set out in the Underwriting Agreement.

### Waiver of Pre-Emptive Right by Province

The Province waived its pre-emptive right to participate in the Offering under the Governance Agreement. In consideration of granting the waiver, the Corporation agreed that until July 19, 2018: (i) the Corporation shall not issue Common Shares pursuant to the Corporation’s equity compensation plans and any dividend reinvestment plan in an aggregate number that exceeds 1% of the Common Shares outstanding as of July 19, 2017; and (ii) the Corporation shall not issue voting securities (or securities convertible into voting securities) pursuant to any acquisition transaction without complying with the pre-emptive right provisions of the Governance Agreement.

### Instalment Receipts

The following is a summary of the material attributes and characteristics of the Instalment Receipts representing Debentures and the rights and obligations of holders thereof. This summary does not purport to be complete and is subject to, and is qualified in its entirety by, the terms of the instalment receipt and pledge agreement (the “**Instalment Receipt Agreement**”), to be dated as of the Closing Date, among the Corporation, the Selling Debentureholder, the Underwriters and Computershare Trust Company of Canada in its capacity as

custodian and security agent (the “**Custodian**”). Copies of the Instalment Receipt Agreement will be available for inspection at the principal offices of the Custodian in Toronto, Ontario. A prospective purchaser of Debentures represented by Instalment Receipts should carefully review the Instalment Receipt Agreement, a copy of which will also be available on the Corporation’s SEDAR profile at [www.sedar.com](http://www.sedar.com) on or about the Closing Date.

Holders of Instalment Receipts will be bound by the terms of the Instalment Receipt Agreement. The Instalment Receipt Agreement will provide that legal title to the Debentures offered hereby will be held by the Custodian following payment of the first instalment and until the Final Instalment Date, provided that legal title will be retained if the final instalment has not been fully paid to the Custodian for the benefit of the Selling Debentureholder on or before the Final Instalment Date (and in no case later than 3:30 p.m. (Toronto time) on the Final Instalment Date). The Debentures offered hereby will be pledged to the Selling Debentureholder by the Underwriters (for and on behalf of the purchasers of Debentures represented by Instalment Receipts under the Offering) at the closing of the Offering and the physical certificate or certificates representing the Debentures will be held in the possession of the Custodian, as security agent, on behalf of the Selling Debentureholder, subject to the terms of the Instalment Receipt Agreement.

Prior to payment of the final instalment, beneficial ownership of Debentures will be represented by Instalment Receipts. An Instalment Receipt will evidence, among other things, (i) the fact that the first instalment has been paid in respect of the Debenture represented thereby and (ii) the right of a holder thereof, subject to compliance with the provisions of the Instalment Receipt Agreement, (x) to have the pledge of the Debentures released following the Final Instalment Date provided that payment in full of the final instalment with respect to such Debentures has been received by the Custodian on or prior to such date or (y) if the Debentures are redeemed by the Corporation prior to payment of the final instalment, to receive (after the Custodian pays the final instalment to the Selling Debentureholder on behalf of the holder) \$333 per underlying Debenture plus accrued and unpaid interest on such Debenture up to but excluding the redemption date. A holder of an Instalment Receipt will be deemed to have assumed the obligation to pay the final instalment on or before the Final Instalment Date and to have acquired beneficial ownership of the Debenture represented by the Instalment Receipt, subject to the pledge of such Debenture which secures such obligations subject to the terms of the Instalment Receipt Agreement. Subject to the terms of the Instalment Receipt Agreement, a holder of an Instalment Receipt will be further deemed to agree that the foregoing pledge will remain in effect and be binding and effective notwithstanding any transfer of or other dealings with the Instalment Receipt and the rights evidenced or arising thereby.

The Corporation shall as soon as practicable following satisfaction of the Approval Conditions (but no later than April 30, 2019) cause a Final Instalment Notice to be given to holders of Debentures represented by Instalment Receipts (i) confirming that all Approval Conditions have been fulfilled to the satisfaction of the Corporation, (ii) setting the Final Instalment Date (which shall not be less than 15 days nor more than 90 days following the date that such notice is first given) and (iii) advising holders of their ability to exercise the conversion privilege with respect to Debentures represented by their Instalment Receipts concurrently with the payment of the final instalment. See “Details of the Offering – Debentures – Conversion Right”. The Selling Debentureholder shall also cause to be issued a press release containing particulars of the Final Instalment Notice. Payment of the final instalment is required regardless of whether a holder receives the Final Instalment Notice, directly or indirectly. The Final Instalment Date may occur up to 90 days following April 30, 2019.

A holder of an Instalment Receipt will be entitled to make payment, in accordance with the provisions of the Instalment Receipt Agreement, of the final instalment at any time following receipt of the Final Instalment Notice and prior to 3:30 p.m. (Toronto time) on the Final Instalment Date. **A holder of Instalment Receipts that fails to pay the final instalment in full by 3:30 p.m. (Toronto time) on the Final Instalment Date (a “Defaulting Holder”) will have no further right to pay the final instalment and all rights and privileges of the Defaulting Holder described below under “– Rights and Privileges” shall immediately cease (unless otherwise waived by the Selling Debentureholder).**

Subject to compliance with the provisions of the Instalment Receipt Agreement and timely payment of the final instalment, the Custodian will, as soon as practicable on or after the Final Instalment Date, discharge and release the pledge of the Debentures represented by such Instalment Receipts. At that time, the Debentures (or the Common Shares into which the Debentures may be converted) will be held through the facilities of CDS, and the holder will receive only a customer confirmation of purchase of the Debentures (or, if the conversion privilege is exercised, the underlying Common Shares) from the holder’s CDS Participant.



The Instalment Receipts representing the Debentures will be issued in “book-entry only” form and must be purchased or transferred through a CDS Participant. The Corporation will cause a global certificate or certificates representing any newly issued Instalment Receipts to be delivered to, and registered in the name of, CDS or its nominee. All rights and obligations of holders of Instalment Receipts must be exercised or performed through, and all notices, payments or other property to which such holders are entitled or obligated will be made or delivered by the holder holding such Instalment Receipts through CDS or the CDS Participants in accordance with the rules and procedures applicable to CDS and such CDS Participants. Each person who acquires Instalment Receipts will only receive a customer confirmation of purchase from the CDS Participant from or through which the Instalment Receipts representing the Debentures are acquired in accordance with the practices and procedures of that registered dealer. The practices of CDS Participants may vary, but generally customer confirmations are issued promptly after execution of a customer order. CDS is responsible for establishing and maintaining book-entry accounts for its CDS Participants having interests in Instalment Receipts. See “– Book-Entry Only System”. Because payment of the final instalment will be made by holders of Instalment Receipts through CDS and CDS Participants, it is strongly advised that holders make arrangements with the securities broker, trust company or other financial institution through which they hold Instalment Receipts to pay their final instalment sufficiently in advance of the Final Instalment Date to ensure that such payment is received by the Custodian by no later than 3:30 p.m. (Toronto time) on the Final Instalment Date.

### ***Transfer of Instalment Receipts***

The TSX has conditionally approved the listing of the Instalment Receipts on the facilities of the TSX, subject to the fulfillment of all of the requirements of the TSX. Once listed, it is anticipated that holders will be able to transfer Instalment Receipts through the facilities of the TSX until the close of trading on the trading day immediately preceding the Final Instalment Date, following which Instalment Receipts will stop trading on the TSX. Upon a transfer of an Instalment Receipt, the transferee will acquire the transferor’s rights, subject to the pledge of the Debentures in favour of the Selling Debentureholder, and become subject to the obligations of a holder of Instalment Receipts under the Instalment Receipt Agreement, including the assumption by the transferee of the obligation to pay the final instalment on or before the Final Instalment Date. No transfer of an Instalment Receipt after the Final Instalment Date will be accepted (except where an intermediary holds Instalment Receipts on behalf of a non-registered holder and such non-registered holder has failed to pay the final instalment when due, or with the express consent of the Selling Debentureholder).

### ***Liability of Instalment Receipt Holders***

Pursuant to the Instalment Receipt Agreement, the Underwriters will pledge (for and on behalf of the purchasers of Debentures represented by Instalment Receipts under the Offering) the Debentures purchased on an instalment basis to secure payment of the final instalment. If payment of the final instalment is not duly received by the Custodian from a holder of Instalment Receipts when due, the Instalment Receipt Agreement will provide that (except as set out below) any Debenture then remaining pledged under the Instalment Receipt Agreement may, at the option of the Selling Debentureholder, subject to complying with applicable law, be forfeited to the Selling Debentureholder in full satisfaction of the obligations of such holder of Instalment Receipts secured thereby. The Instalment Receipt Agreement will further provide that the Selling Debentureholder may, alternatively, direct the Custodian to sell the Debentures in respect of which payment of the final instalment was not duly received, in accordance with the requirements of applicable law and of the Instalment Receipt Agreement, and remit to the Defaulting Holder of Instalment Receipts its pro rata portion of the proceeds of sale after deducting therefrom the amount of the remaining unpaid final instalment, the amount of any applicable withholding taxes and the Defaulting Holder’s pro rata portion of the costs of sale (such costs not to exceed \$25 per \$1,000 principal amount of Debentures). The Instalment Receipt Agreement will provide that the foregoing shall not limit any other remedies available to the Selling Debentureholder against such Defaulting Holder of the Instalment Receipt in the event proceeds of such sale are insufficient to cover the amount of the final instalment and the costs of sale and accordingly, such holder shall in such circumstances remain liable to the Selling Debentureholder for any such deficiency.

### ***Rights and Privileges***

Under the Instalment Receipt Agreement, holders of Instalment Receipts will have the same rights and privileges, and will be subject to the same limitations, as holders of Debentures pursuant to the Indenture (as defined

in this Prospectus). In particular, holders of Instalment Receipts will be entitled under arrangements through the Custodian, in the manner set forth in the Instalment Receipt Agreement, to (i) receive interest on the Debentures represented by Instalment Receipts up to and including the Final Instalment Date, after which the interest rate payable on the Debentures will fall to an annual rate of 0% and interest will cease to accrue on the Debentures, (ii) receive the Make-Whole Payment in respect of the Debentures represented thereby if the Final Instalment Date occurs prior to the first anniversary of the Closing Date and provided that a holder of Debentures represented by Instalment Receipts has paid the final instalment on or prior to the Final Instalment Date and (iii) exercise the votes attached to the Debentures represented by such Instalment Receipts. In the event that the Corporation issues (including on liquidation, dissolution or winding-up) to the holders of Debentures any securities, or options, rights or warrants to purchase any securities, or any securities convertible into or exchangeable for securities, or other property or assets of like nature, the Custodian will, as promptly as commercially reasonable sell such securities, options, rights, warrants, evidences of indebtedness, property or assets and remit pro rata to the holders of Instalment Receipts, the proceeds of sale net of the Custodian's costs of disposition, subject to withholding tax requirements.

### ***Redemption of Debentures and Cancellation of Instalment Receipts***

In the event that Debentures are required to be redeemed by the Corporation prior to the Final Instalment Date, the Corporation shall, in respect of each Instalment Receipt outstanding on the date of such redemption, pay (or cause to be paid) to the Selling Debentureholder, on behalf of the holder of an Instalment Receipt, an amount equal to the final instalment and pay the balance plus any accrued and unpaid interest to the holder. Payment of such redemption price will be made on the date that the Debentures are redeemed by the Corporation.

### ***Modification***

Apart from changes which do not adversely affect in any material respect the holders of Instalment Receipts as a group (which may be made without the consent of such holders), the Instalment Receipt Agreement may not be amended without the affirmative vote of the holders of Instalment Receipts entitled to not less than two-thirds of the principal amount of Debentures represented by Instalment Receipts which are represented and voted at a meeting duly called for the purpose or rendered by instruments in writing signed by the holders of Instalment Receipts representing not less than two-thirds of the principal amount of the Debentures.

### ***General***

The Custodian may require holders of Instalment Receipts from time to time to furnish such information and documents as may be necessary or appropriate to comply with any fiscal or other laws or regulations relating to the Debentures or to rights and obligations represented by Instalment Receipts. The Custodian shall not be responsible for any taxes, duties, governmental charges or expenses which are or may become payable in respect of the Debentures or Instalment Receipts. In this regard, the Custodian shall be entitled to deduct or withhold from any payment or other distribution required or contemplated by the Instalment Receipt Agreement the appropriate amount of money or property, or to require holders of Instalment Receipts to make any required payments, and to withhold delivery of certificates representing the Debentures until satisfactory provision for payment is made, in respect of any non-resident Canadian withholding taxes or other taxes, duties, governmental charges or expenses required by applicable law to be withheld or paid.

Holders of Instalment Receipts will not be liable for charges and expenses of the Custodian except for any taxes, duties, governmental charges or expenses which may be payable as described above.

### ***Book-Entry Only System***

Registration of interests in and transfers of Instalment Receipts will be made only through the book-entry only system of CDS (the "**Book-Entry Only System**"). Instalment Receipts must be purchased, transferred and surrendered through a CDS Participant. Upon purchase of any Instalment Receipts representing Debentures, the Corporation understands that the holder of Instalment Receipts will receive only a customer confirmation from the registered dealer which is a CDS Participant and from or through which the Instalment Receipts are purchased. References in this Prospectus to a holder of Instalment Receipts mean, unless the context otherwise requires, the owner of the beneficial interest in such Instalment Receipts.

The ability of a beneficial owner of Instalment Receipts to pledge such Instalment Receipts or otherwise take action with respect to such beneficial holder's interest in such Instalment Receipts (other than through a CDS Participant) may be limited due to the lack of a physical certificate.

The Selling Debentureholder has the option to terminate registration of the Instalment Receipts through the Book-Entry Only System in which case certificates for the Instalment Receipts in fully registered form would be issued to holders of such Instalment Receipts.

## **Debentures**

The following is a summary of the material attributes and characteristics of the Debentures. This summary does not purport to be complete and is subject to, and is qualified in its entirety by, the terms of the trust indenture (the "**Indenture**") to be dated on or about the Closing Date between the Corporation, as issuer, and Computershare Trust Company of Canada, as trustee (in such capacity, the "**Trustee**"). A prospective purchaser of Debentures represented by Instalment Receipts should carefully review the Indenture, a copy of which will be available on the Corporation's SEDAR profile at [www.sedar.com](http://www.sedar.com) on or about the Closing Date.

The Debentures will be issued to the Selling Debentureholder on the Closing Date as the initial series under the Indenture and in the aggregate principal amount of \$1,400,000,000. In the event that the Over-Allotment Option is exercised, Hydro One Limited will issue additional Debentures of the same series under the Indenture.

The Debentures will be dated as of the Closing Date and will mature on the Maturity Date. The Debentures are issuable in denominations of \$1,000 and integral multiples thereof and will bear interest at an annual rate of 4.00% per \$1,000 principal amount of Debentures and will be payable quarterly in arrears in equal instalments (other than the first interest payment and, depending on the Final Instalment Date, the final interest payment) on the last day of December, March, June and September of each year (or the prior business day if the last day falls on a weekend or holiday) to and including the Final Instalment Date. The first interest payment in the amount of \$15.78082 per \$1,000 principal amount of Debentures will be made on December 29, 2017 and will include interest payable from and including the date of issue. Subsequently, quarterly interest payments will be made in the amount of \$10.00 per \$1,000 principal amount of Debentures. A final interest payment will be made on the Final Instalment Date, will be equal to the unpaid interest accrued from the date of the last quarterly interest payment to and including the Final Instalment Date and will be computed on the basis of a 365-day year and the number of days elapsed in the period. On the day following the Final Instalment Date, the interest rate payable on the Debentures will fall to an annual rate of 0% and interest will cease to accrue on the Debentures. Based on a first instalment of \$333 per \$1,000 principal amount of Debenture and assuming the Final Instalment Date occurs on or after the first anniversary of the Closing Date, the effective annual yield to and including the Final Instalment Date will be 12.0%, and the effective yield thereafter will be 0%.

If the Final Instalment Date occurs on a day that is prior to the first anniversary of the Closing Date, holders of Debentures who have paid the final instalment on or before the Final Instalment Date will be entitled to receive, on the business day following the Final Instalment Date, in addition to the payment of accrued and unpaid interest to and including the Final Instalment Date, the Make-Whole Payment, being an amount equal to the interest that would have accrued from the day following the Final Instalment Date to and including the first anniversary of the Closing Date had the Debentures remained outstanding and continued to accrue interest until and including such date. No Make-Whole Payment will be payable if the Final Instalment Date occurs on or after the first anniversary of the Closing Date. No Make-Whole Payment will be made in the event that the Corporation redeems the Debentures.

The Debentures will be direct obligations of Hydro One Limited and will not be secured by any mortgage, pledge, hypothec or other charge and will be subordinated to other liabilities of the Corporation as described below under "– Subordination". The Indenture does not restrict the Corporation from incurring additional indebtedness for borrowed money or from mortgaging, pledging or charging its properties to secure any indebtedness.

## ***Payment Upon Maturity***

On the Maturity Date, the Corporation will repay the principal amount of any Debentures not converted into Common Shares and remaining outstanding, in cash, provided that the Corporation may, at its option and without prior notice, satisfy the obligation to pay all or a portion of the principal amount of such Debentures on

maturity by delivery of that number of freely tradable Common Shares obtained by dividing the aggregate principal amount of the Debentures then outstanding by 95% of the Market Price.

### ***Conversion Right***

At the option of the holder and provided that payment of the final instalment has been made, each Debenture will be convertible into Common Shares on or at any time on or after the Final Instalment Date, but prior to the earlier of the date that the Corporation redeems the Debentures or the Maturity Date. The Conversion Price will be \$21.40 per Common Share, being a conversion rate of 46.7290 Common Shares per \$1,000 principal amount of Debentures, subject to adjustment in certain events. No adjustment will be made for cash dividends on Common Shares issuable upon conversion or for accrued and unpaid interest, which will be paid by the Corporation in cash. A holder of Debentures who does not exercise its conversion privilege concurrently with the payment of the final instalment will hold a Debenture that pays 0% interest and may be redeemed by the Corporation in whole or in part on any trading day following the Final Instalment Date at a price equal to its principal amount plus any unpaid interest which accrued prior to and including the Final Instalment Date. The Corporation reserves the right to not issue Common Shares to a holder upon conversion of the Debentures in the event the Corporation reasonably determines that issuing such Common Shares to such holder would result in such holder breaching the share ownership restrictions under the *Electricity Act, 1998* (Ontario) or be prohibited by the Corporation's articles.

Subject to the provisions thereof, the Indenture will provide for the adjustment of the Conversion Price in certain events including: (a) the distribution of Common Shares or securities convertible into Common Shares to holders of its Common Shares by way of stock dividend or otherwise, other than an issue of Common Shares to holders of outstanding Common Shares who have elected to receive dividends in stock in lieu of receiving cash dividends paid in the ordinary course; (b) the subdivision or consolidation of the outstanding Common Shares; (c) the issuance of rights or warrants to all holders of Common Shares entitling them to acquire Common Shares or other securities convertible into Common Shares at less than the Conversion Price; (d) the distribution to all holders of Common Shares of any securities or assets (other than cash dividends and dividends in Common Shares); or (e) if an issuer bid or exchange offer is made by the Corporation for its Common Shares. There will be no adjustment of the Conversion Price in respect of any event described herein if, with the prior regulatory approval and the approval of the TSX, the holders of the Debentures are allowed to participate as though they had converted their Debentures prior to such transaction. The Corporation will not be required to make adjustments in the Conversion Price unless the effect of such adjustment would change the Conversion Price by at least 1%, provided that any adjustment of less than 1% will be carried forward and taken into account in connection with any subsequent adjustment.

No fractional Common Shares will be issued on any conversion but in lieu thereof, the Corporation will satisfy such fractional interest by a cash payment equal to the Conversion Price of such fractional interest, provided that the Corporation shall not be required to make any cash payment of less than \$10.00.

### ***Redemption***

Prior to the Final Instalment Date, the Debentures may not be redeemed by the Corporation, except that the Debentures will be redeemed by the Corporation at a price equal to their principal amount plus accrued and unpaid interest (without any Make-Whole Payment) following the earlier of: (i) notification to holders that the Approval Conditions will not be satisfied; (ii) termination of the Merger Agreement in accordance with its terms; and (iii) May 1, 2019, if the Final Instalment Notice has not been given on or before April 30, 2019. Upon any such redemption, the redemption proceeds will be paid by the Corporation to the Custodian on behalf of the holders. The Custodian will pay the following for each \$1,000 principal amount of Debentures: (i) \$333 plus accrued and unpaid interest to the holder of the Instalment Receipt; and (ii) \$667 to the Selling Debentureholder on behalf of the holder of the Instalment Receipt in satisfaction of the final instalment. Under the terms of the Instalment Receipt Agreement, Hydro One Limited has agreed that until such time as the Debentures have been redeemed or the Final Instalment Date has occurred, the Corporation will at all times hold short-term interest bearing U.S. dollar securities with investment grade counterparties, maintain readily available capacity under the Operating Credit Facility or the revolving credit facilities of its subsidiaries, or have cash on hand together with such available capacity, in an amount at least equal to the net proceeds of the first instalment paid on the closing of the Offering and the exercise of the Over-Allotment Option, if applicable.

In addition, after the Final Instalment Date, any Debentures not converted to Common Shares may be redeemed by the Corporation at a price equal to their principal amount plus any unpaid interest which accrued prior to the Final Instalment Date.

### ***Subordination***

The Debentures will be direct unsecured obligations of Hydro One Limited. Payment of the principal of, interest on, the Make-Whole Payment, if any, and other amounts owing in respect of each Debenture will be subordinated in right of payment to any present or future senior unsubordinated indebtedness or obligation of the Corporation, whether or not contingent, for (i) moneys borrowed or raised by whatever means (including, without limitation, by means of commercial paper, bankers acceptances, debt instruments and any liability represented by bonds, debentures, notes or similar instruments), (ii) reimbursement obligations with respect to letters of credit; (iii) payment and guarantee obligations under or with respect to swap contracts, (iv) capital leases, (v) cash management obligations, (vi) the deferred purchase price of assets or services and (vii) any trade debts in effect at any time and from time to time (collectively, the “**Senior Indebtedness**”). Payment of the principal of, interest on, the Make-Whole Payment, if any, and other amounts owing in respect of each Debenture will rank *pari passu* with each other Debenture issued under the Indenture regardless of their actual date or terms of issue, and with all other present and future unsecured and subordinated indebtedness of Hydro One Limited, except as prescribed by law.

The Indenture does not limit the ability of the Corporation to incur additional indebtedness, including indebtedness that ranks senior to the Debentures or from mortgaging, pledging, charging, hypothecating, granting a security interest in or otherwise encumbering any or all of its properties to secure any indebtedness. The Indenture provides that the Corporation shall not make any payment, and the holders of Debentures shall not be entitled to demand, accelerate, institute proceedings for the collection of, or receive any payment or benefit (including, without limitation, by set-off, combination of accounts or realization of security or otherwise in any manner whatsoever) on account of indebtedness represented by the Debentures (i) in a manner inconsistent with the terms (as they exist on the date of issue) of the Debentures; (ii) unless all payments of interest then due or payable on all Senior Indebtedness for borrowed money have been made; (iii) at any time when any amount is in arrears under any Senior Indebtedness or an event of default has occurred under Senior Indebtedness, and such a default or event of default is continuing, unless and until such Senior Indebtedness has been paid and satisfied in full or such default or event of default shall have been cured or waived in writing in accordance with the provisions of such Senior Indebtedness; or (iv) if the making of any such payment or the taking of any such action would create, including by the lapse of time or giving of notice, a default or an event of default under any Senior Indebtedness unless and until such Senior Indebtedness has been satisfied in full or the making of any such payment or taking of any such action would no longer create, including by lapse of time or giving of notice, a default or an event of default under any Senior Indebtedness.

In addition, the Trustee on behalf of the holders of Debentures may, at the request of the Corporation, enter into contractual subordination agreements with certain lenders of the Corporation with terms to the foregoing effect.

### ***Events of Default***

The Indenture will include the following events of default:

- (a) failure to pay any principal or premium, if any, on the Debentures, when the same becomes due and payable whether on maturity, redemption, acceleration or otherwise, which default continues for a period of five business days;
- (b) failure to pay any interest or Make-Whole Payment, if any, on the Debentures, which default continues for 45 days after the date when due;
- (c) failure to deliver when due all cash and Common Shares deliverable upon conversion of the Debentures, which failure continues for 45 days;
- (d) the Corporation’s failure to perform or observe any other material term, covenant or agreement contained in the Debentures or contained in the Indenture for a period of 60 days after receipt of notice of default specifying such failure;

- (e) default by the Corporation or any “material subsidiary” (as defined in the Indenture), with respect to any indebtedness (excluding amounts due to the holders of Debentures), where the aggregate principal amount of such indebtedness exceeds an amount equal to the greater of 2% of the consolidated net worth of the Corporation or \$100,000,000 at such time and (i) if the default is a payment default, such default continues to exist for a period exceeding 60 days; provided that if the payment obligation to which the default relates is accelerated, then the default shall constitute an event of default immediately following such acceleration, and (ii) if the default is not a payment default, then as a result of the default and the passing of any applicable cure period, the maturity of the obligation is accelerated; provided that, in each case, if the default is cured prior to acceleration of the Debentures, then the event of default shall be deemed to have been cured; and
- (f) certain events of bankruptcy, insolvency or reorganization affecting the Corporation.

If an event of default (other than the events listed in (f)) occurs and is continuing, either the Trustee or the holders of at least 25% in aggregate principal amount of the Debentures then outstanding may declare (by notice to the Corporation and the Trustee) the principal of the Debentures and any accrued and unpaid interest, if any, through the date of such declaration to be immediately due and payable. In the case of certain events of bankruptcy or insolvency, the principal amount of the Debentures together with any accrued but unpaid interest, if any, through the occurrence of such event shall automatically become and be immediately due and payable.

### ***Modification***

The rights of the holders of the Debentures may be modified. For that purpose, among others, the Indenture will contain certain provisions which will make binding on all holders of Debentures resolutions passed at meetings of the holders of Debentures by votes cast thereat by holders of not less than two-thirds of the principal amount of the Debentures, or rendered by instruments in writing signed by the holders of not less than two-thirds of the principal amount of the Debentures then outstanding.

### ***Certification and the Book-Entry Only System***

Registration of interests in and transfers of Debentures represented by Instalment Receipts will be made only through the Book-Entry Only System. Debentures represented by Instalment Receipts must be purchased, transferred and surrendered through a CDS Participant. From the Closing Date to the Final Instalment Date, the Debentures will be issued in certificated and fully registered form in the name of Computershare Trust Company of Canada, in its capacity as security agent under the Instalment Receipt Agreement. Promptly following 3:30 p.m. (Toronto time) on the Final Instalment Date, provided due payment of the final instalment has been made in accordance with the terms of the Instalment Receipt Agreement, the Selling Debentureholder will cause the Custodian to deliver to CDS (i) a global certificate representing those Debentures not converted to Common Shares by exercise of the conversion right and (ii) Common Shares issued upon conversion of Debentures, in each case, to be registered in the name of CDS or its nominee. The Debentures will be represented by one or more global certificates. Thereafter, registration of interests in and transfers of the Debentures will be made only through the depository service of CDS and transfers of Common Shares will be effected electronically through the non-certificated inventory system administered by CDS.

Upon purchase of any Debentures through the Book-Entry Only System, the Corporation understands that the holder of Debentures will receive only a customer confirmation from the registered dealer which is a CDS Participant and from or through which the Debentures are purchased. References in this Prospectus to a holder of Debentures mean, unless the context otherwise requires, the owner of the beneficial interest in such Debentures.

The Corporation will have the option to terminate registration of the Debentures through the Book-Entry Only System, in which case certificates for the Debentures in fully registered form would be issued to holders of such Debentures.

## USE OF PROCEEDS

The net proceeds from the Offering (including both the first instalment and final instalment) will be, in the aggregate, \$1,349,500,000 determined after deducting the Underwriters' fee and the estimated expenses of the Offering. In the event that the Over-Allotment Option is exercised in full, the net proceeds will be, in the aggregate, \$1,484,600,000.

Prior to the closing of the Merger, Hydro One Limited intends to use the net proceeds of the first instalment under the Offering, which are expected to be \$441,700,000 (assuming no exercise of the Over-Allotment Option), to repay borrowings under the Operating Credit Facility or its subsidiaries' existing revolving credit facilities or other existing indebtedness (such indebtedness having been incurred for general corporate purposes), or for other general corporate purposes, including investing in short-term interest bearing U.S. dollar securities with investment grade counterparties and in Hydro One Limited's wholly-owned subsidiaries. In the event that the net proceeds of the first instalment under the Offering are used to reduce outstanding indebtedness or for other general corporate purposes, Hydro One Limited will maintain readily available capacity on its revolving credit facilities (on a consolidated basis), or have cash on hand together with such available capacity, in an amount at least equal to the net proceeds of the first instalment under the Offering. Upon the closing of the Merger, Hydro One Limited intends to use the net proceeds of the final instalment under the Offering, which are expected to be \$909,300,000 (assuming no exercise of the Over-Allotment Option), to finance, directly or indirectly, together with the net proceeds of the first instalment under the Offering to the extent available, part of the purchase price payable for the Merger and for other Merger-Related Expenses. See "Relationship between Hydro One Limited, the Selling Debentureholder and Certain Underwriters" and "Financing the Merger".

## PLAN OF DISTRIBUTION

Pursuant to an underwriting agreement dated July 25, 2017 (the "**Underwriting Agreement**") among Hydro One Limited, the Selling Debentureholder and the Underwriters, the Selling Debentureholder has agreed to sell, and the Underwriters have agreed to purchase, as principals, on the Closing Date, all but not less than all of the Debentures offered hereby on an instalment basis at a price of \$1,000 per \$1,000 principal amount of Debentures (the "**Offering Price**"). The Offering Price is payable in cash to the Selling Debentureholder on delivery as follows: the first instalment of \$333 per \$1,000 principal amount of Debenture is payable on the Closing Date against delivery; and the final instalment of \$667 per \$1,000 principal amount of Debenture is payable by the holders of Instalment Receipts on or before the Final Instalment Date. See "Details of the Offering".

The obligations of the Underwriters under the Underwriting Agreement are several and not joint or joint and several and may be terminated by them on the basis of certain stated events. Under the Underwriting Agreement, the obligations of any Underwriter may be terminated in their discretion if, at or prior to the Closing Date: (i) there should occur, be announced or be discovered any material change or any change in a material fact in relation to Hydro One Limited which, in the opinion of any of the Underwriters, acting reasonably, is expected to result in the purchasers of a material number of Debentures exercising their right under applicable Canadian securities laws to withdraw from their purchase of Debentures or would be expected to have a significant adverse effect on the market price or value of the Debentures, the Instalment Receipts, the Common Shares issuable upon conversion of the Debentures or any other securities of Hydro One Limited; (ii) there should develop, occur or come into effect or existence any event, action, state, condition or major financial occurrence of national or international consequence or there shall have occurred any outbreak or escalation of hostilities, declaration by Canada or the United States of a national emergency or war, or other calamity or crisis, in either case, which, in the opinion of any Underwriter, acting reasonably, seriously adversely affects, or involves, or will seriously adversely affect, or involve, the financial markets of the business, operations or affairs of Hydro One; (iii) any inquiry, action, suit, investigation or other proceeding (collectively, a "**Proceeding**"), whether formal or informal, is instituted, announced or threatened (other than Proceedings existing as of the date of the Underwriting Agreement and other Proceedings in connection therewith or related thereto), or any order is made by any federal, provincial, state, municipal or other governmental authority, which, in the opinion of any Underwriter, acting reasonably, operates to prevent or restrict the sale, purchase, distribution or trading of the Debentures or Instalment Receipts; (iv) any order to cease or suspend trading in Hydro One Limited's securities or Instalment Receipts or to prohibit or restrict the distribution of the Debentures, the Common Shares issuable upon conversion of the Debentures or Instalment Receipts is made, or proceedings are announced, commenced or threatened for the making of any such order, by any

of the Canadian Securities Regulators or the TSX and has not been rescinded, revoked or withdrawn; (v) there is announced any change or proposed change in law, regulation or policy or the interpretation or administration thereof, if, in the opinion of any Underwriter, acting reasonably, such change, announcement, or proposal materially adversely affects, or may materially adversely affect, the trading of the Debentures, Instalment Receipts, Common Shares issuable upon conversion of the Debentures or the trading of any other securities of Hydro One Limited; or (vi) termination of the Merger Agreement occurs prior to 8:00 a.m. (Toronto time) on the Closing Date.

The Underwriters are obligated to take up and pay for all of the Debentures represented by Instalment Receipts offered hereby (other than the Debentures represented by Instalment Receipts issuable on exercise of the Over-Allotment Option) if any of those Debentures represented by Instalment Receipts are purchased under the Underwriting Agreement. The Debentures represented by Instalment Receipts offered hereby are to be taken up by the Underwriters, if at all, on or before a date not later than 42 days after the date of the receipt for the final short form prospectus relating to the Offering.

The Selling Debentureholder has granted to the Underwriters the Over-Allotment Option, which is exercisable in whole or in part at any time prior to the 30th day following the Closing Date and pursuant to which the Underwriters may purchase additional Debentures represented by Instalment Receipts equal to up to 10% of the aggregate principal amount of Debentures represented by Instalment Receipts sold in the Offering on the same terms as set forth above, to cover over-allotments, if any. This Prospectus qualifies the grant of the Over-Allotment Option and the issuance of Debentures represented by Instalment Receipts on the exercise of the Over-Allotment Option. A purchaser who acquires Debentures represented by Instalment Receipts forming part of the Underwriters' over-allocation position acquires those Debentures represented by Instalment Receipts under this Prospectus, regardless of whether the over-allocation position is ultimately filled through the exercise of the Over-Allotment Option or secondary market purchases.

The Underwriting Agreement provides that the Underwriters will be paid a fee by Hydro One Limited equal to 3.5% of the gross proceeds of the sale of the Debentures (\$35.00 per Debenture) in consideration for their services in connection with the Offering. One-half of the fee is payable on the Closing Date and the remaining one-half is payable on the Final Instalment Date. Accordingly, upon payment of the final instalment and assuming the final instalment payment is made for all outstanding Instalment Receipts and that the Over-Allotment Option is not exercised, the total price to the public will be \$1,400,000,000, the Underwriters' fee will be \$49,000,000 and the net proceeds will be approximately \$1,349,500,000, after deducting the expenses of the Offering estimated at \$1,500,000. After the Underwriters have made reasonable efforts to sell all the Debentures represented by Instalment Receipts at the Offering Price, the Offering Price may be decreased and may be further changed from time to time to an amount not greater than that set out on the cover page, and the compensation realized by the Underwriters will be decreased by the amount that the aggregate price paid by purchasers for the Debentures represented by Instalment Receipts is less than the gross proceeds paid by the Underwriters to the Selling Debentureholder. The Offering Price and other terms of the Offering were determined by negotiation between the Corporation, the Selling Debentureholder and the Underwriters.

**There is currently no market through which the Debentures represented by Instalment Receipts may be sold and purchasers may not be able to resell securities purchased under this Prospectus. This may affect the pricing of the Securities in the secondary market, the transparency and availability of trading prices, the liquidity of the Securities and the extent of issuer regulation.** The TSX has conditionally approved the listing of the Instalment Receipts (representing the Debentures) and the Common Shares issuable on the conversion of the Debentures on the TSX. Listing will be subject to the Corporation fulfilling all of the requirements of the TSX. The Corporation has no current intention to list the Debentures for trading on any exchange, as it currently anticipates all Debentures will be converted to Common Shares on the Final Instalment Date.

Once listed, the Instalment Receipts (representing the Debentures) will be quoted and traded on the TSX in the same manner as other debentures listed on the TSX, with all bids and offers for and trades of Instalment Receipts reflecting only the partly paid capital portion of the Debentures and not accrued interest. Accrued interest will be reflected in the settlement amount and in the confirmations generated by the CDS Participant from or through whom the trade was executed. Bid, offer and trading prices for the Instalment Receipts listed on the TSX will be expressed as a percentage of the \$1,000 principal amount of a fully paid Debenture (and not as a percentage of the \$333 first instalment already paid). In accordance with TSX trading rules, the Instalment Receipts will be quoted based on



\$100 principal amounts and all trades in Instalment Receipts will be made in multiples of \$1,000. A board lot of Instalment Receipts is represented by one Instalment Receipt, the underlying value of which is \$1,000 principal amount of a fully paid Debenture.

Pursuant to rules and policy statements of certain Canadian securities regulators, the Underwriters may not, at any time during the period ending on the date the selling process for the Debentures represented by Instalment Receipts ends and all stabilization arrangements relating to the Debentures represented by Instalment Receipts are terminated, bid for or purchase Instalment Receipts, Debentures or Common Shares. The foregoing restrictions are subject to certain exceptions including: (i) a bid for or purchase made through the facilities of the TSX, in accordance with the Universal Market Integrity Rules of the Investment Industry Regulatory Organization of Canada; (ii) a bid or purchase on behalf of a client, other than certain prescribed clients, provided that the client's order was not solicited by the Underwriter, or if the client's order was solicited, the solicitation occurred before the commencement of a prescribed restricted period; and (iii) a bid or purchase to cover a short position entered into prior to the commencement of a prescribed restricted period. The Underwriters may engage in market stabilization or market balancing activities on the TSX where the bid for or purchase of the Instalment Receipts, Debentures or Common Shares is for the purpose of maintaining a fair and orderly market in the Instalment Receipts, Debentures or Common Shares, subject to price limitations applicable to such bids or purchases. Such transactions, if commenced, may be discontinued at any time.

**The securities offered pursuant to this Prospectus may not be offered or sold in the United States.** The Debentures, the Instalment Receipts representing the Debentures, and the Common Shares into which the Debentures may be converted have not been, and will not be, registered under the United States Securities Act of 1933, as amended (the “1933 Act”) or any state securities laws and, may not be offered, or delivered, directly or indirectly, or sold in the United States. The Underwriters have agreed that they will not sell the Debentures represented by Instalment Receipts within the United States. When used in this section, the term “United States” has the meaning ascribed to it in Regulation S under the 1933 Act.

### **Lock-up Arrangements**

Pursuant to the Underwriting Agreement, each of Hydro One Limited and the Selling Debentureholder has agreed that, during the period beginning on the Closing Date and ending on the date that is 90 days following the Closing Date, each of Hydro One Limited and the Selling Debentureholder will not, directly or indirectly, without the prior written consent of RBC Dominion Securities Inc., CIBC World Markets Inc. and BMO Nesbitt Burns Inc., issue, sell, offer, grant any option, warrant or other right to purchase or agree to issue or sell, or otherwise lend, transfer, assign, pledge or dispose of (including without limitation by making any short sale, engaging in any hedging, monetization or derivative transaction or entering into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of Common Shares or other securities of Hydro One Limited or securities convertible into, exchangeable for, or otherwise exercisable into Common Shares or other securities of Hydro One Limited, whether or not cash settled), in a public offering or by way of private placement or otherwise, any equity securities of Hydro One Limited or other securities convertible into, exchangeable for, or otherwise exercisable into Common Shares or other equity securities of Hydro One Limited, or agree to do any of the foregoing or publicly announce any intention to do any of the foregoing, other than: (i) the Debentures sold to the Underwriters pursuant to this Prospectus; (ii) Common Shares purchased or delivered under Hydro One Limited's dividend reinvestment plan; or (iii) securities granted, issued or delivered in the ordinary course of business under Hydro One Limited's security-based compensation arrangements, or employee share ownership plans, or pursuant to the conversion, exchange or exercise of any securities so granted, issued or delivered.

### **RELATIONSHIP BETWEEN HYDRO ONE LIMITED, THE SELLING DEBENTUREHOLDER AND CERTAIN UNDERWRITERS**

RBC Dominion Securities Inc., CIBC World Market Inc., BMO Nesbitt Burns Inc., National Bank Financial Inc., Scotia Capital Inc. and TD Securities Inc. are subsidiaries or affiliates of lenders that have made the Operating Credit Facility available to Hydro One Limited. In addition, RBC Dominion Securities Inc., CIBC World Markets Inc., BMO Nesbitt Burns Inc., National Bank Financial Inc., Scotia Capital Inc., TD Securities Inc., Desjardins Securities Inc. and Laurentian Bank Securities Inc. are subsidiaries or affiliates of lenders that have made

a \$2.3 billion unsecured revolving credit facility available to Hydro One Inc. (the “**Revolving Credit Facility**”). **Consequently, the Corporation and/or the Selling Debentureholder may be considered a “connected issuer” of these Underwriters within the meaning of applicable securities legislation.**

None of these Underwriters will receive any direct benefit from the Offering other than the Underwriters’ Fees relating to the Offering. The decision to distribute the Debentures hereunder and the determination of the terms of the Offering were made through negotiation between the Corporation, the Selling Debentureholder and the Underwriters. As of the date of this Prospectus, there was no outstanding indebtedness under the Operating Credit Facility or the Revolving Credit Facility. Neither Hydro One Limited nor Hydro One Inc. is in default of its obligations to the lenders under the Operating Credit Facility or the Revolving Credit Facility, as applicable, and the lenders have not waived any breach of such credit facilities since their execution. Indebtedness under the Operating Credit Facility and the Revolving Credit Facility is unsecured.

## **CERTAIN CANADIAN FEDERAL INCOME TAX CONSIDERATIONS**

In the opinion of Osler, Hoskin & Harcourt LLP, counsel to Hydro One Limited and the Selling Debentureholder, and Blake, Cassels & Graydon LLP, counsel to the Underwriters, (collectively, “**Counsel**”) the following summary describes the principal Canadian federal income tax considerations generally applicable to a holder who acquires Debentures represented by Instalment Receipts as beneficial owner pursuant to this Offering and who, for the purposes of the application of the Tax Act and at all relevant times: (i) is resident, or is deemed to be resident, in Canada; (ii) holds the Debentures and will hold any Common Shares received on the conversion or maturity of the Debentures (collectively, the “**Securities**”) as capital property; (iii) deals at arm’s length with Hydro One Limited, the Selling Debentureholder and the Underwriters; and (iv) is not affiliated with Hydro One Limited, the Selling Debentureholder and the Underwriters (a “**Holder**”). Generally, the Securities will be capital property to a Holder provided the Holder does not acquire or hold the Securities in the course of carrying on a business or as part of an adventure or concern in the nature of trade. Certain holders who might not otherwise be considered to hold their Securities as capital property may, in certain circumstances, be entitled to have the Securities, and all other “Canadian securities” (as defined in the Tax Act) owned by such holders in the taxation year of the election and all subsequent taxation years, deemed to be capital property by making the irrevocable election permitted by subsection 39(4) of the Tax Act. Holders are advised to consult their personal tax advisors to determine whether such an election is available and desirable in their particular circumstances.

This summary is not applicable to a purchaser: (i) that is a “financial institution”, as defined in the Tax Act for the purposes of the mark-to-market rules; (ii) that is a “specified financial institution” as defined in the Tax Act; (iii) an interest which would be a “tax shelter investment” as defined in the Tax Act; (iv) that reports its “Canadian tax results”, as defined in the Tax Act, in a currency other than Canadian currency; (v) that enters into a “derivative forward agreement”, as defined in the Tax Act, in respect of the Debentures or Common Shares; or (vi) that is a corporation resident in Canada and that is or becomes, or does not deal at arm’s length for purposes of the Tax Act with a corporation resident in Canada that is or becomes, as part of a transaction or event or series of transactions or events that includes the acquisition of Securities, controlled by a non-resident corporation for purposes of the foreign affiliate dumping rules in section 212.3 of the Tax Act. Any such purchaser should consult its own tax advisor with respect to an investment in the Securities.

This summary is based upon the provisions of the Tax Act in force as of the date hereof, all specific proposals to amend the Tax Act that have been publicly announced prior to the date hereof (the “**Proposed Amendments**”) and Counsel’s understanding of the current published administrative practices of the Canada Revenue Agency. This summary assumes that the Proposed Amendments will be enacted in the form proposed; however, no assurance can be given that the Proposed Amendments will be enacted in the form proposed, if at all. This summary does not take into account the discussion paper seeking input on possible approaches to address certain perceived tax advantages of investing passively through a private corporation released, for consultation, by the Minister of Finance (Canada) on July 18, 2017. See, in this regard, “Risk Factors – Risk Factors Relating to the Debentures – Change of Tax Law”. This summary is not exhaustive of all possible Canadian federal income tax considerations and, except for the Proposed Amendments, does not take into account any changes in the law, whether by legislative, governmental or judicial action, nor does it take into account any other federal or any provincial, territorial or foreign tax considerations, which may differ from those discussed herein.

**This summary is of a general nature only and is not intended to be, nor should it be construed to be, legal or tax advice to any particular Holder, and no representations with respect to the income tax consequences to any Holder are made. Consequently, prospective Holders should consult their own tax advisors for advice with respect to the tax consequences to them of acquiring Securities pursuant to this Offering, having regard to their particular circumstances. This summary does not address any tax considerations applicable to persons other than Holders and such persons should consult their own tax advisors regarding the consequences of acquiring, holding and disposing of Securities under the Tax Act and the laws of any jurisdiction in which they may be subject to tax.**

### **Taxation of Interest on Debentures**

A Holder of Debentures represented by Instalment Receipts that is a corporation, partnership, unit trust or any trust of which a corporation or a partnership is a beneficiary will be required to include in computing its income for a taxation year any interest on the Debentures that accrues, or is deemed to accrue, to such Holder to the end of the particular taxation year or that has become receivable by or is received by the Holder before the end of that taxation year, including on a conversion, redemption or repayment at maturity, except to the extent that such interest was included in computing the Holder's income for a preceding taxation year.

Any other Holder, including an individual, will be required to include in computing income for a taxation year all interest on the Debentures that is received or receivable by the Holder in that taxation year (depending upon the method regularly followed by the Holder in computing income), including on a conversion, redemption or repayment at maturity, except to the extent that the interest was included in the Holder's income for a preceding taxation year.

Any Make-Whole Payment will be deemed to be interest received by the Holder at the time of such Make-Whole Payment and will be required to be included in the Holder's income as described above, to the extent that such Make-Whole Payment can reasonably be considered to relate to, and does not exceed the value at the time of such Make-Whole Payment of, the interest that would have been paid or payable on the Debenture for a taxation year ending after the time of such Make-Whole Payment had the Final Instalment Date not occurred on a day that is prior to the first anniversary of the Closing Date.

### **Exercise of Conversion Privilege**

Generally, a Holder who converts a Debenture into Common Shares pursuant to the conversion privilege will be deemed not to have disposed of the Debenture (except for purposes of the deduction for interest included in income but not received as discussed below under “– Disposition of Debentures”). Accordingly, a Holder who converts a Debenture into Common Shares will not be considered to realize a capital gain (or capital loss) on such conversion. Under the current administrative practice of the Canada Revenue Agency, a Holder who, upon conversion of a Debenture, receives cash not in excess of \$200 in lieu of a fraction of a Common Share may either treat this amount as proceeds of disposition of a portion of the Debenture, thereby realizing a capital gain (or capital loss), or reduce the adjusted cost base of the Common Shares that the Holder receives on the conversion by the amount of the cash received.

The aggregate cost to a Holder of Common Shares acquired on the conversion of a Debenture will generally be equal to the Holder's adjusted cost base of the Debenture immediately before the conversion, subject to any reduction in respect of cash received in lieu of fractional common shares, as described above. For the purposes of determining the adjusted cost base to a Holder of Common Shares at any time, the cost of such Common Shares will be averaged with the adjusted cost base of any other Common Shares owned by the Holder as capital property at the time.

### **Disposition of Debentures**

A disposition or deemed disposition of a Debenture by a Holder, including upon redemption or at maturity but not including the conversion of a Debenture into Common Shares pursuant to the Holder's right of conversion as described above, will generally result in the Holder realizing a capital gain (or a capital loss) equal to the amount by which the proceeds of disposition (adjusted as described below) are greater (or less) than the aggregate of the Holder's adjusted cost base thereof and any reasonable costs of disposition. Such capital gain (or capital loss) will be subject to the tax treatment described below under “– Taxation of Capital Gains and Capital Losses”. In this regard, the cost to a Holder of a Debenture represented by an Instalment Receipt will include all amounts paid or payable by the Holder for such Debenture, including the amount of the final instalment, whether paid or unpaid. The proceeds

of disposition to a Holder who disposes of a Debenture represented by an Instalment Receipt will include the amount of any unpaid final instalment.

Upon a disposition or deemed disposition, other than upon redemption or at maturity, interest accrued on the Debenture to the date of disposition will be included in computing the Holder's income for the year of disposition, except to the extent that it was included in computing the Holder's income for that or a preceding taxation year, and will be excluded from the Holder's proceeds of disposition of the Debenture. Where a Holder has disposed of a Debenture for consideration equal to its fair market value, the Holder will be entitled to deduct in computing income for the year of disposition any amount that has been included in the Holder's income as interest in respect of such Debenture for that year or any preceding taxation year to the extent such amount exceeds the amount received or receivable by the Holder in respect thereof. A conversion of a Debenture into Common Shares is a disposition for purposes of this rule.

If Hydro One Limited pays the principal amount of the Debentures upon maturity by issuing Common Shares to the Holder, the Holder's proceeds of disposition of the Debenture will be equal to the fair market value, at the time of disposition of the Debenture, of the Common Shares and any other consideration so received. The Holder's aggregate cost of the Common Shares so received will be equal to the fair market value of such Common Shares. For the purposes of determining the adjusted cost base to a Holder of the Common Shares at any time, the cost of such Common Shares will be averaged with the adjusted cost base of any other Common Shares owned by the Holder as capital property at that time.

Where a Debenture represented by an Instalment Receipt is forfeited to the Selling Debentureholder or is sold by the Custodian as a consequence of the Holder's failure to pay the final instalment, the Holder may be subject to special rules in the Tax Act relating to the seizure by a seller of property previously sold or the settlement or forgiveness of debt. Holders should consult their own tax advisors with respect to these special rules.

### **Dividends on Common Shares**

A Holder will be required to include in computing its income for a taxation year any dividends received (or deemed to be received) on the Common Shares. In the case of a Holder that is an individual (other than certain trusts), such dividends will be subject to the gross-up and dividend tax credit rules applicable to taxable dividends received from "taxable Canadian corporations" (as defined in the Tax Act), including the enhanced gross-up and dividend tax credit applicable to any dividends designated by Hydro One Limited as an "eligible dividend" (as defined in the Tax Act) in accordance with the provisions of the Tax Act.

A dividend received (or deemed to be received) on the Common Shares by a Holder that is a corporation will generally be deductible in computing the corporation's taxable income. In certain circumstances, however, a dividend received (or deemed to be received) by a Holder that is a corporation will be deemed to be a capital gain or proceeds of disposition. Holders that are corporations should consult their own tax advisors having regard to their own circumstances.

A Holder that is a "private corporation", as defined in the Tax Act, or any other corporation controlled, whether because of a beneficial interest in one or more trusts or otherwise, by or for the benefit of an individual (other than a trust) or a related group of individuals (other than trusts), will generally be liable to pay a refundable tax under Part IV of the Tax Act on dividends received (or deemed to be received) on the Common Shares to the extent such dividends are deductible in computing the Holder's taxable income for the taxation year.

### **Disposition of Common Shares**

Generally, on a disposition or deemed disposition of a Common Share, a Holder will realize a capital gain (or capital loss) equal to the amount, if any, by which the proceeds of disposition, net of any reasonable costs of disposition, exceed (or are less than) the adjusted cost base to the Holder of the Common Share immediately before the disposition or deemed disposition. Such capital gain (or capital loss) will be subject to the tax treatment described below under "– Taxation of Capital Gains and Capital Losses".

### **Taxation of Capital Gains and Capital Losses**

Generally, a Holder is required to include in computing its income for a taxation year one-half of the amount of any capital gain (a "taxable capital gain") realized in the year. Subject to and in accordance with the provisions of the Tax Act, a Holder is required to deduct one-half of the amount of any capital loss (an "allowable capital loss") realized in a taxation year from taxable capital gains realized by the Holder in the year and allowable

capital losses in excess of taxable capital gains for the year may be carried back and deducted in any of the three preceding taxation years or carried forward and deducted in any subsequent taxation year against net taxable capital gains realized in such years. The amount of any capital loss realized by a Holder that is a corporation on the disposition of a Common Share may be reduced by the amount of dividends received or deemed to be received by it on such Common Share to the extent and under the circumstances prescribed by the Tax Act. Similar rules may apply where a Common Share is owned by a partnership or trust of which a corporation, trust or partnership is a member or beneficiary. Such Holders should consult their own tax advisors.

## **RISK FACTORS**

An investment in: (i) the Debentures represented by Instalment Receipts pending payment of the final instalment; (ii) the Debentures following payment of the final instalment; and (iii) the Common Shares issuable upon the conversion of the Debentures, is speculative due to various factors and involves certain risks. A prospective purchaser of Debentures should carefully consider the risk factors and other risks relating to Hydro One's business as described in Hydro One Limited's documents incorporated by reference in this Prospectus, including under:

- (i) the heading "Risk Management and Risk Factors" at pages 16 to 23 in the Annual MD&A; and
- (ii) the heading "Forward-Looking Statements and Information" at pages 10 to 11 in the Interim MD&A.

In addition, a prospective purchaser of Debentures should carefully consider the risk factors described in this section which relate to the Merger, the Instalment Receipts, the Debentures and the post-Merger business and operations of Hydro One and Avista Corp., as well as the other information contained in this Prospectus (including the documents incorporated herein by reference).

If any of the identified risks were to materialize, it could have a materially adverse effect on the Corporation's future results of operations, business, prospects or financial condition, and could cause actual events to differ materially from those described in forward-looking statements. Additional risks and uncertainties not currently known to the Corporation, or which the Corporation currently deems to be immaterial, may also have an adverse effect on Hydro One and/or its future results of operations, business, prospects or financial condition.

### **Risk Factors Relating to the Merger**

#### ***Hydro One Limited may fail to complete the Merger***

The closing of the Merger is subject to the normal commercial risks that the Merger will not close on the terms negotiated (including with respect to the consideration to be paid in respect of the common stock of Avista Corporation) or at all. The completion of the Merger is subject to receipt of Avista Shareholder Approval and satisfaction of the other Approval Conditions, including certain regulatory and governmental approvals, including the expiration or termination of any applicable waiting period under the HSR Act, clearance of the Merger by CFIUS, the approval by each of IPUC, MPSC, OPUC, RCA, WUTC, FERC and the FCC and the satisfaction or waiver of certain closing conditions contained in the Merger Agreement. The failure to obtain the required approvals or satisfy or waive the conditions contained in the Merger Agreement may result in the termination of the Merger Agreement. There is no assurance that such closing conditions will be satisfied or waived. Accordingly, there can be no assurance that Hydro One Limited will complete the Merger in the timeframe or on the basis described herein, if at all. The termination of the Merger Agreement may have a negative effect on the price of the Instalment Receipts, the Debentures and the Common Shares and will result in the redemption of the Debentures. If the closing of the Merger does not take place as contemplated, the Corporation could suffer adverse consequences, including the loss of investor confidence, and may incur significant costs or losses, including an obligation to pay or cause to be paid to Avista Corporation the Corporation Termination Fee. See "The Merger Agreement – Termination".

#### ***The purchase price could increase***

Avista Corporation is a public company and its directors owe fiduciary duties to Avista Corporation shareholders, which may require them to consider competing offers to purchase the common stock of Avista Corporation as alternatives to the Merger. The Merger Agreement preserves the ability of the directors of Avista Corp. to accept an alternative or competing offer in certain circumstances if such offer constitutes a Superior Proposal. If a Superior Proposal to acquire Avista Corporation is made, and if the Superior Proposal results in Avista

Corporation's board of directors making an Adverse Recommendation Change, Avista Corporation is required to negotiate in good faith with Hydro One Limited regarding any revisions to the Merger Agreement, which could result in an increase to the purchase price of the Merger or changes to other terms and conditions of the Merger. See "The Merger Agreement".

***Length of time required to complete the Merger is unknown***

As described above under "– Hydro One Limited may fail to complete the Merger", the closing of the Merger is subject to the receipt of required Avista Shareholder Approval and certain regulatory approvals and the satisfaction of other closing conditions contained in the Merger Agreement. There is no certainty, nor can Hydro One Limited provide any assurance, as to when these conditions will be satisfied, if at all. A substantial delay in obtaining regulatory approvals or the imposition of unfavourable terms and/or conditions in such approvals could have a material adverse effect on the Corporation's ability to complete the Merger and on Hydro One's or Avista Corp.'s business, financial condition or results of operations. In addition, in the event that such regulatory agencies imposed unfavorable terms and/or conditions on Hydro One Limited or Avista Corporation (including the requirement to sell or divest of certain assets or limitations on the future conduct of the combined entities), the Corporation could still be required to complete the transaction on the terms set forth in the Merger Agreement. Hydro One Limited intends to complete the Merger as soon as practicable after obtaining the required Avista Shareholder Approval and regulatory approvals and satisfying the other required closing conditions. See "The Merger Agreement – Closing Conditions".

***Foreign exchange risk***

The cash consideration for the Merger is required to be paid in U.S. dollars, while funds raised in the Offering, which will constitute a significant portion of the funds ultimately used to finance the Merger, are denominated in Canadian dollars. See "Use of Proceeds". As a result, increases in the value of the U.S. dollar versus the Canadian dollar prior to payment of the final instalment will increase the purchase price translated in Canadian dollars and thereby reduce the proportion of the purchase price for the Merger ultimately obtained by Hydro One Limited under the Offering, which could cause a failure to realize the anticipated benefits of the Merger.

In addition, the operations of Avista Corp. are conducted in U.S. dollars. Following the Merger, the consolidated net earnings and cash flows of Hydro One will be impacted to a much greater extent by movements in the U.S. dollar relative to the Canadian dollar. In particular, decreases in the value of the U.S. dollar versus the Canadian dollar following the Merger could negatively impact the Corporation's net earnings as reported in Canadian dollars, which could cause a failure to realize the anticipated benefits of the Merger.

***Additional demands will be placed on Hydro One as a result of the Merger***

As a result of the pursuit and completion of the Merger, additional demands will be placed on the Corporation's managerial, operational and financial personnel and systems. No assurance can be given that the Corporation's systems, procedures and controls will be adequate to support the expansion of the Corporation's operations resulting from the Merger. The Corporation's future operating results will be affected by the ability of its officers and key employees to manage changing business conditions and to maintain its operational and financial controls and reporting systems.

***Sources of funding that would be used to fund the Merger may not be available***

Hydro One Limited intends to finance the cash purchase price of the Merger and the Merger-Related Expenses at the closing of the Merger with a combination of some or all of the following: (i) net proceeds of the first instalment (to the extent available) and final instalment under the Offering; (ii) net proceeds of any subsequent bond or other debt offerings; (iii) amounts drawn under the Operating Credit Facility; and (iv) existing cash on hand and other sources available to the Corporation.

There is no guarantee that adequate sources of funding will be available to Hydro One Limited or its affiliates at the desired time or at all, or on cost-efficient terms. The inability to obtain adequate sources of funding to fund the Merger may result in Hydro One Limited being unable to complete the Merger or may negatively impact Hydro One Limited, including its ability to finance the Merger. In addition, any movement in interest rates that could affect the underlying cost of any financing may affect the expected accretion of the Merger.

***Hydro One does not currently control Avista Corp.***

Although the Merger Agreement contains covenants on the part of Avista Corporation regarding the operation of its business prior to closing the Merger, Hydro One will not control Avista Corp. until completion of the Merger and Avista Corp.'s business and results of operations may be adversely affected by events that are outside of the Corporation's control during the intervening period. Historic and current performance of Avista Corp.'s business and operations may not be indicative of results in future periods. The future performance of Avista Corp. may be influenced by, among other factors, weather, economic conditions, increased environmental or other regulation, turmoil or disruption in financial markets, unfavourable regulatory decisions, rising interest rates, changes or uncertainty in government policy, energy commodity price changes and operational risks, including unplanned outages and other factors beyond the Corporation's control. As a result of any one or more of these factors, among others, the operations and financial performance of Avista Corp. may be negatively affected which may adversely affect the future financial results of Hydro One. See "– Risk Factors Relating to the Post-Merger Business and Operations of Hydro One and Avista Corp."

***Hydro One Limited expects to incur significant Merger-Related Expenses***

Hydro One Limited expects to incur a number of costs associated with completing the Merger. The substantial majority of these costs will be non-recurring expenses resulting from the Merger and will consist of transaction costs related to the Merger, including costs relating to the financing of the Merger and obtaining regulatory approval. Additional unanticipated costs may be incurred.

