BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 20210034-EI

IN RE: PETITION FOR RATE INCREASE

BY TAMPA ELECTRIC COMPANY

DIRECT TESTIMONY AND EXHIBIT

OF

KENNETH D. MCONIE

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

PREPARED DIRECT TESTIMONY

OF

KENNETH D. MCONIE

Q. Please state your name, business address, occupation, and employer.

A. My name is Kenneth D. McOnie. My business address is Emera Place, 5151 Terminal Road, Halifax, Nova Scotia, Canada. I am Vice President Investor Relations and Treasurer for Emera Inc. ("Emera"), which is the parent company of TECO Energy, Inc. ("TECO Energy" or "parent company"), which is the parent company of Tampa Electric Company ("Tampa Electric" or "company").

Q. Please describe your duties and responsibilities in that position.

A. I am responsible for the treasury, investor relations and pension functions of Emera. I am also responsible for establishing and maintaining effective working relations with the investment and banking communities, and for communicating the results of our operations to investors and rating agencies.

Q. Please provide a brief outline of your educational background and business experience.

A. I hold a Bachelor of Commerce degree from Saint Mary's University and an MBA with a concentration in Finance and International Business from Dalhousie University. I also hold the Chartered Professional Accountant – Certified Managerial Accountant designation (Canadian equivalent of a Certified Public Accountant in the United States). I have been working with Emera for 19 years in roles with increasing responsibility and have been in the role of Treasurer for over 10 years.

Q. What is the purpose of your direct testimony?

A. My direct testimony will discuss why it is important for Tampa Electric to maintain its financial integrity. I will describe Tampa Electric's credit ratings and the role of strong credit ratings in providing unimpeded access to capital with reasonable terms and costs. I will address the impact of the Company's infrastructure modernization on its need for capital and the importance of the requested rate relief to maintain Tampa Electric's financial integrity and credit ratings. Finally, my direct testimony will support Tampa Electric's requested capital structure and our

proposed 55 percent equity ratio (investor sources).

Q. Have you prepared an exhibit for presentation in this proceeding?

A. Yes. Exhibit No. KDM-1 entitled "Exhibit of Kenneth D. McOnie" was prepared under my direction and supervision. The contents of my exhibit were derived from the business records of the company and are true and correct to the best of my information and belief. It consists of the following seven documents:

Document No. 1	List of Minimum Filing Requirement Schedules Sponsored or Co-Sponsored by Kenneth D. McOnie
Document No. 2	Tampa Electric Credit Metrics
Document No. 3	Rating Agency Conventions and Scales-Senior Unsecured Notes (Long-Term Debt)
Document No. 4	Utility Senior Unsecured Credit Ratings
Document No. 5	S&P Global Corporate Ratings Matrix
Document No. 6	Moody's Credit Rating Factors – Regulated Utilities

Document No. 7 Public Utility Commission Rankings – RRA

Q. How will Tampa Electric fund its infrastructure modernization efforts?

A. Due to the magnitude and timing of these efforts, Tampa Electric cannot generate all the required funds from operations. Without an increase in base rates, internal generation of funds averages only 81 percent of construction capital expenditures for 2013 through 2022. Even with the increased rates requested in this proceeding, internally generated funds for the period 2013 through 2022 will account for an average of only 83 percent of the estimated construction expenditures. The balance of the needed funds must be obtained from investors, primarily through the issuance of long-term debt and equity infusions from the parent company.

FINANCIAL INTEGRITY

Q. What is financial integrity?

A. Financial integrity refers to a relatively stable condition of liquidity and profitability in which the company is able to meet its financial obligations to investors while

maintaining the ability to attract investor capital as needed with reasonable terms and costs.

Q. How is financial integrity measured?

A. Financial integrity is a function of financial risk which represents the risk that a company may not have adequate cash flows to meet its financial obligations. The level of cash flows and the percentage of debt, or financial leverage, in the capital structure is a key determinant of financial integrity. As such, as the percentage of debt in the capital structure increases so do the fixed obligations for the repayment of that debt. Consequently, as financial leverage increases the level of financial distress (financial risk) increases as well. Therefore, the percentage of internally generated cash flows compared to these financial obligations is a primary indicator of financial integrity and is relied upon by rating agencies in the assignment of favorable debt ratings.

Q. Why is financial integrity important to Tampa Electric and its customers?

A. As a regulated electric utility, Tampa Electric has an obligation to provide electric utility service to all

customers in its defined service area at rates the Commission determines to be fair and reasonable. Fulfilling this obligation to serve requires significant investment, both planned and unplanned, in Tampa Electric's property, plant and equipment thereby making our business very capital intensive.

Customers benefit directly from Tampa Electric's infrastructure investments. For example, transmission and distribution system investments enhance service reliability by mitigating storm damage and facilitating efficient service restoration, generating fleet modernization investments improve fuel efficiency thus lowering fuel costs for customers and reducing emissions, and new technology projects improve the efficiency of the company's operations and overall customer experience. Maintaining a strong financial position allows the company to finance infrastructure investments in support of an improved system at a lower cost than would otherwise be possible.

Financial integrity is also important to ensure access to capital. As a regulated utility, Tampa Electric has a statutory obligation to serve all customers. The responsibility to serve is not contingent upon the health or the state of the financial markets. In times of

constrained access to capital and depressed market conditions, only those utilities exhibiting financial integrity are able to attract capital under reasonable terms providing significant and potentially critical flexibility. This obligation to serve means Tampa Electric cannot adjust the timing and amount of their major capital expenditures to align with economic cycles or wait out market disruptions. If faced with a major storm, for example, Tampa Electric would not have that option.

Tampa Electric's balance sheet strength and financial flexibility are important factors influencing its ability to finance major infrastructure investments as well as manage unexpected events. Financial integrity is essential to supporting these capital expenditure requirements which are necessary to serve and in times of emergency, maintain and restore power to Tampa Electric's customers. Tampa Electric competes in a global market for capital, and a strong balance sheet with appropriate rates of return attracts capital market investors. Financial strength and flexibility enable Tampa Electric to have ready access to capital with reasonable terms and costs for the long-term benefit of its customers.

