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BEFORE THE ARIZONA CORPORATION

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AZ CORP COMMISSION
DOCKET CONTROL

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 E-01933A-14-0011 **STAFF'S NOTICE OF FILING DIRECT TESTIMONY**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Direct Testimony of Gerald Becker in the above docket.

RESPECTFULLY SUBMITTED this 30th day of April, 2014.

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Attorneys, Legal Division
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Arizona Corporation Commission
DOCKETED
APR 30 2014
DOCKETED BY ne

Original and thirteen (13) copies of the foregoing filed this 30th day of April 2014 with:

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

Copy of the foregoing emailed and/or mailed this 30th day of April 2014 to:

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

IN THE MATTER OF THE APPLICATION FOR APPROVAL OF THE REORGANIZATION OF UNS ENERGY CORPORATION ON BEHALF OF ITSELF AND ITS AFFILIATES UNISOURCE ENERGY SERVICES AND TUCSON ELECTRIC POWER COMPANY	DOCKET NOS. E-01933A-14-0011 E-04230A-14-0011

DIRECT

TESTIMONY

OF

GERALD BECKER

EXECUTIVE CONSULTANT

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

APRIL 30, 2014

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EXECUTIVE SUMMARY
UNS ENERGY CORPORATION
DOCKET NOS. E-04230A-14-0011 AND E-01933A-14-0011

On January 24, 2014, UNS Energy Corporation ("UNS Energy"), on behalf of itself and its affiliates UniSource Energy Services, Inc., Tucson Electric Power Company, UNS Electric, Inc. and UNS Gas, Inc., and Fortis Inc. ("Fortis") on behalf of itself and its affiliates, FortisUS Holdings Nova Scotia Limited, FortisUS Inc., and Color Acquisition Sub Inc. filed an application to reorganize UNS Energy whereby Fortis would acquire UNS Energy for US$60.25 per common share in cash, representing an aggregate purchase price of approximately US$4.3 billion, including the assumption of approximately US$1.8 billion of debt on closing. The purchase price of $60.25 per common share represents a premium over book value of approximately 31.4 percent.

Staff recommends approval of the merger subject to certain conditions. These conditions include:

1. Ratepayer Benefits/Savings – UNS Energy shall be required to establish a regulatory liability in the amount of $60 million for the benefit of the ratepayers in future proceedings. This is intended to represent a 90 percent/10 percent sharing of the benefits to be derived from the proposed transaction between the shareholders and the ratepayers, respectively. This shall include a one-time bill credit totaling $12 million to retail customers of the regulated entities[1] and shall be deducted against the regulatory liability. The amounts payable to each respective customer group will be calculated proportionately based on each group's respective monthly minimum charges and be credited monthly over six months starting in January 2015.
2. Ring Fencing - Appropriate ring fencing measures as discussed below shall be implemented to protect each regulated entity and its ratepayers from any financial distress that may be incurred by the Fortis or its other affiliates. These shall include but are not limited to maintaining the existence of separate capital structures, the establishment of a 'golden share' held by one independent director residing in Arizona (the consent of which would be required in order for UNS Energy to file for voluntary bankruptcy protection), the establishment of an independent Board of Directors for UNS Energy, dividend restrictions, and prohibitions on intercompany loans and guarantees burdening UNS Energy.
3. Annual reporting of ring fencing measures - Conditions contained herein shall be tracked and reported on for a period of 5 years. UNS Energy will file a report in Docket Control by April 1 of each year, beginning April 1, 2016, reporting on the prior calendar year's status of the conditions. The report will, at a minimum, provide a description of the performance of each condition that has quantifiable results. If any condition is not being met, the report shall provide proposed corrective measures and target dates for completion of such measures.
4. UNS Energy and its regulated entities shall each obtain Commission approval before distributing any monies from the regulated entities to Fortis above a specified amount for 5 years after the closing. Staff has not yet determined the appropriate amount, however, Staff will supplement its pre-filed testimony to provide a specified amount for each entity.
5. UNS Energy shall maintain a capital structure that is separate from that of Fortis.

[1] "Regulated entity" or "Regulated entities" are defined to mean those regulated utilities of UNS Energy, namely Tucson Electric Power Company, UNS Electric, Inc., and UNS Gas, Inc.

