



0000153149

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

2014 APR 30 P 3:16

AZ CORP COMMISSION  
DOCKET CONTROL

ORIGINAL

COMMISSIONERS

- BOB STUMP – Chairman
- GARY PIERCE
- BRENDA BURNS
- BOB BURNS
- SUSAN BITTER SMITH

IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY  
CORPORATION.

DOCKET NO. E-04230A-14-0011  
DOCKET NO. E-01933A-14-0011

NOTICE OF FILING

The Residential Utility Consumer Office (“RUCO”) hereby provides notice of filing the Redacted Direct Testimony of Ralph Smith and the Direct Testimony of Lon Huber, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 30th day of April, 2014.

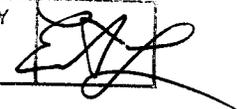
  
 Daniel W. Pozefsky  
 Chief Counsel

AN ORIGINAL AND THIRTEEN COPIES  
of the foregoing filed this 30th day  
of April, 2014 with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

Arizona Corporation Commission  
DOCKETED

APR 30 2014

DOCKETED BY 

1 COPIES of the foregoing hand delivered/  
mailed this 30th day of April, 2014 to:

2  
3 Lyn Farmer  
4 Chief Administrative Law Judge  
5 Hearing Division  
6 Arizona Corporation Commission  
7 1200 West Washington  
8 Phoenix, Arizona 85007

9  
10 Brian E. Smith  
11 Bridget Humphrey  
12 Legal Division  
13 Arizona Corporation Commission  
14 1200 West Washington  
15 Phoenix, Arizona 85007

16  
17 Steve Olea, Director  
18 Utilities Division  
19 Arizona Corporation Commission  
20 1200 West Washington  
21 Phoenix, Arizona 85007

22  
23 Michael W. Patten  
24 Roshka, DeWulf & Patten PLC  
One Arizona Center  
400 E. Van Buren, Suite 800  
Phoenix, AZ 85004

Bradley S. Carroll  
UNS Electric, Inc.  
88 E. Broadway, MS HQE910  
P.O. Box 711  
Tucson, Arizona 85702

Patricia Lee Refo  
Snell & Wilmer, LLP  
One Arizona Center  
400 E. Van Buren St., Suite 1900  
Phoenix, Arizona 85004

C. Webb Crockett  
Patrick J. Black  
Fennemore Craig, PC  
2394 E. Camelback Road, Suite 600  
Phoenix, Arizona 85016-3429

Thomas L. Mumaw  
Melissa Krueger  
Pinnacle West Capital Corporation  
P.O. Box 53999, MS 8695  
Phoenix, Arizona 85072-3393

Meghan H. Grabel  
Arizona Public Service Company  
P.O. Box 53999, MS 9708  
Phoenix, Arizona 85072-3999

Cynthia Zwick  
Arizona Community Action Association  
2700 N. 3<sup>rd</sup> St., Suite 3040  
Phoenix, Arizona 85004

Nicholas J. Enoch  
Jarrett J. Haskovec  
Lubin & Enoch, PC  
349 N. Fourth Ave.  
Phoenix, Arizona 85003

Lawrence V. Robertson  
Attorney At Law  
P.O. Box 1448  
Tubac, Arizona 85646

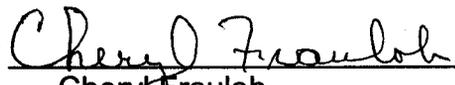
Timothy Hogan  
AZ Center for Law in the Public Interest  
202 E. McDowell Rd, Suite 153  
Phoenix, Arizona 85004

Jeff Schlegel  
SWEEP Arizona Representative  
1167 W. Samalayuca Dr.  
Tucson, Arizona 85704-3224

Michael Grant  
Jennifer A. Cranston  
Gallagher & Kennedy, PA  
2575 E. Camelback Road  
Phoenix, Arizona 85016-9225

1 Gary Yaquinto  
Arizona Investment Council  
2 2100 N. Central Ave., Suite 210  
Phoenix, Arizona 85004  
3  
4 Michael A. Curtis  
William P. Sullivan  
Larry K. Udall  
5 Curtis, Goodwin, Sullivan, Udall  
& Schwabb, PLC  
6 501 E. Thomas Road  
Phoenix, Arizona 85012  
7  
8 Peggy Gillman  
Mohave Electric Cooperative, Inc.  
P.O. Box 1045  
9 Bullhead City, Arizona 86430  
10  
11 Joe L. Machado  
Michael J. Masee  
City Attorney's Office  
777 N. Grand Avenue  
12 Nogales, Arizona 85621  
13  
14 Court Rich  
6613 N. Scottsdale Road, Suite 200  
Scottsdale, Arizona 85250  
15  
16 Charles R. Moore  
Navopache Electric Cooperative  
1878 West White Mountain Blvd  
Lakeside, Arizona 85929  
17  
18 Christopher Hitchcock  
P.O. Box AT  
Bisbee, Arizona 85603-0115  
19  
20 Jack Blair  
Sulphur Springs Valley Electric  
Cooperative  
21 311 E. Wilcox Drive  
Sierra Vista, Arizona 85635-2527  
22  
23 Garry D. Hays  
Law Offices of Garry D. Hays  
1702 E. Highland Ave., Suite 204  
24 Phoenix, Arizona 85016

Giancarlo G. Estrada  
Estrada-Legal, PC  
One E. Camelback Rd, Suite 550  
Phoenix, Arizona 85012

By   
Cheryl Fraulob

**BEFORE THE ARIZONA CORPORATION COMMISSION**

BOB STUMP - Chairman  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH

IN THE MATTER OF THE REORGANIZATION OF  
UNS ENERGY CORPORATION

) DOCKET NO. E-04230A-14-0011  
) DOCKET NO. E-01933A-14-0011  
)

---

DIRECT  
TESTIMONY  
OF  
RALPH C. SMITH  
ON BEHALF OF THE  
RESIDENTIAL UTILITY CONSUMER OFFICE  
APRIL 30, 2014

[CONFIDENTIAL AND COMPETITIVELY SENSITIVE Information has been Redacted]

## TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION .....	1
II. SUMMARY OF TESTIMONY AND CONCLUSIONS .....	6
III. OVERVIEW OF THE PROPOSED ACQUISITION AND MERGER.....	8
Omissions from Presentation of Post-Merger Corporate Organizational Structure .....	14
IV. STANDARD OF REVIEW .....	14
V. PREVIOUS ATTEMPT TO SELL UNISOURCE ENERGY.....	17
VI. FORTIS' ACQUISITION OF OTHER U.S. UTILITIES.....	20
VII. GOODWILL/ ACQUISITION ADJUSTMENT / TRANSACTION COSTS .....	25
Goodwill .....	25
Transaction Costs.....	32
Change in Control Costs .....	33
Retention Bonuses .....	33
VIII. UNS ENERGY SHAREHOLDER LITIGATION COSTS.....	34
IX. CONFIRMATION THAT THERE IS NO INTERNAL REVENUE CODE §338(H)(10) ELECTION.....	36
X. BOND RATINGS / CHANGES TO COST OF DEBT / POST MERGER CAPITAL STRUCTURE .....	37
XI. PRESERVING TEP SPRINGVILLE SECTION 45 SYNFUEL BENEFITS FOR ARIZONA RATEPAYERS.....	39
XII. LUXEMBOURG CONDUIT / INTER-COMPANY DEBT FINANCING / IMPACT ON FORTIS' ANTICIPATED EARNINGS ACCRETION.....	42
XIII. ARIZONA RATEPAYER BENEFITS .....	48
XIV. FORTIS CORPORATE COST INCREASES RESULTING FROM THE MERGER.....	50

**ATTACHMENTS**

Background and Qualifications.....RCS-1

Pre- and Post-Acquisition Corporate Organizational Charts (from Joint Application Ex. 2) RCS-2

Fortis, Inc. Corporate Organizational Charts .....RCS-3

Illustrative news articles about the current status of an acquisition of a former Texas utility, TXU, by a buyout group that had included KKR & Co. L.P. ("KKR" aka Kohlberg Kravis Roberts, an investment firm that had been part of the consortium that had previously attempted to acquire UNS Energy in 2005), and some new articles about high profile Goodwill impairment write-offs that have occurred after other acquisition/merger transactions. ....RCS-4

UNS Energy and Fortis' non-confidential responses to data requests and other UNS Energy non-confidential material referenced in testimony .....RCS-5

UNS Energy and Fortis' Confidential responses to data requests referenced in testimony ...RCS-6

UNS Energy CONFIDENTIAL AND COMPETITIVELY SENSITIVE material referenced in testimony (2 pages of copies obtained from "due diligence" review) .....RCS-7

1     **I. INTRODUCTION**

2     **Q. Please state your name, position and business address.**

3     A. Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates, PLLC,  
4         15728 Farmington Road, Livonia, Michigan 48154.

5  
6     **Q. Please describe Larkin & Associates.**

7     A. Larkin & Associates is a Certified Public Accounting and Regulatory Consulting firm.  
8         The firm performs independent regulatory consulting primarily for public service/utility  
9         commission staffs and consumer interest groups (public counsels, public advocates,  
10         consumer counsels, attorneys general, etc.). Larkin & Associates has extensive experience  
11         in the utility regulatory field as expert witnesses in over 600 regulatory proceedings  
12         including numerous electric, gas, telephone, and water and sewer matters.

13  
14     **Q. Mr. Smith, please summarize your educational background.**

15     A. I received a Bachelor of Science degree in Business Administration (Accounting Major)  
16         with distinction from the University of Michigan - Dearborn, in April 1979. I passed all  
17         parts of the Certified Public Accountant ("C.P.A.") examination in my first sitting in 1979,  
18         received my CPA license in 1981, and received a certified financial planning certificate in  
19         1983. I also have a Master of Science in Taxation from Walsh College, 1981, and a law  
20         degree (J.D.) cum laude from Wayne State University, 1986. In addition, I have attended  
21         a variety of continuing education courses in conjunction with maintaining my accountancy  
22         license. I am a licensed C.P.A. and attorney in the State of Michigan. I am also a  
23         Certified Financial Planner™ professional and a Certified Rate of Return Analyst  
24         ("CRRRA"). Since 1981, I have been a member of the Michigan Association of Certified  
25         Public Accountants. I am also a member of the Michigan Bar Association and the Society  
26         of Utility and Regulatory Financial Analysts ("SURFA"). I have also been a member of

1 the American Bar Association (ABA), and the ABA sections on Public Utility Law and  
2 Taxation.

3  
4 **Q. Please summarize your professional experience.**

5 A. Subsequent to graduation from the University of Michigan, and after a short period of  
6 installing a computerized accounting system for a Southfield, Michigan realty  
7 management firm, I accepted a position as an auditor with the predecessor CPA firm to  
8 Larkin & Associates in July 1979. Before becoming involved in utility regulation where  
9 the majority of my time for the past 34 years has been spent, I performed audit,  
10 accounting, and tax work for a wide variety of businesses that were clients of the firm.

11 During my service in the regulatory section of our firm, I have been involved in  
12 rate cases and other regulatory matters concerning electric, gas, telephone, water, and  
13 sewer utility companies. My present work consists primarily of analyzing rate case and  
14 regulatory filings of public utility companies before various regulatory commissions, and,  
15 where appropriate, preparing testimony and schedules relating to the issues for  
16 presentation before these regulatory agencies.

17 I have performed work in the field of utility regulation on behalf of industry, state  
18 attorneys general, consumer groups, municipalities, and public service commission staffs  
19 concerning regulatory matters before regulatory agencies in Alabama, Alaska, Arizona,  
20 Arkansas, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Indiana, Illinois,  
21 Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota,  
22 Mississippi, Missouri, New Jersey, New Mexico, New York, Nevada, North Carolina,  
23 North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont,  
24 Virginia, Washington, Washington D.C., West Virginia and Canada as well as the Federal  
25 Energy Regulatory Commission and various state and federal courts of law.  
26

1 **Q. Have you prepared an attachment summarizing your educational background and**  
2 **regulatory experience?**

3 A. Yes. Attachment RCS-1 provides details concerning my experience and qualifications.  
4

5 **Q. On whose behalf are you appearing?**

6 A. I am appearing on behalf of the Residential Utility Consumer Office ("RUCO").  
7

8 **Q. Have you previously testified before the Arizona Corporation Commission?**

9 A. Yes. I have previously testified before the Commission on a number of occasions. As  
10 illustrative examples, in 2000, I filed testimony on behalf of the Commission Utilities  
11 Division Staff in Docket No. T-1051B-99-0497, involving the merger of the parent  
12 companies of Qwest Communications Corporation, LCI International Telecom Corp. and  
13 U.S. West Communications, Inc. I testified before the Commission in Docket No. E-  
14 01345A-06-0009, involving an emergency rate increase request by Arizona Public Service  
15 Company ("APS" or "Company"), APS' Docket Nos. E-01345A-05-0816, E-01345A-05-  
16 0826 and E-01345A-05-0827, concerning proceedings involving APS base rates and other  
17 matters, Docket No. E-01345A-08-0172, concerning an emergency rate increase and  
18 general rate case request and the most recent APS case, Docket No. E-01345A-11-0224. I  
19 also testified before the Commission in UNS Gas, Inc. rate cases, Docket Nos. G-04204A-  
20 11-0158, G-04204A-08-0571, G-04204A-06-0463, G-04204A-06-0013 and G-04204A-  
21 05-0831, and in UNS Electric, Inc. rate cases Docket No. E-04204A-06-0783 and E-  
22 04204A-12-0504, as well as Southwest Gas Corporation rate cases, G-01551A-07-0504  
23 and G-01551A-10-0458. I testified before the Commission in the Arizona-American  
24 Water Company in Docket Nos. W-01303A-09-0343 and SW-01303A-09-0343. I have  
25 also presented testimony in Tucson Electric Power Company rate cases, Docket Nos. E-  
26 01933A-07-0402 and E-01933A-12-0291, among others.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

**Q. What is the purpose of the testimony you are presenting?**

A. The purpose of my testimony is to address the proposed acquisition of UNS Energy by Fortis, Inc.

**Q. Which Arizona public utilities are involved in the proposed merger?**

A. The proposed merger of Fortis and UNS involves these UNS utility subsidiaries:  
Tucson Electric Power Company ("TEP")  
UNS Electric, Inc. ("UNSE")  
UNS Gas, Inc. ("UNSG")

**Q. What information did you review in conducting your analysis?**

A. I reviewed the Joint Notice of Intent to Reorganize, the direct testimony of UNS Energy and Fortis, responses to data requests, UNS Energy's confidential and competitively sensitive "due diligence" documentation, the Fortis confidential and competitively sensitive "due diligence" documentation, and public information.

**Q. Have you prepared any attachments to be filed with your testimony?**

A. Yes. Attachments RCS-1 through RCS-7 contain additional background and qualifications information and copies of selected documents that are referenced in my testimony.

**Q. Please briefly explain what is included in each of those attachments.**

A. Attachment RCS-1 contains additional information on my Background and Qualifications.  
Attachment RCS-2 presents the pre- and post-merger corporate organizational charts that were presented by Joint Applicants as Exhibit 2 to their application.

1            Attachment RCS-3 presents a corporate organizational chart for Fortis, Inc. (as of  
2            February 2014).

3            Attachment RCS-4 presents some illustrative news articles about the current status  
4            of an acquisition of a former Texas utility, TXU, by a buyout group that had included  
5            KKR & Co. L.P. ("KKR" aka Kohlberg Kravis Roberts, an investment firm that had been  
6            part of the consortium that had previously attempted to acquire UNS Energy in 2005), and  
7            some new articles about high profile Goodwill impairment write-offs that have occurred  
8            after other acquisition/merger transactions.

9            Attachment RCS-5 contains copies of UNS Energy and Fortis' non-confidential  
10           responses to data requests and other non-confidential material referenced in testimony.

11           Attachment RCS-6 contains selected Confidential material that is referenced in my  
12           testimony.

13           Attachment RCS-7 contains two pages of information from UNS Energy  
14           Confidential and Competitively Sensitive "due diligence" material referenced in  
15           testimony.

16  
17           **Q.    You mentioned UNS Energy and Fortis "due diligence" materials. Can you please**  
18           **briefly explain what the "due diligence" materials are?**

19           A.    Yes. In a major acquisition transaction, such as this one, both the seller (in this case UNS  
20           Energy) and the buyer (in this case Fortis) prior to entering into a formal acquisition and  
21           merger agreement, will engage in detailed investigations to help ensure, from the seller's  
22           perspective, that it is getting a fair price for the stock sale, and, from the buyer's  
23           perspective, that it has a sufficiently detailed understanding of the company that it is  
24           buying, including the condition of the system and the operating environment, as well as  
25           risk factors that may be present. These investigations by the seller and buyer are  
26           commonly referred to as "due diligence." Typically, the investigations include advice

1 from investment banking firms/financial advisors, as well as legal, engineering,  
2 accounting, operational and technical advisors.

3  
4 **II. SUMMARY OF TESTIMONY AND CONCLUSIONS**

5 **Q. Please summarize your testimony and conclusions.**

6 A. The proposed transaction entails risks to ratepayers of the Arizona Utilities that should be  
7 mitigated by imposing some additional conditions on the proposed transaction and  
8 tightening up, via use of improved specific enforceable language, some of the  
9 commitments that are being offered by the Joint Applicants. Additionally, a provision for  
10 specific tangible ratepayer benefits should be included in the conditions to be imposed on  
11 the proposed transaction.

12  
13 **Q. Please summarize your recommended additional conditions that should be imposed**  
14 **on the proposed transaction to prevent harm to Arizona ratepayers and provide for**  
15 **specific tangible benefits.**

16 A. My recommended additional conditions and tightening up of the conditions proposed by  
17 Joint Applicants include these additions to the conditions proposed by the Joint  
18 Applicants:

- 19 • Fortis and UNS Energy agree to provide economic customer benefit adjustments  
20 totaling \$59 million.<sup>1</sup> These benefits will include both immediate and long term  
21 benefits. RUCO is still working on defining these benefits and will either supplement  
22 this testimony or provide details of the nature of the benefits in its surrebuttal case.  
23 This amount is based on UNS being larger than Central Hudson and Central Hudson  
24 received the equivalent of \$49 million in customer benefits.
- 25 • In the event that Fortis completes any additional mergers or acquisitions within the  
26 United States before the Commission adopts an order approving new base rates for  
27 TEP, Fortis must share the follow-on merger savings that are reasonably applicable

---

<sup>1</sup> This compares with \$44.25 million (\$9.25 million plus \$35 million) of ratepayer benefits guaranteed by Fortis in its acquisition of the Central Hudson utilities in New York, and \$5 million for a Community Benefit Fund for economic development and low income purposes for that Central Hudson acquisition. See, e.g., RUCO Fortis 1.04 Attachment A, UNS (0011) 001819-1820, included in Attachment RCS-5.

1 to TEP, UNS Electric and UNS Gas and their customers between shareholders and  
2 ratepayers, on a 50/50 basis, to the extent the portions of such savings realized by  
3 Fortis are material (i.e., 5 percent or more of TEP, UNS Electric and UNS Gas net  
4 income on an after-tax basis). UNS Energy must submit, within 90 days of the  
5 follow-on merger closing, a comprehensive and detailed proposal to share the follow-  
6 on merger savings, to begin on the closing date of the follow-on merger. In addition,  
7 the proposal must include an allocation method for sharing the synergy savings and  
8 efficiency gains among corporate entities that addresses the time period from the  
9 receipt of the synergy savings by TEP, UNS Electric and UNS Gas until the  
10 Commission approves new rates. The ratepayer share shall be set aside in a deferral  
11 account for future Commission disposition.<sup>2</sup>

- 12 • Fortis and UNS Energy agree and commit that none of the shareholder litigation costs  
13 shall be borne by the ratepayers of TEP, UNS Electric or UNS Gas.<sup>3</sup>
- 14 • Fortis and UNS Energy agree and commit that all Change of Control costs and  
15 Retention Bonus costs are transaction costs and none of those costs shall be borne by  
16 the ratepayers of TEP, UNS Electric or UNS Gas.<sup>4</sup> None of the transaction costs  
17 related to this acquisition and merger shall be borne by the ratepayers of TEP, UNS  
18 Electric or UNS Gas.
- 19 • Fortis and UNS Energy agree and commit that all benefits of the plans to sell coal to  
20 third parties for treatment to generate Internal Revenue Code §45 credits and to buy-  
21 back treated coal for burn at Springerville 1 and 2 (and at any other TEP coal-fired  
22 generating plants where such arrangements are established) will be passed onto TEP  
23 ratepayers through the PPFAC as described in the response to RUCO UNS 2.07.<sup>5</sup>
- 24 • Fortis and UNS Energy shall report to the Commission within five business days any  
25 changes in the credit ratings of Fortis, Inc., UNS Energy, TEP, UNS Electric or UNS  
26 Gas.

27  
28 **Q. Does your testimony address the ultimate question of whether the proposed**  
29 **transaction is in the public interest?**

30 **A. No. RUCO witness Lon Huber is presenting RUCO's position concerning whether the**  
31 **proposed transaction is in the public interest.**

32  

---

<sup>2</sup> This is similar to the provision for Follow-On Merger Savings that Fortis committed to in its acquisition of the Central Hudson utilities in New York. See, e.g., RUCO Fortis 1.04 Attachment A, page UNS (0011) 001816, included in Attachment RCS-5.

<sup>3</sup> See, e.g., Response to RUCO Fortis 2.09, a copy of which is included in Attachment RCS-5.

<sup>4</sup> See, e.g., Responses to RUCO Fortis 2.32, 2.11 and 2.02 and RUCO UNS 1.04, copies of which is included in Attachment RCS-6.

<sup>5</sup> A copy of the response to RUCO UNS 2.07 is included in Attachment RCS-5.

1 **III. OVERVIEW OF THE PROPOSED ACQUISITION AND MERGER**

2 **Q. Please provide a brief overview of the proposed acquisition and merger.**

3 A. UNS Energy Corporation ("UNS Energy"), pursuant to A.A.C. R14-2-803, on behalf of  
4 itself and its affiliates UniSource Energy Services ("UES"), Tucson Electric Power  
5 Company ("TEP"), UNS Electric, Inc. ("UNS Electric" or "UNSE") and UNS Gas, Inc.  
6 ("UNS Gas" or "UNSG") (TEP, UNS Electric and UNS Gas are referred to collectively as  
7 the "Arizona Utilities"), and Fortis Inc. ("Fortis"), on behalf of itself and its affiliates,  
8 FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia"), a wholly owned  
9 subsidiary of Fortis, FortisUS Inc. ("FortisUS"), a wholly-owned subsidiary of FortisUS  
10 Nova Scotia, and Color Acquisition Sub Inc. ("Color Acquisition"), a wholly-owned  
11 subsidiary of FortisUS, have submitted in this docket their Joint Notice of Intent to  
12 Reorganize. On December 11, 2013, UNS Energy, Fortis, FortisUS and Color Acquisition  
13 entered into an Agreement and Plan of Merger ("Merger Agreement") as described UNS  
14 Energy's December 12, 2013 Form 8-K, and the related Merger Agreement. Pursuant to  
15 the Merger Agreement, and subject to various conditions such as shareholder and  
16 regulatory approvals, including approval by the Arizona Corporation Commission  
17 ("Commission"), Color Acquisition will merge with UNS Energy. UNS Energy will be the  
18 surviving entity, becoming a wholly-owned subsidiary of FortisUS with Fortis as its  
19 ultimate parent. In effect, UNS Energy's existing shareholders will be replaced by  
20 FortisUS as the sole shareholder. Direct ownership of UNS Energy's affiliates, including  
21 the Arizona Utilities, will remain at UNS Energy and thus, will not be changed by the  
22 merger.

23  
24 **Q. What benefits are claimed by the Joint Applicants?**

25 A. Pages 7-8 of the Joint Application claim the following benefits:

26 In light of the increasing challenges that face all electric utilities and will  
27 prove particularly daunting for smaller companies, UNS Energy and Fortis

1 believe that the merger will produce important benefits for the Arizona  
2 Utilities' customers, their employees and the communities they serve.  
3 Those benefits include, but are not limited to, the following:

4 (i) **The ability to continue to provide safe, reliable and adequate**  
5 **service.** The merger will financially strengthen UNS Energy and the  
6 Arizona Utilities so as to enhance their ability to provide safe and reliable  
7 service, especially in an increasingly challenging and capital intensive  
8 environment.

9 (ii) **Infusion of equity capital into Arizona entities.** Upon closing of the  
10 merger, Fortis has agreed to immediately inject \$200 million of equity  
11 capital into UNS Energy for the benefit of UNS Energy and the Arizona  
12 Utilities, thereby further strengthening their financial position.

13 On an on-going basis and consistent with established utility regulation, it is  
14 the practice of Fortis to inject equity into its regulated utility subsidiaries,  
15 when required, to maintain a capital structure consistent with that which is  
16 reflected in the regulated utility's customer rates and to support the  
17 regulated utility's credit ratings.

18 (iii) **Improved access to the capital markets on fair and reasonable**  
19 **terms.** UNS Energy and Fortis believe that Fortis' financial status and  
20 access to capital markets will improve the Arizona Utilities' ability to  
21 obtain sufficient capital to meet their needs. For example, any credit rating  
22 improvements should result in better access to debt capital at lower cost.

23 (iv) **The commitment to continue the current union contracts,**  
24 **employee levels and employee benefits.** As described in Part III below,  
25 the parties have committed to maintain existing employee levels at the  
26 Arizona Utilities and employee benefits for a period of at least two years  
27 after the conclusion of the merger. Moreover, the parties will continue to  
28 perform under the existing collective bargaining agreements for the  
29 Arizona Utilities. All future decisions on staffing, employment practices  
30 and labor relations at the Arizona Utilities will continue to be made by  
31 local management of the Arizona Utilities.

32 (v) **The commitment to keep UNS Energy an Arizona-based and**  
33 **operated company.** The parties have committed to retain UNS Energy's  
34 senior management, to maintain UNS Energy's headquarters in Tucson,  
35 Arizona, and to sustain UNS Energy's contributions to charitable and  
36 community programs. The parties also have committed to retain four  
37 members of the existing UNS Energy board of directors who are acceptable  
38 to FortisUS at the time of closing the merger, provided that one such  
39 designee shall be UNS Energy's Chief Executive Officer. In addition, as  
40 described in Part III below, no later than one year after closing of the  
41 merger, FortisUS shall have appointed a board of directors for UNS Energy  
42 and the Arizona Utilities, the majority of whom will be independent, with  
43 the majority of such independent directors being residents of the State of

1 Arizona, and with emphasis on selecting candidates who reside, conduct  
2 business or work within the Arizona Utilities' service territories.

3 **Q. Are the first three claimed benefits all related to a claim by Joint Applicants that the**  
4 **financial strength would be improved?**

5 A. Essentially, yes.  
6

7 **Q. Is it guaranteed that the Arizona Utilities' financial strength would improve under**  
8 **Fortis' ownership?**

9 A. No. The Arizona Utilities have exhibited the ability to obtain sufficient capital to meet  
10 their needs in recent years, and have improved their capital structure and bond ratings  
11 without needing to be acquired. Additionally, while any credit rating improvements  
12 should result in better access to debt capital at lower cost, there is also no guarantee that  
13 credit ratings would improve under Fortis' ownership. The claim that the Arizona  
14 Utilities' financial strength would improve is an expectation not a guarantee.  
15

16 **Q. The second claimed benefit is that Fortis would inject \$200 million of equity into**  
17 **UNS Energy, and would employ the practice of Fortis to inject equity into its**  
18 **regulated utility subsidiaries, when required, to maintain a capital structure**  
19 **consistent with that which is reflected in the regulated utility's customer rates and to**  
20 **support the regulated utility's credit ratings. Is that a benefit?**

21 A. Yes, however, the benefit of the \$200 million of Fortis equity injection needs to be viewed  
22 in context, and balanced with the risks of creating a very large amount of Goodwill that  
23 would result from the transaction.<sup>6</sup> Goodwill represents the excess, at the dates of  
24 acquisition, of the purchase price over the fair value of the net tangible and identifiable  
25 intangible assets acquired and liabilities assumed relating to business acquisitions.

---

<sup>6</sup>Estimated Goodwill provided in response to data request RUCO Fortis 2.05 is US \$1.407 billion (C \$1.496 billion). The initial Goodwill amount is therefore approximately seven times the size of the initial Fortis equity injection of \$200 million noted above.

1 Goodwill is carried at initial cost less any write-down for impairment. Goodwill is  
2 basically an intangible asset that arises as a result of the acquisition of one company by  
3 another for a premium value. Goodwill is usually recorded on the acquiring company's  
4 balance sheet and is considered an intangible asset because it is not a physical asset like  
5 buildings or equipment. The equity injection amount is relatively small compared to the  
6 amount of Goodwill that Fortis is projected to record as a result of the acquisition.  
7 Additionally, the injection of \$200 million may be returned to Fortis in the form of  
8 dividends and inter-company interest within a relatively short time frame after assuming  
9 ownership, such as 2.5 to 3 years. Also, it appears that [BEGIN CONFIDENTIAL] [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 [REDACTED]<sup>7</sup> [END CONFIDENTIAL]

13  
14 **Q. In recent years has UNS Energy been able to maintain a capital structure for the**  
15 **Arizona Utilities which supported their credit ratings?**

16 **A.** Yes. As reflected in the most recent rate applications of TEP, UNS Electric and UNS Gas  
17 a capital structure consistent with that which is reflected in the regulated utility's customer  
18 rates has been used, and those capital structures have supported the regulated utility's  
19 credit ratings. That has been done without having foreign ownership.

20  
21 **Q. Can the creation of a large amount of Goodwill present risks even if there is not an**  
22 **attempt to recover the Goodwill directly from ratepayers?**

23 **A.** Yes. Large amounts of Goodwill which are intangibles assets that do not earn a return and  
24 which are not amortized can present a challenge for the acquiring company's management  
25 in a number of respects. Goodwill is not used or useful in the provision of utility service.

<sup>7</sup> [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL]

1 Having large amounts of such assets on the books also requires the acquiring company to  
2 finance those assets by having long term capital sources such as debt and equity on the  
3 liabilities and shareholder equity side of its balance sheet. Having large amounts of non-  
4 earning assets on a company's balance can put pressure on earnings per share. Goodwill is  
5 also subject to periodic impairment testing. Impairments of Goodwill can result in large  
6 losses and can lead to reductions to recorded amounts of equity capital.<sup>8</sup> I discuss the  
7 Joint Applicants proposed safeguards relating to Goodwill in additional detail in a  
8 subsequent section of my testimony.

9  
10 **Q. Are the fourth and fifth items benefits that would result from the proposed**  
11 **transaction?**

12 **A.** No. Without the proposed acquisition, there is no indication that UNS Energy would fail  
13 to maintain existing employee levels at the Arizona Utilities and employee benefits for a  
14 period of at least two years, or honor existing union contracts, or have Arizona-based  
15 management making decisions about staffing. Additionally, there is no indication that  
16 without the proposed acquisition, UNS Energy's senior management would fail to be  
17 maintained, UNS Energy's headquarters would not be maintained in Tucson, Arizona, or  
18 that UNS Energy's contributions to charitable and community programs would not be  
19 sustained. Consequently, these items are more the nature of maintaining the status quo  
20 that would exist without the proposed transaction.

21  
22 **Q. Are there risks that Fortis' access to long term capital at reasonable costs could be**  
23 **impaired?**

---

<sup>8</sup> As some illustrative examples, Qwest recognized a Goodwill impairment loss of approximately \$41 billion subsequent to acquiring U.S. West. AOL had a Goodwill impairment loss of approximately \$54 billion after acquiring Time Warner. Other companies which have acquired utilities, such as Scottish Power which had acquired PacifiCorp and Thames Water which had acquired American Water Works, have also experienced substantial amounts of Goodwill impairment write-downs subsequent to those acquisitions.

1 A. Yes. For example, as described at page 47 of the Fortis Inc. 2013 Annual Report:

2 The Corporation's financial position could be adversely affected if it and/or  
3 its larger subsidiaries fail to arrange sufficient and cost-effective financing  
4 to fund, among other things, capital expenditures and the repayment of  
5 maturing debt. The ability to arrange sufficient and cost-effective financing  
6 is subject to numerous factors, including the results of operations and  
7 financial position of the Corporation and its subsidiaries; the regulatory  
8 environment in which the utilities operate and the nature and outcome of  
9 regulatory decisions regarding capital structure and allowed ROEs;  
10 conditions in the capital and bank credit markets; ratings assigned by credit  
11 rating agencies; and general economic conditions. Funds generated from  
12 operations after payment of expected expenses, including interest payments  
13 on any outstanding debt, may not be sufficient to fund the repayment of all  
14 outstanding liabilities when due and anticipated capital expenditures. There  
15 can be no assurance that sufficient capital will continue to be available on  
16 acceptable terms to fund capital expenditures and repay existing debt.

17  
18 **Q. Is Fortis also subject to foreign currency risks in a way that UNS Energy currently is  
19 not?**

20 A. Yes. Fluctuations in exchange rates between the Canadian Dollar and other currencies are  
21 a risk affecting Fortis. Fluctuations in the exchange rate between the U.S. and Canadian  
22 dollar will have a more significant impact on Fortis if the proposed transaction is  
23 consummated. The acquisition of UNS Energy will heighten the degree of exchange rate  
24 risk. As described on page 45 of the Fortis, Inc., 2013 Annual Report:

25 Fortis is exposed to foreign exchange risk associated with the acquisition of  
26 UNS Energy as the cash consideration for the acquisition is required to be  
27 paid in US dollars, while funds raised in the Debenture offering, which will  
28 constitute a significant portion of the funds used to finance the acquisition,  
29 are denominated in Canadian dollars. As a result, increases in the US  
30 dollar-to-Canadian dollar exchange rate prior to payment of the Final  
31 Installment will increase the purchase price translated in Canadian dollars,  
32 and thereby reduce the proportion of the purchase price for the acquisition  
33 ultimately obtained by Fortis under the Debenture offering. In addition, the  
34 operations of UNS Energy are conducted in US dollars and, following the  
35 acquisition, the consolidated earnings and cash flows of Fortis will be  
36 impacted to a greater extent by fluctuations in the US dollar-to-Canadian  
37 dollar exchange rate.

1 **Q. What cost savings are anticipated as a result of the proposed transaction?**

2 A. The response to UDR 1.36 states that anticipated cost savings include reduced or  
3 eliminated public company costs, reduced insurance costs, and a potentially lower cost of  
4 debt as the result of anticipated credit rating upgrades.

5  
6 **Omissions from Presentation of Post-Merger Corporate Organizational Structure**

7 **Q. Were organizational charts provided by the Joint Applicants?**

8 A. Yes. Joint Applicants provided pre-merger and post-merger corporate organizational  
9 charts in Exhibit 2 to their application. Those corporate organizational charts are  
10 reproduced for ease of reference in Attachment RCS-2.

11  
12 **Q. Do the organizational charts presented by Joint Applicants appear to provide a  
13 complete depiction of the post-merger corporate structuring including disclosure of  
14 the Fortis subsidiaries that are proposed to be used to finance the acquisition?**

15 A. No. Attachment RCS-3 shows a corporate organizational chart for Fortis, Inc. as of  
16 February 2014. Shown on that Fortis, Inc. organizational chart is an entity,  
17 NewfoundlandEnergy Luxembourg S.à.r.l ("Luxembourg" or "Luxembourg conduit") that  
18 appears to be a key component in the financing arrangement being used by Fortis;  
19 however, there is no disclosure of this Luxembourg conduit entity or its role in the  
20 financing arrangement in Exhibit 2 in the Joint Application (or anywhere else in the Joint  
21 Application or in Joint Applicant's testimony).

22  
23 **IV. STANDARD OF REVIEW**

24 **Q. Where do the Joint Applicants recognize that their proposed merger is subject to the  
25 approval of the Arizona Corporation Commission?**

1 A. The Applicants' "Joint Notice of Proposed Merger" requests that the Commission issue an  
2 order approving the merger. In that Joint Notice, Applicants recognize that, pursuant to  
3 A.A.C. R14-2-803, their proposed merger is subject to the Commission's approval.

4  
5 **Q. What does A.A.C. R14-2-803(C) state regarding the Commission approval or**  
6 **rejection of a notice of intent to reorganize?**

7 A. A.A.C. R14-2-803(C) states that: "At the conclusion of any hearing on the organization or  
8 reorganization of a utility holding company, the Commission may reject the proposal if it  
9 determines that it would impair the financial status of the public utility, otherwise prevent  
10 it from attracting capital at fair and reasonable terms, or impair the ability of the public  
11 utility to provide safe, reasonable and adequate service."

12  
13 **Q. Is the Standard of Review for a proposed merger limited to the statements in A.A.C.**  
14 **R14-2-803(C)?**

15 A. This is obviously a legal matter for the Commission to determine; however, the  
16 Commission has previously concluded in its January 4, 2005 Decision No. 67454 in  
17 Docket No. E-04230A-03-0933<sup>9</sup> at page 49 that:

18 5. Pursuant to the Arizona Constitution and A.R. S. Title 40 generally, the  
19 Commission is required to act in the "public interest" and must consider all  
20 of the evidence available in determining the "public interest".

21 6. The public interest requires that the Commission apply the Affiliated  
22 Interest Rues in a manner that will maximize protection to ratepayers.

23 7. Utility ratepayers should not be required to bear the burden of risk  
24 resulting from holding company structure or diversification.

25 8. The factors set out in A.A.C. R14-2-803(C) are only a part of the "public  
26 interest" inquiry that the Commission must make as part of its  
27 consideration of the proposed transaction.

28

---

<sup>9</sup> UniSource Energy's previous attempt to sell itself which was unsuccessful and will be discussed in more detail below.

1 **Q. Is additional guidance on the Standard of Review provided in Decision No. 67454?**

2 A. Yes. The following discussion is presented at pages 20-21 of Decision No. 67454:

3  
4 Standard of Review

5 Staff states that the Arizona Constitution vests the Commission with a duty  
6 to consider and act in the interest of the public. Article 15 § 3 of the  
7 Constitution gives the Commission the power "to make and enforce  
8 reasonable rules, regulations, and orders for the convenience, comfort, and  
9 safety, and the preservation of the health, of the employees and patrons of  
10 [public service corporations]." Staff asserts the Commission must not only  
11 consider, but act, in the public interest. *James P. Paul Water Co. v Arizona*  
12 *Corporation Commission*, 137 Ariz. 426, 429, 671 P.2d 404, 407 (1983)  
13 and *Arizona Corporation Commission v. Woods*, 171 Ariz. 286, 296, 830  
14 P.2d 807, 818 (1992). Further, determining the public interest involves a  
15 broad consideration of all the evidence presented. *Pueblo Del Sol Water*  
16 *Co. v. Arizona Corporation Commission*, 160 Ariz. 285, 286, 772 P.2d  
17 1138, 1139 (App. 1989).

18 Staff asserts that as part of its public interest analysis, the Commission may  
19 appropriately consider all applicable statutes and rules, which in the matter  
20 at hand includes A.A.C. R14-2-803 of the Affiliated Interest Rules. Staff  
21 argues, however, that this Rule does not limit the Commission's review to  
22 the three listed factors in subsection (C). Staff suggests that an appropriate  
23 view of the Rule is one that considers the language set forth in subsection  
24 (C) as examples of when this type of transaction can be found to be not in  
25 the public interest.

26 Considering the great deference courts have granted the Commission  
27 pursuant to its ratemaking authority, coupled with clear authority over  
28 "Affiliated Interest" matters, Staff argues the Commission must be free to  
29 act in the furtherance of its constitutional duty. Staff argues it would be  
30 counter to that duty for the Commission to construct a rule that would act  
31 to obstruct the broad constitutional duty to take any action necessary in the  
32 furtherance of proper ratemaking. Thus, Staff advances, Rule 803(C) must  
33 be interpreted consistent with the Constitution, and to interpret Rule 803(C)  
34 as a limit on the review of the public interest would obstruct the  
35 Commission's constitutional duty. Staff questions whether an interpretation  
36 of Rule 803(C) that would limit the "public interest" to the three areas  
37 spelled out would render the Commission powerless to protect against a  
38 merger that could potentially harm the health or safety of Arizonans if the  
39 harm was not directly tied to the regulated utilities' provision of service.  
40 Staff asserts Rule 803 is designed to highlight particularly problematic  
41 areas that the Commission should include in its consideration of the public  
42 interest.

1 Staff further notes that in Decision No. 56844 (March 14, 1990), the  
2 Decision adopting the Affiliated Interest Rules, the Commission made no  
3 indication that these rules were intended to supersede or replace the  
4 Commission's constitutional charge. Decision No. 56844 states the  
5 Affiliated Interest Rules are "designed to insure that utility ratepayers are  
6 insulated from the dangers proven to be inherent in holding structure and  
7 diversification." (Attachment B, at 2) The Decision provides that the Rules'  
8 purpose is to provide specific additional protections to ratepayers, which  
9 demonstrate the Commission's intent that they enhance, rather than limit,  
10 the public interest analysis.

11 Staff submits that without conditions, the Application clearly fails AAC  
12 R14-2-803(C) and is not in the public interest. Staff believes its proposed  
13 conditions, as set forth in Exhibit C attached hereto, are necessary to  
14 mitigate potential detriments from the proposed Merger. Even with its  
15 recommended conditions, Staff was unable to identify any benefits to  
16 consumers from the proposed Merger.

17 Staff states that benefits are not inherent requirements for finding a  
18 transaction in the public interest, but that in this matter there are so many  
19 potential risks and unknowns, that without benefits it is difficult for Staff to  
20 state that the matter is in the public interest. Even with the adoption of all  
21 of Staff's recommended conditions, in the absence of benefits to customers,  
22 Staff is neutral regarding approval of the transaction.

23

24 **Q. What do you conclude from this guidance?**

25 A. I conclude that the Standard for Review is to examine whether a proposed transaction is in  
26 the "public interest" and the Commission's review must consider all of the evidence  
27 available in determining the "public interest" and apply the Affiliated Interest Rules in a  
28 manner that will maximize protection to ratepayers.

29

30 **V. PREVIOUS ATTEMPT TO SELL UNISOURCE ENERGY**

31 **Q. Does the present application represent the first attempt to sell UniSource Energy in  
32 recent years?**

33 A. No. In 2004, in Docket No. E-04230A-03-0933, a proposed sale of UniSource Energy to  
34 Saguaro Acquisition Corporation ("Saguaro") was presented to the Commission for  
35 approval. The proposed Saguaro acquisition involved a consortium of investment firms,

1 including KKR, J.P. Morgan Partners ("JPMP") and Wachovia Capital Partners ("WCP"),  
2 and was purported to provide a tangible benefit to Arizona ratepayers.

3  
4 **Q. Was that application to sell UniSource Energy approved by the Commission?**

5 A. No, it was not. In 2004, the Commission denied the proposed merger of UniSource  
6 Energy, after determining that the risks of that proposed transaction outweighed the  
7 proposed benefits, and concluding that proposed transaction was not in the public interest.

8  
9 **Q. Was a subsequent acquisition consummated by a leveraged buyout group of another**  
10 **utility operating in the Southwest U.S.?**

11 A. Yes. An investment group including KKR and others acquired the Texas electric utility  
12 formerly known as TXU Energy in 2007. Under the new ownership, the company was  
13 renamed Energy Future Holdings Corp. ("EFH").

14  
15 **Q. What are the electric industry components of EFH, and which are regulated public**  
16 **utilities?**

17 A. EFH is the largest power-plant owner in Texas. Its units include Oncor Electric Delivery  
18 Co. ("Oncor"), the regulated business that delivers electricity to more than 3 million  
19 homes and businesses; TXU Energy, a retail electricity seller; and Luminant, which owns  
20 more than 15,400 megawatts of generation capacity in Texas.

21  
22 **Q. Has that acquisition subsequently run into difficulties?**

23 A. Yes. As reported in recent news articles<sup>10</sup>, Energy Future appears to be marching toward  
24 the largest leveraged-buyout bankruptcy in history and is in jeopardy of deteriorating into  
25 a free-for-all among Wall Street titans ranging from KKR & Co. to Centerbridge Capital

---

<sup>10</sup> See, e.g., illustrative recent news articles, included in Attachment RCS-4.

1 Partners LP and Apollo Global Management LLC. Doubts have been raised about Energy  
2 Future's ability to remain a going concern, which could trigger a default on approximately  
3 \$45 billion of debt. As noted in recent news articles<sup>11</sup>:

4 The clock is ticking for Dallas-based EFH because the company skipped a  
5 \$109 million interest payment that was due April 1, giving the company  
6 until April 30 to reach a pre-packaged bankruptcy or face the wrath of  
7 scorned creditors.<sup>12</sup>

8 ...

9 KKR, Goldman Sachs Capital Partners and TPG Capital bought out the  
10 former TXU Corp. in 2007 with tens of billions in borrowed dollars,  
11 hoping that the deregulated electricity market, high power prices and steady  
12 growth would prove a winning investment. But falling natural gas prices  
13 led to lower electricity prices, eroding EFH's ability to generate enough  
14 money to pay down the loans.

15 It now owes about \$45 billion in debt. EFH owns about 80 percent of  
16 Oncor, having sold the rest shortly after the buyout to raise cash.

17 ...

18 EFH, now in a 30-day grace period of a missed interest payment that was  
19 due April 1, is widely expected to file a Chapter 11 bankruptcy petition this  
20 month.<sup>13</sup>

21  
22 **Q. Do you think that the proposed Fortis acquisition of UNS Energy represents the**  
23 **same risks as the previously proposed KKR-led buyout of UNS Energy which was**  
24 **rejected by the Commission in 2004, or of the KKR-led acquisition of EFH?**

25 **A.** No. The subsequent events related to the KKR-led acquisition of EFH highlight some of  
26 the risks related to a large acquisition, including the dangers of using excessive debt  
27 leverage in the transaction. The generation business of EFH operates in a  
28 deregulated/competitive market, unlike the Arizona electric utilities of UNS Energy, each  
29 of which have cost-based base rates, which include the costs related to electric generation  
30 plant. The proposed Fortis acquisition of UNS Energy is not being structured as a

---

<sup>11</sup> Id.

<sup>12</sup> Apr. 17, 2014, Star-Telegram.

<sup>13</sup> Apr 14, 2014, Dallas Business Journal, Morning Edition.

1 leveraged buyout. Fortis has proposed to utilize a financing arrangement which appears to  
2 be less leveraged and more conducive to financing a regulated utility operation, although  
3 there are some concerns, which I will articulate in additional detail in a subsequent section  
4 of my testimony, about Fortis' intended use of inter-company debt and a Luxembourg  
5 conduit entity as part of its anticipated financing. In view of the serious financial  
6 problems developing at EFH after its leveraged buyout, the Commission's rejection of the  
7 previously proposed attempt to sell UNS Energy, which helped avoid such problems from  
8 affecting UNS Energy and its Arizona utilities, certainly appears to have protected the  
9 public interest.

10  
11 **VI. FORTIS' ACQUISITION OF OTHER U.S. UTILITIES**

12 **Q. Is the proposed acquisition of UNS Energy by Fortis the first attempted acquisition**  
13 **of a regulated utility in the United States by Fortis?**

14 **A.** No. The proposed acquisition of UNS Energy appears to be the third attempted  
15 acquisition of a regulated utility (or its holding company) located in the United States by  
16 Fortis.