***Information relating to Avista Corp. in this Prospectus has been obtained from Avista Corporation or its public disclosure record***

All information relating to Avista Corporation or its affiliates contained in this Prospectus has been obtained from Avista Corporation or taken from Avista Corporation's public disclosure record. Although the Corporation has conducted what it believes to be a prudent and thorough level of investigation in connection with the Merger and the disclosure relating to Avista Corp. contained in this Prospectus, an unavoidable level of risk remains regarding the accuracy and completeness of such information. While Hydro One has no reason to believe the information obtained from Avista Corporation or taken from the public disclosure record is misleading, untrue or incomplete, Hydro One cannot assure the accuracy or completeness of such information nor can Hydro One compel Avista Corporation to disclose events which may have occurred or may affect the completeness or accuracy of such information but which are unknown to Hydro One.

***Risk Factors Relating to the Post-Merger Business and Operations of Hydro One and Avista Corp.***

***Hydro One will substantially increase its amount of indebtedness following the Merger***

After giving effect to the Merger, Hydro One will have a significant amount of debt, including approximately US\$1.9 billion of debt of Avista Corp. assumed by Hydro One as a result of the Merger. As of March 31, 2017, on a *pro forma* basis after giving effect to the Merger, but assuming conversion of all Debentures to Common Shares (assuming no exercise of the Over-Allotment Option), details of which are included in the capitalization table provided herein, Hydro One would have had approximately \$17.098 billion of total indebtedness outstanding. See "Capitalization". Hydro One will substantially increase its amount of indebtedness following the Merger and such increased indebtedness may adversely affect Hydro One's cash flow and ability to operate its business.

***The Offering could result in a downgrade of Hydro One's credit ratings***

The change in the capital structure of Hydro One Limited as a result of the Merger and the Offering could cause credit rating agencies which rate the outstanding debt obligations of Hydro One Limited and Hydro One Inc. to re-evaluate and potentially downgrade their current credit ratings, which could increase the Corporation's borrowing costs.

***Hydro One Limited's historical and pro forma combined financial information may not be representative of the results of the Corporation following the Merger***

The *pro forma* combined financial information included in this Prospectus has been prepared using the consolidated historical financial statements of Hydro One Limited and the consolidated historical financial statements of Avista Corporation and does not purport to be indicative of the financial information that will result

from the operations of Hydro One Limited on a consolidated basis following the Merger. In addition, the *pro forma* financial information included in this Prospectus is based in part on certain assumptions regarding the Merger that Hydro One currently believes are reasonable. Hydro One makes no assurances that its current assumptions will prove to be accurate over time. Accordingly, the historical and *pro forma* financial information included in this Prospectus does not necessarily represent the Corporation's results of operations and financial condition had Hydro One and Avista Corp. operated as a combined entity during the periods presented, or of the Corporation's consolidated results of operations and financial condition in the future. Additionally, the actual amount assigned to the fair values of the identifiable assets and liabilities acquired will result in changes to earnings in periods subsequent to the Merger, and those changes could be material.

In preparing the *pro forma* financial information contained in this Prospectus, Hydro One Limited has given effect to, among other items, the Offering, the completion of the Merger and the assumption of Avista Corp.'s outstanding indebtedness. Hydro One Limited has also assumed that the Debentures will be converted into Common Shares on or immediately following the Final Instalment Date. While management believes that the estimates and assumptions underlying the *pro forma* financial information are reasonable, such assumptions and estimates may be materially different than the Corporation's actual experience following completion of the Merger. See also "– Risk Factors Relating to the Merger" and "Presentation of Financial Information". See the notes to the *pro forma* financial statements of Hydro One Limited in this Prospectus.

#### ***Potential undisclosed liabilities associated with the Merger***

In connection with the Merger, there may be liabilities of Avista Corp. that the Corporation failed to discover or was unable to quantify in the due diligence which it conducted prior to the execution of the Merger Agreement. The discovery or quantification of any material liabilities of Avista Corp. could have a material adverse effect on Hydro One's business, financial condition, results of operations or future prospects.

The Corporation will not be obligated to close the Merger if (i) there are inaccuracies in the representations and warranties made by Avista Corporation in the Merger Agreement as to its liabilities which would reasonably be expected to have an Avista Material Adverse Effect, (ii) if any Final Orders impose or require any obligations that would, individually or in the aggregate, constitute a Burdensome Condition or (iii) if any Avista Material Adverse Effect has occurred, subject to certain prescribed exceptions, as described in further detail under "The Merger Agreement – Closing Conditions".

Following the closing of the Merger, Avista Corporation will have become an indirect wholly-owned subsidiary of the Corporation and the full merger consideration under the Merger Agreement will have been paid, and the Corporation will have no further recourse (against Avista Corporation, its shareholders or any other persons) and will fully bear the risk for any inaccuracies in the information, representations or warranties provided by Avista Corporation in the Merger Agreement and any material liabilities of Avista Corp.

#### ***Hydro One may be unable to successfully realize the anticipated benefits of the Merger***

Hydro One believes that the Merger will provide benefits to the Corporation. See "The Merger – Merger Highlights". However, there is a risk that some or all of the expected benefits of the Merger may fail to materialize, or may not occur within the time periods anticipated by the Corporation. The realization of such benefits may be affected by a number of factors, many of which are beyond the control of the Corporation. The past financial performance of the Corporation or Avista Corporation may not be indicative of its future financial performance. In addition, any regulatory approvals required in connection with the Merger may include terms which could have an adverse effect on the Corporation's financial performance, including reduced revenues or investment recovery, increased competition or costs, or adverse alterations to the rate structure. Failure to realize the anticipated benefits of the Merger may impact the financial performance of the Corporation and the price of its Common Shares.

#### ***Reputational and Public Opinion Risk***

Reputation risk is the risk of a negative impact to Hydro One's business, operations or financial condition that could result from a deterioration of Hydro One's reputation. Hydro One's reputation could be negatively impacted by changes in public opinion (including as a result of the Merger), attitudes towards the Corporation's privatization, failure to deliver on its customer promises and other external forces. Adverse reputational events or political actions could have negative impacts on Hydro One's business and prospects including, but not limited to, delays or denials of requisite approvals and accommodations for Hydro One's planned projects, escalated costs, legal or regulatory action, and damage to stakeholder relationships.



***Hydro One may not be successful in retaining the services of key personnel of Avista Corp. following the Merger***

Hydro One currently intends to retain key personnel of Avista Corp. following the completion of the Merger to continue to manage and operate Avista Corp. as a separate operating company. Hydro One will compete with other potential employers for employees, and it may not be successful in keeping the services of the executives and other employees of Avista Corp. that it needs to realize the anticipated benefits of the Merger. Hydro One's failure to retain key personnel to remain as part of the management team of Avista Corp. in the period following the Merger could have a material adverse effect on the business and operations of Avista Corp. and Hydro One on a consolidated basis.

***Hydro One is subject to risks associated with its results of operations and financing risks***

Management of Hydro One believes, based on its current expectations as to the Corporation's future performance (which reflects, among other things, the completion of the Merger), that the cash flow from its operations and funds available to it under the Operating Credit Facility and the revolving credit facilities of the subsidiaries of Hydro One Limited and its ability to access capital markets will be adequate to enable the Corporation to finance its operations, execute its business strategy and maintain an adequate level of liquidity. However, expected revenue and the costs of planned capital expenditures are only estimates. Moreover, actual cash flows from operations are dependent on regulatory, market and other conditions that are beyond the control of the Corporation. As such, no assurance can be given that management's expectations as to future performance will be realized. In addition, management's expectations as to the Corporation's future performance reflect the current state of its information about Avista Corp. and its operations and there can be no assurance that such information is correct and complete in all material respects.

Hydro One's degree of leverage could have adverse consequences for Hydro One, particularly if a significant portion of the Debentures are not converted into Common Shares by the holders thereof. The significant increase in the degree of Hydro One's leverage in connection with the Merger could, among other things, limit Hydro One's ability to obtain additional financing for working capital, investment in subsidiaries, capital expenditures, debt service requirements, acquisitions and general corporate or other purposes; restrict Hydro One's flexibility and discretion to operate its business; limit Hydro One Limited's ability to declare dividends on its Common Shares; require Hydro One to dedicate a portion of cash flows from operations to the payment of interest on its existing indebtedness, in which case such cash flows will not be available for other purposes; cause ratings agencies to re-evaluate or downgrade Hydro One's existing credit ratings; expose Hydro One to increased interest expense on borrowings at variable rates; limit Hydro One's ability to adjust to changing market conditions; place Hydro One at a competitive disadvantage compared to its competitors that have less debt; make Hydro One vulnerable to any downturn in general economic conditions; and render Hydro One unable to make expenditures that are important to its future growth strategies.

Hydro One will need to refinance or reimburse amounts outstanding under Hydro One's existing consolidated indebtedness over time. There can be no assurance that any indebtedness of Hydro One will be refinanced or that additional financing on commercially reasonable terms will be obtained, if at all. In the event that such indebtedness cannot be refinanced, or if it can be refinanced on terms that are less favourable than the current terms, the ability of Hydro One Limited to declare dividends may be adversely affected.

The ability of Hydro One to meet its debt service requirements will depend on its ability to generate cash in the future, which depends on many factors, including the financial performance of Hydro One, debt service obligations, the realization of the anticipated benefits of the Merger and working capital and future capital expenditure requirements. In addition, the ability of Hydro One to borrow funds in the future to make payments on outstanding debt will depend on the satisfaction of covenants in existing credit agreements and other agreements. A failure to comply with any covenants or obligations under Hydro One's consolidated indebtedness could result in a default under one or more such instruments, which, if not cured or waived, could result in the termination of dividends and distributions by Hydro One and permit acceleration of the relevant indebtedness. If such indebtedness were to be accelerated, there can be no assurance that the assets of Hydro One would be sufficient to repay such indebtedness in full. There can also be no assurance that Hydro One will generate cash flow in amounts sufficient to pay outstanding indebtedness or to fund any other liquidity needs.

***National and local economic conditions can have a significant impact on the results of operations, net income and cash flows at Avista Corp.***

The business of Avista Corp. is concentrated in the State of Washington with business also conducted in Idaho, Oregon Montana and Alaska. Economic conditions in these states and in Avista Corp.'s service territories could change and if they should worsen, retail customer growth rates may stagnate or decline and customers' energy usage may further decline, adversely affecting Avista Corp.'s results of operations, net income and cash flows and those of the Corporation following the Merger.

***Developments in technology could reduce demand for electricity and gas***

Research and development activities are ongoing for new technologies that produce power or reduce power consumption. These technologies include renewable energy, customer-oriented generation, energy storage, energy efficiency and more energy efficient appliances and equipment. Advances in these, or other technologies, could reduce the cost of producing electricity, transporting gas or make the existing generating facilities of Avista Corp. uneconomic. In addition, advances in such technologies could reduce electrical or natural gas demand, which could negatively impact the results of operations, net income and cash flows of Avista Corp. and those of the Corporation following the Merger.

***Weather (temperatures, precipitation levels, wind patterns and storms) has a significant effect on Avista Corp.'s results of operations, financial condition and cash flows***

Weather impacts are described in the following subtopics:

- certain retail electricity and natural gas sales,
- the cost of natural gas supply, and
- the cost of power supply.

***Certain retail electricity and natural gas sales volumes vary directly with changes in temperatures***

Avista Corp. normally has its highest retail (electric and natural gas) energy sales during the winter heating season in the first and fourth quarters of the year. Avista Corp. also has high electricity demand for air conditioning during the summer (third quarter) in the Pacific Northwest. In general, warmer weather in the heating season and cooler weather in the cooling season will reduce its customers' energy demand and retail operating revenues. The revenue and earnings impact of weather fluctuations is somewhat mitigated by Avista Corp.'s decoupling mechanisms; however, Avista Corp. could experience liquidity constraints during the period between when decoupling revenue is earned and when it is subsequently collected from customers through retail rates.

***The cost of natural gas supply tends to increase with higher demand during periods of cold weather***

Increased costs adversely affect cash flows when Avista Corp. purchases natural gas for retail supply at prices above the amount then allowed for recovery in retail rates. Avista Corp. defers differences between actual natural gas supply costs and the amount currently recovered in retail rates and Avista Corp. is generally allowed to recover substantially all of these differences after regulatory review. However, these deferred costs require cash outflows from the time of natural gas purchases until the costs are later recovered. Inter-regional natural gas pipelines and competition for supply can allow demand-driven price volatility in other regions of North America to affect prices in Avista Corp.'s region, even though there may be less extreme weather conditions in Avista Corp.'s area.

***The cost of power supply can be significantly affected by weather***

Precipitation (consisting of snowpack, its water content and melting pattern plus rainfall) and other streamflow conditions (such as regional water storage operations) significantly affect hydroelectric generation capability. Variations in hydroelectric generation inversely affect Avista Corp.'s reliance on market purchases and thermal generation. To the extent that hydroelectric generation is less than normal, significantly more costly power supply resources must be acquired and the ability to realize net benefits from surplus hydroelectric wholesale sales is reduced. Wholesale prices also vary based on wind patterns as wind generation capacity is material in Avista Corp.'s region but its contribution to supply is inconsistent.

The price of power in the wholesale energy markets tends to be higher during periods of high regional demand, such as occurs with temperature extremes. Avista Corp. may need to purchase power in the wholesale

market during peak price periods. The price of natural gas as fuel for natural gas-fired electric generation also tends to increase during periods of high demand which are often related to temperature extremes. Avista Corp. may need to purchase natural gas fuel in these periods of high prices to meet electric demands. The cost of power supply during peak usage periods may be higher than the retail sales price or the amount allowed in retail rates by Avista Corp.'s regulators. To the extent that power supply costs are above the amount allowed currently in retail rates, the difference is partially absorbed by Avista Corp. in current expense and it is partially deferred or shared with customers through regulatory mechanisms.

The price of power tends to be lower during periods with excess supply, such as the spring when hydroelectric conditions are usually at their maximum and various facilities are required to operate to meet environmental mandates. Oversupply can be exacerbated when intermittent resources such as wind generation are producing output that may be supported by price subsidies. In extreme situations, Avista Corp. may be required to sell excess energy at negative prices.

As a result of these combined factors, Avista Corp.'s net cost of power supply – the difference between its costs of generation and market purchases, reduced by its revenue from wholesale sales – varies significantly because of weather.

***Avista Corp. relies on regular access to financial markets but cannot assure favourable or reasonable financing terms will be available when Avista Corp. needs them***

*Access to capital markets is critical to Avista Corp.'s operations and its capital structure*

Avista Corp. has significant capital requirements that it expects to fund, in part, by accessing capital markets. As such, the state of financial markets and credit availability in the global, United States and regional economies impacts Avista Corp.'s financial condition. Avista Corp. could experience increased borrowing costs or limited access to capital on reasonable terms.

Avista Corp. accesses long-term capital markets to finance capital expenditures, repay maturing long-term debt and obtain additional working capital from time-to-time. Avista Corp.'s ability to access capital on reasonable terms is subject to numerous factors and market conditions, many of which are beyond its control. If Avista Corp. is unable to obtain capital on reasonable terms, it may limit or prohibit its ability to finance capital expenditures and repay maturing long-term debt. Avista Corp.'s liquidity needs could exceed its short-term credit availability and lead to defaults on various financing arrangements.

Performance of the financial markets could also result in significant declines in the market values of assets held by its pension plan and/or a significant increase in the pension liability (which impacts the funded status of the plan) and could increase future funding obligations and pension expense.

*Avista Corp. relies on credit from financial institutions for short-term borrowings*

Avista Corp. needs adequate levels of credit with financial institutions for short-term liquidity. Avista Corporation has a US\$400.0 million committed line of credit that expires in April 2021. Avista Corporation's subsidiary AEL&P has a US\$25.0 million committed line of credit that expires in November 2019. There is no assurance that Avista Corp. will have access to credit beyond these expiration dates. The committed line of credit agreements contain customary covenants and default provisions.

Any default on the lines of credit or other financing arrangements of Avista Corporation or any of its "significant subsidiaries," if any, could result in cross-defaults to other agreements of such entity, and/or to the line of credit or other financing arrangements of any other of such entities. Any defaults could also induce vendors and other counterparties to demand collateral. In the event of any such default, it would be difficult for Avista Corp. to obtain financing on reasonable terms to pay creditors or fund operations.

*Avista Corp. hedges a portion of its interest rate risk with financial derivative instruments, which may include interest rate swap derivatives and U.S. Treasury lock agreements*

If market interest rates decrease below the interest rates Avista Corp. has locked in, this will result in a liability related to its interest rate swap derivatives, which can be significant. As of March 31, 2017, Avista Corp. had a net interest rate swap derivative liability of US\$53.9 million, reflecting a decline in interest rates since the time Avista Corp. entered into the agreements. Avista Corp. does not have any U.S. Treasury lock agreements outstanding as of March 31, 2017. Avista Corp. may be required to post cash or letters of credit as collateral depending on fluctuations in the fair value of the derivative instruments. Settlement of interest rate swap derivative

instruments in a liability position could require a significant amount of cash, which could negatively impact Avista Corp.'s liquidity and short-term credit availability and increase interest expense over the term of the associated debt.

*Downgrades in Avista Corporation's credit ratings could impede its ability to obtain financing, adversely affect the terms of financing and impact its ability to transact for or hedge energy resources*

If Avista Corporation does not maintain its investment grade credit rating with the major credit rating agencies, it could expect increased debt service costs, limitations on its ability to access capital markets or obtain other financing on reasonable terms, and requirements to provide collateral (in the form of cash or letters of credit) to lenders and counterparties. In addition, credit rating downgrades could reduce the number of counterparties willing to do business with Avista Corp. or result in the termination of outstanding regulatory authorizations for certain financing activities.

***Credit risk may be affected by industry concentration and geographic concentration***

Avista Corp. has concentrations of suppliers and customers in the electric and natural gas industries including:

- electric and natural gas utilities,
- electric generators and transmission providers,
- oil and natural gas producers and pipelines,
- financial institutions including commodity clearing exchanges and related parties, and
- energy marketing and trading companies.

Avista Corp. has concentrations of credit risk related to its geographic location in the western United States and western Canada energy markets. These concentrations of counterparties and concentrations of geographic location may affect Avista Corp.'s overall exposure to credit risk because the counterparties may be similarly affected by changes in conditions.

***Regulators may not grant rates that provide timely or sufficient recovery of Avista Corp.'s costs or allow a reasonable rate of return***

Avista Utilities' annual operating expenses and the costs associated with incremental investments in utility assets continue to grow at a faster rate than revenue growth. Avista Corp.'s ability to recover these expenses and capital costs depends on the amount and timeliness of retail rate changes allowed by regulatory agencies. Avista Corp. expects to periodically file for rate increases with regulatory agencies to recover its expenses and capital costs and provide an opportunity to earn a reasonable rate of return. If regulators do not grant rate increases or grant substantially lower rate increases than Avista Corp. requests in the future or if recovery of deferred expenses is disallowed, it could have a negative effect on Avista Corp.'s operating revenues, net income and cash flows. During December 2016, the WUTC denied Avista Corp.'s 2016 electric and natural gas general rate requests and granted zero rate relief. Avista Corp. filed a petition for reconsideration and alternately for rehearing of its 2016 general rate cases, which was denied by the WUTC in February 2017. Avista Corp. has determined it will not appeal the WUTC's decision to the courts and as a result, Avista Corp. expects its 2017 annual earnings to decrease by US\$0.20 to US\$0.30 per diluted share as compared to 2016 actual results (without consideration to its 2017 Washington general rate cases that were filed in May 2017). This equates to an expected reduction of Avista Corp.'s 2017 utility return on equity of 100 to 120 basis points.

***In the future, Avista Corp. and/or Hydro One may no longer meet the criteria for continued application of regulatory accounting practices for all or a portion of its regulated operations***

If Avista Corp. and/or Hydro One could no longer apply regulatory accounting, it could be:

- required to write off its regulatory assets, and
- be precluded from the future deferral of costs or decoupled revenues not recovered through rates at the time such amounts are incurred, even if Avista Corp. and/or Hydro One is expected to recover these amounts from customers in the future.

### ***Energy commodity price changes affect Avista Corp.'s cash flows and results of operations***

#### ***Energy commodity prices can be volatile***

Avista Corp. relies on energy markets and other counterparties for energy supply, surplus and optimization transactions and commodity price hedging. A combination of factors exposes its operations to commodity price risks, including:

- Avista Corp.'s obligation to serve its retail customers at rates set through the regulatory process - Avista Corp. cannot change retail rates to reflect current energy prices unless and until it receives regulatory approval,
- customer demand, which is beyond Avista Corp.'s control because of weather, customer choices, prevailing economic conditions and other factors,
- some of Avista Corp.'s energy supply cost is fixed by the nature of the energy-producing assets or through contractual arrangements (however, a significant portion of its energy resource costs are not fixed), and
- the potential non-performance by commodity counterparties, which could lead to replacement of the scheduled energy or natural gas at higher prices.

Because Avista Corp. must supply the amount of energy demanded by its customers and it must sell it at fixed rates and only a portion of its energy supply costs are fixed, Avista Corp. is subject to the risk of buying energy at higher prices in wholesale energy markets (and the risk of selling energy at lower prices if in a surplus position). Electricity and natural gas in wholesale markets are commodities with historically high price volatility. Changes in wholesale energy prices affect, among other things, the cash requirements to purchase electricity and natural gas for retail customers or wholesale obligations and the market value of derivative assets and liabilities.

When Avista Corp. enters into fixed price energy commodity transactions for future delivery, Avista Corp. is subject to credit terms that may require it to provide collateral to wholesale counterparties related to the difference between current prices and the agreed upon fixed prices. These collateral requirements can place significant demands on Avista Corp.'s cash flows or borrowing arrangements. Price volatility can cause collateral requirements to change quickly and significantly.

#### ***Cash flow deferrals related to energy commodities can be significant***

Avista Corp. is permitted to collect from customers only amounts approved by regulatory commissions. However, Avista Corp.'s costs to provide energy service can be much higher or lower than the amounts currently billed to customers. Avista Corp. is permitted to defer income statement recognition and recovery from customers for some of these differences, which are recorded as deferred charges with the opportunity for future recovery through retail rates. These deferred costs are subject to review for prudence and potential disallowance by regulators, who have discretion as to the extent and timing of future recovery or refund to customers.

Power and natural gas costs higher than those recovered in retail rates reduce cash flows. Amounts that are not allowed for deferral or which are not approved to become part of customer rates affect Avista Corp.'s results of operations.

Even if Avista Corp.'s regulators ultimately allow Avista Corp. to recover deferred power and natural gas costs, Avista Corp.'s operating cash flows can be negatively affected until these costs are recovered from customers.

#### ***Fluctuating energy commodity prices and volumes in relation to Avista Corp.'s energy risk management process can cause volatility in its cash flows and results of operations***

Avista Corp. engages in active hedging and resource optimization practices to reduce energy cost volatility and economic exposure related to commodity price fluctuations. Avista Corp. routinely enters into contracts to hedge a portion of its purchase and sale commitments for electricity and natural gas, as well as forecasted excess or deficit energy positions and inventories of natural gas. Avista Corp. uses physical energy contracts and derivative instruments, such as forwards, futures, swaps and options traded in the over-the-counter markets or on exchanges. Avista Corp. does not attempt to fully hedge its energy resource assets or its forecasted net positions for various time

horizons. To the extent Avista Corp. has positions that are not hedged, or if hedging positions do not fully match the corresponding purchase or sale, fluctuating commodity prices could have a material effect on Avista Corp.'s operating revenues, resource costs, derivative assets and liabilities, and operating cash flows. In addition, actual loads and resources typically vary from forecasts, sometimes to a significant degree, which require additional transactions or dispatch decisions that impact cash flows.

The hedges Avista Corp. enters into are reviewed for prudence by Avista Corp.'s various regulators and any deferred costs (including those as a result of Avista Corp.'s hedging transactions) are subject to review for prudence and potential disallowance by regulators.

*Generation plants may become obsolete*

Avista Corp. relies on a variety of generation and energy commodity market sources to fulfill its obligation to serve customers and meet the demands of its counterparty agreements. There is the potential that some of Avista Corp.'s generation sources, such as coal, may become obsolete. This could result in higher commodity costs to replace the lost generation, as well as higher costs to retire the generation source before the end of its expected life.

***Avista Corp. is subject to various operational and event risks***

Avista Corp.'s operations are subject to operational and event risks that include:

- severe weather or natural disasters, including, but not limited to, avalanches, wind storms, wildfires, earthquakes, snow and ice storms, which can disrupt energy generation, transmission and distribution, as well as the availability and costs of materials, equipment, supplies, support services and general business operations,
- blackouts or disruptions of interconnected transmission systems (the regional power grid),
- unplanned outages at generating plants,
- fuel cost and availability, including delivery constraints,
- explosions, fires, accidents, or mechanical breakdowns that may occur while operating and maintaining its generation, transmission and distribution systems,
- damage or injuries to third parties caused by its generation, transmission and distribution systems,
- natural disasters that can disrupt energy generation, transmission and distribution, and general business operations, and
- terrorist attacks or other malicious acts that may disrupt or cause damage to Avista Corp.'s utility assets or the vendors it utilizes.

Disasters may affect the general economy, financial and capital markets, specific industries, or Avista Corp.'s ability to conduct business. As protection against operational and event risks, Avista Corp. maintains business continuity and disaster recovery plans, maintains insurance coverage against some, but not all, potential losses and seeks to negotiate indemnification arrangements with contractors for certain event risks. However, insurance or indemnification agreements may not be adequate to protect against liability, extra expenses and operating disruptions from all of the operational and event risks described above. In addition, Avista Corp. is subject to the risk that insurers and/or other parties will dispute or be unable to perform on their obligations to it.

Damage to facilities may be caused by severe weather, such as snow, ice, wind storms or avalanches. The cost to implement rapid or any repair to such facilities can be significant. Overhead electric lines are most susceptible to damage caused by severe weather.

***Adverse impacts may occur at Avista Corp.'s Alaska operations that could result from an extended outage of its hydroelectric generating resources or its inability to deliver energy, due to the lack of interconnectivity to any other electrical grids and the extensive cost of replacement power (diesel)***

AEL&P operates several hydroelectric power generation facilities and has diesel generating capacity from multiple facilities to provide backup service to firm customers when necessary; however, a single hydroelectric power generation facility, the Snettisham hydroelectric project, provides approximately two-thirds of AEL&P's hydroelectric power generation. Any issues that negatively affect AEL&P's ability to generate or transmit power or

any decrease in the demand for the power generated by AEL&P could negatively affect Avista Corp.'s results of operations, financial condition and cash flows.

***There have been numerous changes in legislation, related administrative rulemakings, and Executive Orders, including periodic audits of compliance with such rules, which may adversely affect Avista Corp.'s operational and financial performance***

Avista Corp. expects to continue to be affected by legislation at the national, state and local level, as well as by administrative rules and requirements published by government agencies, including but not limited to the FERC, the EPA and state regulators. Avista Corp. is also subject to NERC and WECC reliability standards. The FERC, the NERC and the WECC perform periodic audits of Avista Corp. Failure to comply with the FERC, the NERC, or the WECC requirements can result in financial penalties of up to US\$1 million per day per violation.

Future legislation or administrative rules could have a material adverse effect on Avista Corp.'s operations, results of operations, financial condition and cash flows.

***Actions or limitations to address concerns over the long-term global and Avista Corp.'s utilities' service area climate changes may affect Avista Corp's operations and financial performance***

Legislative, regulatory and advocacy efforts at the state, national and international levels concerning climate change and other environmental issues could have significant impacts on Avista Corp.'s operations. The electric and natural gas utility industries are frequently affected by proposals to curb greenhouse gas and other air emissions. Various regulatory and legislative proposals have been made to limit or further restrict byproducts of combustion, including that resulting from the use of natural gas by Avista Corp. customers. Such proposals, if adopted, could restrict the operation and raise the costs of Avista Corp.'s power generation resources as well as the distribution of natural gas to its customers.

Avista Corp. expects continuing activity in the future and will evaluate the extent to which potential changes to environmental laws and regulations may:

- increase the operating costs of generating plants,
- increase the lead time and capital costs for the construction of new generating plants,
- require modification of Avista Corp.'s existing generating plants,
- require existing generating plant operations to be curtailed or shut down,
- reduce the amount of energy available from Avista Corp.'s generating plants,
- restrict the types of generating plants that can be built or contracted with,
- require construction of specific types of generation plants at higher cost, and
- increase the cost of distributing natural gas to customers.

***Avista Corp. has contingent liabilities, including certain matters related to potential environmental liabilities, and cannot predict the outcome of these matters***

In the normal course of Avista Corp.'s business, it has matters that are the subject of ongoing litigation, mediation, investigation and/or negotiation. Although Avista Corp. believes that any ultimate liability arising from these actions will not have a material impact on its financial condition, results of operations or cash flows, it is possible that a significant change could occur in Avista Corp.'s estimates of the probability or amount of a liability being incurred. Moreover, Avista Corp. cannot predict the ultimate outcome or potential impact of any particular issue, including the extent, if any, of insurance coverage or that amounts payable by Avista Corp. may be recoverable through the ratemaking process. Avista Corp. is subject to environmental regulation by federal, state and local authorities related to its past, present and future operations.

***Cyber-attacks, terrorism or other malicious acts could disrupt Avista Corp.'s businesses and have a negative impact on its results of operations and cash flows***

In the course of Avista Corp.'s operations, it relies on interconnected technology systems for operation of its generating plants, electric transmission and distribution systems, natural gas distribution systems, customer billing and customer service, accounting and other administrative processes and compliance with various

regulations. In addition, in the ordinary course of business, Avista Corp. collects and retains sensitive information including personal information about its customers and employees.

There are various risks associated with technology systems such as hardware or software failure, communications failure, data distortion or destruction, unauthorized access to data, misuse of proprietary or confidential data, unauthorized control through electronic means, programming mistakes and other deliberate or inadvertent human errors. In particular, cyber-attacks, terrorism or other malicious acts could damage, destroy or disrupt these systems. Additionally, the facilities and systems of clients, suppliers and third party service providers could be vulnerable to these same risks and, to the extent of interconnection to Avista Corp.'s technology, may impact Avista Corp. Any failure, unexpected, or unauthorized use of technology systems could result in the unavailability of such systems, and could result in a loss of operating revenues, an increase in operating expenses and costs to repair or replace damaged assets. Any of the above could also result in the loss or release of confidential customer and/or employee information or other proprietary data that could adversely affect Avista Corp.'s reputation and competitiveness, could result in costly litigation and negatively impact Avista Corp.'s results of operations. As these potential cyber-attacks become more common and sophisticated, Avista Corp. could be required to incur costs to strengthen its systems and respond to emerging concerns.

Terrorist attacks could also be directed at physical electric and natural gas facilities, as well as technology systems.

***Avista Corp. may be adversely affected by its inability to successfully implement certain technology projects***

Avista Corp. is currently planning to replace all of its electric meter infrastructure in the State of Washington with two-way communication advanced metering infrastructure ("AMI"). There is the risk that regulators will not allow the full recovery of new AMI. In addition, there are inherent risks associated with replacing and changing these types of systems, such as incorrect or non-functioning metering and/or delayed or inaccurate customer bills or unplanned outages, which could have a material adverse effect on Avista Corp.'s results of operations, financial condition and cash flows. Finally, there is the risk that Avista Corp. does not ultimately complete the project and will incur contract cancellation or other costs, which could be significant.

***Avista Corp.'s strategic business plans, which may be affected by any or all of the foregoing, may change, including the entry into new businesses and/or the exit from existing businesses and the extent of its business development efforts where potential future business is uncertain***

Avista Corp.'s strategic business plans could be affected by its result in any of the following:

- disruptive innovations in the marketplace may outpace Avista Corp.'s ability to compete or manage its risk,
- potential difficulties in integrating acquired operations and in realizing expected opportunities, diversions of management resources and losses of key employees, challenges with respect to operating new businesses and other unanticipated risks and liabilities,
- market or other conditions may adversely affect Avista Corp.'s operations or require changes to its business strategy, which could result in a non-cash goodwill impairment charge that would reduce assets and reduce Avista Corp.'s net income, and
- potential reputational risk arising from repeated general rate case filings, degradation in the quality of service, or from failed strategic investments and opportunities, which could erode customer and community satisfaction with Avista Corp.

**Risk Factors Relating to the Instalment Receipts**

***The balance of the Instalment Receipt purchase price remains outstanding and the failure of a holder of Instalment Receipts to pay the balance of the purchase price on or before the Final Instalment Date will have adverse consequences for the holder***

Each Instalment Receipt purchased in the Offering represents an obligation of the holder of such security to pay \$667 per \$1,000 principal amount of Debentures on or before the Final Instalment Date. If the final instalment of the purchase price is not paid when due, the Defaulting Holder will no longer be able to pay the final instalment without the consent of the Selling Debentureholder. In addition, the Defaulting Holder will no longer be able to exercise the rights described under "Details of the Offering – Instalment Receipts – Rights and Privileges" and will



cease to be entitled to any repayment of principal in respect of the Debenture represented by such Instalment Receipt. In addition, if the holder of an Instalment Receipt does not pay the final instalment when due, the Debentures evidenced by such Instalment Receipt may, at the Selling Debentureholder's option, upon compliance with applicable law and the terms of the Instalment Receipt Agreement, be forfeited to the Selling Debentureholder in full satisfaction of the Defaulting Holder's obligations or such Debentures may be sold and the Defaulting Holder will remain liable for any deficiency in the proceeds of such sale. The Selling Debentureholder will have the right to and may commence legal action against Defaulting Holders who do not pay the final instalment on or before the Final Instalment Date. The commencement of any such litigation by the Selling Debentureholder may negatively affect the Corporation and the Selling Debentureholder, and could have an adverse effect on the price of the Debentures and the Common Shares.

***There is currently no market through which the Instalment Receipts may be sold***

There is currently no market through which the Instalment Receipts may be sold and purchasers of Debentures may not be able to resell Instalment Receipts. There can be no assurance that an active trading market will develop for the Instalment Receipts after the Offering or, if developed, that such a market will be sustained. This may affect the pricing of the Instalment Receipts in the secondary market, the transparency and availability of trading prices, the liquidity of Instalment Receipts, and the extent of issuer regulation. If an active market for the Instalment Receipts fails to develop or be sustained, the prices at which the Instalment Receipts trade may be adversely affected. Whether or not the Instalment Receipts will trade at lower prices depends on many factors, including liquidity of the Instalment Receipts, prevailing interest rates and the market for similar securities, the market price of debt securities with maturities comparable to the Debentures, the market price of the Common Shares, general economic conditions and Hydro One's financial condition, historic financial performance and future prospects.

The TSX has conditionally approved the listing of the Instalment Receipts (representing the Debentures) and the Common Shares issuable on the conversion of the Debentures on the TSX. Listing will be subject to the Corporation fulfilling all of the requirements of the TSX and there is no assurance that the TSX will approve such listing application. The Corporation has no current intention to list the Debentures for trading on the TSX or any other exchange as it currently anticipates all Debentures will be converted to Common Shares on the Final Instalment Date.

***Fluctuations in trading price***

An Instalment Receipt entitles the holder to unencumbered ownership of a Debenture upon payment of the final instalment on or before the Final Instalment Date. Interest rate movements will cause the value of debt instruments with a maturity comparable to the Debentures to fluctuate, and this will be reflected in the market price of the Instalment Receipts. The price volatility of the Instalment Receipts will be greater than the price volatility of debt instruments of a maturity comparable to the Debentures. This is due to the fact that the payment for the Instalment Receipts represents only 33.3% of the total principal amount payable for the underlying Debenture.

Further, the market price of the Common Shares underlying the Debentures may be volatile. This volatility may affect the ability of holders of Instalment Receipts to sell the Instalment Receipts at an advantageous price, particularly if the market price for Common Shares falls below the Conversion Price of Debentures represented by Instalment Receipts. In addition, it may result in greater volatility in the market price of the Instalment Receipts than would be expected for other debt securities or for non-convertible or non-exchangeable securities. Market price fluctuations in the Common Shares may be due to, among other things, the operating results of the Corporation failing to meet the expectations of securities analysts or investors in any quarter, downward revision in securities analysts' estimates, governmental regulatory action, market perception of the likelihood of the completion of the Merger, adverse changes in general market conditions or economic trends, acquisitions, dispositions or other material public announcements by Hydro One, along with a variety of additional factors. These broad market fluctuations may adversely affect the prices of the Instalment Receipts and the Common Shares.

***Rights of holders of Instalment Receipts may change***

Purchasers of Debentures will, prior to payment of the final instalment, be holders of Instalment Receipts and will be bound by the terms and conditions of the Instalment Receipt Agreement. The Instalment Receipt Agreement will provide that, pending payment of the final instalment, legal title to the Debentures offered hereby will be held by the Custodian on behalf of the Selling Debentureholder pursuant to the pledge to secure the payment of the final instalment. The terms and conditions of the Instalment Receipt Agreement may be amended in certain

circumstances, including with the approval of holders of Instalment Receipts representing two-thirds of the principal amount of the Debentures represented thereby. The description of the Instalment Receipt Agreement contained in this Prospectus is qualified in its entirety by the provisions of such agreement, which should be reviewed by holders of Instalment Receipts. The Instalment Receipt Agreement will be filed by Hydro One Limited on SEDAR on or about the Closing Date.

***The Right to receive unencumbered Debentures may terminate***

The Corporation has the obligation to redeem the Debentures at a price equal to their principal amount plus accrued and unpaid interest (without any Make-Whole Payment) following the earlier of: (i) notification to holders that the Approval Conditions will not be satisfied; (ii) termination of the Merger Agreement in accordance with its terms; and (iii) May 1, 2019 if the Final Instalment Notice has not been given on or before April 30, 2019. See “Details of the Offering – Debentures – Redemption”. Accordingly, it is possible that Instalment Receipts will be outstanding for a very limited period of time. Upon such redemption, a holder will no longer be entitled to pay the final instalment or to receive any unencumbered Debentures and will only be entitled to receive a net payment equal to the redemption price less the amount of the final instalment otherwise payable by such holder to the Selling Debentureholder plus accrued and unpaid interest thereon. Until the Approval Conditions are satisfied and the Debentures are delivered to holders of Instalment Receipts pursuant to the Instalment Receipt Agreement, such holders have the rights described under “Details of the Offering – Instalment Receipts”.

While the right of holders of Instalment Receipts to receive unencumbered Debentures may terminate as a result of a redemption by the Corporation of the Debentures as described herein, the Merger could potentially still be completed by the Corporation. If the Merger is completed following the redemption of the Debentures, holders of Instalment Receipts will not receive any of the benefits which may accrue to shareholders of the Corporation following completion of the Merger.

***Merger may be completed on other terms***

Both before and after payment of the final instalment, the Corporation may, in its sole discretion, amend the Merger Agreement and consummate the Merger on terms that may be substantially different from those contemplated in this Prospectus. Any such change will not affect the obligation of the holder of an Instalment Receipt to pay the final instalment on or before the Final Instalment Date. See “The Merger Agreement” and “– Risk Factors Relating to the Merger – Hydro One Limited may fail to complete the Merger”.

**Risk Factors Relating to the Debentures**

***There is currently no market through which the Debentures may be sold***

There is currently no market through which the Debentures may be sold and purchasers of Debentures may not be able to resell Debentures purchased under this Prospectus. The Corporation has not applied to list the Debentures for trading on the TSX, but has received conditional approval to list the Instalment Receipts (representing the Debentures) and the Common Shares issuable on the conversion of the Debentures on the TSX. Accordingly, an investor who does not exercise the conversion privilege in respect of fully paid Debentures will be holding what Hydro One Limited expects will be highly illiquid securities. There can be no assurance that an active trading market will develop for the Debentures after payment of the final instalment or, if developed, that such a market will be sustained. This may affect the pricing of the Debentures in the secondary market, the transparency and availability of trading prices, the liquidity of Debentures, and the extent of issuer regulation. If an active market for the Debentures fails to develop or be sustained, the prices at which the Debentures trade may be adversely affected. Whether or not the Debentures will trade at lower prices depends on many factors, including, among others, liquidity of the Debentures, prevailing interest rates and the market for similar securities, the market price of the Common Shares, general economic conditions and the Corporation’s financial condition, historic financial performance and future prospects.

***Fluctuations in trading price***

After the Final Instalment Date, Debentures will stop accruing interest. Accordingly, their value will be a function of the value of the underlying Common Shares into which the Debenture is convertible. The market price of the Common Shares underlying the Debentures may be volatile. This volatility may affect the ability of holders of Debentures to sell the Debentures at an advantageous price. In addition, it may result in greater volatility in the market price of the Debentures than would be expected for other debt securities or non-convertible securities.

Market price fluctuations in the Common Shares may be due to the operating results of the Corporation failing to meet the expectations of securities analysts or investors in any quarter, downward revision in securities analysts' estimates, governmental regulatory action, market perception of the likelihood of the completion of the Merger, adverse changes in general market conditions or economic trends, acquisitions, dispositions or other material public announcements by Hydro One, along with a variety of additional factors.

#### ***Existing and prior ranking of indebtedness***

On the Closing Date, the Corporation expects to have consolidated indebtedness of approximately \$12.740 billion (including the Debentures, excluding the Over-Allotment Option). After giving effect to the Merger, assuming receipt of the aggregate total amount of the final instalment for each of the Debentures (excluding those issuable upon exercise of the Over-Allotment Option), conversion of all Debentures into Common Shares and the assumption of Avista Corp.'s outstanding indebtedness, management estimates that the consolidated indebtedness of the Corporation will be approximately \$17.098 billion (calculated as of March 31, 2017). See "Financing of the Merger" and "Capitalization".

The Debentures will be subordinate to all Senior Indebtedness of the Corporation. See "Details of the Offering – Debentures – Subordination". Therefore, in the event of the insolvency, bankruptcy, liquidation, reorganization, dissolution or winding up of the Corporation, the assets of the Corporation would be made available to satisfy its obligations with respect to the Debentures only after it has paid all of its secured creditors and all holders of Senior Indebtedness. Accordingly, all or a substantial portion of the Corporation's assets could be unavailable to satisfy the claims of holders of the Debentures. There may be insufficient assets remaining following such payments to pay amounts due on any or all of the Debentures then outstanding. See "– Risk Factors Relating to the Post-Merger Business and Operations of Hydro One and Avista Corp."

#### ***The Debentures will be effectively subordinated to the debt and other liabilities of Hydro One Limited's subsidiaries and to any future secured debt of Hydro One Limited***

Hydro One Limited's subsidiaries will not guarantee or otherwise be responsible for the payment of principal or interest or other payments required to be made by Hydro One Limited on the Debentures. Accordingly, the Debentures will be effectively subordinated to all existing and future liabilities (including trade payables and debt) of Hydro One Limited's subsidiaries. In the event of an insolvency, bankruptcy, liquidation, reorganization or similar proceeding in respect of any of Hydro One Limited's subsidiaries, holders of the Debentures will have no right to proceed against the assets of such subsidiaries. Creditors of such subsidiaries would generally be entitled to payment in full from such assets before any assets are made available for distribution to Hydro One Limited to pay its debts and other obligations. The Debentures will also be effectively subordinated in right of payment to any future secured debt of Hydro One Limited, to the extent of the value of the assets securing such debt.

#### ***Absence of covenant protection***

The Indenture does not restrict the Corporation or any of its subsidiaries from incurring additional indebtedness for borrowed money or otherwise from mortgaging, pledging or charging their properties to secure any indebtedness or other financing. The Indenture does not contain any provisions specifically intended to protect holders of the Debentures in the event of a future leveraged transaction involving the Corporation or any of its subsidiaries.

#### ***The rights of holders of Debentures may change***

Holders of Debentures will be bound by the terms and conditions of the Indenture. The terms and conditions of the Indenture may be amended in certain circumstances, including with the approval of two-thirds of holders of outstanding Debentures. The description of the Indenture contained in this Prospectus is qualified in its entirety by the provisions of the Indenture, which should be reviewed by holders of Instalment Receipts and Debentures. The Indenture will be filed by Hydro One Limited on SEDAR on or about the Closing Date.

#### ***Redemption prior to maturity may prevent holders from exercising their conversion privilege***

The Debentures may be redeemed, at the option of the Corporation and without the consent of holders of Debentures, subject to certain conditions, after the Final Instalment Date and prior to the Maturity Date at a redemption price equal to the principal amount thereof, plus any unpaid interest which accrued prior to the Final Instalment Date, as described under "Details of the Offering – Debentures – Redemption".

The right of holders of Debentures to receive Common Shares will terminate as a result of a redemption by the Corporation of the Debentures as described herein. If a holder of Debentures has its Debentures redeemed by the Corporation following completion of the Merger, but prior to conversion by the holder of such Debentures into Common Shares, such holder will not receive any of the benefits which may accrue to shareholders of the Corporation following completion of the Merger. In addition, the redemption price of the Debentures may be worth less than the consideration obtained on a conversion of those Debentures by the holder thereof.

***Conversion of Debentures following satisfaction of the Approval Conditions can be negatively affected by the market price of the Common Shares***

Subject to satisfaction of the Approval Conditions and payment of the final instalment by the holder of an Instalment Receipt on or prior to the Final Instalment Date, such holder may convert its Debentures after the Final Instalment Date but prior to the earlier of the date of redemption or the Maturity Date. The Conversion Price will be \$21.40 per Common Share, being a conversion rate of 46.7290 Common Shares per \$1,000 principal amount of Debentures, subject to adjustment in certain circumstances. See “Details of the Offering – Debentures – Conversion Right”. If the market price of the Common Shares is less than the Conversion Price, the trading price of the Debentures will be negatively impacted. If the market price of the Common Shares is less than the Conversion Price on the date of conversion by a holder, such holder will receive fewer Common Shares on conversion of its Debentures than they would be able to purchase with funds equal to the principal amount of its Debentures.

***Issuance of common shares upon conversion of the Debentures may be restricted if such issuance would violate the Electricity Act, 1998 (Ontario)***

Voting securities of Hydro One Limited, which include the Common Shares, are subject to share ownership restrictions under the *Electricity Act, 1998* (Ontario). The share ownership restrictions provide that no person or company (or combination of persons or companies acting jointly or in concert), other than the Province or an underwriter who holds voting securities of Hydro One Limited solely for the purposes of distributing them to purchasers who comply with the share ownership restrictions, may beneficially own or exercise control or direction over more than 10% of any class or series of voting securities of Hydro One Limited. The articles of Hydro One Limited provide for comprehensive enforcement mechanisms that are applicable in the event of a contravention of the share ownership requirements. **A potential purchaser of Debentures represented by Instalment Receipts should not subscribe for a number of such Debentures in this Offering that would, upon conversion of such Debentures into Common Shares, cause such purchaser to violate this prohibition.** Under the Indenture, the Corporation has reserved the right to not issue Common Shares to a holder upon conversion of the Debentures in the event the Corporation reasonably determines that issuing such Common Shares to such holder would result in such holder breaching the share ownership restrictions under the *Electricity Act, 1998* (Ontario) or be prohibited by the Corporation’s articles.

***Interest on Debentures will cease to be payable prior to the Maturity Date***

After giving the Final Instalment Notice, Hydro One Limited has the right, but not the obligation, to redeem any outstanding and unconverted Debentures at any time on or after the Final Instalment Date and prior to the Maturity Date, but may choose not to redeem such Debentures. Any unconverted Debentures outstanding on or after the day following the Final Instalment Date will cease to accrue interest. A holder who has not exercised its conversion privilege by such date will be holding a convertible debt security which no longer earns interest.

***The likelihood that holders of the Debentures will receive payments owing to them under the terms of the Debentures will depend on the financial health of the Corporation and its creditworthiness***

Although Hydro One Limited currently has an investment grade credit rating, there is no assurance the Corporation will have sufficient capital to repay the Debentures in cash on redemption or at the Maturity Date or that it will be able to raise sufficient capital on acceptable terms by the applicable redemption date or the Maturity Date to repay the outstanding Debentures. While Hydro One Limited covenants to maintain readily available capacity under its revolving credit facilities (on a consolidated basis), or have cash on hand together with such available capacity, in an amount at least equal to the net proceeds of the first instalment paid on the closing of the Offering (and on the closing of the Over-Allotment Option, if applicable), in the event of a mandatory redemption, there can be no certainty that the revolving credit facilities (on a consolidated basis), or such cash on hand, will continue to be available at the time of redemption, such that Hydro One Limited may not have sufficient funds to

repay the Debentures. The risk of default in any payment obligation by Hydro One Limited may increase to the extent that there is a significant decline in the price of the Common Shares.

***Debentures are unsecured obligations***

The Debentures are unsecured obligations of the Corporation and are not secured by any of its assets or assets of any current or future subsidiaries of the Corporation.

***Prevailing yields on similar securities***

The prevailing yield on debt securities with comparable maturities will affect the market value of the Debentures. Assuming all other factors remain unchanged, the market value of the Debentures will decline as prevailing yields for similar securities rise, and will increase as prevailing yields for similar securities decline. The market value of the Debentures may also decline after the Debentures cease to accrue interest depending on the value of the underlying Common Shares.

***Dilutive effects on shareholders***

The issuance of Common Shares on conversion of the Debentures may have a dilutive effect on shareholders of Common Shares of Hydro One Limited and an adverse impact on the price of the Common Shares, which may also adversely impact the price of the Debentures. Potential future offerings by Hydro One Limited of Common Shares or securities convertible into or exchangeable for Common Shares would dilute purchasers acquiring securities under this Prospectus.

***Investment eligibility is not guaranteed***

The Corporation will endeavour to ensure that the Debentures represented by Instalment Receipts and the Common Shares continue to be qualified investments for Exempt Plans under the Tax Act, although there is no assurance that the conditions prescribed for such qualified investments will be adhered to at any particular time. The Tax Act imposes taxes in respect of the acquisition or holding of non-qualified or prohibited investments by Exempt Plans.

***Income tax consequences***

The income of the Corporation and its subsidiaries must be computed and is taxed in accordance with Canadian and other applicable tax laws, all of which may be changed in a manner that could adversely affect the holders of Debentures or Common Shares or the Corporation, including the latter's ability to service the Debentures or pay dividends on the Common Shares. There can be no assurance that taxation authorities will accept the tax positions adopted by the Corporation or its subsidiaries, including their determinations of the amounts of income and capital taxes and the reasonableness of inter-company transfer prices, including interest charges, which could materially adversely affect cash positions of the Corporation or its subsidiaries, and holders of Debentures and the Common Shares.

***Change of Tax Law***

On July 18, 2017, the Minister of Finance (Canada) released for consultation a discussion paper seeking input on possible approaches to address certain perceived tax advantages of investing passively through a private corporation. Potential alternatives for amending the current system of corporate taxation under the Tax Act are outlined in this paper, although specific proposals to amend the Tax Act are not included. Legislative proposals are expected to be released by the Minister of Finance (Canada) following such consultation. There can be no assurance that, following the enactment of any such proposals, Securities held by a Canadian corporation will not be taxed under the Tax Act in a manner that is less favourable than under the current system.

***Rights with respect to the Common Shares will arise only if and when the Corporation delivers Common Shares upon conversion of a Debenture***

Holders of Debentures will not be entitled to any rights with respect to the Common Shares (including, without limitation, voting rights and rights to receive any dividends or other distributions on the Common Shares), but if a holder of Debentures subsequently converts its Debentures into Common Shares, such holder will be subject to all changes affecting the Common Shares. Rights with respect to the Common Shares will arise only if and when the Corporation delivers Common Shares upon conversion of a Debenture and, to a limited extent, under the conversion rate adjustments applicable to the Debentures. For example, in the event that an amendment is proposed to the Corporation's constating documents requiring shareholder approval and the record date for determining the

shareholders of record entitled to vote on the amendment occurs prior to delivery of Common Shares to a holder, such holder will not be entitled to vote on the amendment, although such holder will nevertheless be subject to any changes in the powers or rights of Common Shares that result from such amendment.

## **EXEMPTIONS**

On August 27, 2015, Hydro One Inc. obtained a decision from the Ontario Securities Commission, as principal regulator, on behalf of itself and the securities regulatory authorities in each of the other provinces and territories of Canada, exempting Hydro One Limited from the requirements in section 3.2 of National Instrument 52-107 – *Acceptable Accounting Principles and Auditing Standards* which requires financial statements to be prepared in accordance with and disclosed in compliance with International Financial Reporting Standards. The decision granting the exemption permits Hydro One Limited to prepare and present its financial statements required to be filed with the securities regulatory authorities in each of the provinces and territories of Canada (including financial statements included in any prospectus of Hydro One Limited) in accordance with U.S. GAAP until the earliest to occur of the following:

- (a) January 1, 2019;
- (b) if Hydro One Limited ceases to have activities subject to rate regulation, the first day of Hydro One Limited's financial year commencing after its ceases to have such activities subject to rate regulation; and
- (c) the effective date prescribed by the International Accounting Standards Board for the mandatory application of a standard within International Financial Reporting Standards specific to entities with activities subject to rate regulation.

The exemption was requested: (i) due to continuing uncertainty of accounting treatment and lack of a specific mandatory standard for entities with activities subject to rate regulation under International Financial Reporting Standards; (ii) because U.S. GAAP provides a more suitable set of accounting principles for entities with activities subject to rate regulation and is more consistent with those prescribed by the Ontario Energy Board in its Accounting Procedures Handbook for Electric Distribution Utilities; and (iii) to ensure consistency with and comparability to the financial statements of Hydro One Inc. which reports in U.S. GAAP, as well as Hydro One Limited's industry peers that currently report in U.S. GAAP.

## **AUDITORS**

KPMG LLP, located at 333 Bay Street, Suite 4600, Bay Adelaide Centre, Toronto, Ontario, M5H 2S5, are the auditors of Hydro One Limited and have confirmed that they are independent of Hydro One Limited within the meaning of the relevant rules and related interpretations prescribed by the relevant professional bodies in Canada and any applicable legislation or regulation.

The auditors of Avista Corporation are Deloitte & Touche LLP, in Seattle, Washington. Deloitte & Touche LLP is an independent registered public accounting firm that audited Avista Corporation's consolidated financial statements as at December 31, 2016 and December 31, 2015, and for each of the three years in the period ended December 31, 2016, included in this Prospectus.

## **LEGAL MATTERS**

Certain legal matters relating to the Offering will be passed upon on behalf of the Corporation and the Selling Debentureholder by Osler, Hoskin & Harcourt LLP and on behalf of the Underwriters by Blake, Cassels & Graydon LLP. At the date hereof, partners and associates of each of Osler, Hoskin & Harcourt LLP and Blake, Cassels & Graydon LLP own beneficially, directly or indirectly, less than 1% of any securities of the Corporation or any associate or affiliate of the Corporation.

## **TRANSFER AGENT AND REGISTRAR**

Computershare Trust Company of Canada at its principal office in Toronto, Ontario is the transfer agent and registrar for the Common Shares.

## **ENFORCEABILITY OF CERTAIN CIVIL LIABILITIES**

Kathryn Jackson, a director of Hydro One Limited, resides outside of Canada. Ms. Jackson has appointed Hydro One Limited as her agent for service of process at 483 Bay Street, South Tower, 8<sup>th</sup> Floor, Toronto, Ontario, M5G 2P5.

Purchasers are advised that it may not be possible for investors to enforce judgments obtained in Canada against any person who resides outside of Canada, even if the party has appointed an agent for service of process.

## **PURCHASERS' STATUTORY RIGHTS**

Securities legislation in certain of the provinces and territories of Canada provides purchasers with the right to withdraw from an agreement to purchase securities. This right may be exercised within two business days after receipt or deemed receipt of a prospectus and any amendment. In several of the provinces and territories of Canada, securities legislation further provides a purchaser with remedies for rescission or, in some jurisdictions, revisions of the price or damages if the prospectus and any amendment contains a misrepresentation or is not delivered to the purchaser, provided that the remedies for rescission, revisions of the price or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's province or territory. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser's province or territory for the particulars of these rights or consult with a legal advisor.

Original purchasers of Debentures will have a contractual right of rescission against Hydro One Limited following the conversion of such Debentures in the event that this Prospectus or any amendment thereto contains a misrepresentation. The contractual right of rescission will entitle such original purchasers to receive from Hydro One Limited, upon surrender of the Common Shares issued upon conversion of such Debentures, the amount paid for such Debentures, provided that the right of rescission is exercised within 180 days from the date of the purchase of such Debentures under this Prospectus.

In an offering of Debentures represented by Instalment Receipts, investors are cautioned that the statutory right of action for damages for a misrepresentation contained in this Prospectus is limited, in certain provincial and territorial securities legislation, to the price at which the Debentures represented by Instalment Receipts are offered to the public under the prospectus offering. This means that, under the securities legislation of certain provinces and territories, if the purchaser pays additional amounts upon conversion of the security, those amounts may not be recoverable under the statutory right of action for damages that applies in those provinces and territories. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser's province or territory for the particulars of this right of action for damages or consult with a legal adviser.

## **PROMOTERS**

Hydro One Inc. has taken the initiative in founding and organizing Hydro One Limited and may therefore be considered a promoter of Hydro One Limited for the purposes of applicable securities legislation. In connection with a series of pre-closing transactions completed in connection with the initial public offering of Hydro One Limited, on October 31, 2015, Hydro One Limited acquired all of the issued and outstanding common shares of Hydro One Inc. from the Province in exchange for the issuance to the Province of 16,720,000 Series 1 Preferred Shares and 12,197,500,000 Common Shares. For further details concerning the relationship between Hydro One Limited and Hydro One Inc., see the documents incorporated by reference in this Prospectus.

## GLOSSARY OF TERMS

*In this Prospectus, unless the context otherwise requires, the following terms have the meanings set forth below.*

“**1933 Act**” has the meaning ascribed thereto under the heading “Plan of Distribution”.

“**2016 Annual Financial Statements**” has the meaning ascribed thereto under the heading “Documents Incorporated by Reference”.

“**Adjusted EPS**” means adjusted earnings per common share.

“**Adverse Recommendation Change**” has the meaning ascribed thereto under the heading “The Merger Agreement – No Solicitation; Avista Corporation’s Board of Directors Recommendation”.

“**AEL&P**” means Alaska Electric Light and Power Company.

“**AERC**” means Alaska Energy and Resources Company.

“**AFUDC**” means allowance for funds used during construction and represents the cost of financing regulated construction projects and is capitalized to the cost of property, plant and equipment, where permitted by the regulator.

“**AIDEA**” means Alaska Industrial Development and Export Authority.

“**AIF**” has the meaning ascribed thereto under the heading “Documents Incorporated by Reference”.

“**AM&D**” means Advanced Manufacturing and Development, doing business as METALfx.

“**AMI**” has the meaning ascribed thereto under the heading “Risk Factors – Risk Factors Relating to the Post-Merger Business and Operations of Hydro One and Avista Corp”.

“**Annual MD&A**” has the meaning ascribed thereto under the heading “Documents Incorporated by Reference”.

“**Approval Conditions**” has the meaning ascribed thereto under the heading “Details of the Offering”.

“**ARO**” means asset retirement obligation.

“**Avista Corp.**” means Avista Corporation and its subsidiaries, and references to individual subsidiaries of Avista Corporation refer to that company and its respective subsidiaries.