6. Fortis shall appoint a Board of Directors no later than one year after the closing. A majority of the directors shall have permanent residence in Arizona and shall have been permanent residents for at least 3 years prior to appointment. A majority of directors of UNS Energy shall be independent.
7. The corporate headquarters for UNS Energy will remain in Arizona.
8. Fortis shall establish a 'golden share' held by one independent director with permanent residence in Arizona. The consent of the holder of the golden share would be required in order for UNS Energy or any of its regulated entities to file for voluntary bankruptcy protection.
9. UNS Energy and the regulated entities shall not pledge or encumber any assets for the benefit of Fortis or Fortis' other affiliates, nor shall the regulated entities guarantee any indebtedness of Fortis or Fortis' other affiliates.
10. Fortis shall take notice of and agrees to fully comply with applicable Arizona and federal statutes and Commission rules including, without limitation, the affiliated interest rules as set forth in the Arizona Administrative Code.
11. Fortis affirmatively acknowledges the need to secure Commission approval when incurring debt, issuing equity instruments, and selling assets of the regulated entities.
12. Fortis acknowledges the potential impact of future acquisitions on the regulated entities and agrees that the Commission may establish additional requirements to protect the regulated entities, as deemed necessary by the Commission.
13. UNS Energy will not share customer specific information with Fortis affiliates for purposes other than the management of UNS Energy and the regulated entities and provision of electric and/or natural gas service to customers. Fortis shall secure confidentiality agreements from any affiliate with which it shares customer information. Fortis is on notice of a rule making docket in Docket No. RU-00000A-14-0014 regarding the sharing of customer information.
14. There shall be no sale or transfer of ownership of UNS Energy or any of its components for 5 years after the closing. Fortis acknowledges that Commission approval must be obtained in advance for any sale or transfer of ownership that occurs after 5 years of the closing.
15. Fortis, UNS Energy and/or the regulated entities shall not seek recovery of or on the acquisition premium in any future rate proceeding.
16. Fortis, UNS Energy, and/or the regulated entities shall not seek recovery of or on the transaction and transition costs associated with the merger, including any amounts paid to executives who leave employment within 5 years after the closing, any amounts paid as retention bonuses or other compensation, and any amount paid as severance to any employee. This shall apply for a period of 5 years after the closing.
17. Fortis, UNS Energy, and/or the regulated entities shall not include in the regulated entities' revenue requirement any increase in salaries of Senior Management Personnel[2] for a period of 5 years after the close of the proposed transaction.
18. Any plan for a reduction in force of existing employees by the regulated entities of UNS Energy through actions other than normal course of business or attrition, or for the relocation of non-Senior Management Personnel outside of Arizona, will be filed with the Commission, identifying the timing and economic justification for such plans for a reduction in force. Fortis agrees to file any intent to make reductions in its work force at least 120 days before implementing the plan.

[2] "Senior Management Personnel" shall include the positions held by the 11 existing executives.