17 In 2012, Fortis attempted to acquire Central Vermont Public Service Corporation;  
18 however, that acquisition attempt by Fortis was ultimately unsuccessful.<sup>14</sup>

19 In 2013, Fortis was successful in acquiring CH Energy, the holding company for  
20 Central Hudson Gas & Electric Corporation ("Central Hudson"), a gas and electric utility  
21 serving approximately 376,000 customers in New York State.

22  
23 **Q. Have you reviewed some of the materials related to Fortis' acquisition of Central**  
24 **Hudson?**

---

<sup>14</sup> Central Vermont was ultimately acquired by another company, Gaz Metro, and was subsequently merged with another Vermont electric utility, Green Mountain Power Company.

1 A. Yes. I reviewed some of the publicly available materials related to Fortis' acquisition of  
2 CH Energy, including the New York Public Service Commission's orders dated June 26,  
3 2013 and November 26, 2013 in NYPSC Case No. 12-M-0192, which address that  
4 acquisition and merger.

5  
6 **Q. Were provisions to protect ratepayers from harm and for providing specific tangible**  
7 **benefits to ratepayers imposed upon Fortis' acquisition of CH Energy?**

8 A. Yes. A copy of the portions of the NYPSC Order in Case No. 12-M-0192 listing the  
9 conditions that were imposed upon Fortis' acquisition of CH Energy is presented in  
10 Appendix RCS-5.

11  
12 **Q. What specific conditions to provide for specific tangible ratepayer benefits were**  
13 **provided for in that acquisition?**

14 A. As shown in the response to RUCO Fortis 1.04 Attachment A (a copy of which is included  
15 in Attachment RCS-5) the Central Hudson conditions included the following specific  
16 tangible ratepayer benefits:

17 10. Economic Benefits, Including Synergies and Positive Benefit  
18 Adjustments

19 Fortis and Central Hudson have agreed to provide quantified economic  
20 benefits comprised of the following synergy and positive benefit  
21 adjustments: (i) synergy savings which are guaranteed for a period of 5  
22 years and which will provide for future rate mitigation of \$9.25 million  
23 over the 5 years; (ii) a total of \$35 million of combined write-offs of  
24 deferred regulatory assets and future rate mitigation funds; and, (iii) one-  
25 time funding of \$5 million for a Community Benefit Fund for economic  
26 development and low income purposes.

27 a) Synergy Savings/Guaranteed Rate Reductions

28 The Signatories have agreed that the transaction will produce synergy  
29 savings/guaranteed future rate mitigation totaling \$9.25 million (\$1.85  
30 million/year for 5 years). Petitioners have agreed to guarantee these cost  
31 savings for a period of five years, and will begin accruing these guaranteed  
32 cost savings in the month following closing. The Signatories recognize that

1 this accrual will provide rate mitigation for the benefit of customers that  
2 will be available at the start of the first rate year in the next rate case filed  
3 by Central Hudson. The Signatories anticipate that the forecast effect of the  
4 synergy cost savings will also be reflected in rates in Central Hudson's next  
5 rate case.

6 b) Deferred Storm Restoration Cost Write-offs and Future Rate Mitigation

7 A total of \$35 million will be provided to Central Hudson by Fortis upon  
8 the closing of the transaction and will be recorded as a regulatory liability  
9 to be applied to write off regulatory assets on the books of Central Hudson  
10 due to storm restoration costs and to provide balance sheet offsets and rate  
11 mitigation in Central Hudson's next rate filing.

12 i) Storm Restoration Cost Write-offs

13 Central Hudson currently has two storm restoration cost deferral petitions  
14 pending before the Commission in Cases 11-E-0651 (\$11.0 million  
15 exclusive of carrying charges) and 12-M-0204 (\$1.6 million exclusive of  
16 carrying charges) , for a total of \$12.6 million exclusive of carrying  
17 charges. Additionally, Central Hudson has estimated that the incremental  
18 storm restoration costs above the current rate allowance resulting from  
19 Super-storm Sandy will be approximately \$10 million. The Signatories  
20 agree that Central Hudson shall file a formal Super-storm Sandy deferral  
21 petition as soon as reasonably practicable.

22 The Signatories agree to utilize a placeholder total for these three events of  
23 \$22 million. The Signatories agree that \$22 million will be written off  
24 promptly after the closing against the \$35 million regulatory liability being  
25 funded by Fortis, subject to true-up for subsequent Commission  
26 determinations concerning the storm restoration costs of the three storms.  
27 The Signatories agree that the three deferral requests will be reviewed by  
28 Staff consistent with the principles and practices in the recent Central  
29 Hudson storm restoration deferral petitions involving Twin Peaks  
30 (February 2010) in Case 10-M-0473 and the December 2008 ice storm in  
31 Case 09-M-0004.

32 ii) Disposition of the Remaining Balance

33 The difference between the \$35 million being provided by Fortis and the  
34 \$22 million in placeholder storm restoration cost write-offs is currently  
35 estimated as a \$13 million placeholder. The Signatories agree that this \$13  
36 million difference will be reserved as a regulatory liability with carrying  
37 charges at the pre-tax rate of return rate. At the time of the final, true-up  
38 storm restoration cost determination by the Commission, the reserve and  
39 associated carrying charges will be adjusted up or down to conform to the  
40 Commission's determination. The final amount will be reserved for  
41 additional future balance sheet write-offs or other rate moderation  
42 purposes, as shall be determined in Central Hudson's next rate case.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
29  
30  
31  
32  
33  
34  
35  
36

c) Community Benefit Fund

A total of \$5 million will be provided by Fortis for a Community Benefit Fund to be utilized for low income and economic development purposes as discussed in greater detail previously in this Joint Proposal.

**Q. If and after it acquires UNS Energy, does Fortis intend to continue to seek other acquisitions of utilities in the United States or elsewhere?**

A. This question was posed to Fortis in RUCO Fortis 2.08. Fortis' response states that:

Fortis will continue to assess acquisition opportunities in Canada and the United States that may arise from time to time. These would be limited to regulated utilities and hydroelectric generation opportunities with long term contracts. Fortis currently does not intend to pursue opportunities outside these two countries.

Currently, Fortis is not assessing other acquisition opportunities and is focused on completing the acquisition of UNS Energy. In the near term, Fortis expects to focus on organic growth opportunities within its regulated utilities.

**Q. Was a specific condition included in Fortis' acquisition of Central Hudson to address sharing of follow-on merger synergies?**

A. Yes. The Central Hudson conditions included the following provision for follow-on merger savings:

7. Follow-On Merger Savings

a) In the event that Fortis completes any additional mergers or acquisitions within the United States before the Commission adopts an order approving new rates for Central Hudson, Fortis must share the follow-on merger savings that are reasonably applicable to Central Hudson and its customers between shareholders and ratepayers, on a 50/50 basis, to the extent the portions of such savings realized by Fortis are material (i.e., 5 percent or more of Central Hudson net income on an after-tax basis). Central Hudson must submit, within 90 days of the follow-on merger closing, a comprehensive and detailed proposal to share the follow-on merger savings, to begin on the closing date of the follow-on merger. In addition, the proposal must include an allocation method for sharing the synergy savings and efficiency gains among corporate entities that addresses the time period from the receipt of the synergy savings by Central Hudson until

1 the Commission approves new rates. The ratepayer share shall be set aside  
2 in a deferral account for future Commission disposition.

3  
4 **Q. Are similar specific tangible ratepayer benefits reflected in the Joint Applicants'**  
5 **proposal filed to date?**

6 A. No. Tangible ratepayer benefits similar to those that were imposed upon Fortis'  
7 acquisition of CH Energy are lacking in the conditions that have been reflected in the Joint  
8 Applicants' proposal for Fortis to acquire UNS Energy in the Joint Applicant materials  
9 filed to date.

10  
11 **Q. Is there a similar need for conditions providing for specific tangible ratepayer**  
12 **benefits for Fortis' proposed acquisition of UNS Energy?**

13 A. I believe there is, in order to help mitigate risks that the transaction poses for Arizona  
14 ratepayers of the three utilities. As described above<sup>15</sup> my recommended additional  
15 conditions for approval of the proposed transaction includes the following conditions to  
16 provide for ratepayer benefits from the proposed transaction and, similar to the Central  
17 Hudson condition, for sharing of any follow-on merger synergies:

- 18 • Fortis and UNS Energy agree to provide economic customer benefit adjustments  
19 totaling \$59 million.<sup>16</sup> These benefits will include both immediate and long term  
20 benefits. This amount is based on UNS being larger than Central Hudson and Central  
21 Hudson received the equivalent of \$49 million in customer benefits.
- 22 • In the event that Fortis completes any additional mergers or acquisitions within the  
23 United States before the Commission adopts an order approving new base rates for  
24 TEP, Fortis must share the follow-on merger savings that are reasonably applicable  
25 to TEP, UNS Electric and UNS Gas and their customers between shareholders and  
26 ratepayers, on a 50/50 basis, to the extent the portions of such savings realized by  
27 Fortis are material (i.e., 5 percent or more of TEP, UNS Electric and UNS Gas net

---

<sup>15</sup> See, this testimony, section II. SUMMARY OF TESTIMONY AND CONCLUSIONS.

<sup>16</sup> This compares with \$44.25 million (\$9.25 million plus \$35 million) of ratepayer benefits guaranteed by Fortis in its acquisition of the Central Hudson utilities in New York, and \$5 million for a Community Benefit Fund for economic development and low income purposes for that Central Hudson acquisition. See, e.g., RUCO Fortis 1.04 Attachment A, UNS (0011) 001819-1820, included in Attachment RCS-5. As mentioned above, RUCO is still working on defining these benefits and will either supplement this testimony or provide details of the nature of the benefits in its surrebuttal case.

1 income on an after-tax basis). UNS Energy must submit, within 90 days of the  
2 follow-on merger closing, a comprehensive and detailed proposal to share the follow-  
3 on merger savings, to begin on the closing date of the follow-on merger. In addition,  
4 the proposal must include an allocation method for sharing the synergy savings and  
5 efficiency gains among corporate entities that addresses the time period from the  
6 receipt of the synergy savings by TEP, UNS Electric and UNS Gas until the  
7 Commission approves new rates. The ratepayer share shall be set aside in a deferral  
8 account for future Commission disposition.<sup>17</sup>

9  
10 I discuss in additional detail in a subsequent section of my testimony,<sup>18</sup> one potential  
11 source to fund these benefits could be based on a sharing of estimated Fortis, Inc. earnings  
12 accretion for 2015-2018 related to the Luxembourg conduit and affiliated debt  
13 arrangement that Fortis plans to use for this transaction for financing and repatriation of  
14 dividends.

15  
16 **VII. GOODWILL/ ACQUISITION ADJUSTMENT / TRANSACTION COSTS**

17 **Goodwill**

18 **Q. Will the proposed acquisition result in the recording of Goodwill?**

19 A. Yes. It appears that it will in a substantial amount.

20  
21 **Q. Approximately what amount of Goodwill would be recorded?**

22 A. Approximately \$1.407 billion.<sup>19</sup>

23  
24 **Q. On which entity's books would the Goodwill be recorded?**

---

<sup>17</sup> This is similar to the provision for Follow-On Merger Savings that Fortis committed to in its acquisition of the Central Hudson utilities in New York. See, e.g., RUCO Fortis 1.04 Attachment A, page UNS (0011) 001816, included in Attachment RCS-5.

<sup>18</sup> See, e.g., this testimony at section XII, I. LUXEMBOURG CONDUIT / INTER-COMPANY DEBT FINANCING / IMPACT ON FORTIS' ANTICIPATED EARNINGS ACCRETION.

<sup>19</sup> See, Data response to RUCO Fortis 2.05(a).

1 A. As proposed by the Joint Applicants, an attempt would be made to avoid having to record  
2 any Goodwill resulting from the transaction on the books of any of the Arizona utilities.  
3 However, there appears to be some uncertainty as to whether U.S. generally accepted  
4 accounting principles ("GAAP") would allow the acquired company to avoid "push down"  
5 accounting, i.e., to avoid having to record Goodwill (or some equivalent to Goodwill, such  
6 as an Acquisition Adjustment) on the books of the Arizona utilities.<sup>20</sup>

7  
8 **Q. Have the Joint Applicant's offered conditions to protect Arizona utility ratepayers**  
9 **from the impact of Goodwill that is expected to result from the proposed**  
10 **transaction?**

11 A. Yes. Applicants propose the following conditions relating to Goodwill and transaction  
12 costs:

13 5. UNS Energy, the Arizona Utilities and FortisUS agree that the goodwill  
14 and transaction costs of this acquisition will be excluded from the rate base,  
15 expenses, and capitalization in the determination of rates and earned returns  
16 of the Arizona Utilities and for Arizona state regulatory accounting and  
17 reporting purposes.

18 6. To the extent permissible under U.S. Generally Accepted Accounting  
19 Principles ("U.S. GAAP"), no goodwill or transaction costs associated with  
20 this acquisition will be reflected on the books of the Arizona Utilities.  
21 Should U.S. GAAP, including any future accounting changes, require that  
22 the goodwill associated with the acquisition be "pushed down" and  
23 therefore reflected in the accounts of the Arizona Utilities, the goodwill  
24 will not be reflected in the regulated accounts of the Arizona Utilities for  
25 purposes of determining rate base, setting rates, establishing capital  
26 structure or other regulatory accounting and reporting purposes.

27 7. UNS Energy and the Arizona Utilities will prepare a final schedule of  
28 the external costs to achieve the merger following consummation of the  
29 transaction as a demonstration that there will be no recovery requested in  
30 the Arizona Utilities' rates, or recognition in the determination of rate base

---

<sup>20</sup> Under the Uniform System of Accounts, Account 114, plant acquisition adjustments are based on the difference between (a) the cost to the accounting utility of gas plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and (b) the original cost, estimated, if not known, of such property, less the amount or amounts credited by the accounting utility at the time of acquisition to accumulated provisions for depreciation, depletion, and amortization and contributions in aid of construction with respect to such property.

1 of any legal or financial advisory fees, or other external costs associated  
2 with the FortisUS acquisition of UNS Energy, and indirectly, the Arizona  
3 Utilities.

4  
5 Additionally, Joint Applicants' response to UDR 1.37 confirms that, per stipulated  
6 condition No. 5 included in the Joint Notice of Intent to Reorganize, TEP, UNS Gas and  
7 UNS Electric will not seek rate recovery of any premium to be paid by Fortis for UNS  
8 Energy common stock or any transaction cost associated with the acquisition.

9  
10 **Q. Can you explain in general terms how a Goodwill impairment could occur?**

11 **A.** Yes. Generally, a Goodwill impairment occurs when a company (1) pays more than book  
12 value for a set of assets (the difference is the Goodwill), and (2) must later adjust the book  
13 value of that Goodwill.

14 Goodwill is an asset, but it does not amortize or depreciate like other assets.  
15 Instead, GAAP rules require companies to "test" Goodwill every year for impairments.

16 As a hypothetical illustration of a Goodwill impairment, let's assume that  
17 Company A purchases Company B. The book value of Company B's assets is \$3 billion,  
18 but for various reasons, Company A pays \$4.4 billion for Company B, including assumed  
19 debt. Because Company A paid \$4.4 billion for \$3 billion worth of assets, Company A  
20 records \$1.4 billion of Goodwill as an intangible asset on its balance sheet.

21 After the acquisition, Company B's actual sales growth or earnings come in lower  
22 than the projections that Company A was expecting when it evaluated the purchase. This  
23 could occur for a variety of reasons including changing economic conditions, changes in  
24 the regulatory environment, changes in competition from new technologies such a  
25 distributed generation or rooftop solar, lower authorized return on equity (ROE), etc. A  
26 Goodwill impairment could also occur if changing conditions in the stock or long-term  
27 debt markets result in lower valuations generally, such as if there were to be a sustained

1 rise in long term interest rates, which could result in higher discount rates being applied  
2 and lower net present values being assigned to future cash flow streams. Generally, all  
3 things being equal, the higher the interest rate used in a net present value calculation of a  
4 stream of estimated future cash flows, the lower the resultant NPV result.

5 In our hypothetical example, a few years have now passed, and for Company A,  
6 this means comparing a current estimate of the fair value of Company B to the book value  
7 on Company's A's financial statements. If the fair value of Company B is less than the  
8 book value (that is, if Company A were to sell Company B today, it wouldn't get a price  
9 equal to or greater than its recorded value), Company A must recognize a Goodwill  
10 impairment. The estimation of fair value involves a considerable degree of judgment, and  
11 therefore its application is subject to some discretion by Company A's management. A  
12 change in management at Company A could trigger a more stringent evaluation of  
13 Goodwill resulting from past acquisitions that are attributable to prior management that is  
14 no longer there. In this hypothetical example, assume that Company B's current estimated  
15 fair market value has fallen and is now \$2 billion. That \$2 billion plus the \$1.4 billion of  
16 Goodwill that has remained on Company A's books (a total of \$3.4 billion) to the \$4.4  
17 billion it had recorded as Company B's value on its books. The difference between the two  
18 is \$1 billion, and Company A must therefore reduce the Goodwill on its books by that  
19 amount to recognize the impairment. The Goodwill entry on its balance sheet goes from  
20 \$1.4 billion to \$400 million, and its total assets fall by \$1 billion correspondingly.  
21 Typically, there would also be a reduction to Company A's common equity balance for the  
22 after-tax impact of recognizing the Goodwill impairment.

23 In summary, Goodwill can represent a large amount of a company's net worth, and  
24 acquisitions can involve the purchase of estimated future earnings streams that are  
25 difficult to estimate accurately in advance and result in purchase premium amounts for  
26 Goodwill that are essentially for an intangible asset. As noted above, Goodwill is an

1 intangible that does not provide service, and which is unlike utility plant which is tangible  
2 and is used in the provision of utility service.

3 When a company records a Goodwill impairment, it is basically telling the market  
4 that the value of the acquired assets has fallen below what the company generally paid for  
5 them.

6  
7 **Q. Can you provide a few illustrative examples of historical Goodwill impairments?**

8 A. Yes. Some of the most famous Goodwill impairments have occurred after large  
9 acquisitions, including Qwest's \$41 billion Goodwill impairment (this followed the  
10 acquisition/merger of Qwest and US West) and AOL-Time Warner's \$54 billion Goodwill  
11 impairment charges in 2002.<sup>21</sup> In conjunction with utility acquisitions, in 2006, Scottish  
12 Power recorded a Goodwill impairment of 922 million British pounds as an exceptional  
13 charge related to goodwill impairment at its then discontinued PacifiCorp operations.<sup>22</sup> In  
14 some of the years following its acquisition of and merger with Commonwealth Edison  
15 Company (ComEd), Exelon Corporation recognized a significant Goodwill impairment  
16 charge of approximately \$776 million in the third quarter of 2006 after issuance of a 2005  
17 ComEd rate case decision by the Illinois Commerce Commission.<sup>23</sup>

18  
19 **Q. Has Fortis explained how it tests for impairment of recorded Goodwill amounts?**

20 A. Yes. The Fortis Inc. 2013 Annual Report at pages 88-89 explains the concept of Goodwill  
21 and how Fortis has applied impairment testing of amounts recorded as Goodwill:

---

<sup>21</sup> Illustrative copies of news articles describing these Goodwill impairments are included in Attachment RCS-4.

<sup>22</sup> Id.

<sup>23</sup> A footnote in the Exelon Corporation financial statements has the following description: "2006 Interim Goodwill Impairment Assessment. Due to the significant negative impact of the ICC's July 2006 order in ComEd's 2005 Rate Case to the cash flows and value of ComEd, an interim impairment assessment was completed during the third quarter of 2006. Based on the results of this interim goodwill impairment analysis, which was performed using the same model and assumptions discussed above, Exelon and ComEd recorded a charge of \$776 million associated with the impairment of goodwill during the third quarter of 2006."

1 Goodwill represents the excess, at the dates of acquisition, of the purchase  
2 price over the fair value of the net tangible and identifiable intangible  
3 assets acquired and liabilities assumed relating to business acquisitions.  
4 Goodwill is carried at initial cost less any write-down for impairment.

5 Fortis performs an annual internal quantitative assessment for each  
6 reporting unit and, for those reporting units where: (i) management's  
7 assessment of quantitative and qualitative factors indicates that fair value is  
8 not 50% or more likely to be greater than carrying value; or (ii) where the  
9 excess of estimated fair value over carrying value, as determined by an  
10 independent external consultant as of the date of the immediately preceding  
11 impairment test, was not significant, then fair value of the reporting unit  
12 will be estimated by an independent external consultant in the current year.  
13 Irrespective of the above-noted approach, a reporting unit to which  
14 goodwill has been allocated may have its fair value estimated by an  
15 independent external consultant as at the annual impairment date, as Fortis  
16 will, at a minimum, have fair value for each reporting unit estimated by an  
17 independent external consultant once every three years.

18 Fortis performs the annual impairment test as at October 1. In addition, the  
19 Corporation also performs an impairment test if any event occurs or if  
20 circumstances change that would indicate that the fair value of a reporting  
21 unit is below its carrying value. No such event or change in circumstances  
22 occurred during 2013 or 2012 and no impairment provisions were required  
23 in either year.

24 In calculating goodwill impairment, Fortis determines those reporting units  
25 that will have fair value estimated by an independent external consultant, as  
26 described above, and such estimated fair value is then compared to the  
27 book value of the applicable reporting units. If the fair value of the  
28 reporting unit is less than the book value, then a second measurement step  
29 is performed to determine the amount of the impairment. The amount of the  
30 impairment is determined by deducting the fair value of the reporting unit's  
31 assets and liabilities from the fair value of the reporting unit to determine  
32 the implied fair value of goodwill, and then comparing that amount to the  
33 book value of the reporting unit's goodwill. Any excess of the book value  
34 of the goodwill over the implied fair value is the impairment amount  
35 recognized.

36 The primary method for estimating fair value of the reporting units is the  
37 income approach, whereby net cash flow projections for the reporting units  
38 are discounted using an enterprise value approach. Under the enterprise  
39 value approach, sustainable cash flow is determined on an after-tax basis,  
40 prior to the deduction of interest expense, and is then discounted at the  
41 weighted average cost of capital to yield the value of the enterprise. An  
42 enterprise value approach does not assess the appropriateness of the  
43 reporting unit's existing debt level. The estimated fair value of the  
44 reporting unit is then determined by subtracting the fair value of the

1 reporting unit's interest-bearing debt from the enterprise value of the  
2 reporting unit. A secondary valuation method, the market approach, is also  
3 performed by an independent external consultant as a check on the  
4 conclusions reached under the income approach. The market approach  
5 includes comparing various valuation multiples underlying the discounted  
6 cash flow analysis of the applicable reporting units to trading multiples of  
7 guideline entities and recent transactions involving guideline entities,  
8 recognizing differences in growth expectations, product mix and risks of  
9 those guideline entities with the applicable reporting units.

10

11 **Q. If a large additional amount of Goodwill is recorded related to Fortis' proposed**  
12 **acquisition of UNS Energy, could that present additional challenges to Fortis to**  
13 **avoid an impairment related write-down?**

14 A. Yes. As noted above, post-acquisition impairments of Goodwill at other companies have  
15 occurred. Having large amounts of non-revenue producing assets, such as an intangible  
16 like Goodwill, present risks of prospective impairment write-offs, which, if they occur, will  
17 also tend to reduce the common equity balances that have been recorded on the entity's  
18 books and may therefore hinder future investments.

19

20 **Q. Do the conditions proposed by Joint Applicants appear to be reasonable for**  
21 **protecting Arizona ratepayers from having to pay for the Goodwill that would be**  
22 **recorded as a result of the proposed transaction?**

23 A. Yes. However, as noted above, the mere presence of a very large amount of Goodwill  
24 may create pressures on management to generate other means of improving earnings  
25 and/or achieving a return on and of the recorded Goodwill amounts. Moreover, an  
26 impairment of Goodwill could affect Fortis' balance sheet and financial strength.  
27 Maintaining or improving upon current credit ratings and access to capital is an important  
28 factor to the success of the proposed merger. In addition to the Joint Applicant's  
29 conditions, RUCO recommends that Fortis and UNS Energy report to the Commission

1 within five business days any changes in the credit ratings of Fortis, Inc., UNS Energy,  
2 TEP, UNS Electric or UNS Gas.

3  
4 **Transaction Costs**

5 **Q. Will Fortis incur other transaction costs in addition to the Goodwill discussed above?**

6 A. Yes. Fortis will incur other transaction costs related to its proposed acquisition of UNS  
7 Energy. Fortis' 2013 Annual Report at page 45, for example, states that:

8 Fortis also expects to incur a number of costs associated with completing  
9 the acquisition. The majority of these costs will be non-recurring expenses  
10 and will consist of transaction costs related to the acquisition, including  
11 costs related to financing and obtaining regulatory approval. Additional  
12 unanticipated costs may be incurred in 2014 related to the acquisition.

13  
14 **Q. The Joint Applicants have also proposed a condition to protect Arizona ratepayers  
15 from having to pay for transaction costs. Is that condition sufficient?**

16 A. The Joint Applicants' proposed condition for transaction costs, which provides that such  
17 costs "will be excluded from the rate base, expenses, and capitalization in the  
18 determination of rates and earned returns of the Arizona Utilities and for Arizona state  
19 regulatory accounting and reporting purposes." This condition appears to be adequate,  
20 providing that it is clear that the transaction costs being excluded include costs under the  
21 UNS Energy Change of Control provision and costs for retention payments for UNS  
22 Energy management (sometimes referred to as retention bonuses). The Change in Control  
23 costs and the Retention Bonuses are discussed in additional detail below. Such costs  
24 would not be incurred but for the proposed transaction and should therefore be part of the  
25 excluded transaction costs.  
26  
27

1 **Change in Control Costs**

2 **Q. Please discuss the Change in Control costs that would be incurred as a result of the**  
3 **proposed transaction.**

4 A. The proposed transaction would constitute a Change of Control and would thus trigger  
5 recognition of various costs as described in the confidential response to RUCO Fortis  
6 2.32.

7  
8 **Q. What amount of Change in Control cost is expected to be incurred?**

9 A. According to the confidential response to RUCO UNS 1.04, Change in Control costs of  
10 [BEGIN CONFIDENTIAL] [REDACTED] [END CONFIDENTIAL] are expected to be  
11 incurred as a result of the proposed transaction.

12  
13 **Q. Should the Change in Control costs be considered part of the transaction costs and**  
14 **be excluded from the rate base, expenses, and capitalization in the determination of**  
15 **rates and earned returns of the Arizona Utilities and for Arizona state regulatory**  
16 **accounting and reporting purposes?**

17 A. Yes.

18  
19 **Retention Bonuses**

20 **Q. Please discuss the Retention Bonuses cost that would be incurred as a result of the**  
21 **proposed transaction.**

22 A. According to the response to RUCO Fortis 2.11 and RUCO UNS 1.04 and 2.02, Retention  
23 Bonuses costs [BEGIN CONFIDENTIAL] [REDACTED]  
24 [REDACTED]  
25 [REDACTED] [END CONFIDENTIAL]

26

1 **Q. Should the Retention Bonuses costs be considered part of the transaction costs and**  
2 **be excluded from the rate base, expenses, and capitalization in the determination of**  
3 **rates and earned returns of the Arizona Utilities and for Arizona state regulatory**  
4 **accounting and reporting purposes?**

5 A. Yes. The Retention Bonus amounts would not be incurred, but for the proposed  
6 transaction and should therefore be considered to be part of the transaction costs that are  
7 being excluded.

8  
9 **VIII. UNS ENERGY SHAREHOLDER LITIGATION COSTS**

10 **Q. Has the proposed acquisition resulted in certain UNS Energy shareholders filing**  
11 **lawsuits?**

12 A. Yes. For example, the Fortis Inc. 2013 Annual Report at page 135 states that:

13 Following the announcement of the proposed acquisition of UNS Energy  
14 on December 11, 2013, several complaints, which named Fortis and other  
15 defendants, were filed in the Superior Court of Arizona, Pima County, and  
16 the United States District Court of the District of Arizona, challenging the  
17 proposed acquisition. The complaints generally allege that the directors of  
18 UNS Energy breached their fiduciary duties in connection with the  
19 proposed acquisition and that UNS Energy, Fortis, FortisUS Inc. and Color  
20 Acquisition Sub Inc. aided and abetted that breach.

21 The outcome of these lawsuits cannot be predicted with any certainty and,  
22 accordingly, no amount has been accrued in the consolidated financial  
23 statements. An adverse judgment for monetary damages could have a  
24 material adverse effect on the operations of the surviving company after the  
25 completion of the acquisition. A preliminary injunction could delay or  
26 jeopardize the completion of the acquisition and an adverse judgment  
27 granting permanent injunctive relief could indefinitely enjoin completion of  
28 the transaction. Subject to the foregoing, in management's opinion, based  
29 upon currently known facts and circumstances, the outcome of such  
30 lawsuits is not expected to have a material adverse effect on the  
31 consolidated financial condition of Fortis. The defendants intend to  
32 vigorously defend themselves against the lawsuits.

33 The response to RUCO Fortis 2.09 indicates that a number of lawsuits have been  
34 filed by shareholders of UNS Energy concerning the proposed transaction. Additionally,

1 the Joint Applicants' response to UDR 1.33 describes the nature and current status of  
2 litigation concerning the acquisition and states that five putative shareholder class action  
3 lawsuits challenging the merger have been filed, and provides some high level information  
4 about those shareholder lawsuits.

5  
6 **Q. Did you ask the Joint Applicants if litigation costs are being charged to UNS**  
7 **subsidiaries?**

8 A. Yes. Data request RUCO Fortis 2.09 asked about the UNS Energy shareholder litigation  
9 costs. The response to RUCO Fortis 2.09(a) indicates that the costs related to this  
10 shareholder litigation will be an expense on the books of UNS Energy. The response  
11 states further that Fortis anticipates injecting equity to fund acquisition related costs that  
12 are being expensed by UNS Energy.

13  
14 **Q. How are litigation costs charged to UNS subsidiaries?**

15 A. In response to data request RUCO Fortis 2.09(b), Fortis responded:

16 The merger related costs recorded on UNS Energy's books are allocated to  
17 subsidiaries using the allocation method described by UNS Energy in UDR  
18 1.14. All merger related costs are tracked using identifiable accounting  
19 coding to allow them to be removed for rate making purposes from each  
20 subsidiary.

21 The Joint Applicants' response to RUCO Fortis 2.09, however, did not provide the  
22 amounts charged to each utility to date, nor did the response specify the accounts on each  
23 utility subsidiary's books into which these UNS Energy shareholder litigation costs are  
24 being charged.

25  
26 **Q. Does Fortis agree that these shareholder litigation costs should be borne by**  
27 **shareholders and not charged to the ratepayers of any of the Arizona utilities?**

1 A. Yes. The response to RUCO Fortis 2.09(c) states that: "Yes. Fortis agrees that none of the  
2 costs related to the litigation should be borne by the customers of TEP, UNS Electric or  
3 UNS Gas." Moreover, "Fortis has committed that transaction costs will not be recovered  
4 from customers through rates."  
5

6 **Q. Should a condition be placed on the proposed acquisition and merger to require that**  
7 **none of the UNS Energy shareholder litigation costs are charged to the Arizona**  
8 **utilities or their ratepayers?**

9 A. Yes. This could potentially be accomplished by clarifying that the transaction costs that  
10 Fortis has committed will not be borne by the customers of TEP, UNSE or UNSG include  
11 all costs of shareholder litigation related to the proposed transaction.  
12

13 **IX. CONFIRMATION THAT THERE IS NO INTERNAL REVENUE CODE**  
14 **§338(H)(10) ELECTION**

15 **Q. Did you investigate and confirm that there is no Internal Revenue Code §338(h)(10)**  
16 **election being made related to this proposed acquisition?**

17 A. Yes. The response to RUCO UNS 1.02 confirmed that there is no §338(h)(10) election  
18 being made related to the proposed Fortis-UNS acquisition.  
19

20 **Q. Why did you deem it important to confirm that?**

21 A. The application does not contain an election under Internal Revenue Code §338(h)(10),  
22 which would result in treating the stock purchase as an asset purchase for federal income  
23 tax purposes. Such a tax election if made could eliminate the Accumulated Deferred  
24 Income Tax ("ADIT") balance that has been accumulating for years on the books of the  
25 acquired utilities. Because ADIT functions as a substantial rate base deduction, this type  
26 of tax election could present an additional form of ratepayer harm. Where this type of tax

1 election is seen, in order to protect the utility ratepayers from the rate base increase related  
2 to this detrimental aspect caused by the change in ownership, a hold harmless provision  
3 that will protect ratepayers from substantial rate base increases caused by the ownership  
4 change must be incorporated into the conditions for approval. Because the Fortis-UNS  
5 transaction does not incorporate this type of tax election, additional specially tailored  
6 ratepayer protections to help counteract its impact in eliminating utility ADIT do not  
7 appear to be needed.

8  
9 **X. BOND RATINGS / CHANGES TO COST OF DEBT / POST MERGER CAPITAL**  
10 **STRUCTURE**

11 **Q. Please discuss the present bond ratings of Fortis and the UNS Energy utilities.**

12 A. Joint Applicants provided information on the current bond ratings for each of the Arizona  
13 utilities in their responses to UDR 1.08 through UDR 1.10 and for UNS Energy in  
14 response to UDR 1.11.<sup>24</sup> Bond/debt rating information for Fortis Inc. was provided in  
15 response to UDR 1.16.<sup>25</sup>

16  
17 **Q. How do the Joint Applicants anticipate that the cost of debt for TEP, UNS Electric**  
18 **and UNS Gas will be impacted by the proposed transaction?**

19 A. The response to UDR 1.30 describes their expectation that the cost of new long-term debt  
20 could be lower if credit ratings are upgraded:

21 The cost of new long-term debt issued by TEP should be lower as a result  
22 of anticipated upgrades of TEP's credit ratings by S&P and Fitch than the  
23 cost would otherwise be absent the acquisition. The extent of cost savings  
24 to be realized would depend on a variety of factors including (i) the  
25 maturity date of the debt being issued, (ii) the extent of the credit rating  
26 upgrade(s), and (iii) the interest rate spread demanded by the market for  
27 utility bonds at different credit rating levels. Likewise, the cost of short-  
28 term debt under TEP's revolving credit facility would be lower as a result

<sup>24</sup> Copies of these responses are included in Attachment RCS-5.

<sup>25</sup> Id.

1 of a credit rating upgrade. Under TEP's current revolving credit facility the  
2 cost of short-term borrowing would decrease by 12.5 basis points and the  
3 cost of TEP's letters of credit would decrease by 12.5 to 25 basis points if  
4 either S&P or Moody's increased TEP's credit rating by one notch.

5 The debt obligations of UNS Gas and UNS Electric are presently rated only  
6 by Moody's Service. Moody's has remarked that the merger should be  
7 credit neutral to slightly positive for UNS Energy and its subsidiaries. If a  
8 ratings upgrade by Moody's were to occur, the cost of new long-term debt  
9 issued by UNS Gas and UNS Electric should be lower than it would  
10 otherwise be absent the acquisition. With regard to short-term borrowings  
11 under the joint revolving credit facility shared by UNS Gas and UNS  
12 Electric, a one-notch upgrade from Moody's would also result in a 12.5  
13 basis point reduction to the cost of short-term borrowing.

14  
15 **Q. Will UNS Energy continue to issue debt in connection with the merger?**

16 A. The response to UDR 1.32 indicates that UNS Energy will issue no debt in connection  
17 with the merger; however, it may borrow on a short-term basis to finance projects, such as  
18 Gila River Unit 3, with the expectation that such short-term debt would be paid off upon  
19 closing the merger with Fortis:

20 UNS Energy will issue no debt in connection with the merger. However, if  
21 the merger is not completed prior to the planned purchase of Gila River  
22 Unit 3 by TEP and UNS Electric in December 2014, UNS Energy will  
23 borrow on a short-term basis and contribute the proceeds to TEP and UNS  
24 Electric to fund a portion of the Gila River purchase price and to TEP for  
25 its purchase of a portion of Springerville Unit 1. It is anticipated that any  
26 such short-term borrowing by UNS Energy would be paid off upon closing  
27 of the merger with Fortis.

28  
29 **Q. What capital structure is anticipated for UNS Energy, post-acquisition?**

30 A. The response to UDR 1.31 provides the following information on the pre- and post-  
31 acquisition capital structure for UNS Energy:

**UNS Energy Consolidated Capital Structure**

(\$ Thousands)	Pre Acquisition Balance as of 9/30/2013	Pro Forma Adjustments For Acquisition Contribution and Generation Purchases	Post Acquisition Pro Forma Balance
Common Equity	\$1,132,286	\$200,000	\$1,332,286
Long-Term Debt	\$1,505,536	\$157,000	\$1,662,536
Short-Term Debt	\$23,000	-	\$23,000
	<u>\$2,660,822</u>	<u>\$357,000</u>	<u>\$3,017,822</u>

% Common Equity                      42.6%    44.1%

Note: Pro forma adjustments reflect anticipated financing for the following generation purchases:

<u>\$219,000</u>	Gila River Unit 3 in December 2014 (75% TEP, 25% UNS Electric)
<u>\$65,000</u>	Springerville Unit 1 in Dec. 2014 and Jan. 2015 (TEP)
<u>\$73,000</u>	Springerville coal handling facilities in April 2015 (TEP)
<u>\$357,000</u>	

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15

**Q. Are you recommending any conditions with respect to the bond ratings or capital structure?**

**A.** Yes. Because changes in bond ratings for the Arizona utilities, UNS Energy and Fortis Inc. that occur after the transaction is consummated could have a major impact on whether the cost of debt and access to capital on reasonable terms improves or deteriorates, I recommend that a condition be added that: Fortis and UNS Energy shall report to the Commission within five business days any changes in the credit ratings of Fortis, Inc., UNS Energy, TEP, UNS Electric or UNS Gas.

**XI. PRESERVING TEP SPRINGERVILLE SECTION 45 SYNFUEL BENEFITS FOR ARIZONA RATEPAYERS**

**Q. During the last TEP rate case, did you become aware that TEP has been pursuing an arrangement with a third party to set up a Section 45 synfuel operation at the Springerville Plant?**

1 A. Yes. TEP was investigating and/or had plans to sell coal for Springerville Units 1 and 2 to  
2 a third party and to buy-back treated coal from the third party for burn at Springerville  
3 Units 1 and 2 so that Internal Revenue Code Section 45 (formerly Section 29) credits can  
4 be generated.

5

6 **Q. What is the current status of those plans?**

7 A. The response to RUCO UNS 2.07 states that: "TEP is currently in discussions with TCG  
8 Global to refine coal which will qualify for tax credits under IRC Section 45(c)(7) and not  
9 under IRC Section 29. TCG Global is marketing the project to several tax investors and  
10 we plan to proceed as soon as they are successful."

11

12 **Q. Does TEP anticipate that such arrangements will reduce the cost of coal burned at  
13 Springerville?**

14 A. Yes. TEP's response to RUCO-UNS 2.07(a) states that the contemplated arrangement is  
15 expected to reduce the cost of coal to Springerville between \$1.00/ton and \$2.00/ton in  
16 each of the years in the period 2014-2018. If the project begins refining coal by October  
17 2014 the fuel reduction in 2014 will be approximately \$1.2 Million based on the midpoint  
18 of \$1.50 per ton and 800,000 tons burned in the last quarter of 2014. The anticipated  
19 reduction in years 2015 through 2018 is approximately \$3.6 Million based on a burn of 2.4  
20 Million tons.

21

22 **Q. Has it been TEP's stated intention to flow the benefits of this arrangement through to  
23 ratepayers through its PPFAC?**

24 A. Yes. That was our understanding from discussions about this during the TEP rate case  
25 investigation. Additionally, the response to RUCO UNS 2.07(c) affirms that: "This  
26 benefit will be passed through to customers as a reduction of PPFAC eligible fuel costs."

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
29  
30  
31

**Q. How does TEP propose to account for the net benefits of the Section 45 arrangement?**

A. The response to RUCO UNS 2.07(b) contains the following explanation:

As coal is purchased, it is recorded in an inventory account until consumed. In the transaction described in this request, the coal initially would have been recorded to inventory at its original cost. When sold to the third-party, the inventory would be relieved by its original cost, with no gain or loss resulting from that sale. When it was bought-back at a later date, the new lower price would be recorded as the new inventory carrying amount. Accordingly, there are no anticipated costs under the current arrangement, simply a reduction in FERC 501 fuel expenses.

**Q. Has TEP or UNS Energy provided any information to Fortis about entering into an arrangement with a third party to generate Section 45 (formally Section 29) credits for coal treatments at Springerville or any other coal-fired generating plants in which TEP has an ownership or lease interest during the period 2014-2018?**

A. This question was posed to TEP in RUCO UNS 2.08, and the response received was: "No."

**Q. Does Fortis have any experience with coal-fired generation?**

A. No. According to the response to RUCO Fortis 2.15:

Fortis does not have experience with the operation or ownership of coal fired generation within its existing utility businesses. However, there will be no changes in the current operation or ownership of the coal fired generating plants that will continue to be locally operated and managed by experienced UNS Energy and TEP personnel.

**Q. Would it be prudent as a merger condition to formalize TEP's commitment to pass the benefits of the reduced Springerville coal costs resulting from the Section 45 synfuel arrangement to ratepayers through TEP's PPFAC?**

1 A. Yes. Given the fact that Fortis has no prior experience with utilities owning and operating  
2 coal-fired generation and the fact that TEP and UNS apparently had not previously  
3 notified Fortis of the Springerville Section 45 arrangement being pursued by TEP, it  
4 would be prudent to formalize TEP's commitment to pass the benefits of the reduced  
5 Springerville coal costs resulting from the arrangement to ratepayers through TEP's  
6 PPFAC. This will help ensure that such benefits flow through to ratepayers as intended by  
7 TEP under the new corporate ownership. A merger condition should therefore reaffirm in  
8 writing TEP's stated commitment to benefits of the reduced Springerville coal costs  
9 resulting from the Section 45 synfuel arrangement to ratepayers through TEP's PPFAC,  
10 and ensure that these benefits are not subsequently diverted to Fortis Inc. shareholders.

11

12 **XII. LUXEMBOURG CONDUIT / INTER-COMPANY DEBT FINANCING / IMPACT**  
13 **ON FORTIS' ANTICIPATED EARNINGS ACCRETION**

14 **Q. Please discuss the use by Fortis of a Luxembourg conduit entity and the related**  
15 **inter-company debt financing.**

16 A. An important component of Fortis' proposed financing involves the use of a Luxembourg  
17 conduit entity and related inter-company debt financing. This arrangement was not  
18 disclosed in the Joint Application or direct testimony. It was uncovered only by reviewing  
19 Fortis' financing details in the "due diligence" documentation.

20

21 **Q. Did you ask Fortis why this key component of its anticipated financing arrangements**  
22 **was not disclosed in the application or in Applicants' direct testimony?**

23 A. Yes. In response to RUCO Fortis 2.02, Fortis provided the following explanation:

24

25

26

27

28

Fortis provided a high level overview of its plan to finance the acquisition of UNS Energy in the pre-filed testimony of Barry V. Perry. In the pre-filed testimony, it was explained that Fortis plans to finance the acquisition by issuing a combination of common shares, preferred shares and debt financing. This is still the case. Fortis has already secured a substantial

1 portion of the equity financing by issuing C\$1.8 billion of convertible  
2 debentures which will convert to common equity once all regulatory and  
3 governmental approvals required to finalize the acquisition have been  
4 obtained and all other outstanding conditions under the Merger Agreement  
5 have been fulfilled or waived.

6 The use of an overseas conduit entity was not specifically referred to in the  
7 joint notice or pre-filed testimony as it represents internal funding of  
8 FortisUS by Fortis that was not considered necessary to be included in  
9 order to meet the Commission's filing standard. Overseas conduit entities  
10 are a commonly used mechanism to finance cross-border transactions in  
11 organizations where the parent company resides in Canada and a subsidiary  
12 resides in the United States (or vice versa). The use of an overseas conduit  
13 entity allows Fortis to take advantage of international tax treaties to finance  
14 cross-border subsidiaries. A similar overseas conduit structure was used by  
15 Fortis in funding the FortisUS acquisition of CH Energy Group, Inc. in  
16 2013.

17  
18 **Q. Did Fortis ultimately provide an organizational chart that included disclosure of the**  
19 **Luxembourg conduit entity?**

20 A. Yes. Fortis' response to RUCO Fortis 2.01 included a Fortis corporate organizational  
21 chart similar to that provided in Exhibit 4 to the Joint Notice of Intent to Reorganize,  
22 modified to include the Luxembourg affiliate conduit (i.e., Fortis Energy Corporation,  
23 Newfoundland Energy Holdings Inc., and NewfoundlandEnergy Luxembourg S.à.r.l.).

24  
25 **Q. How much inter-company debt does Fortis anticipate using relating to financing the**  
26 **transaction and which entities does Fortis intend to use for that purpose?**

27 A. As described in the response to RUCO Fortis 2.04, additional intercompany loans from the  
28 Luxembourg conduit to FortisUS of at least US\$500 million would be used as an  
29 intercompany debt arrangement that is part of the plan Fortis intends to employ to  
30 repatriate UNS Energy dividends.

31

1 **Q. Does inter-company debt financing of an amount of US\$500 million (or more) seem**  
2 **like part of the financing arrangement that should have been disclosed up-front in**  
3 **the Joint Application?**

4 A. Yes, it does. A.A.C. R14-2-803 requires disclosure of the proposed method of financing  
5 the holding company. Referring to Applicant's Post-Merger organizational chart in  
6 Exhibit 2 of the Application there is no disclosure of the Luxembourg conduit entity, and  
7 no discussion in the Application about the inter-company debt arrangement or the fact that  
8 such intercompany debt was anticipated to be used by the FortisUS holding company.

9  
10 **Q. Did Fortis provide a public version of its proposed inter-company debt and UNS**  
11 **Energy dividend repatriation plan in response to RUCO discovery?**

12 A. Yes. Fortis' response to RUCO Fortis 2.04 including Attachment A to that response  
13 provides a public description of that arrangement. The public description includes the  
14 following explanation:

15 RUCO Fortis 2.04 Attachment A.xlsx outlines how the annual dividends of  
16 UNS Energy would be repatriated to Fortis Inc., assuming all the forecast  
17 dividends were repatriated back to Canada. RUCO Fortis 2.04 Attachment  
18 A.xlsx also shows payments by FortisUS of interest on intercompany loans  
19 from its Luxembourg affiliate, NewfoundlandEnergy Luxembourg  
20 S.A.R.L.

21 **Dividends of UNS Energy to FortisUS**

22 FortisUS would hold all of the common equity of UNS Energy. Thus,  
23 FortisUS would receive all of the dividends paid by UNS Energy. As  
24 committed to by Fortis and UNS Energy in the Joint Notice of Intent to  
25 Reorganize, the board of directors of UNS Energy will be responsible for  
26 the establishment of dividend policy and the declaration of dividends to be  
27 paid by UNS Energy.

28 **FortisUS**

29 FortisUS is a Delaware corporation and a direct wholly owned subsidiary  
30 of FortisUS Holdings Nova Scotia Limited which in turn is a direct wholly  
31 owned subsidiary of Fortis Inc.