Q. How will the company's proposed base rate increase affect

Tampa Electric's financial integrity?

A. The requested base rate increase will place Tampa Electric in a prudent and responsible financial position to fund its capital program and continue providing a high level of reliable service to its customers. To raise the required capital, the company must be able to provide fair returns to investors commensurate with the risks they assume. A strong financial position ensures a reliable stream of external capital and allows the company's capital spending needs to be met in the most cost-effective and timely manner. Uninterrupted access to the financial markets provides Tampa Electric with capital on reasonable terms and costs to further reinvest in the business to continue to improve and protect the long-term interests of our customers.

Q. Please discuss the company's projected financial integrity indicators.

A. Document No. 2 of my exhibit shows Tampa Electric's credit parameters on a historical and projected basis. I have provided the information both with and without the impacts of bonus depreciation for comparability between years. It is important to recognize that the temporary tax benefits

have enhanced Tampa Electric's credit metrics in recent years, but those benefits will probably not be available in the future. The requested rate relief would maintain other key credit metrics at levels similar to the recent levels that have supported the company's current credit ratings. Without rate relief, these metrics would substantially deteriorate in 2022, as the exhibit illustrates, and would continue to deteriorate beyond 2022 as capital spending increases and earned returns decline. Such deterioration would not support Tampa Electric's current credit ratings and would have negative implications for the company's credit ratings, borrowing costs, and access to capital.

CREDIT RATINGS

Q. Please describe Tampa Electric's current credit ratings.

A. Tampa Electric's senior unsecured debt is currently rated A3 with a Positive Outlook by Moody's Investors Service ("Moody's"), BBB+ with a Stable Outlook by S&P Global Ratings ("S&P") and A with a Stable Outlook by Fitch Ratings ("Fitch").

Q. Why is it important that Tampa Electric continue to maintain its current ratings?

A. Maintaining Tampa Electric's current ratings is very important for two reasons. First, Tampa Electric is making capital investments to serve customers and strong debt ratings ensure Tampa Electric has adequate credit quality to raise the capital necessary to meet these requirements. Second, Tampa Electric's current ratings provide a reasonable degree of assurance that ratings will not slip below investment grade in the event of a hurricane or other significant weather event.

Q. Why is it so important to maintain an "A" level rating on balance from all three rating agencies?

A. At present, the median rating for the utility industry is A- (Document No. 4 of my exhibit). Obtaining a consistent "A" level rating across all three rating agencies would mean Tampa Electric would be viewed positively regardless of an investor's preference among the rating agencies.

Additionally, investors distinguish between companies with split ratings versus companies who have the same rating across all rating agencies. The lower rating in a split rated company will result in a higher cost of debt for that company. Typically, the lowest credit rating from the rating agencies becomes the more critical rating when the

company seeks access to capital markets.

Obtaining, and maintaining, a consistent "A" level rating from the rating agencies has been one of the contributing factors enabling Tampa Electric to reduce its embedded cost of long-term debt from 5.4 percent in 2014 to 4.17 percent in the 2022 test year.

Q. Why are strong ratings important considering the company's future capital needs?

A. A strong credit rating is important because it affects a company's cost of capital and access to the capital markets. Credit ratings indicate the relative riskiness of the company's debt securities. Therefore, credit ratings are reflected in the cost of borrowed funds. All other factors being equal (*i.e.*, timing, markets, size, and terms of an offering), the higher the credit rating, the lower the cost of funds.

Additionally, companies with lower credit ratings have greater difficulty raising funds in any market, but especially in times of economic uncertainty, credit crunches, or during periods when large volumes of government and higher-grade corporate debt are being sold.

Given the capital-intensive nature of the utility industry, it is critical that utilities maintain strong credit ratings sufficiently above the investment grade threshold to retain uninterrupted access to capital. The impact of being investment grade versus non-investment grade is material. For example, a company raising debt that has non-investment grade ("speculative grade") credit ratings will be subject to occasional lapses in availability of debt capital, onerous debt covenants and higher borrowing costs. In addition, companies with non-investment grade ratings are generally unable to obtain unsecured commercial credit and must provide collateral, prepayment, or letters of credit for contractual agreements such as long-term gas transportation, fuel purchase, and fuel hedging agreements.

Given the high capital needs, obligation to serve existing and new customers, and significant requirements for unsecured commercial credit that electric utilities have, non-investment grade ratings are unacceptable. Tampa Electric's current ratings should also be strong enough to buffer against of the costs of tropical windstorm and hurricane events.

Q. Can the financial credit market be foreclosed by unforeseen events extraneous to the utility industry?

A. Yes. There have been times when financial credit markets have been closed or challenged due to unforeseen events. Market instability resulting from the sub-prime mortgage problems affected liquidity in the entire financial sector causing a financial recession, and there were periods of time in 2008 and 2009 when the debt markets were effectively closed to all but the highest rated borrowers. This is a good example of how access to the marketplace can be shut off for even creditworthy borrowers by extraneous, unforeseen events, and it emphasizes why a strong credit rating is essential to ongoing, unimpeded access to the capital markets.

More recently, the measures adopted to contain COVID-19 have pushed the global economy into recession. The utility industry continued to exhibit adequate liquidity and access to the debt markets, despite the uneven performance of the commercial paper market. This access enabled the industry to proactively manage the potential risks of lower electricity usage and increased bad debt expense by establishing additional capacity through term loans and credit facilities from banks. These actions are in contrast to the last financial recession when many utilities fully drew on their available credit lines and access to the banks or to the debt market was effectively shut down for many

weeks.

Maintaining unimpeded access to the capital markets is particularly important for a utility like Tampa Electric with an obligation to its customers to finance very significant capital investments. Being unable to access funds could place the completion of critical construction in jeopardy and undermine reliability of service.

