**BEFORE THE STATE CORPORATION COMMISSION**
**OF THE STATE OF KANSAS**

| | | |
|---|---|---|
| In the Matter of the Joint Application of | ) | |
| ITC Great Plains, LLC, and its Parent | ) | |
| Company, ITC Holdings Corp., Together | ) | Docket No. 16- ____________ |
| With Fortis Inc., FortisUS Inc., ITC | ) | |
| Investment Holdings Inc. and | ) | |
| Element Acquisition Sub Inc., for an | ) | |
| Order Approving the Acquisition by | ) | |
| Fortis Inc. of the Majority of All Classes | ) | |
| of the Stock of ITC Holdings Corp., | ) | |
| and its Subsidiary Companies, Including | ) | |
| ITC Great Plains, LLC. | ) | |

**Direct Testimony of**

**KARL W. SMITH**

**Executive Vice President, Chief Financial Officer of Fortis Inc.**

**May 10, 2016**

## I. INTRODUCTION

**Q. Please state your name and business address.**

**A.** My name is Karl W. Smith. I am the Executive Vice President, Chief Financial Officer ("CFO") of Fortis Inc. ("Fortis"). My business address is Fortis Place, Suite 1100, 5 Springdale Street, St. John's, Newfoundland and Labrador, Canada.

**Q. What is your educational background and work experience?**

**A.** I earned a Bachelor of Commerce degree from Memorial University of Newfoundland in 1981 and I am a member of the Chartered Professional Accountants of Newfoundland and Labrador. I have held my current position at Fortis since June 2014. Prior to that, I served as President and Chief Executive Officer of FortisAlberta Inc. ("FortisAlberta") from 2007. Before that, I held the position of President and Chief Executive Officer of Newfoundland Power Inc. ("Newfoundland Power") from January 2004 to April 2007. Both FortisAlberta and Newfoundland Power are wholly owned regulated utility subsidiaries of Fortis. From September 1999 to December 2003, I served as Vice President, Finance & Chief Financial Officer of Fortis.

I serve on the boards of directors of a number of Fortis companies. My *curriculum vitae* is attached as **Exhibit KWS-1**.

**Q. What is the purpose of your Testimony?**

**A.** The purpose of my testimony is to explain how Fortis' acquisition of ITC Holdings Corp. ("ITC") will promote the public interest. As a preliminary matter, I will first discuss the financial condition of Fortis, its demonstrated ability to raise capital, and how the regulated utility subsidiaries of Fortis are financed on a standalone basis. I will also explain Fortis' plans to finance the acquisition.

I will describe the details of the transaction under which Fortis proposes to acquire an indirect, controlling interest in ITC pursuant to the Agreement and Plan of Merger[1] among Fortis, FortisUS, Element Acquisition, and ITC dated as of February 9, 2016 (the "Merger Agreement") (the "Transaction"). I will also describe the indirect minority participation of Finn Investment Pte. Ltd. ("Finn"), a wholly-owned affiliate of GIC Private Limited ("GIC"), in ITC, and the regulatory approvals that are required to complete the Transaction. I will also describe the effect of the Transaction on Fortis' credit ratings.

My testimony will also describe how ITC Great Plains joining the larger and more diverse Fortis organization will support its ability to access capital on favorable terms.

## II. FINANCIAL CONDITION OF FORTIS

1 This document describes the merger of Element Acquisition Sub Inc. ("Element Acquisition"), a wholly-owned subsidiary of FortisUS Inc. ("FortisUS"), with ITC. FortisUS is a wholly-owned subsidiary of FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia"), which is a wholly-owned subsidiary of Fortis. ITC is the ultimate parent company of International Transmission Company ("ITC*Transmission*"), Michigan Electric Transmission Company, LLC ("METC"), ITC Midwest LLC ("ITC Midwest"), and ITC Great Plains, LLC ("ITC Great Plains") (collectively referred to as the "ITC Utilities"). FortisUS subsequently assigned its rights under the Merger Agreement to ITC Investment Holdings Inc. ("ITC Investment"), which entity will be 80.1% owned by FortisUS. At the conclusion of the Transaction, ITC will be a direct, wholly-owned subsidiary of ITC Investment.

**Q. Please describe the financial condition of Fortis.**

**A.** Fortis, with most of its business composed of low-risk regulated utilities, has investment-grade credit ratings and a sound financial standing. As of December 31, 2015, Fortis had total assets of approximately US$23.2 billion[2] and fiscal 2015 revenues of approximately US$5.4 billion. In 2015, Fortis had cash flow from operations of approximately US$1.4 billion and unadjusted earnings to common equity shareholders of US$582 million.

The Fortis 2015 Annual Report can be found on the Fortis website.[3] The financial statements contained in that report are prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP").

Fortis' common equity is traded on the Toronto Stock Exchange ("TSX") under the ticker symbol "FTS" with a market capitalization of approximately US$9 billion as of April 29, 2016. Fortis has applied to cross-list its common shares on the New York Stock Exchange ("NYSE"). Upon completion of this process Fortis' common shares will be cross-listed on both the TSX and the NYSE.

The enterprise value of Fortis, which includes common and preferred equity and debt, was approximately US$20.4 billion as of March 31, 2016. Fortis has consolidated committed credit facilities of approximately US$2.9 billion, of which approximately US$1.8 billion was undrawn as of March 31, 2016. The consolidated facilities include a US$0.8 billion corporate facility, with an option to increase this facility by an additional US$240 million.

---

[2] US$ amounts are converted at a USD/CAD exchange rate of 1.25, the Bank of Canada's closing rate on April 29, 2016.