32 FortisUS is also the parent company of CH Energy Group, Inc. and  
33 FortisUS Energy Corporation and would also receive dividends from these

1 companies. At December 31, 2013, FortisUS had a capital structure  
2 comprised of approximately US\$590 million in common equity and  
3 US\$450 million in interest bearing long-term debt from  
4 NewfoundlandEnergy Luxembourg S.A.R.L.

5 The pro-forma capital structure of FortisUS, assuming an acquisition price  
6 for UNS Energy equity of US\$2.5 billion and a post-closing common  
7 equity injection of US\$200 million, would increase by US\$2.7 billion. The  
8 new capital of FortisUS would be comprised of additional common equity  
9 of US\$2.2 billion from FortisUS Holding Nova Scotia Limited and  
10 additional intercompany loans from NewfoundlandEnergy Luxembourg  
11 S.A.R.L. of US\$500 million.

12 **Payment of UNS Energy Dividends**

13 Assuming an annual dividend of US\$80 million from UNS Energy to  
14 FortisUS, Fortis anticipates that FortisUS would pay interest of US\$25  
15 million on its intercompany loans from NewfoundlandEnergy Luxembourg  
16 S.A.R.L. (US\$500 million in loans at an interest rate of 5%). The  
17 remaining US\$55 million, if repatriated to Canada, would be paid as a  
18 dividend from FortisUS to FortisUS Holdings Nova Scotia Limited. The  
19 dividend from FortisUS to its Canadian parent would be subject to a 5%  
20 withholding tax in accordance with IRS rules.

21 FortisUS Holdings Nova Scotia Limited would pay the dividend received  
22 from FortisUS, net of the 5% withholding tax, (i.e., US\$52.25 million) as a  
23 dividend to Fortis Inc.

24 **Payment of Interest to Luxembourg Affiliate**

25 The interest payment of US\$25 million by FortisUS to  
26 NewfoundlandEnergy Luxembourg S.A.R.L. would be assessed income tax  
27 in Luxembourg of approximately US\$150,000. NewfoundlandEnergy  
28 Luxembourg S.A.R.L. would therefore pay a dividend, net of Luxembourg  
29 income tax and administrative expenses totaling approximately  
30 US\$200,000, (i.e., US\$24.8 million) to its Canadian parent, Newfoundland  
31 Energy Holdings Inc. Newfoundland Energy Holdings Inc. would then pay  
32 this US\$24.8 million as a dividend to its parent, Fortis Energy Corporation.  
33 Fortis Energy Corporation would, in turn, pay US\$24.8 million as a  
34 dividend to its parent, Fortis Inc.

35  
36 **Q. Is there also a CONFIDENTIAL AND COMPETITIVELY SENSITIVE document**  
37 **showing and describing the Fortis inter-company debt and UNS Energy dividend**  
38 **repatriation -plan that Fortis has proposed to utilize?**

1 A. Yes. Attachment RCS-6 includes 2 pages of copies obtained from the UNS Energy "due  
2 diligence" review containing [BEGIN CONFIDENTIAL AND COMPETITIVELY  
3 SENSITIVE] [REDACTED]  
4 [REDACTED] [END CONFIDENTIAL AND  
5 COMPETITIVELY SENSITIVE] Because such material from the UNS Energy "due  
6 diligence" documentation is considered CONFIDENTIAL AND COMPETITIVELY  
7 SENSITIVE, so I will not include any further discussion of such contents in my  
8 testimony.

9  
10 **Q. Is Fortis expecting that its acquisition of UNS Energy will be accretive to the**  
11 **earnings of Fortis Inc.?**

12 A. Yes. Excluding the impact of transaction costs, Fortis had announced that it expects its  
13 acquisition of UNS Energy will be accretive to the earnings of Fortis Inc.

14  
15 **Q. Have you reviewed Fortis' estimates of the Fortis Inc. earnings accretion?**

16 A. Yes, to the extent that Fortis' estimates of the Fortis Inc. earnings accretion expected to  
17 result from its acquisition of UNS Energy were disclosed in responses to discovery or  
18 Fortis news announcements or in the Fortis "due diligence" documentation.

19  
20 **Q. Approximately how much of the Fortis Inc. estimated earnings accretion in the first**  
21 **four years of ownership is produced by the inter-company debt and Luxembourg**  
22 **conduit arrangement?**

23 A. [BEGIN CONFIDENTIAL AND COMPETITIVELY SENSITIVE] [REDACTED]  
24 [REDACTED]  
25 [REDACTED]

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

[REDACTED]<sup>26</sup> [END

CONFIDENTIAL AND COMPETITIVELY SENSITIVE]

**Q. Is having the acquisition being accretive to the earnings of Fortis Inc. important to Fortis?**

**A. Yes. Data request RUCO Fortis 2.16 asked:**

Is being accretive to Fortis' earnings in the first year (2015) or in other years in the 2015-2018 time period considered to be a critical element to Fortis in pursuing the proposed acquisition of UNS Energy?

a. Explain fully how important being "accretive to earnings" is to Fortis for this proposed transaction.

Fortis' response states:

Growth in earnings is as important to Fortis as it is to any successful corporation. Earnings growth supports common share dividend growth and adds shareholder value. This ultimately supports the market price of Fortis common shares and enhances Fortis' access to equity capital. In addition, Fortis funds the growth in its existing regulated operations by retaining a significant portion of earnings at the utility level, supplemented by the provision of common equity injections as required.

To finance the acquisition of UNS Energy, Fortis has issued C\$1.8 billion of securities that are convertible to new equity. The Fortis common share price at which this equity was issued is based on shareholders' expectations that the UNS Energy acquisition will be accretive to earnings.

**Q. Does the revealing of the inter-company debt and Luxembourg conduit arrangement that Fortis would employ as part of its financing plan and use for the repatriation of UNS Energy dividends also suggest that access to affiliate books and records may become important?**

---

<sup>26</sup> [BEGIN CONFIDENTIAL AND COMPETITIVELY SENSITIVE] [REDACTED]  
[REDACTED] [END CONFIDENTIAL AND COMPETITIVELY SENSITIVE]

1 A. Yes. The condition proposed by the Joint Applicants regarding access to affiliate books  
2 and records should be strengthened to clearly provide for access to the books and records  
3 of all affiliates that are part of the financing arrangement. This would include the  
4 FortisUS holding company and the Luxembourg conduit entity, as well as any Fortis  
5 entities that would charge or allocate corporate costs to any of the Arizona Utilities.  
6

7 **XIII. ARIZONA RATEPAYER BENEFITS**

8 **Q. Were specific tangible ratepayer benefits provided for in the conditions imposed**  
9 **upon Fortis' acquisition in 2013 of Central Hudson?**

10 A. Yes. As previously noted, the NYPSC approval of Fortis' acquisition of CH Energy, the  
11 parent of the Central Hudson utilities, included tangible quantified economic benefits to  
12 ratepayers including \$9.25 (\$1.85 million for 5 years) of cost savings/guaranteed future  
13 rate mitigation, and \$35 million provided to Central Hudson by Fortis to be recorded as a  
14 regulatory liability to be applied to write off regulatory assets on the books of Central  
15 Hudson for storm restoration and to provide balance sheet offsets and rate mitigation in  
16 Central Hudson's next rate filing. Additionally, the Central Hudson conditions included  
17 an additional \$5 million provided by Fortis for a Community Benefit Fund to be utilized  
18 for low income and economic development purposes. These Fortis-provided benefits for  
19 Central Hudson ratepayers in conjunction with that acquisition/merger transaction total to  
20 \$49.25 million.  
21

22 **Q. Is it important to provide ratepayers in this case as a condition of approval with a**  
23 **specific tangible benefit similar to the one provided by Fortis in the Central Hudson**  
24 **case?**

25 A. Yes. Providing Arizona ratepayer benefits of at least \$59 million by establishing a  
26 regulatory liability account for use in mitigating future utility rate increases, as described

1 above is one way to provide for a specific tangible ratepayer benefit resulting from the  
2 proposed transaction, and will help mitigate risks that the transaction poses for Arizona  
3 ratepayers of the three utilities. As described above, one potential source for such Arizona  
4 ratepayer benefits is sharing a portion of the estimated Fortis, Inc. earnings accretion  
5 related to the inter-company debt/Luxembourg conduit arrangement  
6

7 **Q. How did you arrive at this amount?**

8 A. The amount for Arizona utility ratepayer benefits that RUCO recommends is roughly  
9 comparable to the benefits received by the Central Hudson ratepayers from Fortis in the  
10 New York merger. In that acquisition, Fortis agreed to \$9.25 million in cost  
11 savings/guaranteed future rate mitigation, \$5 million for a Community Benefit Fund and  
12 \$35 million to be recorded as a regulatory liability to be applied to write off regulatory  
13 assets on the books of Central Hudson for storm restoration and to provide balance sheet  
14 offsets and rate mitigation in Central Hudson's next rate filing. In total, the Central  
15 Hudson acquisition included \$49.25 million in ratepayer benefits from Fortis. In the  
16 present case, which is a notably bigger acquisition by Fortis than Central Hudson, RUCO  
17 is recommending \$59 million in ratepayer benefits. Information on Central Hudson's size  
18 has been provided in the response to RUCO Fortis 1.05 and indicates, for example, that  
19 the \$9.25 million amount of guaranteed future rate mitigation represents 1.38 percent of  
20 Central Hudson's 2013 regulated revenue of \$668.4 million. In comparison, \$9.25 million  
21 would be only 0.62 percent of UNS Energy's 2013 operating revenue from the three  
22 Arizona utilities (TEP, UNS Electric, and UNS Gas), which was \$1.485 billion.<sup>27</sup> In terms  
23 of utility revenue, UNS Energy is more than twice as big as Central Hudson. An  
24 argument could be made that the percentage of the benefits should be at the very least the  
25 same or similar for Arizona as it was in New York or that the total benefits for Arizona

---

<sup>27</sup> See, e.g., UNS Energy SEC Form 10-K for the fiscal year ended December 31, 2013, page K-101, a copy of which is included in Attachment RCS-5.

1 ratepayers should be proportional to the Central Hudson ratepayer benefits, recognizing  
2 that the three Arizona utilities being acquired here are significantly larger than Central  
3 Hudson. However, all RUCO is recommending is the same ratepayer benefits for UNS  
4 Energy with only the cost savings/guaranteed future rate mitigation costs being doubled.  
5 RUCO's recommendation is balanced and reasonable.  
6

7 **XIV. FORTIS CORPORATE COST INCREASES RESULTING FROM THE MERGER**

8 **Q. How does Fortis anticipate that its corporate costs will be impacted by the proposed**  
9 **merger?**

10 A. As stated in the response to RUCO Fortis 2.29, Fortis estimates that the merger will  
11 increase Fortis' annual corporate general and administrative costs by approximately  
12 C\$700,000.  
13

14 **Q. How does Fortis intend to account for those increased corporate costs?**

15 A. Fortis' response to RUCO Fortis 2.29(a) provided illustrative accounting entries.<sup>28</sup>  
16

17 **Q. Would Fortis' increased corporate costs be charged or allocated to the Arizona**  
18 **Utilities?**

19 A. It appears they would. Fortis' response to RUCO Fortis 2.29(b) provided the following  
20 explanation:

21 Fortis Inc. utilizes a cost allocation method to calculate management fees  
22 charged to its subsidiaries. The allocation to subsidiaries is calculated as a  
23 proportion of Fortis Inc.'s corporate expenses, as per below, excluding: (i)  
24 finance charges associated with credit facilities and long-term debt; (ii)  
25 50% of salary and salary-related expenses of Fortis Inc.'s CEO, CFO and  
26 Treasurer; and (iii) 100% of business development costs. The allocable  
27 costs are charged to the operating subsidiaries based on the percentage of  
28 their assets to the total consolidated assets of Fortis Inc.

---

<sup>28</sup> A copy of this response is included in Attachment RCS-5.

1 Fortis Inc.'s costs (i.e., corporate expenses) typically relate to public capital  
2 market access related to investment in operating subsidiaries. Such costs  
3 include governance costs, capital market fees, public reporting  
4 requirements, trustee fees, common share plans and other related fees.  
5 These costs are allocated between regulated and non-regulated operations  
6 by each operating subsidiary as required under appropriate local regulatory  
7 guidelines governing that operating subsidiary. Generally, capital market  
8 costs related to equity are regarded as costs which are appropriately  
9 allocated to regulated operations (because the costs benefit the regulated  
10 subsidiary and are not duplicative), whereas costs such as those related to  
11 governance may not be allocated to regulated operations (because the  
12 regulated subsidiary has its own independent board of directors and  
13 additional governance costs tend to be duplicative).

14 For additional information on Fortis' cost allocation methodology, please  
15 refer to RUCO Fortis 2.29 Attachment 2.pdf, Bates Nos. 002180-002209,  
16 which contains a June 22, 2009 report from KPMG pertaining to a review  
17 of the cost allocation methodology utilized by Fortis Inc. This report  
18 reviewed the cost allocation policy of Fortis Inc. as well as FortisBC  
19 Holdings Inc. (formerly known as Terasen Gas Inc.). Fortis Inc. would  
20 allocate applicable costs to its subsidiaries, including UNS Energy  
21 Corporation, in accordance with the indicated methodology. The  
22 methodology used by UNS Energy to allocate costs to its subsidiaries is  
23 described in UDR 1.14.

24

25 **Q. Will access to Fortis Inc.'s books and records relating to Fortis' corporate costs that**  
26 **are being charged or allocated to the Arizona Utilities be important?**

27 **A.** Yes. The merger conditions should make clear that access to books and records will be  
28 provided for any entities that are charging or allocating cost to any of the Arizona  
29 Utilities. This would presumably include any accounting records and documentation  
30 related to Fortis Inc. corporate costs.

31

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

33 **A.** Yes, it does.

**Attachment RCS-1**  
**QUALIFICATIONS OF RALPH C. SMITH**

**Accomplishments**

Mr. Smith's professional credentials include being a Certified Financial Planner™ professional, a Certified Rate of Return Analyst, a licensed Certified Public Accountant and attorney. He functions as project manager on consulting projects involving utility regulation, regulatory policy and ratemaking and utility management. His involvement in public utility regulation has included project management and in-depth analyses of numerous issues involving telephone, electric, gas, and water and sewer utilities.

Mr. Smith has performed work in the field of utility regulation on behalf of industry, public service commission staffs, state attorney generals, municipalities, and consumer groups concerning regulatory matters before regulatory agencies in Alabama, Alaska, Arizona, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Hawaii, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New Mexico, New York, Nevada, North Carolina, North Dakota, Ohio, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Vermont, Virginia, Washington, Washington DC, West Virginia, Canada, Federal Energy Regulatory Commission and various state and federal courts of law. He has presented expert testimony in regulatory hearings on behalf of utility commission staffs and intervenors on several occasions.

Project manager in Larkin & Associates' review, on behalf of the Georgia Commission Staff, of the budget and planning activities of Georgia Power Company; supervised 13 professionals; coordinated over 200 interviews with Company budget center managers and executives; organized and edited voluminous audit report; presented testimony before the Commission. Functional areas covered included fossil plant O&M, headquarters and district operations, internal audit, legal, affiliated transactions, and responsibility reporting. All of our findings and recommendations were accepted by the Commission.

Key team member in the firm's management audit of the Anchorage Water and Wastewater Utility on behalf of the Alaska Commission Staff, which assessed the effectiveness of the Utility's operations in several areas; responsible for in-depth investigation and report writing in areas involving information systems, finance and accounting, affiliated relationships and transactions, and use of outside contractors. Testified before the Alaska Commission concerning certain areas of the audit report. AWWU concurred with each of Mr. Smith's 40 plus recommendations for improvement.

Co-consultant in the analysis of the issues surrounding gas transportation performed for the law firm of Cravath, Swaine & Moore in conjunction with the case of Reynolds Metals Co. vs. the Columbia Gas System, Inc.; drafted in-depth report concerning the regulatory treatment at both state and federal levels of issues such as flexible pricing and mandatory gas transportation.

Lead consultant and expert witness in the analysis of the rate increase request of the City of Austin - Electric Utility on behalf of the residential consumers. Among the numerous ratemaking issues addressed were the economies of the Utility's employment of outside services; provided both written and oral testimony outlining recommendations and their bases. Most of Mr. Smith's recommendations were adopted by the City Council and Utility in a settlement.

Key team member performing an analysis of the rate stabilization plan submitted by the Southern Bell Telephone & Telegraph Company to the Florida PSC; performed comprehensive analysis of the Company's projections and budgets which were used as the basis for establishing rates.

Lead consultant in analyzing Southwestern Bell Telephone separations in Missouri; sponsored the complex technical analysis and calculations upon which the firm's testimony in that case was based. He has also assisted in analyzing changes in depreciation methodology for setting telephone rates.

Lead consultant in the review of gas cost recovery reconciliation applications of Michigan Gas Utilities Company, Michigan Consolidated Gas Company, and Consumers Power Company. Drafted recommendations regarding the appropriate rate of interest to be applied to any over or under collections and the proper procedures and allocation methodology to be used to distribute any refunds to customer classes.

Lead consultant in the review of Consumers Power Company's gas cost recovery refund plan. Addressed appropriate interest rate and compounding procedures and proper allocation methodology.

Project manager in the review of the request by Central Maine Power Company for an increase in rates. The major area addressed was the propriety of the Company's ratemaking attrition adjustment in relation to its corporate budgets and projections.

Project manager in an engagement designed to address the impacts of the Tax Reform Act of 1986 on gas distribution utility operations of the Northern States Power Company. Analyzed the reduction in the corporate tax rate, uncollectibles reserve, ACRS, unbilled revenues, customer advances, CIAC, and timing of TRA-related impacts associated with the Company's tax liability.

Project manager and expert witness in the determination of the impacts of the Tax Reform Act of 1986 on the operations of Connecticut Natural Gas Company on behalf of the Connecticut Department of Public Utility Control - Prosecutorial Division, Connecticut Attorney General, and Connecticut Department of Consumer Counsel.

Lead Consultant for The Minnesota Department of Public Service ("DPS") to review the Minnesota Incentive Plan ("Incentive Plan") proposal presented by Northwestern Bell Telephone Company ("NWB") doing business as U S West Communications ("USWC"). Objective was to express an opinion as to whether current rates addressed by the plan were appropriate from a Minnesota intrastate revenue requirements and accounting perspective, and to assist in developing recommended modifications to NWB's proposed Plan.

Performed a variety of analytical and review tasks related to our work effort on this project. Obtained and reviewed data and performed other procedures as necessary (1) to obtain an understanding of the Company's Incentive Plan filing package as it relates to rate base, operating income, revenue requirements, and plan operation, and (2) to formulate an opinion concerning the reasonableness of current rates and of amounts included within the Company's Incentive Plan filing. These procedures included requesting and reviewing extensive discovery, visiting the Company's offices to review data, issuing follow-up information requests in many instances, telephone and on-site discussions with Company representatives, and frequent discussions with counsel and DPS Staff assigned to the project.

Lead Consultant in the regulatory analysis of Jersey Central Power & Light Company for the Department of the Public Advocate, Division of Rate Counsel. Tasks performed included on-site review and audit of Company, identification and analysis of specific issues, preparation of data requests, testimony, and cross examination questions. Testified in Hearings.

Assisted the NARUC Committee on Management Analysis with drafting the Consultant Standards for Management Audits.

Presented training seminars covering public utility accounting, tax reform, ratemaking, affiliated transaction auditing, rate case management, and regulatory policy in Maine, Georgia, Kentucky, and Pennsylvania. Seminars were presented to commission staffs and consumer interest groups.

### Previous Positions

With Larkin, Chapski and Co., the predecessor firm to Larkin & Associates, was involved primarily in utility regulatory consulting, and also in tax planning and tax research for businesses and individuals, tax return preparation and review, and independent audit, review and preparation of financial statements.

Installed computerized accounting system for a realty management firm.

### Education

Bachelor of Science in Administration in Accounting, with distinction, University of Michigan, Dearborn, 1979.

Master of Science in Taxation, Walsh College, Michigan, 1981. Master's thesis dealt with investment tax credit and property tax on various assets.

Juris Doctor, cum laude, Wayne State University Law School, Detroit, Michigan, 1986. Recipient of American Jurisprudence Award for academic excellence.

Continuing education required to maintain CPA license and CFP® certificate.

Passed all parts of CPA examination in first sitting, 1979. Received CPA certificate in 1981 and Certified Financial Planning certificate in 1983. Admitted to Michigan and Federal bars in 1986.

Michigan Bar Association.

American Bar Association, sections on public utility law and taxation.

Partial list of utility cases participated in:

79-228-EL-FAC	Cincinnati Gas & Electric Company (Ohio PUC)
79-231-EL-FAC	Cleveland Electric Illuminating Company (Ohio PUC)
79-535-EL-AIR	East Ohio Gas Company (Ohio PUC)
80-235-EL-FAC	Ohio Edison Company (Ohio PUC)
80-240-EL-FAC	Cleveland Electric Illuminating Company (Ohio PUC)
U-1933*	Tucson Electric Power Company (Arizona Corp. Commission)
U-6794	Michigan Consolidated Gas Co. --16 Refunds (Michigan PSC)
81-0035TP	Southern Bell Telephone Company (Florida PSC)
81-0095TP	General Telephone Company of Florida (Florida PSC)
81-308-EL-EFC	Dayton Power & Light Co.- Fuel Adjustment Clause (Ohio PUC)
810136-EU	Gulf Power Company (Florida PSC)
GR-81-342	Northern States Power Co. -- E-002/Minnesota (Minnesota PUC)
Tr-81-208	Southwestern Bell Telephone Company (Missouri PSC))
U-6949	Detroit Edison Company (Michigan PSC)
8400	East Kentucky Power Cooperative, Inc. (Kentucky PSC)
18328	Alabama Gas Corporation (Alabama PSC)
18416	Alabama Power Company (Alabama PSC)
820100-EU	Florida Power Corporation (Florida PSC)
8624	Kentucky Utilities (Kentucky PSC)
8648	East Kentucky Power Cooperative, Inc. (Kentucky PSC)
U-7236	Detroit Edison - Burlington Northern Refund (Michigan PSC)
U6633-R	Detroit Edison - MRCS Program (Michigan PSC)
U-6797-R	Consumers Power Company -MRCS Program (Michigan PSC)
U-5510-R	Consumers Power Company - Energy conservation Finance Program (Michigan PSC)
82-240E	South Carolina Electric & Gas Company (South Carolina PSC)
7350	Generic Working Capital Hearing (Michigan PSC)
RH-1-83	Westcoast Transmission Co., (National Energy Board of Canada)
820294-TP	Southern Bell Telephone & Telegraph Co. (Florida PSC)
82-165-EL-EFC (Subfile A)	Toledo Edison Company(Ohio PUC)
82-168-EL-EFC	Cleveland Electric Illuminating Company (Ohio PUC)
830012-EU	Tampa Electric Company (Florida PSC)
U-7065	The Detroit Edison Company - Fermi II (Michigan PSC)
8738	Columbia Gas of Kentucky, Inc. (Kentucky PSC)
ER-83-206	Arkansas Power & Light Company (Missouri PSC)
U-4758	The Detroit Edison Company – Refunds (Michigan PSC)
8836	Kentucky American Water Company (Kentucky PSC)
8839	Western Kentucky Gas Company (Kentucky PSC)
83-07-15	Connecticut Light & Power Co. (Connecticut DPU)
81-0485-WS	Palm Coast Utility Corporation (Florida PSC)
U-7650	Consumers Power Co. (Michigan PSC)
83-662	Continental Telephone Company of California, (Nevada PSC)
U-6488-R	Detroit Edison Co., FAC & PIPAC Reconciliation (Michigan PSC)
U-15684	Louisiana Power & Light Company (Louisiana PSC)
7395 & U-7397	Campaign Ballot Proposals (Michigan PSC)
820013-WS	Seacoast Utilities (Florida PSC)
U-7660	Detroit Edison Company (Michigan PSC)
83-1039	CP National Corporation (Nevada PSC)
U-7802	Michigan Gas Utilities Company (Michigan PSC)
83-1226	Sierra Pacific Power Company (Nevada PSC)
830465-EI	Florida Power & Light Company (Florida PSC)
U-7777	Michigan Consolidated Gas Company (Michigan PSC)
U-7779	Consumers Power Company (Michigan PSC)

U-7480-R	Michigan Consolidated Gas Company (Michigan PSC)
U-7488-R	Consumers Power Company – Gas (Michigan PSC)
U-7484-R	Michigan Gas Utilities Company (Michigan PSC)
U-7550-R	Detroit Edison Company (Michigan PSC)
U-7477-R**	Indiana & Michigan Electric Company (Michigan PSC)
18978	Continental Telephone Co. of the South Alabama (Alabama PSC)
R-842583	Duquesne Light Company (Pennsylvania PUC)
R-842740	Pennsylvania Power Company (Pennsylvania PUC)
850050-EI	Tampa Electric Company (Florida PSC)
16091	Louisiana Power & Light Company (Louisiana PSC)
19297	Continental Telephone Co. of the South Alabama (Alabama PSC)
76-18788AA	
&76-18793AA	Detroit Edison - Refund - Appeal of U-4807 (Ingham County, Michigan Circuit Court)
85-53476AA	
& 85-534785AA	Detroit Edison Refund - Appeal of U-4758 (Ingham County, Michigan Circuit Court)
U-8091/U-8239	Consumers Power Company - Gas Refunds (Michigan PSC)
TR-85-179**	United Telephone Company of Missouri (Missouri PSC)
85-212	Central Maine Power Company (Maine PSC)
ER-85646001	
& ER-85647001	New England Power Company (FERC)
850782-EI &	
850783-EI	Florida Power & Light Company (Florida PSC)
R-860378	Duquesne Light Company (Pennsylvania PUC)
R-850267	Pennsylvania Power Company (Pennsylvania PUC)
851007-WU	
& 840419-SU	Florida Cities Water Company (Florida PSC)
G-002/GR-86-160	Northern States Power Company (Minnesota PSC)
7195 (Interim)	Gulf States Utilities Company (Texas PUC)
87-01-03	Connecticut Natural Gas Company (Connecticut PUC))
87-01-02	Southern New England Telephone Company (Connecticut Department of Public Utility Control)
3673-	Georgia Power Company (Georgia PSC)
29484	Long Island Lighting Co. (New York Dept. of Public Service)
U-8924	Consumers Power Company – Gas (Michigan PSC)
Docket No. 1	Austin Electric Utility (City of Austin, Texas)
Docket E-2, Sub 527	Carolina Power & Light Company (North Carolina PUC)
870853	Pennsylvania Gas and Water Company (Pennsylvania PUC)
880069**	Southern Bell Telephone Company (Florida PSC)
U-1954-88-102	Citizens Utilities Rural Company, Inc. & Citizens Utilities Company, Kingman Telephone Division (Arizona CC)
T E-1032-88-102	Illinois Bell Telephone Company (Illinois CC)
89-0033	Puget Sound Power & Light Company (Washington UTC))
U-89-2688-T	Philadelphia Electric Company (Pennsylvania PUC)
R-891364	Potomac Electric Power Company (District of Columbia PSC)
F.C. 889	Niagara Mohawk Power Corporation, et al Plaintiffs, v. Gulf+ Western, Inc. et al, defendants (Supreme Court County of Onondaga, State of New York)
Case No. 88/546*	Duquesne Light Company, et al, plaintiffs, against Gulf+ Western, Inc. et al, defendants (Court of the Common Pleas of Allegheny County, Pennsylvania Civil Division)
87-11628*	Florida Power & Light Company (Florida PSC)
890319-EI	Gulf Power Company (Florida PSC)
891345-EI	Jersey Central Power & Light Company (BPU)
ER 8811 0912J	Hawaiian Electric Company (Hawaii PUCs)
6531	

R0901595	Equitable Gas Company (Pennsylvania Consumer Counsel)
90-10	Artesian Water Company (Delaware PSC)
89-12-05	Southern New England Telephone Company (Connecticut PUC)
900329-WS	Southern States Utilities, Inc. (Florida PSC)
90-12-018	Southern California Edison Company (California PUC)
90-E-1185	Long Island Lighting Company (New York DPS)
R-911966	Pennsylvania Gas & Water Company (Pennsylvania PUC)
I.90-07-037, Phase II	(Investigation of OPEBs) Department of the Navy and all Other Federal Executive Agencies (California PUC)
U-1551-90-322	Southwest Gas Corporation (Arizona CC)
U-1656-91-134	Sun City Water Company (Arizona RUCO)
U-2013-91-133	Havasu Water Company (Arizona RUCO)
91-174***	Central Maine Power Company (Department of the Navy and all Other Federal Executive Agencies)
U-1551-89-102	Southwest Gas Corporation - Rebuttal and PGA Audit (Arizona Corporation Commission)
& U-1551-89-103	
Docket No. 6998	Hawaiian Electric Company (Hawaii PUC)
TC-91-040A and	Intrastate Access Charge Methodology, Pool and Rates
TC-91-040B	Local Exchange Carriers Association and South Dakota Independent Telephone Coalition
9911030-WS &	General Development Utilities - Port Malabar and West Coast Divisions (Florida PSC)
911-67-WS	
922180	The Peoples Natural Gas Company (Pennsylvania PUC)
7233 and 7243	Hawaiian Nonpension Postretirement Benefits (Hawaiian PUC)
R-00922314	
& M-920313C006	Metropolitan Edison Company (Pennsylvania PUC)
R00922428	Pennsylvania American Water Company (Pennsylvania PUC)
E-1032-92-083 &	
U-1656-92-183	Citizens Utilities Company, Agua Fria Water Division (Arizona Corporation Commission)
92-09-19	Southern New England Telephone Company (Connecticut PUC)
E-1032-92-073	Citizens Utilities Company (Electric Division), (Arizona CC)
UE-92-1262	Puget Sound Power and Light Company (Washington UTC))
92-345	Central Maine Power Company (Maine PUC)
R-932667	Pennsylvania Gas & Water Company (Pennsylvania PUC)
U-93-60**	Matanuska Telephone Association, Inc. (Alaska PUC)
U-93-50**	Anchorage Telephone Utility (Alaska PUC)
U-93-64	PTI Communications (Alaska PUC)
7700	Hawaiian Electric Company, Inc. (Hawaii PUC)
E-1032-93-111 &	Citizens Utilities Company - Gas Division
U-1032-93-193	(Arizona Corporation Commission)
R-00932670	Pennsylvania American Water Company (Pennsylvania PUC)
U-1514-93-169/	Sale of Assets CC&N from Contel of the West, Inc. to
E-1032-93-169	Citizens Utilities Company (Arizona Corporation Commission)
7766	Hawaiian Electric Company, Inc. (Hawaii PUC)
93-2006- GA-AIR*	The East Ohio Gas Company (Ohio PUC)
94-E-0334	Consolidated Edison Company (New York DPS)
94-0270	Inter-State Water Company (Illinois Commerce Commission)
94-0097	Citizens Utilities Company, Kauai Electric Division (Hawaii PUC)
PU-314-94-688	Application for Transfer of Local Exchanges (North Dakota PSC)
94-12-005-Phase I	Pacific Gas & Electric Company (California PUC)
R-953297	UGI Utilities, Inc. - Gas Division (Pennsylvania PUC)
95-03-01	Southern New England Telephone Company (Connecticut PUC)
95-0342	Consumer Illinois Water, Kankakee Water District (Illinois CC)
94-996-EL-AIR	Ohio Power Company (Ohio PUC)
95-1000-E	South Carolina Electric & Gas Company (South Carolina PSC)

Non-Docketed Staff Investigation E-1032-95-473 E-1032-95-433	Citizens Utility Company - Arizona Telephone Operations (Arizona Corporation Commission) Citizens Utility Co. - Northern Arizona Gas Division (Arizona CC) Citizens Utility Co. - Arizona Electric Division (Arizona CC) Collaborative Ratemaking Process Columbia Gas of Pennsylvania (Pennsylvania PUC)
GR-96-285 94-10-45 A.96-08-001 et al.	Missouri Gas Energy (Missouri PSC) Southern New England Telephone Company (Connecticut PUC) California Utilities' Applications to Identify Sunk Costs of Non- Nuclear Generation Assets, & Transition Costs for Electric Utility Restructuring, & Consolidated Proceedings (California PUC)
96-324 96-08-070, et al.	Bell Atlantic - Delaware, Inc. (Delaware PSC) Pacific Gas & Electric Co., Southern California Edison Co. and San Diego Gas & Electric Company (California PUC)
97-05-12 R-00973953	Connecticut Light & Power (Connecticut PUC) Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code (Pennsylvania PUC)
97-65	Application of Delmarva Power & Light Co. for Application of a Cost Accounting Manual and a Code of Conduct (Delaware PSC)
16705 E-1072-97-067 Non-Docketed Staff Investigation PU-314-97-12 97-0351 97-8001	Entergy Gulf States, Inc. (Cities Steering Committee) Southwestern Telephone Co. (Arizona Corporation Commission) Delaware - Estimate Impact of Universal Services Issues (Delaware PSC) US West Communications, Inc. Cost Studies (North Dakota PSC) Consumer Illinois Water Company (Illinois CC) Investigation of Issues to be Considered as a Result of Restructuring of Electric Industry (Nevada PSC)
U-0000-94-165	Generic Docket to Consider Competition in the Provision of Retail Electric Service (Arizona Corporation Commission)
98-05-006-Phase I 9355-U	San Diego Gas & Electric Co., Section 386 costs (California PUC)
97-12-020 - Phase I	Georgia Power Company Rate Case (Georgia PUC)
U-98-56, U-98-60, U-98-65, U-98-67	Pacific Gas & Electric Company (California PUC)
(U-99-66, U-99-65, U-99-56, U-99-52)	Investigation of 1998 Intrastate Access charge filings (Alaska PUC)
Phase II of 97-SCCC-149-GIT	Investigation of 1999 Intrastate Access Charge filing (Alaska PUC)
PU-314-97-465 Non-docketed Assistance Contract Dispute	Southwestern Bell Telephone Company Cost Studies (Kansas CC) US West Universal Service Cost Model (North Dakota PSC) Bell Atlantic - Delaware, Inc., Review of New Telecomm. and Tariff Filings (Delaware PSC) City of Zeeland, MI - Water Contract with the City of Holland, MI (Before an arbitration panel)
Non-docketed Project Non-docketed Project	City of Danville, IL - Valuation of Water System (Danville, IL) Village of University Park, IL - Valuation of Water and Sewer System (Village of University Park, Illinois)

E-1032-95-417	Citizens Utility Co., Maricopa Water/Wastewater Companies et al. (Arizona Corporation Commission)
T-1051B-99-0497	Proposed Merger of the Parent Corporation of Qwest Communications Corporation, LCI International Telecom Corp., and US West Communications, Inc. (Arizona CC)
T-01051B-99-0105	US West Communications, Inc. Rate Case (Arizona CC)
A00-07-043	Pacific Gas & Electric - 2001 Attrition (California PUC)
T-01051B-99-0499	US West/Quest Broadband Asset Transfer (Arizona CC)
99-419/420	US West, Inc. Toll and Access Rebalancing (North Dakota PSC)
PU314-99-119	US West, Inc. Residential Rate Increase and Cost Study Review (North Dakota PSC)
98-0252	Ameritech - Illinois, Review of Alternative Regulation Plan (Illinois CUB)
00-108	Delmarva Billing System Investigation (Delaware PSC)
U-00-28	Matanuska Telephone Association (Alaska PUC)
Non-Docketed	Management Audit and Market Power Mitigation Analysis of the Merged Gas System Operation of Pacific Enterprises and Enova Corporation (California PUC)
00-11-038	Southern California Edison (California PUC)
00-11-056	Pacific Gas & Electric (California PUC)
00-10-028	The Utility Reform Network for Modification of Resolution E-3527 (California PUC)
98-479	Delmarva Power & Light Application for Approval of its Electric and Fuel Adjustments Costs (Delaware PSC)
99-457	Delaware Electric Cooperative Restructuring Filing (Delaware PSC)
99-582	Delmarva Power & Light dba Conectiv Power Delivery Analysis of Code of Conduct and Cost Accounting Manual (Delaware PSC)
99-03-04	United Illuminating Company Recovery of Stranded Costs (Connecticut OCC)
99-03-36	Connecticut Light & Power (Connecticut OCC)
Civil Action No.	
98-1117	West Penn Power Company vs. PA PUC (Pennsylvania PSC)
Case No. 12604	Upper Peninsula Power Company (Michigan AG)
Case No. 12613	Wisconsin Public Service Commission (Michigan AG)
41651	Northern Indiana Public Service Co Overearnings investigation (Indiana UCC)
13605-U	Savannah Electric & Power Company – FCR (Georgia PSC)
14000-U	Georgia Power Company Rate Case/M&S Review (Georgia PSC)
13196-U	Savannah Electric & Power Company Natural Gas Procurement and Risk Management/Hedging Proposal, Docket No. 13196-U (Georgia PSC)
Non-Docketed	Georgia Power Company & Savannah Electric & Power FPR Company Fuel Procurement Audit (Georgia PSC)
Non-Docketed	Transition Costs of Nevada Vertically Integrated Utilities (US Department of Navy)
Application No.	Post-Transition Ratemaking Mechanisms for the Electric Industry
99-01-016,	Restructuring (US Department of Navy)
Phase I	
99-02-05	Connecticut Light & Power (Connecticut OCC)
01-05-19-RE03	Yankee Gas Service Application for a Rate Increase, Phase I-2002-IERM (Connecticut OCC)
G-01551A-00-0309	Southwest Gas Corporation, Application to amend its rate Schedules (Arizona CC)
00-07-043	Pacific Gas & Electric Company Attrition & Application for a rate increase (California PUC)

97-12-020	Pacific Gas & Electric Company Rate Case (California PUC)
Phase II	United Illuminating Company (Connecticut OCC)
01-10-10	Georgia Power FCR (Georgia PSC)
13711-U	Verizon Delaware § 271(Delaware DPA)
02-001	Blue Valley Telephone Company Audit/General Rate Investigation (Kansas CC)
02-BLVT-377-AUD	S&T Telephone Cooperative Audit/General Rate Investigation (Kansas CC)
02-S&TT-390-AUD	Sunflower Telephone Company Inc., Audit/General Rate Investigation (Kansas CC)
01-SFLT-879-AUD	Bluestem Telephone Company, Inc. Audit/General Rate Investigation (Kansas CC)
01-BSTT-878-AUD	
P404, 407, 520, 413	
426, 427, 430, 421/	
CI-00-712	Sherburne County Rural Telephone Company, dba as Connections, Etc. (Minnesota DOC)
U-01-85	ACS of Alaska, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-34	ACS of Anchorage, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-83	ACS of Fairbanks, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
U-01-87	ACS of the Northland, dba as Alaska Communications Systems (ACS), Rate Case (Alaska Regulatory Commission PAS)
96-324, Phase II	Verizon Delaware, Inc. UNE Rate Filing (Delaware PSC)
03-WHST-503-AUD	Wheat State Telephone Company (Kansas CC)
04-GNBT-130-AUD	Golden Belt Telephone Association (Kansas CC)
Docket 6914	Shoreham Telephone Company, Inc. (Vermont BPU)
Docket No.	
E-01345A-06-009	Arizona Public Service Company (Arizona Corporation Commission)
Case No.	
05-1278-E-PC-PW-42T	Appalachian Power Company and Wheeling Power Company both d/b/a American Electric Power (West Virginia PSC)
Docket No. 04-0113	Hawaiian Electric Company (Hawaii PUC)
Case No. U-14347	Consumers Energy Company (Michigan PSC)
Case No. 05-725-EL-UNC	Cincinnati Gas & Electric Company (PUC of Ohio)
Docket No. 21229-U	Savannah Electric & Power Company (Georgia PSC)
Docket No. 19142-U	Georgia Power Company (Georgia PSC)
Docket No.	
03-07-01RE01	Connecticut Light & Power Company (CT DPUC)
Docket No. 19042-U	Savannah Electric & Power Company (Georgia PSC)
Docket No. 2004-178-E	South Carolina Electric & Gas Company (South Carolina PSC)
Docket No. 03-07-02	Connecticut Light & Power Company (CT DPUC)
Docket No. EX02060363,	
Phases I&II	Rockland Electric Company (NJ BPU)
Docket No. U-00-88	ENSTAR Natural Gas Company and Alaska Pipeline Company (Regulatory Commission of Alaska)
Phase 1-2002 IERM,	
Docket No. U-02-075	Interior Telephone Company, Inc. (Regulatory Commission of Alaska)
Docket No. 05-SCNT-1048-AUD	South Central Telephone Company (Kansas CC)
Docket No. 05-TRCT-607-KSF	Tri-County Telephone Company (Kansas CC)
Docket No. 05-KOKT-060-AUD	Kan Okla Telephone Company (Kansas CC)
Docket No. 2002-747	Northland Telephone Company of Maine (Maine PUC)

Docket No. 2003-34	Sidney Telephone Company (Maine PUC)
Docket No. 2003-35	Maine Telephone Company (Maine PUC)
Docket No. 2003-36	China Telephone Company (Maine PUC)
Docket No. 2003-37	Standish Telephone Company (Maine PUC)
Docket Nos. U-04-022, U-04-023	Anchorage Water and Wastewater Utility (Regulatory Commission of Alaska)
Case 05-116-U/06-055-U	Entergy Arkansas, Inc. EFC (Arkansas Public Service Commission)
Case 04-137-U	Southwest Power Pool RTO (Arkansas Public Service Commission)
Case No. 7109/7160	Vermont Gas Systems (Department of Public Service)
Case No. ER-2006-0315	Empire District Electric Company (Missouri PSC)
Case No. ER-2006-0314	Kansas City Power & Light Company (Missouri PSC)
Docket No. U-05-043,44	Golden Heart Utilities/College Park Utilities (Regulatory Commission of Alaska)
A-122250F5000	Equitable Resources, Inc. and The Peoples Natural Gas Company, d/b/a Dominion Peoples (Pennsylvania PUC)
E-01345A-05-0816	Arizona Public Service Company (Arizona CC)
Docket No. 05-304	Delmarva Power & Light Company (Delaware PSC)
05-806-EL-UNC	Cincinnati Gas & Electric Company (Ohio PUC)
U-06-45	Anchorage Water Utility (Regulatory Commission of Alaska)
03-93-EL-ATA,	
06-1068-EL-UNC	Duke Energy Ohio (Ohio PUC)
PUE-2006-00065	Appalachian Power Company (Virginia Corporation Commission)
G-04204A-06-0463 et. al	UNS Gas, Inc. (Arizona CC)
U-06-134	Chugach Electric Association, Inc. (Regulatory Commission of Alaska)
Docket No. 2006-0386	Hawaiian Electric Company, Inc (Hawaii PUC)
E-01933A-07-0402	Tucson Electric Power Company (Arizona CC)
G-01551A-07-0504	Southwest Gas Corporation (Arizona CC)
Docket No. UE-072300	Puget Sound Energy, Inc. (Washington UTC)
PUE-2008-00009	Virginia-American Water Company (Virginia SCC)
PUE-2008-00046	Appalachian Power Company (Virginia SCC)
E-01345A-08-0172	Arizona Public Service Company (Arizona CC)
A-2008-2063737	Babcock & Brown Infrastructure Fund North America, LP. and The Peoples Natural Gas Company, d/b/a Dominion Peoples (Pennsylvania PUC)
08-1783-G-42T	Hope Gas, Inc., dba Dominion Hope (West Virginia PSC)
08-1761-G-PC	Hope Gas, Inc., dba Dominion Hope, Dominion Resources, Inc., and Peoples Hope Gas Companies (West Virginia PSC)
Docket No. 2008-0085	Hawaiian Electric Company, Inc. (Hawaii PUC)
Docket No. 2008-0266	Young Brothers, Limited (Hawaii PUC)
G-04024A-08-0571	UNS Gas, Inc. (Arizona CC)
Docket No. 09-29	Tidewater Utilities, Inc. (Delaware PSC)
Docket No. UE-090704	Puget Sound Energy, Inc. (Washington UTC)
09-0878-G-42T	Mountaineer Gas Company (West Virginia PSC)
2009-UA-0014	Mississippi Power Company (Mississippi PSC)
Docket No. 09-0319	Illinois-American Water Company (Illinois CC)
Docket No. 09-414	Delmarva Power & Light Company (Delaware PSC)
R-2009-2132019	Aqua Pennsylvania, Inc. (Pennsylvania PUC)
Docket Nos. U-09-069, U-09-070	ENSTAR Natural Gas Company (Regulatory Commission of Alaska)
Docket Nos. U-04-023, U-04-024	Anchorage Water and Wastewater Utility - Remand (Regulatory Commission of Alaska)
W-01303A-09-0343 & SW-01303A-09-0343	Arizona-American Water Company (Arizona CC)
09-872-EL-FAC & 09-873-EL-FAC	Financial Audits of the FAC of the Columbus Southern Power Company and the Ohio Power Company - Audit I (Ohio PUC)

2010-00036	Kentucky-American Water Company (Kentucky PSC)
E-04100A-09-0496	Southwest Transmission Cooperative, Inc. (Arizona CC)
E-01773A-09-0496	Arizona Electric Power Cooperative, Inc. (Arizona CC)
R-2010-2166208,	
R-2010-2166210,	
R-2010-2166212, &	
R-2010-2166214	Pennsylvania-American Water Company (Pennsylvania PUC)
PSC Docket No. 09-0602	Central Illinois Light Company D/B/A AmerenCILCO; Central Illinois Public Service Company D/B/A AmerenCIPS; Illinois Power Company D/B/A AmerenIP (Illinois CC)
10-0713-E-PC	Allegheny Power and FirstEnergy Corp. (West Virginia PSC)
Docket No. 31958	Georgia Power Company (Georgia PSC)
Docket No. 10-0467	Commonwealth Edison Company (Illinois CC)
PSC Docket No. 10-237	Delmarva Power & Light Company (Delaware PSC)
U-10-51	Cook Inlet Natural Gas Storage Alaska, LLC (Regulatory Commission of Alaska)
10-0699-E-42T	Appalachian Power Company and Wheeling Power Company (West Virginia PSC)
10-0920-W-42T	West Virginia-American Water Company (West Virginia PSC)
A.10-07-007	California-American Water Company (California PUC)
A-2010-2210326	TWP Acquisition (Pennsylvania PUC)
08-1012-EL-FAC	Financial, Management, and Performance Audit of the FAC for Dayton Power and Light – Audit I (Ohio PUC)
10-268-EL FAC et al.	Financial Audit of the FAC of the Columbus Southern Power Company and the Ohio Power Company – Audit II (Ohio PUC)
Docket No. 2010-0080	Hawaiian Electric Company, Inc. (Hawaii PUC)
G-01551A-10-0458	Southwest Gas Corporation (Arizona CC)
10-KCPE-415-RTS	Kansas City Power & Light Company – Remand (Kansas CC)
PUE-2011-00037	Virginia Appalachian Power Company (Commonwealth of Virginia SCC)
R-2011-2232243	Pennsylvania-American Water (Pennsylvania PUC)
U-11-100	Power Purchase Agreement between Chugach Association, Inc. and Fire Island Wind, LLC (Regulatory Commission of Alaska)
A.10-12-005	San Diego Gas & Electric Company (California PUC)
PSC Docket No. 11-207	Artesian Water Company, Inc. (Delaware PSC)
Cause No. 44022	Indiana-American Water Company, Inc. (Indiana Utility Regulatory Commission)
PSC Docket No. 10-247	Management Audit of Tidewater Utilities, Inc. Affiliate Transactions (Delaware Public Service Commission)
G-04204A-11-0158	UNS Gas, Inc. (Arizona Corporation Commission)
E-01345A-11-0224	Arizona Public Service Company (Arizona CC)
UE-111048 & UE-11049	Puget Sound Energy, Inc. (Washington Utilities and Transportation Commission)
Docket No. 11-0721	Commonwealth Edison Company (Illinois CC)
11AL-947E	Public Service Company of Colorado (Colorado PSC)
U-11-77 & U-11-78	Golden Heart Utilities, Inc. and College Utilities Corporation (The Regulatory Commission of Alaska)
Docket No. 11-0767	Illinois-American Water Company (Illinois CC)
PSC Docket No. 11-397	Tidewater Utilities, Inc. (Delaware PSC)
Cause No. 44075	Indiana Michigan Power Company (Indiana Utility Regulatory Commission)
Docket No. 12-0001	Ameren Illinois Company (Illinois CC)
11-5730-EL-FAC	Financial, Management, and Performance Audit of the FAC for Dayton Power and Light – Audit 2 (Ohio PUC)
PSC Docket No. 11-528	Delmarva Power & Light Company (Delaware PSC)
11-281-EL FAC et al.	Financial Audit of the FAC of the Columbus Southern Power Company and the Ohio Power Company – Audit III (Ohio PUC)
Cause No. 43114-IGCC-	