Q. How are credit ratings determined?

A. The process the rating agencies follow to determine ratings involves an assessment of both business risk and financial risk. Moody's and S&P Global each publish information on their ratings criteria. S&P Global's Corporate Ratings Matrix is shown in Document No. 5 of my exhibit. Moody's Rating Factors for Regulated Utilities are shown in Document No. 6 of my exhibit.

Q. How does regulation affect ratings?

A. The primary business risk the rating agencies focus on for utilities is regulation, and each of the rating agencies have their own views of the regulatory climate in which a utility operates. The exact assessments of the rating

agencies may differ but the principles they rely upon for their independent views of the regulatory regime are similar. Essentially, the principles, or categories, that shape the views of the rating agencies as they relate to regulation are based upon the degree of transparency, predictability, and stability; timeliness of operating and capital cost recovery; regulatory independence; and financial stability.

Regulatory Research Associates ("RRA"), a firm that focuses primarily on regulation of utilities, ranks the Florida Public Service Commission ("FPSC") as "Above Average 2" on a scale that runs from Above Average 1 to Below Average 3. The RRA rankings are presented in Document No. 7 of my exhibit. According to the rating agencies the maintenance of constructive regulatory practices that support the creditworthiness of the utilities is one of the most important issues rating agencies consider when deliberating ratings.

Regulation in Florida has historically been supportive of maintaining the credit quality of the state's utilities, and that has benefited customers by allowing utilities to provide for their customers' needs consistently and at a reasonable cost. This has been one of the factors that has

helped Florida utilities maintain pace with the growth in the state, which has been essential to economic development. A key test of regulatory quality is the ability of companies to earn a reasonable rate of return over time, including through varying economic cycles, and to maintain satisfactory financial ratios supported by good quality of earnings and stability of cash flows. Regulated utilities cannot materially improve or even maintain their financial condition without regulatory support. Thus, regulators have a large impact on the company, its customers, and its investors.

Q. What are recent concerns expressed by the rating agencies for the industry?

A. All the rating agencies have expressed concerns with respect to the impact of COVID-19 on the utility industry. The rapid spread of the coronavirus outbreak and the severity of its impact on the economy are creating an extensive credit shock across many sectors, regions, and markets. In April 2020, S&P Global's Outlook for the entire North American regulated utilities industry changed from stable to negative. S&P Global's expectation for the utility industry to remain a high-credit-quality investment grade industry was offset by their concern over the

potential for weakening cash flow and credit metrics due to COVID-19.

All rating agencies have also highlighted that the regulatory responses to COVID-19 will be key to a utility's credit prospects. COVID-19 will test utilities' ability to maintain the liquidity and operating cash flow necessary to support credit quality. S&P Global states "Widening gaps in cost recovery could impact utilities. Regulatory jurisdictions will be tested to find creative and supportive ways to bolster the credit quality of their utilities."

CAPITAL STRUCTURE

Q. What capital structure is Tampa Electric proposing in its request for increased base rates?

A. Tampa Electric is projecting, for the 2022 test year and beyond, a 13-month average financial capital structure (over investor sources) consisting of 45 percent debt and 55 percent common equity. The 55 percent equity target referenced is based upon the 54.93 percent year-end financial equity ratio in the 2022 budgeted balance sheet. The equity balances in the budget resulted in a 2022 13-month average System Per Books financial equity ratio of

54.53 percent, as reflected on MFR Schedule D-1a. Also, as reflected on MFR Schedule D-1a, the 2022 13-month average FPSC Adjusted financial equity ratio was 54.56 percent. The 54.56 percent equity ratio was the one used to calculate the 6.67 percent rate of return used to determine the 2022 revenue requirement.

Q. Why is it important that the company's requested capital structure, consisting of 45 percent debt and 55 percent common equity, be authorized in this proceeding?

A. The proposed capital structure is important as it would ensure the long-term financial integrity of the company. This test year equity ratio of 55 percent based on investor sources (equivalent to 45.6 percent based on all sources in jurisdictional FPSC Adjusted capital structure), is appropriate and consistent with the equity ratio deemed appropriate in the Commission-approved 2017 Settlement Agreement. Further, as Tampa Electric witness Dylan W. D'Ascendis explains, the company's equity ratio of 55 percent is consistent with its peers and appropriate for ratemaking purposes as it is both typical and important for utilities to have significant proportions of common equity in their capital structures.

Tampa Electric's requirements for financial strength continue, and therefore the maintenance of the equity ratio is of key importance. If coupled with an adequate ROE and base rates that properly reflect the true cost of service, the combination of this capital structure and the resulting coverage ratios should provide adequate financial strength and credit parameters to maintain the company's credit ratings and assure continued access to capital.

Q. What is Tampa Electric's current equity ratio?

A. Tampa Electric's equity ratio as of December 31, 2020 was 53.9 percent.

Q. What are the expectations of the rating agencies with respect to Tampa Electric's regulatory environment?

A. The rating agencies are aware of the impacts of Tampa Electric's infrastructure modernization efforts and tax reform on the weakening credit metrics over the forecast period absent new rates. While acknowledging this weakening, the rating agencies have cited their support for Tampa Electric's credit profile reflecting the highly supportive Florida regulatory framework allowing for timely cost and investment recovery along with stable and

predictable cash flow. Conversely, the rating agencies highlight a less credit supportive outcome as a development that may possibly lead to a negative rating action.

SUMMARY

Q. Please summarize your direct testimony.

A. Maintaining a strong, prudent, and responsible financial position, or financial integrity, is critical to allow Tampa Electric to attract capital on reasonable terms and continue to provide a safe and reliable electric system for its customers. Financial integrity helps ensure uninterrupted access to capital markets to finance required infrastructure investments as well as to manage unforeseen events.

Tampa Electric's capital spending requirements through 2024 include $7.2 billion for normal replacement and improvement of its facilities and $2.5 billion for the Big Bend Modernization and future utility-scale solar projects. The company cannot fund all of this internally and must access external capital to support its construction program.

The requested capital structure of 55 percent equity and the return on equity of 10.75 percent recommended by Mr.