[3] https://www.fortisinc.com/Investor-Centre/Financial-and-Regulatory-Reports/Documents/2015-ftsanrep-FINAL.pdf

**Q. What are the credit ratings of Fortis and its regulated utilities?**

**A.** Fortis has corporate credit ratings of A- from Standard & Poor's ("S&P") and A (low) from Dominion Bond Rating Service ("DBRS"). Each of Fortis' six largest regulated utility subsidiaries – Tucson Electric Power Company ("TEP"), FortisBC Energy Inc. ("FortisBC Energy"), FortisBC Inc. ("FortisBC"), FortisAlberta, Central Hudson Gas & Electric Corporation ("Central Hudson"), and Newfoundland Power – maintain standalone, investment-grade credit ratings with at least two nationally recognized credit rating agencies. Maritime Electric Company Ltd. ("Maritime Electric") and Fortis TCI Limited (now referred to as Fortis Turks and Caicos) also maintain credit ratings with a single credit rating agency. **Exhibit KWS-2** provides the credit ratings of the rated companies within the Fortis group as at February 17, 2016.

**Q. Describe the liquidity of Fortis, its credit facilities and access to capital markets.**

**A.** As noted, in 2015 Fortis had annual cash flow from operations of approximately US$1.4 billion. In addition, Fortis has consolidated committed credit facilities of approximately US$2.9 billion of which approximately US$1.8 billion was undrawn as of March 31, 2016. The consolidated facilities include a US$0.8 billion corporate facility, syndicated mostly with the seven largest Canadian banks, as well as large banks in the United States, with an option to increase to US$1 billion through the addition of banks or increased commitments from the syndicate members. The credit facility matures in 2021. As at March 31, 2016, Fortis has approximately US$0.47 billion available on its committed corporate credit facility.

Fortis has ready access to equity capital markets. In 2014, Fortis completed public issuances of US$1.4 billion[4] of common equity and approximately US$480 million of preferred equity, used to finance a portion of the acquisition of UNS Energy Corporation in Arizona. In both 2011 and 2012, Fortis completed public issuances of common equity of US$273 million and US$481 million[5], respectively. Fortis' strong access to equity capital markets was demonstrated during the global financial crisis of 2008 when Fortis was able to complete a fully underwritten public issuance of US$240 million of common shares. Including the common equity issuance of US$0.9 billion in 2007 to finance the acquisition of Terasen Inc., a regulated gas distribution business in the Province of British Columbia (now known as FortisBC Energy), Fortis has issued in public markets more than US$3.4 billion of common equity and more than US$1.4 billion of preferred equity over the last decade.

On an ongoing basis, Fortis also issues common equity through its Employee Share Purchase Plan ("ESPP"), Dividend Reinvestment Plan ("DRIP") and stock option plans. During 2015, Fortis issued common equity of approximately US$159 million through these plans. The ESPP plan will also be extended to the employees of Fortis' US regulated subsidiaries following completion of the cross-listing of Fortis' common shares on the NYSE.

## III. STANDALONE FINANCING OF THE REGULATED UTILITIES OF FORTIS

**Q. Describe how the regulated utilities of Fortis are financed.**

---

4 Issued through mandatory convertible debentures.

5 Issued through subscription receipts.

**A.** Each Fortis regulated utility is financed on a standalone basis and has both standalone credit facilities and senior long-term debt instruments. Each Fortis regulated utility is responsible for managing its own financial position, including its capital structure as established by its regulator and used in setting rates, long-term debt instruments and committed credit facilities, in accordance with local regulatory policy and subject to the approval of its governing board of directors.

While the Fortis regulated utilities are responsible for raising their own debt, Fortis will provide equity injections as needed. Fortis is able to issue equity or draw down on its committed corporate credit facilities to fund the equity requirements of its regulated utilities so they can meet their targeted capital structure and investment-grade credit ratings. As shown in the below table, in total over the past five years, Fortis has contributed approximately US$1 billion of common equity to its subsidiaries in order to fund capital expenditure programs and underpin the financial strength of its regulated utilities.

| Year | Common Equity (US$ millions) |
|---|---|
| 2011 | 144 |
| 2012 | 128 |
| 2013 | 130 |
| 2014 | 299 |
| 2015 | 287 |

**Q. What credit protection measures does Fortis employ to protect its regulated utilities?**

**A.** In addition to the maintenance of standalone banking, credit facilities, long-term debt programs and credit ratings, the Fortis regulated utilities do not lend to or provide guarantees to Fortis Inc. or any of its non-regulated subsidiaries. Neither Fortis Inc. nor its regulated subsidiaries have any cross default provisions or cross guarantees to any other companies within the Fortis group. The standalone financial structure of Fortis, together with the credit protection measures, have allowed some of the Fortis utilities, such as Central Hudson and FortisBC Energy, to maintain higher S&P issuer ratings than Fortis Inc.

## IV. DESCRIPTION OF AND PLAN TO FINANCE THE TRANSACTION

**Q. How does Fortis plan to finance the Transaction?**

**A.** The Transaction financing has been structured so that Fortis will maintain investment-grade credit ratings.

The Transaction is valued at approximately US$11.3 billion. The consideration for the Transaction is the exchange of Fortis shares and cash for the common shares of ITC, representing total consideration of approximately US$6.9 billion, plus the assumption of approximately US$4.4 billion in consolidated ITC debt.[6] Fortis will purchase the outstanding common shares of ITC for US$22.57 in cash and stock consideration of 0.7520 of a Fortis common share per ITC common share. The cash portion of the Transaction will be financed through the investment by Finn in ITC Holdings (through ITC Investment), the issuance of approximately US$2 billion of Fortis long-term debt and a combination of one or more offerings

6 US$4.4 billion as at September 30, 2015. US$4.5 billion as at December 31, 2015.

of equity securities, equity-linked securities, preference shares and/or hybrid securities to be completed by Fortis on or before closing of the Transaction. The following table sets out the components of the US$11.3 billion value of the Transaction.

| | |
|---|---|
| Consolidated ITC debt | ~US$4.4 billion |
| Fortis equity[7] | ~US$3.7 billion |
| GIC investment | ~US$1.2 billion |
| Fortis long-term debt and combination of equity securities, equity-linked securities, preference shares and/or hybrid securities | ~US$2 billion |
| **Total Transaction value** | **~US$11.3 billion** |

Fortis has secured approximately US$3.7 billion in committed bridge facilities, which will be sufficient to fully fund the net cash portion of the purchase price. The committed bridge facilities, together with the share exchange, ensure ample liquidity to close the Transaction. Ultimately, Fortis does not intend to draw on these committed bridge facilities.