“**Avista Material Adverse Effect**” means any circumstance, development, change, event, occurrence or effect that:

- (a) has, individually or in the aggregate, a material adverse effect on the business, assets, properties, results of operations or financial condition of Avista Corporation and its subsidiaries taken as a whole; provided that none of the following shall constitute or be taken into account in determining whether an Avista Material Adverse Effect has occurred: (i) any circumstance, development, change, event, occurrence or effect in any of the industries or markets in which Avista Corporation or its subsidiaries operates, including electric generation, transmission or distribution or natural gas distribution or transmission industries (including, in each case, any changes in the operations thereof or with respect to system-wide changes or developments in electric generation, transmission, or distribution or natural gas distribution or transmission systems); (ii) any enactment of, change in, or change in interpretation of, any law or U.S. GAAP or governmental policy; (iii) general economic, regulatory or political conditions (or changes therein) or conditions (or changes therein) in the financial, credit or securities markets (including changes in interest or currency exchange rates) in any country or region in which Avista Corporation or any of its subsidiaries conducts business; (iv) any changes or developments in wholesale or retail electric power prices or any change in the price of natural gas or any other raw material, mineral or commodity used or sold by Avista Corporation or any of its subsidiaries or in the cost of hedges relating to such prices, any change in the price of interstate



electricity or natural gas transportation services or any change in customer usage patterns or customer selection of third-party suppliers for natural gas or electricity; (v) any acts of God, natural disasters, terrorism, armed hostilities, sabotage, war or any escalation or worsening of acts of terrorism, armed hostilities or war; (vi) the announcement, pendency of or performance of the Merger and the related transactions contemplated by the Merger Agreement, including by reason of the identity of the Corporation or any communication by the Corporation regarding the plans or intentions of the Corporation with respect to the conduct of the business of Avista Corporation or its subsidiaries and including the impact of any of the foregoing on any relationships with customers, suppliers, distributors, collaboration partners, joint venture partners, employees or regulators; (vii) any action taken by Avista Corporation or any of its subsidiaries that is required or permitted by the terms of the Merger Agreement or with the consent or at the direction of the Corporation or Merger Sub (or any action not taken as a result of the failure of the Corporation to consent to any action requiring the Corporation's consent pursuant to Section 5.1 of the Merger Agreement); (viii) any change in the market price, or change in trading volume, of the capital stock of Avista Corporation (but not the underlying circumstances giving rise to such change); (ix) any failure by Avista Corporation or its subsidiaries to meet earnings estimates or financial projections or forecasts for any period, or any changes in credit ratings and any changes in any analysts recommendations or ratings with respect to Avista Corporation or any of its subsidiaries (but not the underlying circumstances giving rise to the failure if not otherwise falling within any of the exceptions set forth in clauses (i)-(viii) or (x)-(xii) above and below); (x) any change or effect arising from any rate cases directly related to Avista Corporation or its subsidiaries; (xi) any circumstance, development, change, event, occurrence or effect that results from any shutdown or suspension of operations at any third-party facilities (including with respect to electricity and power plants) from which Avista Corporation or any of its subsidiaries obtains natural gas or electricity and (xii) any pending, initiated or threatened litigation relating to the Merger, in the case of each of clauses (i) through (v), to the extent that such circumstance, development, change, event, occurrence or effect does not affect Avista Corporation and its subsidiaries, taken as a whole, in a materially disproportionate manner relative to other similarly situated participants in the business and industries in which Avista Corporation and its subsidiaries operate; or

- (b) would, individually or in the aggregate, reasonably be expected to prevent or materially impede, interfere with or delay the consummation by Avista Corporation of the Merger and related transactions contemplated by the Merger Agreement.

**“Avista Intervening Event”** has the meaning ascribed thereto under the heading “The Merger Agreement – No Solicitation; Avista Corporation’s Board of Directors Recommendation”.

**“Avista Shareholder Approval”** has the meaning ascribed thereto under the heading “The Merger Agreement – Closing Conditions”.

**“Avista Shareholders Meeting”** has the meaning ascribed thereto under the heading “The Merger Agreement – Termination”.

**“Avista Termination Fee”** has the meaning ascribed thereto under the heading “The Merger Agreement – Termination”.

**“Avista Utilities”** means the operating division of Avista Corporation (not a subsidiary) comprising the regulated utility operations in the Pacific Northwest.

**“BART”** means Best Available Retrofit Technology.

**“Board of Directors”** means the board of directors of Hydro One Limited.

**“Book-Entry Only System”** has the meaning ascribed thereto under the heading “Details of the Offering – Instalment Receipts – Book-Entry Only System”.

**“Boulder Park GS”** has the meaning ascribed thereto under the heading “The Acquired Business – Avista Utilities”.

“**BPA**” means Bonneville Power Administration.

“**Burdensome Condition**” means any undertakings, terms, conditions, liabilities, obligations, commitments or sanctions (including any Remedial Action (as defined in the Merger Agreement)) that, in the aggregate, would have or would be reasonably likely to have, a material adverse effect on the financial condition, businesses or results of operations of Avista Corporation and its subsidiaries, taken as a whole, or of the Corporation and its subsidiaries, taken as a whole and after giving effect to the Merger; provided that, for this purpose, the Corporation and its subsidiaries (including Avista Corporation and its subsidiaries) shall be deemed to be a consolidated group of entities of the size and scale of a hypothetical company that is 100% of the size and scale of Avista Corporation and its subsidiaries, taken as a whole as of immediately prior to the Effective Time (as defined in the Merger Agreement); and provided, further, that the undertakings, terms, conditions, liabilities, obligations, commitments or sanctions described in Section 1.6(a), Section 1.7 and Exhibit B of the Merger Agreement shall not constitute or be taken into account in determining whether there has been or is such a material adverse effect.

“**CAA**” means the *Clean Air Act*.

“**Cabinet Gorge**” means the Cabinet Gorge Hydroelectric Generating Project, located on the Clark Fork River in Idaho.

“**California Parties**” means, together, Pacific Gas & Electric, Southern California Edison, San Diego Gas & Electric, the California Attorney General, the California Department of Water Resources, and the California Public Utilities Commission.

“**Canadian Securities Regulators**” means the applicable securities commission or securities regulatory authority in each of the provinces and territories of Canada.

“**CAR**” means the Clean Air Rule.

“**CCRs**” means coal combustion residuals.

“**Cdn\$**” means the lawful currency of Canada.

“**CDM**” means conversation and demand management.

“**CDS**” means CDS Clearing and Depository Services Inc.

“**CDS Participant**” means a participant in CDS.

“**CFIUS**” means the Committee on Foreign Investment in the United States.

“**CFSA**” means the Clark Fork Settlement Agreement.

“**Closing Date**” means the closing of the Offering, which is expected to take place on or about August 9, 2017.

“**CO2**” means carbon dioxide.

“**Colstrip**” means the coal-fired Colstrip Generating Plant in southeastern Montana.

“**Commerce**” means the Washington State Department of Commerce.

“**Common Shares**” means the common shares in the capital of Hydro One Limited.

“**Complaint**” has the meaning ascribed thereto under the heading “The Acquired Business – Environmental Issues and Contingencies”.

“**Conversion Price**” means \$21.40 per Common Share, being a conversion rate of 46.7290 Common Shares per \$1,000 principal amount of Debentures, subject to adjustment in certain events.

“**Corporation**” means Hydro One Limited.

**“Corporation Material Adverse Effect”** means any change, circumstance, development, event, occurrence or effect that, individually or in the aggregate, has had or would reasonably be expected to have a material and adverse effect on the ability of the Corporation, US Parent or Merger Sub to consummate, or that would reasonably be expected to prevent or materially impede, interfere with or delay the consummation by the Corporation, US Parent or Merger Sub, of the Merger and the related transactions contemplated by the Merger Agreement.

**“Corporation Termination Fee”** has the meaning ascribed thereto under the heading “The Merger Agreement – Termination”.

**“Counsel”** has the meaning ascribed thereto under the heading “Certain Canadian Federal Income Tax Considerations”.

**“Coyote Springs 2”** means the natural gas-fired combined-cycle Coyote Springs 2 Generating Plant located near Boardman, Oregon.

**“CT”** means combustion turbine.

**“Custodian”** has the meaning ascribed thereto under the heading “Details of the Offering – Instalment Receipts”.

**“DBRS”** means DBRS Limited.

**“D.C. Circuit”** has the meaning ascribed thereto under the heading “The Acquired Business – Environmental Issues and Contingencies”.

**“DPSP”** means a deferred profit sharing plan as defined in the Tax Act.

**“Debentures”** means 4.00% convertible unsecured subordinated debentures of Hydro One Limited offered pursuant to this Prospectus.

**“Defaulting Holder”** has the meaning ascribed thereto under the heading “Details of the Offering – Instalment Receipts”.

**“Ecology”** means the Washington State Department of Ecology.

**“Ecova”** means Ecova, Inc., a provider of facility information and cost management services for multi-site customers and energy efficiency program management for commercial enterprises and utilities throughout North America, subsidiary of Avista Capital. Ecova was sold on June 30, 2014.

**“EGUs”** has the meaning ascribed thereto under the heading “The Acquired Business – Environmental Issues and Contingencies”.

**“EIA”** means the *Energy Independence Act*.

**“End Date”** means September 30, 2018.

**“EPA”** means the United States Environmental Protection Agency.

**“ERM”** means the Energy Recovery Mechanism, a mechanism for accounting and rate recovery of certain power supply costs accepted by the utility commission in the state of Washington.

**“ERU”** means Emission Reduction Units.

**“ESA”** means the *Federal Endangered Species Act*.

**“Exempt Plans”** has the meaning ascribed thereto under the heading “Eligibility for Investment”.

**“FCA”** means Fixed Cost Adjustment, the electric and natural gas decoupling mechanism in Idaho.

**“FCC”** means the United States Federal Communications Commission.

**“Federal Tax Regime”** has the meaning ascribed thereto under the heading “Presentation of Financial Information – Funds from Operations and Adjusted FFO”.

**“FERC”** means the United States Federal Energy Regulatory Commission.

**“FFO”** has the meaning ascribed thereto under the heading “Presentation of Financial Information – Funds from Operations and Adjusted FFO”.

**“Final CPP”** has the meaning ascribed thereto under the heading “The Acquired Business – Environmental Issues and Contingencies”.

**“Final CPS”** has the meaning ascribed thereto under the heading “The Acquired Business – Environmental Issues and Contingencies”.

**“Final Instalment Date”** has the meaning ascribed thereto under the heading “Details of the Offering”.

**“Final Instalment Notice”** has the meaning ascribed thereto under the heading “Details of the Offering”.

**“Final Order”** means a Judgment by the relevant Governmental Authority that (i) is not then reversed, stayed, enjoined, set aside, annulled or suspended and is in full force and effect, (ii) with respect to which, if applicable, any mandatory waiting period prescribed by law applicable to such Judgment before the Merger may be consummated has expired or been terminated, and (iii) as to which all conditions precedent to the closing of the Merger expressly set forth in such Judgment have been satisfied.

**“FIP”** has the meaning ascribed thereto under the heading “The Acquired Business – Environmental Issues and Contingencies”.

**“FPA”** means the *Federal Power Act*.

**“GHG”** means greenhouse gas.

**“Governance Agreement”** means the Governance Agreement dated November 5, 2015 between Hydro One Limited and the Province.

**“HAPs”** means hazardous air pollutants.

**“Holder”** has the meaning ascribed thereto under the heading “Certain Canadian Federal Income Tax Considerations”.

**“HSR Act”** means the *Hart-Scott-Rodino Antitrust Improvements Act of 1976*, as amended.

**“Hydro One”** means Hydro One Limited and its subsidiaries taken together as a whole.

**“Hydro One Limited”** means Hydro One Limited.

**“I-732”** has the meaning ascribed thereto under the heading “The Acquired Business – Environmental Issues and Contingencies”.

**“ICNU”** means the Industrial Customers of Northwest Utilities.

**“Indenture”** has the meaning ascribed thereto under the heading “Details of the Offering – Debentures”.

**“Instalment Receipt Agreement”** has the meaning ascribed thereto under the heading “Details of the Offering – Instalment Receipts”.

**“Instalment Receipts”** means the instalment receipts representing beneficial ownership of the Debentures.

**“Interim Financial Statements”** has the meaning ascribed thereto under the heading “Documents Incorporated by Reference”.

**“Interim MD&A”** has the meaning ascribed thereto under the heading “Documents Incorporated by Reference”.

**“Intervening Event”** has the meaning ascribed thereto under the heading “The Merger Agreement – No Solicitation; Avista Corporation’s Board of Directors Recommendation”.

**“Investor Presentation”** has the meaning ascribed thereto under the heading “Marketing Materials”.

**“IPO”** means the initial public offering of Hydro One Limited on November 5, 2015.

**“IPUC”** means the Idaho Public Utilities Commission.

**“IT”** means information technology.

**“Jackson Prairie”** means Jackson Prairie Natural Gas Storage Project, an underground natural gas storage field located near Chehalis, Washington.

**“Judgment”** means a judgment, injunction, order, decree, ruling, writ, assessment or arbitration award of a Governmental Authority of competent jurisdiction.

**“Kettle Falls CT”** has the meaning ascribed thereto under the heading “The Acquired Business – Avista Utilities”.

**“Kettle Falls GS”** has the meaning ascribed thereto under the heading “The Acquired Business – Avista Utilities”.

**“KV”** means kilovolt.

**“KW”** means kilowatt.

**“Lancaster Plant”** means a natural gas-fired combined cycle combustion turbine plant located in Idaho.

**“Legislature”** means the Washington State Legislature.

**“Little Falls”** means the Little Falls Hydroelectric Generating Project.

**“LNG”** means Liquefied Natural Gas.

**“Make-Whole Payment”** has the meaning ascribed thereto under the heading “The Offering – Interest”.

**“Marketing Materials”** has the meaning ascribed thereto under the heading “Documents Incorporated by Reference”.

**“Market Price”** means the weighted average trading price of the Common Shares on the TSX for the 20 consecutive trading days ending five trading days preceding the Maturity Date.

**“MATS”** means the Mercury Air Toxic Standards.

**“Maturity Date”** means September 30, 2027.

**“Merger”** means the direct or indirect acquisition by US Parent of Avista Corporation pursuant to the terms of the Merger Agreement.

**“Merger Agreement”** means the Agreement and Plan of Merger dated as of July 19, 2017 among the Corporation, US Parent, Merger Sub and Avista Corporation.

**“Merger Consideration”** has the meaning ascribed thereto under the heading “The Merger Agreement – The Merger Consideration”.

**“Merger-Related Expenses”** means the estimated non-recurring costs, including related income tax effects and any governmental and other imposed costs that may be incurred to consummate the Merger. Such costs, which will be fully expensed when incurred in accordance with U.S. GAAP, include but are not limited to fees associated with

financial advisory, consulting, accounting, tax, legal and other professional services, costs associated with change of control and integration, out-of-pocket costs and other costs of a non-recurring nature.

**“Merger Sub”** means Olympus Corp., a direct wholly-owned subsidiary of US Parent and, at the effective time of the closing of the Merger, will be collectively owned by US Parent and one or more direct or indirect wholly-owned subsidiaries of the Corporation.

**“Moody’s”** means Moody’s Investors Service, Inc.

**“MPSC”** means the Public Service Commission of the State of Montana.

**“MW”** means megawatts.

**“MWh”** means megawatt-hours.

**“NERC”** means the North American Electric Reliability Corporation.

**“Northeast CT”** has the meaning ascribed thereto under the heading “The Acquired Business – Avista Utilities”.

**“Noxon Rapids”** means the Noxon Rapids Hydroelectric Generating Project, located on the Clark Fork River in Montana.

**“NSPS”** has the meaning ascribed thereto under the heading “The Acquired Business – Environmental Issues and Contingencies”.

**“NYSE”** means the New York Stock Exchange.

**“OBCA”** means the *Business Corporations Act* (Ontario).

**“Offering”** means the offering of Debentures represented by Instalment Receipts pursuant to this Prospectus.

**“Offering Price”** has the meaning ascribed thereto under the heading “Plan of Distribution”.

**“Operating Credit Facility”** has the meaning ascribed thereto under the heading “Financing the Merger”.

**“OPUC”** means the Public Utility Commission of Oregon.

**“Order 05”** has the meaning ascribed thereto under the heading “The Acquired Business – Regulation and Regulatory Matters”.

**“Order 06”** has the meaning ascribed thereto under the heading “The Acquired Business – Regulation and Regulatory Matters”.

**“Over-Allotment Option”** means an option to purchase additional Debentures represented by Instalment Receipts equal to up to 10% of the aggregate principal amount of Debentures, as more fully described on the cover page.

**“PC”** means the Public Counsel Unit of the Washington State Office of the Attorney General.

**“Petition”** has the meaning ascribed thereto under the heading “The Acquired Business – Regulation and Regulatory Matters”.

**“Petitioners”** means, collectively, Avista Corp., Cascade Natural Gas Corp., NW Natural and PSE.

**“PGA”** means purchased gas adjustment.

**“PILs”** has the meaning ascribed thereto under the heading “Presentation of Financial Information – Funds from Operations and Adjusted FFO”.

“**PILs Regime**” has the meaning ascribed thereto under the heading “Presentation of Financial Information – Funds from Operations and Adjusted FFO”.

“**PPA**” means a power purchase agreement.

“**Proceeding**” has the meaning ascribed thereto under the heading “Plan of Distribution”.

“**Proposed Amendments**” has the meaning ascribed thereto under the heading “Certain Canadian Federal Income Tax Considerations”.

“**Prospectus**” means this short form prospectus dated August 1, 2017.

“**Province**” means Her Majesty the Queen in Right of Ontario, as represented by the Minister of Energy.

“**PSE**” means Puget Sound Energy.

“**PSUs**” means performance share units.

“**PUD**” means Public Utility District.

“**PURPA**” means the Public Utility Regulatory Policies Act of 1978, as amended.

“**Rathdrum CT**” has the meaning ascribed thereto under the heading “The Acquired Business – Avista Utilities”.

“**RCA**” means the Regulatory Commission of Alaska.

“**RDSP**” means a registered disability savings plan as defined in the Tax Act.

“**Representatives**” has the meaning ascribed thereto under the heading “The Merger Agreement – No Solicitation; Avista Corporation’s Board of Directors Recommendation”.

“**RESP**” means a registered education savings plan as defined in the Tax Act.

“**Restraint**” has the meaning ascribed thereto under the heading “The Merger Agreement – Termination”.

“**Revolving Credit Facility**” has the meaning ascribed thereto under the heading “Relationships between Hydro One Limited, the Selling Debentureholder and Certain Underwriters.”

“**ROE**” means return on equity.

“**ROR**” means rate of return.

“**RRIF**” means a registered retirement income fund as defined in the Tax Act.

“**RRSP**” means a registered retirement savings plan as defined in the Tax Act.

“**RSUs**” has the meaning ascribed thereto under the heading “The Merger Agreement – The Merger Consideration”.

“**S&P**” means Standard & Poor’s Ratings Services.

“**Salix**” means Salix, Inc., a subsidiary of Avista Capital, launched in 2014 to explore markets that could be served with LNG, primarily in western North America.

“**SEC**” means the U.S. Securities and Exchange Commission.

“**Securities**” has the meaning ascribed thereto under the heading “Certain Canadian Federal Income Tax Considerations”.

“**SEDAR**” means the System for Electronic Document Analysis and Retrieval.

**“Selling Debentureholder”** means 2587264 Ontario Inc., a direct wholly-owned subsidiary of Hydro One Limited.

**“Senior Indebtedness”** has the meaning ascribed thereto under the heading “Details of the Offering – Debentures – Subordination”.

**“Series 1 Preferred Shares”** means the Series 1 preferred shares in the capital of Hydro One Limited.

**“Series 2 Preferred Shares”** means the Series 2 preferred shares in the capital of Hydro One Limited.

**“Subsidiary Board”** has the meaning ascribed thereto under the heading “The Merger Agreement – Covenants”.

**“Superior Proposal”** means any unsolicited written Takeover Proposal on terms which the board of directors of Avista Corporation (or a duly authorized committee thereof) determines in good faith, after consultation with Avista Corporation’s outside legal counsel and independent financial advisors, to be more favourable to the holders of Avista Corporation common stock than the Merger (as may be revised in accordance with the terms of the Merger Agreement), taking into account, to the extent applicable, the legal, financial, regulatory and other aspects of such proposal and the Merger Agreement that the board of directors of Avista Corporation considers relevant, including the prospects for receipt of any required regulatory approvals and taking into account the operational and governance commitments made by the Corporation in the Merger Agreement; provided that for purposes of the definition of “Superior Proposal”, the references to “15%” in the definition of Takeover Proposal shall be deemed to be references to “50%.”

**“Takeover Proposal”** means any bona fide inquiry, proposal or offer from any Person (other than the Corporation, US Parent, Merger Sub or any of their respective affiliates) to purchase or otherwise acquire, directly or indirectly, in a single transaction or series of related transactions, (i) assets of Avista Corporation and its subsidiaries (including securities of subsidiaries) that account for 15% or more of Avista Corporation’s consolidated assets or from which 15% or more of Avista Corporation’s revenues or earnings on a consolidated basis are derived or (ii) 15% or more of the outstanding Avista Corporation common stock pursuant to a merger, consolidation or other business combination, sale or issuance of shares of capital stock, tender offer, share exchange, recapitalization or similar transaction involving Avista Corporation, in each case other than the Merger.

**“Tax Act”** means the *Income Tax Act* (Canada) and the regulations thereunder, as amended from time to time.

**“TFSA”** means a tax-free savings account as defined in the Tax Act.

**“Total Dissolved Gas” or TDG** has the meaning ascribed thereto under the heading “The Acquired Business – Legal Proceedings”.

**“Trustee”** has the meaning ascribed thereto under the heading “Details of the Offering – Debentures”.

**“TSX”** means the Toronto Stock Exchange.

**“U.S.”** means the United States.

**“U.S. dollars” or “US\$”** means the lawful currency of the U.S.

**“U.S. GAAP”** means United States Generally Accepted Accounting Principles.

**“Underwriters”** means, collectively, RBC Dominion Securities Inc., CIBC World Markets Inc., BMO Nesbitt Burns Inc., National Bank Financial Inc., Scotia Capital Inc., TD Securities Inc., Barclays Capital Canada Inc., Credit Suisse Securities (Canada), Inc., Canaccord Genuity Corp., Desjardins Securities Inc., Laurentian Bank Securities Inc., Raymond James Ltd., Industrial Alliance Securities Inc. and Wells Fargo Securities Canada, Ltd.

**“Underwriting Agreement”** has the meaning ascribed thereto under the heading “Plan of Distribution”.

**“USFWS”** means the United States Fish and Wildlife Service.



**“utility boilers and IGCC units”** has the meaning ascribed thereto under the heading “The Acquired Business – Environmental Issues and Contingencies”.

**“US Parent”** means Olympus Holding Corp., an indirect, wholly-owned subsidiary of the Corporation.

**“WECC”** means the Western Electricity Coordinating Council.

**“WUTC”** means the Washington Utilities and Transportation Commission.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

Avista Corporation

Spokane, Washington

We have audited the accompanying consolidated balance sheets of Avista Corporation and subsidiaries (the “Company”) as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, equity and redeemable noncontrolling interests, and cash flows for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Avista Corporation and subsidiaries at December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

Seattle, Washington

February 21, 2017

# CONSOLIDATED STATEMENTS OF INCOME

## Avista Corporation

For the Years Ended December 31

Dollars in thousands, except per share amounts

	2016	2015	2014
Operating Revenues:			
Utility revenues	\$ 1,418,914	\$ 1,456,091	\$ 1,433,343
Non-utility revenues	23,569	28,685	39,219
Total operating revenues	<u>1,442,483</u>	<u>1,484,776</u>	<u>1,472,562</u>
Operating Expenses:			
Utility operating expenses:			
Resource costs	551,366	656,964	678,244
Other operating expenses	315,795	303,221	286,832
Depreciation and amortization	160,514	143,499	129,570
Taxes other than income taxes	98,735	97,657	94,300
Non-utility operating expenses:			
Other operating expenses	25,501	29,526	30,418
Depreciation and amortization	769	695	610
Total operating expenses	<u>1,152,680</u>	<u>1,231,562</u>	<u>1,219,974</u>
Income from operations	289,803	253,214	252,588
Interest expense	86,496	79,968	75,302
Interest expense to affiliated trusts	634	473	450
Capitalized interest	(2,651)	(3,546)	(3,924)
Other income-net	<u>(10,078)</u>	<u>(9,300)</u>	<u>(11,346)</u>
Income from continuing operations before income taxes	215,402	185,619	192,106
Income tax expense	78,086	67,449	72,240
Net income from continuing operations	137,316	118,170	119,866
Net income from discontinued operations (Note 5)	<u>—</u>	<u>5,147</u>	<u>72,411</u>
Net income	137,316	123,317	192,277
Net income attributable to noncontrolling interests	(88)	(90)	(236)
Net income attributable to Avista Corp. shareholders	<u>\$ 137,228</u>	<u>\$ 123,227</u>	<u>\$ 192,041</u>

*The Accompanying Notes are an Integral Part of These Statements.*

CONSOLIDATED STATEMENTS OF INCOME (continued)

*Avista Corporation*

For the Years Ended December 31

Dollars in thousands, except per share amounts

	2016	2015	2014
Amounts attributable to Avista Corp. shareholders:			
Net income from continuing operations	\$ 137,228	\$ 118,080	\$ 119,817
Net income from discontinued operations	—	5,147	72,224
Net income attributable to Avista Corp. shareholders	<u>\$ 137,228</u>	<u>\$ 123,227</u>	<u>\$ 192,041</u>
Weighted-average common shares outstanding (thousands), basic	63,508	62,301	61,632
Weighted-average common shares outstanding (thousands), diluted	63,920	62,708	61,887
Earnings per common share attributable to Avista Corp. shareholders, basic:			
Earnings per common share from continuing operations	\$ 2.16	\$ 1.90	\$ 1.94
Earnings per common share from discontinued operations	—	0.08	1.18
Total earnings per common share attributable to Avista Corp. shareholders, basic	<u>\$ 2.16</u>	<u>\$ 1.98</u>	<u>\$ 3.12</u>
Earnings per common share attributable to Avista Corp. shareholders, diluted:			
Earnings per common share from continuing operations	\$ 2.15	\$ 1.89	\$ 1.93
Earnings per common share from discontinued operations	—	0.08	1.17
Total earnings per common share attributable to Avista Corp. shareholders, diluted	<u>\$ 2.15</u>	<u>\$ 1.97</u>	<u>\$ 3.10</u>
Dividends declared per common share	<u>\$ 1.37</u>	<u>\$ 1.32</u>	<u>\$ 1.27</u>

*The Accompanying Notes are an Integral Part of These Statements.*

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

*Avista Corporation*

For the Years Ended December 31

Dollars in thousands

	2016	2015	2014
Net income	\$ 137,316	\$ 123,317	\$ 192,277
Other Comprehensive Income (Loss):			
Unrealized investment gains - net of taxes of \$0, \$0 and \$664, respectively	—	—	1,126
Reclassification adjustment for realized gains on investment securities included in net income - net of taxes of \$0, \$0 and \$(1), respectively	—	—	(2)
Reclassification adjustment for realized losses on investment securities included in net income from discontinued operations - net of taxes of \$0, \$0 and \$273, respectively	—	—	462
Change in unfunded benefit obligation for pension and other postretirement benefit plans - net of taxes of \$(495), \$667 and \$(1,967), respectively	(918)	1,238	(3,655)
Total other comprehensive income (loss)	(918)	1,238	(2,069)
Comprehensive income	136,398	124,555	190,208
Comprehensive income attributable to noncontrolling interests	(88)	(90)	(236)
Comprehensive income attributable to Avista Corporation shareholders	\$ 136,310	\$ 124,465	\$ 189,972

*The Accompanying Notes are an Integral Part of These Statements.*

# CONSOLIDATED BALANCE SHEETS

Avista Corporation

As of December 31

Dollars in thousands

	2016	2015
<b>Assets:</b>		
Current Assets:		
Cash and cash equivalents	\$ 8,507	\$ 10,484
Accounts and notes receivable-less allowances of \$5,026 and \$4,530, respectively	180,265	169,413
Regulatory asset for energy commodity derivatives	11,365	17,260
Materials and supplies, fuel stock and stored natural gas	53,314	54,148
Income taxes receivable	48,265	24,121
Other current assets	49,625	30,620
Total current assets	<u>351,341</u>	<u>306,046</u>
Net Utility Property:		
Utility plant in service	5,506,499	5,129,192
Construction work in progress	150,474	202,683
Total	<u>5,656,973</u>	<u>5,331,875</u>
Less: Accumulated depreciation and amortization	<u>1,509,473</u>	<u>1,433,286</u>
Total net utility property	<u>4,147,500</u>	<u>3,898,589</u>
Other Non-current Assets:		
Investment in affiliated trusts	11,547	11,547
Goodwill	57,672	57,672
Long-term energy contract receivable	—	14,694
Other property and investments-net and other non-current assets	72,224	59,733
Total other non-current assets	<u>141,443</u>	<u>143,646</u>
Deferred Charges:		
Regulatory assets for deferred income tax	109,853	101,240
Regulatory assets for pensions and other postretirement benefits	240,114	235,009
Other regulatory assets	135,751	99,798
Regulatory asset for interest rate swaps	161,508	83,973
Non-current regulatory asset for energy commodity derivatives	16,919	32,420
Other deferred charges	5,326	5,928
Total deferred charges	<u>669,471</u>	<u>558,368</u>
Total assets	<u>\$ 5,309,755</u>	<u>\$ 4,906,649</u>

*The Accompanying Notes are an Integral Part of These Statements.*

CONSOLIDATED BALANCE SHEETS (continued)

Avista Corporation

As of December 31

Dollars in thousands

	2016	2015
<b>Liabilities and Equity:</b>		
Current Liabilities:		
Accounts payable	\$ 115,545	\$ 114,349
Current portion of long-term debt and capital leases	3,287	93,167
Short-term borrowings	120,000	105,000
Energy commodity derivative liabilities	7,035	14,268
Accrued interest	15,869	15,378
Accrued taxes other than income taxes	33,374	30,978
Deferred natural gas costs	30,820	17,880
Current portion of pensions and other postretirement benefits	10,994	10,233
Other current liabilities	70,604	73,427
Total current liabilities	407,528	474,680
Long-term debt and capital leases	1,678,717	1,480,111
Long-term debt to affiliated trusts	51,547	51,547
Regulatory liability for utility plant retirement costs	273,983	261,594
Pensions and other postretirement benefits	226,552	201,453
Deferred income taxes	840,928	747,477
Non-current interest rate swap derivative liabilities	28,705	30,679
Other non-current liabilities, regulatory liabilities and deferred credits	153,319	130,821
Total liabilities	3,661,279	3,378,362
Commitments and Contingencies (See Notes to Consolidated Financial Statements)		
Equity:		
Avista Corporation Shareholders' Equity:		
Common stock, no par value; 200,000,000 shares authorized; 64,187,934 and 62,312,651 shares issued and outstanding as of December 31, 2016 and December 31, 2015, respectively	1,075,281	1,004,336
Accumulated other comprehensive loss	(7,568)	(6,650)
Retained earnings	581,014	530,940
Total Avista Corporation shareholders' equity	1,648,727	1,528,626
Noncontrolling Interests	(251)	(339)
Total equity	1,648,476	1,528,287
Total liabilities and equity	\$ 5,309,755	\$ 4,906,649

*The Accompanying Notes are an Integral Part of These Statements.*



# CONSOLIDATED STATEMENTS OF CASH FLOWS

Avista Corporation

For the Years Ended December 31

Dollars in thousands

	2016	2015	2014
Operating Activities:			
Net income	\$ 137,316	\$ 123,317	\$ 192,277
Non-cash items included in net income:			
Depreciation and amortization	164,925	147,835	138,337
Provision for deferred income taxes	124,543	51,801	144,269
Power and natural gas cost amortizations (deferrals), net	16,835	21,358	(14,821)
Amortization of debt expense	3,477	3,526	3,692
Amortization of investment in exchange power	2,450	2,450	2,450
Stock-based compensation expense	7,891	6,914	8,114
Equity-related AFUDC	(8,475)	(8,331)	(8,808)
Pension and other postretirement benefit expense	38,786	37,050	22,943
Amortization of Spokane Energy contract	14,694	13,508	12,417
Gain on sale of Ecova	—	(777)	(160,612)
Other regulatory assets and liabilities and deferred debits and credits	(26,245)	4,569	7,906
Change in decoupling regulatory deferral	(29,789)	(10,933)	—
Other	5,557	(517)	1,103
Contributions to defined benefit pension plan	(12,000)	(12,000)	(32,000)
Cash paid for settlement of interest rate swap derivatives	(53,966)	—	—
Changes in certain current assets and liabilities:			
Accounts and notes receivable	(17,170)	(10,538)	16,425
Materials and supplies, fuel stock and stored natural gas	834	12,208	(19,394)
Collateral posted for derivative instruments	10,712	(13,301)	(23,301)
Income taxes receivable	(33,923)	19,772	(36,110)
Other current assets	(3,907)	2,338	(7,117)
Accounts payable	5,176	(8,138)	(12,562)
Other current liabilities	10,546	(6,471)	32,060
Net cash provided by operating activities	358,267	375,640	267,268
Investing Activities:			
Utility property capital expenditures (excluding equity-related AFUDC)	(406,644)	(393,425)	(325,516)
Other capital expenditures	(353)	(885)	(6,427)
Cash received (paid) in acquisition, net	—	(95)	15,007
Issuance of notes receivable at subsidiaries	(10,094)	(2,307)	(1,200)
Repayments from notes receivable at subsidiaries	5,000	—	—
Investments made by subsidiaries	(13,097)	(1,944)	(1,072)
Increase in funds held for clients	—	—	(18,931)
Purchase of securities available for sale	—	—	(12,267)
Sale and maturity of securities available for sale	—	—	14,612
Proceeds from sale of Ecova, net of cash sold	—	13,856	229,903
Other	(7,278)	(3,027)	2,155
Net cash used in investing activities	\$ (432,466)	\$ (387,827)	\$ (103,736)

*The Accompanying Notes are an Integral Part of These Statements.*

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

*Avista Corporation*

For the Years Ended December 31

Dollars in thousands

	2016	2015	2014
Financing Activities:			
Net increase (decrease) in borrowings from committed line of credit	\$ 15,000	\$ —	\$ (66,000)
Repayment of borrowings from Ecova line of credit	—	—	(46,000)
Proceeds from issuance of long-term debt	245,000	100,000	150,000
Redemption and maturity of long-term debt and capital leases	(163,167)	(2,905)	(39,971)
Maturity of nonrecourse long-term debt of Spokane Energy	—	(1,431)	(16,407)
Issuance of common stock, net of issuance costs	66,953	1,560	4,060
Repurchase of common stock	—	(2,920)	(79,856)
Cash dividends paid	(87,154)	(82,397)	(78,314)
Increase in client fund obligations	—	—	16,216
Payment to noncontrolling interests for sale of Ecova	—	—	(54,179)
Payment to option holders and redeemable noncontrolling interests for sale of Ecova	—	—	(20,871)
Other	(4,410)	(11,379)	7,359
Net cash provided by (used in) financing activities	72,222	528	(223,963)
Net decrease in cash and cash equivalents	(1,977)	(11,659)	(60,431)
Cash and cash equivalents at beginning of year	10,484	22,143	82,574
Cash and cash equivalents at end of year	<u>\$ 8,507</u>	<u>\$ 10,484</u>	<u>\$ 22,143</u>
Supplemental Cash Flow Information:			
Cash paid (received) during the year:			
Interest	\$ 86,319	\$ 79,673	\$ 73,526
Income taxes (net of total refunds of \$18,861, \$37,200 and \$35,573, respectively)	(13,458)	(9,961)	45,416
Non-cash financing and investing activities:			
Accounts payable for capital expenditures	30,252	35,248	26,959
Valuation adjustment for redeemable noncontrolling interests	—	—	(15,873)
Receivable for escrow amounts associated with the sale of Ecova	—	—	13,079
Non-cash stock issuance for acquisition of AERC	—	—	150,119

***The Accompanying Notes are an Integral Part of These Statements.***

# CONSOLIDATED STATEMENTS OF EQUITY AND REDEEMABLE NONCONTROLLING INTERESTS

Avista Corporation

For the Years Ended December 31

Dollars in thousands

	2016	2015	2014
Common Stock, Shares:			
Shares outstanding at beginning of year	62,312,651	62,243,374	60,076,752
Shares issued through equity compensation plans	203,727	125,620	51,127
Shares issued through Employee Investment Plan (401-K)	26,556	33,057	33,168
Shares issued through Dividend Reinvestment Plan	—	—	110,501
Shares issued through sales agency agreements	1,645,000	—	—
Shares issued for acquisition	—	—	4,501,441
Shares repurchased	—	(89,400)	(2,529,615)
Shares outstanding at end of year	64,187,934	62,312,651	62,243,374
Common Stock, Amount:			
Balance at beginning of year	\$ 1,004,336	\$ 999,960	\$ 896,993
Equity compensation expense	7,065	6,035	7,676
Issuance of common stock through equity compensation plans	624	462	108
Issuance of common stock through Employee Investment Plan (401-K)	1,061	1,099	1,005
Issuance of common stock through Dividend Reinvestment Plan	—	—	3,441
Issuance of common stock through sales agency agreements, net of issuance costs	65,267	—	—
Issuance of common stock for acquisition, net of issuance costs	—	—	149,625
Payment of minimum tax withholdings for share-based payment awards	(3,072)	(1,832)	—
Repurchase of common stock	—	(1,431)	(40,486)
Equity transactions of consolidated subsidiaries	—	—	(1,062)
Payment to option holders and redeemable noncontrolling interests for sale of Ecova	—	—	(20,871)
Excess tax benefits	—	43	3,531
Balance at end of year	1,075,281	1,004,336	999,960
Accumulated Other Comprehensive Loss:			
Balance at beginning of year	(6,650)	(7,888)	(5,819)
Other comprehensive income (loss)	(918)	1,238	(2,069)
Balance at end of year	(7,568)	(6,650)	(7,888)
Retained Earnings:			
Balance at beginning of year	530,940	491,599	407,092
Net income attributable to Avista Corporation shareholders	137,228	123,227	192,041
Cash dividends paid (common stock)	(87,154)	(82,397)	(78,314)
Repurchase of common stock	—	(1,489)	(39,370)
Valuation adjustments and other noncontrolling interests activity	—	—	10,150
Balance at end of year	581,014	530,940	491,599
Total Avista Corporation shareholders' equity	\$ 1,648,727	\$ 1,528,626	\$ 1,483,671

*The Accompanying Notes are an Integral Part of These Statements.*

CONSOLIDATED STATEMENTS OF EQUITY AND REDEEMABLE NONCONTROLLING INTERESTS (continued)

*Avista Corporation*

For the Years Ended December 31

Dollars in thousands

	2016	2015	2014
Noncontrolling Interests:			
Balance at beginning of year	\$ (339)	\$ (429)	\$ 20,001
Net income attributable to noncontrolling interests	88	90	240
Deconsolidation of noncontrolling interests related to sale of Ecova	—	—	(23,612)
Other	—	—	2,942
Balance at end of year	(251)	(339)	(429)
Total equity	<u>\$ 1,648,476</u>	<u>\$ 1,528,287</u>	<u>\$ 1,483,242</u>
Redeemable Noncontrolling Interests:			
Balance at beginning of year	\$ —	\$ —	\$ 15,889
Net income attributable to noncontrolling interests	—	—	(4)
Purchase of subsidiary noncontrolling interests	—	—	(12)
Valuation adjustments and other noncontrolling interests activity	—	—	(15,873)
Balance at end of year	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

*The Accompanying Notes are an Integral Part of These Statements.*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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#### *Nature of Business*

Avista Corp. is primarily an electric and natural gas utility with certain other business ventures. Avista Utilities is an operating division of Avista Corp., comprising the regulated utility operations in the Pacific Northwest. Avista Utilities provides electric distribution and transmission, and natural gas distribution services in parts of eastern Washington and northern Idaho. Avista Utilities also provides natural gas distribution service in parts of northeastern and southwestern Oregon. Avista Utilities has electric generating facilities in Washington, Idaho, Oregon and Montana. Avista Utilities also supplies electricity to a small number of customers in Montana, most of whom are employees who operate Avista Utilities' Noxon Rapids generating facility.

AERC is a wholly-owned subsidiary of Avista Corp. The primary subsidiary of AERC is AEL&P, which comprises Avista Corp.'s regulated utility operations in Alaska. AERC was acquired by Avista Corp. on July 1, 2014 and there are no AERC earnings included in the overall results of Avista Corp. prior to that date. See Note 4 for information regarding the acquisition of AERC.

Avista Capital, a wholly owned non-regulated subsidiary of Avista Corp., is the parent company of all of the subsidiary companies in the non-utility businesses, with the exception of AJT Mining Properties, which is a subsidiary of AERC. During the first half of 2014 and prior, Avista Capital's subsidiaries included Ecova, which was an 80.2 percent owned subsidiary prior to its disposition on June 30, 2014. See Note 5 for information regarding the disposition of Ecova and Note 21 for business segment information.

#### *Basis of Reporting*

The consolidated financial statements include the assets, liabilities, revenues and expenses of the Company and its subsidiaries and other majority owned subsidiaries and variable interest entities for which the Company or its subsidiaries are the primary beneficiaries. Ecova's revenues and expenses are included in the Consolidated Statements of Income in discontinued operations; however, as of June 30, 2014 and for all subsequent reporting periods there are no balance sheet amounts included for Ecova. All tables throughout the Notes to Consolidated Financial Statements that present information related to the Consolidated Statements of Income were revised to include only the amounts from continuing operations. Intercompany balances were eliminated in consolidation. The accompanying consolidated financial statements include the Company's proportionate share of utility plant and related operations resulting from its interests in jointly owned plants (see Note 7).

#### *Use of Estimates*

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported for assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include:

- determining the market value of energy commodity derivative assets and liabilities,
- pension and other postretirement benefit plan obligations,
- contingent liabilities,
- goodwill impairment testing,
- recoverability of regulatory assets, and
- unbilled revenues.

Changes in these estimates and assumptions are considered reasonably possible and may have a material effect on the consolidated financial statements and thus actual results could differ from the amounts reported and disclosed herein.

### ***System of Accounts***

The accounting records of the Company's utility operations are maintained in accordance with the uniform system of accounts prescribed by the FERC and adopted by the state regulatory commissions in Washington, Idaho, Montana, Oregon and Alaska.

### ***Regulation***

The Company is subject to state regulation in Washington, Idaho, Montana, Oregon and Alaska. The Company is also subject to federal regulation primarily by the FERC, as well as various other federal agencies with regulatory oversight of particular aspects of its operations.

### ***Utility Revenues***

Utility revenues related to the sale of energy are recorded when service is rendered or energy is delivered to customers. Revenues and resource costs from Avista Utilities' settled energy contracts that are "booked out" (not physically delivered) are reported on a net basis as part of utility revenues. AEL&P does not have booked out transactions. The determination of the energy sales to individual customers is based on the reading of their meters, which occurs on a systematic basis throughout the month. At the end of each calendar month, the amount of energy delivered to customers since the date of the last meter reading is estimated and the corresponding unbilled revenue is estimated and recorded. Our estimate of unbilled revenue is based on:

- the number of customers,
- current rates,
- meter reading dates,
- actual native load for electricity,
- actual throughput for natural gas, and
- electric line losses and natural gas system losses.

Any difference between actual and estimated revenue is automatically corrected in the following month when the actual meter reading and customer billing occurs.

Accounts receivable includes unbilled energy revenues of the following amounts as of December 31 (dollars in thousands):

	2016	2015
Unbilled accounts receivable	\$ 72,377	\$ 62,003

### ***Other Non-Utility Revenues***

Revenues from the other businesses are primarily derived from the operations of AM&D, doing business as METALfx, and are recognized when the risk of loss transfers to the customer, which occurs when products are shipped. In addition, prior to Spokane Energy's dissolution in 2015, there were revenues at Spokane Energy related to a long-term fixed rate electric capacity contract. This contract was transferred to Avista Corp. during the second quarter of 2015 and the revenues from this contract subsequent to the transfer are included in utility revenues.

### ***Depreciation***

For utility operations, depreciation expense is estimated by a method of depreciation accounting utilizing composite rates for utility plant. Such rates are designed to provide for retirements of properties at the expiration of their service lives. For utility

operations, the ratio of depreciation provisions to average depreciable property was as follows for the years ended December 31:

	2016	2015	2014
<b>Avista Utilities</b>			
Ratio of depreciation to average depreciable property	3.11%	3.09%	2.97%
<b>Alaska Electric Light and Power Company</b>			
Ratio of depreciation to average depreciable property	2.39%	2.42%	2.43%

The average service lives for the following broad categories of utility plant in service are (in years):

	Avista Utilities	Alaska Electric Light and Power Company
Electric thermal/other production	41	41
Hydroelectric production	78	42
Electric transmission	57	41
Electric distribution	35	40
Natural gas distribution property	45	N/A
Other shorter-lived general plant	9	15

#### ***Taxes Other Than Income Taxes***

Taxes other than income taxes include state excise taxes, city occupational and franchise taxes, real and personal property taxes and certain other taxes not based on income. These taxes are generally based on revenues or the value of property. Utility related taxes collected from customers (primarily state excise taxes and city utility taxes) are recorded as operating revenue and expense. Taxes other than income taxes consisted of the following items for the years ended December 31 (dollars in thousands):

	2016	2015	2014
Utility related taxes	\$ 57,745	\$ 59,173	\$ 58,250
Property taxes	38,505	35,948	33,932
Other taxes	2,485	2,536	2,118
Total	<u>\$ 98,735</u>	<u>\$ 97,657</u>	<u>\$ 94,300</u>

#### ***Allowance for Funds Used During Construction***

AFUDC represents the cost of both the debt and equity funds used to finance utility plant additions during the construction period. As prescribed by regulatory authorities, AFUDC is capitalized as a part of the cost of utility plant. The debt component of AFUDC is credited against total interest expense in the Consolidated Statements of Income in the line item "capitalized interest." The equity component of AFUDC is included in the Consolidated Statement of Income in the line item "other income-net." The Company is permitted, under established regulatory rate practices, to recover the capitalized AFUDC, and a reasonable return thereon, through its inclusion in rate base and the provision for depreciation after the related utility plant is placed in service. Cash inflow related to AFUDC does not occur until the related utility plant is placed in service and included in rate base. The effective AFUDC rate was the following for the years ended December 31:

	2016	2015	2014
<b>Avista Utilities</b>			
Effective AFUDC rate	7.29%	7.32%	7.64%
<b>Alaska Electric Light and Power Company</b>			
Effective AFUDC rate	9.40%	9.31%	10.37%

## ***Income Taxes***

Deferred income tax assets represent future income tax deductions the Company expects to utilize in future tax returns to reduce taxable income. Deferred income tax liabilities represent future taxable income the Company expects to recognize in future tax returns. Deferred tax assets and liabilities arise when there are temporary differences resulting from differing treatment of items for tax and accounting purposes (such as depreciation). A deferred income tax asset or liability is determined based on the enacted tax rates that will be in effect when the temporary differences between the financial statement carrying amounts and tax basis of existing assets and liabilities are expected to be reported in the Company's consolidated income tax returns. The deferred income tax expense for the period is equal to the net change in the deferred income tax asset and liability accounts from the beginning to the end of the period. The effect on deferred income taxes from a change in tax rates is recognized in income in the period that includes the enactment date unless a regulatory order specifies deferral of the effect of the change in tax rates over a longer period of time. The Company establishes a valuation allowance when it is more likely than not that all, or a portion, of a deferred tax asset will not be realized. Deferred income tax liabilities and regulatory assets are established for income tax benefits flowed through to customers. The Company did not incur any penalties on income tax positions in 2016, 2015 or 2014. The Company would recognize interest accrued related to income tax positions as interest expense and any penalties incurred as other operating expense.

## ***Stock-Based Compensation***

The Company currently issues three types of stock-based compensation awards - restricted shares, market-based awards and performance-based awards. Historically, these stock compensation awards have not been material to the Company's overall financial results. Compensation cost relating to share-based payment transactions is recognized in the Company's financial statements based on the fair value of the equity or liability instruments issued and recorded over the requisite service period.

The Company recorded stock-based compensation expense (included in other operating expenses) and income tax benefits in the Consolidated Statements of Income of the following amounts for the years ended December 31 (dollars in thousands):

	2016	2015	2014
Stock-based compensation expense	\$ 7,891	\$ 6,914	\$ 6,007
Income tax benefits (1)	4,359	2,420	2,102

- (1) Income tax benefits for 2016 include \$1.6 million associated with excess tax benefits on settled share-based employee payments. The excess tax benefits were recognized in the Statement of Income for 2016 due to the adoption of ASU 2016-09, effective January 1, 2016. See Note 2 for further discussion.

Restricted share awards vest in equal thirds each year over a three-year period and are payable in Avista Corp. common stock at the end of each year if the service condition is met. In addition to the service condition, the Company must meet a return on equity target in order for the Chief Executive Officer's restricted shares to vest. Restricted stock is valued at the close of market of the Company's common stock on the grant date.

Total Shareholder Return (TSR) awards are market-based awards and Cumulative Earnings Per Share (CEPS) awards are performance awards. CEPS awards were first granted in 2014. Both types of awards vest after a period of three years and are payable in cash or Avista Corp. common stock at the end of the three-year period. The method of settlement is at the discretion of the Company and historically the Company has settled these awards through issuance of Avista Corp. common stock and intends to continue this practice. Both types of awards entitle the recipients to dividend equivalent rights, are subject to forfeiture under certain circumstances, and are subject to meeting specific market or performance conditions. Based on the level of attainment of the market or performance conditions, the amount of cash paid or common stock issued will range from 0 to 200 percent of the initial awards granted. Dividend equivalent rights are accumulated and paid out only on shares that eventually vest and have met the market and performance conditions.



For both the TSR awards and the CEPS awards, the Company accounts for them as equity awards and compensation cost for these awards is recognized over the requisite service period, provided that the requisite service period is rendered. For TSR awards, if the market condition is not met at the end of the three-year service period, there will be no change in the cumulative amount of compensation cost recognized, since the awards are still considered vested even though the market metric was not met. For CEPS awards, at the end of the three-year service period, if the internal performance metric of cumulative earnings per share is not met, all compensation cost for these awards is reversed as these awards are not considered vested.

The fair value of each TSR award is estimated on the date of grant using a statistical model that incorporates the probability of meeting the market targets based on historical returns relative to a peer group. The estimated fair value of the equity component of CEPS awards was estimated on the date of grant as the share price of Avista Corp. common stock on the date of grant, less the net present value of the estimated dividends over the three-year period.

The following table summarizes the number of grants, vested and unvested shares, earned shares (based on market metrics), and other pertinent information related to the Company's stock compensation awards for the years ended December 31:

	2016	2015	2014
<b>Restricted Shares</b>			
Shares granted during the year	58,610	58,302	62,075
Shares vested during the year	(52,385)	(60,379)	(52,899)
Unvested shares at end of year	109,806	106,091	112,042
Unrecognized compensation expense at end of year (in thousands)	\$ 1,853	\$ 1,705	\$ 1,349
<b>TSR Awards</b>			
TSR shares granted during the year	116,435	116,435	117,550
TSR shares vested during the year	(111,665)	(171,334)	(167,584)
TSR shares earned based on market metrics	132,887	222,734	97,199
Unvested TSR shares at end of year	222,228	223,697	287,834
Unrecognized compensation expense (in thousands)	\$ 3,409	\$ 3,219	\$ 2,833
<b>CEPS Awards</b>			
CEPS shares granted during the year	57,521	58,259	59,025
CEPS shares vested during the year	(55,835)	—	—
CEPS shares earned based on market metrics	90,460	—	—
Unvested CEPS shares at end of year	110,452	111,887	58,017
Unrecognized compensation expense (in thousands)	\$ 1,671	\$ 1,840	\$ 1,577

Outstanding TSR and CEPS share awards include a dividend component that is paid in cash. This component of the share grants is accounted for as a liability award. These liability awards are revalued on a quarterly basis taking into account the number of awards outstanding, historical dividend rate, the change in the value of the Company's common stock relative to an external benchmark (TSR awards only) and the amount of CEPS earned to date compared to estimated CEPS over the performance period (CEPS awards only). Over the life of these awards, the cumulative amount of compensation expense recognized will match the actual cash paid. As of December 31, 2016 and 2015, the Company had recognized cumulative compensation expense and a liability of \$1.5 million, respectively, related to the dividend component on the outstanding and unvested share grants.

### ***Other Income - Net***

Other Income - net consisted of the following items for the years ended December 31 (dollars in thousands):

	2016	2015	2014
Interest income	\$ 1,823	\$ 653	\$ 987
Interest on regulatory deferrals	1,308	48	220
Equity-related AFUDC	8,475	8,331	8,808
Net gain (loss) on investments	(2,152)	(637)	276
Other income	624	905	1,055
Total	<u>\$ 10,078</u>	<u>\$ 9,300</u>	<u>\$ 11,346</u>

### ***Earnings per Common Share Attributable to Avista Corporation Shareholders***

Basic earnings per common share attributable to Avista Corp. shareholders is computed by dividing net income attributable to Avista Corp. shareholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per common share attributable to Avista Corp. shareholders is calculated by dividing net income attributable to Avista Corp. shareholders (adjusted for the effect of potentially dilutive securities issued to noncontrolling interests by the Company's subsidiaries) by diluted weighted-average common shares outstanding during the period, including common stock equivalent shares outstanding using the treasury stock method, unless such shares are anti-dilutive. Common stock equivalent shares include shares issuable upon exercise of stock options and contingent stock awards. See Note 18 for earnings per common share calculations.

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

For the purposes of the Consolidated Statements of Cash Flows, the Company considers all temporary investments with a maturity of three months or less when purchased to be cash equivalents.

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

The Company maintains an allowance for doubtful accounts to provide for estimated and potential losses on accounts receivable. The Company determines the allowance for utility and other customer accounts receivable based on historical write-offs as compared to accounts receivable and operating revenues. Additionally, the Company establishes specific allowances for certain individual accounts. The following table presents the activity in the allowance for doubtful accounts during the years ended December 31 (dollars in thousands):

	2016	2015	2014
Allowance as of the beginning of the year	\$ 4,530	\$ 4,888	\$ 44,309
Additions expensed during the year	6,053	5,802	5,296
Net deductions (1)	(5,557)	(6,160)	(44,717)
Allowance as of the end of the year	<u>\$ 5,026</u>	<u>\$ 4,530</u>	<u>\$ 4,888</u>

- (1) During 2014, the Company received \$15.0 million in gross proceeds related to the settlement of its California wholesale power markets litigation. The gross proceeds effectively settled all outstanding receivables and payables at Avista Energy (which had been fully reserved against since 2001). As a result of the settlement, the Company reversed \$15.0 million of the allowance, which was recorded as a reduction to non-utility other operating expenses on the Consolidated Statements of Income, and the remainder of the receivables, payables and allowance of \$24.5 million were removed from the Consolidated Balance Sheets (and had no effect on net income).

### ***Materials and Supplies, Fuel Stock and Stored Natural Gas***

Inventories of materials and supplies, fuel stock and stored natural gas are recorded at average cost for our regulated operations and the lower of cost or market for our non-regulated operations and consisted of the following as of December 31 (dollars in thousands):

	2016	2015
Materials and supplies	\$ 40,700	\$ 37,101
Fuel stock	4,585	4,273
Stored natural gas	8,029	12,774
Total	<u>\$ 53,314</u>	<u>\$ 54,148</u>

### ***Utility Plant in Service***

The cost of additions to utility plant in service, including an allowance for funds used during construction and replacements of units of property and improvements, is capitalized. The cost of depreciable units of property retired plus the cost of removal less salvage is charged to accumulated depreciation.

### ***Asset Retirement Obligations***

The Company records the fair value of a liability for an ARO in the period in which it is incurred. When the liability is initially recorded, the associated costs of the ARO are capitalized as part of the carrying amount of the related long-lived asset. The liability is accreted to its present value each period and the related capitalized costs are depreciated over the useful life of the related asset. In addition, if there are changes in the estimated timing or estimated costs of the AROs, adjustments are recorded during the period new information becomes available as an increase or decrease to the liability, with the offset recorded to the related long-lived asset. Upon retirement of the asset, the Company either settles the ARO for its recorded amount or incurs a gain or loss. The Company records regulatory assets and liabilities for the difference between asset retirement costs currently recovered in rates and AROs recorded since asset retirement costs are recovered through rates charged to customers (see Note 9 for further discussion of the Company's asset retirement obligations).

The Company recovers certain asset retirement costs through rates charged to customers as a portion of its depreciation expense for which the Company has not recorded asset retirement obligations. The Company has recorded the amount of estimated retirement costs collected from customers (that do not represent legal or contractual obligations) and included them as a regulatory liability on the Consolidated Balance Sheets in the following amounts as of December 31 (dollars in thousands):

	2016	2015
Regulatory liability for utility plant retirement costs	\$ 273,983	\$ 261,594

### ***Goodwill***

Goodwill arising from acquisitions represents the future economic benefit arising from other assets acquired in a business combination that are not individually identified and separately recognized. The Company evaluates goodwill for impairment using a qualitative analysis (Step 0) for AEL&P and a combination of discounted cash flow models and a market approach for the other subsidiaries on at least an annual basis or more frequently if impairment indicators arise. The Company completed its annual evaluation of goodwill for potential impairment as of November 30, 2016 and determined that goodwill was not impaired at that time.

The changes in the carrying amount of goodwill are as follows (dollars in thousands):

	AEL&P	Other	Accumulated Impairment	Total
Balance as of January 1, 2015	\$ 52,730	\$ 12,979	\$ (7,733)	\$ 57,976
Adjustments	(304)	—	—	(304)
Balance as of the December 31, 2015	52,426	12,979	(7,733)	57,672
Balance as of the December 31, 2016	\$ 52,426	\$ 12,979	\$ (7,733)	\$ 57,672

Accumulated impairment losses are attributable to the other businesses. The goodwill adjustments recorded during 2015 relate to the final true-up of income taxes associated with the acquisition of AERC, which occurred on July 1, 2014. See Note 4 for information regarding this business acquisition and Note 21 regarding the Company's reportable segments.

### ***Derivative Assets and Liabilities***

Derivatives are recorded as either assets or liabilities on the Consolidated Balance Sheets measured at estimated fair value.

The UTC and the IPUC issued accounting orders authorizing Avista Corp. to offset energy commodity derivative assets or liabilities with a regulatory asset or liability. This accounting treatment is intended to defer the recognition of mark-to-market gains and losses on energy commodity transactions until the period of delivery. Realized benefits and costs result in adjustments to retail rates through PGAs, the ERM in Washington, the PCA mechanism in Idaho, and periodic general rates cases. The resulting regulatory assets have been concluded to be probable of recovery through future rates.

Substantially all forward contracts to purchase or sell power and natural gas are recorded as derivative assets or liabilities at estimated fair value with an offsetting regulatory asset or liability. Contracts that are not considered derivatives are accounted for on the accrual basis until they are settled or realized unless there is a decline in the fair value of the contract that is determined to be other-than-temporary.

For interest rate swap derivatives, Avista Corp. records all mark-to-market gains and losses in each accounting period as assets and liabilities, as well as offsetting regulatory assets and liabilities, such that there is no income statement impact. The interest rate swap derivatives are risk management tools similar to energy commodity derivatives. Upon settlement of interest rate swap derivatives, the regulatory asset or liability is amortized as a component of interest expense over the term of the associated debt. The Company records an offset of interest rate swap derivative assets and liabilities with regulatory assets and liabilities, based on the prior practice of the commissions to provide recovery through the ratemaking process.

As of December 31, 2016, the Company has multiple master netting agreements with a variety of entities that allow for cross-commodity netting of derivative agreements with the same counterparty (i.e. power derivatives can be netted with natural gas derivatives). In addition, some master netting agreements allow for the netting of commodity derivatives and interest rate swap derivatives for the same counterparty. The Company does not have any agreements which allow for cross-affiliate netting among multiple affiliated legal entities. The Company nets all derivative instruments when allowed by the agreement for presentation in the Consolidated Balance Sheets.

### ***Fair Value Measurements***

Fair value represents the price that would be received when selling an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. Energy commodity derivative assets and liabilities, deferred compensation assets, as well as derivatives related to interest rate swap derivatives and foreign currency exchange derivatives, are reported at estimated fair value on the Consolidated Balance Sheets. See Note 16 for the Company's fair value disclosures.

### ***Regulatory Deferred Charges and Credits***

The Company prepares its consolidated financial statements in accordance with regulatory accounting practices because:

- rates for regulated services are established by or subject to approval by independent third-party regulators,
- the regulated rates are designed to recover the cost of providing the regulated services, and
- in view of demand for the regulated services and the level of competition, it is reasonable to assume that rates can be charged to and collected from customers at levels that will recover costs.

Regulatory accounting practices require that certain costs and/or obligations (such as incurred power and natural gas costs not currently included in rates, but expected to be recovered or refunded in the future), are reflected as deferred charges or credits on the Consolidated Balance Sheets. These costs and/or obligations are not reflected in the Consolidated Statements of Income until the period during which matching revenues are recognized. The Company also has decoupling revenue deferrals. Decoupling revenue deferrals are recognized in the Consolidated Statements of Income during the period they occur (i.e. during the period of revenue shortfall or excess due to fluctuations in customer usage), subject to certain limitations, and a regulatory asset/liability is established which will be surcharged or rebated to customers in future periods. GAAP requires that for any alternative regulatory revenue program, like decoupling, the revenue must be expected to be collected from customers within 24 months of the deferral to qualify for recognition in the current period Consolidated Statement of Income. Any amounts included in the Company's decoupling program that are not expected to be collected from customers within 24 months are not recorded in the financial statements until the period in which revenue recognition criteria are met. This could ultimately result in decoupling revenue being recognized in a future period.