D'Ascendis will provide the financial strength and credit parameters needed to maintain the company's credit ratings and assure continued unimpeded access to capital. The proposed equity ratio is consistent with Tampa Electric's actual sources of capital, with its actual equity ratio of 53.9 percent at year-end 2020, and with the 54 percent equity ratio approved in 2009 and in the company's 2013 and 2017 settlement agreements.

Tampa Electric's rate request, which includes the continued appropriate levels of ROE and equity ratio, will maintain the company's financial integrity and place Tampa Electric in an appropriate financial position to fund its infrastructure modernization efforts and continue providing the high level of reliable service to its customers.

Q. Does this conclude your direct testimony?

A. Yes, it does.

EXHIBIT

OF

KENNETH D. MCONIE

Table of Contents

TAMPA ELELCTRIC COMPANY
DOCKET NO. 20210034-EI
EXHIBIT NO. KDM-1
WITNESS: MCONIE
DOCUMENT NO. 1
PAGE 1 OF 1
FILED: 04/09/2021

LIST OF MINIMUM FILING REQUIREMENT SCHEDULES
SPONSORED OR CO-SPONSORED BY KENNETH D. MCONIE

MFR Schedule	TITLE
D-07	Common Stock Data
D-08	Financial Plans-Stock And Bond Issues
D-09	Financial Indicators-Summary

Tampa Electric Credit Metrics
2015 - 2022 Test Year

		Actual			Projected	Proforma Adjusted Test Year	
						w/o rates	w / rates [1]
S&P Adjusted Metrics	**2015 - 2017 Average**	**2018**	**2019**	**2020**	**2021**	**2022**	**2022**
FFO / Debt	29%	23%	22%	22%	20%	20%	26%
FFO Cash Interest Coverage	7.2x	6.6x	6.1x	6.5x	6.1x	6.0x	7.6x
Debt / EBITDA	2.8x	3.3x	3.4x	3.6x	4.1x	4.1x	3.1x

(1) Reflects full year of requested revenue increase.

Rating Agency Conventions and Scales
Senior Unsecured Notes (Long-Term Debt)

S&P [1]		Moody's [2]		Fitch [3]		
Extremely Strong	AAA	Highest Quality	Aaa	Highest Quality	AAA	Investment
	AA+		Aa1		AA+	
	AA		Aa2		AA	
Very Strong	AA-	High Quality	Aa3	Very High Quality	AA-	
	A+		A1		A+	
	A		A2		A	
Strong	A-	Upper-Medium Grade	A3	High Quality	A-	
	BBB+		Baa1		BBB+	
	BBB		Baa2		BBB	
Adequate	BBB-	Medium-Grade	Baa3	Good Quality	BBB-	
	BB+		Ba1		BB+	Speculative Grade
	BB		Ba2		BB	
Less Vulnerable	BB-	Substantial Risk	Ba3	Speculative	BB-	
	B+		B1		B+	
	B		B2		B	
More Vulnerable	B-	High Risk	B3	Highly Speculative	B-	
	CCC+		Caa1		CCC+	
	CCC		Caa2		CCC	
Currently Vulnerable	CCC-	Very High Risk	Caa3	Substantial Risk	CCC-	
Highly Vulnerable	CC	Highly Speculative	Ca	Very High Levels of Risk	CC	
Currently Highly Vulnerable	C	Default	C	Near Default	C	
Default	D			Restricted Default	RD	
				Default	D	

(1) S&P Global - Guide to Credit Rating Essentials - 2019
(2) Moody's Investors Service - Rating Symbols and Definitions - December 2020
(3) Fitch Ratings - Rating Definitions - June 2020

EXHIBIT NO. KDM-1

DOCUMENT NO. 4

BATES PAGE: 27

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S&P Global Corporate Ratings Matrix

Business Risk and Financial Risk Profile Matrix

	--Financial risk profile--					
Business risk profile	**1 (minimal)**	**2 (modest)**	**3 (intermediate)**	**4 (significant)**	**5 (aggressive)**	**6 (highly leveraged)**
1 (excellent)	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
2 (strong)	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
3 (satisfactory)	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
4 (fair)	bbb/bbb-	bbb-	bb+	bb	bb-	b
5 (weak)	bb+	bb+	bb	bb-	b+	b/b-
6 (vulnerable)	bb-	bb-	bb-/b+	b+	b	b-

Source: S&P Global - How We Rate Nonfinancial Corporate Entities - April 2019

Financial Risk Indactiave Ratios - Corporates

Cash Flow/Leverage Analysis Ratios--Medial Volatility

	--Core ratios--		--Supplementary coverage ratios--		--Supplementary payback ratios--		
	FFO/debt (%)	**Debt/EBITDA (x)**	**FFO/cash interest (x)**	**EBITDA/interest (x)**	**CFO/debt (%)**	**FOCF/debt (%)**	**DCF/debt (%)**
Minimal	50+	less than 1.75	10.5+	14+	40+	30+	18+
Modest	35-50	1.75-2.5	7.5-10.5	9-14	27.5-40	17.5-30	11-18
Intermediate	23-35	2.5-3.5	5-7.5	5-9	18.5-27.5	9.5-17.5	6.5-11
Significant	13-23	3.5-4.5	3-5	2.75-5	10.5-18.5	5-9.5	2.5-6.5
Aggressive	9-13	4.5-5.5	1.75-3	1.75-2.75	7-10.5	0-5	(11)-2.5
Highly leveraged	Less than 9	Greater than 5.5	Less than 1.75	Less than 1.75	Less than 7	Less than 0	Less than (11)