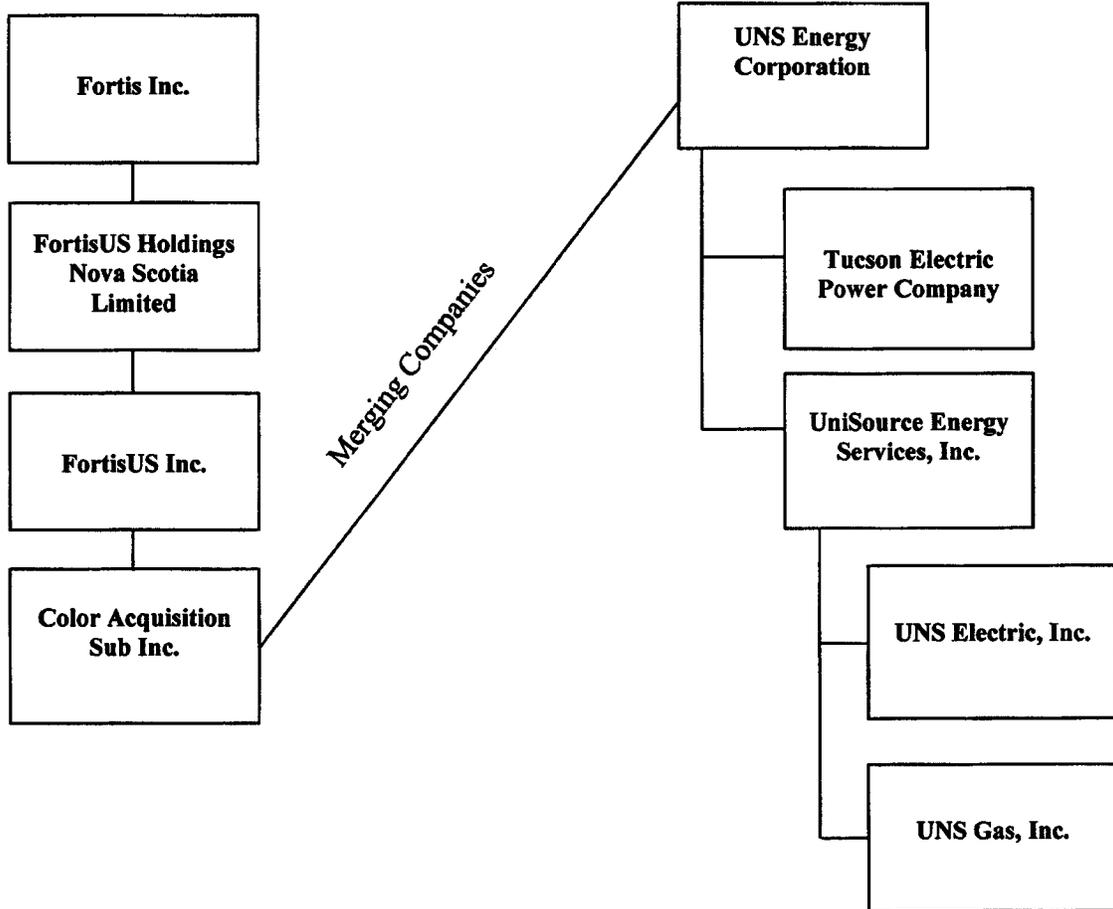
4S1	Duke Energy Indiana, Inc. (Indiana Utility Regulatory Commission)
Docket No. 12-0293	Ameren Illinois Company (Illinois CC)
Docket No. 12-0321	Commonwealth Edison Company (Illinois CC)
12-02019 & 12-04005	Southwest Gas Corporation (Public Utilities Commission of Nevada)
Docket No. 2012-218-E	South Carolina Electric & Gas (South Carolina PSC)
Docket No. E-72, Sub 479	Dominion North Carolina Power (North Carolina Utilities Commission)
12-0511 & 12-0512	North Shore Gas Company and The Peoples Gas Light and Coke Company (Illinois CC)
E-01933A-12-0291	Tucson Electric Power Company (Arizona CC)
Case No. 9311	Potomac Electric Power Company (Maryland PSC)
Cause No. 43114-IGCC-10	Duke Energy Indiana, Inc. (Indiana Utility Regulatory Commission)
Docket No. 36498	Georgia Power Company (Georgia PSC)
Case No. 9316	Columbia Gas of Maryland, Inc. (Maryland PSC)
Docket No. 13-0192	Ameren Illinois Company (Illinois CC)
12-1649-W-42T	West Virginia-American Water Company (West Virginia PSC)
E-04204A-12-0504	UNS Electric, Inc. (Arizona CC)
PUE-2013-00020	Virginia and Electric Power Company (Virginia SCC)
R-2013-2355276	Pennsylvania-American Water Company (Pennsylvania PUC)
Formal Case No. 1103	Potomac Electric Power Company (District of Columbia PSC)
U-13-007	Chugach Electrical Association, Inc. (The Regulatory Commission of Alaska)
12-2881-EL-FAC	Financial, Management, and Performance Audit of the FAC for Dayton Power and Light – Audit 3 (Ohio PUC)
Docket No. 36989	Georgia Power Company (Georgia PSC)
Cause No. 43114-IGCC-11	Duke Energy Indiana, Inc. (Indiana Utility Regulatory Commission)
UM 1633	Investigation into Treatment of Pension Costs in Utility Rates (Oregon PUC)

**Attachment RCS-2**

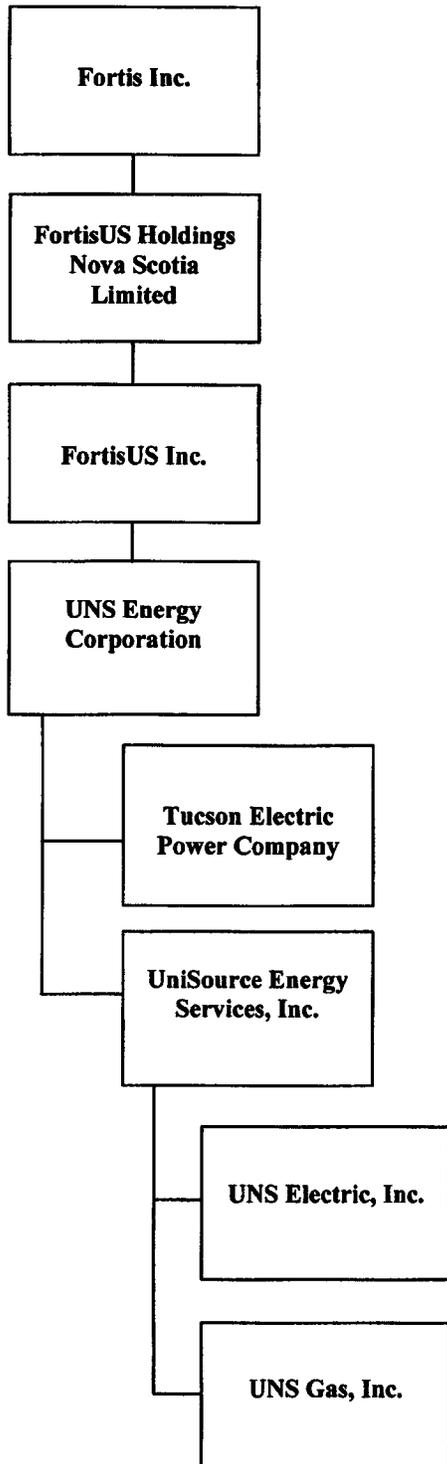
**Pre- and Post-Acquisition Corporate Organizational Chart**

**(From Joint Application Exhibit 2 and  
UNS Energy Testimony Exhibit DGH-2)**

# Pre-Merger



## Post-Merger



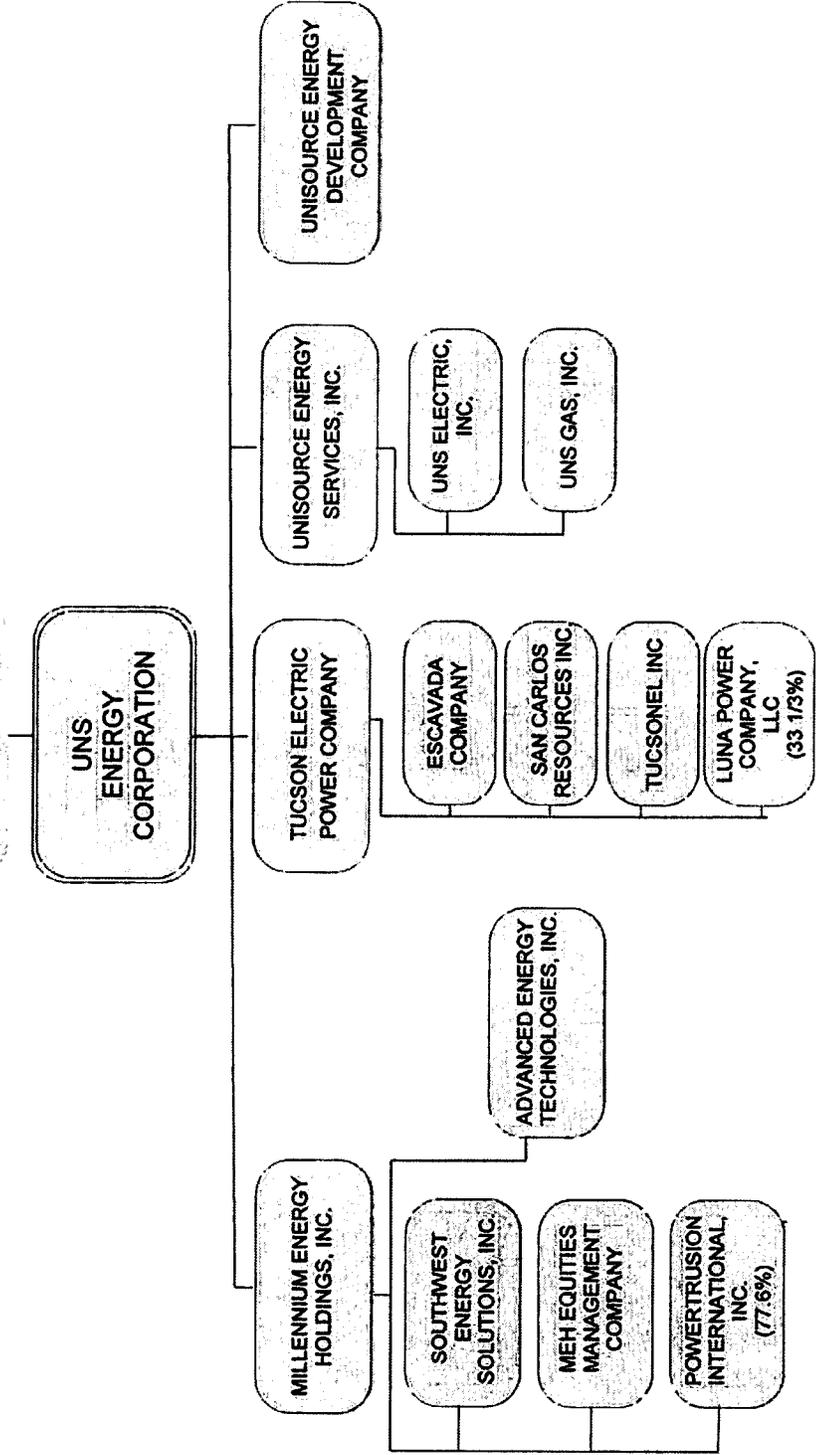
# UNS Energy Corporation & Subsidiaries

Post Merger

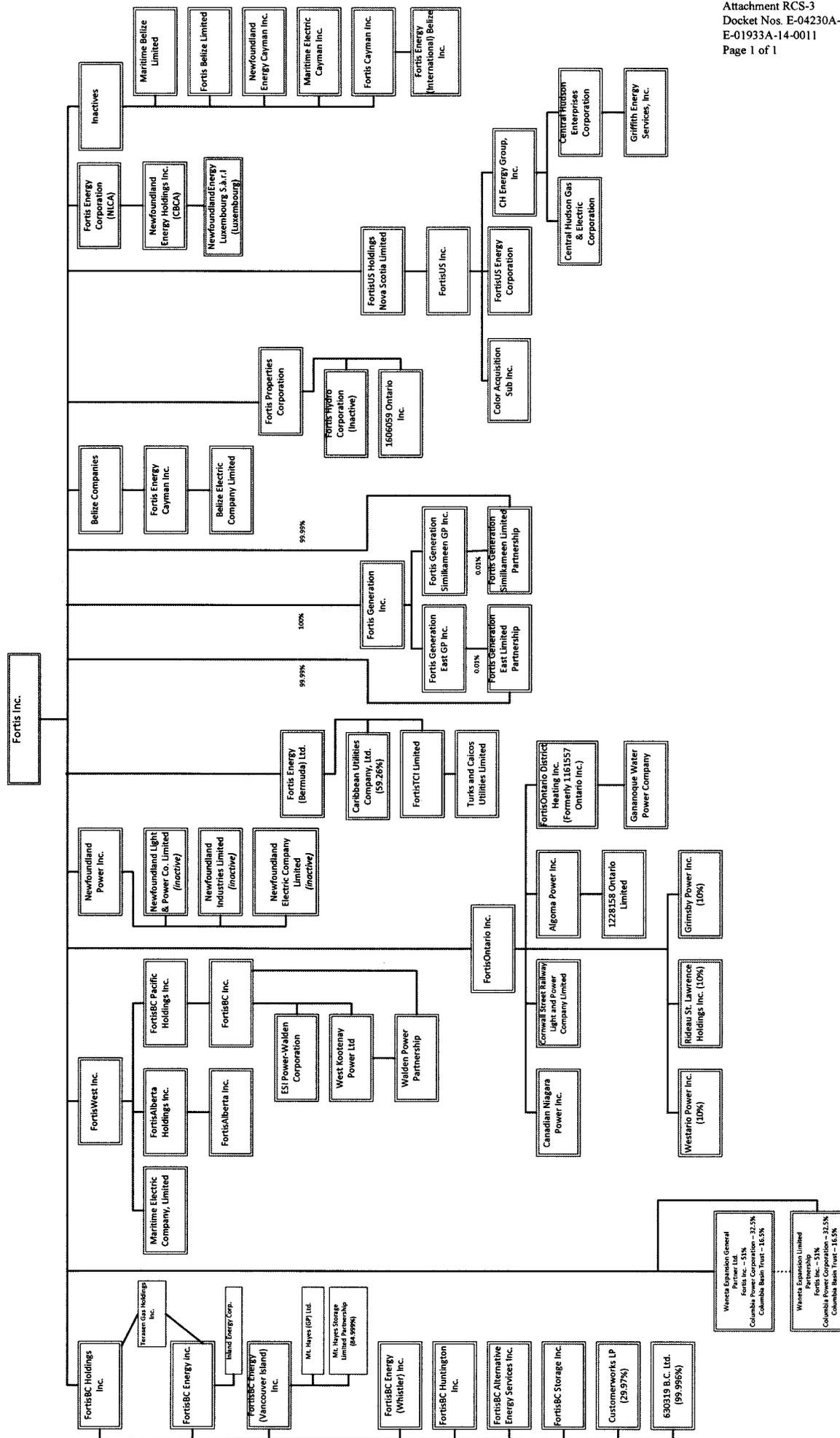
FORTIS INC.

FORTIS US HOLDINGS  
NOVA SCOTIA  
LIMITED

FORTIS US INC.



Attachment RCS-3  
Fortis Inc. Organizational Chart as of February 2014  
(From Email dated March 26, 2014)



**UNS Energy Corporation and Fortis Inc.**  
**Docket Nos. E-04230A-14-0011 and E-01933A-14-0011**  
**Attachment RCS-4**  
**Recent News Articles on Energy Future Holdings' Impending Bankruptcy**  
**and Information Illustrating Large Historical Goodwill Impairment Write-offs**  
**Following Acquisition/Merger Transactions**

<b>Article</b>	<b>No. of Pages</b>	<b>Page No.</b>
Dallas Business Journal - "Drama continues for EFH; new anonymous bonds buyer in the mix", April 14, 2014	2	2 - 3
Bloomberg Businessweek - "Energy Future Holdings misses filing deadline", April 15, 2014	2	4 - 5
Star-Telegram - "Energy Future Holdings bankruptcy would likely attract bidders for Oncor", April 17, 2014	2	6 - 7
Star-Telegram - "Energy Future Holdings files Chapter 11 bankruptcy", April 29, 2014	2	8 - 9
"Qwest Takes \$41 Billion Impairment Hit", October 29, 2002	1	10
"What AOL Time Warner's \$54 Billion [Goodwill Impairment] Loss Means", April 25, 2002	2	11 - 12
Scottish Power 922 million (British pounds) 2006 Goodwill Impairment related to their discontinued PacifiCorp Operations	1	13
Exelon Goodwill Impairment charge of \$776 million for ComEd after Illinois Commerce Commission decision in 2005 ComEd rate case	1	14
Total Pages Including this Page	14	

**From the Dallas Business Journal**

**:[http://www.bizjournals.com/dallas/blog/morning\\_call/2014/04/drama-continues-for-efh-new-anonymous-bonds-buyer.html](http://www.bizjournals.com/dallas/blog/morning_call/2014/04/drama-continues-for-efh-new-anonymous-bonds-buyer.html)**

Apr 14, 2014, 5:27am CDT

## **Drama continues for EFH; new anonymous bonds buyer in the mix**



Nicholas Sakelaris

Staff Writer- *Dallas Business Journal*

[Email](#) | [LinkedIn](#) | [Twitter](#) | [Google+](#)

Despite Energy Future Holdings' massive debt load and inevitable bankruptcy, the power giant's Oncor subsidiary saw the price of 2018 bonds go up 9 cents last week, Bloomberg reported.

The \$1.57 billion in bonds due December, 2018 went from 72.4 cents April 4 to 81.6 cents on April 10, Bloomberg calculated.

One anonymous buyer of those bonds submitted a so-called "Big Boy Letter" last week that, according to Bloomberg sources, indicates the buyer could have non-public information and could be a party in the pre-bankruptcy negotiations.

The clock is ticking for Dallas-based EFH because the company skipped a \$109 million interest payment that was due April 1, giving the company until April 30 to reach a pre-packaged bankruptcy or face the wrath of scorned creditors.

EFH started as a leveraged buyout in 2007 as a gamble that natural gas prices would rise, sending the price of wholesale electricity up with it. Hydraulic fracturing and horizontal drilling techniques made shale gas accessible to the point where it flooded the market, dropping the price. That sent EFH into a downward spiral.

So what happens when the company that generates, sells and delivers electricity throughout North Texas goes bankrupt and why is Oncor being treated differently?

Attachment RCS-4

Page 3 of 14

The cover story for the most recent *Dallas Business Journal* explores the five ways of looking at the looming failure of EFH and what caused the largest leveraged buyout in history to turn into what will be one of the largest bankruptcies in history.

Nicholas covers the energy and banking beats for the Dallas Business Journal. [Subscribe the Energy Inc. newsletter](#)

Bloomberg Businessweek

## News

<http://www.businessweek.com/ap/2014-04-15/energy-future-holdings-misses-filing-deadline>

## Energy Future Holdings misses filing deadline

By Emily Schmall April 15, 2014

FORT WORTH, Texas (AP) — Energy Future Holdings is still not ready to file its already delayed annual report, the company said in a filing Tuesday with the federal Securities and Exchange Commission.

The decision not to submit the report places the Dallas-based company in breach of agreements with creditors for TXU Energy and Luminant, the largest power generator in Texas, and could be another step towards bankruptcy.

Two weeks ago, Energy Future Holdings skipped a deadline to pay \$109 million in interest payments, relying upon a 30-day grace period to avoid a default. Companies have 90 days from the end of the year to file their annual reports. Energy Future asked for a two-week extension on April 1.

The Sierra Club and other environmental watchdogs have said the company's looming bankruptcy could jeopardize nearly \$1 billion in mining cleanup funds owed to Texas.

Luminant Mining Co. has been allowed to operate without a reserve fund to restore the heavily mined areas in East Texas where it operates, but Energy Future spokesman Allan Koenig insisted environmental reclamations will be paid, no matter the outcome.

"This is a financial, rather than operational, issue. There is no chance the plants will shut down," Koenig said.

In an April 1 filing, Energy Future said it expects to have the financing to permit Luminant to grant the Texas Railroad Commission a collateral bond equal to or beyond what it owes for the cleanup.

Still, the Texas Railroad Commission, which regulates the state's oil and gas industries, said this week that it will require Luminant to post real cash bonds to cover future mining operations when and if Energy Future files and emerges from its Chapter 11 bankruptcy protection.

There is no set date for a bankruptcy to commence as negotiations over the company's \$45.6 billion debt continue among Energy Future's owners, management and holders, according to Koenig. However, the company could issue a warning about its ability to continue as a going concern or fail to pay interest due by the end of April, either of which would trigger a default.

The company had bet that natural gas prices would rise, giving its coal-fired plants a competitive edge. Instead, natural gas prices have plummeted amid a glut of production from U.S. shale deposits.

Attachment RCS-4

Page 5 of 14

Energy Future Holdings was acquired in 2007 by private-equity firms KKR & Co., TPG Capital and Goldman Sachs Capital Partners.

The proposal stakeholders are now discussing aims to reduce the amount of time it takes to restructure, avoiding a chaotic free-for-all and protect stakeholders from a tax liability estimated at as much as \$7 billion that could be triggered if the company fails to keep its regulated and deregulated units intact.

---

©2014 Bloomberg L.P. All Rights Reserved. Made in NYC

html  
**Star-Telegram**

## Energy Future Holdings bankruptcy would likely attract bidders for Oncor

Posted Thursday, Apr. 17, 2014

**BY MARK CHEDIAK**  
Bloomberg News

The expected bankruptcy filing by Dallas-based Energy Future Holdings, created through the biggest leveraged buyout in history, is poised to put the most profitable unit of the power producer up for grabs.

Oncor Electric Delivery, which operates most of the power lines serving North Texas, may eventually end up in the hands of creditors, who could sell it to a utility buyer if EFH is broken up during bankruptcy, according to debt researchers Gimme Credit and CreditSights.

MidAmerican Energy Holdings, owned by Warren Buffett's Berkshire Hathaway; Houston-based CenterPoint Energy; Exelon; and American Electric Power may jump at the chance to bid for the operator of the largest transmission and distribution system in Texas, said Moody's Investors Service. Oncor may be the most-coveted unit because of its regulated, steady earnings.

Energy Future's two other big units — Luminant Generation, the state's largest power producer, and TXU Energy, a big electricity retailer — are deregulated.

KKR, Goldman Sachs Capital Partners and TPG Capital bought out the former TXU Corp. in 2007 with tens of billions in borrowed dollars, hoping that the deregulated electricity market, high power prices and steady growth would prove a winning investment. But falling natural gas prices led to lower electricity prices, eroding EFH's ability to generate enough money to pay down the loans.

It now owes about \$45 billion in debt. EFH owns about 80 percent of Oncor, having sold the rest shortly after the buyout to raise cash.

"We view Oncor as a premium asset," said Jim Hempstead, a New York-based analyst at Moody's. "The list of interested buyers would probably be as long as a West Texas country mile."

EFH, now in a 30-day grace period of a missed interest payment that was due April 1, is widely expected to file a Chapter 11 bankruptcy petition this month.

Oncor, which provides electricity to more than 3 million homes and businesses, "recovered faster from the recession than anyone else and is one of the few utilities reporting actual customer growth," said Dot Matthews, a New York-based analyst who covers the utility for CreditSights. "They have remained a stable, good investment."

Allan Koenig, a spokesman for Energy Future Holdings, declined to comment.

Although creditors would take majority ownership of Oncor in the restructuring, they would probably want to sell it eventually instead of holding it for dividend payments that are capped by regulators, said Philip Adams, a credit analyst for Gimme Credit. A buyer could also bid for the other 20 percent not owned by EFH, he said.

Oncor's steady return and growth potential could make it a target for a number of investor-owned utilities, including MidAmerican Energy, said Timothy Winter, an analyst for Gabelli & Co.

Oncor is allowed about a 10 percent return on its investments by regulators and said in February that it plans to spend \$1 billion annually over the next five years as it upgrades its power line network to meet increasing demand.

Net income at the utility increased 24 percent last year to \$432 million, according to a February filing.

Attachment RCS-4

Page 7 of 14

Oncor could appeal to Exelon, which has expressed interest in expanding in Texas, said Julien Dumoulin-Smith, a New York-based analyst with UBS AG.

Representatives for MidAmerican and Exelon declined to comment.

Looking for comments...

## Energy Future Holdings files for Chapter 11 bankruptcy

Posted Tuesday, Apr. 22, 2014

By Jim Fuquay and Steve Kaskovich

jfuquay@star-telegram.com

Dallas-based Energy Future Holdings filed for Chapter 11 bankruptcy protection early today after reaching a deal with creditors that calls for breaking off its power generation and retail arms in exchange for reducing debt. The bankruptcy petition was filed in Delaware.

The state's largest power company, formed in 2007 with the \$45 billion buyout of the former TXU Corp. led by KKR, Texas Pacific Group and Goldman Sachs, has been struggling under the weight of \$40 billion in debt as its revenues have plunged with lower prices for natural gas and electricity.

Under terms of the proposed restructuring agreement, Texas Competitive Electric Holdings — which includes the company's unregulated power company Luminant Generation and retail provider TXU Energy — would be transferred to its first lien lenders in a deal that would eliminate approximately \$23 billion of its debt, the company said in a news release. Luminant is the state's largest power generator. TXU Energy is Texas' biggest electricity retailer, with more than 1.5 million customers.

Energy Future Intermediate Holdings, which owns 80 percent of Oncor Electric Delivery, will remain part of Energy Future Holdings, although creditors would gain an unspecified stake in the unit under a proposal that calls for a new debt structure. Oncor, a regulated utility that operates the power lines serving much of North Texas, is not part of the bankruptcy filing.

"We are pleased to have the support of our key financial stakeholders for a consensual restructuring," said John Young, president and chief executive officer of Energy Future Holdings, in a prepared statement. "This restructuring is focused on our balance sheet, not our operations. We fully expect to continue normal business operations during the reorganization."

EFH said it expects to file its plan of reorganization "in the near term." It said it hopes to have a confirmed reorganization plans within nine months and to exit from its Chapter 11 proceeding in 11 months.

The Electric Reliability Council of Texas, the state's largest power grid, said it and state regulators have "been monitoring this situation. Prior to this filing, ERCOT has communicated, as necessary, with the affected Energy Future Holdings Corp. subsidiaries that operate in the ERCOT market to address any concerns that could impact system reliability or the efficiency of the market."

While the bankruptcy filing has been anticipated for more than a year, EFH's circumstances were particularly urgent now.

Thursday marks the expiration of the grace period on more than \$100 million in debt payments that EFH skipped a month earlier. It also delayed filing its annual financial report, which is expected to contain a report from its auditors that would put the company in default.

EFH had been trying to reach a deal with its major creditors to prevent a free-for-all that could draw out the bankruptcy proceeding. Moody's Investors Service last year estimated that the Texas Competitive Electric unit has roughly \$30 billion in debt but is only worth about \$15 billion.

KKR, TPG, Goldman Sachs and their investors, which put a total of \$8.3 billion into the buyout, are expected to lose all or nearly all that money.

The purpose of a Chapter 11 reorganization is to give a company relief from debt repayment while it restructures its finances into a more sustainable form. EFH said Tuesday it arranged up to \$4.5 billion in new loans for Texas Competitive Electric Holdings and \$7.3 billion for Energy Future Intermediate Holdings.

Loans extended to a company after it files for bankruptcy are senior to debt accumulated before the filing.

“Our existing capital structure has become unsustainable,” Young said in the statement. “We expect that, with the support of our financial stakeholders, our restructuring can proceed expeditiously as we seek to strengthen our balance sheet and position the company for the future.”

### Long slide toward bankruptcy

Here are financial results for Energy Future Holdings starting in 2006, the last year before it was created with the buyout of TXU Corp. (all amounts in billions)

Year	Revenues	Income (loss)	Long-term debt
2006	\$12.0	\$2.55	\$12.0
2007	\$10.0	(\$0.37)	\$38.0
2008	\$11.4	(\$0.8)	\$40.8
2009	\$11.5	\$0.344	\$41.4
2010	\$8.2	(\$2.8)	\$34.2
2011	\$7.0	(\$1.0)	\$35.4
2012	\$5.0	(\$3.4)	\$37.8
2013	\$4.0	(\$0.35)	\$38.1

(as of June 30)

Jim Fuquay, 817-390-7552 Twitter: @jimfuquay

Read more here <http://www.star-telegram.com/2014/04/28/577413/energy-future-holdings-prepares.html> storylink.cpy



[Print this article](#) | [Return to Article](#) | [Return to CFO.com](#)

### **Reverse Charge: Qwest Takes \$41 Billion Impairment Hit**

**FAS 142 strikes again; troubled telco will also restate \$531 million in revenues. Elsewhere: Sarbanes-Oxley could shrink Big Four tax business, blue chips going long, and did IT pay go up or down last year?**

[Stephen Taub](#), CFO.com | US  
October 29, 2002

The feeding frenzy of the late Nineties is starting to catch up to Corporate America.

Yesterday, Qwest Communications International Inc. became the latest company to write down the value of its past acquisitions. Management at the troubled telecom company said Qwest will report goodwill impairment charges totaling as much as \$40.8 billion by the end of the year.

That's a big phone bill. In fact, the writeoff works out to more than half of Qwest's \$74 billion in assets.

Earlier this year, media giant AOL Time Warner took a record \$54 billion charge to write off goodwill to reflect the sharp decline in the value of its \$106.2 billion purchase of Time Warner in 2000.

And last week, AOL warned it will probably report "a substantial overall goodwill impairment" when it completes its impairment analysis under FAS 142 at the end of the fourth quarter.

Here's how Qwest arrived at the \$40.8 figure.

Company management had already said it expects to report a goodwill impairment charge of approximately \$24 billion as of January 1, 2002, the effective date of FAS 142.

On Monday, however, Qwest management said that other factors (such as the business conditions in the telecom industry and the company's market capitalization during 2002) may result in an additional impairment of \$6 billion of goodwill. The company has about 29 million customers in the U.S.

Qwest will also record an \$8.1 billion impairment charge for the second quarter of 2002 to write-down the recoverability of the long-lived assets of its traditional telephone network, global fiber optic broadband network, and related assets.

The telco also figures to take about an \$2.7 billion reduction in the carrying value of intangible assets related to customer lists and product technology associated with the company's interexchange carrier business.

In yesterday's announcement, Qwest management also indicated it would restate \$531 million of revenues. In explaining the restatement, the telco's management noted that Qwest's policies and practices for determining the value of the various elements of the fees earned in connection with the sales of optical capacity assets did not support the accounting treatment. Qwest recorded a net loss of about \$4 billion in 2001.

The company added the announcement relates to optical capacity asset transactions recorded in periods following the merger of Qwest and US West, Inc. on June 30, 2000.

As CFO.com reported in late July, Qwest said it may restate the company's results for 1999, 2000 and 2001 in connection with sales of optical capacity assets. Qwest management said at the time it misapplied about \$1.16 billion in optical capacity sales.

And back in March, CFO.com also reported that the SEC was investigating Qwest's accounting policies, practices, and procedures for 2000 and 2001.

The Justice Department and Congress are currently investigating Qwest.

TIME

Thursday, Apr. 25, 2002

## What AOL Time Warner's \$54 Billion Loss Means

By Frank Pellegrini

Sticking out of AOL Time Warner's rather humdrum earnings report Wednesday was a very gaudy number: A one-time loss of \$54 billion. It's the largest spill of red ink, dollar for dollar, in U.S. corporate history and nearly two-thirds of the company's current stock-market value. (It's also, as a lot of news outlets have noted, more than the annual GDP of Ecuador, but that's hardly relevant here.) All for something called "goodwill impairment."

Sound like an awful lot of money to give to charity? In Wall Street's euphemism-speak, goodwill is more like getting taken to the cleaners. "Goodwill" is the term for the premium one company pays to acquire another, over and above the acquired company's book value. Such overpayment is intentional, whether to beat out fellow suitors or woo the shareholders of the bride, and technically it's an asset (albeit an intangible one), the assumption being that all that extra dough was buying *something*.

Now "goodwill impairment" —that's when that extra millions (or billions) in the purchase price turns out to have wasted, when it becomes apparent that the value of the merged company not only isn't *more* than the original buyer thought it was worth, but a whole lot less. Such losses in actual value used to be quietly swept under the rug, amortized away over the course of as much as 40 years.

But this year the rules have changed. The Financial Accounting Standards Board (yes, there actually standards in accounting) has decreed this year that companies must test their goodwill assets for "impairment" annually —and when they find some, they've got to fess up. And while AOL Time Warner's number may be the biggest (just topping JDS Uniphase's write-down last year of just over \$50 billion), the media giant (and corporate overlord of this writer) isn't standing alone. A recent Bear Stearns study anticipates that some 500 companies are candidates for write-downs this year, with perhaps a dozen in the billion-dollar club.

Why so many? Call it a bunch of drunken sailors nursing a hangover. When AOL and Time Warner first decided to merge, the dot-com love affair was raging and the stock of the combined companies was worth \$290 billion, mostly thanks to the price of AOL. By the time the stock-swap deal closed a year later, the bubble had burst, AOL was back on earth, and even though AOL had technically been the acquirer (thanks to that high stock price), the new AOL Time Warner suddenly had a relative lemon on its hands.

The new rule was originally going to require companies to post such losses as a relevant part of its continuing operations—which is hard to argue with when the asset is in the company's name—but businesses successfully lobbied to have the losses classified under "cumulative effects of changes in accounting principles." And now, even though they've got the rest of the year to do it, many companies are looking to get it out of the way while their excuse—the rule change—is still fresh in investors' minds.

And so Qwest Communications, which acquired the former U.S. West in 2000 only to find a year later that Qwest itself was the overvalued asset, recently predicted a second-quarter goodwill write-down of \$20 billion to \$30 billion. Blockbuster on Wednesday logged its own loss of \$1.82 billion. And the parade is just beginning—future candidates include WorldCom, which lists \$50 billion in potentially-impaired goodwill but is only worth \$42.7 billion in the market, and AT&T, still sporting \$24.8 billion of goodwill from its hostile takeover of MediaOne in 1999. (Notice a lot of tech and telecom companies?)

Investors generally ignore the bad news, either because they'd seen it coming—AOL Time Warner telegraphed its loss weeks ago—and because nearly every survivor of the tech bust has a few embarrassing purchases to own up to. Besides, AOL Time Warner's shares are down 41 percent this year alone, thanks to investors doing their own writing-down of AOL's value (with most analysts pegging it at about \$1 a share on top of Time Warner's assets). So the \$54 billion loss—and the total \$1 trillion in goodwill-impairment writedowns that some analysts expect to hit Wall Street this year—is merely an acknowledgement of what investors have already figured out.

Still, a mistake is a mistake, and some analysts insist that while such write-downs are paper losses, it would be a mistake to ignore them completely—particularly if the company's stock hasn't already taken the appropriate hit. And even if it has, a company that runs around overpaying for assets that don't perform—even if it's only overpaying because investors were fooled too—is one to keep a jaundiced eye on.

Remember, the fall of Enron started with a one-time write-down. And there's not a lot of goodwill left at *that* company any more.

Scottish Power 2006 goodwill impairment  
May 24, 2006, 2:30 a.m. EDT

**Scottish Power swings to fiscal year net profit**

LONDON (MarketWatch) -- Electricity company Scottish Power said Wednesday that it swung to a fiscal 2006 net profit of 1.5 billion pounds (\$2.8 billion), or 83.15 pence a share, after good growth from all its businesses. Last year, the company produced a loss of 188.7 million pounds after taking a 922 million pound exceptional charge related to goodwill impairment at its now discontinued PacifiCorp operations. On an adjusted basis, pretax profit rose 47% to 675 million pounds, ahead of the 655 million pound figure expected by analysts. The company said that it is confident that it will continue to make significant progress and create value for shareholders.

Exelon Corporation and Subsidiary Companies  
Exelon Generation Company, LLC and Subsidiary Companies  
Commonwealth Edison Company and Subsidiary Companies  
PECO Energy Company and Subsidiary Companies

Combined Notes to Consolidated Financial Statements—(Continued)  
(Dollars in millions, except per share data unless otherwise noted)

Exelon assesses goodwill impairment at its ComEd reporting unit. Accordingly, any goodwill impairment charge at ComEd will affect Exelon's consolidated results of operations. In estimating the fair value of ComEd, Exelon and ComEd used a probability-weighted, discounted cash flow model with multiple scenarios. The determination of the fair value was dependent on many sensitive, interrelated and uncertain variables including changing interest rates, utility sector market performance, capital structure, rate regulatory structures, operating and capital expenditure requirements and other factors. Changes in the variables used in the impairment review could possibly result in a future impairment loss of ComEd's goodwill, which could be material.

**2006 Interim Goodwill Impairment Assessment.** Due to the significant negative impact of the ICC's July 2006 order in ComEd's 2005 Rate Case to the cash flows and value of ComEd, an interim impairment assessment was completed during the third quarter of 2006. Based on the results of this interim goodwill impairment analysis, which was performed using the same model and assumptions discussed above, Exelon and ComEd recorded a charge of \$776 million associated with the impairment of goodwill during the third quarter of 2006. See Note 4—Regulatory Issues for further information regarding the 2005 Rate Case.

**UNS Energy Corporation and Fortis Inc.**  
**Docket Nos. E-04230A-14-0011 and E-01933A-14-0011**  
**Attachment RCS-5**  
**Copies of UNS Energy and Fortis Inc.'s Non-Confidential Responses to Data Requests**  
**and Documents Referenced in the Direct Testimony of**  
**Ralph C. Smith**

Data Request/ Workpaper No.	Subject	Confidential	No. of Pages	Page No.
RUCO Fortis 2.05	Estimated amount of Goodwill Fortis expects to record if the acquisition is approved, related journal entries, and description of how Fortis tests for Goodwill impairment.	No	9	2 - 10
UDR 1.37	Joint Applicants confirm that, per stipulated condition No. 5 included in the Joint Notice of Intent to Reorganize, TEP, UNS Gas and UNS Electric will not seek rate recovery of any premium to be paid by Fortis for UNS Energy common stock or any transaction cost associated with the acquisition.	No	1	11
RUCO Fortis 1.04	Description of terms and conditions to Fortis-CH Hudson acquisition in Case No. 12-M-0192, from New York Public Service Commission order dated June 26, 2013 (includes Attachment A, which contains the NY PSC required Terms and Conditions).	No	23	12 - 34
UDR 1.36	Anticipated cost savings include reduced or eliminated public company costs, reduced insurance costs, and a potentially lower cost of debt as the result of anticipated credit rating upgrades.	No	1	35
RUCO Fortis 2.09	Treatment of shareholder litigation costs charged to UNS subsidiaries. Fortis agrees that none of the costs of shareholder litigation should be borne by the customers of TEP, UNS Electric or UNS Gas.	No	2	36 - 37
UDR 1.33	Description of the nature and status of litigation related to the acquisition.	No	2	38 - 39
RUCO UNS 1.02	No Internal Revenue Code §338(h)(10) elections will be made with the acquisition.	No	1	40
UDR 1.08	UNS Gas' current bond rating	No	1	41
UDR 1.09	UNS Electric's current bond rating	No	1	42
UDR 1.10	TEP's current bond ratings	No	1	43
UDR 1.11	UNS Energy's current bond rating	No	1	44
UDR 1.16	Fortis Inc.'s current bond/debt ratings (including attachments)	No	19	45 - 63
UDR 1.30	Changes to the cost of debt for TEP, UNS Gas and UNS Electric anticipated to result from the transaction	No	1	64
UDR 1.31	Pre-acquisition and post-acquisition consolidated capital structure of UNS Energy	No	1	65
UDR 1.32	UNS Energy will issue no debt in connection with the merger but may issue short term debt to finance the purchase of Gila River Unit 3 and for TEP to purchase a portion of Springerville Unit 1	No	1	66
RUCO UNS 2.07	Status of TEP's investigation of plans to sell coal for Springerville Units 1 and 2 to a third party and buy-back treated coal for burn at Springerville Units 1 and 2 so IRS Section 45 credits can be generated; TEP's anticipated net reductions of coal cost during years 2014-2018; TEP's accounting for the anticipated reductions; TEP assurance that the benefits will be passed on to the ratepayers through the PPFAC.	No	2	67 - 68
RUCO UNS 2.08	Neither TEP nor UNS has provided information to Fortis about an arrangement with a third party to generate Section 45 credits for the period of 2014-2018.	No	1	69
RUCO Fortis 2.02	Explanation by Fortis of why the use of an overseas conduit entity as part of the anticipated financing was not specifically disclosed in Fortis' application and prefiled testimony.	No	1	70
RUCO Fortis 2.01	Organizational chart of the proposed Fortis structure including Luxembourg conduit affiliates.	No	2	71 - 72
RUCO Fortis 2.04	Anticipated amount of intercompany debt Fortis will use to finance the acquisition and the entities Fortis intends to use for that purpose as an integrated part of its financing and dividend repatriation plan.	No	3	73 - 75
RUCO Fortis 2.16	Explanation of how important being accretive to earnings is to Fortis in pursuing the acquisition of UNS Energy.	No	1	76
RUCO Fortis 1.05	Fortis-CH Hudson acquisition ratepayer benefits and information on the relative size of the Central Hudson utilities.	No	6	77 - 82
RUCO Fortis 2.29	Anticipated impact of merger on increased Fortis corporate costs, and how the increased Fortis corporate costs will be charged to the Arizona utilities. (includes Attachment 1 only)	No	4	83 - 86
UDR 1.14	Methodology used by UNS Energy to allocate costs to its subsidiaries.	No	1	87
RUCO Fortis 2.08	Fortis' intentions to seek other utility acquisitions.	No	1	88
	Cover and page K-101 from UNS Energy Corporation SEC Form 10-K for the fiscal year ending December 31, 2013 showing 2013 Operating Revenues for reportable business segments TEP, UNS Electric, and UNS Gas.	No	2	89 - 90
Total Pages Including this Page			90	

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.05**

The Fortis Inc. 2013 Annual Report states at pages 88-89:

"Goodwill represents the excess, at the dates of acquisition, of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired and liabilities assumed relating to business acquisitions. Goodwill is carried at initial cost less any write-down for impairment.

"Fortis performs an annual internal quantitative assessment for each reporting unit and, for those reporting units where: (i) management's assessment of quantitative and qualitative factors indicates that fair value is not 50% or more likely to be greater than carrying value; or (ii) where the excess of estimated fair value over carrying value, as determined by an independent external consultant as of the date of the immediately preceding impairment test, was not significant, then fair value of the reporting unit will be estimated by an independent external consultant in the current year. Irrespective of the above-noted approach, a reporting unit to which goodwill has been allocated may have its fair value estimated by an independent external consultant as at the annual impairment date, as Fortis will, at a minimum, have fair value for each reporting unit estimated by an independent external consultant once every three years. Fortis performs the annual impairment test as at October 1. In addition, the Corporation also performs an impairment test if any event occurs or if circumstances change that would indicate that the fair value of a reporting unit is below its carrying value. No such event or change in circumstances occurred during 2013 or 2012 and no impairment provisions were required in either year.

"In calculating goodwill impairment, Fortis determines those reporting units that will have fair value estimated by an independent external consultant, as described above, and such estimated fair value is then compared to the book value of the applicable reporting units. If the fair value of the reporting unit is less than the book value, then a second measurement step is performed to determine the amount of the impairment. The amount of the impairment is determined by deducting the fair value of the reporting unit's assets and liabilities from the fair value of the reporting unit to determine the implied fair value of goodwill, and then comparing that amount to the book value of the reporting unit's goodwill. Any excess of the book value of the goodwill over the implied fair value is the impairment amount recognized.

"The primary method for estimating fair value of the reporting units is the income approach, whereby net cash flow projections for the reporting units are discounted using an enterprise value approach. Under the enterprise value approach, sustainable cash flow is determined on an after-tax basis, prior to the deduction of interest expense, and is then discounted at the weighted average cost of capital to yield the value of the enterprise. An enterprise value approach does not assess the appropriateness of the reporting unit's existing debt level. The estimated fair value of the reporting unit is then determined by subtracting the fair value of the reporting unit's interest-bearing debt from the enterprise value of the reporting unit. A secondary valuation method, the market approach, is also performed by an independent external consultant as a check on the conclusions reached under the income approach. The market approach includes comparing

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

various valuation multiples underlying the discounted cash flow analysis of the applicable reporting units to trading multiples of guideline entities and recent transactions involving guideline entities, recognizing differences in growth expectations, product mix and risks of those guideline entities with the applicable reporting units."

- a. Identify the estimated amount of Goodwill that Fortis anticipates recording related to the acquisition of UNS Energy.
- b. Provide the journal entries that Fortis would use to record the Goodwill, and indicate on which entity's books such journal entries would be utilized.
- c. Identify and provide the journal entries that would be used to record any impairment of Goodwill and indicate on which entity's books such journal entries would be utilized.
- d. Identify what "reporting unit" Fortis would use to evaluate impairment of Goodwill that Fortis anticipates recording related to the acquisition of UNS Energy.
- e. When will the estimated Goodwill related to the acquisition of UNS Energy be tested for impairment and briefly describe how this testing will be performed including what assumptions would be used, such as source of cash flow forecasts, growth assumptions, discount rates and terminal value.
- f. What future events could lead to an impairment of the estimated Goodwill related to the acquisition of UNS Energy?
- g. Did Fortis record any Goodwill related to its acquisition of any of the utilities in British Columbia, Canada, which are now identified by Fortis as FEVI, FEWI and/or FortisBC Electric?
  1. If so, identify the amounts of Goodwill that were recorded by Fortis (and identify the entity upon whose books the Goodwill was recorded).
  2. Did Fortis recognize any impairment of any Goodwill for any of the BC utilities (i.e., for FEVI, FEWI and/or FortisBC Electric) related to the authorized Return on Equity (ROE) being reduced for any of these utilities, or for any other reason since Fortis acquired them? If so, identify, quantify and explain the related Goodwill impairments. If not, explain how a Goodwill impairment was avoided for the reductions in authorized ROEs for these utilities.