**Q. Describe how the Transaction is structured.**

**A.** ITC is currently a widely held, publicly traded corporation listed on the NYSE. Upon completion of the Transaction, ITC will be a private company with 100% of its stock held by ITC Investment, a direct subsidiary of FortisUS created to effect the Transaction. FortisUS will hold 80.1% of the common equity of ITC Investment and a wholly-owned affiliate of GIC will

[7] Calculated based on the estimated 117 million common shares of Fortis being issued to ITC shareholders to satisfy the US$3.2 billion stock consideration being paid to ITC shareholders for their ITC common shares upon closing of the Transaction, plus US$500 of additional equity securities to be raised by Fortis on the public markets.

hold 19.9% of the common equity of ITC Investment. The Transaction is being effected through the merger of Element Acquisition, a wholly-owned indirect subsidiary of ITC Investment, and ITC, with ITC continuing as the surviving corporation. Upon completion of the Transaction, Fortis will be cross-listed on the TSX and NYSE, and approximately 27% of Fortis' outstanding common shares will be held by the former shareholders of ITC.

The Transaction is described in more detail in the Merger Agreement, which is attached to the Joint Application as **Exhibit D**.

The organizational charts depicting the ITC group of companies pre-and post-closing of the Transaction are attached to the Joint Application as **Exhibit E-1** and **E-2**.

**Q. What is the role of the equity investor at the ITC Investment level?**

**A.** The Transaction has been structured to ensure that Fortis will maintain investment-grade credit ratings. With a wholly-owned affiliate of GIC indirectly owning 19.9% of ITC post-closing, the amount of new financing required by Fortis is reduced.

**Q. Will the equity investor involvement impact the governance philosophy of Fortis?**

**A.** No. I believe that the governance philosophy of Fortis is not impacted by the equity investor's involvement. The Transaction will preserve the existing local executive management and operation of the ITC Utilities, and oversight by the ITC board of directors. ITC will have a majority of independent board members and decisions will be made by the local executive management team. Finn will be entitled to one director on the board of ITC Investment[8], and will have the governance rights necessary to protect its economic interests, but will not have authority to manage, direct, or control the day-to-day operations of ITC.

The Shareholders' Agreement setting out Finn's governance rights is included as Annex A of the Co-Investment Subscription Agreement made as of April 20, 2016 among Finn, Fortis, FortisUS, ITC Investment, and Element Acquisition, a copy of which is attached to the Joint Application as **Exhibit F**.

**Q. How do the credit rating agencies view the impact of the Transaction on their ratings of Fortis?**

**A.** After the announcement of the Transaction, S&P stated that "the addition of ITC will support Fortis' already excellent business risk profile". S&P also affirmed Fortis' corporate credit rating of A-; however S&P revised its unsecured debt credit rating from A- to BBB+ reflecting Fortis' Transaction financing plan. The single notch rating difference between the unsecured holding company debt and the corporate rating is consistent with the ratings of other utility holding companies in the US and also consistent with the ratings of ITC. As is typical for these types of transactions in the utility sector, S&P also revised its outlook on Fortis' ratings and the ratings of TEP, Central Hudson, FortisAlberta, Maritime Electric and Caribbean Utilities Company, Ltd. from stable to negative due to the execution and integration risks associated with

---

[8] The board of directors of ITC Investment will be composed of the same members as the board of ITC, with a majority of independent directors.

the Transaction. Typically, outlooks are resolved following closing of such transactions and a reasonable integration period.

A copy of S&P's Ratings Direct Research Update on Fortis Inc. dated February 9, 2016 is attached as **Exhibit KWS-3**.

Following the announcement of the Transaction, DBRS noted the acquisition of ITC as being modestly positive to Fortis' business risk profile. DBRS confirmed Fortis' corporate issuer rating and unsecured debentures rating at A(low). However, DBRS placed Fortis' corporate issuer rating and unsecured debenture rating under review with negative implications due to the increased holding company debt expected as a result of the financing of the Transaction.

A copy of the February 9, 2016 DBRS press release is attached as **Exhibit KWS-4**.

**Q. Do you expect Fortis will maintain investment-grade credit ratings?**

**A.** Yes, Fortis expects to maintain an A- corporate issuer rating from S&P, however there is a possibility of a downgrade to BBB (high) from A (low) from DBRS for Fortis' unsecured debt.

**Q. How do the credit rating agencies view the impact of the Transaction on their ratings of ITC and the ITC Utilities?**

**A.** Following the announcement of the Transaction, S&P revised its outlook of the issuer credit ratings of ITC and the ITC Utilities to negative from developing, reflecting, among other things, execution and integration risks associated with the Transaction. This is common for transactions of this nature, and is typically removed following closing of the transaction and a reasonable integration period.

A copy of S&P's Ratings Direct Research Update on ITC dated February 9, 2016 is attached as **Exhibit KWS-5**.