19. Any plan for a significant adjustment to fringe benefits shall be filed with the Commission at least 120 days before implementing the plan.
20. Any plan for significant adjustment to wages and benefits paid to UNS Energy's 650 contract workers shall be filed with the Commission at least 120 days before implementing the plan.
21. Fortis shall not allocate any Fortis specific costs to the regulated entities for possible recovery in a future rate proceeding for 5 years after the closing. Fortis shall file notice of any intent to use a shared services model whereby central office or general office costs would be allocated to the regulated entities. Fortis and UNS Energy shall file a code of conduct regarding affiliate transactions within 30 days after the closing. Fortis and UNS Energy shall file with the Commission within 30 days after the close of the proposed transaction its procedures for managing any intercompany transactions.
22. Fortis and UNS Energy will ensure that sufficient Senior Management Personnel will be physically located in Arizona on a continuing basis to make decisions on behalf of UNS Energy pertaining to Arizona retail customer service issues.
23. Fortis and UNS Energy shall file for Commission approval within 30 days after the close of the proposed transaction its proposed procedures for valuing and allocating intercompany transactions related to the transfer of assets and to the provision of goods and services to and between affiliates. The Company's proposed procedures could involve making appropriate updates to Tucson Electric Power Company's existing Commission approved Code of Conduct.
24. UNS Energy will maintain its own accounting books and records separate from Fortis'. All UNS Energy financial books and records will be kept in Arizona. UNS Energy's financial books and records and state and federal utility regulatory filings and documents will continue to be available to the Commission and Staff upon request, at UNS Energy's Arizona offices.
25. Fortis will provide the Commission and Staff full access to all books of accounts, as well as all documents, data and records of their affiliated interests.
26. Fortis, UNS Energy, and their subsidiaries shall make their employees, officers, and agents available to testify before the Commission to provide information relevant to the matters within the jurisdiction of the Commission.
27. Fortis acknowledges that any amounts approved in future proceedings including but not limited to income tax expense, cost of equity, rate of return, and capital structures are in the sole discretion of the Commission.
28. In all rate cases filed by the regulated entities through 2020, the regulated entities shall demonstrate that the proposed rate increases are materially lower than those that would have been proposed absent the acquisition of UNS Energy by Fortis.
29. Fortis agrees to cooperate fully with the Commission's or Staff's audits of the accounting records of UNS Energy, the regulated entities, and Fortis and its subsidiaries relevant to matters within the jurisdiction of the Commission.
30. The regulated entities agree to reasonably evaluate long term power purchase and tolling agreements when preparing future resource plans, including those required by Commission rule, and selecting supply side resources in a manner that is consistent with applicable statutes and regulations so that the Commission can make a proper assessment between alternative resources, including comparison against company owned proposals.
31. UNS Energy's regulated entities shall maintain their quality of service based upon the following criteria until otherwise directed by the Commission: Tucson Electric Power and UNS Electric shall maintain a rolling three year average System Average Interruption Duration Index ("SAIDI"), System Average Interruption Frequency Index ("SAIFI"), and

Customer Average Interruption Duration Index ("CAIDI") at a maximum of the three year averages for each of those measures for the period 2011 through 2013 as reported to the Commission in Docket Nos. E-00000A-11-01113 and E-00000V-13-0070. UNS Gas shall maintain a rolling three year average number of customer complaints with the Commission's Consumer Services group at a maximum of the three year average of number of complaints for the period 2011 through 2013.

32. Fortis shall hold the regulated entities' ratepayers harmless from the impacts of any fluctuations in foreign exchange rates and any incremental taxes arising from its international ownership structure.
33. Fortis may infuse equity to include $219 million for the purchase of Gila River Block 3, $65 million for the purchase of Springerville Unit 1, and $73 million for Springerville coal handling facilities. If any of these anticipated purchases does not materialize, the required equity infusion shall be reduced accordingly. However, in no event shall Fortis infuse less than $200 million into the regulated entities. Fortis acknowledges that the prudency of any of these planned purchases is not being determined at this time, but shall be reviewed in a future rate proceeding.

INTRODUCTION

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

A. My name is Gerald Becker. I am an Executive Consultant III employed by the Arizona Corporation Commission ("Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as an Executive Consultant III.

A. I am responsible for the examination and verification of financial and statistical information included in utility rate applications. In addition, I develop revenue requirements, and prepare written reports, testimonies, and schedules that include Staff recommendations to the Commission. I am also responsible for testifying at formal hearings on these matters.

Q. Please describe your educational background and professional experience.

A. I received a Masters of Business Administration with an emphasis in Accounting from Pace University. I am a Certified Public Accountant and a Certified Internal Auditor. I am a member of the Arizona State Society of Certified Public Accountants.

I have participated in multiple rate, financing and other regulatory proceedings. I attended the National Association of Regulatory Utility Commissioners ("NARUC") Utilities Rate School.

I began employment with the Commission as a utilities regulatory analyst in April 2006. Prior to joining the Commission, I worked as an Auditor at the Department of Economic Security and Department of Revenue in the Taxpayer Assistance Section. Prior to those jobs, I worked for 15 years as an Auditor, Analyst, Financial Analyst, and Budget Manager at United Illuminating, an investor-owned electric company in New Haven, CT.