**RESPONSE:**

- a. As shown in the table below, the estimate of goodwill to be added to Fortis Inc.'s consolidated balance sheet if the acquisition of UNS Energy is approved is US\$1.407 billion (C\$1.496 billion).

The goodwill amount has been estimated based on UNS Energy's consolidated net assets and common stock outstanding as at December 31, 2013. It has also been assumed that the book value of UNS Energy's consolidated net assets being acquired approximate their

**Defined Terms:**

Arizona Corporation Commission ("Commission")

Color Acquisition Sub Inc. ("Color Acquisition")

Fortis Inc. ("Fortis")

FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")

FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")

UniSource Energy Services ("UES")

UNS Electric, Inc. ("UNS Electric")

UNS Energy Corporation ("UNS Energy")

UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

fair value. The amount of goodwill, therefore, is subject to change based on the actual consolidated net assets of UNS Energy and common stock outstanding as at the actual closing date of the merger and the determination of fair value adjustments, if any.

<b>Goodwill Estimation <sup>(1)</sup></b>	
<i>(US\$ millions)</i>	
Cash purchase price of UNS Energy common stock	2,503 <sup>(2)</sup>
Estimated payout of liability (not currently recognized in UNS Energy's net assets) associated with unexercised UNS Energy stock options and accelerated vesting of restricted and performance share units (RSUs and PSUs)	<u>35 <sup>(2)</sup></u>
	2,538
Consolidated net assets of UNS Energy to be acquired	<u>(1,131) <sup>(3) (4) (5)</sup></u>
Excess of cash purchase price over net assets to be acquired	<u><b>1,407</b> <sup>(5)</sup></u>
US\$ Exchange at December 31, 2013	1.0636
Total goodwill upon merger	C\$1,496

(1) Assuming a December 31, 2013 merger closing date

(2) Cash purchase price of UNS Energy's common stock is calculated at US\$60.25 per share multiplied by UNS Energy's total common stock outstanding as at December 31, 2013 (per page K-80 of UNS Energy's Form 10-K for the year ended December 31, 2013 filed February 25, 2014) of 41,538,343 = US\$2,502,685,166. The cash purchase price of UNS Energy's common stock and payout of the liability related to unexercised UNS Energy stock options and accelerated vesting of restricted share units ("RSUs") and performance share units ("PSUs") may change based on the actual number of common shares outstanding and the liability associated with stock options, RSUs and PSUs as at the actual closing date of the merger.

(3) Consolidated net assets of UNS Energy to be acquired as at December 31, 2013 (obtained from pages K-78 and K-79 of UNS Energy's Form 10-K for the year ended December 31, 2013 filed February 25, 2014) is calculated as follows:

Total assets	4,273
Less: Long-term debt & capital lease obligations (including current portion)	(1,846)
Less: Total current liabilities (excluding current portion of long-term debt & leases)	(327)
Less: Total deferred credits and other liabilities	(487)
Less: Accumulated deferred income tax	<u>(482)</u>
Net assets to be acquired	<u><b>1,131</b></u>

(4) Consolidated net assets of UNS Energy to be acquired may change as of the actual closing date of the merger.

(5) Assuming book value of the consolidated net assets of UNS Energy to be acquired approximates fair value. No fair value adjustments are currently expected as at the actual closing date of the merger.

b. **RUCO Fortis 2.05 Attachment A.xlsx** sets out the journal entries related to the recording of goodwill on Fortis Inc.'s books. Fortis Inc. anticipates that the goodwill will be recorded on Fortis Inc.'s consolidated balance sheet.

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

However, U.S. GAAP may require that goodwill also be recorded on the acquired company's books if it is a public reporting issuer. TEP is currently a public reporting issuer and may remain so after the acquisition. **RUCO Fortis 2.05 Attachment B.xlsx** sets out the journal entry that may be required on TEP's books in accordance with U.S. GAAP, assuming 80% of the estimated goodwill (i.e., US\$1.126 billion) is attributed to TEP and assuming that TEP remains a public reporting issuer following the merger. See RUCO UNS 2.06.

No matter where it is recorded, goodwill will have no effect on the customers of UNS Energy's regulated subsidiaries. See section III(5) of the Joint Notice Of Intent To Reorganize (the "Notice") wherein it states that, "UNS Energy, the Arizona Utilities and FortisUS agree that the goodwill and transaction costs of this acquisition will be excluded from the rate base, expenses, and capitalization in the determination of rates and earned returns of the Arizona Utilities and for Arizona state regulatory accounting and reporting purposes".

- c. **RUCO Fortis 2.05 Attachment C.xlsx** sets out the journal entry to record an impairment of goodwill, if applicable. Fortis anticipates that the journal entry would be recorded in the consolidated books of Fortis Inc., unless the application of U.S. GAAP requires that goodwill and any associated impairment of that goodwill have to be "pushed down" to TEP, as referred to in part b above.

Regardless of whether goodwill impairment is recorded, or where it is recorded in accordance with U.S. GAAP, it will not have any effect on the customers of UNS Energy's regulated subsidiaries. See section III(5) of the Notice wherein it states that, "UNS Energy, the Arizona Utilities and FortisUS agree that the goodwill and transaction costs of this acquisition will be excluded from the rate base, expenses, and capitalization in the determination of rates and earned returns of the Arizona Utilities and for Arizona state regulatory accounting and reporting purposes".

- d. Fortis anticipates that UNS Energy would be a single reporting unit for the annual assessment of goodwill. UNS Energy would be seen as a single reporting unit because TEP, UNS Electric and UNS Gas are essentially operated and managed as a single utility.
- e. Initially, the fair value of the goodwill associated with UNS Energy will be evaluated as part of the purchase price allocation whereby an independent external consultant estimates the fair value of assets acquired against the price paid. Subsequent to the acquisition, the goodwill associated with UNS Energy will be evaluated annually. The annual impairment testing will follow the Fortis policy which is most recently described in the Corporation's 2013 Annual Report.

Annually, Fortis performs both qualitative and quantitative assessments of goodwill for each reporting unit. For those reporting units where: (i) the assessment of quantitative and qualitative factors indicates that fair value is not 50% or more likely to be greater than carrying value; or (ii) where the excess of estimated fair value over carrying value,

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

as determined by an independent external consultant as of the date of the immediately preceding impairment test, was not significant, then the fair value of the reporting unit will be estimated by an independent external consultant in the current year. At a minimum, the fair value for each Fortis reporting unit will be estimated by an independent external consultant once every three years.

In testing for goodwill impairment, the primary method for estimating the fair value of the reporting unit is the income approach, whereby the net cash flow projections for the reporting unit are discounted using an enterprise value approach. Under the enterprise value approach, sustainable cash flow is determined on an after-tax basis, prior to the deduction of interest expense, and is then discounted at the weighted average cost of capital to yield the value of the enterprise. The fair value of the reporting unit's interest-bearing debt is then subtracted from the enterprise value of the reporting unit to arrive at the reporting unit's estimated fair value.

A secondary valuation method, the market approach, is also performed by the independent external consultant as a check on the conclusions reached under the income approach. The market approach includes comparing various valuation multiples underlying the discounted cash flow analysis of the applicable reporting unit to trading multiples of guideline entities and recent transactions involving guideline entities, recognizing differences in growth expectations, product mix and the risks of those guideline entities with the applicable reporting unit.

The following key assumptions will likely be used in the initial estimation of the fair value of UNS Energy:

1. UNS Energy provided Fortis with cash flow forecasts from 2015 – 2024. Fortis extended these forecasts out through to 2034 assuming long-term growth of 2% to 3%.
  2. The terminal value of the enterprise is calculated based on a multiple of EBITDA of 8.5 to 9.5 times. These exit multiples are consistent with the results of the application of the Gordon Constant Growth formula and with market precedents.<sup>1</sup> The terminal value is not an assumption of an eventual sale of the business, but of the enterprise value of the business on a steady state basis.
  3. The discount rate used in the calculation of fair value is an after tax weighted average cost of capital (the "WACC"). The WACC which will be used in the estimate will range from 5% to 5.5%<sup>2</sup>.
- f. A significant reduction in the financial strength and prospects of the Arizona Utilities, including reduced cash flows over the long term, would likely cause impairment of

<sup>1</sup> See Definitive Proxy Statement 14A page 42 dated February 18, 2014

<sup>2</sup> Lazard valuation used a discount rate of 5.5% to 6.0%, see Definitive Proxy Statement 14A page 41 dated February 18, 2014

**Defined Terms:**

Arizona Corporation Commission ("Commission")

Color Acquisition Sub Inc. ("Color Acquisition")

Fortis Inc. ("Fortis")

FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")

FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")

UniSource Energy Services ("UES")

UNS Electric, Inc. ("UNS Electric")

UNS Energy Corporation ("UNS Energy")

UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

goodwill. An example of such an event would be the removal of a significant asset from rate base resulting in material unrecovered costs and lower sales revenue. This event would also most likely reduce the credit strength of the utilities and result in diminished capital access.

g. Yes.

1. Fortis recorded goodwill as follows: (i) FEI, C\$769 million; (ii) FEVI, C\$145 million; and (iii) FortisBC Electric, C\$235 million.<sup>3</sup> These entities are all public reporting issuers in Canada. Therefore, the goodwill associated with their acquisition by Fortis is recorded on their respective books, in accordance with U.S. GAAP.
2. No. Fortis has never recognized any impairment of goodwill for the noted entities, or for any other affiliate. Impairment testing was last performed as at October 1, 2013 by an external independent consultant for FEI, FEVI and FortisBC Electric. It was determined at that time that the fair value of these reporting units, based on cash flows revised to reflect the change in rates resulting from the generic cost of capital decision (i.e., the reductions in authorized ROEs for these utilities) still exceeded their book values. Consequently, there was no impairment of goodwill.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

---

<sup>3</sup> FEI refers to FortisBC Energy Inc. and FEVI refers to FortisBC Energy (Vancouver Island) Inc. No goodwill was reported by FortisBC Energy (Whistler) Inc. ("FEWI").

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**Attachment A  
RUCO Fortis 2.05**

**JOURNAL ENTRIES - RECORDING OF GOODWILL (*US\$ millions*)  
Fortis records all of goodwill**

<b>Fortis non-consolidated Books</b>	<b><u>Debit</u></b>	<b><u>Credit</u></b>
<b>JE1</b>		
Investment regarding UNS Energy	2,538	
Cash		2,538
<b>To record purchase of UNS Energy common shares.</b>		
<b>JE2 - Fortis Inc. Consolidating Entry</b>		
Goodwill	1,407	
Various balance sheet accounts (net investment assets & liabilities)	1,131	
Investment in UNS Energy		2,538
<b><i>To record UNS Energy on consolidated balance sheet of Fortis Inc.</i></b>		

**Attachment B  
RUCO Fortis 2.05**

**JOURNAL ENTRIES - RECORDING OF GOODWILL (US\$ millions)  
TEP records 80% of goodwill**

<b>TEP Non-consolidated Books</b>	<b><u>Debit</u></b>	<b><u>Credit</u></b>
<b>JE1</b>		
Goodwill	1,126	
Contributed capital		1,126
<b><i>To record purchase of UNS Energy common shares by Fortis and the pushdown of goodwill attributable to TEP if required by U.S. GAAP.</i></b>		

**Attachment C  
RUCO Fortis 2.05**

**JOURNAL ENTRY - RECORDING OF GOODWILL IMPAIRMENT**

<b>Fortis (and TEP, if required by U.S. GAAP)</b>	<b><u>Debit</u></b>	<b><u>Credit</u></b>
Loss on Impairment of Goodwill (Income Statement)	XXX	
Goodwill		XXX
<b>To record loss on impairment of goodwill (TEP to record 80% of goodwill impairment if required by U.S. GAAP.)</b>		

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**January 28, 2014**

**UDR 1.37**

Please confirm that TEP, UNS Gas, and UNS Electric will not seek rate recovery of any premium paid by Fortis Inc. for UNS Energy common stock or any transaction cost associated with the acquisition.

**RESPONSE:**

Pursuant to stipulated condition No. 5 included in the Joint Notice of Intent to Reorganize, TEP, UNS Gas and UNS Electric will not seek rate recovery of any premium to be paid by Fortis for UNS Energy common stock or any transaction cost associated with the acquisition.

**RESPONDENT:**

Kentton Grant

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")

Color Acquisition Sub Inc. ("Color Acquisition")

Fortis Inc. ("Fortis")

FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")

FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")

UniSource Energy Services ("UES")

UNS Electric, Inc. ("UNS Electric")

UNS Energy Corporation ("UNS Energy")

UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S FIRST SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
February 27, 2014**

**RUCO Fortis 1.04**

Page 2 of the Joint Notice Of Intent To Reorganize states that UNS Energy and Fortis have agreed to conditions for approval that ensure continuing high levels of customer service, community support and involvement, and local management and corporate governance. Page 5 of the Joint Notice states that: "The State of New York Public Service Commission ("NYPSC") recently concluded that it was in the public interest for Fortis to acquire Central Hudson Gas & Electric Corporation, a gas and electric utility serving approximately 376,000 customers in New York State." Referring to NYPSC Case No. 12-M-0192 - Joint Petition of Fortis Inc. et al. and CH Energy Group, Inc. et al. for Approval of the Acquisition of CH Energy Group, Inc. by Fortis Inc. and Related Transactions, NYPSC Order Authorizing Acquisition Subject To Conditions (Issued and Effective June 26, 2013):

- a. Identify each condition that was applied to Fortis' acquisition of CH Energy Group.
- b. For each condition identified in response to part a, state whether the same or similar condition has been proposed for Fortis' proposed acquisition of UNS Energy Corporation.
- c. For each condition identified in response to part a, state whether Fortis would proceed with the proposed acquisition if the same or similar condition is imposed with respect to Fortis' proposed acquisition of UNS Energy Corporation.

**RESPONSE:**

- a. **RUCO Fortis 1.04 Attachment A.pdf, Bates Nos. 001811-001828**, includes the terms and conditions (the "CH Conditions") applied to Fortis and Central Hudson with respect to the Fortis acquisition of CH Energy Group (the "CH Acquisition").

The majority of the CH Conditions proposed by Fortis and CH Energy in the petition for approval of the CH Acquisition filed with the NYPSC in April 2013 were intended to:

- (i) address and resolve concerns which arose in prior merger cases before the NYPSC, most notably the conditions applied by the NYPSC in the Iberdrola S.A. acquisition of Energy East Corporation in 2008 (the "Energy East Acquisition"), in a manner consistent with the NYPSC's disposition of these precedent setting cases;
- (ii) deal with specific circumstances unique to the CH Acquisition and the customers of Central Hudson; and,
- (iii) be consistent with the standalone operating philosophy of Fortis.

Certain of the CH Conditions were specifically intended to address the "net positive benefits" test that is applied to the acquisition of utilities in New York pursuant to New York's Public Service Law ("PSL") Section 70. In addition, some of the CH Conditions were the product of settlement negotiations that culminated in a joint settlement agreement which was filed with the NYPSC in January 2013 (the "CH Settlement"), and enhancements offered by Fortis prior to approval of the transaction based on further discussions with other interested parties. Only CH Condition A.5.g, which deals with

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S FIRST SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**February 27, 2014**

indemnification for tax obligations, was added by the NYPSC in conjunction with its final approval of the CH Acquisition in June 2013.

- b. The conditions agreed to by Fortis and UNS Energy (the "UNS Conditions") in the proposed acquisition (the "UNS Acquisition") are outlined in Part III of the Joint Notice of Intent to Reorganize dated January 10, 2014 and in Part VI (and Exhibit BVP-7) of the Direct Testimony of Barry V. Perry dated January 24, 2014.

The UNS Conditions address: quality of service; capital requirements; treatment of goodwill, acquisition costs and synergy savings; credit quality and other restrictions; legal separateness; financial transparency and reporting conditions; affiliate transactions; corporate governance and operational provisions; and low income assistance. These agreed-upon conditions have been tailored to meet the standard for Commission approval of acquisitions based on Arizona's Public Utility Holding Companies and Affiliated Interests rules.

Many of the UNS Conditions are the same or similar to the CH Conditions, as follows:

---

***Quality of Service [Exhibit BVP-7 ¶¶ 1 and 2]***

UNS Energy, FortisUS and Fortis acknowledge and agree to support the Arizona Utilities in maintaining a high level of customer service and providing safe, reliable service to their customers. In addition, the Arizona Utilities agree to maintain, and if necessary improve, their current quality of service so that the number of service complaints does not increase, that the response time to service complaints does not increase and that service interruptions do not increase as a result of the transaction.

These conditions are similar in nature and intent to the conditions contained in Sections B.1 through B.6 of the CH Conditions, bearing in mind that the CH Conditions are specific to their operations and issues brought forward by parties to the CH Settlement.

***Treatment of Goodwill, Acquisition Costs and Synergy Savings [Exhibit BVP-7 ¶¶ 5-8]***

These conditions are similar in nature and intent to the conditions contained in Sections A.1 and A.10 of the CH Conditions.

The filing requirement specified in Section A.1.b of the CH Conditions was requested by staff of the NYPSC during settlement negotiations. Fortis does not believe it should impose unnecessary administrative burden on the Arizona Commission and has, therefore, not included this requirement in the UNS Conditions.

Sections A.10.b and A.10.c of the CH Conditions were intended to address the NYPSC's "net positive benefits" test which is specific to New York and which has not been applied to the acquisition of utilities in Arizona.

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S FIRST SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**February 27, 2014**

***Credit Quality and Other Restrictions [Exhibit BVP-7 ¶¶ 9-15]***

These conditions are similar in nature and intent to the conditions contained in Sections A.2 and A.3 of the CH Conditions.

The filing requirement specified in Section A.2.a of the CH Conditions was requested by staff of the NYPSC during settlement negotiations. Fortis does not believe it should impose unnecessary administrative burden on the Arizona Commission and has, therefore, not included this filing requirement in the UNS Conditions.

Sections A.2.d, A.2.e, A.2.i and A.3.a of the CH Conditions are also specific to Central Hudson or were included at the specific request of NYPSC staff during settlement negotiations.

***Legal Separateness [Exhibit BVP-7 ¶ 16]***

This condition is intended to provide assurance that the Arizona Utilities will amend their respective organizational documents to provide for and ensure legal separateness from UNS Energy and Fortis. Central Hudson provided similar assurances in Section A.4.a of the CH Conditions. This particular CH Condition was deemed necessary by the NYPSC due to the lower credit ratings of Fortis compared to those of Central Hudson. However, the credit ratings of Fortis are higher than those of UNS Energy and the Arizona Utilities. In that regard, the Arizona Utilities, and their customers, thereby stand to benefit from being affiliated with Fortis. As stated in the Direct Testimony of Kevin P. Larson, "S&P and Fitch Ratings, Inc. ("Fitch") indicated that TEP's ratings could be raised by one notch if the acquisition is approved, while Moody's acknowledged the benefit of joining an established utility company of Fortis' size and scope." The benefits of potential credit rating upgrades for the Arizona Utilities could be hampered if a condition similar to that imposed by the NYPSC were applied to the UNS Acquisition. In addition, the inclusion of such a condition in this case would require waivers or amendments to the UNS Energy/Arizona Utilities credit facilities, which may or may not be obtainable without cost.

Section A.4.b of the CH Conditions was added at the request of parties to the CH Settlement. Fortis believes that this condition should apply in any event based on the fact that the Arizona Utilities will be managed, governed, financed and operated on a standalone basis. It has, therefore, not been included as a specific UNS Condition.

***Financial Transparency and Reporting Conditions [Exhibit BVP-7 ¶¶ 17-19]***

These conditions are similar in nature and intent to those contained in Sections A.5.a, A.5.e and A.5.f of the CH Conditions.

Sections A.5.b and A.5.h of the CH Conditions were added at the specific request of NYPSC staff during settlement negotiations. Fortis believes that these conditions are redundant based on existing business, statutory and regulatory requirements. Therefore, they have not been specifically included in the UNS Conditions.

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S FIRST SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**February 27, 2014**

Sections A.5.c, and independent auditor attestation of internal controls over financial reporting referred to in Section A.5.d, of the CH Conditions was also added at the specific request of NYPSC staff. However, SOX compliance by UNS Energy will not be required once it is no longer a public company. Additionally, TEP will have a choice as to whether or not it will remain a public company subject to SEC reporting requirements and SOX compliance. Fortis believes that its own internal controls implementation, assessment and certification process is essentially equivalent to that required by SOX and that eliminating the requirement to comply with SOX 302 – 404, specifically the requirement for external auditor attestation of internal controls, provides opportunity for cost savings that can, and should, be passed on to customers.<sup>1</sup>

***Affiliate Transactions [Exhibit BVP-7 ¶ 20]***

This condition is similar in nature and intent to those contained in Section A.6 of the CH Conditions.

***Corporate Governance and Operational Provisions [Exhibit BVP-7 ¶¶ 21-23]***

These conditions are similar in nature and intent to those contained in Section A.8 of the CH Conditions.

Section A.8.c was added at the specific request of NYPSC staff during settlement negotiations.

***Low income assistance [Exhibit BVP-7 ¶ 24]***

These conditions are similar in nature and intent to those contained in Section C.1 of the CH Conditions, bearing in mind that the CH Conditions are specific to their operations and issues brought forward by parties to the CH Settlement.

---

The remaining CH Conditions, as contained in Sections A.7, A.9, C.2 and D.1 through D.3, are specific to Central Hudson and New York, and therefore have not been included in the UNS Conditions.

The commitment by Fortis to provide the necessary equity capital when required, and to inject \$200 million in new equity upon closing [Exhibit BVP-7 ¶¶ 3-4], have been included in the UNS Conditions to reflect the specific circumstances relevant to the UNS Acquisition, the needs of UNS Energy and the regulatory framework that exists in Arizona. These conditions were not included in the CH Conditions.

The UNS Conditions and CH Conditions referred to above recognize the inherent differences that exist between UNS Energy and Central Hudson, their respective circumstances, needs, customer interests and regulatory jurisdictions, including inherent

---

<sup>1</sup> Securities laws in Canada include SOX-equivalent legislation, with one exception. Canadian securities laws do not require an independent audit opinion on internal controls, as is required by U.S. public companies under SOX.

**Defined Terms:**

Arizona Corporation Commission (“Commission”)

Color Acquisition Sub Inc. (“Color Acquisition”)

Fortis Inc. (“Fortis”)

FortisUS Holdings Nova Scotia Limited (“FortisUS Nova Scotia”)

FortisUS Inc. (“FortisUS”)

Tucson Electric Power Company (“TEP”)

UniSource Energy Services (“UES”)

UNS Electric, Inc. (“UNS Electric”)

UNS Energy Corporation (“UNS Energy”)

UNS Gas, Inc. (“UNS Gas”)

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S FIRST SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**February 27, 2014**

differences in application of the public interest standard in Arizona as compared to New York. The UNS Conditions should be assessed collectively, together with other benefits to be derived by customers of the Arizona Utilities, in determining whether the public interest standard, as applied in Arizona, has been met. The UNS Acquisition will provide overall benefits to customers and is in the public interest.

- c. Section 5.5 (b) of the Agreement and Plan of Merger between Fortis and UNS Energy<sup>2</sup> states that, "In the application filed with the ACC for the ACC Approval, Merger Sub and the Company shall agree to include specific commitments and agreements in such application to implement the principles set forth in Section 5.5(b) of the Company Disclosure Letter." Section 5.5(b) of the Company Disclosure Letter is contained in **RUCO Fortis 1.04 Attachment B.pdf, Bates Nos. 001800-001804**. Should additional conditions be imposed, Fortis will then have to determine whether it is willing to proceed with the acquisition of UNS Energy. No determination can be made until a specific condition is imposed.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

---

<sup>2</sup> A copy of which has been provided in Exhibit BVP-5 to the Direct Testimony of Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")

Color Acquisition Sub Inc. ("Color Acquisition")

Fortis Inc. ("Fortis")

FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")

FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")

UniSource Energy Services ("UES")

UNS Electric, Inc. ("UNS Electric")

UNS Energy Corporation ("UNS Energy")

UNS Gas, Inc. ("UNS Gas")

## **Terms & Conditions**

### **New York Public Service Commission ("Commission") Approval of the Acquisition of CH Energy Group, Inc. ("CHEG") by Fortis Inc. ("Fortis")<sup>1</sup>**

#### **A. Corporate Structure and Financial Protections**

##### **1. Goodwill and Acquisition Cost Conditions**

a) The Goodwill and transaction costs of this acquisition will be excluded from the rate base, expenses, and capitalization in the determination of rates and earned returns of Central Hudson Gas & Electric Corporation ("Central Hudson") for New York State regulatory accounting and reporting purposes.

b) If, at any time after the closing of this acquisition, as a result of any impairment analysis by Fortis, FortisUS<sup>2</sup>, CHEG or Central Hudson, either Fortis or FortisUS makes a book entry reflecting impairment of the Goodwill from this acquisition, Central Hudson must submit the impairment analysis to the Commission within five business days after the entry has been made.

c) To the extent permissible under U.S. Generally Accepted Accounting Principles ("U.S. GAAP"), no goodwill or transaction costs associated with this acquisition will be reflected on the books maintained by Central Hudson after the closing of the acquisition of CHEG by FortisUS and Fortis. Should changes in U.S. GAAP require that the goodwill associated with the acquisition be "pushed down" and therefore reflected in the accounts of Central Hudson, the goodwill will not be reflected in the regulated accounts of Central Hudson for purposes of determining rate base, setting rates, establishing capital structure or other regulatory accounting and reporting purposes.

d) Central Hudson will provide a final schedule of the external costs to achieve the merger following consummation of the transaction as a demonstration that there will be no recovery requested in Central Hudson rates, or recognition in the determination of rate base of any legal and financial advisory fees, or other external costs associated with Fortis' acquisition of CHEG, and indirectly, Central Hudson.

##### **2. Credit Quality and Dividend Restriction Conditions**

a) After the closing of this transaction, copies of all presentations made to credit rating agencies by Central Hudson, Fortis or any Fortis affiliate in the line between Central Hudson and Fortis that present or discuss the finances and credit of Central Hudson or CHEG, will be provided to Staff within ten business days of the presentation on a continuing basis. These presentations will be subject to the confidentiality and privilege provisions of sections VI.B 32 and 33 of the Restructuring Settlement Agreement ("RSA") approved by the Commission in Case 96-E-0909.

b) To the extent not already in place, Fortis and Central Hudson must register with at least two major nationally and internationally recognized bond rating agencies, such as Dominion Bond Rating Services ("DBRS"), Fitch Ratings ("Fitch"), Moody's Investor Services ("Moody's") and

<sup>1</sup> "Signatories" jointly refers to all parties to the joint settlement agreement dated January 25, 2013. "Petitioners" jointly refers to Fortis, CHEG and Central Hudson Gas & Electric Corporation.

<sup>2</sup> FortisUS Inc.

Standard & Poor's ("S&P"). Consistent with section VI.B 20 of the RSA, Central Hudson will continue to maintain separate debt instruments and its own corporate and debt credit ratings with at least two of these nationally recognized credit rating agencies. Neither Fortis nor Central Hudson will enter into any credit or debt instrument containing cross default provisions that would affect Central Hudson.

c) Fortis and Central Hudson will continue to support the objective of maintaining an "A" credit rating for Central Hudson, unless and until the Commission modifies its financial integrity policies. In so doing, Fortis and Central Hudson will maintain the equity capitalization ratio of Central Hudson at the level used by the Commission in establishing Central Hudson's rates as follows. At each month end, Central Hudson and Fortis agree to maintain a minimum common equity ratio ("MER") (measured using a trailing 13-month average) in relation to the equity ratio used to set rates. The MER is defined as no less than 200 basis points below the equity ratio used to set rates. In the event that the MER is not met, no dividends are payable until such time the MER is restored.

d) In the event the Commission establishes rates for Central Hudson on a basis that does not recognize Central Hudson's actual equity capitalization, or deems or imputes for ratemaking purposes an equity capitalization below Central Hudson's actual equity capitalization, Central Hudson shall be free to dividend its excess equity capitalization to match that recognized or deemed by the Commission in establishing Central Hudson's rates.

e) If, as a direct result of a downgrade of Fortis Inc.'s debt within three years following the closing of this transaction, Central Hudson is downgraded to either S&P's or Fitch's BBB category (BBB+ or lower), or the equivalent for Moody's (Baa or lower) or DBRS's (BBB(high) or lower), and Central Hudson incurs increased costs of debt, the incremental cost of debt incurred by Central Hudson in comparison to the cost of debt which would otherwise have been incurred by Central Hudson under its pre-downgrade credit rating will not be reflected in Central Hudson's cost of capital or the determination of Central Hudson's rates in subsequent rate cases. If such a downgrade occurs in the time discussed and debt is issued, then in subsequent rate cases Mergent Bond Record data (or the equivalent, if Mergent data is not available) for the relevant month(s) of issue will be used to quantify the adjustment needed to avoid reflecting the higher interest rate expense. For each one-notch downgrade to Central Hudson, one-third of the difference between A and Baa Public Utility Bond yield averages will be used to adjust the interest rate allowed in rate cases. The differential will only apply for each credit rating agency which downgrades Central Hudson's debt due to a Fortis downgrade. For instance, if Central Hudson is rated by two credit rating agencies and only one downgrades them due to a Fortis downgrade, then only 50% of the one-notch yield difference per Mergent Bond Record data will be used to calculate the interest rate adjustment in subsequent rate cases.

f) Central Hudson will continue to comply with any and all sections of the RSA with respect to restrictions on the payment of common dividends related to credit ratings.

g) Central Hudson will not lend to, guarantee or financially support Fortis or any of its affiliates, or any subsidiary or other joint venture of Central Hudson, except as is consistent with section VI.B 23 of the RSA or permitted by the Money Pooling Conditions referred to below.

Furthermore, Central Hudson will not engage in, provide financial support to or guarantee any non-regulated businesses, except as authorized in the RSA or by Commission order.

h) Central Hudson shall maintain banking, committed credit facilities and cash management arrangements which are separate from other affiliates.

i) In addition to the special class of preferred stock referred to in item 4, below, Central Hudson's financing authorization in Case 12-M-0172, Order Authorizing Issuance of Securities, issued and effective September 14, 2012 ("Financing Order") is amended to authorize Central Hudson to use private financing as an alternative to public debt offerings. This authorization supersedes Ordering Clause 5 in the Financing Order. Private financings are subject to the conditions and requirements described in the other Ordering Clauses in the Financing Order and, Central Hudson's proposal to address Ordering Clause 6 in the Financing Order, as was filed with the Commission on November 9, 2012, is accepted and approved by the Commission's adoption of this Joint Proposal.

### **3. Money Pooling Conditions**

a) Central Hudson may participate in a money pool only if all other participants, with the exception of Fortis and FortisUS, are regulated utilities operating within the United States, in which case Central Hudson may participate as either a borrower or a lender. Fortis and FortisUS may participate only as lenders in money pools involving Central Hudson. Central Hudson may not participate in any money pool in which any participant directly or indirectly loans or transfers funds to Fortis or FortisUS.

b) Neither Fortis nor FortisUS, nor any of their affiliates may, at closing of the approved acquisition of Central Hudson, have any cross default provision that affects Central Hudson in any manner. Neither Fortis nor FortisUS, nor any of their affiliates may enter into any cross default provision following the closing that affects Central Hudson in any manner. Notwithstanding the foregoing, to the extent that any cross default provision that might affect Central Hudson already exists, Fortis and FortisUS must use their best efforts to eliminate that cross default provision within six months after closing. If any cross default provision remains in effect at the end of that period, Fortis and FortisUS must obtain indemnification from an investment grade entity, at a cost not borne by Central Hudson's ratepayers, which fully protects Central Hudson from the effects of any cross default provision.

### **4. Special Class of Preferred Stock Conditions**

a) Central Hudson must modify its corporate by-laws as necessary to establish a voting right in order to prevent a bankruptcy, liquidation, receivership, or similar proceedings ("bankruptcy") of Central Hudson from being caused by a bankruptcy of Fortis, FortisUS, or any other affiliate. The Commission's approval of this Joint Proposal will represent all Commission authorization necessary for Central Hudson to establish a class of preferred stock having one share (the "golden share"), subordinate to any existing preferred stock, and to issue that share of stock to a party who shall protect the interests of New York and be independent of the parent company and its subsidiaries. Such share of stock shall have voting rights only with respect to Central Hudson's right to commence any voluntary bankruptcy without the consent of the holder of that share of stock. Central Hudson shall notify the Commission of the identity and qualifications of

the party to whom the share is issued and the Commission may, to the extent that such party is not reasonably qualified to hold such share in the Commission's opinion, require that the share be reissued to a different party within three months of receipt of such notification. If Central Hudson has failed to propose a shareholder that is approved by the Commission within six months after the closing of the acquisition, the Commission will appoint a shareholder of its own selection. In the event that Central Hudson is unable to meet this condition despite good faith efforts to do so, it must petition for relief from this condition, explaining why the condition is impossible to meet and how it proposes to meet an underlying requirement that a bankruptcy involving Fortis, FortisUS, or any other affiliate does not result in its voluntary inclusion in such a bankruptcy.

b) In any rate proceeding in which use of Central Hudson's capital structure is requested, Central Hudson will submit the most current written evaluations from at least two rating agencies addressing Central Hudson's credit profile. These credit reports shall be relied upon to the extent that they provide written evidence that supports the evaluation of Central Hudson and the treatment of Central Hudson's capital structure by the Commission primarily as a separate company, without material adjustments to the rating based on risks related to the capital structure and ratings of its ultimate parent. This evidence, together with the golden share would provide sufficient proof that the use of Central Hudson's capital structure should be used for rate making purposes. In the event written evaluations from at least two rating agencies do not provide such evidence or are not available, Central Hudson shall have the opportunity to meet its burden of proof through other means. Central Hudson's capital structure will continue to be reviewed in relation to the level of risk of Central Hudson at that time.

#### **5. Financial Transparency and Reporting Conditions**

a) Central Hudson must continue to use the standards of Generally Accepted Accounting Principles applicable to publicly-traded entities ("Public GAAP," "U.S. GAAP," or simply "GAAP") for its financial accounting and financial reports. Central Hudson will, for purposes of its financial accounting and financial reporting, continue to use the generally accepted accounting principles which include, but are not limited to the determinations by the Financial Accounting Standards Board ("FASB"), or any successor entity, for U.S. publicly accountable enterprises ("U.S. GAAP" or simply "GAAP"). Any future changes in U.S. GAAP, including any decision to replace U.S. GAAP with International Financial Reporting Standards ("IFRS"), will be applied by Central Hudson. In the event of future changes to accounting standards, recovery by Central Hudson for the incremental costs incurred in making such changes will be addressed in a future rate proceeding.

b) Central Hudson must continue to satisfy all Commission reporting requirements that currently apply to it; provided however, that nothing in this provision is intended to preclude Central Hudson from requesting relief from any such reporting provision and, further, that nothing herein is intended to require Central Hudson to continue to make reports in the future that utilities have been generally or generically excused by the Commission from making.

c) After the closing of this acquisition, Central Hudson shall continue to comply with the provisions of sections 302 through 404 of the Sarbanes-Oxley Act ("SOX") as if Central Hudson were still bound directly by the provisions of SOX, with the understanding that no filings with

the Securities and Exchange Commission will be required. Specifically, Central Hudson's periodic statutory financial reports must continue to include certifications provided by its officers concerning compliance with SOX requirements, including certifications on internal controls, as if still bound by the provisions of SOX.

d) Central Hudson shall remain subject to annual attestation audits by independent auditors with respect to its financial statements and internal controls over financial reporting.

e) Subject to the confidentiality and privilege provisions of sections VI.B 32 and 33 of the RSA, Fortis and Central Hudson will provide Staff access pursuant to section VI.B 30 of the RSA to the books and records and Standards Pertaining To Transactions, Conflicts Of Interest, Cost Allocations And Sharing Of Information Between Central Hudson Gas And Electric Corporation And Affiliates ("Standards"), including, but not limited to, tax returns, of Fortis and FortisUS to the extent necessary to determine whether the rates and charges of Central Hudson are just and reasonable and provide Staff the opportunity to ensure that costs are allocated equitably among affiliates in accordance with the RSA, Standards and Central Hudson code of conduct and that intercompany transactions involving Central Hudson are priced reasonably in accordance with the RSA, Standards and Central Hudson code of conduct. Subject to the confidentiality and privilege provisions of sections VI.B 32 and 33 of the RSA, that access must include, but not be limited to, all information supporting the underlying costs and the basis for any factor that determines the allocation of those costs.

f) Commencing for the year in which the closing takes place, Central Hudson must file annually with the Commission Fortis financial statements, including balance sheets, income statements, and cash flow statements for Fortis, Inc. and its major regulated and unregulated energy company subsidiaries in the United States. U.S. business entities with annual revenues less than ten percent of total Fortis revenues may be aggregated, provided that each entity included is fully identified. Aggregated U.S. business entities shall be identified as either regulated or unregulated. To satisfy this filing requirement, Fortis Inc.'s U.S. GAAP Canadian dollar denominated quarterly and annual Financial Reports, including Management Discussion and Analysis, which have been filed publically with Canadian securities regulators, will be filed by Central Hudson with the Commission. Additionally, Central Hudson will provide to the Commission, to the extent available from a recognized financial reporting information service such as SNL Financial or Bloomberg, Fortis Inc.'s "as reported" quarterly and annual Balance Sheet, Income Statement and Statement of Cash Flows in U.S. dollars with the underlying currency translation assumptions.

g) Fortis will indemnify Central Hudson for any tax obligations Central Hudson incurs as result of Central Hudson's United States federal and New York State income tax returns being filed as part of the consolidated tax returns of FortisUS and that it would not have occurred if Central Hudson's tax returns were filed on a stand-alone basis. Fortis and Central Hudson are required to enter into an Income Tax Preparation and Sharing Agreement that will formalize the income tax reporting and preparation relationship, protect Central Hudson's customers, and allocate tax benefits and obligations among the companies participating in the consolidated FortisUS income tax returns.

h) All information required by the financial transparency and reporting requirements in subparagraphs (a) through (f) above must be provided in English and in U.S. dollars, with the exception of Financial Reports and Management Discussion and Analysis referred to in subparagraph (f), and books and records and Canadian tax returns that statutorily require Canadian dollar reporting. In such cases, foreign exchange for U.S. dollar translation will be provided as described in subparagraphs (a) through (f) above and, shall be publicly available subject to the confidentiality and privilege provisions of sections VI.B 32 and 33 of the RSA.

#### **6. Affiliate Transactions, Cost Allocations, and Code of Conduct**

a) Fortis shall be subject to the rules, practices, and procedures in the RSA, Standards, and code of conduct governing relations among CHEG and Central Hudson in the same manner as they apply to CHEG.

b) Central Hudson will not enter into transactions with affiliates that are not in compliance with the RSA guidelines regarding affiliate transactions, including the updated Standards set forth in Attachment I. Central Hudson will also not enter into transactions with affiliates on terms less favorable to Central Hudson than specified in the RSA, including the updated Standards.

c) Central Hudson shall provide 180 days notice to the Commission prior to the commencement of any planned material (i.e., individually or collectively exceeding greater than 5% of Central Hudson net income on an after tax basis) shared services initiatives, and prior to establishment of a services organization that would provide material (i.e., individually or collectively exceeding greater than 5% of Central Hudson net income on an after tax basis) services to Central Hudson. Further, any such noticed shared service initiative would require Commission approval.

d) At or prior to the time of Central Hudson's next base rate filing it will consolidate the RSA, Standards and codes of conduct into one comprehensive document and file the consolidated document with the Commission. The intention of this requirement is to organize the provisions into an integrated document without altering the effect and content of the provisions.

#### **7. Follow-On Merger Savings**

a) In the event that Fortis completes any additional mergers or acquisitions within the United States before the Commission adopts an order approving new rates for Central Hudson, Fortis must share the follow-on merger savings that are reasonably applicable to Central Hudson and its customers between shareholders and ratepayers, on a 50/50 basis, to the extent the portions of such savings realized by Fortis are material (i.e., 5 percent or more of Central Hudson net income on an after-tax basis). Central Hudson must submit, within 90 days of the follow-on merger closing, a comprehensive and detailed proposal to share the follow-on merger savings, to begin on the closing date of the follow-on merger. In addition, the proposal must include an allocation method for sharing the synergy savings and efficiency gains among corporate entities that addresses the time period from the receipt of the synergy savings by Central Hudson until the Commission approves new rates. The ratepayer share shall be set aside in a deferral account for future Commission disposition.

## **8. Corporate Governance and Operational Provisions**

a) No later than one year after the closing of Fortis's acquisition of CHEG, Fortis shall appoint a board of directors for Central Hudson, the majority of whom will be independent (as defined in the Standards, see Attachment I), with the majority of such independent directors being resident in the State of New York, with emphasis on selecting candidates who reside, conduct business or work within the Central Hudson service territory. At least two independent director of Central Hudson shall be a resident of the service territory. Except with respect to the initial appointment of the board of directors for Central Hudson within one year following the closing, nothing in this Joint Proposal is intended to restrict the rights of Fortis to take any action before the Commission, or otherwise, regarding the appointment of directors meeting the above residency criteria at any time, as it sees fit.

b) Subject to the right of Central Hudson to petition the Commission for approval to relocate its corporate headquarters outside of Central Hudson's service territory, the corporate headquarters of Central Hudson shall remain within Central Hudson's service territory. Complete books and records of Central Hudson shall be maintained at Central Hudson's corporate headquarters.

c) At least 50% of Central Hudson's officers shall reside within Central Hudson's service territory.

d) Central Hudson shall be governed, managed and operated in the fashion described in Petitioners' testimony. Specifically, the Signatories agree that:

i) The board of directors of Central Hudson will be responsible for management oversight generally, including the approval of annual capital and operating budgets; establishment of dividend policy; and determination of debt and equity requirements. The Central Hudson board of directors will have an audit committee, the majority of whom will also be independent. The responsibility of this committee will include the oversight of the ongoing financial integrity and effectiveness of internal controls of Central Hudson.

ii) Central Hudson's local management will continue to make decisions regarding staffing levels and hiring practices; will continue to negotiate future collective bargaining agreements; will continue to be the direct contact and decision making authority in regulatory matters; and, will continue to represent Central Hudson in all future regulatory matters.

iii) To provide continuity in the management and staffing of Central Hudson, and ensure that the necessary human resources are maintained to continue the delivery of safe, reliable service to customers, the current employees of Central Hudson (union and management) will be retained for a period of four years following the closing under their respective current conditions of employment. Central Hudson reserves the right to take disciplinary and any other actions it determines necessary or appropriate within its existing labor agreement and employee relations practices. Central Hudson also agrees to maintain for two years after the closing the level of operating employees, as defined in the Standards, that is recognized in rates and to file a report with the Secretary of the Commission within 30 days after the first two anniversary dates of the merger's closing

comparing the level of union and management employees on the anniversary to date to the levels on the date upon which the merger closed.

iv) To ensure the continued active corporate and charitable presence of Central Hudson in its service territory, Central Hudson shall maintain its community involvement at not less than current (2011) levels for ten years after the closing of the acquisition (2013 through 2023).

### **9. Rate Freeze Provisions**

The Commission's Order Establishing Rate Plan, issued June 18, 2010, in Cases 09-E-0588 and 09-G-0589, set forth electric and gas rate plans for Central Hudson for the period July 1, 2010 through June 30, 2013. The July 1, 2013 rate reductions for S.C. 11 gas customers (see Section IX, Part B, and Appendix M, Sheet 4 of 5 of the current rate plan) will go into effect as provided in the current rate plan. In the period between July 1, 2013 and June 30, 2015 (Rate Freeze Period), the provisions of the current rate plan applicable to "rate year 3", except as modified in this Joint Proposal, are continued.

#### *a) Earnings Sharing and Calculations of Earned Rates of Return*

The Earnings Sharing Provision in Section VI.D of the current Commission-approved rate plan will be modified as of July 1, 2013, to read:

Actual regulatory earnings in excess of 10.00° and up to 10.50° will be shared equally between ratepayers and shareholders. Actual regulatory earnings in excess of 10.50% will be shared 90/10 (ratepayer/shareholder). These earnings sharing percentages shall be maintained until the effective date of the succeeding Commission rate order.

The Company will defer for the future benefit of ratepayers fifty percent of its share of any actual earnings in excess of 10.50° to reduce the deferred debit under-collections of MGP Site Investigation & Remediation Costs, interest costs on variable rate, interest costs on new issuances of long term debt, property tax, and stray voltage expense; provided, however, that such reduction in deferred debit deferrals will be further limited so as not to cause the resulting actual earnings to decrease below a 10.50% return on equity.

In calculating earned rates of return for regulatory purposes, the \$35 million of combined write-offs of deferred regulatory assets and future rate mitigation funds, and the one-time funding of \$5 million for economic development and low income purposes referred to in this Joint Proposal shall be included and not "normalized out" for purposes of determining actual expenses for the rate year in which those benefits are booked by Central Hudson.

#### *b) Distribution and Transmission Right-of-Way Tree Trimming and SIR Costs*

At the end of Rate Freeze Period, the actual total expenditures for distribution ROW tree trimming will be compared to \$11.397 million and any under-spending will be deferred as of the end of Rate Freeze Period. Carrying charges at the Pre-Tax Rate of Return ("PTROR") will be applied by the Company to the amount deferred from the end of Rate Freeze Period until the effective date of the succeeding Commission rate order.

At the end of Rate Freeze Period, the actual total expenditures for transmission ROW tree trimming will be compared to \$1.711 million and any under-spending will be deferred as of the end of Rate Freeze Period. Carrying charges at the PTROR will be applied by the Company to the amount deferred from the end of Rate Freeze Period until the effective date of the succeeding Commission rate order. In addition, the deferral for Manufactured Gas Plant ("MGP") Site Investigation and Remediation ("SIR") Costs authorized in Paragraph V.A.1 of the current rate plan will be modified as of July 1, 2013 to apply to all Environmental SIR costs incurred by Central Hudson during the period from July 1, 2013 to June 30, 2014. This modification does not limit Staff or the Commission's authority to review the prudence of any SIR costs.

*c) Stray Voltage Testing*

Actual Stray Voltage Testing expenditures, excluding mitigation costs, will be compared to \$2.023 million for the twelve months ending June 30, 2014. Any under-spending as of June 30, 2014, exclusive of expenditures for actual mitigation costs, will be deferred for future return to customers with carrying charges at the PTROR.

Actual mitigation costs in the twelve months ending June 30, 2014 will be compared to \$350,000. The differences between \$350,000 and actual mitigation expenditures will be deferred for future recovery by the Company, or return to customers, with carrying charges.

*d) Next Rate Case Filing*

Central Hudson may file new rate case applications at any time; however, the Fortis and Central Hudson agree to make such filing no earlier than the date that would be permitted for filing for rates to become effective on or after July 1, 2015. In its next rate case filing, Central Hudson shall provide, in a format similar to that provided in rebuttal testimony, an updated comparison between the debt ratings of Central Hudson and the regulated affiliates of Fortis based upon the latest rating agencies' analyses available at that time.