**Q. Do you expect ITC will maintain its credit ratings?**

**A.** Yes.

**Q. How will Transaction costs be treated and allocated as between Fortis and ITC?**

**A.** All Transaction related expenditures incurred by Fortis will be allocated entirely to Fortis. Further, in the Application for Authorization for Merger and Disposition of Jurisdictional Transmission Facilities filed with the Federal Energy Regulatory Commission ("FERC"), the Joint Applicants have committed to hold customers harmless from Transaction costs and will not seek to recover Transaction costs in ITC Great Plains' cost-based rates.[9]

**Q. What operating costs incurred at the Fortis holding company level will be allocated to ITC, and by what methodology will these costs be allocated?**

---

[9] Joint Application for Authorization for Merger and Disposition of Jurisdictional Transmission Facilities Pursuant to Sections 203(a)(1) and 203(a)(2) of the Federal Power Act, at pp. 37-38, filed in FERC Docket No. EC16-110-000 on April 28, 2016.

**A.** Certain operating costs of Fortis are unique to the public holding company, while other operating costs are incurred in support of the regulated utilities. Since Fortis provides a strategic oversight role and supplies equity to its regulated utilities, certain operating costs incurred by Fortis in support of its regulated utilities are recovered from those regulated utilities. Debt servicing costs, including dividends on preference shares, business development costs and other special project costs (e.g. acquisitions or asset disposals) are not recovered from Fortis' regulated utilities.

Since each Fortis regulated utility stands on its own, there is no cross-allocation of operating costs between the utilities. Fortis operating costs will be allocated on a *pro rata* basis to the utilities based on the ratio of each utility's assets, to the total assets (excluding goodwill) of all utilities to which Fortis costs are allocated. ITC Great Plains' rates are exclusively regulated by FERC and no rate changes are being proposed before FERC in connection with the Transaction.

**Q. What impact will the Transaction have on the affiliated interests of the ITC Utilities?**

**A.** The Transaction is not anticipated to have any impact on the affiliated interests of the ITC Utilities. Each of Fortis' regulated utilities operates on a standalone basis, assumes profit and loss responsibility, and is accountable for its own resource allocation.

**Q. What other regulatory approvals are required to complete the Transaction?**

**A.** The ITC Utilities are electric transmission utilities with rates regulated by the FERC, and therefore the Transaction requires regulatory approval under Sections 203(a)(1) and 203(a)(2) of the Federal Power Act and Part 33 of the regulations of FERC. The Transaction also requires approvals from the state regulators of Missouri, Illinois, Wisconsin, and Oklahoma and approvals from the Committee on Foreign Investment in the U.S., the Federal Communications Commission, and the United States Federal Trade Commission/Department of Justice under the Hart-Scott-Rodino Antitrust Improvement Act.

**Q. Please advise whether there are any circumstances that would necessitate expedited approval?**

**A.** Fortis and ITC intend to close the Transaction as soon as all regulatory approvals have been obtained. In order to achieve this objective, it is highly desirable that all required regulatory approvals be in hand by October 1, 2016.

**Q. Does this conclude your testimony?**

**A.** Yes. Thank you.

# VERIFICATION

| | |
|---|---|
| CANADA | ) |
| | ) |
| PROVINCE OF NEWFOUNDLAND AND LABRADOR | ) ss. |
| | ) |
| CITY OF ST. JOHN'S | ) |

I, Karl W. Smith, being duly sworn, on oath state that I am the Executive Vice President, Chief Financial Officer of Fortis Inc., that I have read the foregoing testimony and know the contents thereof, and that the facts set forth therein are true and correct to the best of my knowledge and belief.

By: Karl Smith
KARL W. SMITH

The foregoing pleading was subscribed and sworn to before me this May 9th, 2016.

Paul Fitzpatrick
Notary Public

My Commission Expires:
N/A

**Mr. Karl W. Smith**
*Executive Vice President, Chief Financial Officer*
*Fortis Inc.*
*DOB: 19/7/57*

**Education:**

| | |
|---|---|
| 1981 | Memorial University, St. John's, NL<br>Bachelor of Commerce (Honours) |

**Current Executive Position – Fortis Inc.:**

| | |
|---|---|
| 2014 - | Fortis Inc.<br>Executive Vice President, CFO |

**Prior Positions - Fortis Group of Companies:**

| | |
|---|---|
| 2007 – 2014 | FortisAlberta<br>President and CEO |
| 2004 - 2007 | Newfoundland Power<br>President and CEO |
| 1999 - 2003 | Fortis Inc.<br>Chief Financial Officer |
| 1995 - 1999 | Newfoundland Power<br>Vice President, Finance and Chief Financial Officer |
| 1989 - 1995 | Fortis Properties and Fortis Trust Corporation<br>Vice President, Finance and Chief Financial Officer |

**Fortis Boards:**

Mr. Smith serves as a Director on the Boards of Fortis utilities in British Columbia and New York.

**Current Outside Boards, Associations and Committees:**

| | |
|---|---|
| 2015 – Present | Junior Achievement of Newfoundland and Labrador |
| 2014 – Present | Atlantic Provinces Economic Council, Chair |
| 1983 - Present | Canadian Institute of Chartered Accountants |

**Prior Outside Boards:**

| | |
|---|---|
| 2011 - 2014 | Western Energy Institute, Director |
| 2010 - 2014 | Mount Royal University, Governor |
| 2009 - 2014 | Canadian Electricity Association, Director |
| 2008 - 2014 | Junior Achievement of Southern Alberta, Chair |
| 2009 - 2010 | Canadian Electricity Association, Chair |
| 2002 - 2003 | Atlantic Provinces Economic Council, Chair |
| 2001 - 2006 | Memorial University, Advisory Board Member to the Faculty of Business Administration |
| 1996 - 2000 | Junior Achievement Business Hall of Fame for Newfoundland, Governor, and Organizing Committee, Chair |

## 8.0 CREDIT RATINGS

Securities issued by Fortis and its utilities, that are currently rated, are rated by one or more credit rating agencies, namely, DBRS, S&P and/or Moody's. The ratings assigned to securities issued by Fortis and its utilities are reviewed by the agencies on an ongoing basis. Credit ratings and stability ratings are intended to provide investors with an independent measure of credit quality of an issue of securities and are not recommendations to buy sell or hold securities. Ratings may be subject to revision or withdrawal at any time by the rating organization. The following table summarizes the Corporation's debt credit ratings as at February 17, 2016.