Source: S&P Global - Corporate Methodology - November 2013

Moody's Key Financial Metrics

Weighting 40%	Sub-Factor Weighting		Aaa	Aa	A	Baa	Ba	B	Caa
CFO pre-WC + Interest / Interest	7.50%		≥ 8.0x	6.0x - 8.0x	4.5x - 6.0x	3.0x - 4.5x	2.0x - 3.0x	1.0x - 2.0x	< 1.0x
CFO pre-WC / Debt	15.00%	Standard Grid	≥ 40%	30% - 40%	22% - 30%	13% - 22%	5% - 13%	1% - 5%	< 1%
		Low Business Risk Grid	≥ 38%	27% - 38%	19% - 27%	11% - 19%	5% - 11%	1% - 5%	< 1%
CFO pre-WC - Dividends / Debt	10.00%	Standard Grid	≥ 35%	25% - 35%	17% - 25%	9% - 17%	0% - 9%	(5%) - 0%	< (5%)
		Low Business Risk Grid	≥ 34%	23% - 34%	15% - 23%	7% - 15%	0% - 7%	(5%) - 0%	< (5%)
Debt / Capitalization	7.50%	Standard Grid	< 25%	25% - 35%	35% - 45%	45% - 55%	55% - 65%	65% - 75%	≥ 75%
		Low Business Risk Grid	< 29%	29% - 40%	40% - 50%	50% - 59%	59% - 67%	67% - 75%	≥ 75%

Source: Moody's Investors Service - Regulated Electric and Gas Utilities Rating Methodology - June 2017

Appendix A: Regulated Electric and Gas Utilities Methodology Factor Grid

Factor 1a: Legislative and Judicial Underpinnings of the Regulatory Framework (12.5%)

Aaa	Aa	A	Baa
Utility regulation occurs under a fully developed framework that is national in scope based on legislation that provides the utility a nearly absolute monopoly (see note 1_ within its service territory, an unquestioned assurance that rates will be set in a manner that will permit the utility to make and recover all necessary investments, an extremely high degree of clarity as to the manner in which utilities will be regulated and prescriptive methods and procedures for setting rates. Existing utility law is comprehensive and supportive such that changes in legislation are not expected to be necessary; or any changes that have occurred have been strongly supportive of utilities credit quality in general and sufficiently forward-looking so as to address problems before they occurred. There is an independent and regulator and the utility should			

Factor 1b: Consistency and Predictability of Regulation (12.5%)

Aaa	Aa	A	Baa
The issuer's interaction with the regulator has led to a strong, lengthy track record of predictable, consistent and favorable decisions. The regulator is highly credit supportive of the issuer and utilities in general. We expect these conditions to continue.	The issuer's interaction with the regulator has led to a considerable track record of predominantly predictable and consistent decisions. The regulator is mostly credit supportive of utilities in general and in almost all instances has been highly credit supportive of the issuer. We expect these conditions to continue.	The issuer's interaction with the regulator has led to a track record of largely predictable and consistent decisions. The regulator may be somewhat less credit supportive of utilities in general, but has been quite credit supportive of the issuer in most circumstances. We expect these conditions to continue.	The issuer's interaction with the regulator has led to an adequate track record. The regulator is generally consistent and predictable, but there may some evidence of inconsistency or unpredictability from time to time, or decisions may at times be politically charged. However, instances of less credit supportive decisions are based on reasonable application of existing rules and statutes and are not overly punitive. We expect these conditions to continue.

Ba	B	Caa
We expect that regulatory decisions will demonstrate considerable inconsistency or unpredictability or that decisions will be politically charged, based either on the issuer's track record of interaction with regulators or other governing bodies, or our view that decisions will move in this direction. The regulator may have a history of less credit supportive regulatory decisions with respect to the issuer, but we expect that the issuer will be able to obtain support when it encounters financial stress, with some potentially material delays. The regulator's authority may be eroded at times by legislative or political action. The regulator may not follow the framework for	We expect that regulatory decisions will be largely unpredictable or even somewhat arbitrary, based either on the issuer's track record of interaction with regulators or other governing bodies, or our view that decisions will move in this direction. However, we expect that the issuer will ultimately be able to obtain support when it encounters financial stress, albeit with material or more extended delays. Alternately, the regulator is untested, lacks a consistent track record, or is undergoing substantial change. The regulator's authority may be eroded on frequent occasions by legislative or political action. The regulator may more frequently ignore the framework in a manner detrimental to the issuer.	We expect that regulatory decisions will be highly unpredictable and frequently adverse, based either on the issuer's track record of interaction with regulators or other governing bodies, or our view that decisions will move in this direction. Alternately, decisions may have credit supportive aspects, but may often be unenforceable. The regulator's authority may have been seriously eroded by legislative or political action. The regulator may consistently ignore the framework to the detriment of the issuer.

Factor 2a: Timeliness of Recovery of Operating and Capital Costs (12.5%)

Aaa	Aa	A	Baa
Tariff formulas and automatic cost recovery mechanisms provide full and highly timely recovery of all operating costs and essentially contemporaneous return on all incremental capital investments, with statutory provisions in place to preclude the possibility of challenges to rate increases or cost recovery mechanisms. By statute and by practice, general rate cases are efficient, focused on an impartial review, quick, and permit inclusion of fully forward -looking costs.	Tariff formulas and automatic cost recovery mechanisms provide full and highly timely recovery of all operating costs and essentially contemporaneous or near-contemporaneous return on most incremental capital investments, with minimal challenges by regulators to companies' cost assumptions. By statute and by practice, general rate cases are efficient, focused on an impartial review, of a very reasonable duration before non-appealable interim rates can be collected, and primarily permit inclusion of forward- looking costs.	Automatic cost recovery mechanisms provide full and reasonably timely recovery of fuel, purchased power and all other highly variable operating expenses. Material capital investments may be made under tariff formulas or other rate-making permitting reasonably contemporaneous returns, or may be submitted under other types of filings that provide recovery of cost of capital with minimal delays. Instances of regulatory challenges that delay rate increases or cost recovery are generally related to large, unexpected increases in sizeable construction projects. By statute or by practice, general rate cases are reasonably efficient, primarily focused on an impartial review, of a reasonable duration before rates (either permanent or non- refundable interim rates) can be collected, and permit inclusion of important forward -looking costs.	Fuel, purchased power and all other highly variable expenses are generally recovered through mechanisms incorporating delays of less than one year, although some rapid increases in costs may be delayed longer where such deferrals do not place financial stress on the utility. Incremental capital investments may be recovered primarily through general rate cases with moderate lag, with some through tariff formulas. Alternately, there may be formula rates that are untested or unclear. Potentially greater tendency for delays due to regulatory intervention, although this will generally be limited to rates related to large capital projects or rapid increases in operating costs.