If at some point in the future the Company determines that it no longer meets the criteria for continued application of regulatory accounting practices for all or a portion of its regulated operations, the Company could be:

- required to write off its regulatory assets, and
- precluded from the future deferral of costs or decoupled revenues not recovered through rates at the time such amounts are incurred, even if the Company expected to recover these amounts from customers in the future.

See Note 20 for further details of regulatory assets and liabilities.

### ***Unamortized Debt Expense***

Unamortized debt expense includes debt issuance costs that are amortized over the life of the related debt. These costs are recorded as an offset to Long-Term Debt and Capital Leases on the Consolidated Balance Sheets.

### ***Unamortized Debt Repurchase Costs***

For the Company's Washington regulatory jurisdiction and for any debt repurchases beginning in 2007 in all jurisdictions, premiums paid to repurchase debt are amortized over the remaining life of the original debt that was repurchased or, if new debt is issued in connection with the repurchase, these costs are amortized over the life of the new debt. In the Company's other regulatory jurisdictions, premiums paid to repurchase debt prior to 2007 are being amortized over the average remaining maturity of outstanding debt when no new debt was issued in connection with the debt repurchase. These costs are recovered through retail rates as a component of interest expense.

### ***Accumulated Other Comprehensive Loss***

Accumulated other comprehensive loss, net of tax, consisted of the following as of December 31 (dollars in thousands):

	2016	2015
Unfunded benefit obligation for pensions and other postretirement benefit plans - net of taxes of \$4,075 and \$3,580, respectively	\$ 7,568	\$ 6,650

The following table details the reclassifications out of accumulated other comprehensive loss by component for the years ended December 31 (dollars in thousands):

Details about Accumulated Other Comprehensive Loss Components	Amounts Reclassified from Accumulated Other Comprehensive Loss			Affected Line Item in Statement of Income
	2016	2015	2014	
Realized gains on investment securities	\$ —	\$ —	\$ (3)	(a)
Realized losses on investment securities	—	—	735	(a)
	—	—	732	Total before tax
	—	—	(272)	Tax expense (a)
	\$ —	\$ —	\$ 460	Net of tax
Amortization of defined benefit pension items				
Amortization of net prior service cost	\$ (1,171)	\$ 31	\$ (1,094)	(b)
Amortization of net loss	(7,602)	2,623	(83,301)	(b)
Adjustment due to effects of regulation	7,360	(749)	78,773	(b)
	(1,413)	1,905	(5,622)	Total before tax
	495	(667)	1,967	Tax benefit (expense)
	\$ (918)	\$ 1,238	\$ (3,655)	Net of tax

(a) These amounts were included as part of net income from discontinued operations for all periods presented (see Note 5 for additional details).

(b) These accumulated other comprehensive loss components are included in the computation of net periodic pension cost (see Note 10 for additional details).

### ***Appropriated Retained Earnings***

In accordance with the hydroelectric licensing requirements of section 10(d) of the Federal Power Act (FPA), the Company maintains an appropriated retained earnings account for any earnings in excess of the specified rate of return on the Company's investment in the licenses for its various hydroelectric projects. Per section 10(d) of the FPA, the Company must maintain these excess earnings in an appropriated retained earnings account until the termination of the licensing agreements or apply them to reduce the net investment in the licenses of the hydroelectric projects at the discretion of the FERC. The Company typically calculates the earnings in excess of the specified rate of return on an annual basis, usually during the second quarter.

In addition to the hydroelectric project licenses identified above for Avista Utilities, the requirements of section 10(d) of the FPA also apply to the AEL&P licenses for Lake Dorothy and Annex Creek/Salmon Creek (combined).

The appropriated retained earnings amounts included in retained earnings were as follows as of December 31 (dollars in thousands):

	2016	2015
Appropriated retained earnings	\$ 25,564	\$ 21,030

### ***Operating Leases***

The Company has multiple lease arrangements involving various assets, with minimum terms ranging from 1 to 45 years. Future minimum lease payments required under operating leases having initial or remaining noncancelable lease terms in excess of one year were not material as of December 31, 2016.

### ***Capital Leases***

The Company has two capital leases, one at Avista Corp. and one at AEL&P. The capital lease at Avista Corp. expires in 2018 and is not material to the financial statements as of December 31, 2016. The capital lease at AEL&P is a PPA (treated as a lease for accounting purposes) related to the Snettisham Hydroelectric Project that expires in 2034. While the two leases are treated as capital leases for accounting purposes, for ratemaking purposes these agreements are treated as operating leases with a constant level of annual rental expense (straight line expense). Because of this regulatory treatment, any difference between the operating lease expense for ratemaking purposes and the expenses recognized under capital lease treatment (interest and depreciation of the capital lease asset) is recorded as a regulatory asset and amortized during the later years of the lease when the capital lease expense is less than the operating lease expense included in base rates. See Note 14 for further discussion of the Snettisham capital lease.

### ***Contingencies***

The Company has unresolved regulatory, legal and tax issues which have inherently uncertain outcomes. The Company accrues a loss contingency if it is probable that a liability has been incurred and the amount of the loss or impairment can be reasonably estimated. The Company also discloses losses that do not meet these conditions for accrual, if there is a reasonable possibility that a material loss may be incurred. As of December 31, 2016, the Company has not recorded any significant amounts related to unresolved contingencies. See Note 19 for further discussion of the Company's commitments and contingencies.

## **NOTE 2. NEW ACCOUNTING STANDARDS**

### ***ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)"***

In May 2014, the FASB issued ASU No. 2014-09, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that an entity should identify the various performance obligations in a contract, allocate the transaction price among the performance obligations and recognize revenue when (or as) the entity satisfies each performance obligation. This ASU was originally effective for periods beginning after December 15, 2016 and early adoption was not permitted. In August 2015, the FASB issued ASU No. 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date," which deferred the effective date of ASU No. 2014-09 for one year, with adoption as of the original date permitted.

The Company has formed a revenue recognition standard implementation team that is working through several implementation issues described below. The Company has evaluated this standard and is planning to adopt this standard in 2018 upon its effective date. The Company is currently expecting to use a modified retrospective method of adoption, which would require a cumulative adjustment to opening retained earnings, as opposed to a full retrospective application. The Company is not far enough along in the adoption process to determine the amount, if any, of cumulative adjustment necessary.

Since the vast majority of Avista Corp.'s revenue is from rate-regulated sales of electricity and natural gas to retail customers and revenue is recognized as energy is delivered to these customers, the Company does not expect a significant change in operating revenues or net income. The Company is in the process of reviewing and analyzing certain contracts with customers (most of which are related to wholesale sales of power and natural gas), but has not yet identified any significant differences in revenue recognition between current GAAP and ASU 2014-09.

During the implementation process, the Company has identified several unresolved issues, the most significant of which are as follows based on our current assessment:

Contributions in Aid of Construction – There is the potential that CIACs could be recognized as revenue upon the adoption of ASU 2014-09. Under current GAAP, CIACs are accounted for as an offset to the cost of utility plant in service.

Utility Related Taxes Collected from Customers – There are questions on the presentation of utility related taxes collected from customers (primarily state excise taxes and city utility taxes) on a gross basis. Under current GAAP, the Company is allowed to record these utility related taxes on a gross basis in revenue when billed to customers with an offset included in taxes other than income taxes in operating expenses. The Company is evaluating whether this presentation is appropriate under ASU 2014-09 or whether they should be presented on a net basis. To qualify for gross presentation under the new guidance, the Company must perform an analysis to determine if it is the principal or the agent in regards to utility related taxes.

Collectibility - There are questions regarding the requirement that collection of a sale be probable and how, or if, utilities should consider bad debt collection mechanisms (riders, base rate adjustments, etc.) in assessing probability of collection on sales to low income customers. Within the utility industry, there is support for and against considering these recovery mechanisms when assessing collectibility of a sale. If the bad debt recovery mechanisms cannot be considered, there is the potential that certain sales to low income customers cannot be recognized as revenue until payment is received from the customers, which could result in revenues being recognized in periods other than when the energy was delivered to customers or not recognized at all.

The Company is monitoring utility industry implementation guidance as it relates to unresolved issues to determine if there will be an industry consensus regarding accounting and presentation of these items.

*ASU No. 2015-02, “Consolidation (Topic 810): Amendments to the Consolidation Analysis”*

In February 2015, the FASB issued ASU No. 2015-02. This ASU changes the consolidation analysis required under GAAP, including the identification of variable interest entities (VIE). The ASU also removes the deferral of the VIE analysis related to investments in certain investment funds, which results in a different consolidation evaluation for these types of investments. The Company adopted this standard effective January 1, 2016. The adoption of this standard resulted in the identification of several Avista Corp. investments in limited partnerships (or a functional equivalent) that are now considered VIEs under the new standard. Consolidation of these VIEs by Avista Corp. is not required because the Company does not have majority ownership in any of the entities, it does not have the power to direct any activities of the entities and it does not have the power to appoint executive leadership (including the board of directors). Avista Corp.'s total investment in these entities is not material and it does not have any additional commitments to these VIEs beyond the initial investment. See Note 3 for additional discussion of VIEs.

*ASU No. 2016-02 “Leases (Topic 842).”*

In February 2016, the FASB issued ASU No. 2016-02. This ASU introduces a new lessee model that requires most leases to be capitalized and shown on the balance sheet with corresponding lease assets and liabilities. The standard also aligns certain of the underlying principles of the new lessor model with those in Topic 606, the FASB’s new revenue recognition standard. Furthermore, this ASU addresses other issues that arise under the current lease model; for example, eliminating the required use of bright-line tests in current GAAP for determining lease classification (operating leases versus capital leases). This ASU also includes enhanced disclosures surrounding leases. This ASU is effective for periods beginning on or after December 15, 2018; however, early adoption is permitted. Upon adoption, this ASU must be applied using a modified retrospective approach to the earliest period presented, which will likely require restatements of previously issued financial statements. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. The Company evaluated this standard and determined that it will most likely not early adopt this standard before its effective date in 2019. The Company has formed a lease standard implementation team that is working through the implementation process. The most



significant implementation challenge identified thus far relates to identifying a complete population of leases and potential leases under the new lease standard. Also, the Company is monitoring utility industry implementation guidance as it relates to several unresolved issues to determine if there will be an industry consensus, including whether right-of-ways are considered leases. The Company cannot, at this time, estimate the potential impact on its future financial condition, results of operations and cash flows.

*ASU No. 2016-09 "Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting."*

In March 2016, the FASB issued ASU No. 2016-09. This ASU simplifies several aspects of the accounting for employee share-based payment transactions including:

- allowing excess tax benefits or tax deficiencies to be recognized as income tax benefits or expenses in the Consolidated Statements of Income rather than in Additional Paid in Capital (APIC),
- excess tax benefits no longer represent a financing cash inflow on the Consolidated Statements of Cash Flows and instead will be included as an operating activity,
- excess tax benefits and tax deficiencies will be excluded from the calculation of diluted earnings per share, whereas under current accounting guidance, these amounts must be estimated and included in the calculation,
- allowing forfeitures to be accounted for as they occur, instead of estimating forfeitures, and
- changing the statutory tax withholding requirements for share-based payments.

This ASU is effective for periods beginning after December 15, 2016 and early adoption is permitted. The Company early adopted this standard during the second quarter of 2016, with a retrospective effective date of January 1, 2016. The adoption of this standard resulted in a recognized income tax benefit of \$1.6 million in 2016 associated with excess tax benefits on settled share-based employee payments. In addition, the Consolidated Statement of Cash Flows for 2016 included the excess tax benefits as an operating activity rather than as a financing activity. Periods prior to 2016 were not restated for the adoption of this accounting standard as the Company has adopted this standard on a prospective basis beginning January 1, 2016.

### **NOTE 3. VARIABLE INTEREST ENTITIES**

#### ***Lancaster Power Purchase Agreement***

The Company has a PPA for the purchase of all the output of the Lancaster Plant, a 270 MW natural gas-fired combined cycle combustion turbine plant located in Kootenai County, Idaho, owned by an unrelated third-party (Rathdrum Power LLC), through 2026.

Avista Corp. has a variable interest in the PPA. Accordingly, Avista Corp. made an evaluation of which interest holders have the power to direct the activities that most significantly impact the economic performance of the entity and which interest holders have the obligation to absorb losses or receive benefits that could be significant to the entity. Avista Corp. pays a fixed capacity and operations and maintenance payment and certain monthly variable costs under the PPA. Under the terms of the PPA, Avista Corp. makes the dispatch decisions, provides all natural gas fuel and receives all of the electric energy output from the Lancaster Plant. However, Rathdrum Power LLC (the owner) controls the daily operation of the Lancaster Plant and makes operating and maintenance decisions. Rathdrum Power LLC controls all of the rights and obligations of the Lancaster Plant after the expiration of the PPA in 2026 and Avista Corp. does not have any further obligations after the expiration. It is estimated that the plant will have 15 to 25 years of useful life after that time. Rathdrum Power LLC bears the maintenance risk of the plant and will receive the residual value of the Lancaster Plant. Avista Corp. has no debt or equity investments in the Lancaster Plant and does not provide financial support through liquidity arrangements or other commitments (other than the PPA). Based on its analysis, Avista Corp. does not consider itself to be the primary beneficiary of the Lancaster Plant. Accordingly, neither the Lancaster Plant nor Rathdrum Power LLC is included in Avista Corp.'s consolidated financial

statements. The Company has a future contractual obligation of approximately \$283.6 million under the PPA (representing the fixed capacity and operations and maintenance payments through 2026) and believes this would be its maximum exposure to loss. However, the Company believes that such costs will be recovered through retail rates.

#### ***Limited Partnerships and Similar Entities***

The Company adopted ASU No. 2015-02 effective January 1, 2016. As a result of the adoption of this ASU, the Company evaluated all of its existing investments to determine if any entities would be considered VIEs under the new guidance and whether consolidation would be required. Under the ASU, a limited partnership or similar legal entity that is the functional equivalent of a limited partnership would be considered a VIE regardless of whether it otherwise qualifies as a voting interest entity unless a simple majority or lower threshold of the “unrelated” limited partners (i.e., parties other than the general partner, entities under common control with the general partner, and other parties acting on behalf of the general partner) have substantive kick-out rights (including liquidation rights) or participating rights.

The Company has six investments in limited partnerships (or the functional equivalent) where Avista Corp. is a limited partner investor in an investment fund where the general partner makes all of the investment and operating decisions with regards to the partnership and fund. To remove the general partner from any of the funds, approval from greater than a simple majority of the limited partners is required. As such, the limited partners do not have substantive kick-out rights and these investments are considered VIEs. Consolidation of these VIEs by Avista Corp. is not required because the Company does not have majority ownership in any of the funds, it does not have the power to direct any activities of the funds, and it does not have the power to appoint executive leadership, including the board of directors.

Avista Corp. participates in profits and losses of the investment funds based on its ownership percentage and its losses are capped at its total initial investment in the funds. For five of the six VIEs, Avista Corp. does not have any additional commitments beyond its initial investment. For the sixth VIE, Avista Corp. has up to a \$25.0 million total commitment, and as of December 31, 2016, has invested \$2.1 million, leaving \$22.9 million remaining to be invested. In addition, the Company is not allowed to withdraw any capital contributions from the investment funds until after the funds' expiration dates and all liabilities of the funds are settled. The expiration dates range from 2017 to 2032, with one investment having no termination date (as it is perpetual). As of December 31, 2016, the Company has a total carrying amount in these investment funds of \$7.0 million.

#### **NOTE 4. BUSINESS ACQUISITIONS**

##### ***Alaska Energy and Resources Company***

On July 1, 2014, the Company acquired AERC, based in Juneau, Alaska, and as of that date, AERC became a wholly-owned subsidiary of Avista Corp.

The primary subsidiary of AERC is AEL&P, a regulated utility which provides electric services to approximately 17,000 customers in Juneau, Alaska. In addition to the regulated utility, AERC owns AJT Mining, which is an inactive mining company holding certain properties.

The purpose of the acquisition was to expand and diversify Avista Corp.'s energy assets and deliver long-term value to its customers, communities and investors.

In connection with the closing, Avista Corp. issued 4,501,441 new shares of common stock to the shareholders of AERC based on a contractual formula that resulted in a price of \$32.46 per share, reflecting a purchase price of \$170.0 million, plus acquired cash, less outstanding debt and other closing adjustments. Avista Corp. also paid \$4.8 million in cash. The total fair value of all consideration transferred was \$154.9 million and resulted in goodwill of \$52.4 million, which is not deductible for tax purposes.

The fair value of assets acquired and liabilities assumed as of July 1, 2014 (after consideration of a working capital adjustment and income tax true-ups during the second quarter of 2015) were as follows (in thousands):

	July 1, 2014
<b>Assets acquired:</b>	
Current Assets:	
Cash	\$ 19,704
Accounts receivable - gross totals \$3,928	3,851
Materials and supplies	2,017
Other current assets	999
Total current assets	26,571
Utility Property:	
Utility plant in service	113,964
Utility property under long-term capital lease	71,007
Construction work in progress	3,440
Total utility property	188,411
Other Non-current Assets:	
Non-utility property	6,660
Electric plant held for future use	3,711
Goodwill (1)	52,426
Other deferred charges and non-current assets	5,368
Total other non-current assets	68,165
Total assets	\$ 283,147
<b>Liabilities Assumed:</b>	
Current Liabilities:	
Accounts payable	\$ 700
Current portion of long-term debt and capital lease obligations	3,773
Other current liabilities (1)	2,807
Total current liabilities	7,280
Long-term debt	37,227
Capital lease obligations	68,840
Other non-current liabilities and deferred credits (1)	14,889
Total liabilities	\$ 128,236
Total net assets acquired	\$ 154,911

(1) During the second quarter of 2015, the Company recorded a reduction to goodwill of approximately \$0.3 million due to income tax related adjustments.

The majority of AERC's operations are subject to the rate-setting authority of the RCA and are accounted for pursuant to GAAP, including the accounting guidance for regulated operations. The rate-setting and cost recovery provisions currently in place for AERC's regulated operations provide revenues derived from costs, including a return on investment, of assets and liabilities included in rate base. Due to this regulation, the fair values of AERC's assets and liabilities subject to these rate-setting provisions were assumed to approximate their carrying values. There were not any identifiable intangible assets associated with this acquisition. The excess of the purchase consideration over the estimated fair values of the assets acquired and liabilities assumed was recognized as goodwill at the acquisition date. The goodwill reflects the value paid for the expected continued growth of a rate-regulated business located in a defined service area with a constructive regulatory environment, the

attractiveness of stable, growing cash flows, as well as providing a platform for potential future growth outside of the rate-regulated electric utility in Alaska and potential additional utility investment.

The following table summarizes the supplemental pro forma information for the years ended December 31 related to the acquisition of AERC as if the acquisition had occurred on January 1, 2013 (dollars in thousands - unaudited):

	2016	2015	2014
Actual Avista Corp. revenues from continuing operations (excluding AERC)	\$ 1,395,989	\$ 1,439,807	\$ 1,450,918
Supplemental pro forma AERC revenues (1)	46,494	44,969	46,467
Total pro forma revenues	1,442,483	1,484,776	1,497,385
Actual AERC revenues included in Avista Corp. revenues (1)	46,494	44,969	21,644
Actual Avista Corp. net income from continuing operations attributable to Avista Corp. shareholders (excluding AERC)	129,505	111,772	116,665
Actual Avista Corp. net income from discontinued operations attributable to Avista Corp. shareholders	—	5,147	72,224
Adjustment to Avista Corp.'s net income for acquisition costs (net of tax) (2)	—	22	870
Supplemental pro forma AERC net income (1)	7,723	6,308	8,806
Total pro forma net income	137,228	123,249	198,565
Actual AERC net income included in Avista Corp. net income (1)	\$ 7,723	\$ 6,308	\$ 3,152

- (1) AERC was acquired on July 1, 2014; therefore, all the revenues and net income for the second half of 2014 through 2016 are actual amounts that are included in Avista Corp.'s overall results. All revenue and net income amounts prior to July 1, 2014 are supplemental pro forma amounts and are excluded from Avista Corp.'s overall results.
- (2) This adjustment is to treat all transaction costs as if they occurred on January 1, 2013 and to remove them from the periods in which they actually occurred. The transaction costs were expensed and presented in the Consolidated Statements of Income in other operating expenses within utility operating expenses. Since the start of the transaction through December 31, 2016, Avista Corp. has expensed \$3.0 million (pre-tax) in total transaction fees. In addition to the amounts expensed, through December 31, 2016, Avista Corp. has included \$0.4 million in fees associated with the issuance of common stock for the transaction as a reduction to common stock. These fees do not impact the supplemental pro forma information above.

## NOTE 5. DISCONTINUED OPERATIONS

On June 30, 2014, Avista Capital, completed the sale of its interest in Ecova to Cofely USA Inc., an unrelated party to Avista Corp. The sales price was \$335.0 million in cash, less the payment of debt and other customary closing adjustments. At the closing of the transaction on June 30, 2014, Ecova became a wholly-owned subsidiary of Cofely USA Inc. and the Company has not had and will not have any further involvement with Ecova after such date.

The purchase price of \$335.0 million, as adjusted, was divided among all the security holders of Ecova pro rata based on ownership. After consideration of all escrow amounts received, the sales transaction provided cash proceeds to Avista Corp., net of debt, payment to option and minority holders, income taxes and transaction expenses, of \$143.7 million, and resulted in a net gain of \$74.8 million. Almost all of the net gain was recognized in 2014 with some true-ups during 2015.

Prior to the completion of the sales transaction, Ecova was a reportable business segment. The following table presents amounts that were included in discontinued operations for the years ended December 31, 2015 and 2014 (dollars in thousands):

	2015	2014
Revenues	\$ —	\$ 87,534
Gain on sale of Ecova (1)	777	160,612
Transaction expenses and accelerated employee benefits (2)	71	9,062
Gain on sale of Ecova, net of transaction expenses	706	151,550
Income before income taxes	706	156,025
Income tax expense (benefit) (3)	(4,441)	83,614
Net income from discontinued operations	5,147	72,411
Net income attributable to noncontrolling interests	—	(187)
Net income from discontinued operations attributable to Avista Corp. shareholders	\$ 5,147	\$ 72,224

- (1) This represents the gross gain recorded to discontinued operations. The total gain net of taxes and transactions expenses was \$74.8 million, of which \$69.7 million was recognized during 2014.
- (2) Avista Corp.'s portion of the total transaction expenses was \$9.1 million (including amounts which were withheld from the transaction net proceeds). All transaction expenses paid on the Ecova sale (including Avista Corp.'s portion and the portion attributable to the minority interest holders of Ecova) were \$11.1 million, of which \$5.5 million was withheld from the net proceeds and the remainder was paid during 2014. The transaction expenses were for legal, accounting and other consulting fees, and the accelerated employee benefits related to employee stock options which were settled in accordance with the Ecova equity plan.
- (3) The tax benefit during 2015 primarily resulted from the reversal of a valuation allowance against net operating losses at Ecova because the net operating losses were deemed realizable after further evaluation.

## NOTE 6. DERIVATIVES AND RISK MANAGEMENT

### *Energy Commodity Derivatives*

Avista Utilities is exposed to market risks relating to changes in electricity and natural gas commodity prices and certain other fuel prices. Market risk is, in general, the risk of fluctuation in the market price of the commodity being traded and is influenced primarily by supply and demand. Market risk includes the fluctuation in the market price of associated derivative commodity instruments. Avista Utilities utilizes derivative instruments, such as forwards, futures, swaps and options in order to manage the various risks relating to these commodity price exposures. The Company has an energy resources risk policy and control procedures to manage these risks.

As part of the Company's resource procurement and management operations in the electric business, the Company engages in an ongoing process of resource optimization, which involves the economic selection from available energy resources to serve the Company's load obligations and the use of these resources to capture available economic value. The Company transacts in wholesale markets by selling and purchasing electric capacity and energy, fuel for electric generation, and derivative contracts related to capacity, energy and fuel. Such transactions are part of the process of matching resources with load obligations and hedging the related financial risks. These transactions range from terms of intra-hour up to multiple years.

As part of its resource procurement and management of its natural gas business, the Company makes continuing projections of its natural gas loads and assesses available natural gas resources including natural gas storage availability. Natural gas resource planning typically includes peak requirements, low and average monthly requirements and delivery constraints from natural gas

supply locations to the Company's distribution system. However, daily variations in natural gas demand can be significantly different than monthly demand projections. On the basis of these projections, the Company plans and executes a series of transactions to hedge a portion of its projected natural gas requirements through forward market transactions and derivative instruments. These transactions may extend as much as four natural gas operating years (November through October) into the future. Avista Corp. also leaves a significant portion of its natural gas supply requirements unhedged for purchase in short-term and spot markets.

The Company is required to plan for sufficient natural gas delivery capacity to serve its retail customers for a theoretical peak day event. The Company generally has more pipeline and storage capacity than what is needed during periods other than a peak day. The Company optimizes its natural gas resources by using market opportunities to generate economic value that helps mitigate fixed costs. Avista Utilities also optimizes its natural gas storage capacity by purchasing and storing natural gas when prices are traditionally lower, typically in the summer, and withdrawing during higher priced months, typically during the winter. However, if market conditions and prices indicate that the Company should buy or sell natural gas during other times in the year, the Company engages in optimization transactions to capture value in the marketplace. Natural gas optimization activities include, but are not limited to, wholesale market sales of surplus natural gas supplies, purchases and sales of natural gas to optimize use of pipeline and storage capacity, and participation in the transportation capacity release market.

The following table presents the underlying energy commodity derivative volumes as of December 31, 2016 that are expected to be settled in each respective year (in thousands of MWhs and mmBTUs):

Year	Purchases				Sales			
	Electric Derivatives		Gas Derivatives		Electric Derivatives		Gas Derivatives	
	Physical (1)	Financial (1)	Physical (1)	Financial (1)	Physical (1) MWh	Financial (1) MWh	Physical (1) mmBTUs	Financial (1) mmBTUs
2017	510	907	15,475	110,380	316	1,552	4,165	73,110
2018	397	—	—	52,755	286	1,244	1,360	15,113
2019	235	—	610	29,475	158	982	1,345	4,020
2020	—	—	910	2,725	—	—	1,430	—
2021	—	—	—	—	—	—	1,060	—
Thereafter	—	—	—	—	—	—	—	—

The following table presents the underlying energy commodity derivative volumes as of December 31, 2015 that were expected to be settled in each respective year (in thousands of MWhs and mmBTUs):

Year	Purchases				Sales			
	Electric Derivatives		Gas Derivatives		Electric Derivatives		Gas Derivatives	
	Physical (1)	Financial (1)	Physical (1)	Financial (1)	Physical (1) MWh	Financial (1) MWh	Physical (1) mmBTUs	Financial (1) mmBTUs
2016	407	1,954	17,252	142,693	280	2,656	3,182	112,233
2017	397	97	675	49,200	255	483	1,360	26,965
2018	397	—	—	15,118	286	—	1,360	2,738
2019	235	—	305	6,935	158	—	1,345	—
2020	—	—	455	905	—	—	1,430	—
Thereafter	—	—	—	—	—	—	1,060	—

- (1) Physical transactions represent commodity transactions in which Avista Utilities will take or make delivery of either electricity or natural gas; financial transactions represent derivative instruments with delivery of cash in the amount of benefit or cost but with no physical delivery of the commodity, such as futures, swaps, options, or forward contracts.

The electric and natural gas derivative contracts above will be included in either power supply costs or natural gas supply costs during the period they are settled and will be included in the various recovery mechanisms (ERM, PCA, and PGAs), or in the

general rate case process, and are expected to be collected through retail rates from customers. Any transactions that result in gains will be used to reduce retail rates charged to customers in the future.

### ***Foreign Currency Exchange Derivatives***

A significant portion of Avista Utilities' natural gas supply (including fuel for power generation) is obtained from Canadian sources. Most of those transactions are executed in U.S. dollars, which avoids foreign currency risk. A portion of Avista Utilities' short-term natural gas transactions and long-term Canadian transportation contracts are committed based on Canadian currency prices and settled within 60 days with U.S. dollars. Avista Utilities hedges a portion of the foreign currency risk by purchasing Canadian currency exchange derivatives when such commodity transactions are initiated. The foreign currency exchange derivatives and the unhedged foreign currency risk have not had a material effect on the Company's financial condition, results of operations or cash flows and these differences in cost related to currency fluctuations are included with natural gas supply costs for ratemaking.

The following table summarizes the foreign currency hedges that the Company has entered into as of December 31 (dollars in thousands):

	2016	2015
Number of contracts	21	24
Notional amount (in United States dollars)	\$ 2,819	\$ 1,463
Notional amount (in Canadian dollars)	3,754	2,002

### ***Interest Rate Swap Derivatives***

Avista Corp. is affected by fluctuating interest rates related to a portion of its existing debt, and future borrowing requirements. The Company hedges a portion of its interest rate risk with financial derivative instruments, which may include interest rate swap derivatives and U.S. Treasury lock agreements. These interest rate swap derivatives and U.S. Treasury lock agreements are considered economic hedges against fluctuations in future cash flows associated with anticipated debt issuances.

The following table summarizes the unsettled interest rate swap derivatives that the Company has outstanding as of the balance sheet date indicated below (dollars in thousands):

Balance Sheet Date	Number of Contracts	Notional Amount	Mandatory Cash Settlement Date
December 31, 2016	6	75,000	2017
	14	275,000	2018
	6	70,000	2019
	2	20,000	2020
	5	60,000	2022
December 31, 2015	6	115,000	2016
	3	45,000	2017
	11	245,000	2018
	2	30,000	2019
	1	20,000	2022

During the third quarter 2016, in connection with the execution of a purchase agreement for bonds that the Company issued in December 2016, the Company cash-settled seven interest rate swap derivatives (notional aggregate amount of \$125.0 million) and paid a total of \$54.0 million. The interest rate swap derivatives were settled in connection with the pricing of \$175.0 million of Avista Corp. first mortgage bonds that were issued in December 2016 (see Note 14). Upon settlement of interest rate swap derivatives, the cash payments made or received are recorded as a regulatory asset or liability and are subsequently

amortized as a component of interest expense over the life of the associated debt. The settled interest rate swap derivatives are also included as a part of the Company's cost of debt calculation for ratemaking purposes.

The fair value of outstanding interest rate swap derivatives can vary significantly from period to period depending on the total notional amount of swaps outstanding and fluctuations in market interest rates compared to the interest rates fixed by the swaps. The Company would be required to make cash payments to settle the interest rate swap derivatives if the fixed rates are higher than prevailing market rates at the date of settlement. Conversely, the Company receives cash to settle its interest rate swap derivatives when prevailing market rates at the time of settlement exceed the fixed swap rates.

### ***Summary of Outstanding Derivative Instruments***

The amounts recorded on the Consolidated Balance Sheet as of December 31, 2016 and December 31, 2015 reflect the offsetting of derivative assets and liabilities where a legal right of offset exists.

The following table presents the fair values and locations of derivative instruments recorded on the Consolidated Balance Sheet as of December 31, 2016 (in thousands):

Derivative and Balance Sheet Location	Fair Value			
	Gross Asset	Gross Liability	Collateral Netting	Net Asset (Liability) in Balance Sheet
<b>Foreign currency exchange derivatives</b>				
Other current liabilities	\$ 5	\$ (28)	\$ —	\$ (23)
<b>Interest rate swap derivatives</b>				
Other current assets	3,393	—	—	3,393
Other property and investments-net and other non-current assets	5,754	(397)	—	5,357
Other current liabilities	—	(15,756)	9,731	(6,025)
Non-current interest rate swap derivative liabilities	3,951	(57,825)	25,169	(28,705)
<b>Energy commodity derivatives</b>				
Other current assets	18,682	(16,787)	—	1,895
Current energy commodity derivative liabilities	16,335	(29,598)	6,228	(7,035)
Other non-current liabilities, regulatory liabilities and deferred credits	13,071	(29,990)	3,630	(13,289)
Total derivative instruments recorded on the balance sheet	<u>\$ 61,191</u>	<u>\$ (150,381)</u>	<u>\$ 44,758</u>	<u>\$ (44,432)</u>



The following table presents the fair values and locations of derivative instruments recorded on the Consolidated Balance Sheet as of December 31, 2015 (in thousands):

Derivative and Balance Sheet Location	Fair Value			
	Gross Asset	Gross Liability	Collateral Netting	Net Asset (Liability) in Balance Sheet
<b>Foreign currency exchange derivatives</b>				
Other current liabilities	\$ 2	\$ (19)	\$ —	\$ (17)
<b>Interest rate swap derivatives</b>				
Other property and investments-net and other non-current assets	23	—	—	23
Other current liabilities	118	(23,262)	3,880	(19,264)
Non-current interest rate swap derivative liabilities	1,407	(62,236)	30,150	(30,679)
<b>Energy commodity derivatives</b>				
Other current assets	1,236	(553)	—	683
Current energy commodity derivative liabilities	67,466	(85,409)	3,675	(14,268)
Other non-current liabilities, regulatory liabilities and deferred credits	6,613	(39,033)	10,851	(21,569)
Total derivative instruments recorded on the balance sheet	<u>\$ 76,865</u>	<u>\$ (210,512)</u>	<u>\$ 48,556</u>	<u>\$ (85,091)</u>

#### ***Exposure to Demands for Collateral***

The Company's derivative contracts often require collateral (in the form of cash or letters of credit) or other credit enhancements, or reductions or terminations of a portion of the contract through cash settlement, in the event of a downgrade in the Company's credit ratings or changes in market prices. In periods of price volatility, the level of exposure can change significantly. As a result, sudden and significant demands may be made against the Company's credit facilities and cash. The Company actively monitors the exposure to possible collateral calls and takes steps to mitigate capital requirements.

The following table presents the Company's collateral outstanding related to its derivative instruments as of as of December 31 (in thousands):

	2016	2015
<b>Energy commodity derivatives</b>		
Cash collateral posted	\$ 17,134	\$ 28,716
Letters of credit outstanding	24,400	28,200
Balance sheet offsetting (cash collateral against net derivative positions)	9,858	14,526
<b>Interest rate swap derivatives</b>		
Cash collateral posted	34,900	34,030
Letters of credit outstanding	3,600	9,600
Balance sheet offsetting (cash collateral against net derivative positions)	34,900	34,030

Certain of the Company's derivative instruments contain provisions that require the Company to maintain an "investment grade" credit rating from the major credit rating agencies. If the Company's credit ratings were to fall below "investment grade," it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing collateralization on derivative instruments in net liability positions.

The following table presents the aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a liability position and the amount of additional collateral the Company could be required to post as of December 31 (in thousands):

	2016	2015
<b>Energy commodity derivatives</b>		
Liabilities with credit-risk-related contingent features	\$ 1,124	\$ 7,090
Additional collateral to post	1,046	6,980
<b>Interest rate swap derivatives</b>		
Liabilities with credit-risk-related contingent features	73,978	85,498
Additional collateral to post	21,100	18,750

#### NOTE 7. JOINTLY OWNED ELECTRIC FACILITIES

The Company has a 15 percent ownership interest in a twin-unit coal-fired generating facility, Colstrip, located in southeastern Montana, and provides financing for its ownership interest in the project. The Company's share of related fuel costs as well as operating expenses for plant in service are included in the corresponding accounts in the Consolidated Statements of Income. The Company's share of utility plant in service for Colstrip and accumulated depreciation (inclusive of the ARO assets and accumulated amortization) were as follows as of December 31 (dollars in thousands):

	2016	2015
Utility plant in service	\$ 380,406	\$ 362,199
Accumulated depreciation	(249,359)	(243,363)

See Note 9 for further discussion of AROs.

## NOTE 8. PROPERTY, PLANT AND EQUIPMENT

The balances of the major classifications of property, plant and equipment are detailed in the following table as of December 31 (dollars in thousands):

	2016	2015
<b>Avista Utilities:</b>		
Electric production	\$ 1,346,332	\$ 1,217,179
Electric transmission	682,529	640,586
Electric distribution	1,525,175	1,468,157
Electric construction work-in-progress (CWIP) and other	296,912	358,846
Electric total	<u>3,850,948</u>	<u>3,684,768</u>
Natural gas underground storage	44,672	43,080
Natural gas distribution	954,298	878,982
Natural gas CWIP and other	57,601	62,024
Natural gas total	<u>1,056,571</u>	<u>984,086</u>
Common plant (including CWIP)	<u>527,458</u>	<u>456,796</u>
Total Avista Utilities	<u>5,434,977</u>	<u>5,125,650</u>
<b>AEL&amp;P:</b>		
Electric production	94,839	72,292
Electric transmission	20,252	18,817
Electric distribution	20,057	19,005
Electric production held under long-term capital lease	71,007	71,007
Electric CWIP and other	7,190	16,971
Electric total	<u>213,345</u>	<u>198,092</u>
Common plant	<u>8,651</u>	<u>8,133</u>
Total AEL&P	<u>221,996</u>	<u>206,225</u>
<b>Other (1)</b>	<u>30,764</u>	<u>25,709</u>
Total	<u>\$ 5,687,737</u>	<u>\$ 5,357,584</u>

- (1) Included in other property and investments-net and other non-current assets on the Consolidated Balance Sheets. Accumulated depreciation was \$11.2 million as of December 31, 2016 and \$10.6 million as of December 31, 2015 for the other businesses.

## NOTE 9. ASSET RETIREMENT OBLIGATIONS

The Company has recorded liabilities for future AROs to:

- restore coal ash containment ponds at Colstrip,
- cap a landfill at the Kettle Falls Plant,
- remove plant and restore the land at the Coyote Springs 2 site at the termination of the land lease, and
- dispose of PCBs in certain transformers.

Due to an inability to estimate a range of settlement dates, the Company cannot estimate a liability for the:

- removal and disposal of certain transmission and distribution assets, and
- abandonment and decommissioning of certain hydroelectric generation and natural gas storage facilities.

On April 17, 2015, the EPA published a final rule regarding coal combustion residuals (CCR), also termed coal combustion byproducts or coal ash, in the Federal Register, and this rule became effective on October 15, 2015. Colstrip, of which Avista Corp. is a 15 percent owner of units 3 & 4, produces this byproduct. The rule established technical requirements for CCR landfills and surface impoundments under Subtitle D of the Resource Conservation and Recovery Act, the nation's primary law for regulating solid waste. The Company, in conjunction with the other Colstrip owners, developed a multi-year compliance plan to strategically address the CCR requirements and existing state obligations while maintaining operational stability. During 2015, the operator of Colstrip provided an initial cost estimate of the expected retirement costs associated with complying with the new CCR rule. Based on the initial assessments, Avista Corp. recorded an increase to its ARO of \$12.5 million during 2015 with a corresponding increase in the cost basis of the utility plant. During 2016, due to additional information and updated estimates, the ARO increased to \$13.6 million (including accretion of \$0.7 million).

The actual asset retirement costs related to the CCR rule requirements may vary substantially from the estimates used to record the increased ARO due to uncertainty about the compliance strategies that will be used and the preliminary nature of available data used to estimate costs, such as the quantity of coal ash present at certain sites and the volume of fill that will be needed to cap and cover certain impoundments. Avista Corp. will coordinate with the plant operator and continue to gather additional data in future periods to make decisions about compliance strategies and the timing of closure activities. As additional information becomes available, Avista Corp. will update the ARO for these changes in estimates, which could be material. The Company expects to seek recovery of any increased costs related to complying with the new rule through customer rates.

The following table documents the changes in the Company's asset retirement obligation during the years ended December 31 (dollars in thousands):

	2016	2015	2014
Asset retirement obligation at beginning of year	\$ 15,997	\$ 3,028	\$ 2,859
Liabilities incurred	430	12,539	—
Liabilities settled	(1,529)	(29)	(41)
Accretion expense	617	459	210
Asset retirement obligation at end of year	<u>\$ 15,515</u>	<u>\$ 15,997</u>	<u>\$ 3,028</u>

#### **NOTE 10. PENSION PLANS AND OTHER POSTRETIREMENT BENEFIT PLANS**

The pension and other postretirement benefit plans described below only relate to Avista Utilities. AEL&P (not discussed below) participates in a defined contribution multiemployer plan for its union workers and a defined contribution money purchase pension plan for its nonunion workers. METALfx (not discussed below) has a defined contribution 401(k) savings plan. None of the subsidiary retirement plans, individually or in the aggregate, are significant to Avista Corp.

##### ***Avista Utilities***

The Company has a defined benefit pension plan covering the majority of all regular full-time employees at Avista Utilities that were hired prior to January 1, 2014. Individual benefits under this plan are based upon the employee's years of service, date of hire and average compensation as specified in the plan. Non-union employees hired on or after January 1, 2014 participate in a defined contribution 401(k) plan in lieu of a defined benefit pension plan. The Company's funding policy is to contribute at least the minimum amounts that are required to be funded under the Employee Retirement Income Security Act, but not more than the maximum amounts that are currently deductible for income tax purposes. The Company contributed \$12.0 million in cash to the pension plan in 2016, \$12.0 million in 2015 and \$32.0 million in 2014. The Company expects to contribute \$22.0 million in cash to the pension plan in 2017.

The Company also has a SERP that provides additional pension benefits to executive officers and certain key employees of the Company. The SERP is intended to provide benefits to individuals whose benefits under the defined benefit pension plan are

reduced due to the application of Section 415 of the Internal Revenue Code of 1986 and the deferral of salary under deferred compensation plans. The liability and expense for this plan are included as pension benefits in the tables included in this Note.

The Company expects that benefit payments under the pension plan and the SERP will total (dollars in thousands):

	2017	2018	2019	2020	2021	Total 2022-2026
Expected benefit payments	\$ 30,971	\$ 32,014	\$ 33,047	\$ 34,545	\$ 35,892	\$ 196,322

The expected long-term rate of return on plan assets is based on past performance and economic forecasts for the types of investments held by the plan. In selecting a discount rate, the Company considers yield rates for highly rated corporate bond portfolios with maturities similar to that of the expected term of pension benefits.

The Company provides certain health care and life insurance benefits for eligible retired employees that were hired prior to January 1, 2014. The Company accrues the estimated cost of postretirement benefit obligations during the years that employees provide services. The liability and expense of this plan are included as other postretirement benefits. Non-union employees hired on or after January 1, 2014, will have access to the retiree medical plan upon retirement; however, Avista Corp. will no longer provide a contribution toward their medical premium.

The Company has a Health Reimbursement Arrangement (HRA) to provide employees with tax-advantaged funds to pay for allowable medical expenses upon retirement. The amount earned by the employee is fixed on the retirement date based on the employee's years of service and the ending salary. The liability and expense of the HRA are included as other postretirement benefits.

The Company provides death benefits to beneficiaries of executive officers who die during their term of office or after retirement. Under the plan, an executive officer's designated beneficiary will receive a payment equal to twice the executive officer's annual base salary at the time of death (or if death occurs after retirement, a payment equal to twice the executive officer's total annual pension benefit). The liability and expense for this plan are included as other postretirement benefits.

The Company expects that benefit payments under other postretirement benefit plans will total (dollars in thousands):

	2017	2018	2019	2020	2021	Total 2022-2026
Expected benefit payments	\$ 6,991	\$ 7,302	\$ 7,580	\$ 6,479	\$ 6,675	\$ 34,704

The Company expects to contribute \$7.0 million to other postretirement benefit plans in 2017, representing expected benefit payments to be paid during the year excluding the Medicare Part D subsidy. The Company uses a December 31 measurement date for its pension and other postretirement benefit plans.

The following table sets forth the pension and other postretirement benefit plan disclosures as of December 31, 2016 and 2015 and the components of net periodic benefit costs for the years ended December 31, 2016, 2015 and 2014 (dollars in thousands):

	Pension Benefits		Other Post-	
	2016	2015	2016	2015
<b>Change in benefit obligation:</b>				
Benefit obligation as of beginning of year	\$ 613,503	\$ 634,674	\$ 138,795	\$ 127,989
Service cost	18,302	19,791	3,205	2,925
Interest cost	27,544	26,117	6,110	5,158
Actuarial (gain)/loss	39,997	(35,790)	(3,648)	12,668
Plan change	—	(228)	—	(1,000)
Cumulative adjustment to reclassify liability	—	—	(1,042)	(1,521)
Benefits paid	(32,874)	(31,061)	(6,967)	(7,424)

	Pension Benefits		Other Post-	
	2016	2015	2016	2015
Benefit obligation as of end of year	\$ 666,472	\$ 613,503	\$ 136,453	\$ 138,795
<b>Change in plan assets:</b>				
Fair value of plan assets as of beginning of year	\$ 517,234	\$ 539,311	\$ 30,868	\$ 31,312
Actual return on plan assets	43,212	(4,305)	2,497	(444)
Employer contributions	12,000	12,000	—	—
Benefits paid	(31,532)	(29,772)	—	—
Fair value of plan assets as of end of year	\$ 540,914	\$ 517,234	\$ 33,365	\$ 30,868
Funded status	\$ (125,558)	\$ (96,269)	\$ (103,088)	\$ (107,927)
Unrecognized net actuarial loss	178,783	162,961	81,979	92,433
Unrecognized prior service cost	23	25	(8,981)	(10,180)
Prepaid (accrued) benefit cost	53,248	66,717	(30,090)	(25,674)
Additional liability	(178,806)	(162,986)	(72,998)	(82,253)
Accrued benefit liability	\$ (125,558)	\$ (96,269)	\$ (103,088)	\$ (107,927)
Accumulated pension benefit obligation	\$ 583,498	\$ 542,209	—	—
Accumulated postretirement benefit obligation:				
For retirees			\$ 60,670	\$ 65,652
For fully eligible employees			\$ 34,429	\$ 34,498
For other participants			\$ 41,354	\$ 38,645
<b>Included in accumulated other comprehensive loss (income) (net of tax):</b>				
Unrecognized prior service cost	\$ 15	\$ 16	\$ (5,854)	\$ (6,617)
Unrecognized net actuarial loss	116,209	105,925	53,303	60,081
Total	116,224	105,941	47,449	53,464
Less regulatory asset	(108,903)	(99,414)	(47,202)	(53,341)
Accumulated other comprehensive loss for unfunded benefit obligation for pensions and other postretirement benefit plans	\$ 7,321	\$ 6,527	\$ 247	\$ 123

	Pension Benefits		Other Post-	
	2016	2015	2016	2015
<b>Weighted-average assumptions as of December 31:</b>				
Discount rate for benefit obligation	4.26%	4.57%	4.23%	4.57%
Discount rate for annual expense	4.57%	4.21%	4.57%	4.16%
Expected long-term return on plan assets	5.40%	5.30%	6.03%	6.36%
Rate of compensation increase	4.78%	4.87%		
Medical cost trend pre-age 65 – initial			7.00%	7.00%
Medical cost trend pre-age 65 – ultimate			5.00%	5.00%
Ultimate medical cost trend year pre-age 65			2023	2022
Medical cost trend post-age 65 – initial			7.00%	7.00%
Medical cost trend post-age 65 – ultimate			5.00%	5.00%
Ultimate medical cost trend year post-age 65			2024	2023

	Pension Benefits			Other Post-retirement Benefits		
	2016	2015	2014	2016	2015	2014
<b>Components of net periodic benefit cost:</b>						
Service cost	\$ 18,302	\$ 19,791	\$ 15,757	\$ 3,205	\$ 2,925	\$ 1,844
Interest cost	27,544	26,117	26,224	6,110	5,158	5,226
Expected return on plan assets	(27,547)	(28,299)	(32,131)	(1,861)	(1,991)	(1,903)
Amortization of prior service cost	2	2	22	(1,208)	(1,199)	(1,116)
Net loss recognition	8,511	9,451	4,731	5,728	5,095	4,289
Net periodic benefit cost	<u>\$ 26,812</u>	<u>\$ 27,062</u>	<u>\$ 14,603</u>	<u>\$ 11,974</u>	<u>\$ 9,988</u>	<u>\$ 8,340</u>

### *Plan Assets*

The Finance Committee of the Company's Board of Directors approves investment policies, objectives and strategies that seek an appropriate return for the pension plan and other postretirement benefit plans and reviews and approves changes to the investment and funding policies.

The Company has contracted with investment consultants who are responsible for managing/monitoring the individual investment managers. The investment managers' performance and related individual fund performance is periodically reviewed by an internal benefits committee and by the Finance Committee to monitor compliance with investment policy objectives and strategies.

Pension plan assets are invested in mutual funds, trusts and partnerships that hold marketable debt and equity securities, real estate, absolute return and commodity funds. In seeking to obtain the desired return to fund the pension plan, the investment consultant recommends allocation percentages by asset classes. These recommendations are reviewed by the internal benefits committee, which then recommends their adoption by the Finance Committee. The Finance Committee has established target investment allocation percentages by asset classes and also investment ranges for each asset class. The target investment allocation percentages are typically the midpoint of the established range. The target investment allocation percentages by asset classes are indicated in the table below:

	2016	2015
Equity securities	37%	27%
Debt securities	45%	58%
Real estate	8%	6%
Absolute return	10%	9%

The 2016 target investment allocation percentages were revised in the fourth quarter of 2016 and the pension plan assets were subsequently reinvested during the fourth quarter of 2016 and first quarter of 2017 to move toward the new target investment allocation percentages. The target asset allocation percentages were modified to better align the asset allocations with the funded status of the pension plan. Future contributions to the plan will also be increased to improve the funded status of the plan.

The fair value of pension plan assets invested in debt and equity securities was based primarily on fair value (market prices). The fair value of investment securities traded on a national securities exchange is determined based on the reported last sales price; securities traded in the over-the-counter market are valued at the last reported bid price. Investment securities for which market prices are not readily available or for which market prices do not represent the value at the time of pricing, the investment manager estimates fair value based upon other inputs (including valuations of securities that are comparable in coupon, rating, maturity and industry). Investments in common/collective trust funds are presented at estimated fair value, which is determined based on the unit value of the fund. Unit value is determined by an independent trustee, which sponsors the

fund, by dividing the fund's net assets by its units outstanding at the valuation date. The Company's investments in common/collective trusts have redemption limitations that permit quarterly redemptions following notice requirements of 45 to 60 days. The fair values of the closely held investments and partnership interests are based upon the allocated share of the fair value of the underlying assets as well as the allocated share of the undistributed profits and losses, including realized and unrealized gains and losses. Most of the Company's investments in closely held investments and partnership interests have redemption limitations that range from bi-monthly to semi-annually following redemption notice requirements of 60 to 90 days. One investment in a partnership has a lock-up for redemption currently expiring in 2022 and is subject to extension.

The fair value of pension plan assets invested in real estate was determined by the investment manager based on three basic approaches:

- properties are externally appraised on an annual basis by independent appraisers, additional appraisals may be performed as warranted by specific asset or market conditions,
- property valuations are reviewed quarterly and adjusted as necessary, and
- loans are reflected at fair value.

The fair value of pension plan assets was determined as of December 31, 2016 and 2015.

Pension plan other postretirement plan assets whose fair values are measured using net asset value (NAV) are excluded from the fair value hierarchy and are included as reconciling items in the tables below.

The following table discloses by level within the fair value hierarchy (see Note 16 for a description of the fair value hierarchy) of the pension plan's assets measured and reported as of December 31, 2016 at fair value (dollars in thousands):

	Level 1	Level 2	Level 3	Total
Cash equivalents	\$ —	\$ 10,179	\$ —	\$ 10,179
Fixed income securities:				
U.S. government issues	—	30,919	—	30,919
Corporate issues	—	193,563	—	193,563
International issues	—	34,145	—	34,145
Municipal issues	—	18,888	—	18,888
Mutual funds:				
U.S. equity securities	120,856	—	—	120,856
International equity securities	30,025	—	—	30,025
Absolute return (1)	6,622	—	—	6,622
<b>Plan assets measured at NAV (not subject to hierarchy disclosure)</b>				
Common/collective trusts:				
Real estate	—	—	—	19,779
International equity securities	—	—	—	29,140
Partnership/closely held investments:				
Absolute return (1)	—	—	—	39,077
Private equity funds (2)	—	—	—	72
Real estate	—	—	—	7,649
Total	<u>\$ 157,503</u>	<u>\$ 287,694</u>	<u>\$ —</u>	<u>\$ 540,914</u>

The following table discloses by level within the fair value hierarchy (see Note 16 for a description of the fair value hierarchy) of the pension plan's assets measured and reported as of December 31, 2015 at fair value (dollars in thousands):



	Level 1	Level 2	Level 3	Total
Cash equivalents	\$ 86	\$ 10,641	\$ —	\$ 10,727
Fixed income securities:				
U.S. government issues	—	47,845	—	47,845
Corporate issues	—	187,308	—	187,308
International issues	—	34,458	—	34,458
Municipal issues	—	22,416	—	22,416
Mutual funds:				
U.S. equity securities	87,678	—	—	87,678
International equity securities	40,343	—	—	40,343
Absolute return (1)	13,996	—	—	13,996
<b>Plan assets measured at NAV (not subject to hierarchy disclosure)</b>				
Common/collective trusts:				
Real estate	—	—	—	24,147
Partnership/closely held investments:				
Absolute return (1)	—	—	—	38,302
Private equity funds (2)	—	—	—	73
Real estate	—	—	—	9,941
Total	<u>\$ 142,103</u>	<u>\$ 302,668</u>	<u>\$ —</u>	<u>\$ 517,234</u>

- (1) This category invests in multiple strategies to diversify risk and reduce volatility. The strategies include: (a) event driven, relative value, convertible, and fixed income arbitrage, (b) distressed investments, (c) long/short equity and fixed income, and (d) market neutral strategies.
- (2) This category includes private equity funds that invest primarily in U.S. companies.

The fair value of other postretirement plan assets invested in debt and equity securities was based primarily on market prices. The fair value of investment securities traded on a national securities exchange is determined based on the last reported sales price; securities traded in the over-the-counter market are valued at the last reported bid price. Investment securities for which market prices are not readily available are fair-valued by the investment manager based upon other inputs (including valuations of securities that are comparable in coupon, rating, maturity and industry). The target asset allocation was 60 percent equity securities and 40 percent debt securities in both 2016 and 2015.

The fair value of other postretirement plan assets was determined as of December 31, 2016 and 2015.

The following table discloses by level within the fair value hierarchy (see Note 16 for a description of the fair value hierarchy) of other postretirement plan assets measured and reported as of December 31, 2016 at fair value (dollars in thousands):

	Level 1	Level 2	Level 3	Total
Cash equivalents	\$ —	\$ 6	\$ —	\$ 6
Mutual funds:				
Balanced index fund (1)	33,359	—	—	33,359
Total	<u>\$ 33,359</u>	<u>\$ 6</u>	<u>\$ —</u>	<u>\$ 33,365</u>

- (1) The balanced index fund is a single mutual fund that includes a percentage of U.S. equity securities, fixed income securities and International securities.

The following table discloses by level within the fair value hierarchy (see Note 16 for a description of the fair value hierarchy) of other postretirement plan assets measured and reported as of December 31, 2015 at fair value (dollars in thousands):

	Level 1	Level 2	Level 3	Total
Cash equivalents	\$ —	\$ 9	\$ —	\$ 9
Mutual funds:				
Fixed income securities	12,000	—	—	12,000
U.S. equity securities	13,224	—	—	13,224
International equity securities	5,635	—	—	5,635
Total	<u>\$ 30,859</u>	<u>\$ 9</u>	<u>\$ —</u>	<u>\$ 30,868</u>

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point increase in the assumed health care cost trend rate for each year would increase the accumulated postretirement benefit obligation as of December 31, 2016 by \$8.6 million and the service and interest cost by \$1.0 million. A one-percentage-point decrease in the assumed health care cost trend rate for each year would decrease the accumulated postretirement benefit obligation as of December 31, 2016 by \$6.7 million and the service and interest cost by \$0.7 million.

#### ***401(k) Plans and Executive Deferral Plan***

Avista Utilities and METALfx have salary deferral 401(k) plans that are defined contribution plans and cover substantially all employees. Employees can make contributions to their respective accounts in the plans on a pre-tax basis up to the maximum amount permitted by law. The respective company matches a portion of the salary deferred by each participant according to the schedule in the respective plan.

Employer matching contributions were as follows for the years ended December 31 (dollars in thousands):

	2016	2015	2014
Employer 401(k) matching contributions	\$ 8,710	\$ 8,011	\$ 6,862

The Company has an Executive Deferral Plan. This plan allows executive officers and other key employees the opportunity to defer until the earlier of their retirement, termination, disability or death, up to 75 percent of their base salary and/or up to 100 percent of their incentive payments. Deferred compensation funds are held by the Company in a Rabbi Trust.

There were deferred compensation assets included in other property and investments-net and corresponding deferred compensation liabilities included in other non-current liabilities and deferred credits on the Consolidated Balance Sheets of the following amounts as of December 31 (dollars in thousands):

	2016	2015
Deferred compensation assets and liabilities	\$ 7,679	\$ 8,093

#### **NOTE 11. ACCOUNTING FOR INCOME TAXES**

Income tax expense consisted of the following for the years ended December 31 (dollars in thousands):

	2016	2015	2014
Current income tax expense (benefit)	\$ (46,457)	\$ 12,212	\$ (67,059)
Deferred income tax expense	124,543	55,237	139,299
Total income tax expense	<u>\$ 78,086</u>	<u>\$ 67,449</u>	<u>\$ 72,240</u>

State income taxes do not represent a significant portion of total income tax expense on the Consolidated Statements of Income for any periods presented.

A reconciliation of federal income taxes derived from statutory federal tax rates (35 percent in 2016, 2015 and 2014) applied to income before income taxes as set forth in the accompanying Consolidated Statements of Income is as follows for the years ended December 31 (dollars in thousands):

	2016		2015		2014	
Federal income taxes at statutory rates	\$	75,391	35.0%	\$	64,967	35.0%
Increase (decrease) in tax resulting from:						
Tax effect of regulatory treatment of utility plant differences		3,297	1.5		4,358	2.3
State income tax expense		1,316	0.6		1,012	0.5
Settlement of prior year tax returns and adjustment of tax reserves		13	—		(992)	(0.5)
Manufacturing deduction		—	—		(1,198)	(0.6)
Settlement of equity awards		(1,597)	(0.7)		—	—
Other		(334)	(0.1)		(698)	(0.4)
Total income tax expense	\$	78,086	36.3%	\$	67,449	36.3%
	\$	72,240	37.6%			

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes and tax credit carryforwards. The total net deferred income tax liability consisted of the following as of December 31 (dollars in thousands):

	2016	2015
<b>Deferred income tax assets:</b>		
Unfunded benefit obligation	\$ 80,230	\$ 75,716
Derivatives	31,872	47,009
Regulatory deferred tax credits	15,192	—
Tax credits	27,931	15,011
Power and natural gas deferrals	19,415	12,866
Deferred compensation	11,141	10,354
Other	29,512	29,471
Total gross deferred income tax assets	215,293	190,427
Valuation allowances for deferred tax assets	(7,946)	(2,862)
Total deferred income tax assets after valuation allowances	207,347	187,565
<b>Deferred income tax liabilities:</b>		
Differences between book and tax basis of utility plant	812,916	723,661
Regulatory asset on utility, property plant and equipment	37,301	36,917
Regulatory asset for pensions and other postretirement benefits	84,040	82,253
Utility energy commodity derivatives	31,871	47,010
Long-term debt and borrowing costs	31,955	14,027
Settlement with Coeur d'Alene Tribe	11,711	12,084
Other regulatory assets	30,183	11,691
Other	8,298	7,399
Total deferred income tax liabilities	1,048,275	935,042
Net long-term deferred income tax liability	\$ 840,928	\$ 747,477

The realization of deferred income tax assets is dependent upon the ability to generate taxable income in future periods. The Company evaluated available evidence supporting the realization of its deferred income tax assets and determined it is more likely than not that deferred income tax assets will be realized.

As of December 31, 2016, the Company had \$17.1 million of state tax credit carryforwards of which it is expected \$7.9 million may expire unused; the Company has reflected the net amount of \$9.2 million as an asset at December 31, 2016. State tax credits expire from 2019 to 2028.

The Company and its eligible subsidiaries file consolidated federal income tax returns. The Company also files state income tax returns in certain jurisdictions, including Idaho, Oregon and Montana. Subsidiaries are charged or credited with the tax effects of their operations on a stand-alone basis. The Internal Revenue Service (IRS) has completed its examination of all tax years through 2011 and all issues were resolved related to these years. The statute of limitations for the IRS to review the 2012 tax year has expired, leaving the 2013 through 2015 tax years still open for review. The Company believes that any open tax years for federal or state income taxes will not result in adjustments that would be significant to the consolidated financial statements.