**Fortis Credit Ratings**

| Company | DBRS | S&P | Moody's |
|---|---|---|---|
| Fortis [(1)] | A (low), Under Review - Negative (unsecured debt) | BBB+, Negative (unsecured debt) | N/A |
| Caribbean Utilities [(2)] | A (low), Stable (senior unsecured debt) | A-, Negative (senior unsecured debt) | N/A |
| Central Hudson [(2)] [(3)] | N/A | A, Negative (unsecured debt) | A2, Stable (unsecured debt) |
| FortisBC Energy | A, Stable (secured & unsecured debt) | N/A | A1/A3, Stable (secured/unsecured debt) |
| FortisAlberta [(2)] | A (low), Stable (senior unsecured debt) | A-, Negative (senior unsecured debt) | N/A |
| FortisBC Electric | A (low), Stable (secured & unsecured debt) | N/A | Baa1, Stable (unsecured debt) |
| Fortis Turks and Caicos | N/A | BBB, Stable (senior unsecured debt) | N/A |
| Maritime Electric [(2)] | N/A | A, Negative (senior secured debt) | N/A |
| Newfoundland Power | A, Stable (first mortgage bonds) | N/A | A2, Stable (first mortgage bonds) |
| TEP [(2)] | N/A | BBB+, Negative (unsecured debt) | A3, Stable (senior unsecured debt) |
| UNS Energy | N/A | N/A | Baa1, Stable (senior secured debt) |

*(1) In February 2016, after the announcement by Fortis that it had entered into an agreement to acquire ITC, S&P affirmed the Corporation's corporate credit rating of A-, revised its unsecured debt credit rating to BBB+ from A-, and revised its outlook on the Corporation to negative from stable. Similarly, in February 2016 DBRS placed the Corporation's corporate credit rating under review with negative implications.*

*(2) In February 2016, after the announcement by Fortis that it had entered into an agreement to acquire ITC, S&P revised its outlook on TEP, Central Hudson, FortisAlberta, Maritime Electric and Caribbean Utilities to negative from stable.*

*(3) Central Hudson's senior unsecured debt is also rated by Fitch at 'A-, Stable'.*

STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

# RatingsDirect®

## Research Update:

# Fortis Inc. Outlook Revised To Negative On Proposed ITC Holdings Corp. Acquisition; Affirmed At 'A-'

**Primary Credit Analyst:**
Andrew Ng, Toronto (416) 507-2545; andrew.ng@standardandpoors.com

**Secondary Contact:**
Stephen R Goltz, Toronto (416) 507-2592; stephen.goltz@standardandpoors.com

## Table Of Contents

Research Update:

# Fortis Inc. Outlook Revised To Negative On Proposed ITC Holdings Corp. Acquisition; Affirmed At 'A-'

## Overview

- On Feb. 9, 2016, Fortis Inc. announced the US$11.3 billion proposed acquisition of ITC Holdings Corp. (ITC), a U.S.-based electricity transmission operator.
- We are revising our outlook on St. John's, Nfld.-based holding company Fortis Inc. and its subsidiaries FortisAlberta Inc., Maritime Electric Co. Ltd., and Caribbean Utilities Co. Ltd. to negative from stable.
- We are also affirming our long-term corporate credit ratings on Fortis and its subsidiaries.
- In addition, we are downgrading Fortis' senior unsecured debentures to 'BBB+' from 'A-'.
- We are revising our competitive position score to strong from excellent.
- The negative outlook reflects the execution risks associated with the transaction including selling up to 19.9% of ITC to one or more infrastructure-focused minority investors.
- The negative outlook also reflects the limited cushion in the credit metrics for any post-merger integration or operational issues.

## Rating Action

On Feb. 9, 2016, Standard & Poor's Ratings Services revised its outlook on St. John's, Nfld.-based holding company Fortis Inc. to negative from stable following the company's proposed acquisition of ITC Holdings Corp., a U.S.-based electricity transmission operator. At the same time, Standard & Poor's revised its outlook on Fortis subsidiaries FortisAlberta Inc., Maritime Electric Co. Ltd., and Caribbean Utilities Co. Ltd. to negative from stable.

In addition, Standard & Poor's revised Fortis' competitive position score to strong from excellent. Standard & Poor's affirmed its 'A-' long-term corporate credit rating on Fortis and its subsidiaries FortisAlberta and Caribbean Utilities, and affirmed its 'BBB+' long-term corporate credit rating on Maritime Electric.

Finally, Standard & Poor's lowered its senior unsecured debenture rating on Fortis to 'BBB+' from 'A-'.

## Rationale

We believe that the addition of ITC will support Fortis' already excellent business risk profile. We continue to assess Fortis' country risk as very low risk due to the majority of the company's operating cash flows generated in Canada and the U.S. Similarly, industry risk is unchanged at very low as the majority of cash flows continue to be from regulated utility businesses.

Given the acquisitions that Fortis has undertaken in the past number of years, we have observed that its return of capital has been in decline. This is a factor we look for when assessing the volatility of profitability, which in itself is a factor that affects the company's competitive position score. As a consequence, we have modified our view of the company's competitive position to strong from excellent. Although the new competitive position score weakens the business risk profile, it is not enough for us to change our overall assessment as excellent.

ITC, through its subsidiaries International Transmission Co., Michigan Electric Transmission Co., ITC Great Plains LLC, and ITC Midwest LLC, operates in multiple states across the U.S. ITC is subject to regulation primarily by the Federal Energy Regulatory Commission, a regulatory body with a long track record of presiding over transmission-related regulatory matters, enabling the company to benefit from a stable regulatory environment.