Ba	B	Caa
There is an expectation that fuel, purchased power or other highly variable expenses will eventually be recovered with delays that will not place material financial stress on the utility, but there may be some evidence of an unwillingness by regulators to make timely rate changes to address volatility in fuel, or purchased power, or other market-sensitive expenses. Recovery of costs related to capital investments may be subject to delays that are somewhat lengthy, but not so pervasive as to be expected to discourage important investments.	The expectation that fuel, purchased power or other highly variable expenses will be recovered may be subject to material delays due to second-guessing of spending decisions by regulators or due to political intervention. Recovery of costs related to capital investments may be subject to delays that are material to the issuer, or may be likely to discourage some important investment.	The expectation that fuel, purchased power or other highly variable expenses will be recovered may be subject to extensive delays due to second-guessing of spending decisions by regulators or due to political intervention. Recovery of costs related to capital investments may be uncertain, subject to delays that are extensive, or that may be likely to discourage even necessary investment.

Note: Tariff formulas include formula rate plans as well as trackers and riders related to capital investment.

32

Factor 2b: Sufficiency of Rates and Returns (12.5%)

Aaa	Aa	A	Baa
Sufficiency of rates to cover costs and attract capital is (and will continue to be) unquestioned.	Rates are (and we expect will continue to be) set at a level that permits full cost recovery and a fair return on all investments, with minimal challenges by regulators to companies' cost assumptions. This will translate to returns (measured in relation to equity, total assets, rate base or regulatory asset value, as applicable) that are strong relative to global peers.	Rates are (and we expect will continue to be) set at a level that generally provides full cost recovery and a fair return on investments, with limited instances of regulatory challenges and disallowances. In general, this will translate to returns (measured in relation to equity, total assets, rate base or regulatory asset value, as applicable) that are generally above average relative to global peers, but may at times be average.	Rates are (and we expect will continue to be) set at a level that generally provides full operating cost recovery and a mostly fair return on investments, but there may be somewhat more instances of regulatory challenges and disallowances, although ultimate rate outcomes are sufficient to attract capital without difficulty. In general, this will translate to returns (measured in relation to equity, total assets, rate base or regulatory asset value, as applicable) that are average relative to global peers, but may at times be somewhat below average.

Ba	B	Caa
Rates are (and we expect will continue to be) set at a level that generally provides recovery of most operating costs but return on investments may be less predictable, and there may be decidedly more instances of regulatory challenges and disallowances, but ultimate rate outcomes are generally sufficient to attract capital. In general, this will translate to returns (measured in relation to equity, total assets, rate base or regulatory asset value, as applicable) that are generally below average relative to global peers, or where allowed returns are average but difficult to earn. Alternately, the tariff formula may not take into account all cost components and/or remuneration of investments may be unclear or at times unfavorable.	We expect rates will be set at a level that at times fails to provide recovery of costs other than cash costs, and regulators may engage in somewhat arbitrary second-guessing of spending decisions or deny rate increases related to funding ongoing operations based much more on politics than on prudency reviews. Return on investments may be set at levels that discourage investment. We expect that rate outcomes may be difficult or uncertain, negatively affecting continued access to capital. Alternately, the tariff formula may fail to take into account significant cost components other than cash costs, and/or remuneration of investments may be generally unfavorable.	We expect rates will be set at a level that often fails to provide recovery of material costs, and recovery of cash costs may also be at risk. Regulators may engage in more arbitrary second-guessing of spending decisions or deny rate increases related to funding ongoing operations based primarily on politics. Return on investments may be set at levels that discourage necessary maintenance investment. We expect that rate outcomes may often be punitive or highly uncertain, with a markedly negative impact on access to capital. Alternately, the tariff formula may fail to take into account significant cash cost components, and/or remuneration of investments may be primarily unfavorable.

Factor 3: Diversification (10%)

Weighting 10%	Sub-Factor Weighting	Aaa	Aa	A	Baa
Market Position	5% *	A very high degree of multinational and regional diversity in terms of regulatory regimes and/or service territory economies.	Material operations in three or more nations or substantial geographic regions providing very good diversity of regulatory regimes and/or service territory economies.	Material operations in two to three nations, states, provinces or regions that provide good diversity of regulatory regimes and service territory economies. Alternately, operates within a single regulatory regime with low volatility, and the service territory economy is robust, has a very high degree of diversity and has demonstrated resilience in economic cycles.	May operate under a single regulatory regime viewed as having low volatility, or where multiple regulatory regimes are not viewed as providing much diversity. The service territory economy may have some concentration and cyclicality, but is sufficiently resilient that it can absorb reasonably foreseeable increases in utility rates.
Generation and Fuel Diversity	5% **	A high degree of diversity in terms of generation and/or fuel sources such that the utility and rate-payers are well insulated from commodity price changes, no generation concentration, and very low exposures to Challenged or Threatened Sources (see definitions below).	Very good diversification in terms of generation and/or fuel sources such that the utility and rate-payers are affected only minimally by commodity price changes, little generation concentration, and low exposures to Challenged or Threatened Sources.	Good diversification in terms of generation and/or fuel sources such that the utility and rate-payers have only modest exposure to commodity price changes; however, may have some concentration in a source that is neither Challenged nor Threatened. Exposure to Threatened Sources is low. While there may be some exposure to Challenged Sources, it is not a cause for concern.	Adequate diversification in terms of generation and/or fuel sources such that the utility and rate-payers have moderate exposure to commodity price changes; however, may have some concentration in a source that is Challenged. Exposure to Threatened Sources is moderate, while exposure to Challenged Sources is manageable.