**10. Economic Benefits, Including Synergies and Positive Benefit Adjustments**

Fortis and Central Hudson have agreed to provide quantified economic benefits comprised of the following synergy and positive benefit adjustments: (i) synergy savings which are guaranteed for a period of 5 years and which will provide for future rate mitigation of \$9.25 million over the 5 years; (ii) a total of \$35 million of combined write-offs of deferred regulatory assets and future rate mitigation funds; and, (iii) one-time funding of \$5 million for a Community Benefit Fund for economic development and low income purposes.

*a) Synergy Savings/Guaranteed Rate Reductions*

The Signatories have agreed that the transaction will produce synergy savings/guaranteed future rate mitigation totaling \$9.25 million (\$1.85 million/year for 5 years). Petitioners have agreed to guarantee these cost savings for a period of five years, and will begin accruing these guaranteed cost savings in the month following closing. The Signatories recognize that this accrual will provide rate mitigation for the benefit of customers that will be available at the start of the first rate year in the next rate case filed by Central Hudson. The Signatories anticipate that the forecast effect of the synergy cost savings will also be reflected in rates in Central Hudson's next rate case.

*b) Deferred Storm Restoration Cost Write-offs and Future Rate Mitigation*

A total of \$35 million will be provided to Central Hudson by Fortis upon the closing of the transaction and will be recorded as a regulatory liability to be applied to write off regulatory assets on the books of Central Hudson due to storm restoration costs and to provide balance sheet offsets and rate mitigation in Central Hudson's next rate filing.

*i) Storm Restoration Cost Write-offs*

Central Hudson currently has two storm restoration cost deferral petitions pending before the Commission in Cases 11-E-0651 (\$11.0 million exclusive of carrying charges) and 12-M-0204 (\$1.6 million exclusive of carrying charges) , for a total of \$12.6 million exclusive of carrying charges. Additionally, Central Hudson has estimated that the incremental storm restoration costs above the current rate allowance resulting from Super-storm Sandy will be approximately \$10 million. The Signatories agree that Central Hudson shall file a formal Super-storm Sandy deferral petition as soon as reasonably practicable.

The Signatories agree to utilize a placeholder total for these three events of \$22 million. The Signatories agree that \$22 million will be written off promptly after the closing against the \$35 million regulatory liability being funded by Fortis, subject to true-up for subsequent Commission determinations concerning the storm restoration costs of the three storms. The Signatories agree that the three deferral requests will be reviewed by Staff consistent with the principles and practices in the recent Central Hudson storm restoration deferral petitions involving Twin Peaks (February 2010) in Case 10-M-0473 and the December 2008 ice storm in Case 09-M-0004.

*ii) Disposition of the Remaining Balance*

The difference between the \$35 million being provided by Fortis and the \$22 million in placeholder storm restoration cost write-offs is currently estimated as a \$13 million placeholder. The Signatories agree that this \$13 million difference will be reserved as a regulatory liability with carrying charges at the pre-tax rate of return rate. At the time of the final, trued-up storm restoration cost determination by the Commission, the reserve and associated carrying charges will be adjusted up or down to conform to the Commission's determination. The final amount will be reserved for additional future balance sheet write-offs or other rate moderation purposes, as shall be determined in Central Hudson's next rate case.

*c) Community Benefit Fund*

A total of \$5 million will be provided by Fortis for a Community Benefit Fund to be utilized for low income and economic development purposes as discussed in greater detail previously in this Joint Proposal.

**B. Performance Mechanisms**

RUCO Fortis 1.04 Attachment A.pdf

**1. Customer Service**

The following targets and effective dates will apply:

Measure	Value	Effective
PSC Complaint Rate	1.1 - 1.6	7/1/13
Customer Satisfaction Index	85 - 82, etc. structure per the current rate plan	7/1/13
Keeping Scheduled Appointments	\$20 paid to customer for missed appt. per current rate plan	7/1/13

These targets continue to apply unless and until changed by Commission Order.

**2. Negative Revenue Adjustments ("NRAs")**

The NRAs shown in the following table have been doubled from those in the current rate plan. The NRAs in the current rate plan shall be tripled if targets are missed during a dividend restriction and quadrupled if targets are missed for three years within the next five year period.  
Central Hudson Service Quality Performance Mechanism

Customer Satisfaction Index	Negative Revenue Adjustment
85% or higher	None
84% - 85%	\$475,000
83% - 84%	\$950,000
82% - 83%	\$1,425,000
<82%	\$1,900,000
<b>Total Amount at Risk</b>	<b>\$1,900,000</b>

PSC Annual Complaint Rate	Negative Revenue Adjustment
<1.1	None
1.1	\$950,000
1.2	\$1,140,000
1.3	\$1,330,000
1.4	\$1,520,000
1.5	\$1,710,000
1.6 or higher	\$1,900,000
<b>Total Amount at Risk</b>	<b>\$1,900,000</b>

**3. Electric Reliability**

The electric service annual metrics for System Average Frequency Index (SAIFI) target of 1.45 and Customer Average Duration Index (CAIDI) target of 2.50 continue through 2013.

Electric Reliability Reporting requirements, quarterly meeting requirements, revenue adjustment source, and exclusions are defined in Attachment II. All Electric Reliability NRAs of the current

rate plan shall be doubled. In addition, the NRAs of the current rate plan shall be tripled if targets are missed during a dividend restriction and quadrupled if targets are missed for three years within the next five year period. All electric reliability targets for calendar year 2013 remain in effect until modified by a Commission order in a subsequent Central Hudson electric rate case.

**4. Gas Safety Metrics**

*a) Emergency Response Time*

The gas emergency response time metrics of 75% response within 30 minutes and 90% response within 45 minutes will be continued.

*b) Gas Leak Backlog*

The calendar year 2013 leak backlog target is 260 at year-end. The calendar year 2013 repairable leaks backlog target is 20 at year-end.

*c) Damage Prevention*

The calendar year 2013 total damages per 1,000 one call tickets target is 2.40. The calendar year 2013 mismarks per 1,000 one call tickets target is 0.50. The calendar year 2013 Company and Company Contractor damages per 1,000 one call tickets target is 0.25.

*d) New Parts 255 and 261 Violation Metric*

Central Hudson will incur a negative revenue adjustment for instances of noncompliance (violations) of certain pipeline safety regulations set forth in 16 NYCRR Parts 255 and 261, as identified during Staff's annual field and record audits. Attachment III sets forth a list of identified high risk and other risk pipeline safety regulations pertaining to this metric. Central Hudson will be assessed a negative revenue adjustment for each high risk or other risk violation, up to a combined maximum of 100 basis points per calendar year as follows:

<b>High Risk Violation</b>	<b>Occurrences</b>	<b>Basis Points Per Violation</b>
	Calendar Year 2013	1-30
31+		1/2
Calendar Year 2014	1-25	1/2
	26+	1

<b>Other Risk Violation</b>	<b>Occurrences</b>	<b>Basis Points Per Violation</b>
	Calendar Year 2013	1-30
31+		1/3
Calendar Year 2014	1-25	1/9
	26+	1/3

This metric will be effective as of the start of the Commission Order in this case, but will then be measured on calendar years, as identified above. With respect to violations, only documentation or actions performed, or required to be performed, on or after the date of the Commission Order in this case will constitute an occurrence under the metric.

At the conclusion of each audit, Staff and Central Hudson will have a compliance meeting where Staff will present its findings to Central Hudson. Central Hudson will have five business days from the date the audit findings are presented to cure any identified document deficiency. Only official Central Hudson records, as defined in Central Hudson's Operating and Maintenance plan, will be considered by Staff as a cure to a document deficiency. Staff will submit its final audit report to the Secretary of the Commission under Case 12-M-0192. If Central Hudson disputes any of Staff's final audit results, Central Hudson may appeal Staff's finding[s] to the Commission. Central Hudson will not incur a negative revenue adjustment on the contested finding until such time as the Commission has issued a final decision on the contested findings. Central Hudson does not waive its right to seek an appeal of any Commission determination regarding a violation under applicable law.

If an alleged high risk or other risk violation set forth in Attachment III is the subject of a separate penalty proceeding by the Commission under PSL 25, that instance will not constitute an occurrence under this performance metric.

*e) Negative Revenue Adjustments*

Other than the Parts 255 and 261 metric, all Gas Safety NRAs of the current rate plan shall be doubled. In addition, the NRAs of the current rate plan shall be tripled if targets are missed during a dividend restriction and quadrupled if targets are missed for three years within the next five year period.

*f) Continuation*

All gas safety targets for calendar year 2013 remain in effect until modified by a Commission order in a subsequent Central Hudson gas rate case.

**5. Infrastructure Enhancement for Leak-prone Pipe**

A minimum capital budget of \$7.7 million is established for the replacement of leak-prone pipe over calendar year 2014. The pipe to be removed from service shall be identified and ranked using a risk-based methodology. If actual expenditures fall short of \$7.7 million, Central Hudson will defer for ratepayer benefit the revenue requirement equivalent of the shortfall multiplied by 0.5. Central Hudson shall maintain the minimum pipe replacement level beyond 2014 at \$7.7 million, until changed by the Commission.

**6. Net Plant Targets**

Central Hudson's net plant targets for the twelve month period ending June 30, 2014 of \$919.3 million for Electric and \$252.2 million for Gas, with associated annual depreciation expenses of \$32.7 million and \$9.0 million, respectively, will be established.

The actual average electric and gas net plant balances at the end of the twelve month period ending June 30, 2014 will be calculated using the calculation methods described in Attachment III. The net plant targets shown in Attachment III limit total Common Software construction expenditures, including Legacy Replacements, in the Rate Freeze Period to \$5.0 million.

*a) Reconciliations*

The actual electric and gas net plant will be compared to the electric and gas net plant target for the twelve month period ending June 30, 2014, and the revenue requirement difference (i.e., return and depreciation as described in Attachment IV) will be determined.

*b) Deferral For the Benefit of Ratepayers*

If, at the end of the twelve month period ending June 30, 2014, the revenue requirement difference from net plant additions is negative, Central Hudson will defer the revenue requirement impact for the benefit of customers. If, at the end of the twelve month period ending June 30, 2014, the revenue requirement impact is positive, no deferral will be made. Carrying charges at the PTROR will be applied by the Company to the amount deferred from the end of the twelve month period ending June 30, 2014 until addressed by the Commission in a Central Hudson rate order.

**C. Low Income and Retail Access**

**1. Low Income**

Fortis and Central Hudson agree that the existing funding for low income programs available currently in rates will be supplemented with \$500,000 from the Community Benefit Fund being made available by the Petitioners as a result of this transaction. In addition, the Signatories agree to the following modifications to existing low income programs:

- a) Central Hudson's current low income program is made up of two components: the Enhanced Powerful Opportunities Program ("EPOP"), which is a targeted program open to selected participants, and a broad-based bill discount program that provides a monthly bill credit to all customers that are Home Energy Assistance Program ("HEAP") recipients. The EPOP program and its associated funding will remain unchanged. The bill discount program currently provides a monthly bill credit of \$11.00 to all customers who are HEAP recipients. Data provided by Central Hudson reflect that the program has 8,641 participants as of the twelve months ended November 30, 2012, and projected annual spending of \$1,140,612 (\$11 x 12 x 8,641).
- b) Within 30 days of a Commission order in this proceeding, Central Hudson will modify its current discount program, which provides dual-service customers with one discount, by implementing the following discount levels for single and dual service bill discount program participants:

	Electric only	Gas only	Both Elec. & Gas
Heating	\$17.50	\$17.50	\$23.00
Non-heating	\$5.50	\$5.50	\$11.00

- c) In order to ensure that no current participant faces a reduction in current benefit levels, any single service non-heating customer currently receiving a bill discount of \$11.00 will continue receiving such benefit at the \$11.00 level, instead of the \$5.50 level specified above.

- d) The total cost of the bill discount program is expected to be \$1,662,672. Actual expenditures may vary based on HEAP participation levels.
- e) Central Hudson will waive service reconnection fees, no more than one time per customer until new rates go into effect, for customers participating in either the EPOP or bill discount programs. Funding for reconnection fee waivers is limited to \$50,000 until new rates go into effect. Central Hudson may grant waivers to individual customers more than once during this period, on a case-by-case basis and for good cause shown, provided that the program funding allocation for such waivers is not exceeded. Upon notice to Staff and the UTU, Central Hudson will be permitted, first, to limit the waiver to (50) percent of the total reconnection fee, if the cost of waived reconnection fees is projected to exceed the annual allocation, and, second to suspend the waiver program if the budget limit is reached.
- f) A sum of \$500,000 of the total costs of the low income bill discount and reconnection fee waiver programs is to be supplied from the Community Benefit Fund. To the extent that actual expenditures exceed the rate allowance in current rates of \$1,531,200, plus \$500,000 from the Community Benefit Fund, any shortfall will be supplied first, from the cumulative unused portions of the current rate allowances for the bill discount program, which is expected to be approximately \$500,000, and second, will be deferred as a regulatory asset. To the extent that actual expenditures fall short of the current rate allowance plus the cumulative unused portions of the current rate allowances for the bill discount program plus \$500,000 from the Community Benefit Fund, any excess will be deferred for use of the low-income bill discount program and the reconnection fee waiver program in a future rate proceeding.
- g) Customers enrolled in the EPOP or low income bill discount programs will continue to be referred by Central Hudson to the New York State Energy Research and Development Authority's Empower-NY program or any successor to the Empower-NY program, for energy efficiency services.
- h) The parties agree that these modifications justify returning to a quarterly reporting schedule. Central Hudson will file quarterly and annual reports on the EPOP and bill discount programs with the Secretary and provide copies to other parties currently receiving copies of EPOP reports. With respect to the bill discount program, the reports will provide:
  - i. The number of customers enrolled in the bill discount program;
  - ii. The aggregate amounts of low-income bill discounts for the quarter and year to date; and
  - iii. The number of reconnections of low income customers for which the fee was fully or partially waived, and the aggregate amount of reconnection fees waived to date.
- i) Nothing in this Joint Proposal is intended to prejudge the treatment of low income matters by the Commission in Central Hudson's next rate case.

## **2. Retail Access**

In support of the Commission's retail market development initiatives, Central Hudson will set forth a total bill comparison, using the existing Central Hudson computer program that had been previously implemented, on all retail access residential bills using consolidated billing issued after 90 days following closing. The Signatories agree that this total bill comparison is to provide information to retail access customers that should be made available by the utility as part of the Commission's retail energy markets initiatives. Central Hudson shall report quarterly to the Secretary on this initiative so that Staff can continue to review and supervise this initiative and report any changes deemed desirable to the Commission on an on-going basis. Central Hudson's quarterly reports will also be provided to other parties currently receiving Central Hudson's EPOP reports.

In addition, for similar purposes of supporting the Commission's retail market development initiatives, within 60 days following issuance of the Commission Order in this case, Central Hudson will file a proposal to provide payment-troubled (i.e., subject to termination) customers with bill comparison information. The type of reporting and continued monitoring appropriate for this initiative will be developed as part of the resolution of Central Hudson's pending proposal.

The costs of these two initiatives will be funded from the existing Competition Education Fund (net of the transfer of funds for economic development, as described below). Central Hudson shall propose a use or uses for any balance remaining in the Competition Education Fund, after these two initiatives have been funded, in its first rate filing following the closing. In the event that the costs of these two initiatives exceed the funding available from the existing Competition Education Fund (net of the transfer of funds for economic development), Central Hudson is authorized to defer the excess costs for future recovery with carrying charges at the PTROR.

The Signatories anticipate that modifications to either initiative may become appropriate based on developments in the ongoing generic retail access proceeding, Case 12-M-0476.

## **D. Economic Development and Support for State Infrastructure Enhancements**

### **1. Economic Development**

The Signatories agree that \$5 million will be allocated to economic development purposes to enhance the existing Central Hudson economic development programs. The \$5 million is in addition to the current Central Hudson rate allowance for economic development funding. The funding for this program will be through \$4.5 million from the remaining balance of the \$5 million Community Benefit Fund being provided by Fortis and Central Hudson and \$500,000 from Central Hudson's Competition Education Fund.

The parties to this proceeding will confer following the execution and filing of this Joint Petition in this case to seek to jointly develop consensus modifications to the existing Central Hudson economic development programs. Central Hudson shall make a filing with the Commission within 15 days following the Commission's order in this case proposing modifications to the existing economic development programs that include the parties' agreements. As part of the

filing made by Central Hudson, expedited consideration by the Commission will be requested. The proposal will be for programs that will continue to be administered by Central Hudson pursuant to existing Commission authorizations, with the clarifications and modifications as follows. Central Hudson will continue to hold custody of funds and administer the programs with input from the Counties in Central Hudson's service territory. The \$5 million will not receive carrying charges. The proposal will include the criterion that all applications for projects that do not have participation from Empire State Development, a County Industrial Development Agency, a County Community College, or local municipal resolution pursuant to existing program requirements will seek a letter of support from the County of origin. In addition, the proposal will state that Central Hudson will seek participation concerning award notifications and announcements from the County of origin prior to issuing such announcements.

In addition to filing the above proposal, Central Hudson will meet twice per year with representatives from all of the Counties in the Central Hudson service territory to discuss economic development and potential program improvements. Nothing in this Joint Proposal is intended to prejudge the treatment of economic development matters by the Commission in Central Hudson's next rate case.

## **2. State Infrastructure Enhancements**

Central Hudson shall continue to support the New York State Transmission Assessment and Reliability Study ("STARS"), the Energy Highway and economically justified gas expansion. Fortis agrees to provide equity support to the extent required by Central Hudson for such projects as receive regulatory approval and proceed to construction.

## **3. Gas Expansion Pilot Program**

Central Hudson will commit to actively promote its "Simply Better" gas marketing expansion campaign in the Rate Freeze Period, seeking gas customer additions where Company gas facilities already exist, and economic expansion of its gas system, consistent with the Commission's Part 230 regulations, to identified expansion target areas in each operating district. The Company will continue to provide requesting and targeted customers with access to conversion calculators, third-party turnkey conversion services (potentially including a project specialist from start to finish, a licensed heating installation professional, a detailed cost/benefit proposal on converting their heating equipment, removal of existing oil tank, and coordination of the service and heating installations), and available financing from third-party lenders to assist customers who are seeking gas delivery service or to convert from alternate fuels.

In the event that adequate financial commitments can be secured from new firm service customers and municipal franchise approvals on reasonable conditions are secured in locations where Central Hudson does not currently have gas facilities or local franchises, Central Hudson will commit to file for expedited Commission approval to exercise such franchises as are shown by Central Hudson's analyses to comply with Part 230.

Central Hudson will begin, within 90 days of an Order in this proceeding approving this Joint Proposal, to track all gas service requests and keep record of: (1) applicable gas service request dates (i.e., customer request received, Company evaluation or commitment made, service denied/initiated); (2) the address of requested service including the township and county; (3)

calculated cost to install new service lines and main extensions including customer payment responsibility; and (4) reasons for a service not being initiated. Customer information will be protected consistent with the updated Standards addressed elsewhere in this Joint Proposal.

Central Hudson will propose applying a limited pilot expansion program aimed at testing ideas to economically expand gas to customers. The pilot can be either part of a new franchise filing or a separate filing to the Commission no later than July 1, 2013. The pilot will test all or any of the following ideas:

- a) Piggy back on top of anchor customers to reduce the actual need for additional pipe beyond the 100 foot rule;
- b) surcharge all customers or specific customers over five years or more based on the savings from their alternative fuel to write down assets in order to meet the overall Rate of Return (ROR) by year 5;
- c) increase the minimum 100 feet allowed by a higher "average" amount for everyone in the customer cluster to be served based on anticipated additional revenues; and/or
- d) Trade Alliance by Central Hudson to purchase heating equipment from manufacturers for conversion/new customers and pass the savings to customers.

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**Post-transaction and tangible benefits.**

**UDR 1.36**

Please describe of the financial benefits that will accrue to UNS Gas, UNS Electric, and TEP as the result of the proposed transaction.

**RESPONSE:**

Anticipated cost savings include reduced or eliminated public company costs, reduced insurance costs, and a potentially lower cost of debt as a result of anticipated credit rating upgrades. For more details, please see the testimony of Kevin Larson at pages 2-10.

**RESPONDENT:**

Kentton Grant

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.09**

The Fortis Inc. 2013 Annual Report at page 135 states that:

"Following the announcement of the proposed acquisition of UNS Energy on December 11, 2013, several complaints, which named Fortis and other defendants, were filed in the Superior Court of Arizona, Pima County, and the United States District Court of the District of Arizona, challenging the proposed acquisition. The complaints generally allege that the directors of UNS Energy breached their fiduciary duties in connection with the proposed acquisition and that UNS Energy, Fortis, FortisUS Inc. and Color Acquisition Sub Inc. aided and abetted that breach. The outcome of these lawsuits cannot be predicted with any certainty and, accordingly, no amount has been accrued in the consolidated financial statements. An adverse judgment for monetary damages could have a material adverse effect on the operations of the surviving company after the completion of the acquisition. A preliminary injunction could delay or jeopardize the completion of the acquisition and an adverse judgment granting permanent injunctive relief could indefinitely enjoin completion of the transaction. Subject to the foregoing, in management's opinion, based upon currently known facts and circumstances, the outcome of such lawsuits is not expected to have a material adverse effect on the consolidated financial condition of Fortis. The defendants intend to vigorously defend themselves against the lawsuits."

- a. How are such costs being accounted for (show journal entries and indicate on which entity's books such costs are being recorded)?
- b. Are any of these costs being charged to TEP, UNS Electric or UNS Gas? If so, identify the amounts charged to each utility to date by account.
- c. Does Fortis agree that none of the costs related to this litigation should be borne by the ratepayers of TEP, UNS Electric or UNS Gas?
  1. If not, explain fully why not.
  2. Will Fortis accept a condition that precludes the recovery of any of the costs of such litigation from ratepayers of TEP, UNS Electric or UNS Gas? If not, explain fully why not.
- d. Did Fortis or any of its subsidiaries incur any costs for shareholder litigation related to the acquisition by Fortis of CH Energy (Central Hudson) and its subsidiaries?
  1. If so, how were the costs of that litigation accounted for and on which entity's books were such costs recorded?

**RESPONSE:**

- a. The costs related to litigation referenced at page 135 of the Fortis Inc. 2013 Annual Report will be an expense on the books of UNS Energy. As noted in response to RUCO Fortis 2.22, Fortis anticipates injecting equity to fund acquisition related costs that are being expensed by UNS Energy.

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

- b. Yes. The merger related costs recorded on UNS Energy's books are allocated to subsidiaries using the allocation method described by UNS Energy in UDR 1.14. All merger related costs are tracked using identifiable accounting coding to allow them to be removed for rate making purposes from each subsidiary.
- c. Yes. Fortis agrees that none of the costs related to the litigation should be borne by the customers of TEP, UNS Electric or UNS Gas.
  - 1. Not Applicable
  - 2. Yes. Fortis has committed that transaction costs will not be recovered from customers through rates.
- d. Yes.
  - 1. The costs were accounted for as an expense on the books of CH Energy Group, Inc.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**UDR 1.33**

Please provide a description of the nature and current status of all litigation or anticipated litigation concerning the acquisition.

**RESPONSE:**

Five putative shareholder class action lawsuits challenging the merger have been filed, four in the Superior Court of Pima County, Arizona: (i) *Phillip Malenovsky v. UNS Energy Corporation, et al.* (Case No. C20136942); (ii) *Paul Parshall v. UNS Energy Corporation, et al.* (Case No. C20136943); (iii) *Hillary Kramer v. Paul J. Bonavia, et al.* (Case No. C2014-0026); and (iv) *Vandermeer Trust U/A DTD 03/11/1997 v. UNS Energy Corporation, et al.* (Case No. C2014-0107); and one in federal court in the United States District Court for the District of Arizona: *Milton Pfeiffer v. Paul J. Bonavia, et al.* (Case No. 4:13-CV-02619-JGZ).

All of the cases name the current directors of UNS Energy as defendants, and all name at least one or more Fortis entity as a defendant, including: FortisUS, Merger Sub, and Fortis. Each of the lawsuits has been brought by a purported shareholder of UNS Energy, both individually and on behalf of a putative class of UNS Energy shareholders.

The lawsuits generally allege, among other things, that the directors of UNS Energy breached their fiduciary duties to shareholders of UNS Energy purportedly by agreeing to a transaction pursuant to an inadequate process and for failing to obtain the highest value for UNS Energy shareholders. The *Malenovsky* lawsuit alleges further that the directors of UNS Energy also breached their fiduciary duties purportedly by failing to disclose all material information concerning the transaction and by engaging in self-dealing by approving the transaction. The *Malenovsky*, *Kramer*, and *Vandermeer Trust* lawsuits allege that UNS Energy aided and abetted the directors of UNS Energy in the alleged breach of their fiduciary duties. The lawsuits allege that the Fortis entities also aided and abetted the directors of UNS Energy in the alleged breach of their fiduciary duties.

The lawsuits seek, in general, and among other things, (i) injunctive relief enjoining the transactions contemplated by the merger agreement, (ii) rescission or an award of rescissory damages in the event a merger is consummated, (iii) an award of plaintiffs' costs including reasonable attorneys' and experts' fees, (iv) an accounting by the defendants to plaintiffs for all damages caused by the defendants, and (v) such further relief as the court deems just and proper. The *Vandermeer Trust* lawsuit also requests that the court direct the defendants to disclose all material information concerning the transaction.

These lawsuits are at a preliminary stage. UNS Energy, its directors and the other defendants believe that these lawsuits are without merit and intend to defend against them vigorously.

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**RESPONDENT:**

Todd C. Hixon

**WITNESS:**

David Hutchens

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S FIRST SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
February 28, 2014**

**RUCO UNS 1.02**

**Tax elections.** Will there be any Internal Revenue Code §338(h)(10) election in conjunction with this transaction?

- a. If so, please identify the estimated impacts of the §338(h)(10) election on each Arizona regulated utility's Accumulated Deferred Income Tax balances, showing the estimated (1) before and (2) after amounts of ADIT recorded on each such utility's books.

**RESPONSE:**

No §338(h)(10) election will be made in conjunction with this transaction.

**RESPONDENT:**

Frank Marino / Brian Brumfield

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**January 28, 2014**

**UNS Energy and UNS Utilities – Capital Structure and Cost of Capital**

**UDR 1.08**

Please provide UNS Gas' current bond/debt rating.

**RESPONSE:**

UNS Gas' current senior unsecured rating is Baa2 from Moody's Investor Services ("Moody's").  
UNS Gas is not rated by Standard & Poor's ("S&P") or Fitch Ratings, Inc. ("Fitch").

**RESPONDENT:**

Chris Norman

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")

Color Acquisition Sub Inc. ("Color Acquisition")

Fortis Inc. ("Fortis")

FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")

FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")

UniSource Energy Services ("UES")

UNS Electric, Inc. ("UNS Electric")

UNS Energy Corporation ("UNS Energy")

UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**UDR 1.09**

Please provide UNS Electric's current bond/debt rating.

**RESPONSE:**

UNS Electric's current senior unsecured rating is Baa2 from Moody's. UNS Electric is not rated by S&P or Fitch.

**RESPONDENT:**

Chris Norman

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**UDR 1.10**

Please provide TEP's current bond/debt rating.

**RESPONSE:**

The table below summarizes TEP's current bond ratings.

	<b>S&amp;P</b>	<b>Moody's</b>	<b>Fitch</b>
Senior Unsecured Debt	BBB	Baa2	BBB
Issuer Rating	BBB	Baa2	BBB-

**RESPONDENT:**

Chris Norman

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**UDR 1.11**

Please provide UNS Energy's current bond/debt rating.

**RESPONSE:**

UNS Energy's current senior secured rating is Baa3 from Moody's. UNS Energy is not rated by S&P or Fitch.

**RESPONDENT:**

Chris Norman

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**UDR 1.16**

Please provide Fortis Inc.'s current bond/debt rating.

**RESPONSE:**

Please see the testimony of Barry V. Perry at pages 3-4.

See also the files listed below for the S&P and DBRS ratings reports of Fortis.

<b>File Name</b>	<b>Bates Numbers</b>
UDR 1.16 DBRS - Fortis Inc (Feb 2013).pdf	000921-000928
UDR 1.16 SP - Fortis Inc - Feb 26, 2013.pdf	000929-000938

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")



**Rating Report**

**Report Date:**  
February 19, 2013  
**Previous Report:**  
July 26, 2012

**Fortis Inc.**

**Analysts**

**Eric Eng, MBA**  
+1 416 597 7578  
eeng@dbrs.com

**Chenny Long**  
+1 416 597 7451  
clong@dbrs.com

**Andy Thi**  
+1 416 597 7337  
athi@dbrs.com

**James Jung, CFA,  
FRM, CMA**  
+1 416 597 7577  
jjung@dbrs.com

**The Company**

Fortis Inc. is a holding company for a number of regulated electric and natural gas utilities, including wholly owned FortisBC Energy companies (formerly Terasen Gas Inc. and Terasen Gas (Vancouver Island) Inc.), Newfoundland Power Inc., FortisAlberta Inc., FortisBC Inc., Maritime Electric Company, Limited, FortisOntario Inc. and Fortis Turks and Caicos, as well as majority ownership of Caribbean Utilities Company (slightly over 60%).

Non-regulated operations include Fortis Properties, as well as non-regulated generation in Belize, Ontario and upper New York State.

**Rating**

Debt	Rating	Rating Action	Trend
Issuer Rating	A (low)	Confirmed	Stable
Unsecured Debentures	A (low)	Confirmed	Stable
Preferred Shares	Pfd-2 (low)	Confirmed	Stable

**Rating Update**

DBRS has confirmed the Issuer Rating and ratings of the Unsecured Debentures and Preferred Shares of Fortis Inc. (Fortis or the Company) at A (low), A (low) and Pfd-2 (low), respectively, with Stable trends. The confirmation reflects the Company's strong mix of earnings generated from regulated utilities and reasonable financing strategies for the acquisition of CH Energy Group Inc. (CHG) (the Acquisition; approximately US\$1.5 billion, including US\$500 million assumed debt) and the Waneta hydropower project, of which Fortis has 51% ownership.

Upon completion of the Acquisition and Waneta project, Fortis' non-consolidated leverage is expected to increase modestly, but should be maintained within the 20% range as a result of a prudent funding mix. The 20% threshold is in line with DBRS's rating guidelines for notching a holding company relative to its subsidiaries (see DBRS's methodology *Rating Holding Companies and Their Subsidiaries*). In 2012, the Company completed its subscription receipt offering of approximately \$601 million and preferred shares issuance of approximately \$200 million, which will be used to partially fund the Acquisition and Waneta project (\$116 million in capital expenditures (capex) in 2013, net to Fortis). Although cash flow coverage is expected to weaken temporarily following the Acquisition and Waneta project, it is expected to remain within the current rating category (pro forma debt-to-capital of approximately 14% in 2012).

Fortis' business risk profile is expected to improve moderately with the Acquisition, as approximately 97% of CHG's earnings are generated from its regulated electric and gas businesses. This regulated earnings mix is higher than the Company's consolidated mix of approximately 90% (remainder generated from higher-risk hotel properties and non-regulated generation businesses). The regulatory framework in New York is viewed as reasonable, as CHG is allowed to recover prudently incurred operating, capital and commodity costs in a timely manner and earn a reasonable return on investments.

Fortis is currently rated the same as some of its subsidiaries (FortisBC Inc. and FortisAlberta Inc.), despite the structural subordination and double leverage at the parent, as DBRS believes that Fortis' ratings are supported by strong and stable cash flows from diversified sources, with a prominent portion of dividends coming from regulated subsidiaries with "A" ratings (FortisBC Energy Inc. and Newfoundland Power Inc.).

**Rating Considerations**

**Strengths**

- (1) Strong and stable dividends and cash income
- (2) Diversified sources of cash flow
- (3) 100% ownership of most subsidiaries
- (4) Good liquidity/strong interest coverage

**Challenges**

- (1) Potential higher debt levels at the parent
- (2) Structural subordination to debt at the subsidiaries
- (3) Strong ring-fencing at its wholly owned utilities
- (4) Considerable capex for Waneta Expansion Project

**Financial Information**

Fortis Inc. - Non-consolidated (CA\$ millions)	USGAAP	CGAAP	CGAAP	CGAAP	CGAAP
	2012	2011	2010	2009	2008
EBIT	418.5	414.9	379.3	344.4	320.2
EBIT interest coverage (times)	10.55	9.37	8.01	7.93	8.25
DBRS adjusted total debt	1,088.9	880.4	1,181.7	844.7	654.0
Total debt in capital structure	18.1%	15.7%	22.5%	17.7%	15.0%
Cash flow interest coverage (times)	5.52	4.90	3.27	4.86	3.58
Cash flow/Total debt	20.1%	24.6%	13.1%	25.0%	21.2%

UDR 1.16 DBRS - Fortis



**Fortis Inc.**

**Report Date:**  
February 19, 2013

## Rating Considerations Details

### Strengths

- (1) **Strong and stable dividends and cash income.** Cash income and dividends have been strong, largely supported by stable earnings and cash flow from regulated entities and long-term power contracts. Regulated operations account for approximately 90% of consolidated earnings and 71% of non-consolidated cash flow in 2012.
- (2) **Diversified sources of cash flow.** Fortis benefits from diversified sources of cash flow through its ownership of regulated natural gas utilities in British Columbia and electric utilities in five Canadian provinces and three Caribbean countries. This is expected to improve upon the completion of the CHG acquisition.
- (3) **100% ownership of most subsidiaries.** Fortis owns 100% of most of its operating entities. This provides Fortis, within the boundaries of regulatory oversight, with some discretionary powers over the manner in which cash flows are paid to it by its operating companies.
- (4) **Good liquidity/strong interest coverage.** At the end of December 31, 2012, Fortis had approximately \$991 million in available credit facilities (at the parent level), which is sufficient to finance its near-term operational and capital needs. Non-consolidated cash flow-to-interest coverage remained strong in 2012 at 5.52 times.

### Challenges

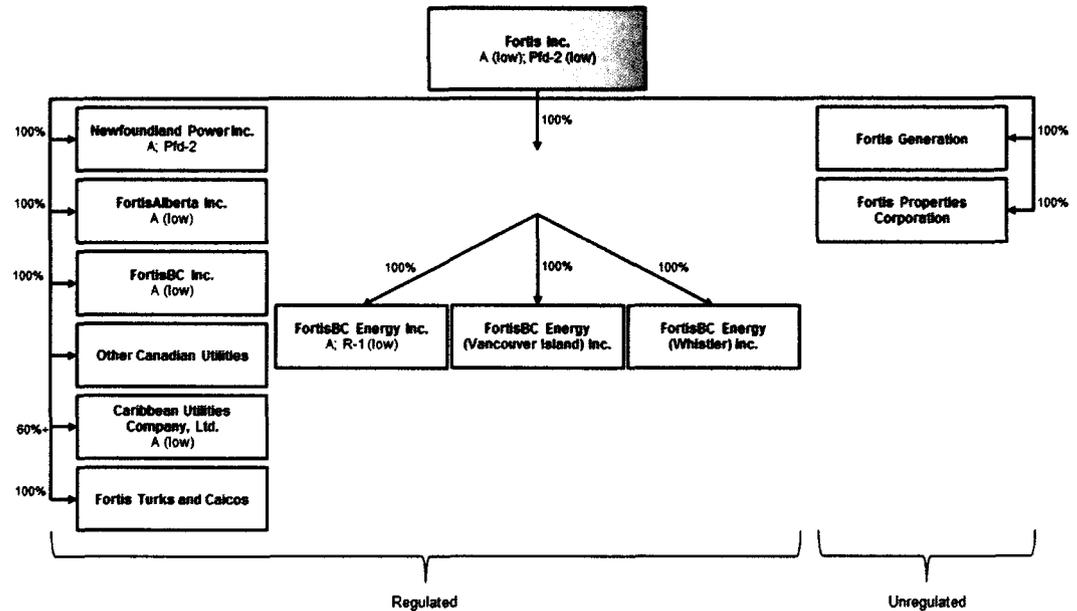
- (1) **Potential higher debt levels at the parent.** Fortis' agreement to acquire CHG could considerably increase debt levels at the parent. As at December 31, 2012, the non-consolidated debt-to-capital ratio was at approximately 14% (pro forma), providing Fortis with financial flexibility. However, Fortis' non-consolidated leverage will likely increase to around the 20% threshold.
- (2) **Structural subordination to debt at the subsidiaries.** Fortis is a holding company whose debt is structurally subordinated to the debt obligations of its operating companies. This accounts for the lower debt rating of Fortis relative to the debt ratings of some its key regulated subsidiaries.
- (3) **Strong ring-fencing at its wholly owned utilities.** Fortis faces strong ring-fencings imposed on FortisBC Energy Inc. and FortisBC (Vancouver Island) Inc., with respect to their capital structure and dividend payouts. In addition, it is common for utilities to maintain their capital structure in line with the regulatory capital structure. As a result, dividend payouts to Fortis could be affected should these utilities have a large capital expenditure program.
- (4) **Large capital expenditures for the Waneta Expansion Project (WEP).** The WEP is a hydroelectric project in British Columbia that is 51% owned by Fortis. The Company's share of capital expenditures is approximately \$450 million. Approximately \$436 million has been spent to date and a further \$227 million is expected to be spent in 2013 (51% contributed by Fortis). The project is expected to be in service in early 2015.



**Fortis Inc.**

**Report Date:**  
February 19, 2013

**Simplified Corporate Structure\***



\*Note: The above chart only includes Fortis' major regulated and non-regulated subsidiaries, which directly or indirectly contribute dividends to Fortis.

**Based on 2012 Data**

Name	Operations	Customers	Rate base (CAD billions)	Allowed RoE for 2012	Net income (CAD millions)	Deemed equity
FortisBC Holdings Inc.	Holding company	945,000	3.6	9.50%-10.00%	138	40%
FortisBC Energy Inc.	Natural gas distribution	N/A	N/A	9.50%	N/A	40%
FortisBC Energy (Vancouver Island)	Natural gas distribution	N/A	N/A	10.00%	N/A	40%
FortisBC Energy (Whistler)	Natural gas distribution	N/A	N/A	10.00%	N/A	40%
FortisAlberta	Electricity distribution	508,000	2.0	8.75%	96	41%
FortisBC	Integrated utility	163,000	1.1	9.90%	50	40%
Newfoundland Power	Electricity distribution	251,000	0.9	8.80%	37	45%
Other Canadian Utilities	-	140,000	0.5	8.01%-9.850%	24	40%
Fortis Properties	Real estate	N/A	N/A	N/A	22	N/A
Caribbean Electric Utilities	Integrated utility	39,000	0.6	7.25%-17.50%	19	N/A
Fortis Generation	Power generation	N/A	N/A	N/A	17	N/A
Corporate and Other	-	N/A	N/A	N/A	(88)	N/A

**The Proposed Acquisition of CHG**

On February 21, 2012, Fortis announced that it had agreed to acquire CHG for a total consideration of approximately US\$1.5 billion, including the assumption of US\$500 million of debt on closing. The Acquisition is expected to close in the second quarter of 2013, subject to various regulatory approvals. To date, CHG shareholders have approved the Acquisition, with a Settlement Agreement filed in January 2013. The parties to the Settlement Agreement, which provides almost \$50 million to fund customer and community benefits, have concluded that the Acquisition is in the public interest and have recommended approval by the New York State Public Service Commission.

CHG's principal businesses comprise: (1) Central Hudson Gas & Electric Corporation (Central Hudson), a regulated utility in New York state with approximately 300,000 electric customers and 75,000 gas customers, and (2) a non-regulated fuel delivery business (3% of CHG income), serving 56,000 customers in the Mid-Atlantic Region. Central Hudson accounts for 97% of CHG's 2011 net income and 93% of its assets. CHG's total assets as of December 31, 2011, were US\$1.7 billion. Net income and operating cash flow in 2011 were US\$45 million and US\$115 million, respectively.



UDR 1.16 DBRS - F

**Fortis Inc.**

**Report Date:**  
February 19, 2013

**Waneta Expansion Project**

WEP, a 335 MW expansion of the hydroelectric generating facility on the Pend d'Oreille River in British Columbia, is the largest capital project currently underway. It is expected to come into service in early 2015 at a cost of around \$900 million, 51% of which Fortis will be responsible for, due to its ownership interest (remainder owned by Columbia Power Corporation (32.5%) and Columbia Basis Trust (16.5%)). By the end of 2012, approximately \$436 million has been spent in total and a further \$227 million is expected to be spent in 2013 (approximately \$116 million by Fortis). WEP is currently on time and on budget. The Company issued \$200 million of preferred shares in 2012 to repay borrowings under its committed corporate credit facility, which borrowings were primarily incurred to support the construction of WEP.

Although the facility is non-regulated, it will be included in the Canal Plan Agreement and will receive fixed energy and capacity entitlements based on long-term average water flows. In the long-term energy purchase agreement with the British Columbia Hydro & Power Authority (rated AA (high); see rating report dated August 15, 2012), approximately 630 GWh and associated capacity required to deliver such energy have been contracted. The remaining capacity, approximately 234 MW, is expected to be sold to FortisBC Inc. (rated A (low); see rating report dated August 9, 2012) under a long-term capacity purchase agreement.

**Non-Consolidated Earnings & Cash Flows**

Earnings - Non-Consolidated (CA\$ millions)	USGAAP	CGAAP	CGAAP		
	Year end December 31				
	2012	2011	2010	2009	2008
Newfoundland Power	36.8	33.9	35.2		
FortisOntario	11.6	9.8	9.3		
FortisWest	103.3	83.5	81.9		
FortisBC Holdings	127.3	128.6	118.9		
Fortis Cayman Inc.	0.0	(0.0)	1.4		
Fortis Energy Bermuda Limited	25.0	26.0	28.2		
<b>Regulated investment income</b>	<b>303.9</b>	<b>281.7</b>	<b>274.9</b>		
Fortis Energy Cayman Inc.	14.5	14.6	18.0		
FOG Partnership	(0.3)	-	-		
FortisUS Inc.	(7.0)	11.9	(3.1)		
Fortis Properties	34.4	34.9	36.8		
52905 Newfoundland and Labrador	0.1	0.1	0.2		
<b>Non-regulated investment income</b>	<b>41.7</b>	<b>61.5</b>	<b>52.0</b>		
Total investment income	345.6	343.1	326.9		
Interest income + Management fee	82.8	77.2	59.6		
<b>Total income</b>	<b>428.4</b>	<b>420.3</b>	<b>386.5</b>		
Operating expenses	(7.9)	(3.9)	(5.9)		
<b>EBITDA</b>	<b>420.4</b>	<b>416.4</b>	<b>380.6</b>		
Earnings - Non-Consolidated (CA\$ millions)	USGAAP	CGAAP	CGAAP	CGAAP	CGAAP
	Year end December 31				
	2012	2011	2010	2009	2008
EBITDA	420.4	416.4	380.6	346.1	322.8
Depreciation	(1.9)	(1.5)	(1.3)	(1.7)	(2.5)
EBIT	418.5	414.9	379.3	344.4	320.2
Interest expense	(39.7)	(44.3)	(47.4)	(43.4)	(38.8)
EBT before extra items	377.0	371.6	332.0	293.6	272.5
Taxes	(17.0)	(6.9)	(2.7)	(1.6)	(3.5)
Net income bef. extra items and pref. dividends	359.9	364.7	329.2	292.1	269.0
Reported net income bef. pref. dividends	361.8	363.7	329.2	297.0	274.9

UDR 1.16 DBRS - Fortis



Fortis Inc.	USGAAP	CGAAP	CGAAP	CGAAP	CGAAP
Report Date: February 19, 2013	2012	2011	2010	2009	2008
<b>Cash flow - Non-Consolidated</b> (CA\$ millions)					
Net income bef. extra items and pref. dividends	359.9	364.7	329.2	292.1	269.0
Depreciation & amortization	1.9	2.0	1.3	1.7	2.5
Equity investments	(168.8)	(164.3)	(188.1)	(89.8)	(141.6)
Deferred income taxes and others	25.8	14.6	12.3	7.4	8.9
<b>Cash flow from operations</b>	<b>218.8</b>	<b>216.9</b>	<b>154.7</b>	<b>211.3</b>	<b>138.9</b>
Common dividends paid	(169.6)	(151.2)	(135.3)	(132.8)	(162.1)
Preferred dividends paid	(45.4)	(45.4)	(44.7)	(34.8)	(30.1)
Capex	(9.1)	(4.0)	(3.3)	(0.2)	(0.3)
<b>Free cash flow (bef. work. cap. changes)</b>	<b>(5.4)</b>	<b>16.3</b>	<b>(28.5)</b>	<b>43.5</b>	<b>(53.6)</b>
Changes in non-cash work. cap.	0.2	2.8	(1.2)	(30.3)	6.4
<b>Net free cash flow</b>	<b>(5.2)</b>	<b>19.1</b>	<b>(29.7)</b>	<b>13.2</b>	<b>(47.2)</b>
Acquisitions & long-term investments	(115.8)	(79.4)	(376.8)	(358.1)	(306.2)
Short-term investments	-	-	-	-	-
Proceeds on asset sales	-	0.0	10.1	-	-
Net equity change	218.4	345.0	264.5	49.0	533.1
Net debt change	52.5	(165.0)	140.6	292.7	(179.0)
DBRS adjustments, advances and others	(147.7)	(129.3)	(0.2)	4.9	6.0
<b>Change in cash</b>	<b>2.2</b>	<b>(9.6)</b>	<b>8.4</b>	<b>1.7</b>	<b>6.7</b>

**2012 Summary**

- Overall, Fortis has benefited from good earnings diversification, underpinned by its investments in regulated utilities, which account for approximately 71% of earnings in 2012.
- The relatively stable EBITDA is reflective of the Company's strong earnings from regulated utilities, contracted generation facilities, property management and interest income.
- Earnings continued to increase over the years, as a result of higher ROE in recent years and growing rate bases among the utilities.
- Fortis Properties' performance has been relatively stable over the past two years, reflecting the recovery of the Canadian economy.
- Cash flow from operations has remained relatively stable. The bulk of the cash flow from operations is distributed as dividends to common and preferred shareholders.
- The Company has continued to fund business acquisitions and investments, with a mix of debt and equity (including preferred shares) in a manner that maintains its credit ratios within the A (low) rating category.

**2013 Outlook**

- Investment income from regulated utilities is expected to increase considerably in 2013, should the proposed Acquisition of CHG be completed as expected in the second quarter of 2013.
- DBRS also expects the Acquisition to improve Fortis' earnings diversification.
- Non-regulated earnings are expected to increase in 2015, when WEP is scheduled to be in service. The project has obtained a long-term power contract with BC Hydro.