From a financial risk perspective, we forecast adjusted funds from operations (AFFO)-to-total debt for Fortis on a consolidated basis, on closing of the transaction, at about 10% in 2016 and 10%-11% in 2017, consistent with the significant financial risk profile. When assessing Fortis' cash flows, we used the low volatility table primarily to reflect that the vast majority of the regulated cash flow from Fortis' operations is at the lower end of the utility risk spectrum in transmission and distribution.

The transaction financing plan benefits from a significant amount of equity in the form of a share exchange.  However, a key element of the transaction is the sale of up to 19.9% of ITC to infrastructure-focused funds. Although we believe that the company will be successful in finding purchasers, at this point no firm commitments have been made and we believe that this introduces a certain degree of execution risk; hence, our negative outlook on the company. In addition, given a downgrade trigger of 10%, we believe that there is limited cushion in the credit metrics for any post-merger integration or operational issues.

The negative outlook on FortisAlberta, Maritime Electric, and Caribbean Utilities reflects the negative outlook on Fortis and the application of our group rating methodology.

Combining our business risk and financial risk assessments, we arrive at an 'a-' anchor score for Fortis. With our group rating methodology, we believe that the group credit profile is also 'a-', which is consistent with the consolidated rating on Fortis Inc. We assess ITC as a strategically important entity to the group. We believe ITC is important to Fortis' long-term strategy, unlikely to be sold in the near term, and likely to receive support from the parent should it fall into financial difficulty.

Part of Fortis' financing plan for the ITC acquisition includes issuance of debt at Fortis Inc. This debt is structurally subordinated to the debt that exists at each of the operating entities. The addition of ITC further concentrates cash flow available to Fortis. Furthermore, the priority liabilities at the subsidiary level to total assets are greater than 20%. Based on these factors, the debt at the Fortis Inc. level is rated one-notch below the corporate credit rating as per our criteria.

Our base-case assumptions include:
- The acquisition will close by end of 2016
- Fortis will receive all required regulatory approval for the transaction
- Fortis will not experience any adverse regulatory decisions from the various regulatory regimes to which it is exposed

Based on these assumptions, we arrive at the following credit measure:
- Consolidated AFFO-to-debt of about 10% in 2016, rising to about 10%-11% in 2017.

## Liquidity

Our assessment of Fortis' 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 EBTIDA, we also expect there are sufficient liquidity sources to 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 a liquidity distress, we expect the company to scale back on its capital spending in order to preserve the credit metrics.

Principal liquidity sources include:
- Cash and cash equivalent of about C$255 million in 2016
- FFO of about C$2.3 billion in 2016 (on closing of the acquisition)
- Available committed revolving credit facilities of about C$3.5 billion (including that of ITC)
- Secured bridge financing of about US$2.0 billion for the acquisition
- Share issuance of about US$3.4 billion to ITC Holdings Corp. shareholders for the acquisition

Principal liquidity uses include:
- Acquisition of ITC Holdings Corp. equity of about US$7.1 billion including transaction cost
- Capital expenditures of about C$2.8 billion in 2016 (including that of ITC)
- Debt maturities of about C$380 million in 2016
- Dividends of about C$350 million in 2016

## Outlook

The negative outlook reflects the execution and integration risk associated with the ITC acquisition including the sale of up to 19.9% of ITC to one or more infrastructure-focused minority investors. In addition, the outlook reflects that credit metrics have a limited cushion in the two-year outlook period. With the acquisition of ITC, we expect the company will reach 11% AFFO to debt in 2019. However, until then metrics will be about 10%, which leaves little cushion for any operational or post-merger integration errors.

### Downside scenario

We could take a negative rating action on Fortis by applying a negative comparable rating modifier if the company's AFFO-to-debt were to fall below 10%, at the low end of the significant financial risk profile during our two-year outlook period. This could happen as a result of cost overruns from the post-merger integration efforts with ITC, material adverse regulatory decisions, or if Fortis encounters operational difficulties.

### Upside scenario

We could revise the outlook to stable if AFFO-to-debt remains consistently above 10% once the transaction has closed and if the acquisition uncertainties have been resolved.

## Ratings Score Snapshot

Corporate Credit Rating: A-/Negative/--

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

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: 'a-'

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: neutral (no impact)

Stand-alone credit profile: 'a-'

Group credit profile: 'a-'

Status within group: Parent

## Related Criteria And Research

### Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Criteria: Ratios and Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology and Assumptions, Nov. 19, 2013
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Ratings List

| | | |
|---|---|---|
| Outlook Revised/Ratings Affirmed | | |
| | To | From |
| Fortis Inc. | | |
| FortisAlberta Inc. | | |
| Caribbean Utilities Co. Ltd. | | |
| Corporate Credit Rating | A-/Negative/-- | A-/Stable/-- |
| | | |
| Maritime Electric Co. Ltd. | | |
| Corporate Credit Rating | BBB+/Negative/-- | BBB+/Stable/-- |
| | | |
| Downgraded | | |
| | To | From |
| Fortis Inc. | | |
| Senior unsecured debt | BBB+ | A- |
| | | |
| Ratings Affirmed | | |
| | | |
| Maritime Electric Co. Ltd. | | |
| Senior secured | A | |
| Recovery Rating | 1+ | |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

KWS-4

# Press Releases

Insight beyond the rating.