The Company had net regulatory assets related to the probable recovery of certain deferred income tax liabilities from customers through future rates as of December 31 (dollars in thousands):

	2016	2015
Regulatory assets for deferred income taxes	\$ 109,853	\$ 101,240
Regulatory liabilities for deferred income taxes	28,966	17,609

## NOTE 12. ENERGY PURCHASE CONTRACTS

The below discussion only relates to Avista Utilities. The sole energy purchase contract at AEL&P is a PPA for the Snettisham hydroelectric project and it is accounted for as a capital lease. AEL&P does not have any other significant operating agreements or contractual obligations. See Note 14 for further discussion of the Snettisham PPA.

Avista Utilities has contracts for the purchase of fuel for thermal generation, natural gas for resale and various agreements for the purchase or exchange of electric energy with other entities. The remaining term of the contracts range from one month to twenty-five years.

Total expenses for power purchased, natural gas purchased, fuel for generation and other fuel costs, which are included in utility resource costs in the Consolidated Statements of Income, were as follows for the years ended December 31 (dollars in thousands):

	2016	2015	2014
Utility power resources	\$ 402,575	\$ 511,937	\$ 556,915

The following table details Avista Utilities' future contractual commitments for power resources (including transmission contracts) and natural gas resources (including transportation contracts) (dollars in thousands):

	2017	2018	2019	2020	2021	Thereafter	Total
Power resources	\$ 202,494	\$ 187,080	\$ 174,285	\$ 109,878	\$ 96,485	\$ 775,548	\$ 1,545,770
Natural gas resources	95,549	65,230	53,860	41,340	29,306	349,468	634,753
Total	<u>\$ 298,043</u>	<u>\$ 252,310</u>	<u>\$ 228,145</u>	<u>\$ 151,218</u>	<u>\$ 125,791</u>	<u>\$ 1,125,016</u>	<u>\$ 2,180,523</u>

These energy purchase contracts were entered into as part of Avista Utilities' obligation to serve its retail electric and natural gas customers' energy requirements, including contracts entered into for resource optimization. As a result, these costs are recovered either through base retail rates or adjustments to retail rates as part of the power and natural gas cost deferral and recovery mechanisms.

The above future contractual commitments for power resources include fixed contractual amounts related to the Company's contracts with certain PUDs to purchase portions of the output of certain generating facilities. Although Avista Utilities has no investment in the PUD generating facilities, the fixed contracts obligate Avista Utilities to pay certain minimum amounts whether or not the facilities are operating. The cost of power obtained under the contracts, including payments made when a facility is not operating, is included in utility resource costs in the Consolidated Statements of Income. The contractual amounts included above consist of Avista Utilities' share of existing debt service cost and its proportionate share of the variable operating expenses of these projects. The minimum amounts payable under these contracts are based in part on the

proportionate share of the debt service requirements of the PUD's revenue bonds for which the Company is indirectly responsible. The Company's total future debt service obligation associated with the revenue bonds outstanding at December 31, 2016 (principal and interest) was \$65.2 million.

In addition, Avista Utilities has operating agreements, settlements and other contractual obligations related to its generating facilities and transmission and distribution services. The expenses associated with these agreements are reflected as other operating expenses in the Consolidated Statements of Income. The following table details future contractual commitments under these agreements (dollars in thousands):

	2017	2018	2019	2020	2021	Thereafter	Total
Contractual obligations	\$ 33,922	\$ 28,783	\$ 32,549	\$ 32,160	\$ 27,019	\$ 189,000	\$ 343,433

### NOTE 13. COMMITTED LINES OF CREDIT

#### *Avista Corp.*

Avista Corp. has a committed line of credit with various financial institutions in the total amount of \$400.0 million. A two-year option was exercised by the Company in 2016 to extend the maturity of the facility agreement to April 2021.

The committed line of credit agreement contains customary covenants and default provisions. The credit agreement has a covenant which does not permit the ratio of "consolidated total debt" to "consolidated total capitalization" of Avista Corp. to be greater than 65 percent at any time. As of December 31, 2016, the Company was in compliance with this covenant.

Balances outstanding and interest rates of borrowings (excluding letters of credit) under the Company's revolving committed lines of credit were as follows as of December 31 (dollars in thousands):

	2016	2015
Balance outstanding at end of period	\$ 120,000	\$ 105,000
Letters of credit outstanding at end of period	\$ 34,353	\$ 44,595
Average interest rate at end of period	1.50%	1.18%

As of December 31, 2016 and 2015, the borrowings outstanding under Avista Corp.'s committed line of credit were classified as short-term borrowings on the Consolidated Balance Sheet.

#### *AEL&P*

AEL&P has a committed line of credit in the amount of \$25.0 million that expires in November 2019. As of December 31, 2016 and 2015, there were no borrowings or letters of credit outstanding under this committed line of credit.

The committed line of credit agreement contains customary covenants and default provisions. The credit agreement has a covenant which does not permit the ratio of "consolidated total debt at AEL&P" to "consolidated total capitalization at AEL&P," including the impact of the Snettisham bonds to be greater than 67.5 percent at any time. As of December 31, 2016, AEL&P was in compliance with this covenant.

## NOTE 14. LONG-TERM DEBT AND CAPITAL LEASES

The following details long-term debt outstanding as of December 31 (dollars in thousands):

Maturity	Description	Interest	2016	2015
<b>Avista Corp. Secured Long-Term Debt</b>				
2016	First Mortgage Bonds (1)	0.84%	\$ —	\$ 90,000
2018	First Mortgage Bonds	5.95%	250,000	250,000
2018	Secured Medium-Term Notes	7.39%-7.45%	22,500	22,500
2019	First Mortgage Bonds	5.45%	90,000	90,000
2020	First Mortgage Bonds	3.89%	52,000	52,000
2022	First Mortgage Bonds	5.13%	250,000	250,000
2023	Secured Medium-Term Notes	7.18%-7.54%	13,500	13,500
2028	Secured Medium-Term Notes	6.37%	25,000	25,000
2032	Secured Pollution Control Bonds (2)	(2)	66,700	66,700
2034	Secured Pollution Control Bonds (2)	(2)	17,000	17,000
2035	First Mortgage Bonds	6.25%	150,000	150,000
2037	First Mortgage Bonds	5.70%	150,000	150,000
2040	First Mortgage Bonds	5.55%	35,000	35,000
2041	First Mortgage Bonds	4.45%	85,000	85,000
2044	First Mortgage Bonds	4.11%	60,000	60,000
2045	First Mortgage Bonds	4.37%	100,000	100,000
2047	First Mortgage Bonds	4.23%	80,000	80,000
2051	First Mortgage Bonds (3)	3.54%	175,000	—
Total Avista Corp. secured long-term debt			1,621,700	1,536,700
<b>Alaska Electric Light and Power Company Secured Long-Term Debt</b>				
2044	First Mortgage Bonds	4.54%	75,000	75,000
Total secured long-term debt			1,696,700	1,611,700
<b>Alaska Energy and Resources Company Unsecured Long-Term Debt</b>				
2019	Unsecured Term Loan	3.85%	15,000	15,000
Total secured and unsecured long-term debt			1,711,700	1,626,700
<b>Other Long-Term Debt Components</b>				
Capital lease obligations			65,435	68,601
Settled interest rate swap derivatives (4)			—	(26,515)
Unamortized debt discount			(792)	(956)
Unamortized long-term debt issuance costs			(10,639)	(10,852)
Total			1,765,704	1,656,978
Secured Pollution Control Bonds held by Avista Corporation (2)			(83,700)	(83,700)
Current portion of long-term debt and capital leases			(3,287)	(93,167)
Total long-term debt and capital leases			<u>\$ 1,678,717</u>	<u>\$ 1,480,111</u>

- (1) In August 2016, Avista Corp. entered into a term loan agreement with a commercial bank in the amount of \$70.0 million with a maturity date of December 30, 2016. Loans under this agreement were unsecured and had a variable annual interest rate. The Company borrowed the entire \$70.0 million available under this agreement, which was used to repay a portion of the \$90.0 million in first mortgage bonds that matured in August 2016. This term loan was

subsequently repaid in full in December using the proceeds from the first mortgage bonds issued in December 2016 (discussed below).

- (2) In December 2010, \$66.7 million and \$17.0 million of the City of Forsyth, Montana Pollution Control Revenue Refunding Bonds (Avista Corporation Colstrip Project) due in 2032 and 2034, respectively, which had been held by Avista Corp. since 2008 and 2009, respectively, were refunded by new bond issues (Series 2010A and Series 2010B). The new bonds were not offered to the public and were purchased by Avista Corp. due to market conditions. The Company expects that at a later date, subject to market conditions, these bonds may be remarketed to unaffiliated investors. So long as Avista Corp. is the holder of these bonds, the bonds will not be reflected as an asset or a liability on Avista Corp.'s Consolidated Balance Sheets.
- (3) In December 2016, Avista Corp. issued and sold \$175.0 million of 3.54 percent first mortgage bonds due in 2051 pursuant to a bond purchase agreement with institutional investors in the private placement market. The total net proceeds from the sale of the bonds were used to repay the \$70.0 million term loan discussed above and to repay a portion of the borrowings outstanding under the Company's \$400.0 million committed line of credit. In connection with the execution of the bond purchase agreement, the Company cash-settled seven interest rate swap derivatives (notional aggregate amount of \$125.0 million) and paid a total of \$54.0 million.
- (4) Prior to December 31, 2016, settled interest rate swap derivatives were included as part of long-term debt on the Consolidated Balance Sheets because they were considered similar to a debt discount or premium. During 2016, the Company reevaluated the presentation of settled interest rate swap derivatives and determined that since they are regulatory assets and liabilities that are being recovered through the ratemaking process, the more appropriate classification is as regulatory assets and liabilities rather than as a component of long-term debt. As such, as of December 31, 2016, the Company has included unamortized settled interest rate swap derivatives of \$91.9 million in regulatory assets and \$12.4 million in regulatory liabilities. The Company did not reclassify any amounts as of December 31, 2015 and prior because the amounts are not material to the financial statements. The increase in settled interest rate swap derivatives during 2016 is due to the cash settlement of interest rate swap derivatives discussed in detail above. There is no impact to the Consolidated Statements of Income and the Consolidated Statements of Cash Flows for any periods as a result of the balance sheet reclassification.

The following table details future long-term debt maturities including long-term debt to affiliated trusts (see Note 15) (dollars in thousands):

	2017	2018	2019	2020	2021	Thereafter	Total
Debt maturities	\$ —	\$ 272,500	\$ 105,000	\$ 52,000	\$ —	\$ 1,250,047	\$ 1,679,547

Substantially all of Avista Utilities' and AEL&P's owned properties are subject to the lien of their respective mortgage indentures. Under the Mortgages and Deeds of Trust (Mortgages) securing their first mortgage bonds (including secured medium-term notes), Avista Utilities and AEL&P may each issue additional first mortgage bonds under their specific mortgage in an aggregate principal amount equal to the sum of:

- 66-2/3 percent of the cost or fair value (whichever is lower) of property additions of that entity which have not previously been made the basis of any application under that entity's Mortgage, or
- an equal principal amount of retired first mortgage bonds of that entity which have not previously been made the basis of any application under that entity's Mortgage, or
- deposit of cash.

However, Avista Utilities and AEL&P may not individually issue any additional first mortgage bonds (with certain exceptions in the case of bonds issued on the basis of retired bonds) unless the particular entity issuing the bonds has "net earnings" (as defined in that entity's Mortgage) for any period of 12 consecutive calendar months out of the preceding 18 calendar months that were at least twice the annual interest requirements on all mortgage securities at the time outstanding, including the first mortgage bonds to be issued, and on all indebtedness of prior rank. As of December 31, 2016, property additions and retired

bonds would have allowed, and the net earnings test would not have prohibited, the issuance of \$1.2 billion in aggregate principal amount of additional first mortgage bonds at Avista Utilities and \$20.8 million at AEL&P.

### ***Snettisham Capital Lease Obligation***

Included in long-term capital leases above is a power purchase agreement between AEL&P and AIDEA, an agency of the State of Alaska, under which AEL&P has a take-or-pay obligation, expiring in December 2038, to purchase all the output of the 78 MW Snettisham Hydroelectric Project. For accounting purposes, this power purchase agreement is treated as a capital lease.

The balances related to the Snettisham capital lease obligation as of December 31 were as follows (dollars in thousands):

	2016	2015
Capital lease obligation (1)	\$ 62,160	\$ 64,455
Capital lease asset (2)	71,007	71,007
Accumulated amortization of capital lease asset (2)	9,104	5,462

(1) The capital lease obligation amount is equal to the amount of AIDEA's revenue bonds outstanding.

(2) These amounts are included in utility plant in service on the Consolidated Balance Sheets.

Interest on the capital lease obligation and amortization of the capital lease asset are included in utility resource costs in the Consolidated Statements of Income and totaled the following amounts for the years ended December 31 (dollars in thousands):

	2016	2015
Interest on capital lease obligation	\$ 3,157	\$ 3,587
Amortization of capital lease asset	3,642	3,641

AIDEA issued \$100.0 million of revenue bonds in 1998 to finance its acquisition of the project and the payments by AEL&P were designed to be sufficient to enable the AIDEA to pay the principal of and interest on its revenue bonds, which bore interest at rates ranging from 4.9 percent to 6.0 percent and were set to mature in January 2034.

In August 2015, AIDEA issued \$65.7 million of new revenue bonds for the purpose of refunding all of the remaining outstanding revenue bonds for the Snettisham Hydroelectric Project. The new revenue bonds have interest rates ranging from 4.0 percent to 5.0 percent and mature in January 2034. The capital lease obligation on Avista Corp.'s Consolidated Balance Sheet at any given time is equal to the amount of revenue bonds outstanding at that time. AEL&P is scheduled to make its last capital lease payment to AIDEA in December 2033. The payments by AEL&P under the PPA between AEL&P and AIDEA are unconditional, notwithstanding any suspension, reduction or curtailment of the operation of the project. The bonds are payable solely out of AIDEA's receipts under the power purchase agreement. AEL&P is also obligated to operate, maintain and insure the project. The PPA did not change as a result of the refunding, other than lower capital lease payments, and the lower capital lease payments that resulted from the refunding will be passed through to AEL&P's customers. AEL&P's payments for power under the agreement are between \$10.0 million and \$10.5 million per year, including the capital lease principal and interest of approximately \$5.5 million per year.

Snettisham Electric Company, a non-operating subsidiary of AERC, has the option to purchase the Snettisham project with certain conditions at any time for the principal amount of the bonds outstanding at that time.

While the power purchase agreement is treated as a capital lease for accounting purposes, for ratemaking purposes this agreement is treated as an operating lease with a constant level of annual rental expense (straight line expense). Because of this regulatory treatment, any difference between the operating lease expense for ratemaking purposes and the expenses recognized under capital lease treatment (interest and depreciation of the capital lease asset) is recorded as a regulatory asset and amortized during the later years of the lease when the capital lease expense is less than the operating lease expense included in base rates.



The Company evaluated this agreement to determine if it has a variable interest which must be consolidated. Based on this evaluation, AIDEA will not be consolidated under ASC 810 "Consolidation" because AIDEA is a government agency and ASC 810 has a specific scope exception which does not allow for the consolidation of government organizations.

The following table details future capital lease obligations, including interest, under the Snettisham PPA (dollars in thousands):

	2017	2018	2019	2020	2021	Thereafter	Total
Principal	\$ 2,415	\$ 2,535	\$ 2,660	\$ 2,800	\$ 2,935	\$ 48,815	\$ 62,160
Interest	3,042	2,921	2,795	2,662	2,522	16,674	30,616
Total	<u>\$ 5,457</u>	<u>\$ 5,456</u>	<u>\$ 5,455</u>	<u>\$ 5,462</u>	<u>\$ 5,457</u>	<u>\$ 65,489</u>	<u>\$ 92,776</u>

## NOTE 15. LONG-TERM DEBT TO AFFILIATED TRUSTS

In 1997, the Company issued Floating Rate Junior Subordinated Deferrable Interest Debentures, Series B, with a principal amount of \$51.5 million to Avista Capital II, an affiliated business trust formed by the Company. Avista Capital II issued \$50.0 million of Preferred Trust Securities with a floating distribution rate of LIBOR plus 0.875 percent, calculated and reset quarterly.

The distribution rates paid were as follows during the years ended December 31:

	2016	2015	2014
Low distribution rate	1.29%	1.11%	1.10%
High distribution rate	1.81%	1.29%	1.11%
Distribution rate at the end of the year	1.81%	1.29%	1.11%

Concurrent with the issuance of the Preferred Trust Securities, Avista Capital II issued \$1.5 million of Common Trust Securities to the Company. These debt securities may be redeemed at the option of Avista Capital II at any time and mature on June 1, 2037. In December 2000, the Company purchased \$10.0 million of these Preferred Trust Securities.

The Company owns 100 percent of Avista Capital II and has solely and unconditionally guaranteed the payment of distributions on, and redemption price and liquidation amount for, the Preferred Trust Securities to the extent that Avista Capital II has funds available for such payments from the respective debt securities. Upon maturity or prior redemption of such debt securities, the Preferred Trust Securities will be mandatorily redeemed. The Company does not include these capital trusts in its consolidated financial statements as Avista Corp. is not the primary beneficiary. As such, the sole assets of the capital trusts are \$51.5 million of junior subordinated deferrable interest debentures of Avista Corp., which are reflected on the Consolidated Balance Sheets. Interest expense to affiliated trusts in the Consolidated Statements of Income represents interest expense on these debentures.

## NOTE 16. FAIR VALUE

The carrying values of cash and cash equivalents, accounts and notes receivable, accounts payable and short-term borrowings are reasonable estimates of their fair values. Long-term debt (including current portion and material capital leases) and long-term debt to affiliated trusts are reported at carrying value on the Consolidated Balance Sheets.

The fair value hierarchy prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to fair values derived from unobservable inputs (Level 3 measurements).

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

Level 1 – Quoted prices are available in active markets for identical assets or liabilities. Active markets are those in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1, but which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

Level 3 – Pricing inputs include significant inputs that are generally unobservable from objective sources. These inputs may be used with internally developed methodologies that result in management’s best estimate of fair value.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company’s assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. The determination of the fair values incorporates various factors that not only include the credit standing of the counterparties involved and the impact of credit enhancements (such as cash deposits and letters of credit), but also the impact of Avista Corp.’s nonperformance risk on its liabilities.

The following table sets forth the carrying value and estimated fair value of the Company’s financial instruments not reported at estimated fair value on the Consolidated Balance Sheets as of December 31 (dollars in thousands):

	2016		2015	
	Carrying	Estimated	Carrying	Estimated
Long-term debt (Level 2)	\$ 951,000	\$ 1,048,661	\$ 951,000	\$ 1,055,797
Long-term debt (Level 3)	677,000	675,251	592,000	595,018
Snettisham capital lease obligation (Level 3)	62,160	62,800	64,455	63,150
Long-term debt to affiliated trusts (Level 3)	51,547	38,660	51,547	36,083

These estimates of fair value of long-term debt and long-term debt to affiliated trusts were primarily based on available market information, which generally consists of estimated market prices from third party brokers for debt with similar risk and terms. The price ranges obtained from the third party brokers consisted of par values of 75.00 to 122.59, where a par value of 100.00 represents the carrying value recorded on the Consolidated Balance Sheets. Level 2 long-term debt represents publicly issued bonds with quoted market prices; however, due to their limited trading activity, they are classified as Level 2 because brokers must generate quotes and make estimates using comparable debt with similar risk and terms if there is no trading activity near a period end. Level 3 long-term debt consists of private placement bonds and debt to affiliated trusts, which typically have no secondary trading activity. Fair values in Level 3 are estimated based on market prices from third party brokers using secondary market quotes for debt with similar risk and terms to generate quotes for Avista Corp. bonds. Due to the unique nature of the Snettisham capital lease obligation, the estimated fair value of these items was determined based on a discounted cash flow model using available market information. Prior to December 31, 2016, the Snettisham capital lease obligation was discounted to present value using the Moody's Aaa Corporate discount rate as published by the Federal Reserve. This rate was discontinued during the fourth quarter of 2016, as such going forward, the Company is using the Morgan Markets A Ex-Fin discount rate, which is the closest approximation to the rate previously used.

The following table discloses by level within the fair value hierarchy the Company's assets and liabilities measured and reported on the Consolidated Balance Sheets as of December 31, 2016 and 2015 at fair value on a recurring basis (dollars in thousands):

	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting (1)	Total
<b>December 31, 2016</b>					
<b>Assets:</b>					
Energy commodity derivatives	\$ —	\$ 47,994	\$ —	\$ (46,099)	\$ 1,895
Level 3 energy commodity derivatives:					
Natural gas exchange agreements	—	—	69	(69)	—
Power exchange agreement	—	—	25	(25)	—
Foreign currency exchange derivatives	—	5	—	(5)	—
Interest rate swap derivatives	—	13,098	—	(4,348)	8,750
Deferred compensation assets:					
Fixed income securities (2)	1,789	—	—	—	1,789
Equity securities (2)	5,481	—	—	—	5,481
Total	<u>\$ 7,270</u>	<u>\$ 61,097</u>	<u>\$ 94</u>	<u>\$ (50,546)</u>	<u>\$ 17,915</u>
<b>Liabilities:</b>					
Energy commodity derivatives	\$ —	\$ 56,871	\$ —	\$ (55,957)	\$ 914
Level 3 energy commodity derivatives:					
Natural gas exchange agreement	—	—	5,954	(69)	5,885
Power exchange agreement	—	—	13,474	(25)	13,449
Power option agreement	—	—	76	—	76
Interest rate swap derivatives	—	73,978	—	(39,248)	34,730
Foreign currency exchange derivatives	—	28	—	(5)	23
Total	<u>\$ —</u>	<u>\$ 130,877</u>	<u>\$ 19,504</u>	<u>\$ (95,304)</u>	<u>\$ 55,077</u>

	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting (1)	Total
<b>December 31, 2015</b>					
<b>Assets:</b>					
Energy commodity derivatives	\$ —	\$ 74,637	\$ —	\$ (73,954)	\$ 683
Level 3 energy commodity derivatives:					
Natural gas exchange agreement	—	—	678	(678)	—
Foreign currency exchange derivatives	—	2	—	(2)	—
Interest rate swap derivatives	—	1,548	—	—	1,548
Deferred compensation assets:					
Fixed income securities (2)	1,727	—	—	—	1,727
Equity securities (2)	5,761	—	—	—	5,761
Total	<u>\$ 7,488</u>	<u>\$ 76,187</u>	<u>\$ 678</u>	<u>\$ (74,634)</u>	<u>\$ 9,719</u>
<b>Liabilities:</b>					
Energy commodity derivatives	\$ —	\$ 97,193	\$ —	\$ (88,480)	\$ 8,713
Level 3 energy commodity derivatives:					
Natural gas exchange agreement	—	—	5,717	(678)	5,039
Power exchange agreement	—	—	21,961	—	21,961
Power option agreement	—	—	124	—	124
Foreign currency exchange derivatives	—	19	—	(2)	17
Interest rate swap derivatives	—	85,498	—	—	85,498
Total	<u>\$ —</u>	<u>\$ 182,710</u>	<u>\$ 27,802</u>	<u>\$ (89,160)</u>	<u>\$ 121,352</u>

- (1) The Company is permitted to net derivative assets and derivative liabilities with the same counterparty when a legally enforceable master netting agreement exists. In addition, the Company nets derivative assets and derivative liabilities against any payables and receivables for cash collateral held or placed with these same counterparties.
- (2) These assets are trading securities and are included in other property and investments-net and other non-current assets on the Consolidated Balance Sheets.

The difference between the amount of derivative assets and liabilities disclosed in respective levels in the table above and the amount of derivative assets and liabilities disclosed on the Consolidated Balance Sheets is due to netting arrangements with certain counterparties. See Note 6 for additional discussion of derivative netting.

To establish fair value for energy commodity derivatives, the Company uses quoted market prices and forward price curves to estimate the fair value of utility derivative commodity instruments included in Level 2. In particular, electric derivative valuations are performed using market quotes, adjusted for periods in between quotable periods. Natural gas derivative valuations are estimated using New York Mercantile Exchange (NYMEX) pricing for similar instruments, adjusted for basin differences, using market quotes. Where observable inputs are available for substantially the full term of the contract, the derivative asset or liability is included in Level 2.

To establish fair values for interest rate swap derivatives, the Company uses forward market curves for interest rates for the term of the swaps and discounts the cash flows back to present value using an appropriate discount rate. The discount rate is calculated by third party brokers according to the terms of the swap derivatives and evaluated by the Company for reasonableness, with consideration given to the potential non-performance risk by the Company. Future cash flows of the interest rate swap derivatives are equal to the fixed interest rate in the swap compared to the floating market interest rate multiplied by the notional amount for each period.

To establish fair value for foreign currency derivatives, the Company uses forward market curves for Canadian dollars against the US dollar and multiplies the difference between the locked-in price and the market price by the notional amount of the derivative. Forward foreign currency market curves are provided by third party brokers. The Company's credit spread is factored into the locked-in price of the foreign exchange contracts.

Deferred compensation assets and liabilities represent funds held by the Company in a Rabbi Trust for an executive deferral plan. These funds consist of actively traded equity and bond funds with quoted prices in active markets. The balance disclosed in the table above excludes cash and cash equivalents of \$0.4 million as of December 31, 2016 and \$0.6 million as of December 31, 2015.

### ***Level 3 Fair Value***

Under the power exchange agreement the Company purchases power at a price that is based on the average operating and maintenance (O&M) charges from three surrogate nuclear power plants around the country. To estimate the fair value of this agreement the Company estimates the difference between the purchase price based on the future O&M charges and forward prices for energy. The Company compares the Level 2 brokered quotes and forward price curves described above to an internally developed forward price which is based on the average O&M charges from the three surrogate nuclear power plants for the current year. Because the nuclear power plant O&M charges are only known for one year, all forward years are estimated assuming an annual escalation. In addition to the forward price being estimated using unobservable inputs, the Company also estimates the volumes of the transactions that will take place in the future based on historical average transaction volumes per delivery year (November to April). Significant increases or decreases in any of these inputs in isolation would result in a significantly higher or lower fair value measurement. Generally, a change in the current year O&M charges for the surrogate plants is accompanied by a directionally similar change in O&M charges in future years. There is generally not a correlation between external market prices and the O&M charges used to develop the internal forward price.

For the power commodity option agreement, the Company uses the Black-Scholes-Merton valuation model to estimate the fair value, and this model includes significant inputs not observable or corroborated in the market. These inputs include: 1) the strike price (which is an internally derived price based on a combination of generation plant heat rate factors, natural gas market pricing, delivery and other O&M charges), 2) estimated delivery volumes, and 3) volatility rates. Significant increases or decreases in any of these inputs in isolation would result in a significantly higher or lower fair value measurement. Generally, changes in overall commodity market prices and volatility rates are accompanied by directionally similar changes in the strike price and volatility assumptions used in the calculation.

For the natural gas commodity exchange agreement, the Company uses the same Level 2 brokered quotes described above; however, the Company also estimates the purchase and sales volumes (within contractual limits) as well as the timing of those transactions. Changing the timing of volume estimates changes the timing of purchases and sales, impacting which brokered quote is used. Because the brokered quotes can vary significantly from period to period, the unobservable estimates of the timing and volume of transactions can have a significant impact on the calculated fair value. The Company currently estimates volumes and timing of transactions based on a most likely scenario using historical data. Historically, the timing and volume of transactions have not been highly correlated with market prices and market volatility.

The following table presents the quantitative information which was used to estimate the fair values of the Level 3 assets and liabilities above as of December 31, 2016 (dollars in thousands):

	Fair Value (Net) at December 31, 2016	Valuation Technique	Unobservable Input	Range
Power exchange agreement	\$ (13,449)	Surrogate facility pricing	O&M charges Escalation factor Transaction volumes	\$33.59-\$49.15/MWh (1) 3% - 2017 to 2019 241,558 - 396,984 MWhs
Power option agreement	(76)	Black-Scholes- Merton	Strike price Delivery volumes Volatility rates	\$37.83/MWh - 2019 \$54.40/MWh - 2018 157,517 - 285,979 MWhs 0.20 (2)
Natural gas exchange agreement	(5,885)	Internally derived weighted-average cost of gas	Forward purchase Forward sales prices Purchase volumes Sales volumes	\$1.83 - \$3.06/mmBTU \$1.90 - \$5.14/mmBTU 115,000 - 310,000 mmBTUs 60,000 - 310,000 mmBTUs

(1) The average O&M charges for the delivery year beginning in November 2016 were \$39.22 per MWh. For ratemaking purposes the average O&M charges to be included for recovery in retail rates vary slightly between regulatory jurisdictions. The average O&M charges for the delivery year beginning in 2016 were \$44.33 for Washington and \$39.22 for Idaho.

(2) The estimated volatility rate of 0.20 is compared to actual quoted volatility rates of 0.35 for 2017 to 0.26 in December 2018.

The valuation methods, significant inputs and resulting fair values described above were developed by the Company's management and are reviewed on at least a quarterly basis to ensure they provide a reasonable estimate of fair value each reporting period.

The following table presents activity for energy commodity derivative assets (liabilities) measured at fair value using significant unobservable inputs (Level 3) for the years ended December 31 (dollars in thousands):

	Natural Gas Exchange Agreement	Power Exchange Agreement	Power Option Agreement	Total
<b>Year ended December 31, 2016:</b>				
Balance as of January 1, 2016	\$ (5,039)	\$ (21,961)	\$ (124)	\$ (27,124)
Total gains or (losses) (realized/unrealized):				
Included in regulatory assets/liabilities (1)	259	400	48	707
Settlements	(1,105)	8,112	—	7,007
Ending balance as of December 31, 2016 (2)	<u>\$ (5,885)</u>	<u>\$ (13,449)</u>	<u>\$ (76)</u>	<u>\$ (19,410)</u>
<b>Year ended December 31, 2015:</b>				
Balance as of January 1, 2015	\$ (35)	\$ (23,299)	\$ (424)	\$ (23,758)
Total gains or (losses) (realized/unrealized):				
Included in regulatory assets/liabilities (1)	(6,008)	(6,198)	300	(11,906)
Settlements	1,004	7,536	—	8,540
Ending balance as of December 31, 2015 (2)	<u>\$ (5,039)</u>	<u>\$ (21,961)</u>	<u>\$ (124)</u>	<u>\$ (27,124)</u>
<b>Year ended December 31, 2014:</b>				
Balance as of January 1, 2014	\$ (1,219)	\$ (14,441)	\$ (775)	\$ (16,435)
Total gains or (losses) (realized/unrealized):				
Included in regulatory assets/liabilities (1)	3,873	(10,002)	351	(5,778)
Settlements	(2,689)	1,144	—	(1,545)
Ending balance as of December 31, 2014 (2)	<u>\$ (35)</u>	<u>\$ (23,299)</u>	<u>\$ (424)</u>	<u>\$ (23,758)</u>

- (1) All gains and losses are included in other regulatory assets and liabilities. There were no gains and losses included in either net income or other comprehensive income during any of the periods presented in the table above.
- (2) There were no purchases, issuances or transfers from other categories of any derivatives instruments during the periods presented in the table above.

## NOTE 17. COMMON STOCK

The payment of dividends on common stock could be limited by:

- certain covenants applicable to preferred stock (when outstanding) contained in the Company's Restated Articles of Incorporation, as amended (currently there are no preferred shares outstanding),
- certain covenants applicable to the Company's outstanding long-term debt and committed line of credit agreements,
- the hydroelectric licensing requirements of section 10(d) of the FPA (see Note 1), and
- certain requirements under the OPUC approval of the AERC acquisition in 2014. The OPUC's AERC acquisition order requires Avista Utilities to maintain a capital structure of no less than 40 percent common equity (inclusive of short-term debt). This limitation may be revised upon request by the Company with approval from the OPUC.

The Company declared the following dividends for the year ended December 31:

	2016	2015	2014
Dividends paid per common share	\$ 1.37	\$ 1.32	\$ 1.27

Under the most restrictive of the dividend limitations discussed above, which are the requirements of the OPUC approval of the AERC acquisition, the amount available for dividends at December 31, 2016 was limited to \$263.4 million.

The Company has 10 million authorized shares of preferred stock. The Company did not have any preferred stock outstanding as of December 31, 2016 and 2015.

### ***Stock Repurchase Programs***

During 2014 and 2015, Avista Corp.'s Board of Directors approved programs to repurchase shares of the Company's outstanding common stock. The number of shares repurchased and the total cost of repurchases are disclosed in the Consolidated Statements of Equity and Redeemable Noncontrolling Interests. The average repurchase price was \$31.57 in 2014 and \$32.66 in 2015. All repurchased shares reverted to the status of authorized but unissued shares.

### ***Equity Issuances***

In March 2016, the Company entered into four separate sales agency agreements under which Avista Corp.'s sales agents may offer and sell up to 3.8 million new shares of Avista Corp.'s common stock, no par value, from time to time. The sales agency agreements expire on February 29, 2020. In 2016, 1.6 million shares were issued under these agreements resulting in total net proceeds of \$65.3 million, leaving 2.2 million shares remaining to be issued.

In 2016, the Company also issued \$1.7 million (net of issuance costs) of common stock under the employee plans.



## NOTE 18. EARNINGS PER COMMON SHARE ATTRIBUTABLE TO AVISTA CORPORATION SHAREHOLDERS

The following table presents the computation of basic and diluted earnings per common share attributable to Avista Corp. shareholders for the years ended December 31 (in thousands, except per share amounts):

	2016	2015	2014
<b>Numerator:</b>			
Net income from continuing operations attributable to Avista Corp. shareholders	\$ 137,228	\$ 118,080	\$ 119,817
Net income from discontinued operations attributable to Avista Corp. shareholders	—	5,147	72,224
Subsidiary earnings adjustment for dilutive securities (discontinued operations)	—	—	5
Adjusted net income from discontinued operations attributable to Avista Corp. shareholders for computation of diluted earnings per common share	\$ —	\$ 5,147	\$ 72,229
<b>Denominator:</b>			
Weighted-average number of common shares outstanding-basic	63,508	62,301	61,632
Effect of dilutive securities:			
Performance and restricted stock awards	412	407	255
Weighted-average number of common shares outstanding-diluted	63,920	62,708	61,887
<b>Earnings per common share attributable to Avista Corp. shareholders, basic:</b>			
Earnings per common share from continuing operations	\$ 2.16	\$ 1.90	\$ 1.94
Earnings per common share from discontinued operations	\$ —	\$ 0.08	\$ 1.18
Total earnings per common share attributable to Avista Corp. shareholders, basic	\$ 2.16	\$ 1.98	\$ 3.12
<b>Earnings per common share attributable to Avista Corp. shareholders, diluted:</b>			
Earnings per common share from continuing operations	\$ 2.15	\$ 1.89	\$ 1.93
Earnings per common share from discontinued operations	\$ —	\$ 0.08	\$ 1.17
Total earnings per common share attributable to Avista Corp. shareholders, diluted	\$ 2.15	\$ 1.97	\$ 3.10

There were no shares excluded from the calculation because they were antidilutive.

## NOTE 19. COMMITMENTS AND CONTINGENCIES

In the course of its business, the Company becomes involved in various claims, controversies, disputes and other contingent matters, including the items described in this Note. Some of these claims, controversies, disputes and other contingent matters involve litigation or other contested proceedings. For all such matters, the Company intends to vigorously protect and defend its interests and pursue its rights. However, no assurance can be given as to the ultimate outcome of any particular matter because litigation and other contested proceedings are inherently subject to numerous uncertainties. For matters that affect Avista Utilities' or AEL&P's operations, the Company intends to seek, to the extent appropriate, recovery of incurred costs through the ratemaking process.

### *California Refund Proceeding*

In February 2016, APX, a market maker in the California Refund Proceedings in whose markets Avista Energy participated in the summer of 2000, asserted that Avista Energy and its other customer/participants may be responsible for a share of the disgorgement penalty APX may be found to owe to Pacific Gas & Electric (PG&E), Southern California Edison, San Diego

Gas & Electric, the California Attorney General (AG), the California Department of Water Resources (CERS), and the California Public Utilities Commission (together, the “California Parties”). The penalty arises as a result of the FERC's finding that APX committed violations in the California market in the summer of 2000. APX is making these assertions despite Avista Energy having been dismissed in FERC Opinion No. 536 from the on-going administrative proceeding at the FERC regarding potential wrongdoing in the California markets in the summer of 2000. APX has identified Avista Energy's share of APX's exposure to be as much as \$16.0 million even though no wrongdoing allegations are specifically attributable to Avista Energy. Avista Energy believes its settlement with the California Parties in 2014 insulates it from any such liability and that as a dismissed party it cannot be drawn back into the litigation. Avista Energy intends to vigorously dispute APX's assertions of indirect liability, but cannot at this time predict the eventual outcome.

### ***Pacific Northwest Refund Proceeding***

In July 2001, the FERC initiated a preliminary evidentiary hearing to develop a factual record as to whether prices for spot market sales of wholesale energy in the Pacific Northwest between December 25, 2000 and June 20, 2001 were just and reasonable. In June 2003, the FERC terminated the Pacific Northwest refund proceedings, after finding that the equities do not justify the imposition of refunds. In August 2007, the Ninth Circuit found that the FERC had failed to take into account new evidence of market manipulation and that such failure was arbitrary and capricious and, accordingly, remanded the case to the FERC, stating that the FERC's findings must be reevaluated in light of the new evidence. The Ninth Circuit expressly declined to direct the FERC to grant refunds. On October 3, 2011, the FERC issued an Order on Remand and on April 5, 2013 expanded the temporal scope of the proceeding to permit parties to submit evidence on transactions during the period from January 1, 2000 through and including June 20, 2001.

On July 11, 2012 and March 28, 2013, Avista Energy and Avista Corp. filed settlements of all issues in this docket with regard to the claims made by the City of Tacoma and the California AG (on behalf of the California Department of Water Resources). The FERC approved the settlements and they are final.

The remaining direct claimant against Avista Corp. and Avista Energy in this proceeding was the City of Seattle, Washington (Seattle). An evidentiary, trial type hearing before an Administrative Law Judge (ALJ) to permit parties to present evidence of unlawful market activity was conducted in 2013.

With regard to the Seattle claims, on March 28, 2014, the Presiding ALJ issued an Initial Decision finding that: 1) Seattle failed to demonstrate that either Avista Corp. or Avista Energy engaged in unlawful market activity and also failed to identify any specific contracts at issue; 2) Seattle failed to demonstrate that contracts with either Avista Corp. or Avista Energy imposed an excessive burden on consumers or seriously harmed the public interest; and that 3) Seattle failed to demonstrate that either Avista Corp. or Avista Energy engaged in any specific violations of substantive provisions of the FPA or any filed tariffs or rate schedules. Accordingly, the ALJ denied all of Seattle's claims under both section 206 and section 309 of the FPA. On May 22, 2015, the FERC issued its Order on Initial Decision in which it upheld the ALJ's Initial Decision denying all of Seattle's claims against Avista Corp. and Avista Energy. Seattle filed a Request for Rehearing of the FERC's Order on Initial Decision which was denied on December 31, 2015. Seattle appealed the FERC's decision to the Ninth Circuit. In October 2016, Seattle settled all of the matters with the remaining parties and withdrew its appeal at the Ninth Circuit. All the remaining parties signed the settlement agreement and a petition to dismiss the case was filed with the Ninth Circuit on October 27, 2016. There are no remaining claims outstanding under this proceeding. The settlement did not have a material adverse effect on the Company's financial condition, results of operations or cash flows.

### ***Sierra Club and Montana Environmental Information Center Litigation***

In 2013, the Sierra Club and Montana Environmental Information Center (MEIC) (collectively "Plaintiffs"), filed a Complaint in the United States District Court for the District of Montana, Billings Division, against the Owners of the Colstrip Generating Project ("Colstrip"); Avista Corp. owns a 15 percent interest in Units 3 & 4 of Colstrip. The other Colstrip co-Owners are Talen Montana, LLC (formerly PPL Montana, LLC, an indirect subsidiary of Talen Energy Corporation), Puget Sound Energy,

Portland General Electric Company, NorthWestern Energy and PacifiCorp. The Complaint alleged certain violations of the Clean Air Act, including the New Source Review, Title V and opacity requirements with respect to post-January 1, 2001 Colstrip projects. The Plaintiffs requested that the Court grant injunctive and declaratory relief, order remediation of alleged environmental damages, impose civil penalties, require a beneficial environmental project in the areas affected by the alleged air pollution and require payment of Plaintiffs' costs of litigation and attorney fees.

The liability trial was scheduled to start on May 31, 2016. The parties engaged in settlement discussions with the Plaintiffs to resolve the claims raised in the litigation. On July 12, 2016, the parties filed a proposed Consent Decree with the court which contained the terms of the settlement of the matter with respect to all four units at Colstrip. The settlement does not include any monetary payments by any party, dismisses all claims against all four units, and provides for the shut-down of units 1 & 2 (which are owned solely by Talen Montana, LLC and Puget Sound Energy) no later than July, 2022. The Consent Decree was entered on September 6, 2016. The parties have petitioned the Court for costs and attorneys' fees. The Court denied the defendant's claim for fees and reduced the plaintiff's claimed fees from approximately \$3.0 million to \$1.6 million. On February 15, 2017 the Court issued an Order adopting this resolution in full and closing the case.

The Company does not expect that this matter will have a material adverse effect on its financial condition, results of operations or cash flows.

#### ***Cabinet Gorge Total Dissolved Gas Abatement Plan***

Dissolved atmospheric gas levels (referred to as "Total Dissolved Gas" or "TDG") in the Clark Fork River exceed state of Idaho and federal water quality numeric standards downstream of Cabinet Gorge particularly during periods when excess river flows must be diverted over the spillway. Under the terms of the Clark Fork Settlement Agreement (CFSA) as incorporated in Avista Corp.'s FERC license for the Clark Fork Project, Avista Corp. has worked in consultation with agencies, tribes and other stakeholders to address this issue. Under the terms of a gas supersaturation mitigation plan, Avista is reducing TDG by constructing spill crest modifications on spill gates at the dam, and the Company expects to continue spill crest modifications over the next several years, in ongoing consultation with key stakeholders. Avista Corp. cannot at this time predict the outcome or estimate a range of costs associated with this contingency; however, the Company will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to this issue.

#### ***Fish Passage at Cabinet Gorge and Noxon Rapids***

In 1999, the United States Fish and Wildlife Service (USFWS) listed bull trout as threatened under the Endangered Species Act. In 2010, the USFWS issued a revised designation of critical habitat for bull trout, which includes the lower Clark Fork River. The USFWS issued a final recovery plan in October 2015.

The CFSA describes programs intended to help restore bull trout populations in the project area. Using the concept of adaptive management and working closely with the USFWS, the Company evaluated the feasibility of fish passage at Cabinet Gorge and Noxon Rapids. The results of these studies led, in part, to the decision to move forward with development of permanent facilities, among other bull trout enhancement efforts. Parties to the CFSA are working to resolve several issues. The Company believes its ongoing efforts through the CFSA continue to effectively address issues related to bull trout. Avista Corp. cannot at this time predict the outcome or estimate a range of costs associated with this contingency; however, the Company will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to fish passage at Cabinet Gorge and Noxon Rapids.

#### ***Collective Bargaining Agreements***

The Company's collective bargaining agreements with the IBEW represent approximately 45 percent of all of Avista Utilities' employees. A new three-year agreement with the local union in Washington and Idaho representing the majority

(approximately 90 percent) of the Avista Utilities' bargaining unit employees was approved in March 2016 and expires in March 2019.

A three-year agreement in Oregon, which covers approximately 50 employees was set to expire in March 2017. A new three-year agreement has been approved by the IBEW membership that will expire in March 2020. It is still awaiting approval from the National IBEW.

A collective bargaining agreement with the local union of the IBEW in Alaska expires in March 2017. The collective bargaining agreement with the IBEW in Alaska represents approximately 50 percent of all AERC employees. The remainder of AERC's employees are non-union.

There is a risk that if collective bargaining agreements expire and new agreements are not reached in each of our jurisdictions, employees could strike. Given the magnitude of employees that are covered by collective bargaining agreements, this could result in disruptions of our operations. However, the Company believes that the possibility of this occurring is remote.

### ***Other Contingencies***

In the normal course of business, the Company has various other legal claims and contingent matters outstanding. The Company believes that any ultimate liability arising from these actions will not have a material impact on its financial condition, results of operations or cash flows. It is possible that a change could occur in the Company's estimates of the probability or amount of a liability being incurred. Such a change, should it occur, could be significant.

The Company routinely assesses, based on studies, expert analyses and legal reviews, its contingencies, obligations and commitments for remediation of contaminated sites, including assessments of ranges and probabilities of recoveries from other responsible parties who either have or have not agreed to a settlement as well as recoveries from insurance carriers. The Company's policy is to accrue and charge to current expense identified exposures related to environmental remediation sites based on estimates of investigation, cleanup and monitoring costs to be incurred. For matters that affect Avista Utilities' or AEL&P's operations, the Company seeks, to the extent appropriate, recovery of incurred costs through the ratemaking process.

The Company has potential liabilities under the Endangered Species Act for species of fish, plants and wildlife that have either already been added to the endangered species list, listed as "threatened" or petitioned for listing. Thus far, measures adopted and implemented have had minimal impact on the Company. However, the Company will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to these issues.

Under the federal licenses for its hydroelectric projects, the Company is obligated to protect its property rights, including water rights. In addition, the company holds additional non-hydro water rights. The state of Montana is examining the status of all water right claims within state boundaries through a general adjudication. Claims within the Clark Fork River basin could adversely affect the energy production of the Company's Cabinet Gorge and Noxon Rapids hydroelectric facilities. The state of Idaho has initiated adjudication in northern Idaho, which will ultimately include the lower Clark Fork River, the Spokane River and the Coeur d'Alene basin. The Company is and will continue to be a participant in these and any other relevant adjudication processes. The complexity of such adjudications makes each unlikely to be concluded in the foreseeable future. As such, it is not possible for the Company to estimate the impact of any outcome at this time. The Company will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to this issue.

## NOTE 20. REGULATORY MATTERS

### *Regulatory Assets and Liabilities*

The following table presents the Company's regulatory assets and liabilities as of December 31, 2016 (dollars in thousands):

		Receiving					
	Remaining	(1)	Not	(2)			
	Amortization	Earning	Earning	Expected	Total 2016	Total 2015	
<b>Regulatory Assets:</b>							
Investment in exchange power-net	2019	\$ 6,533	\$ —	\$ —	\$ 6,533	\$ 8,983	
Regulatory assets for deferred income tax	(3)	101,372	8,481	—	109,853	101,240	
Regulatory assets for pensions and other postretirement benefit plans	(4)	—	240,114	—	240,114	235,009	
Current regulatory asset for energy commodity derivatives	(5)	—	11,365	—	11,365	17,260	
Unamortized debt repurchase costs	(6)	13,700	—	—	13,700	15,520	
Regulatory asset for settlement with Coeur d’Alene Tribe	2059	45,265	—	—	45,265	46,576	
Demand side management programs	(3)	—	15,700	—	15,700	3,168	
Deferred maintenance costs	2018	—	2,672	—	2,672	4,823	
Decoupling surcharge	2018	43,126	—	—	43,126	13,312	
Regulatory asset for utility plant to be abandoned	(7)	19,100	—	—	19,100	—	
Regulatory asset for interest rate swaps	(8)	37,912	—	123,596	161,508	83,973	
Non-current regulatory asset for energy commodity derivatives	(5)	—	16,919	—	16,919	32,420	
Other regulatory assets	(3)	3,633	5,755	4,585	13,973	17,348	
Total regulatory assets		<u>\$ 270,641</u>	<u>\$ 301,006</u>	<u>\$ 128,181</u>	<u>\$ 699,828</u>	<u>\$ 579,632</u>	
<b>Regulatory Liabilities:</b>							
Natural gas deferrals	(3)	\$ 30,820	\$ —	\$ —	\$ 30,820	\$ 17,880	
Power deferrals	(3)	23,528	—	—	23,528	18,747	
Regulatory liability for utility plant retirement costs	(9)	273,983	—	—	273,983	261,594	
Income tax related liabilities	(3)	—	28,966	—	28,966	17,609	
Regulatory liability for interest rate swaps	(8)	12,442	—	8,749	21,191	23	
Provision for earnings sharing rebate	(3)	—	3,697	6,600	10,297	12,237	
Decoupling rebate	2017	2,405	—	—	2,405	2,373	
Other regulatory liabilities	(3)	2,505	3,257	—	5,762	3,420	
Total regulatory liabilities		<u>\$ 345,683</u>	<u>\$ 35,920</u>	<u>\$ 15,349</u>	<u>\$ 396,952</u>	<u>\$ 333,883</u>	

- (1) Earning a return includes either interest on the regulatory asset/liability or a return on the investment as a component of rate base at the allowed rate of return.
- (2) Expected recovery is pending regulatory treatment including regulatory assets and liabilities with prior regulatory precedence.
- (3) Remaining amortization period varies depending on timing of underlying transactions.

- (4) As the Company has historically recovered and currently recovers its pension and other postretirement benefit costs related to its regulated operations in retail rates, the Company records a regulatory asset for that portion of its pension and other postretirement benefit funding deficiency.
- (5) The UTC and the IPUC issued accounting orders authorizing Avista Corp. to offset energy commodity derivative assets or liabilities with a regulatory asset or liability. This accounting treatment is intended to defer the recognition of mark-to-market gains and losses on energy commodity transactions until the period of settlement, subject to approval for recovery through retail rates. Realized gains and losses, subject to regulatory approval, result in adjustments to retail rates through purchased gas cost adjustments, the ERM in Washington, the PCA mechanism in Idaho, and periodic general rates cases.
- (6) For the Company's Washington jurisdiction and for any debt repurchases beginning in 2007 in all jurisdictions, premiums paid to repurchase debt are amortized over the remaining life of the original debt that was repurchased or, if new debt is issued in connection with the repurchase, these costs are amortized over the life of the new debt. In the Company's other regulatory jurisdictions, premiums paid to repurchase debt prior to 2007 are being amortized over the average remaining maturity of outstanding debt when no new debt was issued in connection with the debt repurchase. These costs are included in the Company's cost of debt calculation for ratemaking purposes and are recovered through retail rates.
- (7) In March 2016, the UTC granted the Company's Petition for an Accounting Order to defer and include in a regulatory asset the undepreciated value of its existing Washington electric meters for the opportunity for later recovery. This accounting treatment is related to the Company's plan to replace approximately 253,000 of its existing electric meters with new two-way digital meters and the related software and support services through its AMI project in Washington State. Replacement of the meters is expected to begin in the second half of 2017. For ratemaking purposes, the existing electric meters won't be recorded as regulatory assets until they are physically removed from service, but for GAAP purposes, they are regulatory assets upon the commitment by management to retire the meters.
- (8) For interest rate swap derivatives, each period Avista Utilities records all mark-to-market gains and losses in each accounting period as assets and liabilities and records offsetting regulatory assets and liabilities, such that there is no income statement impact. This is similar to the treatment of energy commodity derivatives described above. Upon settlement of interest rate swap derivatives, the regulatory asset or liability is amortized as a component of interest expense over the term of the associated debt and are also included as a part of the Company's cost of debt calculation for ratemaking purposes. See Note 14 regarding a reclassification of settled interest rate swap derivatives during 2016. Settled interest rate swap derivatives which have been through a general rate case proceeding are classified as earning a return in the table above, whereas all unsettled interest rate swap derivatives and settled interest rate swap derivatives which have not been included in a general rate case are classified as expected recovery.
- (9) This amount is dependent upon the cost of removal of underlying utility plant assets and the life of utility plant.

#### ***Power Cost Deferrals and Recovery Mechanisms***

Deferred power supply costs are recorded as a deferred charge on the Consolidated Balance Sheets for future prudence review and recovery through retail rates. The power supply costs deferred include certain differences between actual net power supply costs incurred by Avista Utilities and the costs included in base retail rates. This difference in net power supply costs primarily results from changes in:

- short-term wholesale market prices and sales and purchase volumes,
- the level and availability of hydroelectric generation,
- the level and availability of thermal generation (including changes in fuel prices), and
- retail loads.

In Washington, the ERM allows Avista Utilities to periodically increase or decrease electric rates with UTC approval to reflect changes in power supply costs. The ERM is an accounting method used to track certain differences between actual power

supply costs, net of wholesale sales and sales of fuel, and the amount included in base retail rates for Washington customers. The Washington ERM calculation is subject to certain deadbands and sharing bands. For 2016, the Company recognized a pre-tax benefit of \$5.1 million under the ERM in Washington compared to a benefit of \$6.3 million for 2015. Total net deferred power costs under the ERM were a liability of \$21.3 million as of December 31, 2016 compared to a liability of \$18.0 million as of December 31, 2015, and these deferred power cost balances represent amounts due to customers.

Avista Utilities has a PCA mechanism in Idaho that allows it to modify electric rates on October 1 of each year with IPUC approval. Under the PCA mechanism, Avista Utilities defers 90 percent of the difference between certain actual net power supply expenses and the amount included in base retail rates for its Idaho customers. The October 1 rate adjustments recover or rebate power costs deferred during the preceding July-June twelve-month period. Total net power supply costs deferred under the PCA mechanism were a liability of \$2.2 million as of December 31, 2016 compared to an asset of \$0.2 million as of December 31, 2015.

### ***Natural Gas Cost Deferrals and Recovery Mechanisms***

Avista Utilities files a PGA in all three states it serves to adjust natural gas rates for: 1) estimated commodity and pipeline transportation costs to serve natural gas customers for the coming year, and 2) the difference between actual and estimated commodity and transportation costs for the prior year. Total net deferred natural gas costs to be refunded to customers were a liability of \$30.8 million as of December 31, 2016 compared to a liability of \$17.9 million as of December 31, 2015.

### ***Decoupling and Earnings Sharing Mechanisms***

Decoupling is a mechanism designed to sever the link between a utility's revenues and consumers' energy usage. In each of Avista Utilities' jurisdictions, each month Avista Utilities' electric and natural gas revenues are adjusted so as to be based on the number of customers in certain customer rate classes, rather than KWh and therm sales. The difference between revenues based on the number of customers and revenues based on actual usage is deferred and either surcharged or rebated to customers beginning in the following year.

#### ***Washington Decoupling and Earnings Sharing***

In Washington, the UTC approved the Company's decoupling mechanisms for electric and natural gas for a five-year period beginning January 1, 2015. Electric and natural gas decoupling surcharge rate adjustments to customers are limited to 3 percent on an annual basis, with any remaining surcharge balance carried forward for recovery in a future period. There is no limit on the level of rebate rate adjustments.

The electric and natural gas decoupling mechanisms each include an after-the-fact earnings test. At the end of each calendar year, separate electric and natural gas earnings calculations will be made for the prior calendar year. These earnings tests will reflect actual decoupled revenues, normalized power supply costs and other normalizing adjustments. See below for a summary of cumulative balances under the decoupling and earnings sharing mechanisms.

#### ***Idaho Fixed Cost Adjustment (FCA) and Earnings Sharing Mechanisms***

In Idaho, the IPUC approved the implementation of FCAs for electric and natural gas (similar in operation and effect to the Washington decoupling mechanisms) for an initial term of three years, beginning January 1, 2016.

For the period 2013 through 2015 the Company had an after-the-fact earnings test, such that if Avista Corp., on a consolidated basis for electric and natural gas operations in Idaho, earned more than a 9.8 percent ROE, the Company was required to share with customers 50 percent of any earnings above the 9.8 percent. There was no provision for a surcharge to customers if the Company's ROE was less than 9.8 percent. This after-the-fact earnings test was discontinued as part of the settlement of the Company's 2015 Idaho electric and natural gas general rates cases. See below for a summary of cumulative balances under the decoupling and earnings sharing mechanisms.

### *Oregon Decoupling Mechanism*

In February 2016, the OPUC approved the implementation of a decoupling mechanism for natural gas, similar to the Washington and Idaho mechanisms described above. The decoupling mechanism became effective on March 1, 2016 and there will be an opportunity for interested parties to review the mechanism and recommend changes, if any, by September 2019. An earnings review is conducted on an annual basis, which is filed by the Company with the OPUC on or before June 1 of each year for the prior calendar year. In the annual earnings review, if the Company earns more than 100 basis points above its allowed return on equity, one-third of the earnings above the 100 basis points would be deferred and later returned to customers. The earnings review is separate from the decoupling mechanism and was in place prior to decoupling. See below for a summary of cumulative balances under the decoupling and earnings sharing mechanisms.

### *Cumulative Decoupling and Earnings Sharing Mechanism Balances*

As of December 31, 2016 and December 31, 2015, the Company had the following cumulative balances outstanding related to decoupling and earnings sharing mechanisms in its various jurisdictions (dollars in thousands):

	December 31, 2016	December 31, 2015
<b>Washington</b>		
Decoupling surcharge	\$ 30,408	\$ 10,933
Provision for earnings sharing rebate	(5,113)	(3,422)
<b>Idaho</b>		
Decoupling surcharge	\$ 8,292	n/a
Provision for earnings sharing rebate	(5,184)	(8,814)
<b>Oregon</b>		
Decoupling surcharge	\$ 2,021	n/a
Provision for earnings sharing rebate	—	—

(n/a) This mechanism did not exist during this time period.

### **NOTE 21. INFORMATION BY BUSINESS SEGMENTS**

The business segment presentation reflects the basis used by the Company's management to analyze performance and determine the allocation of resources. The Company's management evaluates performance based on income (loss) from operations before income taxes as well as net income (loss) attributable to Avista Corp. shareholders. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Avista Utilities' business is managed based on the total regulated utility operation; therefore, it is considered one segment. AEL&P is a separate reportable business segment as it has separate financial reports that are reviewed in detail by the Chief Operating Decision Maker and its operations and risks are sufficiently different from Avista Utilities and the other businesses at AERC that it cannot be aggregated with any other operating segments. The Other category, which is not a reportable segment, includes other investments and operations of various subsidiaries, as well as certain other operations of Avista Capital.



The following table presents information for each of the Company's business segments (dollars in thousands):

	Avista	Alaska Electric Light and Power Company	Total Utility	Other	Intersegment Eliminations (1)	Total
<b>For the year ended December 31, 2016:</b>						
Operating revenues	\$ 1,372,638	\$ 46,276	\$ 1,418,914	\$ 23,569	\$ —	\$ 1,442,483
Resource costs	539,352	12,014	551,366	—	—	551,366
Other operating expenses	304,644	11,151	315,795	25,501	—	341,296
Depreciation and amortization	155,162	5,352	160,514	769	—	161,283
Income (loss) from operations	277,070	15,434	292,504	(2,701)	—	289,803
Interest expense (2)	83,070	3,584	86,654	608	(132)	87,130
Income taxes	74,121	5,321	79,442	(1,356)	—	78,086
Net income (loss) from continuing operations attributable to Avista Corp. shareholders	132,490	7,968	140,458	(3,230)	—	137,228
Capital expenditures (3)	390,690	15,954	406,644	353	—	406,997
<b>For the year ended December 31, 2015:</b>						
Operating revenues	\$ 1,411,863	\$ 44,778	\$ 1,456,641	\$ 28,685	\$ (550)	\$ 1,484,776
Resource costs	644,991	11,973	656,964	—	—	656,964
Other operating expenses	292,096	11,125	303,221	30,076	(550)	332,747
Depreciation and amortization	138,236	5,263	143,499	695	—	144,194
Income (loss) from operations	241,228	14,072	255,300	(2,086)	—	253,214
Interest expense (2)	76,405	3,558	79,963	610	(132)	80,441
Income taxes	64,489	4,202	68,691	(1,242)	—	67,449
Net income (loss) from continuing operations attributable to Avista Corp. shareholders	113,360	6,641	120,001	(1,921)	—	118,080
Capital expenditures (3)	381,174	12,251	393,425	885	—	394,310
<b>For the year ended December 31, 2014:</b>						
Operating revenues	\$ 1,413,499	\$ 21,644	\$ 1,435,143	\$ 39,219	\$ (1,800)	\$ 1,472,562
Resource costs	672,344	5,900	678,244	—	—	678,244
Other operating expenses	280,964	5,868	286,832	32,218	(1,800)	317,250
Depreciation and amortization	126,987	2,583	129,570	610	—	130,180
Income from operations	239,976	6,221	246,197	6,391	—	252,588
Interest expense (2)	73,750	1,382	75,132	1,004	(384)	75,752
Income taxes	67,634	1,816	69,450	2,790	—	72,240
Net income from continuing operations attributable to Avista Corp. shareholders	113,263	3,152	116,415	3,236	166	119,817
Capital expenditures (3)	323,931	1,585	325,516	406	—	325,922
<b>Total Assets:</b>						
As of December 31, 2016	\$ 4,975,555	\$ 273,770	\$ 5,249,325	\$ 60,430	\$ —	\$ 5,309,755
As of December 31, 2015	\$ 4,601,708	\$ 265,735	\$ 4,867,443	\$ 39,206	\$ —	\$ 4,906,649
As of December 31, 2014	\$ 4,357,760	\$ 263,070	\$ 4,620,830	\$ 80,141	\$ —	\$ 4,700,971

- (1) Intersegment eliminations reported as operating revenues and resource costs represent intercompany purchases and sales of electric capacity and energy between Avista Utilities and Spokane Energy (included in other). Intersegment eliminations reported as interest expense and net income (loss) attributable to Avista Corp. shareholders represent intercompany interest.
- (2) Including interest expense to affiliated trusts.
- (3) The capital expenditures for the other businesses are included as other capital expenditures on the Consolidated Statements of Cash Flows. The remainder of the balance included in other capital expenditures on the Consolidated Statements of Cash Flows for 2014 are related to Ecova.