UDR 1.16 DBRS - Fortis I

**Fortis Inc.**

**Report Date:**  
February 19, 2013

**Capital Structure and Liquidity**

**Capital Structure - Non-Consolidated**

(CA\$ millions)	As at December 31				
	2012	2011	2010	2009	2008
Short-term debt	-	-	-	100	-
Credit facilities	53	-	165	125	32
Long-term debt	747	759	742	564	524
Sub. convertible debentures	-	-	42	44	50
Preferred shares	1,108	912	912	667	667
Common equity	4,000	3,867	3,308	3,195	3,046
<b>Total non-consolidated capital</b>	<b>5,907</b>	<b>5,538</b>	<b>5,169</b>	<b>4,695</b>	<b>4,319</b>
Total debt in capital structure	18.1%	15.7%	22.5%	17.7%	15.0%
EBIT interest coverage (times)	10.55	9.37	8.01	7.93	8.25
Cash flow interest coverage (times)	5.52	4.90	3.27	4.86	3.58
Cash flow/Total debt	20.1%	24.6%	13.1%	25.0%	21.2%

**Summary**

- Fortis' non-consolidated balance sheet remained strong in 2012, reflecting a debt-to-capital ratio of 18.1% (not including equity subscription of approximately \$601 million, which, if included, could reduce the ratio to around 14%), which provides the Company with some financial flexibility.
- This leverage remained well within the 20% threshold in DBRS's notching guidelines for a holding company relative to its subsidiaries.
- Cash flow-to-interest coverage remained strong for a holding company, at 5.52 times.

**Potential Impact of the Proposed Acquisition of CHG**

- The price of the Acquisition is approximately \$1.5 billion (including US\$500 million of assumed debt).
- In June 2012, Fortis completed a subscription receipt offering for approximately \$601 million, which will be used to partially finance the Acquisition, with the remainder expected to be financed with debt and preferred shares.
- Based on the Company's financing strategy, the debt-to-capital ratio will likely increase from the current level should the Acquisition be completed.
- The new debt-to-capital ratio is expected to remain within the 20% level.

**Liquidity**

Credit Facilities as at December 31, 2012

(\$ millions)	HoldCo & other	Regulated		Non-regulated	Total
		Subsidiaries	Subsidiaries		
Total credit facilities	1,045	1,402	13	2,460	
Drawing on credit facilities (S-T)	-	(136)	-	(136)	
Drawing on credit facilities (L-T)	(53)	(97)	-	(150)	
Letters of credit	(1)	(66)	-	(67)	
Credit facilities available	991	1,103	13	2,107	

Debt maturities - (\$ millions)	2013	2014	2015	2016	2017	Thereafter	Total
Fortis Inc. senior debt	0	149	0	0	0	598	747
Total	0	149	0	0	0	598	747
% of total debt	0%	20%	0%	0%	0%	80%	100%

- Fortis has approximately \$4 million in cash and cash equivalents as at December 31, 2012.
- Fortis has sufficient liquidity to finance its near-term funding requirements.
- Debt maturity is concentrated in 2014, when 20% of Fortis' total debt is due. DBRS believes that the refinancing of this amount is within the Company's capacity, given its strong credit profile.



**Fortis Inc.**

**Report Date:**  
February 19, 2013

**Description of Operations**

Fortis' main subsidiaries and investments are as follows:

**FortisBC Holdings Inc. (100% owned)** is a holding company for the following utilities:

(1) **FortisBC Energy Inc. (FEI)** is the largest natural gas distributor in British Columbia, serving residential, commercial and industrial customers in an area extending from Vancouver to the Fraser Valley and the interior of British Columbia.

(2) **FortisBC Energy (Vancouver Island) Inc. (FEVI)** owns a combined distribution and transmission system, serving residential, commercial and industrial customers along the Sunshine Coast and in Victoria and various communities on Vancouver Island.

(3) **FortisBC Energy (Whistler) Inc. (FEW)** owns and operates a propane distribution system in Whistler, British Columbia, and provides service to residential and commercial customers.

**FortisAlberta Inc. (100% owned)** is a regulated electricity distributor with a franchise area that includes central and southern Alberta, the suburbs surrounding Edmonton and Calgary, Red Deer, Lethbridge and Medicine Hat.

**FortisBC Inc. (100% owned)** is a vertically integrated regulated utility operating in south-central British Columbia. Its generation assets include four hydroelectric generating plants (totaling 223 MW) on the Kootenay River in south-central British Columbia.

**Newfoundland Power Inc. (100% owned) (NP)** is a principal distributor of electricity on the island portion of Newfoundland and Labrador. Fortis also owns 25% of NP's preferred shares.

**Other Canadian Utilities**

(1) **FortisOntario Inc.** is an integrated electric utility providing services to customers in Fort Erie, Cornwall, Gananoque, Port Colborne and the District of Algoma in Ontario. FortisOntario also owns a 10% interest in each of Westario Power Inc., Rideau St. Lawrence Holdings Inc. and Grimsby Power Inc., three regional electric distribution companies.

(2) **Maritime Electric Company Limited (Maritime Electric)** is the principal distributor of electricity on Prince Edward Island. It also maintains on-island generating facilities with a combined capacity of 150 MW. Maritime Electric is indirectly owned by Fortis through FortisWest.

**Fortis Properties Corporation** owns and operates 23 hotels in eight Canadian provinces and approximately 2.8 million square feet of commercial real estate, primarily in Atlantic Canada. In October 2012, Fortis Properties acquired the 126-room StationPark All Suite Hotel in London, Ontario, for approximately \$13 million, inclusive of approximately \$6 million of debt.

**Caribbean Utilities Company, Ltd. (Caribbean Utilities)** is a fully integrated electricity utility on Grand Cayman, Cayman Islands with an installed generating capacity of approximately 151 MW. Fortis has an approximate 60% controlling ownership interest in Caribbean Utilities, with the remaining ownership publicly traded on the Toronto Stock Exchange.

**Fortis Turks and Caicos** serves approximately 85% of electricity consumers in the Turks and Caicos Islands, pursuant to 50-year licenses that expire in 2036 and 2037. The Company has a combined diesel-fired generating capacity of 54 MW.

**Belize Electric Company Limited** is a non-regulated 32 MW hydro generation facility in Belize. All output is sold to Belize Electricity Limited under a 50-year power purchase agreement expiring in 2055. The US\$53 million 19 MW hydroelectric generating facility at Vaca in Belize was commissioned in March 2010.

**Belize Electricity Limited** is recorded as equity investment following the expropriation by the Government of Belize in June 2011.



UDR 1.16 DBRS - Fo

**Fortis Inc.**

**Report Date:**  
February 19, 2013

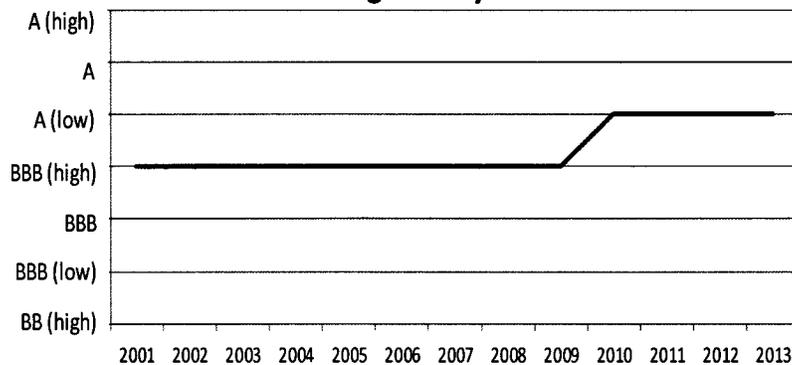
**Rating**

Debt	Rating	Rating Action	Trend
Issuer Rating	A (low)	Confirmed	Stable
Unsecured Debentures	A (low)	Confirmed	Stable
Preferred Shares	Pfd-2 (low)	Confirmed	Stable

**Rating History**

	Current	2012	2011	2010	2009	2008
Issuer Rating	A (low)	A (low)	NR	NR	NR	NR
Unsecured Debentures	A (low)	A (low)	A (low)	A (low)	BBB (high)	BBB (high)
Preferred Shares	Pfd-2 (low)	Pfd-2 (low)	Pfd-2 (low)	Pfd-2 (low)	Pfd-3 (high)	Pfd-3 (high)

**Rating History of Fortis Inc.**



Note:  
All figures are in Canadian dollars unless otherwise noted.

Copyright © 2013, DBRS Limited, DBRS, Inc. and DBRS Ratings Limited (collectively, DBRS). All rights reserved. The information upon which DBRS ratings and reports are based is obtained by DBRS from sources DBRS believes to be accurate and reliable. DBRS does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance. The extent of any factual investigation or independent verification depends on facts and circumstances. DBRS ratings, reports and any other information provided by DBRS are provided "as is" and without representation or warranty of any kind. DBRS hereby disclaims any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall DBRS or its directors, officers, employees, independent contractors, agents and representatives (collectively, DBRS Representatives) be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting therefrom, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of ratings and rating reports or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of DBRS or any DBRS Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. Ratings and other opinions issued by DBRS are, and must be construed solely as, statements of opinion and not statements of fact as to credit worthiness or recommendations to purchase, sell or hold any securities. A report providing a DBRS rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. DBRS receives compensation for its rating activities from issuers, insurers, guarantors and/or underwriters of debt securities for assigning ratings and from subscribers to its website. DBRS is not responsible for the content or operation of third party websites accessed through hypertext or other computer links and DBRS shall have no liability to any person or entity for the use of such third party websites. This publication may not be reproduced, retransmitted or distributed in any form without the prior written consent of DBRS. ALL DBRS RATINGS ARE SUBJECT TO DISCLAIMERS AND CERTAIN LIMITATIONS. PLEASE READ THESE DISCLAIMERS AND LIMITATIONS AT <http://www.dbrs.com/about/disclaimer>. ADDITIONAL INFORMATION REGARDING DBRS RATINGS, INCLUDING DEFINITIONS, POLICIES AND METHODOLOGIES, ARE AVAILABLE ON <http://www.dbrs.com>.

# RatingsDirect®

---

## Fortis Inc.

**Primary Credit Analyst:**

Gavin MacFarlane, Toronto (1) 416-507-2545; [gavin\\_macfarlane@standardandpoors.com](mailto:gavin_macfarlane@standardandpoors.com)

**Secondary Contact:**

Stephen R Goltz, Toronto (1) 416-507-2592; [stephen\\_goltz@standardandpoors.com](mailto:stephen_goltz@standardandpoors.com)

### Table Of Contents

---

Rationale

Outlook

Standard & Poor's Base-Case Scenario

Company Description

Business Risk

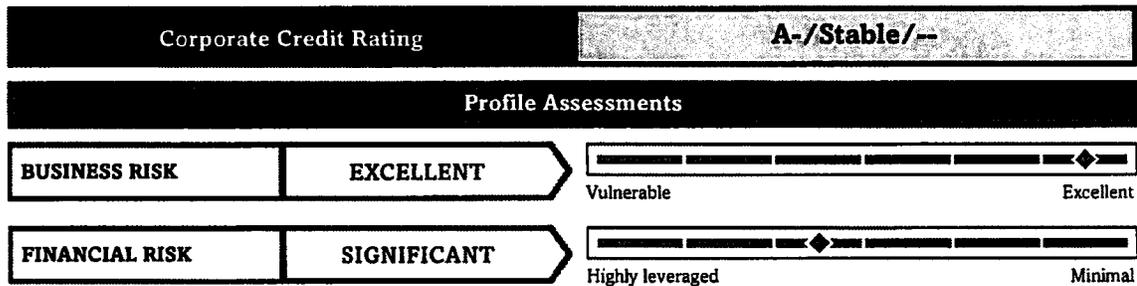
Financial Risk

Liquidity

Reconciliation

Related Criteria And Research

# Fortis Inc.



## Rationale

<b>Business Risk: Excellent</b>	<b>Financial Risk: Significant</b>
<ul style="list-style-type: none"> <li>• Low risk, and regulated assets</li> <li>• Limited commodity price and volume risk exposure</li> <li>• Diversified portfolio of regulated utilities</li> <li>• Monopoly service providers</li> </ul>	<ul style="list-style-type: none"> <li>• Stable regulated cash flow</li> <li>• High levels of leverage</li> </ul>

## **Outlook: Stable**

The stable outlook reflects Standard & Poor's Ratings Services' assessment of the operating companies' underlying operational and financial stability, which mitigates the relatively weak financial measures for the ratings.

### **Downside scenario**

We could lower the ratings if Fortis Inc. were to employ more leverage or if it were to invest in assets with materially higher business risks and cash flow variability, one of its larger subsidiaries encountered major financial or operational difficulties or if the company experiences material challenges in completing its Waneta project on time and budget. We could also lower the ratings if company-level adjusted funds from operations (AFFO)-to-debt remains below 20% in 2015 or if consolidated AFFO-to-debt falls below 10%.

### **Upside scenario**

A positive outlook or upgrade during our two-year forecast horizon is unlikely, given Fortis' weak credit metrics.

## Standard & Poor's Base-Case Scenario

Our base case scenario results in limited headroom above existing credit metric thresholds until the Waneta project is completed.

Assumptions	Key Metrics			
<ul style="list-style-type: none"> <li>• The regulated utilities continue to generate stable cash flow</li> <li>• Fortis does not experience any adverse regulatory decisions</li> <li>• The company continues to finance its regulated utilities in line with allowed capital structure as established by related regulators.</li> <li>• The acquisition of CH Energy Group Inc. is completed in second-quarter 2013 and the Waneta hydroelectric project is completed on time and on budget in the first half of 2015.</li> </ul>	(%)	2012A	2013E	2014E
	Consolidated AFFO/debt	11	10-12	10-12
	Consolidated AFFO/interest	2.8	2.5-3.0	2.5-3.0
	Deconsolidated AFFO/debt	25-27	18-20	18-20
<p>Note: 2012 actual is based on 2012 reported results with 2011 adjustments. 2012 adjustments are not yet available. AFFO—Adjusted funds from operations. A—Actual. E—Estimated.</p>				

## Company Description

Fortis is a holding company with 100% interests in a number of regulated utilities in Canada that account for about 85% of consolidated earnings. The company also has regulated utility assets in the Caribbean (5% of earnings) and unregulated power generation assets and a property segment each contributing about 5% of earnings.

## Business Risk: Excellent

Fortis' business risk continues to benefit from its stable, low risk, regulated utility portfolio. Regulation typically employs a cost-of-service methodology that provides an allowed regulated rate of return. The utilities typically have relatively low levels of commodity and volume risk exposure, further reducing cash flow volatility. Fortis' regulated companies are monopoly service providers in the territories they serve with limited bypass risk and are not exposed to typical market forces, which we also view as a key credit strength.

In our view, a key ongoing credit strength for the company is the regulatory, geographic, and market diversification of its subsidiaries and their cash flow. There continues to be some concentration in British Columbia, where about 50% of the rate base, including the CH Energy acquisition, is located.

The unregulated businesses make a relatively small consolidated contribution to the group. The size and quality of these cash flows will improve with the Waneta project's completion. This project has limited hydrology and price risk, no dispatch risk and strong counterparties in British Columbia Hydro & Power Authority and FortisBC.

Insulating provisions restrict Fortis' access to assets at some of its subsidiaries, enabling stronger subsidiaries to have a higher rating than the parent and limiting the support these entities could be forced to provide to the parent. This, combined with structural subordination of holdco debt, provides a key rationale for our deconsolidated analysis.

**S&P Base-Case Operating Scenario**

- The regulated utilities continue to generate stable cash flow.
- The company does not experience any material adverse regulatory decisions
- The C\$900 million Waneta project is completed on time and budget
- The CH Energy Acquisition will close in second-quarter 2013

**Peer comparison**

**Table 1**

**Fortis Inc.--Peer Comparison**

**Industry Sector: Electric Utility**

(Mil. C\$)	TransCanada Pipelines				
	Fortis Inc.	Enbridge Inc.	Ltd.	CU Inc.	EPCOR Utilities Inc.
Rating as of Feb. 26, 2013	A-/Stable/--	A-/Stable/--	A-/Stable/A-2	A/Stable/A-1	BBB+/Stable/--
--Average of past three fiscal years--					
Revenues	3,685.3	22,495.3	7,970.0	1,629.4	1,861.7
EBITDA	1,222.3	2,996.2	4,242.9	750.3	350.1
Net income from continuing operations	349.7	926.7	1,380.3	273.4	125.7
Funds from operations (FFO)	786.8	2,817.7	3,111.2	537.6	291.3
Capital expenditures	1,014.9	3,781.0	3,132.1	799.0	415.3
Dividends paid	210.8	837.0	1,298.7	28.3	152.2
Debt	6,963.1	19,593.9	24,308.2	3,445.0	1,916.8
Preferred stock	673.3	1,432.5	591.7	210.3	0.0
Equity	4,454.5	11,138.0	18,393.9	2,314.8	2,385.2
Debt and equity	11,417.6	30,731.9	42,702.1	5,759.8	4,302.0
<b>Adjusted ratios</b>					
EBITDA margin (%)	33.2	13.3	53.2	46.0	18.8
EBIT interest coverage (x)	2.1	2.3	2.1	2.5	2.1
FFO interest coverage (x)	2.4	4.0	3.1	3.6	2.8
FFO/debt (%)	11.3	14.4	12.8	15.6	15.2
Discretionary cash flow/debt (%)	(5.5)	(10.4)	(5.1)	(8.8)	(17.0)
Net cash flow/capex (%)	56.8	52.4	57.9	63.7	33.5
Total debt/debt plus equity (%)	61.0	63.8	56.9	59.8	44.6
Return on capital (%)	6.9	7.2	6.8	9.2	7.0
Return on common equity (%)	8.2	8.7	5.8	11.2	4.8
Common dividend payout ratio (unadjusted; %)	62.0	86.7	86.6	13.0	109.1

**Financial Risk: Significant**

We expect cash flow from the regulated utilities to remain very stable, a factor we believe is a key credit strength that offsets high leverage. Regulated utility cash flow is primarily composed of a return of capital (depreciation) and a

return on capital and return on equity, both of which continue to experience limited volatility. We expect consolidated leverage to remain high, with limited headroom above thresholds we associate with the ratings. Consolidated leverage is a function of the regulatory capital structure of the underlying utilities that generally follows levels allowed by regulation.

We expect deconsolidated credit metrics to deteriorate in 2013 and 2014 but improve dramatically with the completion of the Waneta project in 2015. We expect deconsolidated credit metrics in 2013 and 2014 to deteriorate as a result of the CH Energy acquisition and the largely debt-financed Waneta project.

Deconsolidated credit metrics are not as stable owing to the residual nature of cash flow from regulated utilities and the larger contribution of unregulated businesses.

Fortis achieves its growth targets through a mixture of growth in organic rate base and acquisitions. Mergers and acquisitions are typically riskier and material acquisitions can stress the financial risk profile. The company has a long history of increasing its dividends and would likely be very reluctant to reduce its dividends to support credit quality.

#### S&P Base-Case Cash Flow And Capital Structure Scenario

- The company experiences growth in rate base of about 15% in 2013, including the CH Energy acquisition
- Subsequent rate base growth returns to midsingle digits
- Growth in rate base leads to a corresponding growth in cash flow
- The company continues to finance its regulated utilities in line with allowed capital structure as established by related regulators
- Depreciation rates are stable
- The utilities continue to earn their allowed returns
- Ongoing use of the dividend reinvestment program raising about C\$100 million per year

#### Financing the CH Energy acquisition

- Fortis has issued C\$600 million in subscription receipts
- It also issued C\$200 million in preferred shares in fourth-quarter 2012 that received intermediate equity treatment and plans to issue a further C\$100 million-C\$150 million in preferred shares in 2013
- The company will assume about C\$500 million in debt
- It will fund the balance with debt drawn on committed facilities

#### Financial summary

Table 2

#### Fortis Inc.--Financial Summary

Industry Sector: Electric Utility

(MIL C\$)	--Fiscal year ended Dec. 31--				
	2012	2011	2010	2009	2008
Rating history	A-/Stable/--	A-/Stable/--	A-/Stable/--	A-/Stable/--	A-/Stable/--
Revenues	3,654.0	3,738.0	3,664.0	3,637.0	3,903.0
EBITDA	1,302.7	1,229.7	1,177.2	1,085.0	1,064.7
Net income from continuing operations	362.0	357.0	330.0	297.0	276.0

Fortis Inc.

UDR 1.16 SP - Fortis Inc - Feb 26, 2013.pdf

**Table 2**

Fortis Inc.--Financial Summary (cont.)					
Funds from operations (FFO)	834.9	764.9	716.6	656.7	648.4
Capital expenditures	1,020.0	1,069.9	954.9	927.0	822.1
Dividends paid	225.0	183.0	224.5	160.5	185.5
Debt	7,593.3	7,407.3	6,895.9	6,591.5	6,159.9
Preferred stock	554.0	456.0	456.0	333.5	333.5
Equity	4,594.0	4,225.0	3,728.5	3,497.4	3,385.5
Debt and equity	12,741.3	12,088.2	10,624.4	10,088.9	9,545.4
<b>Adjusted ratios</b>					
EBITDA margin (%)	35.7	32.9	32.1	29.8	27.3
EBIT interest coverage (x)	1.9	1.9	1.9	1.9	1.8
FFO interest coverage (x)	2.8	2.7	2.7	2.7	2.7
FFO/debt (%)	11.0	10.3	10.4	10.0	10.5
Discretionary cash flow/debt (%)	(4.0)	(4.8)	(6.7)	(7.2)	(5.2)
Net cash flow/capex (%)	62.3	56.2	51.5	53.5	56.3
Debt/debt and equity (%)	62.3	63.7	64.9	65.3	64.5
Return on capital (%)	6.4	7.2	7.1	7.2	7.7
Return on common equity (%)	8.1	8.7	7.9	7.8	7.6
Common dividend payout ratio (unadjusted; %)	53.8	48.6	85.6	50.8	70.1

## Liquidity: Adequate

Fortis' liquidity is adequate, in our view. At the holding company level, we expect that liquidity sources will be sufficient to cover uses more than 1.2x. We expect that in the event of a 15% decline in deconsolidated earnings, Fortis' sources of funds would still exceed its uses. In our view, the company has sound relationships with its banks and generally satisfactory standing in credit markets.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> <li>Expected remitted cash flows from Fortis' subsidiaries of about C\$400 million per year</li> <li>Unused committed credit facilities of about C\$975 million as of Dec. 31, 2012</li> </ul>	<ul style="list-style-type: none"> <li>Primarily interest and preferred share dividends of about C\$100 million</li> <li>Capital spending and dividends to shareholders of about C\$500 million (excluding the CH Energy acquisition), but we believe that some of the capital spending has some deferability</li> </ul>

## Debt maturities

**Table 3**

Fortis Inc.--Debt Maturities (Mil. C\$)	
2013	117
2014	702
2015	152

**Table 3**

Fortis Inc.--Debt Maturities (Mil. C\$) (cont.)	
2016	294
Thereafter	4,477

## Reconciliation

**Table 4**

Reconciliation Of Fortis Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. C\$)										
--Fiscal year ended Dec. 31, 2012--										
Fortis Inc. reported amounts	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	Cash flow from operations	Cash flow from operations	Dividends paid	Capital expenditures
Reported	6,471.0	5,100.0	3,654.0	1,264.0	794.0	366.0	938.0	938.0	225.0	1,020.0
<b>Standard &amp; Poor's adjustments</b>										
Operating leases	118.9	N/A	N/A	6.7	6.7	6.7	14.8	14.8	N/A	31.9
Intermediate hybrids reported as equity	554.0	(554.0)	N/A	N/A	N/A	23.0	(23.0)	(23.0)	(23.0)	N/A
Postretirement benefit obligations	318.3	(262.0)	N/A	28.0	28.0	10.0	2.1	2.1	N/A	N/A
Capitalized interest	N/A	N/A	N/A	N/A	N/A	19.0	(19.0)	(19.0)	N/A	(19.0)
Share-based compensation expense	N/A	N/A	N/A	4.0	N/A	N/A	N/A	N/A	N/A	N/A
Asset retirement obligations	246.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Reclassification of nonoperating income (expenses)	N/A	N/A	N/A	N/A	19.0	N/A	N/A	N/A	N/A	N/A
Reclassification of working-capital cash flow changes	N/A	N/A	N/A	N/A	N/A	N/A	N/A	(78.0)	N/A	N/A
Minority interests	N/A	208.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Debt--other	(115.0)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total adjustments	1,122.3	(608.0)	0.0	38.7	53.7	58.7	(25.1)	(103.1)	(23.0)	12.9
<b>Standard &amp; Poor's adjusted amounts</b>										
Adjusted	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	7,593.3	4,492.0	3,654.0	1,302.7	847.7	424.7	912.9	834.9	202.0	1,032.9

**Table 4**

**Reconciliation Of Fortis Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. C\$) (cont.)**

N/A--Not applicable.

**Related Criteria And Research**

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Criteria Methodology: Differentiating The Issuer Credit Ratings Of A Regulated Utility Subsidiary And Its Parent, March 11, 2010
- Key Credit Factors: Business And Financial Risks In The Investor-Owned Utilities Industry, Nov. 26, 2008
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008

**Business And Financial Risk Matrix**

Business Risk	Financial Risk					
	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA/AA+	AA	A	A-	BBB	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	B- or below

**Note:** These rating outcomes are shown for guidance purposes only. The ratings indicated in each cell of the matrix are the midpoints of the likely rating possibilities. There can be small positives and negatives that would lead to an outcome of one notch higher or lower than the typical matrix outcome. Moreover, there will be exceptions that go beyond a one-notch divergence. For example, the matrix does not address the lowest rungs of the credit spectrum (i.e., the 'CCC' category and lower). Other rating outcomes that are more than one notch off the matrix may occur for companies that have liquidity that we judge as "less than adequate" or "weak" under our criteria, or companies with "satisfactory" or better business risk profiles that have extreme debt burdens due to leveraged buyouts or other reasons. For government-related entities (GREs), the indicated rating would apply to the standalone credit profile, before giving any credit for potential government support.

**Ratings Detail (As Of February 26, 2013)**

**Fortis Inc.**

Corporate Credit Rating	A-/Stable/--
Preference Stock	
Canadian Preferred Stock Rating Scale	P-2
Preferred Stock	
Canadian Preferred Stock Rating Scale	P-2
Preferred Stock	BBB
Senior Unsecured	A-
<b>Corporate Credit Ratings History</b>	
23-May-2012	A-/Stable/--
22-Feb-2012	A-/Watch Neg/--
19-Jun-2007	A-/Stable/--

**Ratings Detail (As Of February 26, 2013) (cont.)**

**Related Entities**

**Caribbean Utilities Co. Ltd.**

Issuer Credit Rating A-/Stable/--  
Senior Unsecured A-

**Fortis Alberta Inc.**

Issuer Credit Rating A-/Stable/--  
Senior Unsecured A-

**Maritime Electric Co. Ltd.**

Issuer Credit Rating BBB+/Stable/--  
Senior Secured A

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Copyright © 2013 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription) and [www.spcapitaliq.com](http://www.spcapitaliq.com) (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

**McGRAW-HILL**

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**UDR 1.30**

Please provide a description of any changes to the cost of debt for TEP, UNS Gas and UNS Electric as a result of the transaction.

**RESPONSE:**

The cost of new long-term debt issued by TEP should be lower as a result of anticipated upgrades of TEP's credit ratings by S&P and Fitch than the cost would otherwise be absent the acquisition. The extent of cost savings to be realized would depend on a variety of factors including (i) the maturity date of the debt being issued, (ii) the extent of the credit rating upgrade(s), and (iii) the interest rate spread demanded by the market for utility bonds at different credit rating levels. Likewise, the cost of short-term debt under TEP's revolving credit facility would be lower as a result of a credit rating upgrade. Under TEP's current revolving credit facility the cost of short-term borrowing would decrease by 12.5 basis points and the cost of TEP's letters of credit would decrease by 12.5 to 25 basis points if either S&P or Moody's increased TEP's credit rating by one notch.

The debt obligations of UNS Gas and UNS Electric are presently rated only by Moody's Service. Moody's has remarked that the merger should be credit neutral to slightly positive for UNS Energy and its subsidiaries. If a ratings upgrade by Moody's were to occur, the cost of new long-term debt issued by UNS Gas and UNS Electric should be lower than it would otherwise be absent the acquisition. With regard to short-term borrowings under the joint revolving credit facility shared by UNS Gas and UNS Electric, a one-notch upgrade from Moody's would also result in a 12.5 basis point reduction to the cost of short-term borrowing.

**RESPONDENT:**

Kentton Grant

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**UDR 1.31**

Please provide the pre-acquisition capital structure of the consolidated entity (including UNS Energy and its affiliates) as well as the post-acquisition capital structure of the consolidated entity.

**RESPONSE:**

**UNS Energy Consolidated Capital Structure**

(\$ Thousands)	Pre Acquisition Balance as of 9/30/2013	Pro Forma Adjustments For Acquisition Contribution and Generation Purchases	Post Acquisition Pro Forma Balance
Common Equity	\$1,132,286	\$200,000	\$1,332,286
Long-Term Debt	\$1,505,536	\$157,000	\$1,662,536
Short-Term Debt	\$23,000	-	\$23,000
	<u>\$2,660,822</u>	<u>\$357,000</u>	<u>\$3,017,822</u>
% Common Equity	42.6%		44.1%

Note: Pro forma adjustments reflect anticipated financing for the following generation purchases:

\$219,000	Gila River Unit 3 in December 2014 (75% TEP, 25% UNS Electric)
\$65,000	Springerville Unit 1 in Dec. 2014 and Jan. 2015 (TEP)
<u>\$73,000</u>	Springerville coal handling facilities in April 2015 (TEP)
\$357,000	

**RESPONDENT:**

Kentton Grant

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**UDR 1.32**

If applicable, provide the amount, terms, and purpose of any debt to be issued by UNS Energy in connection with the proposed transaction – or confirm that UNS Energy will issue no debt in connection with the proposal.

**RESPONSE:**

UNS Energy will issue no debt in connection with the merger. However, if the merger is not completed prior to the planned purchase of Gila River Unit 3 by TEP and UNS Electric in December 2014, UNS Energy will borrow on a short-term basis and contribute the proceeds to TEP and UNS Electric to fund a portion of the Gila River purchase price and to TEP for its purchase of a portion of Springerville Unit 1. It is anticipated that any such short-term borrowing by UNS Energy would be paid off upon closing of the merger with Fortis.

**RESPONDENT:**

Kentton Grant

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission (“Commission”)  
Color Acquisition Sub Inc. (“Color Acquisition”)  
Fortis Inc. (“Fortis”)  
FortisUS Holdings Nova Scotia Limited (“FortisUS Nova Scotia”)  
FortisUS Inc. (“FortisUS”)

Tucson Electric Power Company (“TEP”)  
UniSource Energy Services (“UES”)  
UNS Electric, Inc. (“UNS Electric”)  
UNS Energy Corporation (“UNS Energy”)  
UNS Gas, Inc. (“UNS Gas”)

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**April 1, 2014**

**RUCO UNS 2.07**

Please describe the current status of TEP's investigation of and/or plans to sell coal for Springerville Units 1 and 2 to a third party and to buy-back treated coal from the third party for burn at Springerville Units 1 and 2 so that Internal Revenue Code Section 45 (formerly Section 29) credits can be generated.

- a. Does TEP anticipate such an arrangement would reduce its cost of coal to Springerville units 1 and/or 2 during any of the years in the period 2014-2018?
  1. If so, explain briefly the anticipated net reductions in each year.
- b. If TEP's cost of coal to Springerville Units 1 and 2 is reduced by such an arrangement, how would TEP account for the revenue and cost on its books?
- c. Is it TEP's intention that any net reductions to Springerville coal costs generated by such an arrangement be passed through to customers via TEP's PPFAC?
  1. If not, how would TEP treat the net Springerville coal cost reductions associated with such an arrangement for ratemaking purposes?

**RESPONSE:**

TEP is currently in discussions with TCG Global to refine coal which will qualify for tax credits under IRC Section 45(c)(7) and not under IRC Section 29. TCG Global is marketing the project to several tax investors and we plan to proceed as soon as they are successful.

- a. Yes.
  1. The contemplated arrangement is expected to reduce the cost of coal to Springerville between \$1.00/ton and \$2.00/ton in each of the years. If the project begins refining coal by October, 2014 the fuel reduction in 2014 will be approximately \$1.2 Million based on the midpoint of \$1.50 per ton and 800,000 tons burned in the last quarter of 2014. The anticipated reduction in years 2015 through 2018 is approximately \$3.6 Million based on a burn of 2.4 Million tons
- b. As coal is purchased, it is recorded in an inventory account until consumed. In the transaction described in this request, the coal initially would have been recorded to inventory at its original cost. When sold to the third-party, the inventory would be relieved by its original cost, with no gain or loss resulting from that sale. When it was bought-back at a later date, the new lower price would be recorded as the new inventory carrying amount. Accordingly, there are no anticipated costs under the current arrangement, simply a reduction in FERC 501 fuel expenses.
- c. Yes. This benefit will be passed through to customers as a reduction of PPFAC eligible fuel costs.

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**April 1, 2014**

**RESPONDENT:**

David Jacobs / Jason Rademacher

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**April 1, 2014**

**RUCO UNS 2.08**

Has TEP or UNS provided any information to Fortis about entering into an arrangement with a third party to generate Section 45 (formerly Section 29) credits for coal treatments at Springerville or any other coal-fired generating plants in which TEP has an ownership or lease interest during the period 2014-2018?

a. If so, please identify and provide such information.

**RESPONSE:**

No.

**RESPONDENT:**

David Jacobs

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.02**

In the Company's application and prefiled testimony was any use of an overseas conduit entity as part of the anticipated financing disclosed?

- a. If so, please identify where this was disclosed.
- b. If not, explain fully why not.

**RESPONSE:**

Fortis provided a high level overview of its plan to finance the acquisition of UNS Energy in the pre-filed testimony of Barry V. Perry. In the pre-filed testimony, it was explained that Fortis plans to finance the acquisition by issuing a combination of common shares, preferred shares and debt financing. This is still the case. Fortis has already secured a substantial portion of the equity financing by issuing C\$1.8 billion of convertible debentures which will convert to common equity once all regulatory and governmental approvals required to finalize the acquisition have been obtained and all other outstanding conditions under the Merger Agreement have been fulfilled or waived.

The use of an overseas conduit entity was not specifically referred to in the joint notice or pre-filed testimony as it represents internal funding of FortisUS by Fortis that was not considered necessary to be included in order to meet the Commission's filing standard. Overseas conduit entities are a commonly used mechanism to finance cross-border transactions in organizations where the parent company resides in Canada and a subsidiary resides in the United States (or vice versa). The use of an overseas conduit entity allows Fortis to take advantage of international tax treaties to finance cross-border subsidiaries. A similar overseas conduit structure was used by Fortis in funding the FortisUS acquisition of CH Energy Group, Inc. in 2013.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.01**

Provide an organizational chart of the proposed Fortis structure that includes all affiliates and their relationships with Fortis, Inc. and FortisUS.

- a. Include any Luxembourg conduit affiliates.

**RESPONSE:**

**RUCO Fortis 2.01 Attachment 1.pdf, Bates No. 002171**, contains a Fortis organizational chart similar to that provided in Exhibit 4 to the Joint Notice of Intent to Reorganize, modified to include the Luxembourg affiliate conduit (i.e., Fortis Energy Corporation, Newfoundland Energy Holdings Inc., and NewfoundlandEnergy Luxembourg S.a.r.l.).

**RESPONDENT:**

Robert Meyers

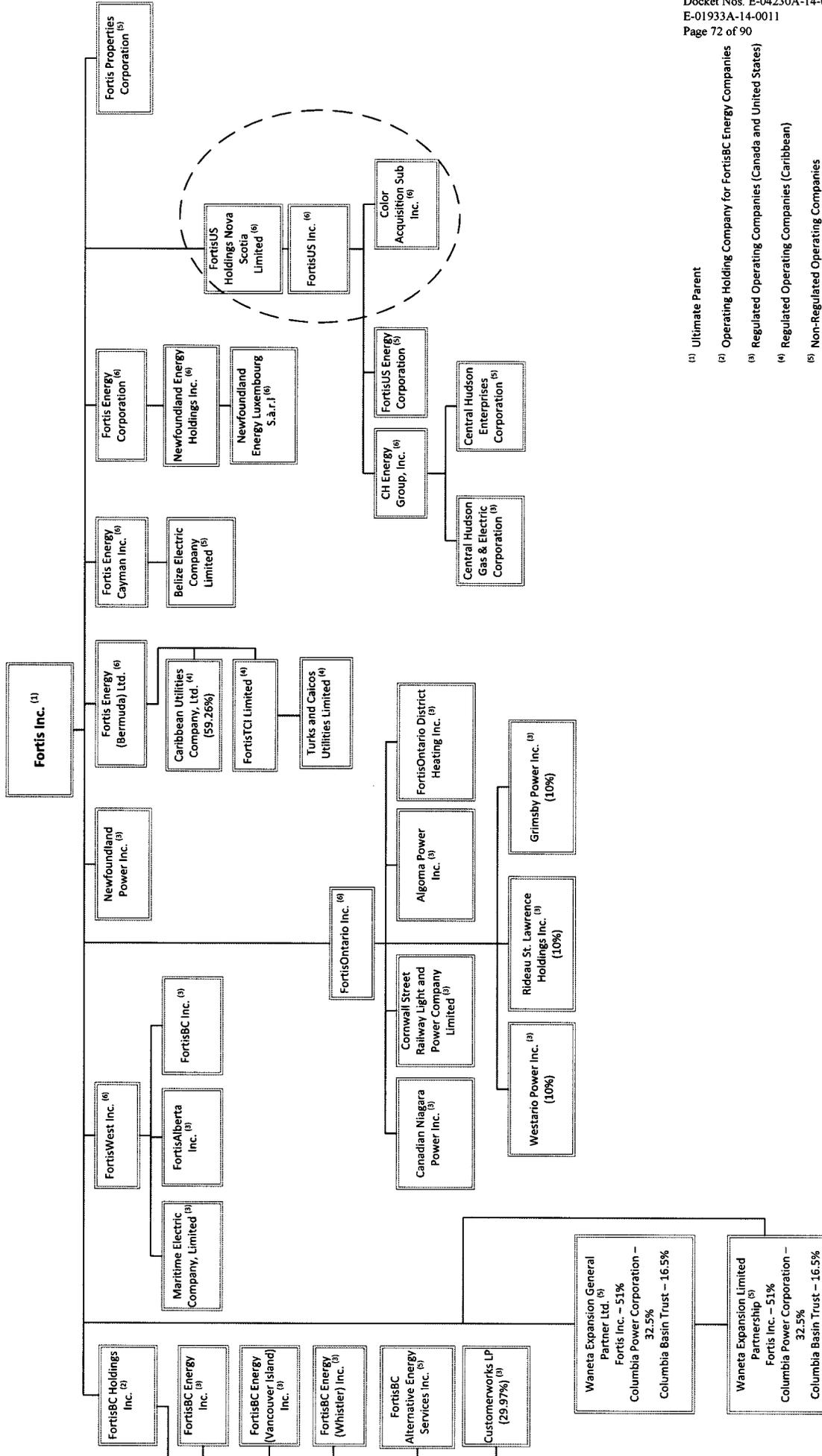
**WITNESS:**

Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")



- (1) Ultimate Parent
- (2) Operating Holding Company for FortisBC Energy Companies
- (3) Regulated Operating Companies (Canada and United States)
- (4) Regulated Operating Companies (Caribbean)
- (5) Non-Regulated Operating Companies
- (6) Internal Holding Companies and Subsidiaries

This chart does not include certain inactive, intermediate or immaterial subsidiaries.

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.04**

The Fortis Inc. 2013 Annual Report states at pages 57-58:

"Changes in Tax Legislation: In June 2013 Canada enacted legislation relating to the taxation of multinationals, which included new rules, originally proposed on August 19, 2011, relating to upstream loans and a new regime for the repatriation of capital. This new legislation also enacted tax rates to be used for Part VI.1 tax deductions. For further information on Part VI.1 tax, refer to the "Significant Items – Part VI.1 Tax" section of this MD&A."

\*\*\*

"Repatriation of Capital: The new legislation also introduces changes in how earnings can be repatriated to Canada. Earnings are divided into four categories: exempt surplus, taxable surplus, hybrid surplus and pre-acquisition surplus. Historically, earnings were repatriated first from exempt surplus, then taxable surplus and finally pre-acquisition surplus. The new legislation will allow taxpayers to elect which surplus account to use for any repatriation of earnings. However, Canada requires the governments of these tax-free jurisdictions to enter into tax treaties or other comprehensive Tax Information Exchange Agreements ("TIEAs") to access the repatriation rules. Once in force, the TIEAs will permit dividends paid out of active business income to be exempted from tax when received in Canada."

Please identify all entities that Fortis intends to use for repatriation of earnings and dividends from UNS Energy and identify the related amounts of intercompany debt and any impacts on Fortis earnings accretion for years 2015 through the period that Fortis evaluated for due diligence purposes.

**RESPONSE:**

**RUCO Fortis 2.04 Attachment A.xlsx** outlines how the annual dividends of UNS Energy would be repatriated to Fortis Inc., assuming all the forecast dividends were repatriated back to Canada. **RUCO Fortis 2.04 Attachment A.xlsx** also shows payments by FortisUS of interest on intercompany loans from its Luxembourg affiliate, NewfoundlandEnergy Luxembourg S.A.R.L.

*Dividends of UNS Energy to FortisUS*

FortisUS would hold all of the common equity of UNS Energy. Thus, FortisUS would receive all of the dividends paid by UNS Energy. As committed to by Fortis and UNS Energy in the Joint Notice of Intent to Reorganize, the board of directors of UNS Energy will be responsible for the establishment of dividend policy and the declaration of dividends to be paid by UNS Energy.

*FortisUS*

FortisUS is a Delaware corporation and a direct wholly owned subsidiary of FortisUS Holdings Nova Scotia Limited which in turn is a direct wholly owned subsidiary of Fortis Inc.

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

FortisUS is also the parent company of CH Energy Group, Inc. and FortisUS Energy Corporation and would also receive dividends from these companies. At December 31, 2013, FortisUS had a capital structure comprised of approximately US\$590 million in common equity and US\$450 million in interest bearing long-term debt from NewfoundlandEnergy Luxembourg S.A.R.L.

The pro-forma capital structure of FortisUS, assuming an acquisition price for UNS Energy equity of US\$2.5 billion and a post-closing common equity injection of US\$200 million, would increase by US\$2.7 billion. The new capital of FortisUS would be comprised of additional common equity of US\$2.2 billion from FortisUS Holding Nova Scotia Limited and additional intercompany loans from NewfoundlandEnergy Luxembourg S.A.R.L. of US\$500 million.

*Payment of UNS Energy Dividends*

Assuming an annual dividend of US\$80 million from UNS Energy to FortisUS, Fortis anticipates that FortisUS would pay interest of US\$25 million on its intercompany loans from NewfoundlandEnergy Luxembourg S.A.R.L. (US\$500 million in loans at an interest rate of 5%). The remaining US\$55 million, if repatriated to Canada, would be paid as a dividend from FortisUS to FortisUS Holdings Nova Scotia Limited. The dividend from FortisUS to its Canadian parent would be subject to a 5% withholding tax in accordance with IRS rules.

FortisUS Holdings Nova Scotia Limited would pay the dividend received from FortisUS, net of the 5% withholding tax, (i.e., US\$52.25 million) as a dividend to Fortis Inc.

*Payment of Interest to Luxembourg Affiliate*

The interest payment of US\$25 million by FortisUS to NewfoundlandEnergy Luxembourg S.A.R.L. would be assessed income tax in Luxembourg of approximately US\$150,000. NewfoundlandEnergy Luxembourg S.A.R.L. would therefore pay a dividend, net of Luxembourg income tax and administrative expenses totaling approximately US\$200,000, (i.e., US\$24.8 million) to its Canadian parent, Newfoundland Energy Holdings Inc. Newfoundland Energy Holdings Inc. would then pay this US\$24.8 million as a dividend to its parent, Fortis Energy Corporation. Fortis Energy Corporation would, in turn, pay US\$24.8 million as a dividend to its parent, Fortis Inc.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

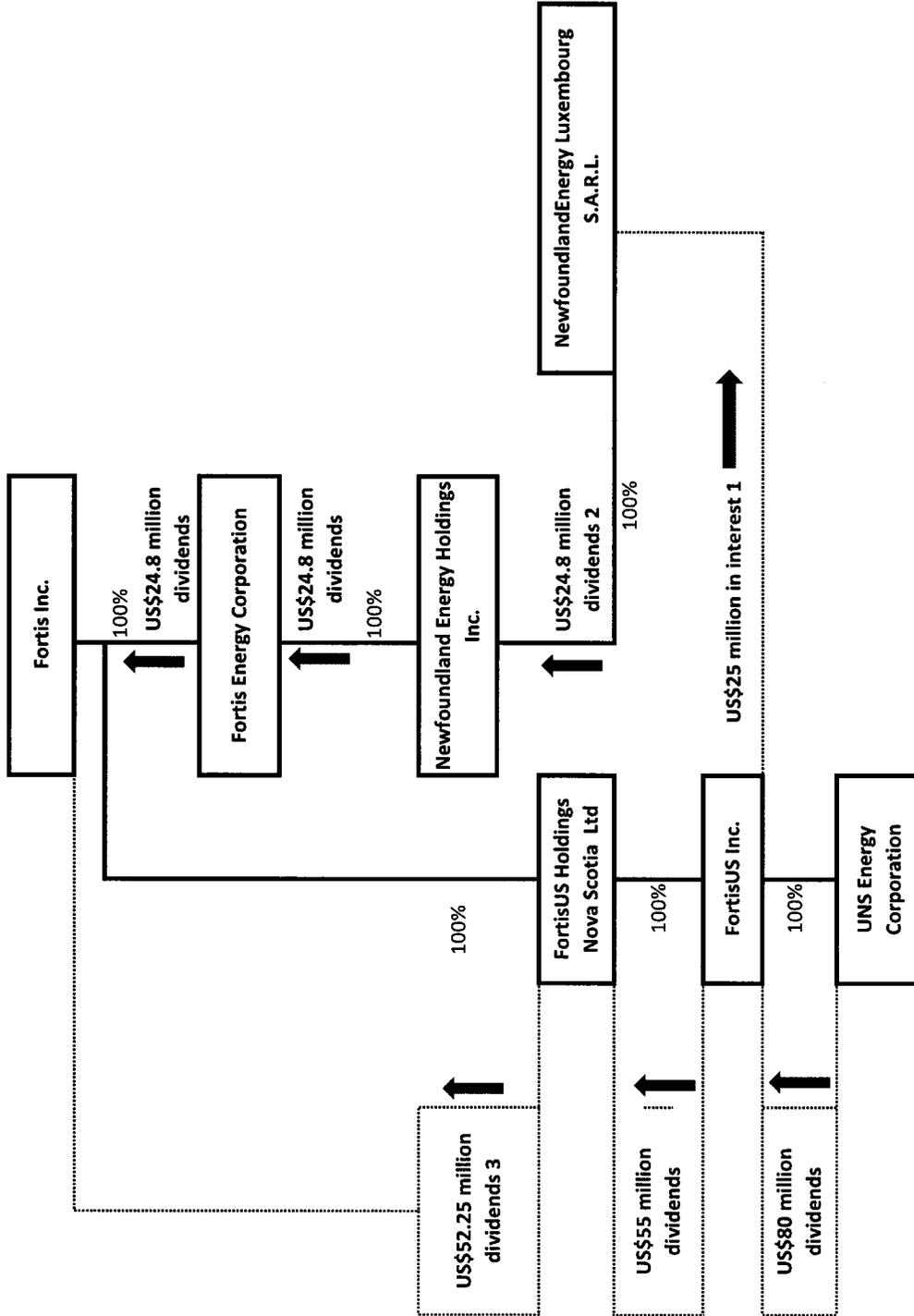
Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**Attachment A**  
**RUCO Fortis 2.04**  
**UNS Energy**  
**Dividend Flow to Fortis Inc.**



*1 Interest on US\$500 million intercompany loan at 5%*  
*2 Dividend is net of Luxembourg tax and administrative expenses*  
*3 Dividend is net of 5% withholding tax paid to IRS by FortisUS Inc*

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.16**

Is being accretive to Fortis' earnings in the first year (2015) or in other years in the 2015-2018 time period considered to be a critical element to Fortis in pursuing the proposed acquisition of UNS Energy?