Date of Release: February 9, 2016

## DBRS Places Fortis Inc. Under Review - Negative After ITC Holdings Corp. Acquisition Announcement

DBRS Limited (DBRS) has today placed the A (low) Issuer Rating, the A (low) Unsecured Debentures rating and the Pfd-2 (low) Preferred Shares rating of Fortis Inc. (Fortis or the Company) Under Review with Negative Implications. This action follows the announcement that the Company has agreed to acquire ITC Holdings Corp. (ITC) for a total consideration of approximately US$11.3 billion, including the assumption of US$4.4 billion of debt on closing (the Acquisition). The rating action reflects DBRS's view that the Acquisition will have a modestly positive impact on the Company's business risk profile but a negative impact on its financial risk profile. The Acquisition is expected to close in late 2016 and is subject to both Fortis and ITC shareholder approvals, as well as various regulatory and federal approvals.

Based on a preliminary review, DBRS views the Acquisition as modestly positive to Fortis's business risk profile. ITC, as an electricity transmission company operating in eight states, is fully regulated by the Federal Energy Regulatory Commission (FERC) and is allowed to earn above-average returns on investments based on a favourable equity component (60%) in the capital structure. DBRS notes that the allowed returns and capital structure are both higher than Fortis's current portfolio of regulated utilities. ITC's tariffs are also calculated under a cost-of-service methodology with an annual true-up mechanism, resulting in no volume risk, and provide ITC with stable and predictable earnings and cash flows. The Acquisition will additionally result in further geographic diversification for Fortis.

Fortis intends to fund the Acquisition by issuing approximately (1) US$3.5 billion to US$3.9 billion of equity, largely satisfied through the share consideration to be paid to ITC shareholders, (2) US$2.0 billion of debt, and by (3) selling 15.0% to 19.9% of ITC to minority investors for approximately US$1.0 billion to US$1.4 billion. DBRS considers the current financing plan to be negative to the Company's non-consolidated financial risk profile. Based on DBRS's pro forma 2015 calculations, Fortis had a non-consolidated debt-to-capital ratio of approximately 21.9% and a non-consolidated cash flow-to-debt ratio of 21.4%. Based on the Company's proposed financing plan and DBRS's estimate of future dividends from the Acquisition assets to

KWS-4

Fortis, DBRS expects a significantly negative impact on the Company's non-consolidated metrics. As a result, DBRS believes that placing Fortis's ratings Under Review with Negative Implications is the appropriate rating action at this time.

DBRS will continue to review the final financing plan for the Acquisition and will resolve the Under Review rating action once the transaction closes. The Company's ratings could be downgraded by one notch if the non-consolidated debt-to-capital ratio following the Acquisition is materially over the 20% threshold and the non-consolidated cash flow-to-debt ratio is significantly below 20%.

Notes:
All figures are in U.S. dollars unless otherwise noted.

The related regulatory disclosures pursuant to the National Instrument 25-101 Designated Rating Organizations are hereby incorporated by reference and can be found by clicking on the link to the right under Related Research or by contacting us at info@dbrs.com.

The applicable methodologies are Rating Companies in the Regulated Electric, Natural Gas and Water Utilities Industry (October 2015), Rating Holding Companies and Their subsidiaries (January 2016) and Preferred Share and Hybrid Criteria for Corporate Issuers (January 2016), which can be found on our website under Methodologies.

This rating is endorsed by DBRS Ratings Limited for use in the European Union.

For more information on this credit or on this industry, visit www.dbrs.com or contact us at info@dbrs.com.

# Ratings

| Issuer | Debt Rated | Rating Action | Rating | Trend | Notes | Published | Issued |
|---|---|---|---|---|---|---|---|
| Fortis Inc. | Issuer Rating | UR-Neg. | A (low) | -- | | Feb 9, 2016 | CA E |
| Fortis Inc. | Unsecured Debentures | UR-Neg. | A (low) | -- | | Feb 9, 2016 | CA E |
| Fortis Inc. | Preferred Shares | UR-Neg. | Pfd-2 (low) | -- | | Feb 9, 2016 | CA E |

US = USA Issued, NRSRO
CA = Canada Issued, NRSRO
EU = EU Issued
E = EU Endorsed
Unsolicited Participating
Unsolicited Non-participating

ALL DBRS RATINGS ARE SUBJECT TO DISCLAIMERS AND CERTAIN LIMITATIONS. PLEASE READ THESE DISCLAIMERS AND LIMITATIONS AND ADDITIONAL

KWS-4

INFORMATION REGARDING DBRS RATINGS, INCLUDING DEFINITIONS, POLICIES, RATING SCALES AND METHODOLOGIES.

# Contacts

Eric Eng, MBA
Vice President - Corporate Research & Analysis
+1 416 597 7578
eeng@dbrs.com

Chris Gifford, CEng
Vice President – Project Finance
+1 416 597 7398
cgifford@dbrs.com

Tom Li
Senior Financial Analyst - Corporate Research & Analysis
+1 416 597 7378
tli@dbrs.com

Andrew Lin
Managing Director, Energy and Project Finance - Global Corporates
+1 416 597 7453
andrew.lin@dbrs.com

STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

## Research Update:

# ITC Holdings Corp. And Subsidiaries Ratings Affirmed, Outlook Revised To Negative On Acquisition By Fortis Inc.

**Primary Credit Analyst:**
Gabe Grosberg, New York (1) 212-438-6043; gabe.grosberg@standardandpoors.com

**Secondary Contact:**
Obioma Ugboaja, New York 212-438-7406; obioma.ugboaja@standardandpoors.com

## Table Of Contents

Research Update:

# ITC Holdings Corp. And Subsidiaries Ratings Affirmed, Outlook Revised To Negative On Acquisition By Fortis Inc.

## Overview

- St. John's, Nfld., Canada-based utility holding company Fortis Inc. announced it will acquire U.S. utility holding company ITC Holdings Corp. for about $11.3 billion, including assumed debt of about $4.4 billion.
- If acquired, we would assess ITC as a strategically important subsidiary of Fortis.
- We are affirming the ratings, including the 'A-' issuer credit ratings, on ITC Holdings and its regulated utility subsidiaries, Michigan Electric Transmission Co., International Transmission Co., ITC Midwest LLC, and ITC Great Plains LLC, and revising the outlook to negative from developing.
- The negative outlook reflects the probability that we could downgrade Fortis by up to one notch due to the acquisition. This reflects execution and integration risks, as well as the probability that consolidated financial measures could weaken because of increased consolidated debt from the acquisition's financing.