## NOTE 22. SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

The Company's energy operations are significantly affected by weather conditions. Consequently, there can be large variances in revenues, expenses and net income between quarters based on seasonal factors such as, but not limited to, temperatures and streamflow conditions.

A summary of quarterly operations (in thousands, except per share amounts) for 2016 and 2015 follows:

	Three Months Ended			
	March 31	June 30	September 30	December 31
<b>2016</b>				
Operating revenues	\$ 418,173	\$ 318,838	\$ 303,349	\$ 402,123
Operating expenses	312,088	257,247	263,755	319,590
Income from operations	<u>\$ 106,085</u>	<u>\$ 61,591</u>	<u>\$ 39,594</u>	<u>\$ 82,533</u>
Net income (1)	57,665	27,287	12,261	40,103
Net income attributable to noncontrolling interests	(16)	(33)	(27)	(12)
Net income attributable to Avista Corporation shareholders (1)	<u>\$ 57,649</u>	<u>\$ 27,254</u>	<u>\$ 12,234</u>	<u>\$ 40,091</u>
Outstanding common stock:				
weighted-average, basic	62,605	63,386	63,857	64,185
weighted-average, diluted	62,907	63,783	64,325	64,620
Earnings per common share attributable to Avista Corp. shareholders, diluted (1)	\$ 0.92	\$ 0.43	\$ 0.19	\$ 0.62

	Three Months Ended			
	March 31	June 30	September 30	December 31
<b>2015</b>				
Operating revenues from continuing operations	\$ 446,490	\$ 337,332	\$ 313,649	\$ 387,305
Operating expenses from continuing operations	356,915	279,972	277,737	316,938
Income from continuing operations	<u>\$ 89,575</u>	<u>\$ 57,360</u>	<u>\$ 35,912</u>	<u>\$ 70,367</u>
Net income from continuing operations	\$ 46,462	\$ 25,078	\$ 12,754	\$ 33,876
Net income from discontinued operations	—	196	289	4,662
Net income	46,462	25,274	13,043	38,538
Net income attributable to noncontrolling interests	(13)	(28)	(32)	(17)
Net income attributable to Avista Corporation shareholders	<u>\$ 46,449</u>	<u>\$ 25,246</u>	<u>\$ 13,011</u>	<u>\$ 38,521</u>
Amounts attributable to Avista Corp. shareholders:				
Net income from continuing operations attributable to Avista Corp. shareholders	\$ 46,449	\$ 25,050	\$ 12,722	\$ 33,859
Net income from discontinued operations attributable to Avista Corp. shareholders	—	196	289	4,662
Net income attributable to Avista Corp. shareholders	<u>\$ 46,449</u>	<u>\$ 25,246</u>	<u>\$ 13,011</u>	<u>\$ 38,521</u>
Outstanding common stock:				
weighted-average, basic	62,318	62,281	62,299	62,308
weighted-average, diluted	62,889	62,600	62,688	62,758
Earnings per common share attributable to Avista Corp. shareholders, diluted:				
Earnings per common share from continuing operations	\$ 0.74	\$ 0.40	\$ 0.21	\$ 0.54
Earnings per common share from discontinued operations	—	—	—	0.07
Total earnings per common share attributable to Avista Corp. shareholders, diluted	<u>\$ 0.74</u>	<u>\$ 0.40</u>	<u>\$ 0.21</u>	<u>\$ 0.61</u>

- (1) The Company adopted ASU 2016-09 during the second quarter of 2016, with a retrospective effective date of January 1, 2016. The adoption of this standard resulted in a recognized income tax benefit of \$1.6 million in 2016 associated with excess tax benefits on settled share-based employee payments. Because this standard was adopted in the second quarter of 2016, but has a retrospective effective date of January 1, 2016, the effects from the adoption were pushed back to the first quarter of 2016 and the results for that quarter were recast in the presentation above. In all future reports which include the first quarter of 2016, the results for that quarter will be recast to include the effects of the excess tax benefits recognized.

# CONDENSED CONSOLIDATED STATEMENTS OF INCOME

## Avista Corporation

For the Three Months Ended March 31

Dollars in thousands, except per share amounts

(Unaudited)

	2017	2016
Operating Revenues:		
Utility revenues	\$ 430,537	\$ 412,793
Non-utility revenues	5,933	5,380
Total operating revenues	<u>436,470</u>	<u>418,173</u>
Operating Expenses:		
Utility operating expenses:		
Resource costs	165,586	161,719
Other operating expenses	74,484	75,779
Depreciation and amortization	41,985	39,192
Taxes other than income taxes	32,662	29,385
Non-utility operating expenses:		
Other operating expenses	6,179	5,825
Depreciation and amortization	188	188
Total operating expenses	<u>321,084</u>	<u>312,088</u>
Income from operations	115,386	106,085
Interest expense	23,545	21,273
Interest expense to affiliated trusts	185	138
Capitalized interest	(724)	(914)
Other income-net	<u>(3,101)</u>	<u>(2,422)</u>
Income before income taxes	95,481	88,010
Income tax expense	<u>33,344</u>	<u>30,345</u>
Net income	62,137	57,665
Net income attributable to noncontrolling interests	<u>(21)</u>	<u>(16)</u>
Net income attributable to Avista Corp. shareholders	<u>\$ 62,116</u>	<u>\$ 57,649</u>
Weighted-average common shares outstanding (thousands), basic	64,362	62,605
Weighted-average common shares outstanding (thousands), diluted	64,469	62,907
Earnings per common share attributable to Avista Corp. shareholders:		
Basic	\$ 0.97	\$ 0.92
Diluted	\$ 0.96	\$ 0.92
Dividends declared per common share	<u>\$ 0.3575</u>	<u>\$ 0.3425</u>

*The Accompanying Notes are an Integral Part of These Statements.*

# CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

## *Avista Corporation*

For the Three Months Ended March 31

Dollars in thousands

(Unaudited)

	2017	2016
Net income	<u>\$ 62,137</u>	<u>\$ 57,665</u>
Other Comprehensive Income (Loss):		
Change in unfunded benefit obligation for pension and other postretirement benefit plans - net of taxes of \$98 and \$(663) respectively	<u>183</u>	<u>(1,229)</u>
Total other comprehensive income (loss)	<u>183</u>	<u>(1,229)</u>
Comprehensive income	62,320	56,436
Comprehensive income attributable to noncontrolling interests	<u>(21)</u>	<u>(16)</u>
Comprehensive income attributable to Avista Corporation shareholders	<u>\$ 62,299</u>	<u>\$ 56,420</u>

*The Accompanying Notes are an Integral Part of These Statements.*

# CONDENSED CONSOLIDATED BALANCE SHEETS

*Avista Corporation*

Dollars in thousands

(Unaudited)

	March 31, 2017	December 31, 2016
<b>Assets:</b>		
Current Assets:		
Cash and cash equivalents	\$ 26,179	\$ 8,507
Accounts and notes receivable-less allowances of \$5,966 and \$5,026, respectively	179,403	180,265
Regulatory asset for energy commodity derivatives	11,649	11,365
Materials and supplies, fuel stock and stored natural gas	47,184	53,314
Income taxes receivable	34,159	48,265
Other current assets	58,718	49,625
Total current assets	<u>357,292</u>	<u>351,341</u>
Net Utility Property:		
Utility plant in service	5,543,736	5,506,499
Construction work in progress	158,271	150,474
Total	<u>5,702,007</u>	<u>5,656,973</u>
Less: Accumulated depreciation and amortization	<u>1,533,404</u>	<u>1,509,473</u>
Total net utility property	<u>4,168,603</u>	<u>4,147,500</u>
Other Non-current Assets:		
Investment in affiliated trusts	11,547	11,547
Goodwill	57,672	57,672
Other property and investments-net and other non-current assets	76,525	72,224
Total other non-current assets	<u>145,744</u>	<u>141,443</u>
Deferred Charges:		
Regulatory assets for deferred income tax	117,923	109,853
Regulatory assets for pensions and other postretirement benefits	237,104	240,114
Other regulatory assets	137,366	135,751
Regulatory asset for interest rate swaps	155,027	161,508
Non-current regulatory asset for energy commodity derivatives	15,236	16,919
Other deferred charges	6,064	5,326
Total deferred charges	<u>668,720</u>	<u>669,471</u>
Total assets	<u>\$ 5,340,359</u>	<u>\$ 5,309,755</u>

*The Accompanying Notes are an Integral Part of These Statements.*

CONDENSED CONSOLIDATED BALANCE SHEETS (continued)

*Avista Corporation*

Dollars in thousands

(Unaudited)

	March 31, 2017	December 31, 2016
<b>Liabilities and Equity:</b>		
Current Liabilities:		
Accounts payable	\$ 72,354	\$ 115,545
Current portion of long-term debt and capital leases	3,317	3,287
Short-term borrowings	105,000	120,000
Energy commodity derivative liabilities	7,481	7,035
Accrued interest	28,689	15,869
Accrued taxes other than income taxes	42,853	33,374
Deferred natural gas costs	30,987	30,820
Current portion of pensions and other postretirement benefits	10,906	10,994
Other current liabilities	65,238	70,604
Total current liabilities	366,825	407,528
Long-term debt and capital leases	1,678,113	1,678,717
Long-term debt to affiliated trusts	51,547	51,547
Regulatory liability for utility plant retirement costs	276,533	273,983
Pensions and other postretirement benefits	223,304	226,552
Deferred income taxes	866,861	840,928
Non-current interest rate swap derivative liabilities	23,143	28,705
Other non-current liabilities, regulatory liabilities and deferred credits	168,587	153,319
Total liabilities	3,654,913	3,661,279
Commitments and Contingencies (See Notes to Condensed Consolidated Financial Statements)		
Equity:		
Avista Corporation Shareholders' Equity:		
Common stock, no par value; 200,000,000 shares authorized; 64,386,152 and 64,187,934 shares issued and outstanding as of March 31, 2017 and December 31, 2016, respectively	1,073,098	1,075,281
Accumulated other comprehensive loss	(7,385)	(7,568)
Retained earnings	619,963	581,014
Total Avista Corporation shareholders' equity	1,685,676	1,648,727
Noncontrolling Interests	(230)	(251)
Total equity	1,685,446	1,648,476
Total liabilities and equity	\$ 5,340,359	\$ 5,309,755

*The Accompanying Notes are an Integral Part of These Statements.*

# CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

*Avista Corporation*

For the Three Months Ended March 31

Dollars in thousands

(Unaudited)

	2017	2016
Operating Activities:		
Net income	\$ 62,137	\$ 57,665
Non-cash items included in net income:		
Depreciation and amortization	43,084	40,291
Deferred income tax provision and investment tax credits	17,614	34,030
Power and natural gas cost amortizations, net	3,091	5,379
Amortization of debt expense	813	876
Amortization of investment in exchange power	613	613
Stock-based compensation expense	832	2,313
Equity-related Allowance for Funds Used During Construction (AFUDC)	(1,650)	(2,261)
Pension and other postretirement benefit expense	9,348	9,475
Amortization of Spokane Energy contract	—	3,558
Other regulatory assets and liabilities and deferred debits and credits	(6,878)	(7,127)
Change in decoupling regulatory deferral	14,857	(11,456)
Other	(116)	(9)
Contributions to defined benefit pension plan	(7,400)	(4,000)
Changes in certain current assets and liabilities:		
Accounts and notes receivable	(668)	18,364
Materials and supplies, fuel stock and stored natural gas	6,129	10,263
Collateral posted for derivative instruments	(2,620)	(42,871)
Income taxes receivable	14,106	11,210
Other current assets	(116)	(4,106)
Accounts payable	(20,239)	(30,804)
Other current liabilities	16,778	15,752
Net cash provided by operating activities	<u>149,715</u>	<u>107,155</u>
Investing Activities:		
Utility property capital expenditures (excluding equity-related AFUDC)	(86,763)	(88,878)
Other capital expenditures	(35)	(119)
Issuance of notes receivable at subsidiaries	(400)	(1,076)
Investments made by subsidiaries	(2,627)	(1,358)
Other	(102)	(223)
Net cash used in investing activities	<u>(89,927)</u>	<u>(91,654)</u>

*The Accompanying Notes are an Integral Part of These Statements.*



CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

*Avista Corporation*

For the Three Months Ended March 31

Dollars in thousands

(Unaudited)

	2017	2016
Financing Activities:		
Net decrease in borrowings from committed line of credit	\$ (15,000)	\$ (15,000)
Maturity of long-term debt and capital leases	(822)	(792)
Issuance of common stock, net of issuance costs	315	27,150
Cash dividends paid	(23,167)	(21,545)
Other	(3,442)	(3,031)
Net cash used in financing activities	<u>(42,116)</u>	<u>(13,218)</u>
Net increase in cash and cash equivalents	17,672	2,283
Cash and cash equivalents at beginning of period	<u>8,507</u>	<u>10,484</u>
Cash and cash equivalents at end of period	<u>\$ 26,179</u>	<u>\$ 12,767</u>

*The Accompanying Notes are an Integral Part of These Statements.*

# CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

## *Avista Corporation*

For the Three Months Ended March 31

Dollars in thousands

(Unaudited)

	2017	2016
Common Stock, Shares:		
Shares outstanding at beginning of period	64,187,934	62,312,651
Shares issued	198,218	895,408
Shares outstanding at end of period	64,386,152	63,208,059
Common Stock, Amount:		
Balance at beginning of period	\$ 1,075,281	\$ 1,004,336
Equity compensation expense	922	1,967
Issuance of common stock, net of issuance costs	315	27,150
Payment of minimum tax withholdings for share-based payment awards	(3,420)	(3,027)
Balance at end of period	1,073,098	1,030,426
Accumulated Other Comprehensive Loss:		
Balance at beginning of period	(7,568)	(6,650)
Other comprehensive income (loss)	183	(1,229)
Balance at end of period	(7,385)	(7,879)
Retained Earnings:		
Balance at beginning of period	581,014	530,940
Net income attributable to Avista Corporation shareholders	62,116	57,649
Cash dividends paid on common stock	(23,167)	(21,545)
Balance at end of period	619,963	567,044
Total Avista Corporation shareholders' equity	1,685,676	1,589,591
Noncontrolling Interests:		
Balance at beginning of period	(251)	(339)
Net income attributable to noncontrolling interests	21	16
Balance at end of period	(230)	(323)
Total equity	\$ 1,685,446	\$ 1,589,268

*The Accompanying Notes are an Integral Part of These Statements.*

## **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

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The accompanying condensed consolidated financial statements of Avista Corporation (Avista Corp. or the Company) for the interim periods ended March 31, 2017 and March 31, 2016 are unaudited; however, in the opinion of management, the statements reflect all adjustments necessary for a fair statement of the results for the interim periods. All such adjustments are of a normal recurring nature. The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The Condensed Consolidated Statements of Income for the interim periods are not necessarily indicative of the results to be expected for the full year. These condensed consolidated financial statements do not contain the detail or footnote disclosure concerning accounting policies and other matters which would be included in full fiscal year consolidated financial statements; therefore, they should be read in conjunction with the Company's audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 (2016 Form 10-K). Please refer to the section "Acronyms and Terms" in the 2016 Form 10-K for definitions of certain terms not defined herein. The acronyms and terms are an integral part of these condensed consolidated financial statements.

### **NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### ***Nature of Business***

Avista Corp. is primarily an electric and natural gas utility with certain other business ventures. Avista Utilities is an operating division of Avista Corp., comprising the regulated utility operations in the Pacific Northwest. Avista Utilities provides electric distribution and transmission, and natural gas distribution services in parts of eastern Washington and northern Idaho. Avista Utilities also provides natural gas distribution service in parts of northeastern and southwestern Oregon. Avista Utilities has electric generating facilities in Washington, Idaho, Oregon and Montana. Avista Utilities also supplies electricity to a small number of customers in Montana, most of whom are employees who operate Avista Utilities' Noxon Rapids generating facility.

Alaska Energy and Resources Company (AERC) is a wholly-owned subsidiary of Avista Corp. The primary subsidiary of AERC is Alaska Electric Light and Power Company (AEL&P), which comprises Avista Corp.'s regulated utility operations in Alaska. Avista Capital, Inc. (Avista Capital), a wholly owned non-regulated subsidiary of Avista Corp., is the parent company of all of the subsidiary companies in the non-utility businesses, with the exception of AJT Mining Properties, Inc., which is a subsidiary of AERC.

#### ***Basis of Reporting***

The condensed consolidated financial statements include the assets, liabilities, revenues and expenses of the Company and its subsidiaries and other majority owned subsidiaries and variable interest entities for which the Company or its subsidiaries are the primary beneficiaries. Intercompany balances were eliminated in consolidation. The accompanying condensed consolidated financial statements include the Company's proportionate share of utility plant and related operations resulting from its interests in jointly owned plants.

#### ***Taxes Other Than Income Taxes***

Taxes other than income taxes include state excise taxes, city occupational and franchise taxes, real and personal property taxes and certain other taxes not based on income. These taxes are generally based on revenues or the value of property. Utility related taxes collected from customers (primarily state excise taxes and city utility taxes) are recorded as operating revenue and expense. Taxes other than income taxes consisted of the following items for the three months ended March 31 (dollars in thousands):

	2017	2016
Utility related taxes	\$ 21,584	\$ 18,365
Property taxes	10,406	10,420
Other taxes	672	600
Total	<u>\$ 32,662</u>	<u>\$ 29,385</u>

### ***Materials and Supplies, Fuel Stock and Stored Natural Gas***

Inventories of materials and supplies, fuel stock and stored natural gas are recorded at average cost for our regulated operations and the lower of cost or net realizable value for our non-regulated operations and consisted of the following as of March 31, 2017 and December 31, 2016 (dollars in thousands):

	March 31, 2017	December 31, 2016
Materials and supplies	\$ 42,198	\$ 40,700
Fuel stock	4,277	4,585
Stored natural gas	709	8,029
Total	<u>\$ 47,184</u>	<u>\$ 53,314</u>

### ***Derivative Assets and Liabilities***

Derivatives are recorded as either assets or liabilities on the Condensed Consolidated Balance Sheets measured at estimated fair value.

The Washington Utilities and Transportation Commission (UTC) and the Idaho Public Utilities Commission (IPUC) issued accounting orders authorizing Avista Corp. to offset energy commodity derivative assets or liabilities with a regulatory asset or liability. This accounting treatment is intended to defer the recognition of mark-to-market gains and losses on energy commodity transactions until the period of delivery. Realized benefits and costs result in adjustments to retail rates through purchased gas cost adjustments, the Energy Recovery Mechanism (ERM) in Washington, the Power Cost Adjustment (PCA) mechanism in Idaho, and periodic general rate cases. The resulting regulatory assets have been concluded to be probable of recovery through future rates.

Substantially all forward contracts to purchase or sell power and natural gas are recorded as derivative assets or liabilities at estimated fair value with an offsetting regulatory asset or liability. Contracts that are not considered derivatives are accounted for on the accrual basis until they are settled or realized unless there is a decline in the fair value of the contract that is determined to be other-than-temporary.

For interest rate swap derivatives, Avista Corp. records all mark-to-market gains and losses in each accounting period as assets and liabilities, as well as offsetting regulatory assets and liabilities, such that there is no income statement impact. The interest rate swap derivatives are risk management tools similar to energy commodity derivatives. Upon settlement of interest rate swap derivatives, the regulatory asset or liability is amortized as a component of interest expense over the term of the associated debt. The Company records an offset of interest rate swap derivative assets and liabilities with regulatory assets and liabilities, based on the prior practice of the commissions to provide recovery through the ratemaking process.

As of March 31, 2017, the Company has multiple master netting agreements with a variety of entities that allow for cross-commodity netting of derivative agreements with the same counterparty (i.e. power derivatives can be netted with natural gas derivatives). In addition, some master netting agreements allow for the netting of commodity derivatives and interest rate swap derivatives for the same counterparty. The Company does not have any agreements which allow for cross-affiliate netting among multiple affiliated legal entities. The Company nets all derivative instruments when allowed by the agreement for presentation in the Condensed Consolidated Balance Sheets.

## ***Fair Value Measurements***

Fair value represents the price that would be received when selling an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. Energy commodity derivative assets and liabilities, deferred compensation assets, as well as derivatives related to interest rate swaps and foreign currency exchange contracts, are reported at estimated fair value on the Condensed Consolidated Balance Sheets. See Note 7 for the Company's fair value disclosures.

## ***Accumulated Other Comprehensive Loss***

Accumulated other comprehensive loss, net of tax, consisted of the following as of March 31, 2017 and December 31, 2016 (dollars in thousands):

	March 31, 2017	December 31, 2016
Unfunded benefit obligation for pensions and other postretirement benefit plans - net of taxes of \$3,977 and \$4,075, respectively	\$ 7,385	\$ 7,568

The following table details the reclassifications out of accumulated other comprehensive loss by component for the three months ended March 31 (dollars in thousands).

Details about Accumulated Other Comprehensive Loss Components	Amounts Reclassified from Accumulated Other Comprehensive Loss		Affected Line Item in Statement of Income
	2017	2016	
Amortization of defined benefit pension items			
Amortization of net prior service cost	\$ (299)	\$ (311)	(a)
Amortization of net loss	3,638	3,642	(a)
Adjustment due to effects of regulation	(3,058)	(5,223)	(a) (b)
	281	(1,892)	Total before tax
	(98)	663	Tax benefit (expense)
	<u>\$ 183</u>	<u>\$ (1,229)</u>	Net of tax

- (a) These accumulated other comprehensive loss components are included in the computation of net periodic pension cost (see Note 4 for additional details).
- (b) The adjustment for the effects of regulation during the three months ended March 31, 2016 includes approximately \$2.1 million related to the reclassification of a pension regulatory asset associated with one of our jurisdictions into accumulated other comprehensive loss.

## ***Contingencies***

The Company has unresolved regulatory, legal and tax issues which have inherently uncertain outcomes. The Company accrues a loss contingency if it is probable that a liability has been incurred and the amount of the loss or impairment can be reasonably estimated. The Company also discloses loss contingencies that do not meet these conditions for accrual if there is a reasonable possibility that a material loss may be incurred. As of March 31, 2017, the Company has not recorded any significant amounts related to unresolved contingencies. See Note 10 for further discussion of the Company's commitments and contingencies.

## NOTE 2. NEW ACCOUNTING STANDARDS

### *ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)"*

In May 2014, the FASB issued ASU No. 2014-09, which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that an entity should identify the various performance obligations in a contract, allocate the transaction price among the performance obligations and recognize revenue when (or as) the entity satisfies each performance obligation. This ASU is effective for periods beginning after December 15, 2017.

The Company has formed a revenue recognition standard implementation team that is working through several implementation issues described below. The Company has evaluated this standard and is planning to adopt this standard in 2018 upon its effective date. The Company is currently expecting to use a modified retrospective method of adoption, which would require a cumulative adjustment to opening retained earnings, as opposed to a full retrospective application. The Company is not far enough along in the adoption process to determine the amount of cumulative adjustment necessary.

Since the majority of Avista Corp.'s revenue is from rate-regulated sales of electricity and natural gas to retail customers and revenue is recognized as energy is delivered to these customers, the Company does not expect a significant change in operating revenues or net income. The Company is in the process of reviewing and analyzing certain contracts with customers (most of which are related to wholesale sales of power and natural gas), but has not yet identified any significant differences in revenue recognition between current GAAP and ASU No. 2014-09.

During the implementation process, the Company has identified several unresolved issues, the most significant of which are as follows based on our current assessment:

Contributions in Aid of Construction – There is the potential that contributions in aid of construction (CIAC) could be recognized as revenue upon the adoption of ASU No. 2014-09. Under current GAAP, CIACs are accounted for as an offset to the cost of utility plant in service.

Utility-Related Taxes Collected from Customers – There are questions on the presentation of utility related taxes collected from customers (primarily state excise taxes and city utility taxes) on a gross basis. Under current GAAP, the Company is allowed to record these utility related taxes on a gross basis in revenue when billed to customers with an offset included in taxes other than income taxes in operating expenses. The Company is evaluating whether this presentation is appropriate under ASU 2014-09 or whether they should be presented on a net basis.

Collectibility - There are questions regarding the requirement that collection of a sale be probable and how, or if, utilities should consider bad debt collection mechanisms (riders, base rate adjustments, etc.) in assessing probability of collection on sales to low income customers. If the bad debt recovery mechanisms cannot be considered, there is the potential that certain sales to low income customers cannot be recognized as revenue until payment is received from the customers.

The Company is monitoring utility industry implementation guidance as it relates to unresolved issues to determine if there will be an industry consensus regarding accounting and presentation of these items.

In addition to the unresolved issues described above, the Company also expects significant changes to its revenue-related footnote disclosures. The Company continues to evaluate what information would be most useful for users of the financial statements, including information already provided elsewhere in the document outside the footnote disclosures. These additional disclosures could include the disaggregation of revenues by geographic location, type of service, source of revenue or customer class. Also, the Company expects enhanced disclosures regarding its revenue recognition policies and elections.

*ASU No. 2016-02 “Leases (Topic 842).”*

In February 2016, the FASB issued ASU No. 2016-02. This ASU introduces a new lessee model that requires most leases to be capitalized and shown on the balance sheet with corresponding lease assets and liabilities. The standard also aligns certain of the underlying principles of the new lessor model with those in Topic 606, the FASB’s new revenue recognition standard. Furthermore, this ASU addresses other issues that arise under the current lease model; for example, eliminating the required use of bright-line tests in current GAAP for determining lease classification (operating leases versus capital leases). This ASU also includes enhanced disclosures surrounding leases. This ASU is effective for periods beginning on or after December 15, 2018; however, early adoption is permitted. Upon adoption, this ASU must be applied using a modified retrospective approach to the earliest period presented, which will likely require restatements of previously issued financial statements. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. The Company evaluated this standard and determined that it will most likely not early adopt this standard before its effective date in 2019. The Company has formed a lease standard implementation team that is working through the implementation process. The most significant implementation challenge identified thus far relates to identifying a complete population of leases and potential leases under the new lease standard. Also, the Company is monitoring utility industry implementation guidance as it relates to several unresolved issues to determine if there will be an industry consensus, including whether right-of-ways are considered leases. The Company cannot, at this time, estimate the potential impact on its future financial condition, results of operations and cash flows.

*ASU No. 2016-09 “Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.”*

In March 2016, the FASB issued ASU No. 2016-09. This ASU simplified several aspects of the accounting for employee share-based payment transactions including:

- allowing excess tax benefits or tax deficiencies to be recognized as income tax benefits or expenses in the Condensed Consolidated Statements of Income rather than in Additional Paid in Capital (APIC),
- excess tax benefits no longer represent a financing cash inflow on the Condensed Consolidated Statements of Cash Flows and instead will be included as an operating activity,
- requiring excess tax benefits and tax deficiencies to be excluded from the calculation of diluted earnings per share, whereas under previous accounting guidance, these amounts had to be estimated and included in the calculation,
- allowing forfeitures to be accounted for as they occur, instead of estimating forfeitures, and
- changing the statutory tax withholding requirements for share-based payments.

The Company early adopted this standard during the second quarter of 2016, with a retrospective effective date of January 1, 2016. The adoption of this standard resulted in a recognized income tax benefit of \$1.6 million in 2016 associated with excess tax benefits on settled share-based employee payments. Because this standard was adopted in the second quarter of 2016, but had a retrospective effective date of January 1, 2016, the effects from the adoption were reflected in the first quarter of 2016 and the Condensed Consolidated Financial Statements for that quarter were recast from those presented when the financial statements were originally issued.

*ASU No. 2017-07 “Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost”*

In March 2017, the FASB issued ASU No. 2017-07, which amends the income statement presentation of the components of net period benefit cost for an entity’s defined benefit pension and other postretirement plans. Under current GAAP, net benefit cost consists of several components that reflect different aspects of an employer’s financial arrangements as well as the cost of benefits earned by employees. These components are aggregated and reported net in the financial statements. ASU No. 2017-07 requires entities to (1) disaggregate the current service-cost component from the other components of net benefit cost (other components) and present it with other current compensation costs for related employees in the income statement and (2) present the other components elsewhere in the income statement and outside of income from operations.

In addition, only the service-cost component of net benefit cost is eligible for capitalization (e.g., as part of utility plant). This is a change from current practice, under which entities capitalize the aggregate net benefit cost to utility plant when applicable, in accordance with Federal Energy and Regulatory Commission (FERC) accounting guidance. Avista Corp. is a rate-regulated entity and all components of net benefit cost are currently recovered from rate payers as a component of utility plant and under the new ASU these costs will continue to be recovered from rate payers in the same manner over the depreciable lives of utility plant. As all such costs are expected to continue to be recoverable, the components that are no longer eligible to be recorded as a component of plant for GAAP will be recorded as regulatory assets.

This ASU is effective for periods beginning after December 15, 2017 and early adoption is permitted. Upon adoption, entities must use a retrospective transition method to adopt the requirement for separate presentation in the income statement and a prospective transition method to adopt the requirement to limit the capitalization of benefit costs to the service-cost component. The Company does not expect to early adopt this standard and does not expect a material impact on its future financial condition, results of operations or cash flows upon adoption of this standard.

### **NOTE 3. DERIVATIVES AND RISK MANAGEMENT**

The disclosures below in Note 3 apply only to Avista Corp. and its operating division Avista Utilities; AERC and its primary subsidiary AEL&P do not enter into derivative instruments.

#### ***Energy Commodity Derivatives***

Avista Corp. is exposed to market risks relating to changes in electricity and natural gas commodity prices and certain other fuel prices. Market risk is, in general, the risk of fluctuation in the market price of the commodity being traded and is influenced primarily by supply and demand. Market risk includes the fluctuation in the market price of associated derivative commodity instruments. Avista Corp. utilizes derivative instruments, such as forwards, futures, swap derivatives and options in order to manage the various risks relating to these commodity price exposures. Avista Corp. has an energy resources risk policy and control procedures to manage these risks.

As part of the Avista Corp.’s resource procurement and management operations in the electric business, Avista Corp. engages in an ongoing process of resource optimization, which involves the economic selection from available energy resources to serve Avista Corp.’s load obligations and the use of these resources to capture available economic value. Avista Corp. transacts in wholesale markets by selling and purchasing electric capacity and energy, fuel for electric generation, and derivative contracts related to capacity, energy and fuel. Such transactions are part of the process of matching resources with load obligations and hedging a portion of the related financial risks. These transactions range from terms of intra-hour up to multiple years.

As part of its resource procurement and management of its natural gas business, Avista Corp. makes continuing projections of its natural gas loads and assesses available natural gas resources including natural gas storage availability. Natural gas resource planning typically includes peak requirements, low and average monthly requirements and delivery constraints from natural gas supply locations to Avista Corp.’s distribution system. However, daily variations in natural gas demand can be significantly different than monthly demand projections. On the basis of these projections, Avista Corp. plans and executes a series of



transactions to hedge a portion of its projected natural gas requirements through forward market transactions and derivative instruments. These transactions may extend as much as four natural gas operating years (November through October) into the future. Avista Corp. also leaves a significant portion of its natural gas supply requirements unhedged for purchase in short-term and spot markets.

Avista Corp. plans for sufficient natural gas delivery capacity to serve its retail customers for a theoretical peak day event. Avista Corp. generally has more pipeline and storage capacity than what is needed during periods other than a peak day. Avista Corp. optimizes its natural gas resources by using market opportunities to generate economic value that helps mitigate fixed costs. Avista Corp. also optimizes its natural gas storage capacity by purchasing and storing natural gas when prices are traditionally lower, typically in the summer, and withdrawing during higher priced months, typically during the winter. However, if market conditions and prices indicate that Avista Corp. should buy or sell natural gas at other times during the year, Avista Corp. engages in optimization transactions to capture value in the marketplace. Natural gas optimization activities include, but are not limited to, wholesale market sales of surplus natural gas supplies, purchases and sales of natural gas to optimize use of pipeline and storage capacity, and participation in the transportation capacity release market.

The following table presents the underlying energy commodity derivative volumes as of March 31, 2017 that are expected to be delivered in each respective year (in thousands of MWhs and mmbTUs):

Year	Purchases				Sales			
	Electric Derivatives		Gas Derivatives		Electric Derivatives		Gas Derivatives	
	Physical (1)	Financial (1)	Physical (1)	Financial (1)	Physical (1) MWH	Financial (1) MWH	Physical (1) mmbTUs	Financial (1) mmbTUs
April - December 2017	214	1,044	8,891	83,808	149	1,101	4,448	61,633
2018	397	246	—	64,415	286	1,244	1,360	33,188
2019	235	737	610	35,623	126	982	1,345	19,598
2020	—	—	910	2,725	—	—	1,430	—
2021	—	—	—	—	—	—	1,049	—
Thereafter	—	—	—	—	—	—	—	—

The following table presents the underlying energy commodity derivative volumes as of December 31, 2016 that are expected to be delivered in each respective year (in thousands of MWhs and mmbTUs):

Year	Purchases				Sales			
	Electric Derivatives		Gas Derivatives		Electric Derivatives		Gas Derivatives	
	Physical (1)	Financial (1)	Physical (1)	Financial (1)	Physical (1) MWH	Financial (1) MWH	Physical (1) mmbTUs	Financial (1) mmbTUs
2017	510	907	15,475	110,380	316	1,552	4,165	73,110
2018	397	—	—	52,755	286	1,244	1,360	15,113
2019	235	—	610	29,475	158	982	1,345	4,020
2020	—	—	910	2,725	—	—	1,430	—
2021	—	—	—	—	—	—	1,060	—
Thereafter	—	—	—	—	—	—	—	—

- (1) Physical transactions represent commodity transactions in which Avista Corp. will take or make delivery of either electricity or natural gas; financial transactions represent derivative instruments with delivery of cash in the amount of the benefit or cost but with no physical delivery of the commodity, such as futures, swap derivatives, options, or forward contracts.

The electric and natural gas derivative contracts above will be included in either power supply costs or natural gas supply costs during the period they are delivered and will be included in the various recovery mechanisms (ERM, PCA, and Purchased Gas Adjustments (PGA)), or in the general rate case process, and are expected to be collected through retail rates from customers.

### ***Foreign Currency Exchange Derivatives***

A significant portion of Avista Corp.'s natural gas supply (including fuel for power generation) is obtained from Canadian sources. Most of those transactions are executed in U.S. dollars, which avoids foreign currency risk. A portion of Avista Corp.'s short-term natural gas transactions and long-term Canadian transportation contracts are committed based on Canadian currency prices and settled within 60 days with U.S. dollars. Avista Corp. hedges a portion of the foreign currency risk by purchasing Canadian currency exchange derivatives when such commodity transactions are initiated. The foreign currency exchange derivatives and the unhedged foreign currency risk have not had a material effect on Avista Corp.'s financial condition, results of operations or cash flows and these differences in cost related to currency fluctuations are included with natural gas supply costs for ratemaking.

The following table summarizes the foreign currency exchange derivatives that Avista Corp. has outstanding as of March 31, 2017 and December 31, 2016 (dollars in thousands):

	March 31, 2017	December 31, 2016
Number of contracts	24	21
Notional amount (in United States dollars)	\$ 5,808	\$ 2,819
Notional amount (in Canadian dollars)	7,766	3,754

### ***Interest Rate Derivatives***

Avista Corp. is affected by fluctuating interest rates related to a portion of its existing debt, and future borrowing requirements. Avista Corp. hedges a portion of its interest rate risk with financial derivative instruments, which may include interest rate swap derivatives and U.S. Treasury lock agreements. These interest rate swap derivatives and U.S. Treasury lock agreements are considered economic hedges against fluctuations in future cash flows associated with anticipated debt issuances.

The following table summarizes the unsettled interest rate swap derivatives that Avista Corp. has outstanding as of March 31, 2017 and December 31, 2016 (dollars in thousands):

Balance Sheet Date	Number of Contracts	Notional Amount	Mandatory Cash Settlement Date
March 31, 2017	6	\$ 75,000	2017
	14	275,000	2018
	6	70,000	2019
	2	20,000	2020
	5	60,000	2022
December 31, 2016	6	\$ 75,000	2017
	14	275,000	2018
	6	70,000	2019
	2	20,000	2020
	5	60,000	2022

The fair value of outstanding interest rate swap derivatives can vary significantly from period to period depending on the total notional amount of swap derivatives outstanding and fluctuations in market interest rates compared to the interest rates fixed by the swaps. Avista Corp. is required to make cash payments to settle the interest rate swap derivatives when the fixed rates are higher than prevailing market rates at the date of settlement. Conversely, Avista Corp. receives cash to settle its interest rate swap derivatives when prevailing market rates at the time of settlement exceed the fixed swap rates. Upon settlement of interest rate swaps, the cash payments made or received are recorded as a regulatory asset or liability and are amortized as a component of interest expense over the life of the associated debt. The settled interest rate swaps are also included as a part of the Company's cost of debt calculation for ratemaking purposes.

### Summary of Outstanding Derivative Instruments

The amounts recorded on the Condensed Consolidated Balance Sheet as of March 31, 2017 and December 31, 2016 reflect the offsetting of derivative assets and liabilities where a legal right of offset exists.

The following table presents the fair values and locations of derivative instruments recorded on the Condensed Consolidated Balance Sheet as of March 31, 2017 (in thousands):

Derivative and Balance Sheet Location	Fair Value as of March 31, 2017			
	Gross Asset	Gross Liability	Collateral Netted	Net Asset (Liability)
<b>Foreign currency exchange derivatives</b>				
Other current assets	\$ 37	\$ —	\$ —	\$ 37
<b>Interest rate swap derivatives</b>				
Other current assets	3,748	—	—	3,748
Other property and investments-net and other non-current assets	6,754	(116)	—	6,638
Other current liabilities	—	(15,069)	10,100	(4,969)
Non-current interest rate swap derivative liabilities	5,078	(54,261)	26,040	(23,143)
<b>Energy commodity derivatives</b>				
Other current assets	604	(47)	—	557
Current energy commodity derivative liabilities	29,929	(42,136)	4,726	(7,481)
Other non-current liabilities, regulatory liabilities and deferred credits	17,422	(32,658)	2,817	(12,419)
Total derivative instruments recorded on the balance sheet	<u>\$ 63,572</u>	<u>\$ (144,287)</u>	<u>\$ 43,683</u>	<u>\$ (37,032)</u>

The following table presents the fair values and locations of derivative instruments recorded on the Condensed Consolidated Balance Sheet as of December 31, 2016 (in thousands):

Derivative and Balance Sheet Location	Fair Value as of December 31, 2016			
	Gross Asset	Gross Liability	Collateral Netted	Net Asset (Liability) on Balance Sheet
<b>Foreign currency exchange derivatives</b>				
Other current liabilities	\$ 5	\$ (28)	\$ —	\$ (23)
<b>Interest rate swap derivatives</b>				
Other current assets	3,393	—	—	3,393
Other property and investments-net and other non-current assets	5,754	(397)	—	5,357
Other current liabilities	—	(15,756)	9,731	(6,025)
Non-current interest rate swap derivative liabilities	3,951	(57,825)	25,169	(28,705)
<b>Energy commodity derivatives</b>				
Other current assets	18,682	(16,787)	—	1,895
Current energy commodity derivative liabilities	16,335	(29,598)	6,228	(7,035)
Other non-current liabilities, regulatory liabilities and deferred credits	13,071	(29,990)	3,630	(13,289)
Total derivative instruments recorded on the balance sheet	<u>\$ 61,191</u>	<u>\$ (150,381)</u>	<u>\$ 44,758</u>	<u>\$ (44,432)</u>

### ***Exposure to Demands for Collateral***

Avista Corp.'s derivative contracts often require collateral (in the form of cash or letters of credit) or other credit enhancements, or reductions or terminations of a portion of the contract through cash settlement. In the event of a downgrade in Avista Corp.'s credit ratings or changes in market prices, additional collateral may be required. In periods of price volatility, the level of exposure can change significantly. As a result, sudden and significant demands may be made against Avista Corp.'s credit facilities and cash. Avista Corp. actively monitors the exposure to possible collateral calls and takes steps to mitigate capital requirements.

The following table presents Avista Corp.'s collateral outstanding related to its derivative instruments as of March 31, 2017 and December 31, 2016 (in thousands):

	March 31, 2017	December 31, 2016
<b>Energy commodity derivatives</b>		
Cash collateral posted	\$ 18,514	\$ 17,134
Letters of credit outstanding	30,900	24,400
Balance sheet offsetting (cash collateral against net derivative positions)	7,543	9,858
<b>Interest rate swap derivatives</b>		
Cash collateral posted	36,140	34,900
Letters of credit outstanding	4,800	3,600
Balance sheet offsetting (cash collateral against net derivative positions)	36,140	34,900

Certain of Avista Corp.'s derivative instruments contain provisions that require Avista Corp. to maintain an "investment grade" credit rating from the major credit rating agencies. If Avista Corp.'s credit ratings were to fall below "investment grade," it would be in violation of these provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing collateralization on derivative instruments in net liability positions.

The following table presents the aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a liability position and the amount of additional collateral Avista Corp. could be required to post as of March 31, 2017 and December 31, 2016 (in thousands):

	March 31, 2017	December 31, 2016
<b>Energy commodity derivatives</b>		
Liabilities with credit-risk-related contingent features	\$ 771	\$ 1,124
Additional collateral to post	771	1,046
<b>Interest rate swap derivatives</b>		
Liabilities with credit-risk-related contingent features	69,446	73,978
Additional collateral to post	13,310	21,100

### **NOTE 4. PENSION PLANS AND OTHER POSTRETIREMENT BENEFIT PLANS**

#### ***Avista Utilities***

Avista Utilities' pension and other postretirement plans have not changed during the three months ended March 31, 2017. The Company's funding policy is to contribute at least the minimum amounts that are required to be funded under the Employee Retirement Income Security Act, but not more than the maximum amounts that are currently deductible for income tax

purposes. The Company contributed \$7.4 million in cash to the pension plan for the three months ended March 31, 2017 and expects to contribute a total of \$22.0 million in 2017. The Company contributed \$12.0 million in cash to the pension plan in 2016.

The Company uses a December 31 measurement date for its defined benefit pension and other postretirement benefit plans. The following table sets forth the components of net periodic benefit costs for the three months ended March 31 (dollars in thousands):

	Pension Benefits		Other Post-retirement Benefits	
	2017	2016	2017	2016
<b>Three months ended March 31:</b>				
Service cost	\$ 5,042	\$ 4,519	\$ 824	\$ 779
Interest cost	6,951	6,900	1,399	1,559
Expected return on plan assets	(7,900)	(6,750)	(475)	(475)
Amortization of prior service cost	—	—	(312)	(312)
Net loss recognition	2,546	1,890	1,273	1,365
Net periodic benefit cost	<u>\$ 6,639</u>	<u>\$ 6,559</u>	<u>\$ 2,709</u>	<u>\$ 2,916</u>

Total net periodic benefit costs in the table above are recorded to the same accounts as labor expense. Labor and benefits expense is recorded to various projects based on whether the work is a capital project or an operating expense. Approximately 40 percent of all labor and benefits is capitalized to utility property and 60 percent is expensed to other operating expenses.

## NOTE 5. COMMITTED LINES OF CREDIT

### *Avista Corp.*

Avista Corp. has a committed line of credit with various financial institutions in the total amount of \$400.0 million that expires in April 2021.

Borrowings outstanding and interest rates of borrowings (excluding letters of credit) under the Company's revolving committed line of credit were as follows as of March 31, 2017 and December 31, 2016 (dollars in thousands):

	March 31, 2017	December 31, 2016
Borrowings outstanding at end of period	\$ 105,000	\$ 120,000
Letters of credit outstanding at end of period	\$ 42,053	\$ 34,353
Average interest rates at end of period	1.74%	1.50%

As of March 31, 2017 and December 31, 2016, the borrowings outstanding under Avista Corp.'s committed line of credit were classified as short-term borrowings on the Condensed Consolidated Balance Sheet.

### *AEL&P*

AEL&P has a committed line of credit in the amount of \$25.0 million that expires in November 2019. As of March 31, 2017 and December 31, 2016, there were no borrowings or letters of credit outstanding under this committed line of credit.

## NOTE 6. LONG-TERM DEBT TO AFFILIATED TRUSTS

In 1997, the Company issued Floating Rate Junior Subordinated Deferrable Interest Debentures, Series B, with a principal amount of \$51.5 million to Avista Capital II, an affiliated business trust formed by the Company. Avista Capital II issued \$50.0 million of Preferred Trust Securities with a floating distribution rate of LIBOR plus 0.875 percent, calculated and reset quarterly.

The distribution rates paid were as follows during the three months ended March 31, 2017 and the year ended December 31, 2016:

	March 31, 2017	December 31, 2016
Low distribution rate	1.81%	1.29%
High distribution rate	1.93%	1.81%
Distribution rate at the end of the period	1.93%	1.81%

Concurrent with the issuance of the Preferred Trust Securities, Avista Capital II issued \$1.5 million of Common Trust Securities to the Company. These debt securities may be redeemed at the option of Avista Capital II at any time and mature on June 1, 2037. In December 2000, the Company purchased \$10.0 million of these Preferred Trust Securities.

The Company owns 100 percent of Avista Capital II and has solely and unconditionally guaranteed the payment of distributions on, and redemption price and liquidation amount for, the Preferred Trust Securities to the extent that Avista Capital II has funds available for such payments from the respective debt securities. Upon maturity or prior redemption of such debt securities, the Preferred Trust Securities will be mandatorily redeemed. The Company does not include these capital trusts in its consolidated financial statements as Avista Corp. is not the primary beneficiary. As such, the sole assets of the capital trusts are \$51.5 million of junior subordinated deferrable interest debentures of Avista Corp., which are reflected on the Condensed Consolidated Balance Sheets. Interest expense to affiliated trusts in the Condensed Consolidated Statements of Income represents interest expense on these debentures.

#### NOTE 7. FAIR VALUE

The carrying values of cash and cash equivalents, accounts and notes receivable, accounts payable, and short-term borrowings are reasonable estimates of their fair values. Long-term debt (including current portion and material capital leases) and long-term debt to affiliated trusts are reported at carrying value on the Condensed Consolidated Balance Sheets.

The fair value hierarchy prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to fair values derived from unobservable inputs (Level 3 measurement).

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

Level 1 – Quoted prices are available in active markets for identical assets or liabilities. Active markets are those in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1, but which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace.

Level 3 – Pricing inputs include significant inputs that are generally unobservable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires

judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. The determination of the fair values incorporates various factors that not only include the credit standing of the counterparties involved and the impact of credit enhancements (such as cash deposits and letters of credit), but also the impact of Avista Corp.'s nonperformance risk on its liabilities.

The following table sets forth the carrying value and estimated fair value of the Company's financial instruments not reported at estimated fair value on the Condensed Consolidated Balance Sheets as of March 31, 2017 and December 31, 2016 (dollars in thousands):

	March 31, 2017		December 31, 2016	
	Carrying	Estimated	Carrying	Estimated
Long-term debt (Level 2)	\$ 951,000	\$ 1,077,127	\$ 951,000	\$ 1,048,661
Long-term debt (Level 3)	677,000	690,772	677,000	675,251
Snettisham capital lease obligation (Level 3)	61,556	62,200	62,160	62,800
Long-term debt to affiliated trusts (Level 3)	51,547	38,145	51,547	38,660

These estimates of fair value of long-term debt and long-term debt to affiliated trusts were primarily based on available market information, which generally consists of estimated market prices from third party brokers for debt with similar risk and terms. The price ranges obtained from the third party brokers consisted of par values of 74.00 to 129.85, where a par value of 100.0 represents the carrying value recorded on the Condensed Consolidated Balance Sheets. Level 2 long-term debt represents publicly issued bonds with quoted market prices; however, due to their limited trading activity, they are classified as Level 2 because brokers must generate quotes and make estimates if there is no trading activity near a period end. Level 3 long-term debt consists of private placement bonds and debt to affiliated trusts, which typically have no secondary trading activity. Fair values in Level 3 are estimated based on market prices from third party brokers using secondary market quotes for debt with similar risk and terms to generate quotes for Avista Corp. bonds. Due to the unique nature of the Snettisham capital lease obligation, the estimated fair value of these items was determined based on a discounted cash flow model using available market information. The Snettisham capital lease obligation was discounted to present value using the Morgan Markets A Ex-Fin discount rate as published on March 31, 2017.

The following table discloses by level within the fair value hierarchy the Company's assets and liabilities measured and reported on the Condensed Consolidated Balance Sheets as of March 31, 2017 and December 31, 2016 at fair value on a recurring basis (dollars in thousands):

	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting (1)	Total
<b>March 31, 2017</b>					
<b>Assets:</b>					
Energy commodity derivatives	\$ —	\$ 47,856	\$ —	\$ (47,299)	\$ 557
Level 3 energy commodity derivatives:					
Natural gas exchange agreement	—	—	99	(99)	—
Foreign currency exchange derivatives	—	37	—	—	37
Interest rate swap derivatives	—	15,580	—	(5,194)	10,386
Deferred compensation assets:					
Fixed income securities (2)	1,725	—	—	—	1,725
Equity securities (2)	5,963	—	—	—	5,963
Total	<u>\$ 7,688</u>	<u>\$ 63,473</u>	<u>\$ 99</u>	<u>\$ (52,592)</u>	<u>\$ 18,668</u>
<b>Liabilities:</b>					
Energy commodity derivatives	\$ —	\$ 55,779	\$ —	\$ (54,842)	\$ 937
Level 3 energy commodity derivatives:					

Natural gas exchange agreement	—	—	4,377	(99)	4,278
Power exchange agreement	—	—	14,419	—	14,419
Power option agreement	—	—	266	—	266
Interest rate swap derivatives	—	69,446	—	(41,334)	28,112
Total	<u>\$ —</u>	<u>\$ 125,225</u>	<u>\$ 19,062</u>	<u>\$ (96,275)</u>	<u>\$ 48,012</u>

	Level 1	Level 2	Level 3	Counterparty and Cash Collateral Netting (1)	Total
<b>December 31, 2016</b>					
<b>Assets:</b>					
Energy commodity derivatives	\$ —	\$ 47,994	\$ —	\$ (46,099)	\$ 1,895
Level 3 energy commodity derivatives:					
Natural gas exchange agreement	—	—	69	(69)	—
Power exchange agreement	—	—	25	(25)	—
Foreign currency exchange derivatives	—	5	—	(5)	—
Interest rate swap derivatives	—	13,098	—	(4,348)	8,750
Deferred compensation assets:					
Fixed income securities (2)	1,789	—	—	—	1,789
Equity securities (2)	5,481	—	—	—	5,481
Total	<u>\$ 7,270</u>	<u>\$ 61,097</u>	<u>\$ 94</u>	<u>\$ (50,546)</u>	<u>\$ 17,915</u>
<b>Liabilities:</b>					
Energy commodity derivatives	\$ —	\$ 56,871	\$ —	\$ (55,957)	\$ 914
Level 3 energy commodity derivatives:					
Natural gas exchange agreement	—	—	5,954	(69)	5,885
Power exchange agreement	—	—	13,474	(25)	13,449
Power option agreement	—	—	76	—	76
Foreign currency exchange derivatives	—	28	—	(5)	23
Interest rate swap derivatives	—	73,978	—	(39,248)	34,730
Total	<u>\$ —</u>	<u>\$ 130,877</u>	<u>\$ 19,504</u>	<u>\$ (95,304)</u>	<u>\$ 55,077</u>

- (1) The Company is permitted to net derivative assets and derivative liabilities with the same counterparty when a legally enforceable master netting agreement exists. In addition, the Company nets derivative assets and derivative liabilities against any payables and receivables for cash collateral held or placed with these same counterparties.
- (2) These assets are trading securities and are included in other property and investments-net and other non-current assets on the Condensed Consolidated Balance Sheets.

The difference between the amount of derivative assets and liabilities disclosed in respective levels in the table above and the amount of derivative assets and liabilities disclosed on the Condensed Consolidated Balance Sheets is due to netting arrangements with certain counterparties. See Note 3 for additional discussion of derivative netting.

To establish fair value for energy commodity derivatives, the Company uses quoted market prices and forward price curves to estimate the fair value of energy commodity derivative instruments included in Level 2. In particular, electric derivative valuations are performed using market quotes, adjusted for periods in between quotable periods. Natural gas derivative valuations are estimated using New York Mercantile Exchange (NYMEX) pricing for similar instruments, adjusted for basin differences, using market quotes. Where observable inputs are available for substantially the full term of the contract, the derivative asset or liability is included in Level 2.

To establish fair values for interest rate swap derivatives, the Company uses forward market curves for interest rates for the term of the swaps and discounts the cash flows back to present value using an appropriate discount rate. The discount rate is



calculated by third party brokers according to the terms of the swap derivatives and evaluated by the Company for reasonableness, with consideration given to the potential non-performance risk by the Company. Future cash flows of the interest rate swap derivatives are equal to the fixed interest rate in the swap compared to the floating market interest rate multiplied by the notional amount for each period.

To establish fair value for foreign currency derivatives, the Company uses forward market curves for Canadian dollars against the US dollar and multiplies the difference between the locked-in price and the market price by the notional amount of the derivative. Forward foreign currency market curves are provided by third party brokers. The Company's credit spread is factored into the locked-in price of the foreign exchange contracts.

Deferred compensation assets and liabilities represent funds held by the Company in a Rabbi Trust for an executive deferral plan. These funds consist of actively traded equity and bond funds with quoted prices in active markets. The balance disclosed in the table above excludes cash and cash equivalents of \$0.3 million as of March 31, 2017 and \$0.4 million as of December 31, 2016.

### ***Level 3 Fair Value***

Under the power exchange agreement the Company purchases power at a price that is based on the average operating and maintenance (O&M) charges from three surrogate nuclear power plants around the country. To estimate the fair value of this agreement the Company estimates the difference between the purchase price based on the future O&M charges and forward prices for energy. The Company compares the Level 2 brokered quotes and forward price curves described above to an internally developed forward price which is based on the average O&M charges from the three surrogate nuclear power plants for the current year. Because the nuclear power plant O&M charges are only known for one year, all forward years are estimated assuming an annual escalation. In addition to the forward price being estimated using unobservable inputs, the Company also estimates the volumes of the transactions that will take place in the future based on historical average transaction volumes per delivery year (November to April). Significant increases or decreases in any of these inputs in isolation would result in a significantly higher or lower fair value measurement. Generally, a change in the current year O&M charges for the surrogate plants is accompanied by a directionally similar change in O&M charges in future years. There is generally not a correlation between external market prices and the O&M charges used to develop the internal forward price.

For the power commodity option agreement, the Company uses the Black-Scholes-Merton valuation model to estimate the fair value, and this model includes significant inputs not observable or corroborated in the market. These inputs include: 1) the strike price (which is an internally derived price based on a combination of generation plant heat rate factors, natural gas market pricing, delivery and other O&M charges), 2) estimated delivery volumes, and 3) volatility rates. Significant increases or decreases in any of these inputs in isolation would result in a significantly higher or lower fair value measurement. Generally, changes in overall commodity market prices and volatility rates are accompanied by directionally similar changes in the strike price and volatility assumptions used in the calculation.

For the natural gas commodity exchange agreement, the Company uses the same Level 2 brokered quotes described above; however, the Company also estimates the purchase and sales volumes (within contractual limits) as well as the timing of those transactions. Changing the timing of volume estimates changes the timing of purchases and sales, impacting which brokered quote is used. Because the brokered quotes can vary significantly from period to period, the unobservable estimates of the timing and volume of transactions can have a significant impact on the calculated fair value. The Company currently estimates volumes and timing of transactions based on a most likely scenario using historical data. Historically, the timing and volume of transactions have not been highly correlated with market prices and market volatility.

The following table presents the quantitative information which was used to estimate the fair values of the Level 3 assets and liabilities above as of March 31, 2017 (dollars in thousands):

	Fair Value (Net) at March 31, 2017	Valuation Technique	Unobservable	Range
Power exchange agreement	\$ (14,419)	Surrogate facility pricing	O&M charges Escalation factor Transaction volumes	\$33.59-\$49.15/MWh (1) 3% - 2017 to 2019 396,984 MWhs
Power option agreement	\$ (266)	Black-Scholes- Merton	Strike price Delivery volumes Volatility rates	\$35.30/MWh - 2019 \$50.43/MWh - 2018 125,837 - 285,979 MWhs 0.20
Natural gas exchange agreement	\$ (4,278)	Internally derived weighted average cost of gas	Forward purchase Forward sales prices Purchase volumes Sales volumes	\$1.65 - \$2.83/mmBTU \$1.67 - \$3.50/mmBTU 115,000 - 310,000 mmBTUs 60,000 - 310,000 mmBTUs

- (1) The average O&M charges for the delivery year beginning in November 2016 are \$39.22 per MWh. For ratemaking purposes the average O&M charges to be included for recovery in retail rates vary slightly between regulatory jurisdictions. The average O&M charges for the delivery year beginning in 2016 are \$44.33 for Washington and \$39.22 for Idaho.

The valuation methods, significant inputs and resulting fair values described above were developed by the Company's management and are reviewed on at least a quarterly basis to ensure they provide a reasonable estimate of fair value each reporting period.

The following table presents activity for energy commodity derivative assets (liabilities) measured at fair value using significant unobservable inputs (Level 3) for the three months ended March 31 (dollars in thousands):

	Natural Gas Exchange Agreement	Power Exchange Agreement	Power Option Agreement	Total
<b>Three months ended March 31, 2017:</b>				
Balance as of January 1, 2017	\$ (5,885)	\$ (13,449)	\$ (76)	\$ (19,410)
Total gains or (losses) (realized/unrealized):				
Included in regulatory assets/liabilities (1)	2,012	(4,493)	(190)	(2,671)
Settlements	(405)	3,523	—	3,118
Ending balance as of March 31, 2017 (2)	<u>\$ (4,278)</u>	<u>\$ (14,419)</u>	<u>\$ (266)</u>	<u>\$ (18,963)</u>
<b>Three months ended March 31, 2016:</b>				
Balance as of January 1, 2016	\$ (5,039)	\$ (21,961)	\$ (124)	\$ (27,124)
Total gains or (losses) (realized/unrealized):				
Included in regulatory assets/liabilities (1)	(1,745)	(2,432)	27	(4,150)
Settlements	778	4,200	—	4,978
Ending balance as of March 31, 2016 (2)	<u>\$ (6,006)</u>	<u>\$ (20,193)</u>	<u>\$ (97)</u>	<u>\$ (26,296)</u>

- (1) All gains and losses are included in other regulatory assets and liabilities. There were no gains and losses included in either net income or other comprehensive income during any of the periods presented in the table above.

- (2) There were no purchases, issuances or transfers from other categories of any derivatives instruments during the periods presented in the table above.

## NOTE 8. COMMON STOCK

In March 2016, the Company entered into four separate sales agency agreements under which Avista Corp.'s sales agents may offer and sell up to 3.8 million new shares of Avista Corp.'s common stock, no par value, from time to time. The sales agency agreements expire on February 29, 2020. As of March 31, 2017, 1.6 million shares have been issued under these agreements, leaving 2.2 million shares remaining to be issued. No shares were issued under these agreements in the three months ended March 31, 2017.