	Sub-Factor Weighting	Ba	B	Caa	Definitions
Market Position	5% *	Operates in a market area with somewhat greater concentration and cyclicality in the service territory economy and/or exposure to storms and other natural disasters, and thus less resilience to absorbing reasonably foreseeable increases in utility rates. May show somewhat greater volatility in the regulatory regime(s).	Operates in a limited market area with material concentration and more severe cyclicality in service territory economy such that cycles are of materially longer duration or reasonably foreseeable increases in utility rates could present a material challenge to the economy. Service territory may have geographic concentration that limits its resilience to storms and other natural disasters, or may be an emerging market. May show decided volatility in the regulatory regime(s).	Operates in a concentrated economic service territory with pronounced concentration, macroeconomic risk factors, and/or exposure to natural disasters.	Challenged Sources are generation plants that face higher but not insurmountable economic hurdles resulting from penalties or taxes on their operation, or from environmental upgrades that are required or likely to be required. Some examples are carbon-emitting plants that incur carbon taxes, plants that must buy emissions credits to operate, and plants that must install environmental equipment to continue to operate, in each where the taxes/credits/upgrades are sufficient to have a material impact on those plants' competitiveness relative to other generation types or on the utility's rates, but where the impact is not so severe as to be likely require plant closure.
Generation and Fuel Diversity	5% **	Modest diversification in generation and/or fuel sources such that the utility or rate- payers have greater exposure to commodity price changes. Exposure to Challenged and Threatened Sources may be more pronounced, but the utility will be able to access alternative sources without undue financial stress.	Operates with little diversification in generation and/or fuel sources such that the utility or rate-payers have high exposure to commodity price changes. Exposure to Challenged and Threatened Sources may be high, and accessing alternate sources may be challenging and cause more financial stress, but ultimately feasible.	Operates with high concentration in generation and/or fuel sources such that the utility or rate-payers have exposure to commodity price shocks. Exposure to Challenged and Threatened Sources may be very high, and accessing alternate sources may be highly uncertain.	Threatened Sources are generation plants that are not currently able to operate due to major unplanned outages or issues with licensing or other regulatory compliance, and plants that are highly likely to be required to de- activate, whether due to the effectiveness of currently existing or expected rules and regulations or due to economic challenges. Some recent examples would include coal fired plants in the US that are not economic to retro-fit to meet mercury and air toxics standards, plants that cannot meet the effective date of those standards, nuclear plants in Japan that have not been licensed to re-start after the Fukushima Dai-ichi accident, and nuclear plants that are required to be phased out within 10 years (as is the case in some European countries).

* 10% weight for issuers that lack generation **0% weight for issuers that lack generation

Factor 4: Financial Strength

Weighting 40%	Sub-Factor Weighting		Aaa	Aa	A	Baa	Ba	B	Caa
CFO pre-WC + Interest / Interest	7.5%		≥ 8x	6x - 8x	4.5x - 6x	3x - 4.5x	2x - 3x	1x - 2x	< 1x
		Standard Grid	≥ 40%	30% - 40%	22% - 30%	13% - 22%	5% - 13%	1% - 5%	< 1%
CFO pre-WC / Debt	15%								
		Low Business Risk Grid	≥ 38%	27% - 38%	19% - 27%	11% - 19%	5% - 11%	1% - 5%	< 1%
		Standard Grid	≥ 35%	25% - 35%	17% - 25%	9% - 17%	0% - 9%	(5%) - 0%	< (5%)
CFO pre-WC - Dividends / Debt	10%								
		Low Business Risk Grid	≥ 34%	23% - 34%	15% - 23%	7% - 15%	0% - 7%	(5%) - 0%	< (5%)
		Standard Grid	< 25%	25% - 35%	35% - 45%	45% - 55%	55% - 65%	65% - 75%	≥ 75%
Debt / Capitalization	7.5%								
		Low Business Risk Grid	< 29%	29% - 40%	40% - 50%	50% - 59%	59% - 67%	67% - 75%	≥ 75%

35

Fitch Key Rating Factors

Key Rating Factors

Sector risk profile	Financial profile
Country risk	• Cash flow and profitability
Management strategy/governance	• Financial structure
Group structure	• Financial flexibility
Business profile	
Source: Fitch Ratings	