- a. Explain fully how important being "accretive to earnings" is to Fortis for this proposed transaction.

**RESPONSE:**

Growth in earnings is as important to Fortis as it is to any successful corporation. Earnings growth supports common share dividend growth and adds shareholder value. This ultimately supports the market price of Fortis common shares and enhances Fortis' access to equity capital. In addition, Fortis funds the growth in its existing regulated operations by retaining a significant portion of earnings at the utility level, supplemented by the provision of common equity injections as required.

To finance the acquisition of UNS Energy, Fortis has issued C\$1.8 billion of securities that are convertible to new equity. The Fortis common share price at which this equity was issued is based on shareholders' expectations that the UNS Energy acquisition will be accretive to earnings.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S FIRST SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**February 27, 2014**

**RUCO Fortis 1.05**

Refer to NYPSC Case No. 12-M-0192 - Joint Petition of Fortis Inc. et al. and CH Energy Group, Inc. et al. for Approval of the Acquisition of CH Energy Group, Inc. by Fortis Inc. and Related Transactions, NYPSC Order Authorizing Acquisition Subject To Conditions (Issued and Effective June 26, 2013), Joint Proposal for Commission Approval of the Acquisition of CH Energy Group, Inc. by Fortis Inc. and Related Transactions, at page 48 which states as follows: "V. ECONOMIC BENEFITS, INCLUDING SYNERGIES AND POSITIVE BENEFIT ADJUSTMENTS Petitioners have agreed to provide quantified economic benefits comprised of the following synergy and positive benefit adjustments: (i) synergy savings which are guaranteed for a period of 5 years and which will provide for future rate mitigation of \$9.25 million over the 5 years; (ii) a total of \$35 million of combined write-offs of deferred regulatory assets and future rate mitigation funds; and, (iii) one-time funding of \$5 million for a Community Benefit Fund for economic development and low income purposes."

- a. What is the annual Central Hudson regulated utility revenue for each of the five years up to the acquisition by Fortis.
- b. What percent does the \$9.5 million of synergy savings represent of the Central Hudson regulated annual utility revenue?
- c. What percent does the \$5 million of Community Benefit Fund represent of the Central Hudson regulated annual utility revenue?
- d. Show in detail how the \$35 million of combined write-offs of deferred regulatory assets and future rate mitigation funds has been accounted for and applied. Include journal entries recorded by the Central Hudson regulated utilities as of the date of the Fortis acquisition and subsequently to reflect this.

**RESPONSE:**

- a. Central Hudson Gas & Electric Corp.'s annual regulated utility revenues for the last five years are as follows:

2013	\$668.4 million
2012	\$644.5 million
2011	\$700.5 million
2010	\$719.9 million
2009	\$710.5 million

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S FIRST SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**February 27, 2014**

- b. The 5-year synergy savings of \$9.25 million represents 1.38% of Central Hudson's 2013 regulated utility revenue.<sup>3</sup>
- c. The \$5 million Community Benefit Fund represents 0.75% of Central Hudson's 2013 regulated utility revenue.
- d. **RUCO Fortis 1.05 Attachment A.pdf, Bates Nos. 001805-001808**, contains the Central Hudson journal entries and related work papers with respect to both the \$35 million and \$5 million regulatory liabilities and related authorized offsets.

Page 1 contains the journal entry recorded upon acquisition (June 2013) showing how the \$35 million and \$5 million regulatory liabilities were recorded, including related deferred federal and state income taxes.

Page 2 provides the calculated allocation of the \$35 million regulatory liability between electric and gas, after offset of authorized storm restoration costs referred to in the NYPSC Order. Page 2 also shows the remaining balances of \$11,654,322 and \$3,008,526 million for electric and gas, respectively, that continue to be available for future rate mitigation as will be determined by the NYPSC at some later date.

Page 3 provides the calculated allocation of the \$5 million Community Benefit Fund amount between electric and gas.

Page 4 includes a summary of the offset of the storm charges against the \$35 million regulatory liability.

**RESPONDENT:**

Michael Mosher, Central Hudson Gas & Electric Corporation

**WITNESS:**

Barry V. Perry

---

<sup>3</sup> The annual synergy savings of \$1.85 million (i.e., \$9.25 million / 5 years) represents 0.28% of Central Hudson's 2013 regulated utility revenue.

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

CENTRAL HUDSON G. & E. CORP.	TRANSACTION 410	Month of	<u>June 2013</u>	Journal Voucher No.	<u>06 - 600</u>	
		PSC, REV or RPT #	Account	Payroll Area	Amount	CR
Regulatory Debits		407.30	40730-1-940		35,965,573	
Regulatory Debits		407.30	40730-2-940		4,034,427	
Regulatory Liability - PBA - ELECTRIC		254.83	0823A		(20,337,152)	CR
Regulatory Liability - PBA - ELECTRIC		254.83	0823A		(11,654,322)	CR
Regulatory Liability - PBA - GAS		254.84	0844A		(3,008,526)	CR
Regulatory Liability - Customer Benefit Fund - Electric		254.70	0873A		(3,974,099)	CR
Regulatory Liability - Customer Benefit Fund - Gas		254.70	0876A		(1,025,901)	CR
Deferred FIT - PBA Funds (Electric)		410.13	41246-1-930		(11,197,000)	CR
Deferred FIT - PBA Funds (Electric)		190.12	19012-3-970		11,197,000	
Deferred SIT - PBA Funds (Electric)		410.17	41247-1-930		(1,476,400)	CR
Deferred SIT - PBA Funds (Electric)		192.12	19212-3-970		1,476,400	
Deferred FIT - PBA Funds (Gas)		410.14	41246-2-930		(1,053,000)	CR
Deferred FIT - PBA Funds (Gas)		190.13	19013-3-970		1,053,000	
Deferred SIT - PBA Funds (Gas)		410.18	41247-2-930		(138,800)	CR
Deferred SIT - PBA Funds (Gas)		192.13	19213-3-970		138,800	
Deferred FIT - Use of CBA Funds (Electric)		410.13	41251-1-930		(1,390,900)	CR
Deferred FIT - Use of CBA Funds (Electric)		190.78	19078-3-970		1,390,900	
Deferred SIT - Use of CBA Funds (Electric)		410.17	41252-1-930		(183,400)	CR
Deferred SIT - Use of CBA Funds (Electric)		192.78	19278-3-970		183,400	
Deferred FIT - Use of CBA Funds (Gas)		410.14	41251-2-930		(359,100)	CR
Deferred FIT - Use of CBA Funds (Gas)		190.78	19078-3-970		359,100	
Deferred SIT - Use of CBA Funds (Gas)		410.18	41252-2-930		(47,300)	CR
Deferred SIT - Use of CBA Funds (Gas)		192.78	19278-3-970		47,300	

**THE ESTABLISHMENT OF A REGULATORY LIABILITY FOR THE \$35M OF PBA's and \$5M OF CUSTOMER BENEFIT FUND AS OUTLINED IN THE JOINT PROPOSAL**

Prepared By:

*[Signature]*  
6/27/13

Approved:

*[Signature]*  
6/27/13

Total Debits

55,845,900.00

Total Credits

(55,845,900.00)

CR

Journal Voucher No. 06 0

UNS (0011) 001805

Central Hudson Gas & Electric Corporation  
Case 12-M-0192  
Allocation Method of PBA's - Customer Benefit Fund

Allocation Basis:

	<u>Rate Year 3</u> (1)	<u>Allocation</u>
Electric Delivery Revenues	286,062	79%
Gas Delivery Revenues	<u>73,846</u>	<u>21%</u>
	359,908	100%

(1) Per Cases 09-E-0588 & 09-G-0589, Joint Proposal, Appendix A, Schedule 2.

Allocation of \$35 Million of PBA's:

	<u>Electric</u>	<u>Gas</u>	<u>Total</u>
Allocation Percentage	79%	21%	100%
Amount of PBA - Customer Benefit Fund			35,000,000
Less: Deferred Irene Storm Costs (Actual)			(8,919,779)
Less: Deferred October 2011 Storm Costs (Actual)			-
Less: Deferred Sandy Storm Costs (Estimate)			(10,165,126)
Less: Deferred Carrying Charges on Irene			(967,556)
Less: Deferred Carrying Charges on October 2011			-
Less: Deferred Carrying Charges on Sandy			<u>(284,691)</u>
Balance Available for Future Mitigation			<u>14,662,848</u>
Allocation of Remaining Balance After Storm Offset	<u>11,654,322</u> ✓	<u>3,008,526</u> ✓	<u>14,662,848</u>

Central Hudson Gas & Electric Corporation  
Case 12-M-0192  
Allocation Method of PBA's - Economic Development

Allocation Basis:

	<u>Rate Year 3</u> (1)	<u>Allocation</u>
Electric Delivery Revenues	286,062	79%
Gas Delivery Revenues	<u>73,846</u>	<u>21%</u>
	359,908	100%

(1) Per Cases 09-E-0588 & 09-G-0589, Joint Proposal, Appendix A, Schedule 2.

Allocation of \$5 Million for Economic Development:

	<u>Electric</u>	<u>Gas</u>	<u>Total</u>
Allocation Percentage	79%	21%	100%
Allocation of \$5 million of CBF	3,974,099 ✓	1,025,901 ✓	5,000,000

CENTRAL HUDSON G. & E. CORP.	TRANSACTION 410	Month of	<u>June 2013</u>	Journal Voucher No.	<u>06</u>	
		PSC, REV or RPT #	Account	Payroll Area	Amount	CR
Use of PBA - Storm Offset		254.83	0824A		① 19,084,905	
Use of PBA - Storm CC Offset		254.83	0841A		1,252,247	
Storm Deferral - August 2011 Storm Costs		182.35	7126A		(8,919,779)	CR
Storm Deferral - October 2012 Storm Costs		182.35	8779A		(10,165,126)	CR
Storm Deferral - August 2011 Storm Costs		182.47	7127A		(967,556)	CR
Storm Deferral - October 2012 Storm Costs		182.47	8820A		(284,691)	CR
Deferred FIT - PBA Funds (Electric)		190.12	19012-3-970		(6,679,700)	CR
Deferred FIT - Storm Deferrals		283.85	5364A-3-620		6,679,700	
Deferred SIT - PBA Funds (Electric)		192.12	19212-3-970		(880,800)	CR
Deferred SIT - Storm Deferrals		284.85	5365A-3-620		880,800	
Deferred FIT - PBA Funds (Electric)		190.13	19013-3-970		(438,300)	CR
Deferred FIT - CC - Storm Deferrals		283.10	28310-3-970		438,300	
Deferred SIT - PBA Funds (Electric)		192.13	19213-3-970		(57,800)	CR
Deferred SIT - CC - Storm Deferrals		284.10	28410-3-970		57,800	

**TO OFFSET THE STORM DEFERRALS AND ASSOCIATED CARRYING CHARGES WITH USE OF THE PBA DOLLARS ESTABLISHED UNDER THE JOINT PROPOSAL**

20 = 20,337,152

Prepared By:	Approved:	Total Debits	28,393,752.00	
		Total Credits	(28,393,752.00)	CR

Journal Voucher No. 06 0

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.29**

How does Fortis anticipate the corporate costs will be impacted by merger?

- a. How does Fortis intend to account for these increased corporate costs? (Show accounting entries and identify the entity upon whose books such costs are being recorded. Include any accounting entries to allocate or charge such costs to other entities.)
- b. Does Fortis intend to charge any of these increased Fortis corporate costs to any of the Arizona utilities (TEP, UNSE or UNSG)?
  1. If so, show the estimated amounts for each year and identify and explain what services are being provided associated with such costs.

**RESPONSE:**

Fortis estimates that the merger will increase its annual corporate general and administrative costs by approximately C\$700,000.

- a. Illustrative accounting entries for the C\$700,000 in incremental costs and the entity recording each entry are shown in **RUCO Fortis 2.29 Attachment 1.xlsx**.
- b. Fortis Inc. utilizes a cost allocation method to calculate management fees charged to its subsidiaries. The allocation to subsidiaries is calculated as a proportion of Fortis Inc.'s corporate expenses, as per below, excluding: (i) finance charges associated with credit facilities and long-term debt; (ii) 50% of salary and salary-related expenses of Fortis Inc.'s CEO, CFO and Treasurer; and (iii) 100% of business development costs. The allocable costs are charged to the operating subsidiaries based on the percentage of their assets to the total consolidated assets of Fortis Inc.

Fortis Inc.'s costs (i.e., corporate expenses) typically relate to public capital market access related to investment in operating subsidiaries. Such costs include governance costs, capital market fees, public reporting requirements, trustee fees, common share plans and other related fees. These costs are allocated between regulated and non-regulated operations by each operating subsidiary as required under appropriate local regulatory guidelines governing that operating subsidiary. Generally, capital market costs related to equity are regarded as costs which are appropriately allocated to regulated operations (because the costs benefit the regulated subsidiary and are not duplicative), whereas costs such as those related to governance may not be allocated to regulated operations (because the regulated subsidiary has its own independent board of directors and additional governance costs tend to be duplicative).

For additional information on Fortis' cost allocation methodology, please refer to **RUCO Fortis 2.29 Attachment 2.pdf, Bates Nos. 002180-002209**, which contains a June 22, 2009 report from KPMG pertaining to a review of the cost allocation methodology utilized by Fortis Inc. This report reviewed the cost allocation policy of Fortis Inc. as well as FortisBC Holdings Inc. (formerly known as Terasen Gas Inc.). Fortis Inc. would

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

allocate applicable costs to its subsidiaries, including UNS Energy Corporation, in accordance with the indicated methodology. The methodology used by UNS Energy to allocate costs to its subsidiaries is described in UDR 1.14.

The merger and contemporaneous delisting of UNS Energy will eliminate many of the public company costs now being incurred by UNS Energy and its subsidiaries. Additionally, UNS Energy and its subsidiaries will be able to take advantage of cost saving opportunities, where appropriate: a prominent example being the Fortis group insurance program that allows participating subsidiaries to lower their insurance premiums. Consequently, total operating costs borne by the regulated subsidiaries of UNS Energy will not increase from what they otherwise would have been in the absence of the merger and should, in fact, decrease.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**RUCO Fortis 2.29 Attachment 1  
Illustrative Accounting Entries  
Allocation of Fortis Inc Incremental Corporate Costs  
(C\$ thousands)**

	<u>Debit</u>	<u>Credit</u>
<b><u>Fortis Inc. Books</u></b>		
<b>JE 1</b>		
Corporate Expenses	700	
Accounts Payable		700
To record incurrence of estimated incremental corporate expenses.		
<b>JE 2</b>		
Income Tax Payable	203	
Income Tax Expense		203
To record tax shield on incremental corporate expenses at the Fortis Inc marginal income tax rate of 29%.		
<b>JE 3</b>		
Accounts receivable - UNS Energy Corporation	xxx	
Accounts receivable - various subsidiaries	xxx	
Corporate expenses		xxx
To record chargeback of certain corporate expenses to the subsidiaries of Fortis Inc in accordance with established allocation methodology.		
<b>JE 4</b>		
Income Tax Expense	xxx	
Income Tax Payable		xxx
To record lost income tax shield on chargeback of incremental corporate expenses at the Fortis Inc marginal income tax rate of 29% (amounts are 29% of the total corporate expenses charged back in JE 3).		
<b><u>UNS Energy Corporation Books</u></b>		
<b>(Note: Amounts would also be recorded by other Fortis subsidiaries based on a percentage allocation as described in the response to RUCO Fortis 2.29)</b>		
<b>JE 5</b>		
Corporate Expenses	xxx	
Accounts Payable - Fortis Inc		xxx
To record corporate expenses charged back to UNS Energy Corporation by Fortis Inc per JE 3 above.		
<b>JE 6</b>		
Income Tax Payable	xxx	
Income Tax Expense		xxx
To record income tax shield on Fortis Inc corporate expenses charged back to UNS Energy Corporation at the US statutory income tax rate of 35% (amounts are 35% of the corporate expenses charged back in JE 5).		

**RUCO Fortis 2.29 Attachment 1  
Illustrative Accounting Entries  
Allocation of Fortis Inc Incremental Corporate Costs  
(C\$ thousands)**

	<u>Debit</u>	<u>Credit</u>
<b>JE 7</b>		
Accounts Receivable - Non Regulated Subsidiaries	xxx	
Accounts Receivable - Regulated Subsidiaries	xxx	
Corporate Expenses		xxx
To record chargeback of certain corporate expenses to subsidiaries. Amounts charged back to regulated subsidiaries are determined by UNS Energy Corporation management based on the appropriate local regulatory guidelines.		
<b>JE 8</b>		
Income Tax Expense	xxx	
Income Tax Payable		xxx
To record lost income tax shield on chargeback of corporate expenses to subsidiaries at the US marginal income tax rate of 35% (amounts are 35% of the total corporate expenses charged back in JE 7).		
 <b><u>UNS Energy Corporation Subsidiaries Books</u></b>		
 <b>(NOTE: The methodology used by UNS Energy to allocate costs to its subsidiaries is described in UDR 1.14)</b>		
<b>JE 9</b>		
Corporate Expenses	xxx	
Accounts Payable - UNS Energy Corporation		xxx
To record corporate expenses charged back by UNS Energy Corporation to its subsidiaries in JE 7.		
<b>JE 10</b>		
Income Tax Payable	xxx	
Income Tax Expense		xxx
To record income tax shield on corporate expenses charged back by UNS Energy Corporation at the US statutory income tax rate of 35% (amounts are 35% of the corporate expenses charged back in JE 9).		

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
UPFRONT DATA REQUESTS IN THE MATTER OF THE REORGANIZATION OF UNS  
ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
January 28, 2014**

**UDR 1.14**

Please describe UNS Energy's and its utility subsidiaries' current cost allocation methodology.

**RESPONSE:**

The approach to allocating costs between UNS Energy and its subsidiaries is designed to share the costs of common or jointly used equipment, space and shared service employees in an equitable and systematic way. Whenever possible, time is tracked on a direct project basis to allow for direct billing to the benefiting subsidiary. When that is not possible, various allocation methods may be used. The exact allocation methodology may differ between types of cost, but the underlying principle remains the same, to identify the determining driver that most closely represents the benefit incurred and allocate appropriately. For example; a shared payroll system might be charged out based on employee headcount, while a shared billing system on number of bills produced.

Where elements of cost causation cannot be reasonably or economically identified as the basis for allocation, a residual factor is applied to the allocation pool. The residual factor used by TEP is a three-factor formula, based on an equal weighting of payroll costs, plant/tangible assets, and total revenues. Such formula, known as the "Massachusetts Formula" has been widely used throughout the utility industry, has been accepted by the Cost Accounting Standards Board, and is consistent with the manner by which taxable income is partitioned between states under UDITPA and the Multistate Tax Compact.

These cost allocation procedures used by UNS Energy and its utility subsidiaries' (the Companies) to allocate annual affiliated costs follow the cost allocation procedures and cost causative concepts that were filed and approved as a part of the formation of UNS Energy as a holding company for TEP [Commission Decision No. 60480 (November 25, 1997)].

The methodology underlying the allocations are described in the cost allocation procedures approved by the Commission in Commission Decision No. 60480 (November 25, 1997) and Commission Decision No. 62767 (August 2, 2000).

**RESPONDENT:**

Frank Marino and Brian Brumfield

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.08**

If and after it acquires UNS Energy, does Fortis intend to continue to seek other acquisitions of utilities in the United States (or elsewhere)?

**RESPONSE:**

Fortis will continue to assess acquisition opportunities in Canada and the United States that may arise from time to time. These would be limited to regulated utilities and hydroelectric generation opportunities with long term contracts. Fortis currently does not intend to pursue opportunities outside these two countries.

Currently, Fortis is not assessing other acquisition opportunities and is focused on completing the acquisition of UNS Energy. In the near term, Fortis expects to focus on organic growth opportunities within its regulated utilities.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2013

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number	Registrant; State of Incorporation; Address; and Telephone Number	IRS Employer Identification Number
1-13739	<b>UNS ENERGY CORPORATION</b> (An Arizona Corporation) 88 East Broadway Boulevard Tucson, AZ 85701 (520) 571-4000	86-0786732
1-5924	<b>TUCSON ELECTRIC POWER COMPANY</b> (An Arizona Corporation) 88 East Broadway Boulevard Tucson, AZ 85701 (520) 571-4000	86-0062700

**Securities registered pursuant to Section 12(b) of the Exchange Act:**

<u>Registrant</u>	<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
UNS Energy Corporation	Common Stock, no par value	New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Exchange Act:**

<u>Registrant</u>	<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Tucson Electric Power Company	Common Stock, without par value	N/A

Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933.

UNS Energy Corporation	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
Tucson Electric Power Company	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Regulatory liabilities represent items that we either expect to pay to customers through billing reductions in future periods or plan to use for the purpose for which they were collected from customers, as described below:

- (7) Net Cost of Removal for Interim Retirements represents amounts recovered through depreciation rates associated with asset retirement costs expected to be incurred in the future.
- (8) The Deferred Investment Tax Credit relates to federal energy credits generated in 2012 and is amortized over the tax life of the underlying asset.

**IMPACTS OF REGULATORY ACCOUNTING**

If we determine that we no longer meet the criteria for continued application of regulatory accounting, we would be required to write off our regulatory assets and liabilities related to those operations not meeting the regulatory accounting requirements. Discontinuation of regulatory accounting could have a material impact on our financial statements.

**NOTE 4. BUSINESS SEGMENTS**

We have three reportable segments regularly reviewed by our chief operating decision makers to evaluate performance and make operating decisions.

- (1) TEP, a regulated electric utility and our largest subsidiary
- (2) UNS Electric, a regulated electric utility
- (3) UNS Gas, a regulated gas distribution utility

We disclose selected financial data for our reportable segments in the following tables:

	<u>Reportable Segments</u>				<u>Reconciling Adjustments</u>	<u>UNS Energy</u>
	<u>TEP</u>	<u>UNS Electric</u>	<u>UNS Gas</u>	<u>Other <sup>(2)</sup></u>		
	Millions of Dollars					
<b>2013</b>						
<b><u>Income Statement</u></b>						
Operating Revenues-External	\$ 1,180	\$ 174	\$ 131	\$ 2	\$ (2)	\$ 1,485
Operating Revenues-Intersegment <sup>(1)</sup>	17	2	3	17	(39)	—
Depreciation and Amortization	149	19	9	—	—	177
Interest Income	—	1	—	—	—	1
Interest Expense	79	7	6	1	—	93
Income Tax Expense	48	7	7	(4)	—	58
Net Income	101	12	11	3	—	127
<b><u>Cash Flow Statement</u></b>						
Capital Expenditures	(253)	(56)	(17)	—	—	(326)
<b><u>Balance Sheet</u></b>						
Total Assets	3,556	404	311	1,194	(1,192)	4,273



**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.32**

Does Fortis anticipate incurring costs or expenses for Change in Control payments for UNS officers/employees.

- a. If yes, what expense or cost does Fortis anticipate?
- b. If yes, how does Fortis intend to account for these costs? (Show accounting entries and identify the entity upon whose books such costs are being recorded. Include any accounting entries to allocate or charge such costs to other entities.)
- c. If yes, does Fortis intend to charge any of these change in control costs to any of the Arizona utilities (TEP, UNSE or UNSG)?
  1. If so, show the estimated amounts for each year and identify and explain what services are being provided associated with such costs.

**RESPONSE:**

**THE FILE LISTED BELOW CONTAINS CONFIDENTIAL INFORMATION AND IS BEING PROVIDED PURSUANT TO THE TERMS OF THE PROTECTIVE AGREEMENT.**

Please see **RUCO Fortis 2.32 Response-Confidential.pdf**, Bates No. 002212-002213, for the requested information.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**THE FOLLOWING DOCUMENT  
CONTAINS “CONFIDENTIAL  
INFORMATION” THAT IS  
BEING PROVIDED PURSUANT  
TO THE TERMS OF THE  
PROTECTIVE AGREEMENT IN  
THIS DOCKET AND MAY NOT  
BE SHARED WITH ANYONE  
WHO HAS NOT SIGNED THE  
PROTECTIVE AGREEMENT.**

**PAGE 4 IS  
CONFIDENTIAL AND  
HAS BEEN REDACTED**

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S FIRST SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
February 28, 2014**

**RUCO UNS 1.04**

Refer to page 19 of the UNS Energy Corporation SEC 8-K filing which addresses change in control payments.

- a. Identify each change in control payment that is anticipated.
- b. Provide the pro forma journal entries showing how the change in control payments would be recorded.

**RESPONSE:**

**THE FILE LISTED BELOW CONTAINS CONFIDENTIAL INFORMATION AND IS BEING PROVIDED PURSUANT TO THE TERMS OF THE PROTECTIVE AGREEMENT.**

- a.-b. Please see RUCO UNS 1.04-Confidential.pdf, Bates Nos. 001809-001810, for the requested information.

**RESPONDENT:**

Frank Marino / Brian Brumfield

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**THE FOLLOWING DOCUMENT  
CONTAINS “CONFIDENTIAL  
INFORMATION” THAT IS  
BEING PROVIDED PURSUANT  
TO THE TERMS OF THE  
PROTECTIVE AGREEMENT IN  
THIS DOCKET AND MAY NOT  
BE SHARED WITH ANYONE  
WHO HAS NOT SIGNED THE  
PROTECTIVE AGREEMENT.**

**PAGE 7 IS  
CONFIDENTIAL AND  
HAS BEEN REDACTED**

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION**

**DOCKET NO. E-04230A-14-0011, et al.**

**April 4, 2014 (COMPLETE SET)**

**RUCO Fortis 2.11**

Retention payments and retention bonuses. Are any payments being made or anticipated to be made in order to retain any employees of TEP, UNS Electric, UNS Gas or other UNS Energy affiliates?

- a. If so, identify all committed or anticipated retention payments or retention bonuses, and show how they are to be accounted for (provide journal entries).
- b. Also, identify the amounts for any committed or anticipated retention payments or retention bonuses, and the period in which they have been or would be recorded.
- c. Does Fortis agree that such payments to retain existing employees of TEP, UNS Electric, UNS Gas or other UNS Energy affiliates so such employees are available subsequent to the acquisition/merger are a transaction cost and should not be borne by the ratepayers of TEP, UNS Electric or UNS Gas?
  1. If not, explain fully why not.

**RESPONSE:**

**THE FILE LISTED BELOW CONTAINS CONFIDENTIAL INFORMATION AND IS BEING PROVIDED PURSUANT TO THE TERMS OF THE PROTECTIVE AGREEMENT.**

Please see RUCO Fortis 2.11 Response-Confidential.pdf, Bates No. 002004-002005, for the requested information.

**RESPONDENT:**

Robert Meyers

**WITNESS:**

Barry V. Perry

**Defined Terms:**

Arizona Corporation Commission ("Commission")

Color Acquisition Sub Inc. ("Color Acquisition")

Fortis Inc. ("Fortis")

FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")

FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")

UniSource Energy Services ("UES")

UNS Electric, Inc. ("UNS Electric")

UNS Energy Corporation ("UNS Energy")

UNS Gas, Inc. ("UNS Gas")

**THE FOLLOWING DOCUMENT  
CONTAINS “CONFIDENTIAL  
INFORMATION” THAT IS  
BEING PROVIDED PURSUANT  
TO THE TERMS OF THE  
PROTECTIVE AGREEMENT IN  
THIS DOCKET AND MAY NOT  
BE SHARED WITH ANYONE  
WHO HAS NOT SIGNED THE  
PROTECTIVE AGREEMENT.**

**PAGE 10 IS  
CONFIDENTIAL AND  
HAS BEEN REDACTED**

**UNS ENERGY CORPORATION'S AND FORTIS INC.'S RESPONSE TO  
RUCO'S SECOND SET OF DATA REQUESTS IN THE MATTER OF THE  
REORGANIZATION OF UNS ENERGY CORPORATION  
DOCKET NO. E-04230A-14-0011, et al.  
April 1, 2014**

**RUCO UNS 2.02**

Retention payments and retention bonuses. Are any payments being made or anticipated to be made in order to retain any employees of TEP, UNS Electric, UNS Gas or other UNS Energy affiliates?

- a. If so, identify all committed or anticipated retention payments or retention bonuses, and show how they are to be accounted for (provide journal entries).
- b. Also, identify the amounts for any committed or anticipated retention payments or retention bonuses, and the period in which they have been or would be recorded.
- c. Does Fortis [We think you mean UNS.] agree that such payments to retain existing employees of TEP, UNS Electric, UNS Gas or other UNS Energy affiliates so such employees are available subsequent to the acquisition/merger are a transaction cost and should not be borne by the ratepayers of TEP, UNS Electric or UNS Gas?
  1. If not, explain fully why not.

**RESPONSE:**

**THE FILE LISTED BELOW CONTAINS CONFIDENTIAL INFORMATION AND IS BEING PROVIDED PURSUANT TO THE TERMS OF THE PROTECTIVE AGREEMENT.**

Please see RUCO UNS 2.02 Response-Confidential.pdf, Bates No. 001998-001999, for the requested information.

**RESPONDENT:**

Frank Marino / Brian Brumfield

**WITNESS:**

Kevin Larson

**Defined Terms:**

Arizona Corporation Commission ("Commission")  
Color Acquisition Sub Inc. ("Color Acquisition")  
Fortis Inc. ("Fortis")  
FortisUS Holdings Nova Scotia Limited ("FortisUS Nova Scotia")  
FortisUS Inc. ("FortisUS")

Tucson Electric Power Company ("TEP")  
UniSource Energy Services ("UES")  
UNS Electric, Inc. ("UNS Electric")  
UNS Energy Corporation ("UNS Energy")  
UNS Gas, Inc. ("UNS Gas")

**THE FOLLOWING DOCUMENT  
CONTAINS “CONFIDENTIAL  
INFORMATION” THAT IS  
BEING PROVIDED PURSUANT  
TO THE TERMS OF THE  
PROTECTIVE AGREEMENT IN  
THIS DOCKET AND MAY NOT  
BE SHARED WITH ANYONE  
WHO HAS NOT SIGNED THE  
PROTECTIVE AGREEMENT.**

**PAGE 13 IS  
CONFIDENTIAL AND  
HAS BEEN REDACTED**

**UNS Energy Corporation and Fortis Inc.**  
**Docket Nos. E-04230A-14-0011 and E-01933A-14-0011**  
**Attachment RCS-7**  
**Copies of Confidential UNS Energy's Due Diligence Documentation**  
**Referenced in the Direct Testimony of**  
**Ralph C. Smith**

\*\*Contains UNS Energy CONFIDENTIAL Information Has Been Redacted\*\*

UNS Page No.	Subject	Highly Confidential and Competitively Sensitive	Confidential Information	No. of Pages	Page No.
REDACTED	REDACTED	No	Yes		
REDACTED	REDACTED	No	Yes		
Total Pages Including this Page				1	

Note: On April 30, 2014 counsel for UNS Energy advised that the attached two pages can be treated as "Confidential" rather than Highly Confidential and Competitively Sensitive  
Pages 2 and 3 are not included in the Redacted version of this attachment

REORGANIZATION OF UNS ENERGY CORPORATION

DOCKET NO. E-04230A-14-0011

DOCKET NO. E-01933A-14-0011

DIRECT TESTIMONY

OF

LON HUBER

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

APRIL 30, 2014

**TABLE OF CONTENTS**

1

2

3 **INTRODUCTION ..... 1**

4

5 **OVERVIEW OF ACQUISITION ..... 2**

6

7 **POTENTIAL BENEFITS OF ACQUISITION ..... 3**

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24 **RATEPAYER AND PUBLIC INTEREST CONSIDERATIONS..... 6**

1 **INTRODUCTION**

2 **Q. Please state your name, position, employer and address.**

3 A. Lon Huber. I am a special projects advisor for Arizona's Residential Utility Consumer  
4 Office ("RUCO"), located at 1110 W. Washington, Suite 220, Phoenix, AZ 85007.

5  
6 **Q. Please state your educational background and work experience.**

7 A. I started working in the energy field in 2007 at a research institute housed within the  
8 University of Arizona. In 2010, I became the governmental affairs staffer for TFS Solar,  
9 an integrator based in Tucson. I was hired by Suntech America in 2011 as a Manager of  
10 Regional Policy where I served as the point person for the company in numerous US  
11 states. Next, I started working in economic development as a senior analyst for the  
12 Greater Phoenix Economic Council while also serving as a consultant for RUCO on  
13 energy issues. I joined RUCO as a full time employee in January 2014.

14  
15 I obtained a Bachelor of Science Public Administration degree in Public Policy and  
16 Management from the University of Arizona in 2009. I also received a Masters of  
17 Business Administration from the Eller College of Management at the same university.  
18 My primary residence is in Tucson Arizona.

19  
20 **Q. Please state the purpose of your testimony.**

21 A. The purpose of my testimony is to present recommendations that are based on my  
22 review of the acquisition from a public policy perspective only. My testimony will  
23 specifically touch on whether or not this proposed transaction is in the public interest.

1 **Q. What are the standards that you relied on in determining whether or not an**  
2 **acquisition of UNS Energy by Fortis is in the public interest?**

3 A. I relied upon A.A.C. R14-2-803(C) and Decision No. 67454  
4

5 **OVERVIEW OF ACQUISITION**

6 **Q. Please provide a high-level overview of the proposed transaction.**

7 A. Fortis, a large publicly traded Canadian gas and electric distribution utility<sup>1</sup>, plans to  
8 acquire all of the outstanding common stock of UNS Energy for \$60.25 per share in  
9 cash.<sup>2</sup> Upon completion, UNS Energy will cease being a publicly traded company.  
10

11 **Q. Please comment on suitability of the two companies coming together.**

12 A. Fortis has acquired several other Canadian utilities and one U.S. utility over recent years  
13 and now serves 2.4 million customers across all of its utilities.<sup>3</sup> Like UNS Energy, the  
14 primary business of Fortis is in the provision of utility services. Their management  
15 philosophy is that of local control and Fortis appears to be a company that takes a long-  
16 term view when acquiring companies. UNS Energy in particular would be a large  
17 addition to the Fortis's portfolio. The acquisition provides diversity to that portfolio that  
18 can strengthen Fortis in numerous ways. By being an integral part of Fortis, UNS Energy  
19 may gain improved access to debt and equity capital due to the relative financial  
20 strength of Fortis.  
21  
22

---

23 <sup>1</sup> Fortis trades under the symbol FTS on the Toronto stock exchange.

24 <sup>2</sup> <http://ir.uns.com/releasedetail.cfm?ReleaseID=835639>

<sup>3</sup> Direct Testimony Mr. Kevin Larson page 3

1 **Q. Briefly summarize the major conditions of approval as submitted by the**  
2 **applicants.**

3 A. The central conditions of the agreement between Fortis and UNS Energy include but not  
4 limited to the following:

- 5 • Agreement to maintain a high level quality of service across UNS Energy's  
6 regulated subsidiaries. This includes the commitment to maintain a low level  
7 of complaints and service interruptions.
- 8 • Commitment to keep UNS Energy Arizona based and operated.
- 9 • Provide equity capital when required and \$200 million of equity infusion upon  
10 closing.
- 11 • Commitment to continue current union contracts, employee levels and  
12 benefits.
- 13 • Commitment to maintain current levels of community support and donations.
- 14 • Costs related to merger including any goodwill, acquisition premium, and  
15 transaction costs will be borne by Fortis shareholders and will not be  
16 recouped from ratepayers.

#### 12 **POTENTIAL BENEFITS OF ACQUISITION**

13 **Q. How does RUCO view the potential benefits of this transaction?**

14 A. As the transaction is currently structured, there are clear benefits to both companies but  
15 an absence of tangible and material near term benefits to ratepayers - even though  
16 significant benefits can be realized. Furthermore, the benefits that are mentioned by  
17 UNS Energy and Fortis are indeterminate and long-term and could be negated by risks  
18 produced from this deal.

19  
20 **Q. Please explain.**

21 A. Fortis gains a well-run utility in the context of a steadily consolidating industry. With the  
22 acquisition, Fortis brings diversity to its portfolio and the opportunity to make a sizable  
23 amount of rate base eligible investments in the near term. Fortis estimates that the  
24

1 acquisition will be accretive to its earnings, excluding the impact of transaction costs.  
2 UNS Energy shareholders receive a premium for their stock while executives of UNS  
3 Energy are protected and also share in the stock premium.

4  
5 In terms of benefits to ratepayers, the deal offers zero commitment to delivering any  
6 specific benefit. From the ratepayers view, the companies are committing to the status  
7 quo with the possibility of positive side effects down the road. However, as detailed in  
8 Ralph Smith's testimony, there may also be ratepayer exposure to long-term risks.

9  
10 **Q. Please describe these risks.**

11 A. The acquisition is expected to result in a substantial amount of goodwill, currently  
12 estimated at over \$1.4 billion, to be recorded. If a large amount of impairment is realized  
13 on this non-revenue producing asset, raising capital in the future may be more difficult  
14 and expensive. Moreover, having such a large additional amount of goodwill would be  
15 expected to put pressure on Fortis management to keep earnings high and thereby  
16 avoid having to recognize an impairment. This pressure may manifest itself in different  
17 ways that may or may not be in the best long-term interest of ratepayers. This  
18 uncertainty may be digestible if the transaction contained additional safeguards and  
19 tangible near term benefits to ratepayers. However, the acquisition as currently  
20 proposed, is lacking benefits and a few key safeguards.

1 **Q. Could you be more specific on the lack of near term benefits to ratepayers?**

2 A. In Mr. Hutchens's testimony, he noted that cost savings might be realized by ratepayers  
3 after the next rate case.<sup>4</sup> He did not state or guarantee an exact number. Similarly, Mr.  
4 Larson made a claim on potential future cost savings but did not specify timing or an  
5 amount.<sup>5</sup> In Fortis' recent acquisition of Central Hudson Gas & Electric Corporation  
6 savings were guaranteed - \$9.25 million was guaranteed to customers over five years.<sup>6</sup>  
7 In addition, \$5 million was set aside in a Customer Benefit Fund to be used for economic  
8 development and low-income assistance programs. Additionally, conditions imposed on  
9 Fortis' Central Hudson acquisition required that \$35 million provided to Central Hudson  
10 by Fortis be recorded as a regulatory liability to be applied to write off regulatory assets  
11 on the books of Central Hudson for storm restoration and to provide balance sheet  
12 offsets and rate mitigation in Central Hudson's next rate filing. Finally, the level of  
13 community support was guaranteed for 10 years, instead of the five Fortis is offering in  
14 this case.

15  
16 **Q. Are there near terms savings that can be realized by ratepayers?**

17 A. Yes, UNS Energy will be assimilated into a larger and more sophisticated entity that has  
18 access to financial techniques and tools that can deliver direct savings to ratepayers. As  
19 mentioned, it is not unprecedented for Fortis to grant and guarantee near term savings  
20 to ratepayers. Moreover, Fortis was able to provide \$49 million in customer benefits to  
21 Central Hudson's ratepayers, a utility roughly half the size of UNS Energy.

22  
23 <sup>4</sup> Direct Testimony Mr. David Hutchens page 5

<sup>5</sup> Direct Testimony Mr. Kevin Larson page 10

24 <sup>6</sup> <https://www.fortisinc.com/News/Pages/Fortis-Acquisition-of-CH-Energy-Group,-Inc--Approved-by-New-York-State-Public-Service-Commission.aspx>

1 **Q. What level of savings would you recommend in this case?**

2 A. As discussed in Ralph Smith's testimony, RUCO is seeking \$59 million in ratepayer  
3 benefits. These benefits can be delivered over time and applied against different  
4 accounts and/or adjustors such as the Lost Fixed Cost Recovery adjustor. Again, this  
5 amount is reasonable compared to the savings Fortis agreed to in the company's last  
6 acquisition. In fact, if savings were proportional to the size of the Central Hudson  
7 transaction, UNS Energy ratepayers would receive around \$100 million in savings.

8  
9 **RATEPAYER AND PUBLIC INTEREST CONSIDERATIONS**

10 **Q. In addition to the lack of tangible benefits are there other conditions that should**  
11 **be imposed upon the transaction?**

12 A. Yes. There are additional conditions which are described more fully in Ralph Smith's  
13 testimony. These important conditions are summarized below:

- 14 1. Fortis and UNS Energy agree to share any follow-on merger savings that are  
reasonably applicable to TEP, UNS Electric and UNS Gas.
- 15 2. Fortis and UNS Energy agree and commit that none of the shareholder  
16 litigation costs shall be borne by the ratepayers of TEP, UNS Electric or UNS  
Gas.
- 17 3. Fortis and UNS Energy to agree and commit that all Change of Control costs  
18 and Retention Bonus costs are transaction costs and none of those costs  
shall be borne by the ratepayers of TEP, UNS Electric or UNS Gas.
- 19 4. Fortis and UNS Energy to agree and commit that all tax benefits of the plans  
20 to sell coal to third parties will be passed onto TEP ratepayers through the  
PPFAC.
- 21 5. Fortis and UNS Energy shall report to the Commission within five business  
22 days any changes in the credit ratings of Fortis, Inc., UNS Energy, TEP,  
UNS Electric or UNS Gas.

1 **Q. What is your understanding of the public interest standard that the Commission**  
2 **applies for approval or rejection of a notice of intent to reorganize?**

3 A. A.A.C. R14-2-803(C) states that: "At the conclusion of any hearing on the organization  
4 or reorganization of a utility holding company, the Commission may reject the proposal if  
5 it determines that it would impair the financial status of the public utility, otherwise  
6 prevent it from attracting capital at fair and reasonable terms, or impair the ability of the  
7 public utility to provide safe, reasonable and adequate service." However, the  
8 Commission has previously elaborated on the standard. In Decision No. 67545,  
9 (January 4, 2005 Docket No. E-04230A-03-0933 at page 49<sup>7</sup>) the Commission  
10 concluded that the factors set out in A.A.C. R14-2-803(C) are only a part of the "public  
11 interest" inquiry that the Commission must make as part of its consideration of the  
12 proposed transaction:

- 13 5. Pursuant to the Arizona Constitution and A.R. S. Title 40 generally, the  
14 Commission is required to act in the "public interest" and must consider all of  
the evidence available in determining the "public interest".
- 15 6. The public interest requires that the Commission apply the Affiliated Interest  
16 Rules in a manner that will maximize protection to ratepayers.
- 17 7. Utility ratepayers should not be required to bear the burden of risk resulting  
18 from holding company structure or diversification.
- 19 8. The factors set out in A.A.C. R14-2-803(C) are only a part of the "public  
interest" inquiry that the Commission must make as part of its consideration  
of the proposed transaction.

20 Based on this guidance RUCO believes that the standard of review is broad and that the  
21 Commission's review must consider all of the evidence available in determining the  
22

23  
24 

---

<sup>7</sup> This proceeding involved a previous attempt to sell UniSource Energy.

1 "public interest" and apply the Affiliated Interest Rules in a manner that will maximize  
2 protection to ratepayers.

3  
4 **Q. Would the acquisition impair the financial status of the public utility?**

5 A. Probably not directly given Fortis' financial position and better credit rating. Fortis'  
6 current financial strength could enhance the financial status of UNS Energy and UNS  
7 Energy's access to capital at favorable rates, which is one reason why RUCO could  
8 support the transaction provided that the near term benefits and safe guard issues as  
9 described above are adequately addressed. However, there is a risk that the additional  
10 goodwill of over \$1.4 billion (which Fortis has committed will not be recovered from  
11 Arizona ratepayers) could ultimately result in impairing Fortis' financial strength if Fortis  
12 has to recognize impairment losses to the value of that goodwill in future accounting  
13 periods.

14  
15 **Q. Would the acquisition prevent the utility from attracting capital at fair and  
16 reasonable terms?**

17 A. No, again the transaction does not appear to present any near-term issues with the  
18 ability of the utility to attract capital on reasonable terms. Again, it should enhance the  
19 ability of UNS Energy to attract capital because of the stronger financial position that  
20 could result by the merger. However, as noted above, the transaction will result in  
21 Fortis recording additional goodwill of over \$1.4 billion, which could ultimately result in a  
22 future impairment to Fortis' financial strength if the significant amounts of goodwill that  
23 Fortis has been accumulating from its acquisition of UNS Energy and its other recent  
24 acquisitions become impaired.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24

**Q. Would the acquisition impair the ability of the utility to provide safe, reasonable and adequate service?**

A. Not in the near term, and not in the intermediate term, as long as Fortis is able to maintain its financial strength prospectively while taken on the increasing financial burdens of carrying large additional amounts of goodwill on its books that are not recoverable through utility rates. As noted above, there is a concern that the amounts of goodwill that Fortis is recording may ultimately result in impairment write-downs that could imperil Fortis' financial strength.

**Q. Does the acquisition maximize protection to ratepayers?**

A. No. Additional safe guards are needed, including monetary guarantees to help render a net positive deal for ratepayers.

**Q. Is the acquisition in the public interest?**

A. If the conditions specified in this testimony and Ralph Smith's testimony are met, the acquisition would be in the public interest. As currently proposed, the acquisition has clear near-term benefits for UNS Energy shareholders (stock price premium), to UNS Energy executives (financial benefits from stock based compensation, Change-in Control payments, etc.) and to Fortis (earnings accretion, diversity enhancement, etc.) but no near-term tangible benefits to the ratepayers of the three Arizona Utilities. Moreover, taking on an additional \$1.4 billion of goodwill that is not going to recoverable from ratepayers, and which is roughly seven times the amount of Fortis' \$200 million committed equity infusion in to UNS Energy, could ultimately result in the impairment of

1 Fortis' financial strength, thus jeopardizing the potential benefit of improved access to  
2 capital on reasonable terms that is promised by the proposed transaction.

3  
4 **Q. Does RUCO recommend approval of the merger?**

5 A. RUCO can endorse the proposed merger if the additional conditions outlined in this  
6 testimony are met. RUCO is concerned that the significant amount of additional goodwill  
7 resulting from the proposed transaction could ultimately result in future impairments to  
8 Fortis' financial strength, thus impairing or negating the potential benefits of improved  
9 access to capital markets on reasonable terms. RUCO is also troubled by the lack of  
10 quantifiable near term benefits to ratepayers. As mentioned, tangible ratepayer benefits  
11 were guaranteed in the conditions applied to Fortis' only other acquisition of a U.S.  
12 based utility, i.e., its acquisition of the Central Hudson utilities in New York in 2013.  
13 Given these facts, RUCO would support the merger only if Fortis makes a firm  
14 commitment to deliver tangible and quantifiable savings to ratepayers and grants the  
15 safeguards mentioned above.

16  
17 **Q. Does this conclude your testimony?**

18 A. Yes it does.  
19  
20  
21  
22  
23  
24