## Rating Action

On Feb. 9, 2016, Standard & Poor's Ratings Services revised its rating outlook on ITC Holdings Corp. and its regulated utility subsidiaries, Michigan Electric Transmission Co., International Transmission Co., ITC Midwest LLC, and ITC Great Plains LLC, to negative from developing. At the same time, we affirmed our ratings, including the 'A-' issuer credit ratings (ICR), on ITC and its subsidiaries.

## Rationale

We base our negative outlook on Fortis Inc.'s announcement that it will acquire ITC and that Fortis' consolidated financial measures could consistently weaken from current levels, reflecting funds from operations (FFO) to debt of below 10%.

We base our rating on ITC on our assessment of its excellent business risk profile and significant financial risk profile.

The excellent business risk assessment on ITC reflects the company's lower-risk electric transmission business. The Federal Energy Regulatory Commission (FERC) regulates ITC and we view the FERC's regulation of electric transmission as among the most supportive regulation in the U.S. We base this assessment on rate mechanisms that allow the operating subsidiaries to recover their costs and return on investments on a forward-looking basis, authorized rates of return that are often incentive-based, and an operating capital structure of 60% equity. Overall, we view the company's management of regulatory risk as above-average compared with peers. This reflects the company's consistent ability to generally earn its allowed return on equity.

We view ITC's financial risk profile as significant based on our use of the low volatility table. The use of that table reflects the company's lower-risk utility business model that solely consists of electric transmission and the company's above-average management of regulated risk compared with peers.

We expect under our base-case scenario that ITC's financial measures will consistently reach the middle of the range for the significant financial risk profile category, reflecting FFO to debt at about 10% to 12%. This incorporates our expectations that the company continues to move forward with its non-rate regulated projects, high capital spending that is consistently greater than $700 million annually, and modestly lower FERC-regulated returns on equity beginning in 2016 due to a complaint filing that challenges the FERC's rate construct. We expect that discretionary cash flow will remain negative, reflecting the company's high capital spending program.

Under our group rating methodology, we view ITC as the parent of a group that includes Michigan Electric Transmission, International Transmission, ITC Midwest, and ITC Great Plains. ITC's group credit profile is 'a-', leading to an ICR of 'A-'.

### Liquidity

We consider ITC's liquidity as adequate and believe it can more than cover its needs for the next 12 months, even if EBITDA declines by 10%. We expect the company's liquidity sources over the next 12 months will exceed uses by more than 1.1x. Under our stress scenario, we do not expect that ITC would require access to capital markets during that period to meet liquidity needs.

Principal liquidity sources:

- Cash and short-term investments of about $25 million;
- Credit facility availability of about $800 million; and
- FFO of about $550 million.

Principal liquidity uses:

- Capital spending of more than $700 million;
- Dividends of about $100 million; and
- Long-term debt maturities of $300 million in 2016.

## Outlook

The negative outlook reflects the outlook on Fortis because, as a strategically important subsidiary, ITC's ratings would be linked to its parent's under our group rating methodology. With a stand-alone credit profile at or above the group credit profile, ITC's ICR would be capped at Fortis'. We could lower our rating on Fortis by up to one notch on the ITC acquisition. This reflects execution and integration risks, as well as the likelihood that Fortis' consolidated financial measures could weaken because of increased consolidated debt from the acquisition's financing.

### Downside scenario

We could downgrade ITC after the transaction closes if Fortis' consolidated financial measures weaken such that FFO to debt remains consistently below 10%. This could occur if there are adverse regulatory conditions imposed on the acquisition, Fortis faces operational difficulties, or if there are material cost overruns from post-merger integration efforts.

### Upside scenario

We could affirm the ratings and revise the outlook to stable if the Fortis acquisition does not materialize, structural insulating measures that would protect ITC from Fortis are implemented, or Fortis' consolidated FFO to debt is consistently above 10%. This could occur if the acquisition is completed with sufficient equity and in a manner that preserves Fortis' credit measures.

## Ratings Score Snapshot

Corporate Credit Rating: A-/Negative/A-2

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

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: a-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: a-
- Group credit profile: a-

## Recovery/Notching Analysis

We rate the senior unsecured debt at ITC one notch lower than the corporate credit rating because of structural subordination. This results from priority obligations exceeding 20% of total assets.

## Related Criteria And Research

### Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

## Ratings List

| | | |
|---|---|---|
| Ratings Affirmed; Outlook Revised To Negative | | |
| | To | From |
| ITC Holdings Corp. | | |
| Corp Credit Rating | A-/Negative/A-2 | A-/Developing/A-2 |
| | | |
| ITC Great Plains LLC | | |
| Michigan Electric Transmission Co. | | |
| International Transmission Co. | | |
| ITC Midwest LLC | | |
| Corp Credit Rating | A-/Negative/-- | A-/Developing/-- |
| | | |
| Ratings Affirmed | | |
| ITC Holdings Corp. | | |
| Senior Unsecured | BBB+ | |
| | | |
| ITC Great Plains LLC | | |
| Senior Secured | A | |
| Recovery Rating | 1+ | |
| | | |
| ITC Midwest LLC | | |
| Senior Secured | A | |
| Recovery Rating | 1+ | |
| | | |
| International Transmission Co. | | |
| Senior Secured | A | |
| Recovery Rating | 1+ | |

```
Michigan Electric Transmission Co.
 Senior Secured              A
   Recovery Rating           1+
```

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.