Q. What is the scope of your testimony in this case?

A. On January 24, 2014, UNS Energy Corporation ("UNS Energy") on behalf of itself and its affiliates, UniSource Energy Services, Inc., Tucson Electric Power Company, UNS Electric, Inc. and UNS Gas, Inc., and Fortis Inc. ("Fortis") on behalf of itself and its affiliates, FortisUS Holdings Nova Scotia Limited, FortisUS Inc., and Color Acquisition Sub Inc. filed an application to reorganize UNS Energy whereby Fortis would acquire UNS Energy for US$60.25 per common share in cash, representing an aggregate purchase price of approximately US$4.3 billion, including the assumption of approximately US$1.8 billion of debt on closing. The purchase price of $60.25 per common share represents a premium of 31.4 percent over the closing market price per share of UNS common stock of $45.84 the day news of the acquisition was made public on December 11, 2013 ((60.25 - $45.84) / $45.84 = 31.4%). I am presenting Staff's recommendations regarding the purchase of UNS Energy by Fortis.

Q. What is the basis of your recommendations?

A. I have reviewed the joint application of UNS Energy and Fortis whereby Fortis would acquire UNS Energy. I compared the application with the terms and conditions attached to reorganizations approved by the Commission and other regulatory bodies to ensure proper safeguards to protect the ratepayers and shareholders along with evaluating the amount of benefits that would accrue to the ratepayers as a result of the proposed reorganization.

SUMMARY OF TESTIMONY AND RECOMMENDATIONS

Q. Please summarize Staff's recommendations.

A. Staff recommends approval of the merger subject to certain conditions which are intended to benefit and protect ratepayers. These conditions include:

1. Ratepayer Benefits/Savings – UNS Energy shall be required to establish a regulatory liability in the amount of $60 million for the benefit of the ratepayers in future proceedings. This is intended to represent a 90 percent/10 percent sharing of the benefits to be derived from the proposed transaction between the shareholders and the ratepayers, respectively. This shall include a one-time bill credit totaling $12 million to retail customers of the regulated entities[3] and shall be deducted against the regulatory liability. The amounts payable to each respective customer group will be calculated proportionately based on each group's respective monthly minimum charges and be credited monthly over six months starting in January 2015.
2. Ring Fencing - Appropriate ring fencing measures as discussed below shall be implemented to protect each regulated entity and its ratepayers from any financial distress that may be incurred by Fortis or its other affiliates. These shall include but are not limited to maintaining the existence of separate capital structures, the establishment of a 'golden share' held by one independent director residing in Arizona, (the consent of which would be required in order for UNS Energy to file for voluntary bankruptcy protection), the establishment of an independent Board of Directors for UNS Energy, dividend restrictions, and prohibitions on intercompany loans and guarantees burdening UNS Energy.
3. Annual reporting of ring fencing measures - Conditions contained herein shall be tracked and reported on for a period of 5 years. UNS Energy will file a report in Docket Control by April 1 of each year, beginning April 1, 2016, reporting on the prior calendar year's status of the conditions. The report will, at a minimum, provide a description of the performance of each condition that has quantifiable results. If any condition is not being met, the report shall provide proposed corrective measures and target dates for completion of such measures.

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5. UNS Energy shall maintain a capital structure that is separate from that of Fortis.
6. Fortis shall appoint a Board of Directors no later than one year after the closing. A majority of the directors shall have permanent residence in Arizona and shall have been permanent residents for at least 3 years prior to appointment. A majority of directors of UNS Energy shall be independent.
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12. Fortis acknowledges the potential impact of future acquisitions on the regulated entities and agrees that the Commission may establish additional requirements to protect the regulated entities, as deemed necessary by the Commission.

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16. Fortis, UNS Energy and/or the regulated entities shall not seek recovery of or on the transaction and transition costs associated with the merger, including any amounts paid to executives who leave employment within 5 years after the closing, any amounts paid as retention bonuses or other compensation, and any amount paid as severance to any employee. This shall apply for a period of 5 years after the closing.
17. Fortis, UNS Energy, and/or the regulated entities shall not include in the regulated entities' revenue requirement any increase in salaries of Senior Management Personnel[4] for a period of 5 years after the close of the proposed transaction.
18. Any plan for a reduction in force of existing employees by the regulated entities of UNS Energy through actions other than normal course of business or attrition, or for the relocation of non-Senior Management Personnel outside of Arizona, will be filed with the Commission, identifying the timing and economic justification for such plans for a

[4] "Senior Management Personnel" shall include the positions held by the 11 existing executives.

reduction in force. Fortis agrees to file any intent to make reductions in its work force at least 120 days before implementing the plan.