Source: Fitch Ratings - Corporate Rating Criteria - December 2020

Sector-Specific Key Factors – US Utilities, Power and Gas

	Regulatory Environment	Market Position	Asset Base and Operations	Commodity Exposure
Rating	**Degree of Transparency and Predictability**	**Market Structure**	**Diversity of Assets**	**Ability to Pass Through Changes in Fuel**
aa	n.a.	n.a.	n.a.	n.a.
a	Track record of transparent and predictable regulation.	Well-established market structure with complete transparency in price-setting mechanisms.	High-quality and/or large-scale diversified assets.	Complete pass-through of commodity costs.
bbb	Generally transparent and predictable regulation with limited political interference.	Established market structure but some level of uncertainty in price-setting mechanisms.	Good quality and/or reasonable scale diversified assets.	Limited exposure to changes in commodity costs.
bb	Poor or uncertain track record of regulation and high political interference.	Still evolving market structure and uncertain price-setting mechanisms.	Small size and limited diversification.	Inability to pass through all changes in commodity costs.
b	Hostile regulatory or political jurisdiction or frequent regulatory interference in market-based mechanisms.	High risk to market structure from regulatory or political interference.	Low quality, small size and highly concentrated assets.	High exposure to commodity price changes.
ccc	Regulatory framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	Market framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	n.a.	Substantial cash impairments crystallized or about to as a result of the failure of derivative and physical hedging measures.
	Timeliness of Cost Recovery	**Consumption Growth Trend**	**Operations Reliability and Cost Competitiveness**	**Underlying Supply Mix**
aa	n.a.	n.a.	n.a.	n.a.
a	Minimal lag to recover capital and operating costs.	Economically vibrant market or service territory with strong sales growth.	Track record of reliable, low-cost operations.	Extremely low cost and flexible supply.
bbb	Moderate lag to recover capital and operating costs.	Customer and usage growth in line with industry averages.	Reliability and cost of operations at par with industry averages.	Low variable costs and moderate flexibility of supply.
bb	Significant lag to recover capital and operating costs.	Exposure to declining usage or volumes or self-generation.	Below-average system reliability and cost structure.	High variable costs and limited flexibility of supply.
b	Material delays in recovering capital and operating costs.	Rapidly shrinking market or service territory and falling unit consumption.	Poor system reliability and disadvantageous cost structure.	Extreme variability in costs and minimal flexibility of supply.
ccc	Regulatory framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	Customer base, key personnel or material operational facilities experiencing a level of flux that significantly impairs cash generation.	Subject to advanced regulatory intervention with material risks for concession ownership/preservation of capital structure.	Substantial cash impairments crystallized or about to as a result of the failure of supply purchasing strategies.
	Trend in Authorized ROEs	**Customer Mix**	**Exposure to Environmental Regulations**	**Hedging Strategy**
aa	n.a.	n.a.	n.a.	n.a.
a	Above-average authorized ROE.	Favorable customer mix.	No exposure to environmental regulations.	Highly captive supply and customer base.
bbb	Average authorized ROE.	Less diversified customer base.	Limited or manageable exposure to environmental regulations.	Long-term supply and sales contracts with creditworthy counterparties.
bb	Significantly below-average authorized ROE.	High concentration of customers in cyclical industries.	Significant exposure to environmental regulations.	Medium-term hedging strategy for supply and sales.
b	Absence of regulatory ROE.	High concentration to risky, less creditworthy customers.	Merchant generator with a material exposure to highly polluting technology.	Minimal hedging of supply and sales or highly speculative trading positions.
ccc	Regulatory framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	Substantial cash impairment crystallized or about to, due to counterparty failures, including systemic collection failures.	Substantial cash impairment crystallized, or about to, due to multiple, punitive environmental cost burdens.	Substantial cash impairments crystallized or about to as a result of the failure of derivative and physical hedging measures.
	Mechanisms Available to Stabilize Cash Flows	**Geographic Location**	**Capital and Technological Intensity of Capex**	
aa	n.a.	n.a.	n.a.	
a	Revenues fully insulated from variability in consumption.	Favorable location or high geographic diversity.	Low levels of reinvestment requirements.	
bbb	Revenues partially insulated from variability in consumption.	Beneficial location or reasonable locational diversity.	Moderate reinvestments requirements in established technologies.	
bb	Revenues fully exposed to variability in consumption.	High sensitivity to extreme weather or disaster disruptions.	Reinvestment concentrated in capital-intensive or unproven technologies.	
b	Revenues fully exposed to declining consumption.	High exposure to event risk.	High exposure to execution risk for projects involving large outlays or unproven technologies.	
ccc	Regulatory framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	Concentration in one location with disruptive economic or logistical characteristics impairing either operation or cash collections.	Substantial cash impairment crystallized, or about to, due to the failure or cost over-run of a major project.	
	Mechanisms Supportive of Creditworthiness	**Supply Demand Dynamics**		
aa	n.a.	n.a.		
a	Effective regulatory ring-fencing.	Beneficial outlook for prices/rates.		
bbb	Effective regulatory ring-fencing or minimum creditworthiness requirements.	Moderately favorable outlook for prices/rates.		
bb	Limited regulatory ring-fencing or minimum creditworthiness requirements.	Uncertain outlook for prices/rates.		
b	Absence of minimum creditworthiness requirements.	Extremely unfavorable outlook for prices/rates.		
ccc	Regulatory framework formally or informally abandoned, with substantial uncertainty around future mechanisms.	Direct exposure to failed market structures crystallized or about to, with substantial negative cash flow implications.		

Financial Profile Key Factors – US Utilities, Power and Gas

	Profitability	Financial Structure	Financial Flexibility
Rating	**Free Cash Flow**	**FFO Leverage**	**Financial Discipline**
aa	n.a.	n.a.	Publicly announced conservative financial policy. Track record of strict compliance.
a	Structurally neutral to positive FCF across the investment cycle.	3.5x	Clear commitment to maintain a conservative policy with only modest deviations allowed.
bbb	Structurally neutral to negative FCF across the investment cycle.	5.0x	Less conservative policy, but generally applied consistently.
bb	Structurally negative FCF across the investment cycle.	6.5x	Financial policies in place but flexibility in applying them could lead to temporarily exceeding downgrade guidelines.
b	Structurally heavily negative FCF across the investment cycle.	7.0x	No financial policy or track record of ignoring it. Opportunistic behavior.
ccc	Negative FCF burden greater than all projected regulatory parameters, and negative operational cash flow the norm.	>9.0x	Financial management has lost much of its discipline, and subject to frequent, sudden changes consistent with a crisis environment.
	Volatility of Profitability	**Total Debt with Equity Credit/Op. EBITDA**	**Liquidity**
aa	n.a.	n.a.	Very comfortable liquidity; no need to use external funding in the next 24 months even under a severe stress scenario. Well-spread debt maturity. Diversified sources of funding.
a	Higher stability and predictability of profits relative to utility peers.	3.25x	Very comfortable liquidity. No need to use external funding in the next 12 months even under a severe stress scenario. Well-spread debt maturity schedule. Diversified sources of funding.
bbb	Stability and predictability of profits in line with utility peers.	3.75x	One-year liquidity ratio above 1.25x. Well-spread maturity schedule of debt but funding may be less diversified.
bb	Lower stability and predictability of profits relative to utility peers.	4.75x	Liquidity ratio around 1.0x. Less smooth debt maturity or concentrated funding.
b	Stability and predictability of profits viewed as negative outliers relative to utility peers.	6.0x	Liquidity ratio below 1.0x. Overly reliant on one funding source.
ccc	Volatility of profits greater than normal bounds of volatility for corporate sector as a whole.	>8.0x	No near-term prospect of recovery in liquidity score above 1.0x. All/most funding sources subject to material execution risk.
			FFO Interest Coverage
aa			n.a.
a			5.5x
bbb			4.5x
bb			3.5x
b			2.0x
ccc			Net FCF debt service cover below 1.0x. All/most funding sources subject to material execution risk.

EXHIBIT NO. KDM-1

DOCUMENT NO. 7

BATES PAGES: 39 - 63

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