In the three months ended March 31, 2017, Avista Corp. issued 0.2 million shares of common stock, most of which were under employee incentive plans, which have zero proceeds. The Company also issued a small number of shares under the 401K employee investment plan for total net proceeds of \$0.3 million.

## NOTE 9. EARNINGS PER COMMON SHARE ATTRIBUTABLE TO AVISTA CORP. SHAREHOLDERS

The following table presents the computation of basic and diluted earnings per common share attributable to Avista Corp. shareholders for the three months ended March 31 (in thousands, except per share amounts):

	2017	2016
<b>Numerator:</b>		
Net income attributable to Avista Corp. shareholders	\$ 62,116	\$ 57,649
<b>Denominator:</b>		
Weighted-average number of common shares outstanding-basic	64,362	62,605
Effect of dilutive securities:		
Performance and restricted stock awards	107	302
Weighted-average number of common shares outstanding-diluted	64,469	62,907
<b>Earnings per common share attributable to Avista Corp. shareholders:</b>		
Basic	\$ 0.97	\$ 0.92
Diluted	\$ 0.96	\$ 0.92

There were no shares excluded from the calculation because they were antidilutive.

## NOTE 10. COMMITMENTS AND CONTINGENCIES

In the course of its business, the Company becomes involved in various claims, controversies, disputes and other contingent matters, including the items described in this Note. Some of these claims, controversies, disputes and other contingent matters involve litigation or other contested proceedings. For all such matters, the Company intends to vigorously protect and defend its interests and pursue its rights. However, no assurance can be given as to the ultimate outcome of any particular matter because litigation and other contested proceedings are inherently subject to numerous uncertainties. For matters that affect Avista Utilities' or AEL&P's operations, the Company intends to seek, to the extent appropriate, recovery of incurred costs through the ratemaking process.

### *California Refund Proceeding*

In February 2016, APX, a market maker in the California Refund Proceedings in whose markets Avista Energy participated in the summer of 2000, asserted that Avista Energy and its other customer/participants may be responsible for a share of the disgorgement penalty APX may be found to owe to the California Parties (as defined in the 2016 Form 10-K). The penalty arises as a result of the Federal Energy and Regulatory Commission's (FERC) finding that APX committed violations in the California market in the summer of 2000. APX is making these assertions despite Avista Energy having been dismissed in

FERC Opinion No. 536 from the on-going administrative proceeding at the FERC regarding potential wrongdoing in the California markets in the summer of 2000. APX has identified Avista Energy's share of APX's exposure to be as much as \$16.0 million even though no wrongdoing allegations are specifically attributable to Avista Energy. Avista Energy believes its 2014 settlement with the California Parties insulates it from any such liability and that as a dismissed party it cannot be drawn back into the litigation. Avista Energy intends to vigorously dispute APX's assertions of indirect liability, but cannot at this time predict the eventual outcome.

#### ***Cabinet Gorge Total Dissolved Gas Abatement Plan***

Dissolved atmospheric gas levels (referred to as "Total Dissolved Gas" or "TDG") in the Clark Fork River exceed state of Idaho and federal water quality numeric standards downstream of Cabinet Gorge particularly during periods when excess river flows must be diverted over the spillway. Under the terms of the Clark Fork Settlement Agreement (CFSA) as incorporated in Avista Corp.'s FERC license for the Clark Fork Project, Avista Corp. has worked in consultation with agencies, tribes and other stakeholders to address this issue. Under the terms of a gas supersaturation mitigation plan, Avista is reducing TDG by constructing spill crest modifications on spill gates at the dam, and the Company expects to continue spill crest modifications over the next several years, in ongoing consultation with key stakeholders. Avista Corp. cannot at this time predict the outcome or estimate a range of costs associated with this contingency; however, the Company will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to this issue.

#### ***Fish Passage at Cabinet Gorge and Noxon Rapids***

In 1999, the United States Fish and Wildlife Service (USFWS) listed bull trout as threatened under the Endangered Species Act. In 2010, the USFWS issued a revised designation of critical habitat for bull trout, which includes the lower Clark Fork River. The USFWS issued a final recovery plan in October 2015.

The CFSA describes programs intended to help restore bull trout populations in the project area. Using the concept of adaptive management and working closely with the USFWS, the Company evaluated the feasibility of fish passage at Cabinet Gorge and Noxon Rapids. The results of these studies led, in part, to the decision to move forward with development of permanent facilities, among other bull trout enhancement efforts. Parties to the CFSA are working to resolve several issues. The Company believes its ongoing efforts through the CFSA continue to effectively address issues related to bull trout. Avista Corp. cannot at this time predict the outcome or estimate a range of costs associated with this contingency; however, the Company will continue to seek recovery, through the ratemaking process, of all operating and capitalized costs related to fish passage at Cabinet Gorge and Noxon Rapids.

#### ***Other Contingencies***

In the normal course of business, the Company has various other legal claims and contingent matters outstanding. The Company believes that any ultimate liability arising from these actions will not have a material impact on its financial condition, results of operations or cash flows. It is possible that a change could occur in the Company's estimates of the probability or amount of a liability being incurred. Such a change, should it occur, could be significant. See "Note 19 of the Notes to Consolidated Financial Statements" in the 2016 Form 10-K for additional discussion regarding other contingencies

## NOTE 11. INFORMATION BY BUSINESS SEGMENTS

The business segment presentation reflects the basis used by the Company's management to analyze performance and determine the allocation of resources. The Company's management evaluates performance based on income (loss) from operations before income taxes as well as net income (loss) attributable to Avista Corp. shareholders. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Avista Utilities' business is managed based on the total regulated utility operation; therefore, it is considered one segment. AEL&P is a separate reportable business segment as it has separate financial reports that are reviewed in detail by the Chief Operating Decision Maker and its operations and risks are sufficiently different from Avista Utilities and the other businesses at AERC that it cannot be aggregated with any other operating segments. The Other category, which is not a reportable segment, includes other investments and operations of various subsidiaries, as well as certain other operations of Avista Capital.

The following table presents information for each of the Company's business segments (dollars in thousands):

	Avista Utilities	Alaska Electric Light and Power Company	Total Utility	Other	Intersegment Eliminations	Total
<b>For the three months ended March 31, 2017:</b>						
Operating revenues	\$ 415,381	\$ 15,156	\$ 430,537	\$ 5,933	\$ —	\$ 436,470
Resource costs	162,613	2,973	165,586	—	—	165,586
Other operating expenses	71,712	2,772	74,484	6,179	—	80,663
Depreciation and amortization	40,538	1,447	41,985	188	—	42,173
Income (loss) from operations	108,635	7,185	115,820	(434)	—	115,386
Interest expense (2)	22,683	894	23,577	167	(14)	23,730
Income taxes	31,017	2,463	33,480	(136)	—	33,344
Net income (loss) attributable to Avista Corp. shareholders	58,439	3,853	62,292	(176)	—	62,116
Capital expenditures (3)	85,403	1,360	86,763	35	—	86,798
<b>For the three months ended March 31, 2016:</b>						
Operating revenues	\$ 400,147	\$ 12,646	\$ 412,793	\$ 5,380	\$ —	\$ 418,173
Resource costs	159,078	2,641	161,719	—	—	161,719
Other operating expenses	73,256	2,523	75,779	5,825	—	81,604
Depreciation and amortization	37,866	1,326	39,192	188	—	39,380
Income (loss) from operations	101,245	5,473	106,718	(633)	—	106,085
Interest expense (2)	20,418	895	21,313	161	(63)	21,411
Income taxes	28,672	1,895	30,567	(222)	—	30,345
Net income (loss) attributable to Avista Corp. shareholders	54,987	2,961	57,948	(299)	—	57,649
Capital expenditures (3)	84,435	4,443	88,878	119	—	88,997
<b>Total Assets:</b>						
As of March 31, 2017:	\$ 5,003,014	\$ 276,495	\$ 5,279,509	\$ 60,850	\$ —	\$ 5,340,359
As of December 31, 2016:	\$ 4,975,555	\$ 273,770	\$ 5,249,325	\$ 60,430	\$ —	\$ 5,309,755

- (1) Intersegment eliminations reported as operating revenues and resource costs represent intercompany purchases and sales of electric capacity and energy. Intersegment eliminations reported as interest expense and net income (loss) attributable to Avista Corp. shareholders represent intercompany interest.
- (2) Including interest expense to affiliated trusts.

- (3) The capital expenditures for the other businesses are included as other capital expenditures on the Condensed Consolidated Statements of Cash Flows.

## UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS OF HYDRO ONE LIMITED

Hydro One Limited (“Hydro One” or the “Corporation”), Olympus Holding Corp., Olympus Corp. and Avista Corporation (“Avista”) entered into an agreement and plan of merger dated as of July 19, 2017 (the “Merger Agreement”). Pursuant to the Merger Agreement, Hydro One will directly or indirectly acquire Avista (the “Merger”) for US\$53 (approximately C\$67 using the exchange rate of C\$1.264 = US\$1.00 on July 18, 2017) per Avista common share for an aggregate purchase price of approximately US\$5,315 million (approximately C\$6,720 million using the exchange rate of C\$1.264 = US\$1.00 on July 18, 2017), comprised of an equity purchase of approximately US\$3,446 million (approximately C\$4,357 million using the exchange rate of C\$1.264 = US\$1.00 on July 18, 2017) and the assumption of approximately US\$1,869 million of Avista’s outstanding debt (approximately C\$2,363 million using the exchange rate of C\$1.264 = US\$1.00 on July 18, 2017).

The accompanying unaudited *pro forma* condensed consolidated financial statements give effect to the proposed acquisition by Hydro One of Avista under the acquisition method of accounting. The unaudited *pro forma* condensed consolidated balance sheet gives effect to the Merger as if it had closed on March 31, 2017. The unaudited *pro forma* consolidated statements of operations for the year ended December 31, 2016 and the three months ended March 31, 2017 give effect to the Merger as if had closed on January 1, 2016.

The following unaudited *pro forma* condensed consolidated financial statements are based on Avista’s historical unaudited consolidated financial statements as at and for the three months ended March 31, 2017 and audited consolidated financial statements for the year ended December 31, 2016 and Hydro One’s historical unaudited consolidated financial statements as at and for the three months ended March 31, 2017 and audited consolidated financial statements for the year ended December 31, 2016 and present the effects of the Merger on the combined historical financial statements of Hydro One and Avista. The unaudited *pro forma* condensed consolidated financial statements should be read together with the notes to the unaudited *pro forma* condensed consolidated financial statements and the historical financial statements of Hydro One and Avista.

The unaudited *pro forma* condensed consolidated financial statements (referred to herein as the *pro forma* financial information) are presented for illustrative purposes only and do not include, among other things, estimated cost synergies, adjustments related to restructuring or integration activities and further acquisitions or disposals not yet known or probable. The *pro forma* adjustments are based upon available information and certain assumptions that Hydro One believes are reasonable in the circumstances, as described in the notes to the unaudited *pro forma* condensed consolidated financial statements.

At the date of preparation of this *pro forma* financial information, certain *pro forma* adjustments have been made as identified herein; however, the fair values of Avista’s identifiable assets and liabilities to be assumed and the full impact of applying acquisition accounting have not been fully determined. After reflecting the *pro forma* adjustments made herein, the excess of the purchase consideration over the adjusted book values of Avista’s net assets has been presented as goodwill. It is expected that following closing of the Merger and once detailed valuations are completed, a portion of the amount allocated to goodwill may be attributable to property, plant and equipment, intangible assets, other assets and liabilities and related deferred income tax balances. Some property, plant and equipment and intangible assets are expected to be finite-lived and accordingly eventual fair values adjustments will be subject to amortization. As such, the actual amount assigned to the fair values of the identifiable assets and liabilities acquired will result in changes to earnings in periods subsequent to the Merger, and those changes could be material.

The *pro forma* financial information is presented for informational purposes only and is not necessarily indicative of what Hydro One’s actual financial condition or results of operations would have been had the Merger been completed on the date indicated, nor does it purport to project Hydro One’s future financial position or results of operations for any future periods or as of any future date. Accordingly, the combined business, assets, results of operations and financial condition may differ significantly from those indicated.

Please note that the *pro forma* financial information uses foreign exchange rates in effect at March 31, 2017 and the average foreign exchange rate for the 12 and 3 month periods ending December 31, 2016 and March 31, 2017 (see Note 5). Certain number quoted elsewhere and in the Prospectus may not use these same exchange rates which may result in different numbers quoted.



Hydro One Limited  
Consolidated Pro Forma Balance Sheet  
As at March 31, 2017  
(millions of Canadian dollars)

	Hydro One Limited	Avista <sup>(1)</sup> Corporation	Adjustments	Note	Hydro One Limited  Pro Forma Consolidated
<b>Assets</b>					
Current assets:					
Cash and cash equivalents	23	35	1,295	<b>3B</b>	-
			3,325	<b>3C</b>	
			(4,583)	<b>3A</b>	
			(164)	<b>3D</b>	
			69	<b>3H</b>	
Accounts receivable	740	239			979
Due from related parties	203	-			203
Regulatory asset for energy commodity derivatives	-	15			15
Materials and supplies, fuel stock and stored natural gas	-	63			63
Income taxes receivable	-	45			45
Other current assets	99	78			177
	<u>1,065</u>	<u>475</u>	<u>(58)</u>		<u>1,482</u>
Property, plant and equipment	19,324	5,544			24,868
Other long-term assets:					
Regulatory assets	3,154	881	126	<b>3I</b>	4,161
Deferred income tax assets	1,180	-	3	<b>3G</b>	1,211
			28	<b>3B</b>	
Intangible assets	347	-			347
Goodwill	327	77	(77)	<b>3A</b>	2,746
			2,462	<b>3A</b>	
Other assets	8	126			134
	<u>24,340</u>	<u>6,628</u>	<u>2,542</u>		<u>33,467</u>
<b>Total assets</b>	<b><u>25,405</u></b>	<b><u>7,103</u></b>	<b><u>2,484</u></b>		<b><u>34,949</u></b>

(1) Avista Corporation's financial statements have been translated to Canadian dollars as described in Note 5 of these *pro forma* financial statements.

	Hydro One Limited	Avista <sup>(1)</sup> Corporation	Adjustments	Note	Hydro One Limited  Pro Forma Consolidated
<b>Liabilities</b>					
Current liabilities:					
Short-term notes payable	451	140	69	<b>3H</b>	660
Long-term debt payable within one year	602	4			606
Accounts payable and other current liabilities	984	183	(8)	<b>3G</b>	1,159
Due to related parties	111	-			111
Energy commodity derivative liabilities	-	10			10
Accrued interest	-	38			38
Accrued taxes other than income taxes	-	57			57
Deferred natural gas costs	-	41			41
Current portion of pensions and other postretirement benefits	-	15			15
	2,148	488	61		2,697
Long term liabilities:					
Long-term debt	10,080	2,301	126 3,325	<b>3I</b> <b>3C</b>	15,832
Regulatory liabilities	211	534			745
Deferred income tax liabilities	61	1,153			1,214
Pension and other postretirement benefits	-	297			297
Non-current interest rate swap derivative liabilities	-	31			31
Other long-term liabilities	2,766	58			2,824
	13,118	4,374	3,451		20,943
<b>Total liabilities</b>	<b>15,266</b>	<b>4,862</b>	<b>3,512</b>		<b>23,640</b>
Noncontrolling interest subject to redemption	22	-			22

(1) Avista Corporation's financial statements have been translated to Canadian dollars as described in Note 5 of these *pro forma* financial statements.

Hydro One Limited  
Consolidated Pro Forma Balance Sheet  
As at March 31, 2017  
(millions of Canadian dollars)

	Hydro One Limited	Avista <sup>(1)</sup> Corporation	Adjustments	Note	Hydro One Limited Pro Forma Consolidated
<b>Equity</b>					
Common shares	5,623	1,427	1,364	3B	6,987
			(1,427)	3A, F	
Preferred shares	418	-			418
Additional paid-in capital	40	-	-		40
Retained earnings	3,992	824	(164)	3D	3,798
			(41)	3B	
			(824)	3A, F	
			11	3G	
Accumulated other comprehensive loss	(7)	(10)	10	3A, F	(7)
Shareholders' equity	10,066	2,241	(1,028)		11,236
Noncontrolling interest	51	-			51
<b>Total equity</b>	<b>10,139</b>	<b>2,241</b>	<b>(1,028)</b>		<b>11,309</b>
<b>Total liabilities and equity</b>	<b>25,405</b>	<b>7,103</b>	<b>2,484</b>		<b>34,949</b>

(1) Avista Corporation's financial statements have been translated to Canadian dollars as described in Note 5 of these *pro forma* financial statements.

Hydro One Limited  
Consolidated Pro Forma Statement of Operations  
For the three months ended March 31, 2017  
(millions of Canadian dollars)

	Hydro One Limited	Avista (1)Corporation	Adjustments	Note	Hydro One Limited Pro Forma Consolidated
<b>Revenues</b>					
Distribution	1,279	-			1,279
Transmission	367	-			367
Utility revenues	-	570			570
Other	12	8			20
	<b>1,658</b>	<b>578</b>	<b>-</b>		<b>2,236</b>
<b>Costs</b>					
Purchased power (2)	889	219			1,108
Operation, maintenance and administration	271	150			421
Depreciation and amortization	195	56			251
Other income-net	-	(4)			(4)
	<b>1,355</b>	<b>421</b>	<b>-</b>		<b>1,776</b>
<b>Income before financing charges and income taxes</b>	<b>303</b>	<b>157</b>	<b>-</b>		<b>460</b>
Financing charges	103	30	34	<b>3F</b>	167
	<b>200</b>	<b>127</b>	<b>(34)</b>		<b>293</b>
<b>Income before income taxes</b>	<b>200</b>	<b>127</b>	<b>(34)</b>		<b>293</b>
Income taxes	27	44	(11)	<b>3G</b>	60
<b>Net income</b>	<b>173</b>	<b>83</b>	<b>(23)</b>		<b>233</b>
<b>Basic earnings per share</b>	<b>\$0.28</b>				<b>\$0.34</b>
<b>Diluted earnings per share</b>	<b>\$0.28</b>				<b>\$0.34</b>

(1) Avista Corporation's financial statements have been translated to Canadian dollars as described in Note 5 of these *pro forma* financial statements.

(2) Purchased power include the cost of purchased natural gas.

Hydro One Limited  
Consolidated Pro Forma Statement of Operations  
For the year ended December 31, 2016  
(millions of Canadian dollars)

	Hydro One Limited	Avista (1)Corporation	Adjustments	Note	Hydro One Limited Pro Forma Consolidated
<b>Revenues</b>					
Distribution	4,915	-			4,915
Transmission	1,584	-			1,584
Utility revenues	-	1,879			1,879
Other	53	31			84
	<b>6,552</b>	<b>1,910</b>	<b>-</b>		<b>8,462</b>
<b>Costs</b>					
Purchased power (2)	3,427	730			4,157
Operation, maintenance and administration	1,069	583			1,652
Depreciation and amortization	778	214			992
Other income-net	-	(13)			(13)
	<b>5,274</b>	<b>1,514</b>	<b>-</b>		<b>6,788</b>
<b>Income before financing charges and income taxes</b>	<b>1,278</b>	<b>396</b>	<b>-</b>		<b>1,674</b>
Financing charges	393	112	134	<b>3F</b>	639
<b>Income before income taxes</b>	<b>885</b>	<b>284</b>	<b>(134)</b>		<b>1,035</b>
Income taxes	139	103	(43)	<b>3G</b>	199
<b>Net income</b>	<b>746</b>	<b>181</b>	<b>(91)</b>		<b>836</b>
<b>Basic earnings per share</b>	\$1.21				\$1.23
<b>Diluted earnings per share</b>	\$1.21				\$1.23

(1) Avista Corporation's financial statements have been translated to Canadian dollars as described in Note 5 of these *pro forma* financial statements.

(2) Purchased power include the cost of purchased natural gas.

## 1. DESCRIPTION OF THE ACQUISITION

Hydro One Limited (“Hydro One” or the “Corporation”), Olympus Holding Corp., Olympus Corp. and Avista Corporation (“Avista”) entered into an agreement and plan of merger dated as of July 19, 2017 (the “Merger Agreement”). Pursuant to the Merger Agreement, Hydro One will directly or indirectly acquire Avista (the “Merger”) for US\$53 (approximately C\$67 at the exchange rate of C\$1.264 = US\$1.00 on July 18, 2017) per Avista common share for an aggregate purchase price of approximately US\$5,315 million (approximately C\$6,720 million at the exchange rate C\$1.264 = US\$1.00 on July 18, 2017), comprised of an equity purchase of approximately US\$3,446 million (approximately C\$4,357 million at the exchange rate of C\$1.264 = US\$1.00 on July 18, 2017) and the assumption of approximately US\$1,869 million of Avista’s outstanding debt (approximately C\$2,363 million at the exchange rate of C\$1.264 = US\$1.00 on July 18, 2017). Since the purchase price is denominated in US dollars, the actual Canadian dollar purchase price paid on closing will be based on exchange rates on that date.

The accompanying *pro forma* financial information assumes that at closing, the Merger will be financed through the net proceeds from issuance of \$C1,400 million of 4% convertible unsecured subordinated debentures (the “Debentures”) which are assumed to be converted to shares on closing of the Merger at C\$21.40 per share. The balance of the purchase price is expected to be funded through medium and long-term debt (as defined and described below). These *pro-forma* condensed consolidated financial statements assume that the over-allotment option granted in connection with the common equity issuance will not be exercised.

Hydro One proposes to issue US dollar denominated medium and long term debt in the amount of US\$2,650 million (approximately C\$3,350 million at the exchange rate on July 18, 2017) maturing over 5, 10 and 30 years respectively.

The accompanying *pro forma* financial information assumes that the Debentures will be issued and immediately fully converted into Hydro One common shares at the assumed closing date of the Merger. Therefore, the accompanying *pro forma* financial information does not recognize interest costs associated with the Debentures. Hydro One anticipates that the closing will occur in the second half of 2018. As a result the Corporation has included the cost of interest on the Debentures for an estimated 12 month period from issuance to their conversion on an assumed Merger closing date in August 2018 as a *pro-forma* adjustment. Due to many factors, including the timing of regulatory approvals, the estimated Merger closing period is subject to change which may change the amount of interest expense incurred on the Debentures and the related income tax recovery. Interest costs associated with the Debentures are expected to be funded through operating cash flows.

## 2. BASIS OF PRESENTATION

The accompanying *pro forma* financial information gives effect to the proposed Merger by Hydro One of Avista as described in the short form prospectus dated August 1, 2017 (the “Prospectus”). The accompanying *pro forma* financial information has been prepared by management of Hydro One and are derived from the unaudited and audited consolidated financial statements of Hydro One as at and for the three months ended March 31, 2017 and for the year ended December 31, 2016, respectively, and the unaudited and audited consolidated financial statements of Avista as at and for the three months ended March 31, 2017 and for the year ended December 31, 2016, respectively.

The *pro forma* financial information utilizes accounting policies that are consistent with those disclosed in Hydro One’s and Avista’s audited consolidated financial statements as at and for the year ended December 31, 2016 and unaudited consolidated financial statements as at and for the three months ended March 31, 2017 and were prepared in accordance with accounting principles generally accepted in the United States (“US GAAP”).

The unaudited *pro forma* consolidated balance sheet is prepared to reflect the Merger assuming it had closed on March 31, 2017. The unaudited *pro forma* consolidated statements of operations for the three months ended March 31, 2017 and for the year ended December 31, 2017 are prepared to reflect the Merger as if it had closed on January 1, 2016. The unaudited *pro forma* consolidated financial statements may not be indicative of the results that would have been achieved if the transactions reflected therein had been completed on the dates indicated or the results which may be obtained in the future. For instance, the purchase price paid will be based on the exchange rates on the date of closing of the Merger, and the actual purchase price allocation will reflect the fair value, at the purchase date,

of the assets acquired and liabilities assumed based upon Hydro One's evaluation of such assets and liabilities following the closing of the Merger. Accordingly, the final purchase price allocation may differ materially from the preliminary allocation reflected herein.

The accompanying *pro forma* financial information should be read in conjunction with the description of the Merger and the financing thereof provided in the Prospectus; the audited and unaudited consolidated financial statements of Avista, including the notes thereto, included in the Prospectus; and the audited and unaudited consolidated financial statements of Hydro One, including the notes thereto, incorporated by reference in the Prospectus.

Certain amounts in the historical financial statements of Avista have been reclassified in the unaudited *pro forma* balance sheet and statements of operations to reflect the presentation classifications in Hydro One's consolidated financial statements. In addition the historical financial statements of Avista have been converted from U.S. dollars to Canadian dollars to conform to the reporting and reporting currency of Hydro One.

Management believes the underlying assumptions for the *pro forma* adjustments provide a reasonable basis for presenting the significant financial effect directly attributable to the Merger. These *pro forma* adjustments are tentative and are based on currently available financial information and certain estimates and assumptions. The actual adjustments to the consolidated financial statements will depend on a number of factors. Therefore, it is expected that the actual adjustments will differ from the *pro forma* adjustments shown in the *pro forma* financial information, and the differences may be material.

The *pro forma* financial information presents the combined effect on the historical statements and provides the following resulting information:

Historical Information of Hydro One and Avista	Historical Dates and Giving Effect	Resulting Information
Unaudited consolidated balance sheet	As of March 31, 2017	Unaudited <i>pro forma</i> condensed consolidated balance sheet, referred to as the unaudited <i>pro forma</i> balance sheet
Audited consolidated statement of operations for the year ended December 31, 2016 and unaudited consolidated statement of operations for the three months ended March 31, 2017	For the year ended December 31, 2016; and for the three months ended March 31, 2017	Unaudited <i>pro forma</i> condensed consolidated statement of operations, referred to as the unaudited <i>pro forma</i> statements of operations.  Limited fair value adjustments to net assets acquired at March 31, 2017 have been applied to the assumed merger date of January 1, 2016 for purposes of the unaudited <i>pro forma</i> statements of operations (see note 3).

Amounts in the notes to the unaudited *pro forma* consolidated financial statements are stated in Canadian dollars, unless otherwise indicated. Please note that the *pro forma* financial information uses foreign exchange rates in effect at March 31, 2017 and the average foreign exchange rate for the 12 and 3 month periods ending December 31, 2016 and March 31, 2017. Certain numbers quoted elsewhere and in the Prospectus may not use these same exchange rates which may result in different numbers quoted. The accompanying *pro forma* financial information may not be indicative of the results that would have been achieved if the transactions reflected herein had been completed on the dates indicated or the results which may be obtained in the future.

### 3. PRO FORMA ASSUMPTIONS AND ADJUSTMENTS

#### A. *Pro forma* Purchase Price and Purchase Price Allocation

At the date of preparation of this *pro forma* financial information, certain *pro forma* adjustments have been made as identified herein; however, the purchase price paid fair values of Avista's identifiable assets and

liabilities to be assumed and the full impact of applying acquisition accounting have not been fully determined. After reflecting the *pro forma* adjustments made herein, the excess of the purchase price consideration over the adjusted book values of Avista's net assets has been presented as goodwill offset by an adjustment to eliminate Avista's historical goodwill.

The Merger consideration in the unaudited *pro forma* financial information is based on the agreed price of US\$53 per share. For purpose of the *pro forma* balance sheet at March 31, 2017, the purchase price has been measured at the exchange rate of C\$1.33=US\$1.00. The *pro forma* statements of operations are prepared based on the assumption the Merger occurred on January 1, 2016, on which date the exchange rate was approximately C\$1.34=US\$1.00.

Avista is a public utility subject to regulation by state utility commissions. The retail electric and natural gas operations are subject to the jurisdiction of various regulatory bodies, including FERC for licensing of hydroelectric generation resources, and for electric transmission services and wholesale sales. The revenues and earnings approved by the utility commissions are based on regulated rates of return that are applied to historic values of the regulated assets. Therefore, no fair value adjustments are expected to be made to property, plant and equipment and intangible assets with respect to the regulated entities of Avista because all economic benefits and obligations associated with regulated assets beyond regulated thresholds accrue to Avista's customers.

The following is the estimated net purchase price, estimated net funding requirements and assumed financing structure for the Merger. These estimates have been reflected in the accompanying unaudited *pro forma* financial information.

		Using exchange rates in effect on July 18, 2017  (in millions of Canadian dollars)	Using exchange rates in effect on March 31, 2017  (in millions of Canadian dollars)
<b>Estimated Net Purchase Price</b>			
Estimated net purchase price, before assumed debt*	\$	4,357	4,583
Assumed debt of Avista		2,363	2,486
Estimated purchase price	\$	<u>6,720</u>	<u>7,069</u>
<b>Estimated Net Funding Requirements</b>			
Estimated net purchase price before assumed long-term debt	\$	4,357	4,583
Assumed debt of Avista		2,363	2,486
Common share issuance costs (Note 3(B))		49	49
Long term debt issuance costs (Note 3(C))		25	25
Estimated transaction costs (Note 3(D),(E))		161	164



Interest on debentures, net of tax (Note 3(B))		41	41
Estimated net funding requirements	\$	6,996	7,348

#### Assumed Financing Structure

Assumed debt of Avista	\$	2,363	2,486
Gross proceeds from Debenture issuance, subsequently converted to common shares (Note 3(B))		1,400	1,400
Issuance of long term debt (Note 3(C))		3,350	3,350
Shortfall (excess) from term financing		(117)	112
	\$	6,996	7,348

\*This purchase price is based on Avista's outstanding shares valued at a foreign exchange rate of C\$1.264 on July 18, 2017. The purchase price used for the purposes of calculating *proforma* adjustments is based on an exchange rate at March 31, 2017 described in section 5 below.

- B. Assumed financing for the Merger contemplates the issuance, through the exercise of conversion rights under the Debentures, of approximately 65 million common shares at C\$21.40 per share for gross proceeds of approximately C\$1,400 million. The Debentures include an over-allotment option to purchase additional Debentures represented by Instalment Receipts equal to up to 10% of the aggregate principal amount of Debentures represented by Instalment Receipts sold on the Closing Date which if exercised would result in the issuance of an additional 7 million common shares for gross proceeds of C\$140 million. The pro forma condensed consolidated financial statements assume that the over-allotment will not be exercised.

Underwriting costs are estimated at 3.5% of gross proceeds in the aggregate of approximately C\$49 million (or C\$54 million if the over-allotment option is exercised in full) and will result in a corresponding deferred tax asset of approximately C\$13 million based on Hydro One's Canadian statutory income tax rate of 26.5%.

Interests costs associated with the Debentures at 4.0% are expected to be approximately C\$56 million (or approximately C\$62 million if the over-allotment option is exercised in full) for a 12 month period following issuance of the Debentures and prior to closing and will result in a corresponding deferred income tax asset of approximately C\$15 million based on Hydro One's Canadian statutory income tax rate of 26.5%. These unaudited *pro forma* financial statements assume the Debentures will be issued and fully converted into Hydro One common shares at the assumed closing date of the Merger. As this incremental interest is directly related to the acquisition and is non-recurring, the accompanying unaudited *pro forma* consolidated statements of operations do not include interest costs associated with the Debentures. However, estimated interest costs for the 12 month period and the related tax effect have been reflected as a pro forma adjustment to retained earnings in the unaudited *pro forma* consolidated balance sheet. The Debentures provide for a make-whole interest payment to Debenture Holders if the Merger closes earlier than 12 months from the date of the Debenture issuance as more fully described in the Prospectus. No make-whole payments have been reflected in these *pro forma* financial statements on the basis that the *pro forma* adjustments assume that the Merger closes 12 months from the date of the Debenture issuance.

- C. Issuance of US denominated medium and long term debt. Hydro One proposes to issue US denominated medium and long term debt that would be equivalent to approximately C\$3,350 million over terms ranging from 5, 10 and 30 years bearing interest at a weighted average rate of 4%. Debt issuance costs are estimated at C\$25 million. The terms of the debt outlined above are current estimates only. The terms of the actual

debt issued will not be known until the time of issuance and could vary significantly from what is proposed based on many factors including market conditions.

- D. Transactions costs are estimated at approximately C\$114 million and are composed of estimated investment banking, advisory, accounting and legal fees and real estate transfer taxes. Change in control payments are estimated at approximately C\$50 million and represent estimated change in control liabilities payable as a result of the Merger. Transaction costs and change in control payments of C\$164 million were assumed to be paid in cash based on estimates by Hydro One management. These costs have been included as a *pro forma* adjustment to retained earnings on the unaudited *pro forma* balance sheet as opposed to being reflected in the unaudited *pro forma* statement of earnings on the basis that these expenses are directly attributable to the Merger of Avista and are non-recurring in nature.
- E. Elimination of Avista's historical outstanding common shares C\$1,427 million, retained earnings C\$824 million and accumulated other comprehensive loss C\$10 million as of March 31, 2017.
- F. Interest expense on the Company's medium and long-term Notes described in Note 3(C) of C\$34 million and C\$134 million for the 3 months ended March 31, 2017 and the year ended December 31, 2016, respectively.
- G. Adjustment to deferred income tax assets relates to the tax saving earned from the deduction of interest expense incurred on the convertible debentures and medium and long term notes described in Note (B) and Note (C).
- H. Cash shortfall will be funded from Hydro One's revolving standby credit facility described in the notes of the financial statements of Hydro One.
- I. Hydro One has recorded an adjustment to the fair value of Avista's long term debt and recorded a regulatory offset of \$126 million in Regulatory Assets for the portion of the fair value adjustment to long-term debt held within regulated operations. Hydro One views the regulatory offset upon consummation of the acquisition as a proxy for the regulatory asset that would be recorded in the event such debt was extinguished at an amount higher than the carrying value.

#### 4. PRO FORMA SHARES OUTSTANDING

Earnings per common share is calculated by dividing earnings attributable to common shareholders by the weighted average number of common shares outstanding.

The calculation of the *pro forma* earnings per common share, for the three months ended March 31, 2017 and for the year ended December 31, 2016, reflect the dilutive effects of the Debentures and the assumed issuance of approximately 2 million of Hydro One's common shares estimated at C\$43 million, as if the issuance of the outstanding stock based compensation awards had taken place on January 1, 2016. The basic and diluted earnings per common share and basic and diluted weighted average number of common shares outstanding for the *pro forma* reporting period is determined as follows:

	For the year ended December 31, 2016	For the three months ended March 31, 2017
(unaudited; Canadian dollars; number of shares in millions)		
<b>Earnings per common share</b>	\$1.23	\$0.34
<b>Diluted earnings per common share</b>	\$1.23	\$0.34
<b>Shares outstanding</b>		
Weighted average shares of Hydro One Limited - basic	595	595
Debenture converted common shares outstanding - basic	<u>65</u>	<u>65</u>
<i>Pro forma</i> weighted average shares outstanding – basic	660	660
Effect of dilutive options and other stock based compensation awards	<u>2</u>	<u>2</u>
<i>Pro forma</i> diluted weighted average shares of Hydro One Limited	662	662

## 5. CURRENCY TRANSLATION AND CLASSIFICATION ADJUSTMENTS

In the pro forma balance sheet at March 31, 2017 the assets and liabilities of Avista, which has a US\$ reporting and functional currency, are translated at the exchange rate of 1.3299 which was the closing rate published by the Bank of Canada for March 31, 2017. Revenues and expenses in Avista's statement of operations are translated to Canadian dollars at average exchange rates of 1.3238 for the three months ended March 31, 2017 and 1.3245 for the year ended December 31, 2016.

Reclassifications were made to align the presentation of Avista's financial statement amounts with Hydro One's financial statement amounts in the accompanying unaudited *pro forma* financial information. No differences in accounting policies under US GAAP have been identified; however, a more detailed analysis will be completed after the Merger.

HYDRO ONE LIMITED  
PRO FORMA CONSOLIDATED BALANCE SHEET  
As of March 31, 2017  
UNAUDITED

	Avista Historical (USD)	Foreign Exchange Impact	Avista Historical (CAD)	Reclasses (CAD)	Amount after Reclassification	
<b>(in millions)</b>						
<b>Assets</b>						
Current Assets:						
Cash and cash equivalents	26	9	35		35	
Accounts and notes receivable	179	60	239		239	
Due from related parties	-	-	-		-	
Regulator asset for energy commodity derivatives	12	3	15		15	
Materials and supplies, fuel stock and stored natural gas	47	16	63		63	
Income taxes receivable	34	11	45		45	
Other current assets	59	19	78		78	
Total current assets	357	118	475	-	475	
Property, plant and equipment	-	-	-	5,544	5,544	1
Net Utility Property:	-	-	-		-	
Utility plant in service	5,544	1,829	7,373	(7,373)	-	1
Construction work in progress	158	52	210	(210)	-	1
Total	5,702	1,881	7,583		-	
Less: Accumulated depreciation and amortization	(1,533)	(506)	(2,039)	2,039	-	1
Total net utility property	4,169	1,375	5,544		-	
Other Non-current Assets:						
Regulatory assets	-	-	-	881	881	2
Deferred income tax assets	-	-	-		-	
Intangible assets	-	-	-		-	
Other assets	-	-	-	126	126	3
Investment in affiliated trusts	12	3	15	(15)	-	3
Goodwill	58	19	77		77	
Other property and investments-net and other non-current assets	77	25	102	(102)	-	3
Total other non-current assets	147	47	194		1,084	
Deferred Charges:						
Regulatory assets for deferred income tax	118	39	157	(157)	-	2
Regulatory assets for pensions and other postretirement benefits	237	78	315	(315)	-	2
Other regulatory assets	137	46	183	(183)	-	2
Regulatory assets for interest rate swaps	155	51	206	(206)	-	2
Non-current regulatory asset for energy commodity derivatives	15	5	20	(20)	-	2
Other deferred charges	6	3	9	(9)	-	3
Total deferred charges	668	222	890		-	
<b>Total assets</b>	<b>5,341</b>	<b>1,762</b>	<b>7,103</b>		<b>7,103</b>	

HYDRO ONE LIMITED  
PRO FORMA CONSOLIDATED BALANCE SHEET  
As of March 31, 2017  
UNAUDITED

	Avista Historical (USD)	Foreign Exchange Impact	Avista Historical (CAD)	Reclasses (CAD)	Amount after Reclassification	
<b>Liabilities and Equity</b>						
Current liabilities:						
Accounts payable	72	24	96	87	183	4
Current portion of long-term debt and capital leases	3	1	4		4	
Short-term borrowings	105	35	140		140	
Energy commodity derivative liabilities	7	3	10		10	
Accrued interest	29	9	38		38	
Accrued taxes other than income taxes	43	14	57		57	
Deferred natural gas costs	31	10	41		41	
Current portion of pensions and other postretirement benefits	11	4	15		15	
Due to related parties	-	-	-		-	
Other current liabilities	65	22	87	(87)	-	4
Total current liabilities	366	122	488	-	488	
	-	-			-	
Long-term debt and capital leases	1,678	554	2,232		2,232	
Long-term debt to affiliated trusts	52	17	69		69	
Regulatory liability for utility plant retirement costs	277	91	368	166	534	5
Pensions and other postretirement benefits	223	74	297		297	
Deferred income taxes	867	286	1,153		1,153	
Non-current interest rate swap derivative liabilities	23	8	31		31	
Other non-current liabilities, regulatory liabilities and deferred credits	169	55	224	(166)	58	5
<b>Total liabilities</b>	<b>3,655</b>	<b>1,207</b>	<b>4,862</b>	<b>-</b>	<b>4,862</b>	
	-	-			-	
Equity:	-	-			-	
Avista Corporation Shareholders' Equity:	-	-			-	
Common stock	1,073	354	1,427		1,427	
Accumulated other comprehensive loss	(7)	(3)	(10)		(10)	
Retained earnings	620	204	824		824	
Total Avista Corporation shareholders' equity	1,686	555	2,241	-	2,241	
Noncontrolling interests	-	-	-		-	
Total equity	1,686	555	2,241	-	2,241	
<b>Total liabilities and equity</b>	<b>5,341</b>	<b>1,762</b>	<b>7,103</b>	<b>-</b>	<b>7,103</b>	

1 Net utility property of \$5,544 million to property, plant and equipment

2 Deferred charges of \$890 million to regulatory assets

3 Investment in affiliates trusts and other property and investments-net and other non-current assets of \$117 million to other assets.

4 Other current liabilities of \$87 million to Accounts payable and other current liabilities.

5 Other non-current liabilities, regulatory liabilities and deferred credits of \$166 to Long term regulatory liabilities.

HYDRO ONE LIMITED  
PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS RECLASSIFICATIONS  
For the three months period ended March 31, 2017  
UNAUDITED

	Avista Historical (USD)	Foreign Exchange Impact	Avista Historical (CAD)	Reclasses (CAD)	Amount after Reclassification	
<b>(in millions)</b>						
Operating Revenues:						
Distribution	-	-	-	-	-	
Transmission	-	-	-	-	-	
Other	-	-	-	8	8	1
Utility revenues	431	139	570		570	
Non-utility revenues	6	2	8	(8)	-	1
<b>Total operating revenues</b>	<b>437</b>	<b>141</b>	<b>578</b>		<b>578</b>	
Operating Expenses:						
Purchased power	-	-	-	219	219	2
Operating, maintenance and administration	-	-	-	150	150	2
Depreciation and amortization	-	-	-	56	56	2
Other income-net	-	-	-	(4)	(4)	4
Utility operating expenses:	-	-	-		-	
Resource costs	166	53	219	(219)	-	2
Other operating expenses	74	25	99	(99)	-	2
Depreciation and amortization	42	14	56	(56)	-	2
Taxes other than income taxes	33	10	43	(43)	-	2
Non-utility operating expenses:	-	-	-		-	
Other operating expenses	6	2	8	(8)	-	2
Depreciation and amortization	-	-	-	-	-	2
<b>Total operating expenses</b>	<b>321</b>	<b>104</b>	<b>425</b>		<b>421</b>	
<b>Income from operations</b>	<b>116</b>	<b>37</b>	<b>153</b>		<b>157</b>	<b>2</b>
Finance charges	-	-	-	30	30	3
Interest expense	24	7	31	(31)	-	3
Interest expense to affiliated trusts	-	-	-	-	-	3
Capitalized interest	(1)	-	(1)	1	-	3
Other income-net	(3)	(1)	(4)	4	-	4
<b>Income before income taxes</b>	<b>96</b>	<b>31</b>	<b>127</b>		<b>127</b>	
Income tax expense	33	11	44		44	
<b>Net income</b>	<b>63</b>	<b>20</b>	<b>83</b>		<b>83</b>	

1 Non-utility revenues of \$8 million to other revenue

2 Utility operating expenses and non-utility operating expenses of \$425 million to operating expenses

3 Interest and other income of \$30 million to finance charges

4 Other income-net of \$4 million to operating expenses

HYDRO ONE LIMITED  
PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS RECLASSIFICATIONS  
For the year ended December 31, 2016  
UNAUDITED

	Avista Historical (USD)	Foreign Exchange Impact	Avista Historical (CAD)	Reclasses (CAD)	Amount after Reclassification	
<b>(in millions)</b>						
Operating Revenues:						
Distribution	-	-	-	-	-	
Transmission	-	-	-	-	-	
Other	-	-	-	31	31	1
Utility revenues	1,419	460	1,879		1,879	
Non-utility revenues	24	7	31	(31)	-	1
<b>Total operating revenues</b>	<b>1,443</b>	<b>467</b>	<b>1,910</b>		<b>1,910</b>	
Operating Expenses:						
Purchased power	-	-	-	730	730	2
Operating, maintenance and administration	-	-	-	583	583	2
Depreciation and amortization	-	-	-	214	214	2
Other income-net	-	-	-	(13)	(13)	4
Utility operating expenses:	-	-	-		-	
Resource costs	551	179	730	(730)	-	2
Other operating expenses	316	102	418	(418)	-	2
Depreciation and amortization	161	52	213	(213)	-	2
Taxes other than income taxes	99	32	131	(131)	-	2
Non-utility operating expenses:	-	-	-		-	
Other operating expenses	26	8	34	(34)	-	2
Depreciation and amortization	1	-	1	(1)	-	2
<b>Total operating expenses</b>	<b>1,154</b>	<b>373</b>	<b>1,527</b>		<b>1,514</b>	
<b>Income from operations</b>	<b>289</b>	<b>94</b>	<b>383</b>		<b>396</b>	2
Finance charges	-	-	-	112	112	3
Interest expense	86	29	115	(115)	-	3
Interest expense to affiliated trusts	1	-	1	(1)	-	3
Capitalized interest	(3)	(1)	(4)	4	-	3
Other income-net	(10)	(3)	(13)	13	-	4
<b>Income before income taxes</b>	<b>215</b>	<b>69</b>	<b>284</b>		<b>284</b>	
Income tax expense	78	25	103		103	
<b>Net income</b>	<b>137</b>	<b>44</b>	<b>181</b>		<b>181</b>	

1 Non-utility revenues of \$31 million to other revenue

2 Utility operating expenses and non-utility operating expenses of \$1,527 million to operating expenses

3 Interest and other income of \$112 million to finance charges

4 Other income-net of \$13 million to operating expenses

## **APPENDIX A – INVESTOR PRESENTATION**





# Hydro One To Acquire Avista Creating a North American Utility Leader

July 19, 2017

One of North America's Largest Electric Utilities

TSX: H



## Disclaimers and cautionary statements



Unless otherwise specified, all references to "\$" or "C\$" in this presentation are to Canadian dollars and all references to "US\$" in this presentation are references to United States dollars. Any graphs, tables or other information in this presentation demonstrating the historical performance of Hydro One Limited or Hydro One Inc. or any other entity contained in this presentation are intended only to illustrate past performance of such entities and are not necessarily indicative of future performance of Hydro One Limited, Hydro One Inc. or such entities. In this presentation, "Hydro One" refers to Hydro One Limited and its subsidiaries and other investments, taken together as a whole.

**Additional Information and Where to Find It:** This presentation may be deemed to be solicitation material in respect of the proposed merger transaction. Avista Corporation ("Avista") intends to file with the U.S. Securities and Exchange Commission (the "SEC") and mail to its shareholders a proxy statement in connection with the proposed merger transaction and this presentation is not a substitute for the proxy statement or any other document that Avista may send to its shareholders in connection with the proposed merger transaction. THE INVESTORS AND SECURITY HOLDERS OF AVISTA ARE URGED TO READ THE PROXY STATEMENT AND OTHER RELEVANT DOCUMENTS WHEN THEY BECOME AVAILABLE, BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION about Avista, Hydro One and the proposed merger transaction. Investors and security holders will be able to obtain these materials (when they are available) and other documents filed with the SEC free of charge at the SEC's website, [www.sec.gov](http://www.sec.gov). In addition, a copy of Avista's proxy statement (when it becomes available) may be obtained free of charge upon request by contacting AVISTA Corporation, Avista Corp. 1411 East Mission Avenue P.O. Box 3727, Spokane, WA 99220. Avista's filings with the SEC are also available on Avista's website at: <http://www.avistacorp.com>. Investors and security holders may also read and copy any reports, statements and other information filed by Avista with the SEC, at the SEC public reference room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 or visit the SEC's website for further information on its public reference room.

**Participants in the Solicitation of Proxies:** This presentation is not a solicitation of proxies in connection with the proposed merger transaction. However, Avista, Hydro One and certain of their respective directors, executive officers and other persons may be deemed under SEC rules to be participants in the solicitation of Avista shareholder proxies in respect of the proposed merger transaction. Information about Hydro One directors and executive officers is available in Hydro One's management information circular, filed with Canadian securities regulators on March 23, 2017, in connection with its 2017 annual meeting of shareholders and is available on its website at <http://www.hydroone.com> and also under its profile on SEDAR and [www.sedar.com](http://www.sedar.com). Information regarding Avista's directors and executive officers is available in Avista's proxy statement filed with the SEC on March 31, 2017 in connection with its 2017 annual meeting of shareholders, and its Annual Report on Form 10K for the fiscal year ended December 31, 2016 filed with the SEC on February 22, 2017, each of which may be obtained from the sources indicated in Additional Information and Where to Find It. Other information regarding persons who may be deemed participants in the proxy solicitation and a description of their direct and indirect interests (which may be different than those of Avista's investors and security holders), by security holdings or otherwise, will be contained in the proxy statement and other relevant materials filed or to be filed with the SEC when they become available.



## Disclaimers and cautionary statements (continued)



**Forward-Looking Information:** This presentation contains “forward-looking statements” and “forward-looking information” within the meaning of applicable securities laws of the U.S. and Canada, respectively. Statements that are not historical facts, including statements about beliefs, expectations, estimates, projections, goals, forecasts, assumptions, risks and uncertainties, are forward looking statements and forward looking information. Forward looking statements and forward looking information are often characterized by the use of words such as “believes,” “estimates,” “expects,” “projects,” “may,” “intends,” “plans,” “anticipates,” “pro forma,” “predicts,” “seeks,” “could,” “would,” “will,” “can,” “continue” or “potential” and the negative of these terms or other comparable or similar terminology or expressions. The forward looking statements and forward looking information in this presentation include, without limitation, statements relating to Hydro One’s proposed merger transaction with Avista and expectations regarding timing and benefits thereof, earnings per share accretion, increases in regulated assets and earnings, financing intentions, strength of credit metrics, scale and diversification, capital expenditures, rate base growth, industry and geographic trends and forecasts, financing plans, stakeholder commitments, stockholder and regulatory approvals, and the completion of the proposed merger transaction. These statements reflect Hydro One and Avista’s management’s current beliefs and are based on information currently available to the management teams. Forward looking statements and forward looking information involve significant risk, uncertainties and assumptions. Certain factors or assumptions have been applied in drawing the conclusions contained in the forward looking statements and forward looking information. Hydro One and Avista caution readers that a number of factors could cause actual results, performance or achievement to differ materially from the results discussed or implied in the forward looking statements and forward looking information. Important factors that could cause actual results, performance and results to differ materially from those indicated by any such forward looking statements and forward looking information include risks and uncertainties relating to the following: (i) the risk that Avista may be unable to obtain shareholder approval for the proposed merger transaction or that Hydro One or Avista may be unable to obtain governmental and regulatory approvals required for the proposed merger transaction, or may be unable to obtain those approvals on favorable terms; (ii) the risk that the required shareholder, governmental or regulatory approvals may delay the proposed merger transaction; (iii) the risk that a condition to the closing of the proposed merger transaction may not be satisfied or the merger agreement may be terminated prior to closing; (iv) the timing to consummate the proposed transaction; (v) disruption from the proposed merger transaction making it more difficult to maintain relationships with customers, employees, regulators or suppliers; (vi) risks associated with the loss and ongoing replacement of key personnel; (vii) the diversion of management time and attention on the transaction; (viii) general worldwide economic conditions and related uncertainties; (ix) the effect and timing of changes in laws or in governmental regulations (including environmental and tax laws and regulations); (x) the risk that financing necessary to fund the proposed merger transaction may not be obtained or may be more difficult and costly to obtain than anticipated; (xi) the impact of acquisition-related expenses; (xii) the ability to maintain an investment grade credit rating; (xiii) the ability to maintain dividend payout ratios; and (xiv) other factors discussed or referred to in the “Risk Factors” section of Hydro One’s most recent annual management’s discussion and analysis of financial results filed with securities regulators in Canada and available under Hydro One’s profile at [www.sedar.com](http://www.sedar.com). The foregoing list is not exhaustive and other unknown or unpredictable factors could also have a material adverse effect on the performance or results of Hydro One or Avista. Additional risks and uncertainties will be discussed in the proxy statement and other materials that Avista will file with the SEC in connection with the proposed merger transaction, or in material Hydro One will file with securities regulatory authorities in Canada. There can be no assurance that the proposed merger transaction will be completed, or if it is completed, that it will close within the anticipated time period or that the expected benefits of the proposed merger transaction will be realized. These factors should be considered carefully and undue reliance should not be placed on the forward looking statements or forward looking information, and actual outcomes and results may differ materially from what is expressed, implied or forecasted in these forward-looking statements and forward looking information. For additional information with respect to certain of the risks or factors, reference should be made to Hydro One’s continuous disclosure materials filed from time to time with Canadian securities regulatory authorities, available at [www.sedar.com](http://www.sedar.com) and Avista’s filings with the SEC available at [www.sec.gov](http://www.sec.gov). Except as required by law, each of Hydro One and Avista disclaims any intention or obligation to update or revise any forward looking statements, whether as a result of new information, future events or otherwise.

**Non-GAAP Measures:** Hydro One Limited and Hydro One Inc. prepare and present financial statements in accordance with U.S. GAAP. This presentation refers financial measures, such as Adjusted EPS, EBITDA and “FFO” or “Funds from Operations”, which are not recognized under U.S. GAAP and which may not be comparable to similar measures presented by other companies. Funds from Operations should not be considered in isolation nor as a substitute for analysis of Hydro One’s financial information reported under U.S. GAAP. For more information, see “Non-GAAP Measures” in Hydro One’s annual and interim Management Discussion and Analysis.

- 1 Executive Summary of Transaction
- 2 Avista Overview
- 3 Strategic Rationale
- 4 Commitment to Customers, Communities and Employees
- 5 Indicative Timeline

## Highlights of the transaction

1

Establishes one of North America's largest regulated utilities with over C\$32 billion (US\$25 billion) in assets (pro forma)

2

Significant increases in stable earnings through fully regulated utility operations in constructive regulatory jurisdictions

3

Increased growth profile through expansion of Hydro One into complementary and diversified regulated assets, including natural gas LDCs

4

Accretive to earnings per share and cash flow for Hydro One in the first full year post closing

5

Combined entity expected to maintain strong investment-grade credit ratings

6

Efficiencies through enhanced scale, innovation, shared IT systems and increased purchasing power provide cost savings opportunities



Transaction brings together two industry-leading regulated utilities with over 230 years of collective operational experience, similar corporate cultures and shared values

## Transaction details



### Key transaction terms

- Offer price of US\$53.00 per Avista common share in cash
  - Represents a 24% premium to Avista's closing price on 18 July, 2017 of US\$42.74
- Equity purchase price of US\$3.4 billion (C\$4.4 billion)
- Total enterprise value of US\$5.3 billion (C\$6.7 billion), including Avista debt assumed

### Financing plan

- All cash transaction
- Proposed transaction contemplates use of short, medium, and long term U.S. denominated debt totaling US\$2.6 billion (C\$3.4 billion), as well as C\$1.4 billion in Contingent Convertible Debentures to fulfill equity component requirement

### Governance

- Avista management will remain in place
- Formation of a subsidiary board which will represent the interests of Avista's service territories and the communities it serves
- No changes in Hydro One management

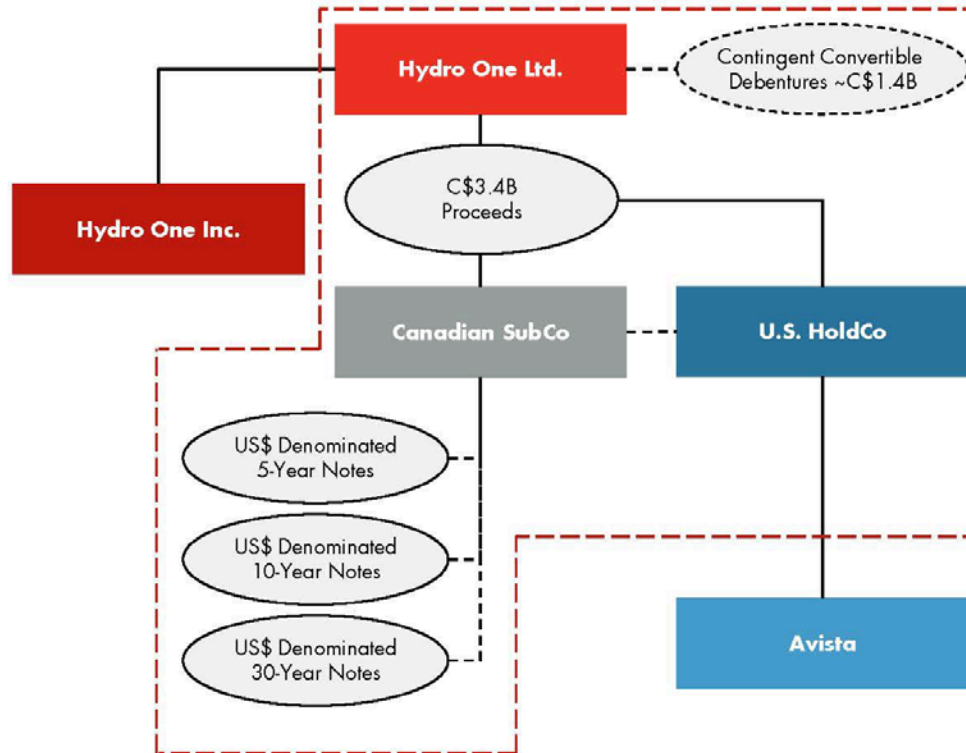
### Timing and approvals

- Will seek approvals from all five state regulators and FERC prior to closing
- All regulatory requests for approvals will be filed concurrently
- Expected closing date in the second half of 2018



# Financing plan

## Planned Transaction Financing Structure



- Transaction structure intended to provide clarity and minimize execution risk
- Planned financing contemplates a combination of 5-year, 10-year and 30-year US\$ denominated notes in order to balance maturities and create a natural currency hedge
  - US\$ denominated debt issued in the US by the Canadian Sub Co.
- Hydro One and Avista expected to maintain a strong investment grade status
- Contingent convertible debenture component fulfills 100% of Hydro One's equity financing requirements for the transaction

➤ All cash transaction with a financing structure that allows Hydro One to maintain a strong investment grade status

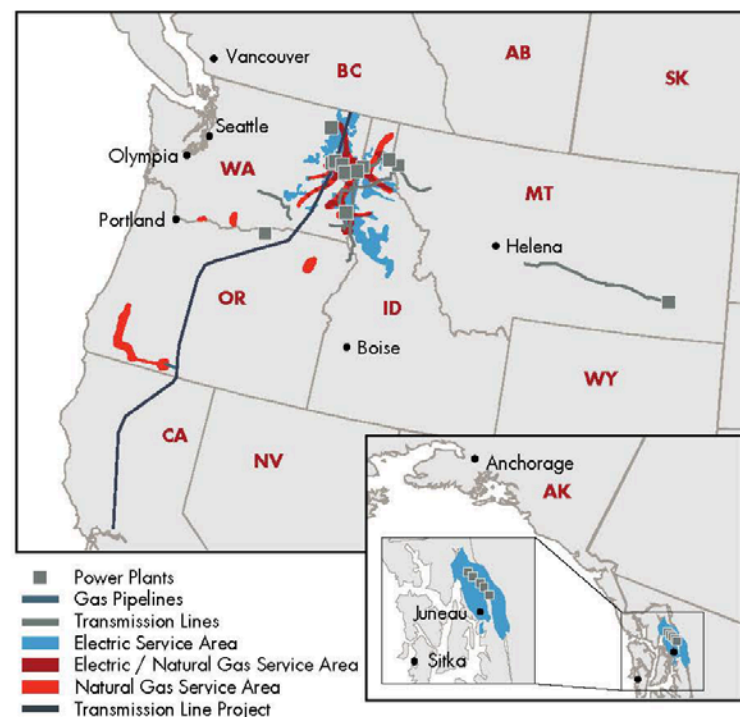
# Avista overview

## AVISTA Business Overview Corp.

- Avista is a regulated utility headquartered in Spokane, WA
  - Avista Utilities, an operating division of Avista supplying retail electric and natural gas service to customers in Washington, Idaho, Oregon and Montana service territories
    - 30,000 square miles and population of 1.6 million
    - Avista Utilities owns 2,072 MW of regulated electric generation
  - Alaska Electric Light & Power (AEL&P), serving customers in the Juneau, Alaska area
    - 16,482 electric customers
    - AEL&P owns and operates 119 MW of regulated generation capacity
- Employs ~2,000 people
- Regulated and primarily clean, renewable generation fleet

### Avista Service Area

Service territories across WA, OR, ID, AK, and MT



Growing regulated business with a geographically diverse customer base, supported by one of the lowest electricity rates in the US

Note: Avista has de minimis retail operations in Montana

One of North America's Largest Electric Utilities

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# Avista financial & operating overview

hydroOne

(C\$ in mm)

## Financial Highlights

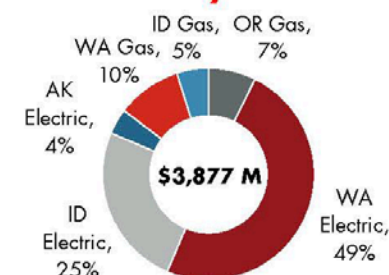
	2016A
Revenue	\$1,824
EBITDA	\$570
Net Income	\$174

		Electric	Gas
Allowed ROE	WA	9.50%	9.50%
	ID	9.50%	9.50%
	OR	-	9.40%
	AK	12.88%	-

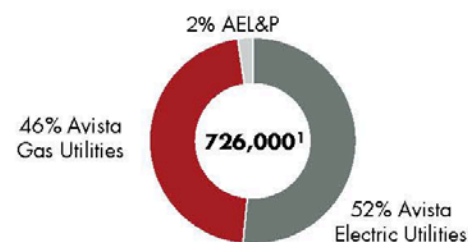
## 2016 Rate Base



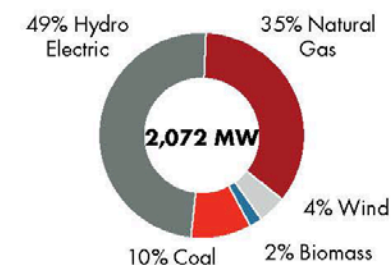
## 2016 Rate Base by State



## 2016 Customers



## 2016 Electric Generation²



Strong financial profile together with a diverse and growing regulated rate base

1. Includes combined electric and gas customers  
2. Based on maximum capacity and excludes Alaska generation

## Strategic rationale



1

### **Building quality regulated asset scale**

- Maintains revenue base as nearly all regulated
- Earnings and cash flow accretion in the first full year following close, excluding transaction costs
- Increases Hydro One's total assets pro forma by C\$6.8B (26.6%)
- Establishes top tier North American utility profile
- Hydro One expected to continue growing dividend and to maintain 70-80% dividend payout ratio

2

### **Diversification**

- Increases geographic, economic, regulatory and asset diversification
- Adds complementary and growing gas distribution
- Provides exposure to regulated and predominantly clean generation

3

### **Shared cultures and values**

- Strong, experienced management team with proven track record
- Common and long-established history between the Companies (over 230 years of collective operational experience)
- Management teams enjoy a deep cultural fit and strong dedication to their respective communities

4

### **Innovation and knowledge transfer**

- Leadership position in innovation in the utility sector
- Cost savings and sharing of research and development initiatives
- Leveraging of technology and sharing of best practices

## Increased scale reinforces top tier status

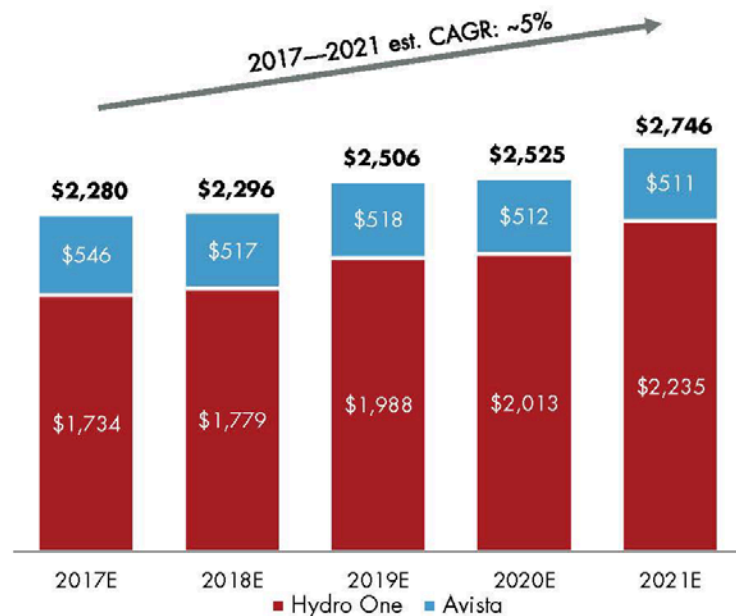
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In accordance with Section 7.6(4) of National Instrument 44-101- *Short Form Prospectus Distributions*, all the information relating to Hydro One's comparables, and any disclosure relating to the comparables, which is contained in the presentation to be provided to potential investors, has been removed from this template version for purposes of its filing on the System for Electronic Document Analysis and Retrieval (SEDAR).

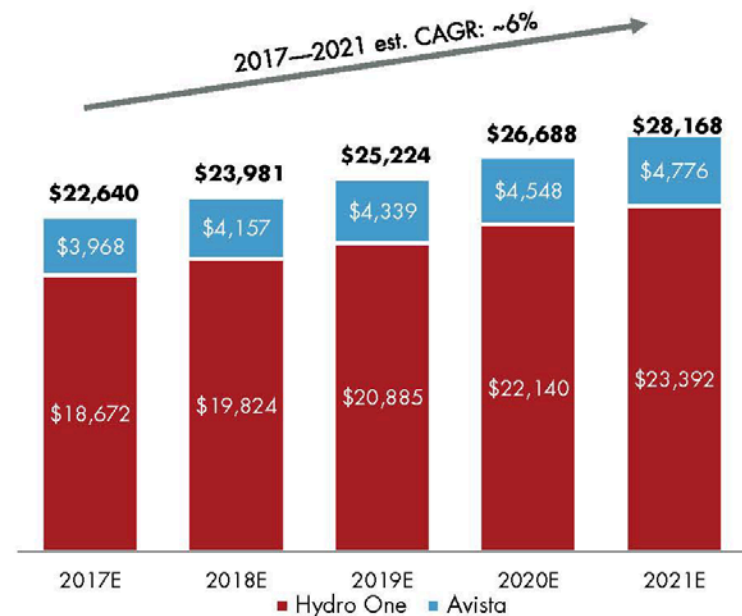
# Sizeable increases in stable regulated earnings 1 | 2 | 3 | 4 hydro<sub>One</sub>

- Planned pro forma investments of over C\$10 billion in T&D through 2021

**Pro Forma Capital Expenditures ('17E-'21E)**  
C\$ in millions



**Pro Forma Rate Base ('17E-'21E)**  
C\$ in millions

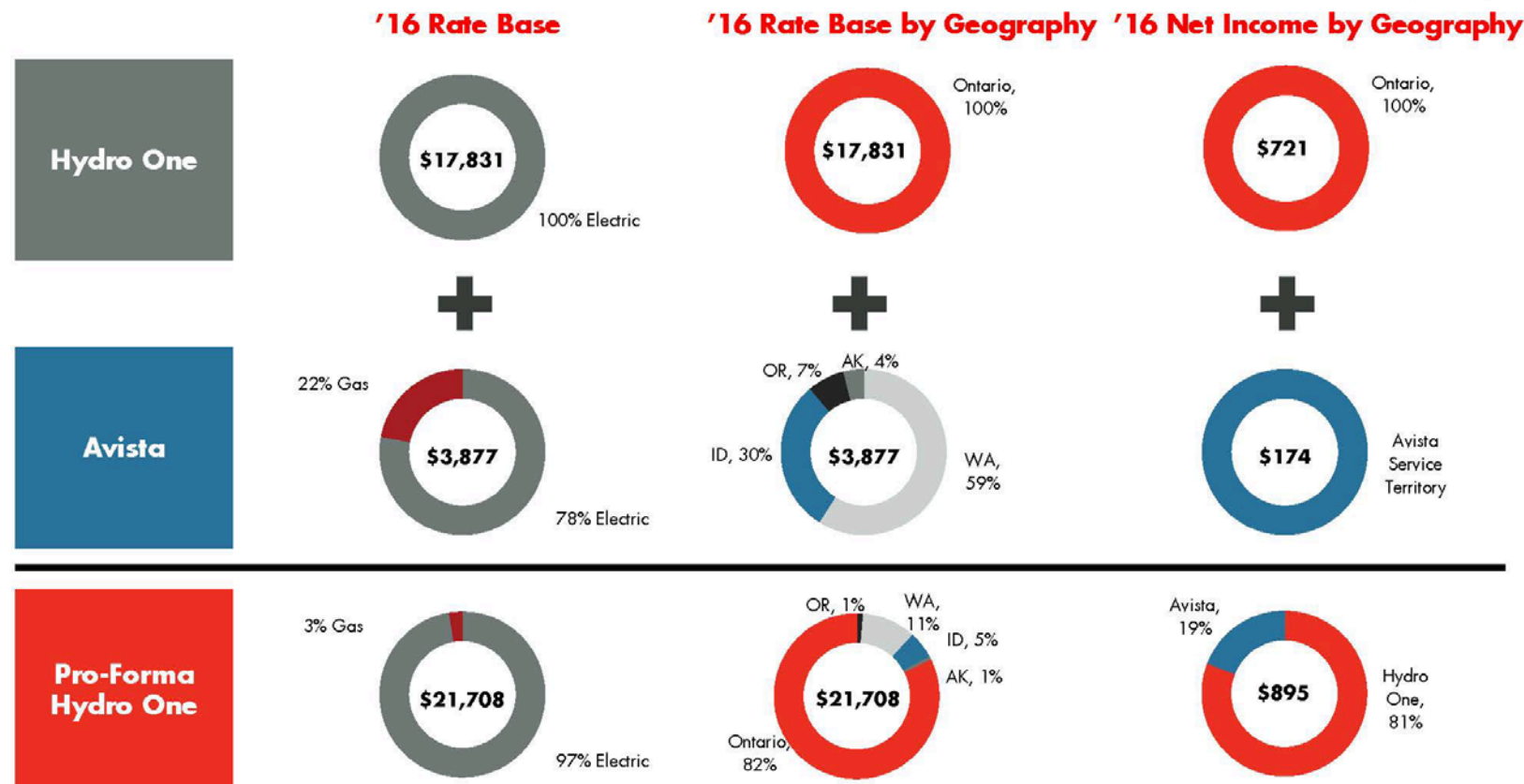


➤ Avista's capital program will further enhance scale, strengthen quality of asset mix and reinforce Hydro One's growth profile

# Diversification

1 | 2 | 3 | 4 hydroOne

(C\$ in mm)



➤ Diversification across multiple geographies, economies, regulatory jurisdictions and utility businesses enhances stability and strategic positioning

Note: Combination of Avista and Hydro One numbers as reported using an exchange rate of C\$ / US\$ 1.264

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## Regulatory diversity

1 | 2 | 3 | 4 hydroOne

(C\$)

	ON	WA	ID	OR	AK
Current Rate Base <sup>1</sup>	\$ 17,831 M	\$ 2,286.6 M	\$ 1,155.5 M	\$ 277.6 M	\$ 157.4 M
Allowed ROE	8.78%	9.50%	9.50%	9.40%	12.88%
Equity Capitalization	40.00%	48.50%	50.00%	50.00%	53.80%



Avista's assets provide an opportunity to expand and diversify the footprint to new regulatory jurisdictions with higher ROEs and attractive allowed capital structures

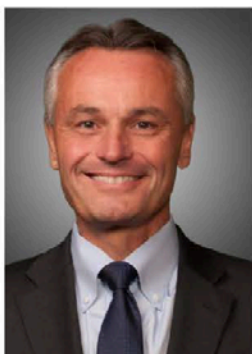
Note:  
1. Avista has de minimis retail operations in Montana and will seek approval from Montana regulators  
Exchange rate of C\$ / US\$ 1.264

One of North America's Largest Electric Utilities

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## Shared culture and values



**Scott Morris**

- Chairman, President and CEO
  - Scott is an experienced utility executive who has served in a variety of leadership positions since joining Avista in 1981
  - He began his career in the company's utility marketing division and has served in leadership positions throughout the company
  - Scott currently chairs the Federal Reserve Bank of San Francisco, Seattle branch, and the Board of Trustees for Gonzaga University. He also serves on the boards of Greater Spokane Incorporated, Edison Electric Institute, Washington Round Table and the American Gas Association
- Hydro One will benefit from the team assembled by Scott of well respected industry leaders who have delivered consistent shareholder value
  - Seasoned leadership team at Avista with an average service of 18 years for the 13 officers
  - Hydro One and Avista management teams enjoy a similar cultural fit and strong dedication to their respective communities with many volunteering on city, region and state committees/initiatives
  - Both companies share a common heritage of over 100 years rooted in hydro generated electric power

➤ **Exceptional cultural fit will allow for a low risk transition and an enhanced ability to quickly find and address areas of mutual benefit that don't compromise either entities' values**

## Innovation and knowledge transfer

1 | 2 | 3 | 4 hydro<sub>One</sub>

- Avista is a proven leader in utility innovation with a deep track record of investments in advanced technologies, including energy management solutions



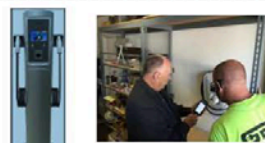
- Avista is the founder of **Itron**, now a global supplier of smart meters with revenues of ~US\$2 billion and total enterprise value of ~US\$2.9 billion
- Sold 24.8 million units in 2016



- Started a fuel cell system business, **ReliOn**
- Sold to Plug Power in 2014



- Grew an energy management services company, **Ecova**, into one of the leaders in the space
- Acquired by Cofely USA, a subsidiary of ENGIE, for more than US\$325 million in 2014



- Providing 272 EV charging stations as part of a 2-year pilot project
- Testing an energy storage system using battery technology



- Developing a “living laboratory for smart city innovation” in collaboration with the City of Spokane and Washington State University and others, called **Urbanova**
  - New technology development focusing in areas such as: a microgrid, solar generation, storage, energy efficient building technology, and advanced metering for electricity/gas/water

➤ Opportunity to reduce operating costs and gain strategic benefits by leveraging and sharing innovation and best practices



## Commitment to customers, communities and employees



### Customers

- Customer rates in the markets served by Hydro One and Avista will be unaffected by transaction costs
- An enhanced transmission and distribution system will achieve operational excellence leading to cost savings over time
- Greater financial capacity will support needed additional investments in energy infrastructure and technology to provide for safe, high quality and reliable service

### Communities

- Both companies will continue to take their responsibility as good corporate citizens very seriously
- This transaction will preserve and in some cases increase the commitment to philanthropy and economic development in the communities served
- Hydro One has committed to do even more, doubling Avista's current levels of community contribution

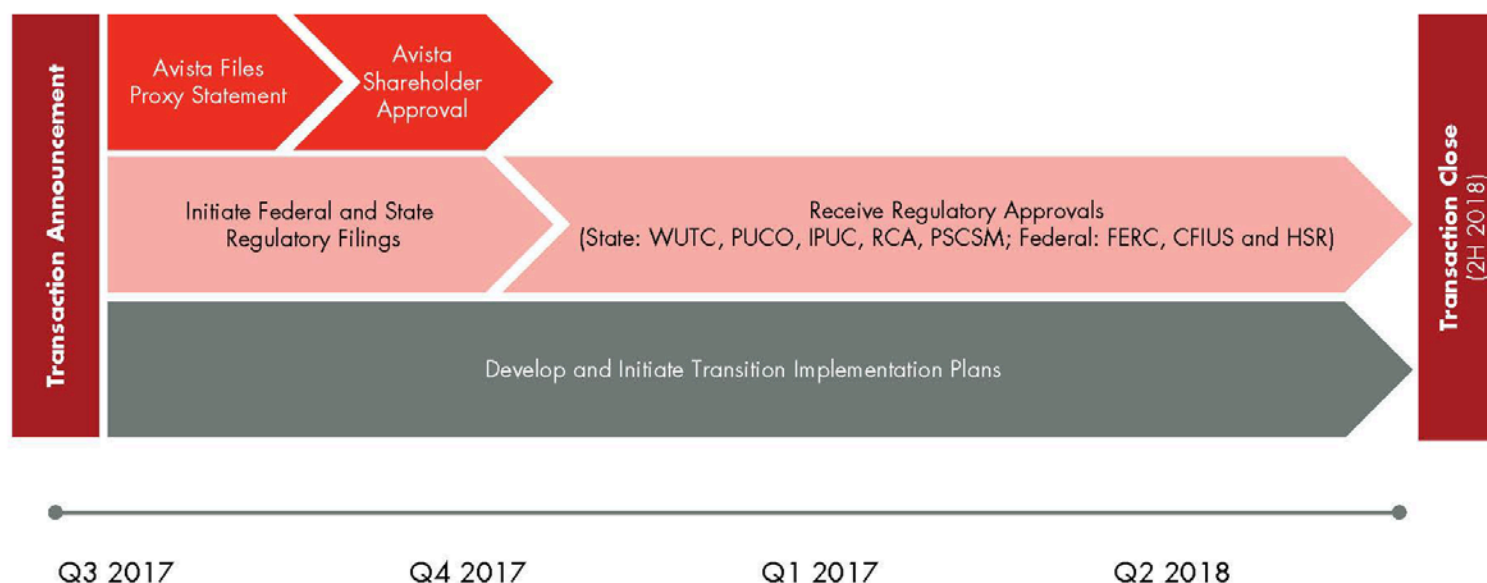
### Employees

- Hydro One and Avista will maintain existing brands, headquarters and employee bases
- Avista's Board of Directors will continue to have significant Pacific Northwest representation
- Scott Morris will be CEO and Chairman of Avista, Mayo Schmidt will continue to be CEO of Hydro One



Committed to maintaining high quality, increasing efficiencies, preserving jobs, and supporting communities and regional economic development

## Indicative timeline to transaction close



➤ Transaction expected to close in the second half of 2018 with federal and state regulatory approval filings expected to occur concurrently for all jurisdictions

Note: WUTC (Washington Utilities and Transportation Commission), OPUC (Oregon Public Utility Commission), IPUC (Idaho Public Utilities Commission), RCA (Regulatory Commission of Alaska), PSCSM (Public Service Commission of the State of Montana), FERC (U.S. Federal Energy Regulatory Commission), CFIUS (Committee on Foreign Investment in the United States) and HSR (U.S. Hart-Scott-Rodino Antitrust Improvements Act of 1976)



# Hydro One To Acquire Avista Creating a North American Utility Leader

July 19, 2017

One of North America's Largest Electric Utilities

TSX: H



## **CERTIFICATE OF HYDRO ONE LIMITED**

Dated: August 1, 2017

This short form prospectus, together with the documents incorporated herein by reference, constitutes full, true and plain disclosure of all material facts relating to the securities offered by this short form prospectus as required by the securities legislation of each of the provinces and territories of Canada.

### **HYDRO ONE LIMITED**

(signed) MAYO SCHMIDT

President and Chief Executive Officer

(signed) CHRIS LOPEZ

Acting in the capacity of Chief Financial  
Officer

On behalf of the Board of Directors:

(signed) DAVID DENISON

Director

(signed) PHILIP ORSINO

Director

### **HYDRO ONE INC.**

(as promoter)

(signed) MAYO SCHMIDT

President and Chief Executive Officer

(signed) CHRIS LOPEZ

Acting in the capacity of Chief Financial  
Officer

On behalf of the Board of Directors:

(signed) DAVID DENISON

Director

(signed) PHILIP ORSINO

Director

## **CERTIFICATE OF THE UNDERWRITERS**

Dated: August 1, 2017

To the best of our knowledge, information and belief, this short form prospectus, together with the documents incorporated herein by reference, constitutes full, true and plain disclosure of all material facts relating to the securities offered by this short form prospectus as required by the securities legislation of each of the provinces and territories of Canada.

**RBC DOMINION SECURITIES INC.**

(Signed) DAVID DAL BELLO

**CIBC WORLD MARKETS INC.**

(Signed) DAVID WILLIAMS

**BMO NESBITT BURNS INC.**

(Signed) GREG PETIT

**NATIONAL BANK FINANCIAL  
INC.**

(Signed) IAIN WATSON

**SCOTIA CAPITAL INC.**

(Signed) THOMAS KURFURST

**TD SECURITIES INC.**

(Signed) HAROLD R. HOLLOWAY

**BARCLAYS CAPITAL CANADA  
INC.**

(Signed) ALAN S. MAYNE

**CREDIT SUISSE SECURITIES  
(CANADA), INC.**

(Signed) MICHAEL COMISAROW

**CANACCORD  
GENUITY CORP.**

(Signed) STEVE WINOKUR

**DESJARDINS SECURITIES  
INC.**

(Signed) FRANÇOIS CARRIER

**LAURENTIAN BANK  
SECURITIES INC.**

(Signed) THOMAS BERKY

**RAYMOND JAMES LTD.**

(Signed) JAMES. A TOWER

**INDUSTRIAL ALLIANCE  
SECURITIES INC.**

(Signed) FRED WESTRA

**WELLS FARGO SECURITIES  
CANADA, LTD.**

(Signed) DARIN E. DESCHAMPS

**HYDRO ONE LIMITED**  
**(Formed under the *Business Corporations Act* (Ontario))**  
**4.00% Convertible Unsecured Subordinated Debentures due September 30, 2027**

No. 3                                      CUSIP/ ISIN:                                      448811AA7/CA448811AA75

Principal Amount:                      \$1,540,000,000  
Interest Rate Per Annum:              4.00% payable quarterly in arrears  
Interest Payment Dates:              the last day of March, June, September and December (or the  
prior Business Day if the last day is not a Business Day) in each  
year to and including the Final Instalment Date (as defined  
below)  
Initial Interest Payment              December 29, 2017  
Date:

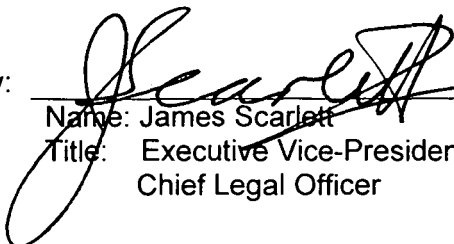
Hydro One Limited, a corporation formed under the *Business Corporations Act* (Ontario), promises to pay to Computershare Trust Company of Canada, as Custodian, or registered assigns the principal amount set forth above on September 30, 2027.

Dated: August 9, 2017

**[SIGNATURE PAGE FOLLOWS]**

IN WITNESS WHEREOF, the Company has caused this instrument to be duly executed.

**HYDRO ONE LIMITED**

by:   
Name: James Scarlett  
Title: Executive Vice-President,  
Chief Legal Officer

by: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

Date: August 9, 2017

Trustee's Certificate of Authentication: This is one of the Debentures referred to in the within mentioned Indenture.

**COMPUTERSHARE TRUST COMPANY OF CANADA, as trustee**

By:   
Authorized Signing Officer



**HYDRO ONE LIMITED**  
**CONVERTIBLE UNSECURED SUBORDINATED DEBENTURES**  
**DUE SEPTEMBER 30, 2027**

Hydro One Limited, a corporation formed under the *Business Corporations Act* (Ontario) (the “**Company**”) for value received hereby acknowledges itself indebted and, subject to the provisions of the trust indenture (the “**Indenture**”) dated as of August 9, 2017 between the Company and Computershare Trust Company of Canada (the “**Trustee**”), promises to pay to the registered holder of this security (the “**Debenture**”) on September 30, 2027 (the “**Maturity Date**”), or on such earlier date as the principal amount hereof may become due in accordance with the provisions of the Indenture, the principal amount set forth on the face page of this Debenture, in lawful money of Canada on presentation and surrender of this Debenture at the main branch of the Trustee in Toronto, Ontario in accordance with the terms of the Indenture. Subject as hereinafter provided, the Company further promises to pay interest on the principal amount of this Debenture from the date hereof at the rate of 4.00% per annum to and including the Final Instalment Date, following which date interest on the principal amount of this Debenture will be payable at the rate of 0%. The Company shall pay interest, while payable, quarterly in arrears in equal instalments (other than the initial interest payment and, depending on the Final Instalment Date, the last interest payment) on the last day of March, June, September and December (or the prior Business Day if the last day is not a Business Day) of each year (each an “**Interest Payment Date**”) until and including the Final Instalment Date (which shall be the final Interest Payment Date for this Debenture), commencing on December 29, 2017 (less any tax required by law to be deducted). Should the Company at any time make default in the payment of any principal or interest, the Company shall pay interest on the amount in default at the same rate, in like money and on the same dates. The first interest payment payable on December 29, 2017 shall be in the amount of \$15.78082 per \$1,000 principal amount of Debentures. If the Final Instalment Date occurs prior to the first anniversary of the date of this Indenture, the Company shall pay, on the Business Day following the Final Instalment Date, the Make-Whole Payment to Holders of record on the Final Instalment Date who have paid the Final Instalment on or before the Final Instalment Date. No Make-Whole Payment will be payable if the Final Instalment Date occurs on or after the first anniversary of the date of the Indenture. Subject to any expressly stated intention to the contrary, in the event that any day on or before which any action required to be taken hereunder is not a Business Day, then such action shall be required to be taken on or before the requisite time on the next day that is a Business Day.

The Company shall pay interest on this Debenture (except defaulted interest) to the person who is the Holder of this Debenture at the close of business on March 15, June 15, September 15 or December 15 (or on the next Business Day, if any such date is not a Business Day), immediately preceding the related Interest Payment Date, or in the case of the Interest Payment Date occurring on the Final Instalment Date, the Final Instalment Date (each, a “**Regular Record Date**”). The Holder must surrender this Debenture to a Paying Agent to collect payment of principal. The Company will pay all amounts due and payable under this Debenture in the lawful currency of Canada. The Company may pay all amounts due and payable under this Debenture in respect of any Certificated Debenture by cheque or wire payable in such money; provided, however, that a Holder with a Debenture in an aggregate principal amount in excess of \$2,000,000 will be paid by wire transfer in immediately available funds at the election or direction of such Holder if such Holder has provided wire transfer instructions to the Trustee at least 10 Business Days prior to the relevant payment date. The Company may mail an interest cheque to the Holder's registered address. Notwithstanding the foregoing, so long as this Debenture is registered in the name of a Depository or its nominee, all payments hereon shall be made by wire transfer of immediately available funds to the account of the Depository or its nominee.



This Debenture is one of a duly authorized issue of Debentures of the Company designated as its 4.00% Convertible Unsecured Subordinated Debentures due on September 30, 2027 issued under the Indenture. The terms of this Debenture include those stated in the Indenture and those required by or made part of the Indenture by reference to Indenture Legislation. This Debenture is subject to all such terms, and the Holder of this Debenture is referred to the Indenture and said legislation for a statement of them. In the event of any contradiction or inconsistency between the provisions of the Indenture and this Debenture, the provisions of the Indenture shall prevail.

The whole of the principal of this Debenture is convertible, at the option of the holder hereof and provided that the Final Instalment has been paid, upon surrender of this Debenture at the principal offices of the Trustee in the City of Toronto at any time on or after the Final Instalment Date and prior to the close of business on the Business Day immediately preceding the Maturity Date or, if this Debenture is called for redemption on or prior to such date, then up to but not after the close of business on the last Business Day immediately preceding the date specified for redemption of this Debenture, into Common Shares (without adjustment for interest accrued hereon or for dividends or distributions on Common Shares issuable upon conversion) at a conversion price of \$21.40 (the "**Conversion Price**") per Common Share, being a rate of approximately 46.7290 Common Shares for each \$1,000 principal amount of Debentures, all subject to the terms and conditions and in the manner set forth in the Indenture. The Indenture makes provision for adjustment of the Conversion Rate and Conversion Price in the events therein specified, including without limitation, in the event of a stock split by the Company or payment of a dividend in kind. No fractional Common Shares will be issued on any conversion but in lieu thereof, the Company will satisfy such fractional interest by a cash payment equal to the fractional interest multiplied by the Conversion Price; provided, however, the Company shall not be required to make any payment of less than \$10.00.

This Debenture may be redeemed after the Final Instalment Date at the option of the Company on the terms and conditions set out in the Indenture at the Redemption Price therein and herein set out and is otherwise not redeemable, except that this Debenture will be redeemed forthwith by the Company at the Redemption Price on the occurrence of any of the following prior to the Final Instalment Date: (a) notification to Holders that the Approval Conditions will not be satisfied; (b) the Acquisition Agreement is terminated in accordance with its terms; or (c) May 1, 2019 if the Final Instalment Notice has not been given on or before April 30, 2019.

The Company may, on notice as provided in the Indenture, at its option and subject to any applicable regulatory approval and provided no Event of Default has occurred and is continuing, elect to satisfy the obligation to repay all or any portion of the principal amount of this Debenture due on the Maturity Date by the issue of that number of Common Shares obtained by dividing the principal amount of this Debenture to be paid for in Common Shares pursuant to the exercise by the Company of the Common Share repayment right by 95% of the Market Price on the Maturity Date.

The indebtedness evidenced by this Debenture, and by all other Debentures now or hereafter certified and delivered under the Indenture, is a direct unsecured obligation of the Company, and (i) will rank equally with one another and with all other unsecured and subordinated indebtedness of the Company except as prescribed by law and (ii) is subordinated in right of payment, to the extent and in the manner provided in the Indenture, to the prior payment of all Senior Indebtedness (including any indebtedness to trade creditors), whether outstanding at the date of the Indenture or thereafter created, incurred, assumed or guaranteed.

The principal hereof may become or be declared due and payable before the stated maturity in the events, in the manner, with the effect and at the times provided in the Indenture.

The Indenture or the Debentures may be amended or supplemented with the consent of the Holders of at least 66⅔% in aggregate principal amount of the Debentures then outstanding (which consent may be obtained at a duly called and constituted meeting of Holders or by an instrument in writing), and an existing Default or Event of Default and its consequence or compliance with any provision of the Indenture or the Debentures may be waived in a particular instance with the consent of the Holders of 66⅔% in aggregate principal amount of the Debentures then outstanding. Without the consent of or notice to any Holder, the Company and the Trustee may amend or supplement the Indenture or the Debentures to, among other things, cure any ambiguity, defect or inconsistency or make any other change that does not adversely affect the rights of the Holders in any material respect.

This Debenture shall not be valid until the Trustee or an authenticating agent manually signs the certificate of authentication on this Debenture.

All terms defined in the Indenture and used in this Debenture but not specifically defined herein are defined in the Indenture and are used herein as so defined.

The Indenture and this Debenture shall be governed by, and construed in accordance with, the laws of the Province of Ontario and the laws of Canada applicable therein. The Company has submitted to the non-exclusive jurisdiction of any court of the Province of Ontario for purposes of all legal actions and proceedings instituted in connection with the Indenture and the Debentures.

The Company will furnish to any Holder, upon written request and without charge, a copy of the Indenture. Requests may be made to: Hydro One Limited, 483 Bay Street, 8th Floor, South Tower, Toronto, ON M5G 2P5 Attention: Corporate Secretary, Facsimile No: (416) 345-5660.

**SCHEDULE 1**  
**NOT APPLICABLE**

**SCHEDULE 2**  
**ASSIGNMENT FORM**

To assign this Debenture, fill in the form below:

I or we assign and transfer this Debenture to \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_

(Print or type assignee's name, address and postal code)

and irrevocably appoint the Registrar as agent to transfer this Debenture on the books of the Company in accordance with the Indenture. The Registrar may substitute another to act for him or her in connection with the foregoing appointment.

Your signature:

Date: \_\_\_\_\_

\_\_\_\_\_  
(sign exactly as your name appears on this Debenture)

\*Signature guaranteed by:

By: \_\_\_\_\_

The signature(s) to this assignment must correspond with the name(s) as written upon the face of this Debenture in every particular without alteration or any change whatsoever. The signature(s) on this form must be guaranteed by one of the following methods:

Canada and the USA: A Medallion Signature Guarantee obtained from a member of an acceptable Medallion Signature Guarantee Program (STAMP, SEMP, MSP). Many commercial banks, savings banks, credit unions, and all broker dealers participate in a Medallion Signature Guarantee Program. The Guarantor must affix a stamp bearing the actual words "Medallion Guaranteed".

Canada: A Signature Guarantee obtained from a major Canadian Schedule I chartered bank. The Guarantor must affix a stamp bearing the actual words "Signature Guaranteed". Signature Guarantees are not accepted from Treasury Branches, Credit Unions or Caisses Populaires unless they are members of a Medallion Signature Guarantee Program.

Outside North America: For holders located outside North America, present the certificate(s) and/or document(s) that require a guarantee to a local financial institution that has a corresponding Canadian or American affiliate which is a member of an acceptable Medallion Signature Guarantee Program. The corresponding affiliate will arrange for the signature to be over-guaranteed.

**SCHEDULE 3**  
**CONVERSION NOTICE FORM**

To convert this Debenture into Common Shares of the Company, check the box:

☐

If you want the share certificate made out in another person's name, fill in the form below:

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(Print or type assignee's name, address and postal code)

Your signature:

Date: \_\_\_\_\_

\_\_\_\_\_  
(sign exactly as your name appears on this  
Debenture)

\*Signature guaranteed by:

By: \_\_\_\_\_

\* The signature(s) to this assignment must correspond with the name(s) as written upon the face of this Debenture in every particular without alteration or any change whatsoever. The signature(s) on this form must be guaranteed by one of the following methods:

Canada and the USA: A Medallion Signature Guarantee obtained from a member of an acceptable Medallion Signature Guarantee Program (STAMP, SEMP, MSP). Many commercial banks, savings banks, credit unions, and all broker dealers participate in a Medallion Signature Guarantee Program. The Guarantor must affix a stamp bearing the actual words "Medallion Guaranteed".

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Outside North America: For holders located outside North America, present the certificate(s) and/or document(s) that require a guarantee to a local financial institution that has a corresponding Canadian or American affiliate which is a member of an acceptable Medallion Signature Guarantee Program. The corresponding affiliate will arrange for the signature to be over-guaranteed.

**Building Owners and Managers Association Toronto Interrogatory # 161**

**Issue:**

Issue 36: Are the proposed timing and methodology for determining the return on equity and short-term debt prior to the effective date of rate implementation appropriate?

**Reference:**

Financial Statements Page: 20

**Interrogatory:**

a) Please provide a detailed explanation of how HONI proposes to finance the Arista acquisition. Will any debt incurred be incurred on a "project basis", that is, be repaid entirely from revenue stream from acquired company, or the shareholders of the unregulated business? How will Networks be insulated against any risks arising from the proposed acquisition? Please discuss fully.

b) One of the risks of the acquisition cited in the second quarter report (p20) is that the additional debt required would result in a reduction of Hydro One Limited and Hydro One Inc. credit ratings and would increase the company's borrowing costs. Will Networks' debt cost be insulated against such a development, and how will this be done?

c) Another risk is that:

*"Hydro One will substantially increase its amount of indebtedness following the merger (including \$1.9 billion of existing debt of Arista corporation) may adversely affect Hydro One's cash flow and ability to operate its business".*

What steps will be taken to address this risk?

**Response:**

a) As discussed in Exhibit I-42-BOMA-B160, HONI is not financing the acquisition. Please see the financing plan on page A-8 of the prospectus for the convertible debenture (Appendix A) issued for the Avista acquisition, as provided in Exhibit I-36-BOMA-B159 Attachment 1.

The additional debt required to fund the acquisition will be issued by a separate subsidiary of Hydro One Limited ("Canadian Subco"), not Hydro One Inc. No debt is planned to be issued on a "project basis". Hydro One Inc. and Hydro One Networks will not be liable for this debt.

- 1 b) Any changes to Hydro One Inc.'s credit rating could impact its borrowing costs. Hydro One  
2 Inc. has not observed any material change to its credit spreads and borrowing costs. No  
3 impact to Networks cost of debt has been included in this rate application.  
4
- 5 c) The additional debt following the merger will be issued by a separate subsidiary of Hydro  
6 One Limited, not Hydro One Inc., thus will not adversely affect Networks' cash flow and  
7 ability to operate its business.

**Building Owners and Managers Association Toronto Interrogatory # 26**

**Issue:**

Issue 37: Is the forecast of long term debt for 2018 and further years appropriate?

Issue 41: Has Hydro One demonstrated improvements in presenting its compensation costs and showing efficiency and value for dollar associated with its compensation costs (excluding executive compensation)?

**Reference:**

A-03-01 Page: 28 Table 11

**Interrogatory:**

Overforecasting in previous four years.

- a) Why have sustained, development, and operation OM&A been overforecast in each of 2015, 2016, and 2017?
- b) Why have HONI Distribution's share of common corporate costs actual substantially exceed approved in 2015 and 2016?

**Response:**

- a) For Sustaining OM&A please refer to Exhibit C1, Tab 1, Schedule 2.  
For Development OM&A please refer to Exhibit C1, Tab 1, Schedule 3.  
For Operations OM&A, please refer to Exhibit C1, Tab 1, Schedule 4.

The variance explanations for the Sustaining, Development, and Operations OM&A expenditures relative to OEB approved levels are explained in Exhibit C1, Tab 1, Schedule 1, pages 5-7.

- b) Please refer to Exhibit C1, Tab 1, Schedule 6, Page 2, Table 2 for a breakdown of common corporate costs allocated to Distribution. High level variance explanations for each component of the table are included on page 3. Within each write-up, a further reference is made as to where in evidence details can be found. The majority of the variance in question relates to Common Corporate Functions & Services (CCF&S) and Other OM&A line items.



1 In 2015, higher CCF&S costs were associated with higher costs in Regulatory Affairs (C1-1-  
2 7 pages 21-23) and Corporate Relations (C1-1-7 pages 15-16).

3  
4 In 2016, higher CCF&S costs were associated with Corporate Management (C1-1-7 pages 5-  
5 7), People and Culture (C1-1-7 pages 12-14), Regulatory Affairs (C1-1-7 pages 21-23) and  
6 Real Estate & Facilities (C1-1-7 pages 26-29). With respect to Corporate Management,  
7 Hydro One has addressed the OEB's concerns with executive compensation and filed Exhibit  
8 Q on December 21, 2017, which reduces the 2018 OM&A by \$3.2 million, relating  
9 specifically to executive compensation.

10  
11 The components of Other OM&A are provided in Exhibit C1, Tab 1, Schedule 7, page 31  
12 within Table 18. Higher Other OM&A was due to the inclusion of compensation reductions  
13 within the Other category in each of 2015 and 2016 as well as lower than planned  
14 environmental expenditures, as described on page 32 of the same exhibit.

**Building Owners and Managers Association Toronto Interrogatory # 27**

**Issue:**

Issue 37: Is the forecast of long term debt for 2018 and further years appropriate?

**Reference:**

A-03-01 Page: 29, line 5 to Table on p22

**Interrogatory:**

- a) Please break down the components of the \$20.2 million forecast reduction in 2017 relative to Board-approved.
- b) What is the most current estimate of that reduction? Please provide an itemized list.

**Response:**

- a) A breakdown of the \$20.2 million lower OM&A components can be found in the following exhibits:
  - Sustainment: Exhibit C1, Tab 1, Schedule 2, page 3
  - Development: Exhibit C1, Tab 1, Schedule 3, page 2
  - Operations: Exhibit C1, Tab 1, Schedule 4, page 3
  - Customer Service: Exhibit C1, Tab 1, Schedule 5, page 2
  - Common Corporate: Exhibit C1, Tab 1, Schedule 6, page 2
  - Property Taxes & Rights Payments: Exhibit C1, Tab 7, Schedule 4, page 1
- b) The best estimate is the bridge year filed in the application. 2017 actuals are not available at this time.

**Canadian Manufacturers & Exporters Interrogatory # 62**

**Issue:**

Issue 37: Is the forecast of long term debt for 2018 and further years appropriate?

**Reference:**

D1-02-01 Updated  
Exhibit Q

**Interrogatory:**

- a) Based on the updated cost of capital that reflects the Board-approved return on equity and short-term debt and the actual long-term debt issued in 2017 and now forecast for 2018, please provide updates to all relevant schedules and tables, including the tables in Exhibit D, Tab 2, Schedule 2, and Exhibit D2, Tab 2, Schedule 2.
- b) Please confirm that Hydro One is not proposing any changes for the return on equity or the short-term debt rate in 2019 or 2020 relative to that used for 2018. If this cannot be confirmed, please explain fully.
- c) Please confirm that Hydro One is not proposing to any changes for the long-term debt rate for 2019 or 2020 relative to the forecast approved for those years as part of the current application. If this cannot be confirmed, please explain fully.
- d) Are there any changes to the long-term debt rates for 2019 and 2020 as a result of the updates provided in Exhibit Q? If yes, please provide a table for each year that shows the difference and fully explain all changes.

**Response:**

- a) Please refer to Exhibit I-37-Staff-182, Exhibit I-37-VECC-35, Exhibit I-37-VECC-36, Exhibit I-37-CME-64.
- b) Confirmed, Hydro One is proposing to use the approved 2018 return on equity and short-term debt for 2019 and 2020 when calculating the approved revenue requirement for 2019 and 2020.
- c) Confirmed, Hydro One is proposing to use the approved 2018 long-term debt rate for 2019 and 2020 when calculating the approved revenue requirement for 2019 and 2020.

Witness: JODOIN Joel and CHHELAVDA Samir

Filed: 2018-02-12  
EB-2017-0049  
Exhibit I  
Tab 37  
Schedule CME-62  
Page 2 of 2

- 1 d) Please refer to part (a) above for an updated long-term debt rate for 2018 which is to be used
- 2 for 2019 and 2020 calculation of the revenue requirement.

**Canadian Manufacturers & Exporters Interrogatory # 63**

**Issue:**

Issue 37: Is the forecast of long term debt for 2018 and further years appropriate?

**Reference:**

D1-02-01 Updated

**Interrogatory:**

Hydro One is proposing to update the cost of capital parameters for the 2021 and 2022 revenue requirements in the fall of 2020 when the OEB releases its 2021 cost of capital parameters.

- a) Please explain why Hydro One believes that a cost of capital parameter update is appropriate or needed in the middle of a custom IR term.
- b) Would the return on equity and the short-term debt rate used for 2022 be the same as the 2021 rates, similar to the approach for these rates in 2019 and 2020 by setting them equal to the 2018 rates? If not, why not and please explain fully the proposal for 2022.
- c) Is Hydro One proposing to set the long-term debt rate for 2022 equal to the 2021 forecast rate, or will Hydro One be providing a new forecast for the long-term debt rate for 2022 as part of the cost of capital parameter updates proposed for the fall of 2020?
- d) What other components of the revenue requirement, or the determination of rates, is Hydro One proposing to update in the fall of 2020 for the 2021 and 2022 revenue requirements and the determination of rates?
- e) How does Hydro One propose to deal with the overlap between the inflation rate used in the Custom IR and the change in the cost of capital parameters to avoid double counting the impact of changes in interest rates in the inflation rate?

**Response:**

- a) Please see the response to part b) of Exhibit I-7-CME-1.
- b) Yes.

- 1 c) Hydro One is proposing to set the long-term debt rate for 2022 equal to the 2021 forecast  
2 rate.  
3
- 4 d) A description of the proposed updates during the 2019-2022 term can be found in Hydro  
5 One's response to Exhibit I-13-CCC-15.  
6
- 7 e) A description of the methodology that will be used to incorporate the change in cost of  
8 capital parameters in Hydro One's proposed Revenue Cap Index is provided in Section 1.3 of  
9 Exhibit A, Tab 3, Schedule 2.

**Canadian Manufacturers & Exporters Interrogatory # 64**

**Issue:**

Issue 37: Is the forecast of long term debt for 2018 and further years appropriate?

**Reference:**

D1-02-02 Updated

D2-02-02

Exhibit Q

**Interrogatory:**

- a) Please update Tables 2, 3 and 4 in Exhibit D1, Tab 2, Schedule 2, Updated to reflect the updated figures referenced in Exhibit Q for the actual long-term debt issuances in 2017 and the forecast for 2018.
- b) Please provide updated versions of Exhibit D2, Tab 2, Schedule 2, pages 5 and 6, showing the cost of long-term debt for each of 2017 and 2018.

**Response:**

- a) Please see Hydro One's responses in Exhibit I-37-VECC-35 and Exhibit I-37-VECC-36 for the updated tables in Exhibit D1, Tab 2, Schedule 2. Please note that the cost of debt figures in Exhibit Q reflect the actual long term debt issuances in 2017 and the forecast interest rate of debt issuances in 2018, but not the updated amount of issuances in 2018.
- b) Please see the schedule as follows for an updated version of Exhibit D2, Tab 2, Schedule 2, page 5, showing the cost of long-term debt in 2017. Please refer to Exhibit I-37-Staff-182 for an updated version of Exhibit D2, Tab 2, Schedule 2, page 6, showing the cost of long-term debt in 2018.

The following information relating to a portion of long term debt to be issued by Hydro One Inc. is provided for regulatory planning purposes only and not intended be relied upon for any purpose other than for analysis in the Ontario Energy Board Proceeding EB-2017-0049 concerning Hydro One Networks Inc.'s application for distribution rates approval. This response includes forward-looking information and is based on a variety of factors and assumptions. Actual principal amounts of debt, the term of the debt, or the related coupon may differ from what is expressed herein.

HYDRO ONE NETWORKS INC.  
DISTRIBUTION  
Cost of Long-Term Debt Capital  
Bridge Year (2017)  
Year ending December 31

Line No.	Offering Date	Coupon Rate	Maturity Date	Premium		Net Capital Employed		Effective Cost Rate	Total Amount Outstanding		Avg. Monthly Averages	Carrying Cost	Projected Average Embedded Cost Rates
				Principal Amount Offered (\$Millions)	Discount and Expenses (\$Millions)	Total Amount (\$Millions)	Per \$100 Principal Amount (Dollars)		at 12/31/2016 (\$Millions)	at 12/31/2017 (\$Millions)			
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)
1	3-Jun-00	7.35%	3-Jun-30	121.6	2.0	119.6	98.37	7.49%	121.6	121.6	121.6	9.1	
2	22-Jun-01	6.93%	1-Jun-32	47.7	0.6	47.1	98.78	7.03%	47.7	47.7	47.7	3.4	
3	17-Sep-02	6.93%	1-Jun-32	142.0	(5.1)	147.1	103.57	6.65%	142.0	142.0	142.0	9.4	
4	31-Jan-03	6.35%	31-Jan-34	74.0	0.6	73.4	99.21	6.41%	74.0	74.0	74.0	4.7	
5	22-Apr-03	6.59%	22-Apr-43	105.0	0.8	104.2	99.26	6.64%	105.0	105.0	105.0	7.0	
6	25-Jun-04	6.35%	31-Jan-34	48.0	(0.1)	48.1	100.22	6.33%	48.0	48.0	48.0	3.0	
7	20-Aug-04	6.59%	22-Apr-43	26.0	(2.1)	28.1	107.89	6.06%	26.0	26.0	26.0	1.6	
8	24-Aug-04	6.35%	31-Jan-34	26.0	(0.9)	26.9	103.48	6.09%	26.0	26.0	26.0	1.6	
9	19-May-05	5.36%	20-May-36	98.1	3.7	94.4	96.19	5.62%	98.1	98.1	98.1	5.5	
10	24-Apr-06	5.36%	20-May-36	62.5	0.8	61.7	98.68	5.45%	62.5	62.5	62.5	3.4	
11	19-Oct-06	5.00%	19-Oct-46	45.0	0.3	44.7	99.29	5.04%	45.0	45.0	45.0	2.3	
12	13-Mar-07	4.89%	13-Mar-37	160.0	0.9	159.1	99.45	4.93%	160.0	160.0	160.0	7.9	
13	18-Oct-07	5.18%	18-Oct-17	75.0	0.3	74.7	99.63	5.23%	75.0	0.0	57.7	3.0	
14	3-Mar-08	5.18%	18-Oct-17	120.0	(2.1)	122.1	101.73	4.95%	120.0	0.0	92.3	4.6	
15	3-Mar-09	6.03%	3-Mar-39	105.0	0.6	104.4	99.41	6.07%	105.0	105.0	105.0	6.4	
16	16-Jul-09	5.49%	16-Jul-40	90.0	0.6	89.4	99.36	5.53%	90.0	90.0	90.0	5.0	
17	15-Mar-10	5.49%	24-Jul-40	80.0	(0.5)	80.5	100.58	5.45%	80.0	80.0	80.0	4.4	
18	15-Mar-10	4.40%	4-Jun-20	120.0	0.5	119.5	99.55	4.46%	120.0	120.0	120.0	5.3	
19	13-Sep-10	5.00%	19-Oct-46	100.0	(0.2)	100.2	100.25	4.98%	100.0	100.0	100.0	5.0	
20	26-Sep-11	4.39%	26-Sep-41	75.0	0.5	74.5	99.35	4.43%	75.0	75.0	75.0	3.3	
21	22-Dec-11	4.00%	22-Dec-51	30.0	0.2	29.8	99.47	4.03%	30.0	30.0	30.0	1.2	
22	13-Jan-12	3.20%	13-Jan-22	126.0	0.7	125.3	99.47	3.26%	126.0	126.0	126.0	4.1	
23	22-May-12	3.20%	13-Jan-22	135.0	(1.3)	136.3	100.97	3.08%	135.0	135.0	135.0	4.2	
24	22-May-12	4.00%	22-Dec-51	56.3	0.3	56.0	99.51	4.02%	56.3	56.3	56.3	2.3	
25	31-Jul-12	3.79%	31-Jul-62	22.5	0.1	22.4	99.47	3.81%	22.5	22.5	22.5	0.9	
26	16-Aug-12	3.79%	31-Jul-62	94.0	0.8	93.2	99.20	3.83%	94.0	94.0	94.0	3.6	
27	9-Oct-13	4.59%	9-Oct-43	195.8	1.1	194.6	99.42	4.63%	195.8	195.8	195.8	9.1	
28	9-Oct-13	2.78%	9-Oct-18	337.5	1.4	336.1	99.59	2.87%	337.5	337.5	337.5	9.7	
29	29-Jan-14	4.31%	29-Jan-64	20.0	0.1	19.9	99.44	4.34%	20.0	20.0	20.0	0.9	
30	6-Jun-14	4.17%	6-Jun-44	132.0	0.8	131.2	99.40	4.21%	132.0	132.0	132.0	5.6	
31	24-Feb-16	3.91%	24-Feb-46	175.0	1.1	173.9	99.36	3.95%	175.0	175.0	175.0	6.9	
32	24-Feb-16	2.77%	24-Feb-26	245.0	1.1	243.9	99.56	2.82%	245.0	245.0	245.0	6.9	
33	24-Feb-16	1.84%	24-Feb-21	250.0	0.9	249.1	99.63	1.92%	250.0	250.0	250.0	4.8	
34	18-Nov-16	3.72%	18-Nov-47	180.0	0.9	179.1	99.50	3.75%	180.0	180.0	180.0	6.7	
35	Subtotal								3719.9	3524.9	3674.9	162.6	
36	Treasury OM&A costs											1.1	
37	Other financing-related fees											2.8	
38	Total								3719.9	3524.9	3674.9	166.5	4.53%



**Energy Probe Research Foundation Interrogatory # 54**

**Issue:**

Issue 37: Is the forecast of long term debt for 2018 and further years appropriate?

**Reference:**

D1-02-01 Page: 5 Table 1

**Interrogatory:**

Please confirm that Table 1 is incorrect and that Short Term Debt is “Deemed”, not Long Term Debt.

**Response:**

Hydro One confirms that the Short Term Debt shown in Table 1 is Deemed Short Term Debt as discussed in Exhibit D1-2-1 page 2.

The “Deemed Long-term debt” on row 4 in the table is correctly labelled. This amount represents the notional amount of long term debt required to match the actual amount of long-term debt to 56% of rate base, as explained on Page 4, line 16 to 19 of Exhibit D1-02-01.

**OEB Staff Interrogatory # 182**

**Issue:**

Issue 37: Is the forecast of long term debt for 2018 and further years appropriate?

**Reference:**

D2-02-02

**Interrogatory:**

In its December 21, 2017 update, Hydro One updated its cost of capital to reflect the most recently released OEB cost of capital parameters but did not file a cost of capital long term debt table to reflect new issuances of debt and new forecasts of debt for 2018.

Please provide an updated schedule of actual debt issued in 2017 and the forecast of planned debt issuances and forecast of interest rates that would apply for the 2018 test year.

**Response:**

The updated schedule as has been provided as requested.

The following information relating to a portion of long term debt to be issued by Hydro One Inc. is provided for regulatory planning purposes only and not intended be relied upon for any purpose other than for analysis in the Ontario Energy Board Proceeding EB-2017-0049 concerning Hydro One Networks Inc.'s application for distribution rates approval. This response includes forward-looking information and is based on a variety of factors and assumptions. Actual principal amounts of debt, the term of the debt, or the related coupon may differ from what is expressed herein.

HYDRO ONE NETWORKS INC.  
DISTRIBUTION  
Cost of Long-Term Debt Capital  
Test Year (2018)  
Year ending December 31

Line No.	Offering Date	Coupon Rate	Maturity Date	Principal Amount Offered (\$Millions)	Premium Discount and Expenses (\$Millions)	Net Capital Employed		Effective Cost Rate	1/1/2017 Total Amount Outstanding at 12/31/2017		1/1/2018 Total Amount Outstanding at 12/31/2018		Avg. Monthly Averages (\$Millions)	Carrying Cost (\$Millions)	Projected Average Embedded Cost Rates
						Total Amount (\$Millions)	Per \$100 Principal Amount (Dollars)		at 12/31/2017 (\$Millions)	at 12/31/2018 (\$Millions)	at 12/31/2018 (\$Millions)	at 12/31/2018 (\$Millions)			
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)			
1	3-Jun-00	7.35%	3-Jun-30	121.6	2.0	119.6	98.37	7.49%	121.6	121.6	121.600	9.1			
2	22-Jun-01	6.93%	1-Jun-32	47.7	0.6	47.1	98.78	7.03%	47.7	47.7	47.728	3.4			
3	17-Sep-02	6.93%	1-Jun-32	142.0	(5.1)	147.1	103.57	6.65%	142.0	142.0	142.000	9.4			
4	31-Jan-03	6.35%	31-Jan-34	74.0	0.6	73.4	99.21	6.41%	74.0	74.0	74.000	4.7			
5	22-Apr-03	6.59%	22-Apr-43	105.0	0.8	104.2	99.26	6.64%	105.0	105.0	105.000	7.0			
6	25-Jun-04	6.35%	31-Jan-34	48.0	(0.1)	48.1	100.22	6.33%	48.0	48.0	48.000	3.0			
7	20-Aug-04	6.59%	22-Apr-43	26.0	(2.1)	28.1	107.89	6.06%	26.0	26.0	26.000	1.6			
8	24-Aug-04	6.35%	31-Jan-34	26.0	(0.9)	26.9	103.48	6.09%	26.0	26.0	26.000	1.6			
9	19-May-05	5.36%	20-May-36	98.1	3.7	94.4	96.19	5.62%	98.1	98.1	98.100	5.5			
10	24-Apr-06	5.36%	20-May-36	62.5	0.8	61.7	98.68	5.45%	62.5	62.5	62.500	3.4			
11	19-Oct-06	5.00%	19-Oct-46	45.0	0.3	44.7	99.29	5.04%	45.0	45.0	45.000	2.3			
12	13-Mar-07	4.89%	13-Mar-37	160.0	0.9	159.1	99.45	4.93%	160.0	160.0	160.000	7.9			
13	3-Mar-09	6.03%	3-Mar-39	105.0	0.6	104.4	99.41	6.07%	105.0	105.0	105.000	6.4			
14	16-Jul-09	5.49%	16-Jul-40	90.0	0.6	89.4	99.36	5.53%	90.0	90.0	90.000	5.0			
15	15-Mar-10	5.49%	24-Jul-40	80.0	(0.5)	80.5	100.58	5.45%	80.0	80.0	80.000	4.4			
16	15-Mar-10	4.40%	4-Jun-20	120.0	0.5	119.5	99.55	4.46%	120.0	120.0	120.000	5.3			
17	13-Sep-10	5.00%	19-Oct-46	100.0	(0.2)	100.2	100.25	4.98%	100.0	100.0	100.000	5.0			
18	26-Sep-11	4.39%	26-Sep-41	75.0	0.5	74.5	99.35	4.43%	75.0	75.0	75.000	3.3			
19	22-Dec-11	4.00%	22-Dec-51	30.0	0.2	29.8	99.47	4.03%	30.0	30.0	30.000	1.2			
20	13-Jan-12	3.20%	13-Jan-22	126.0	0.7	125.3	99.47	3.26%	126.0	126.0	126.000	4.1			
21	22-May-12	3.20%	13-Jan-22	135.0	(1.3)	136.3	100.97	3.08%	135.0	135.0	135.000	4.2			
22	22-May-12	4.00%	22-Dec-51	56.3	0.3	56.0	99.51	4.02%	56.3	56.3	56.250	2.3			
23	31-Jul-12	3.79%	31-Jul-62	22.5	0.1	22.4	99.47	3.81%	22.5	22.5	22.500	0.9			
24	16-Aug-12	3.79%	31-Jul-62	94.0	0.8	93.2	99.20	3.83%	94.0	94.0	94.000	3.6			
25	9-Oct-13	4.59%	9-Oct-43	195.8	1.1	194.6	99.42	4.63%	195.8	195.8	195.750	9.1			
26	9-Oct-13	2.78%	9-Oct-18	337.5	1.4	336.1	99.59	2.87%	337.5	0.0	259.615	7.4			
27	29-Jan-14	4.31%	29-Jan-64	20.0	0.1	19.9	99.44	4.34%	20.0	20.0	20.000	0.9			
28	3-Jun-14	4.17%	3-Jun-44	132.0	0.8	131.2	99.40	4.21%	132.0	132.0	132.000	5.6			
29	24-Feb-16	3.91%	24-Feb-46	175.0	1.1	173.9	99.36	3.95%	175.0	175.0	175.000	6.9			
30	24-Feb-16	2.77%	24-Feb-26	245.0	1.1	243.9	99.56	2.82%	245.0	245.0	245.000	6.9			
31	24-Feb-16	1.84%	24-Feb-21	250.0	0.9	249.1	99.63	1.92%	250.0	250.0	250.000	4.8			
32	18-Nov-16	3.72%	18-Nov-47	180.0	0.9	179.1	99.50	3.75%	180.0	180.0	180.000	6.7			
33	15-Mar-18	4.18%	15-Mar-48	348.4	1.0	347.4	99.71	4.20%	0.0	348.4	267.973	11.3			
34	15-Jun-18	3.38%	15-Jun-28	348.4	1.0	347.4	99.71	3.41%	0.0	348.4	187.581	6.4			
35	15-Sep-18	2.82%	15-Sep-23	348.4	1.0	347.4	99.71	2.89%	0.0	348.4	107.189	3.1			
36	<b>Subtotal</b>								3524.9	4232.5	4009.8	173.5			
37	Treasury OM&A costs											1.1			
38	Other financing-related fees											2.8			
39	<b>Total</b>								3524.9	4232.5	4009.8	177.4			4.42%

**Vulnerable Energy Consumers Coalition Interrogatory # 35**

**Issue:**

Issue 37: Is the forecast of long term debt for 2018 and further years appropriate?

**Reference:**

D1-02-02 Page: 4

**Interrogatory:**

a) Please update Tables 2 and 3 showing the forecast debt issues for 2017 and 2018.

**Response:**

a) Please see the updated tables below as requested.

As shown in Table 2 below, Hydro One did not issue any long term debt in 2017.

**Table 2: Forecast Debt Issues for 2017 (updated)**

Year	Principal Amount (\$Millions)	Term (Years)	Coupon
2017	0	10	n/a
	0	10	n/a
	0	30	n/a
	0	30	n/a

Table 3 lists the updated fixed rate MTN's which Hydro One Distribution plans to issue in 2018.

**Table 3: Forecast Debt Issues for 2018 (updated)**

Year	Principal Amount (\$Millions)	Term (Years)	Coupon
2018	348.4	5	2.82%
	348.4	10	3.38%
	348.4	30	4.18%

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Witness: CHHELAVDA Samir

Filed: 2018-02-12  
EB-2017-0049  
Exhibit I  
Tab 37  
Schedule VECC-35  
Page 2 of 2

- 1 includes forward-looking information and is based on a variety of factors and
- 2 assumptions. Actual principal amounts of debt, the term of the debt, or the related coupon may
- 3 differ from what is expressed herein.

**Vulnerable Energy Consumers Coalition Interrogatory # 36**

**Issue:**

Issue 37: Is the forecast of long term debt for 2018 and further years appropriate?

**Reference:**

D1-02-02 Page: 5

**Interrogatory:**

a) Please update Tables 4 to show the actual (2017) and updated forecast (2018) yield and spreads.

**Response:**

a) Please see the table below as requested.

Table 4 summarizes the updated forecast of Hydro One Inc. yield for each of the planned issuance terms for 2018. Hydro One did not issue any long term debt in 2017, thus the yield is not applicable.

**Table 4: Forecast Yield for 2017-2018 Issuance Terms (updated)**

	2017			2018		
	5-year	10-year	30-year	5-year	10-year	30-year
<b>Government of Canada</b>	n/a	n/a	n/a	2.10%	2.40%	2.76%
<b>Hydro One Spread</b>	n/a	n/a	n/a	0.72%	0.98%	1.42%
<b>Forecast Hydro One Yield</b>	n/a	n/a	n/a	2.82%	3.38%	4.18%

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