19. Any plan for a significant adjustment to fringe benefits shall be filed with the Commission at least 120 days before implementing the plan.

20. Any plan for significant adjustment to wages and benefits paid to UNS Energy's 650 contract workers shall be filed with the Commission at least 120 days before implementing the plan.

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24. UNS Energy will maintain its own accounting books and records separate from Fortis'. All UNS Energy financial books and records will be kept in Arizona. UNS Energy's financial books and records and state and federal utility regulatory filings and documents

will continue to be available to the Commission and Staff upon request, at UNS Energy's Arizona offices.

25. Fortis will provide the Commission and Staff full access to all books of accounts, as well as all documents, data and records of their affiliated interests.

26. Fortis, UNS Energy, and their subsidiaries shall make their employees, officers, and agents available to testify before the Commission to provide information relevant to the matters within the jurisdiction of the Commission.

27. Fortis acknowledges that any amounts approved in future proceedings including but not limited to income tax expense, cost of equity, rate of return, and capital structures are in the sole discretion of the Commission.

28. In all rate cases filed by the regulated entities through 2020, the regulated entities shall demonstrate that the proposed rate increases are materially lower than those that would have been proposed absent the acquisition of UNS Energy by Fortis.

29. Fortis agrees to cooperate fully with the Commission's or Staff's audits of the accounting records of UNS Energy, the regulated entities, and Fortis and its subsidiaries relevant to matters within the jurisdiction of the Commission.

30. The regulated entities agree to reasonably evaluate long term power purchase and tolling agreements when preparing future resource plans, including those required by Commission rule, and selecting supply side resources in a manner that is consistent with applicable statutes and regulations so that the Commission can make a proper assessment between alternative resources, including comparison against company owned proposals.

31. UNS Energy's regulated entities shall maintain their quality of service based upon the following criteria until otherwise directed by the Commission: Tucson Electric Power and UNS Electric shall maintain a rolling three year average System Average Interruption Duration Index ("SAIDI"), System Average Interruption Frequency Index ("SAIFI"), and Customer Average Interruption Duration Index ("CAIDI") at a maximum of the

three year averages for each of those measures for the period 2011 through 2013 as reported to the Commission in Docket Nos. E-00000A-11-01113 and E-00000V-13-0070. UNS Gas shall maintain a rolling three year average number of customer complaints with the Commission's Consumer Services group at a maximum of the three year average of number of complaints for the period 2011 through 2013.

32. Fortis shall hold the regulated entities' ratepayers harmless from the impacts of any fluctuations in foreign exchange rates and any incremental taxes arising from its international ownership structure.

33. Fortis may infuse equity to include $219 million for the purchase of Gila River Block 3, $65 million for the purchase of Springerville Unit 1, and $73 million for Springerville coal handling facilities. If any of these anticipated purchases does not materialize, the required equity infusion shall be reduced accordingly. However, in no event shall Fortis infuse less than $200 million into the regulated entities. Fortis acknowledges that the prudency of any of these planned purchases is not being determined at this time, but shall be reviewed in a future rate proceeding.

Some of these conditions are discussed in greater detail below.

Q. Has Fortis acquired other utilities?

A. Yes. Fortis owns several utilities in Canada, the United States and overseas. On June 27, 2013, Fortis acquired CH Energy Group, parent company of Central Hudson Gas and Electric Corp. for $65 per share in cash, which according to its news release, represented a 13.1 percent above its most recent 20-day trading average of $57.49 per share. The acquisition provides nearly $50 million in ratepayer benefits[5], including:

[5] Per CH Energy Group, Inc., news release dated May 6, 2013.

- $35 million to offset costs associated with restoring electric service to customers following major storms and to mitigate other expenses that would normally be included in future delivery rates;
- $9.25 million in guaranteed savings by customers during the course of the next five years alone once the expenses associated with being a publicly traded company end;
- $5 million set aside in a Customer Benefit Fund to be used for economic development and low income assistance programs for communities and residents of the Mid-Hudson Valley;
- Customer delivery rates will be frozen until July 1, 2014;
- Customers will continue to work with current employees, as all jobs at Central Hudson will be retained;
- Financial protections for CH Energy Group, Central Hudson and its customers as part of the larger Fortis organization; and
- A transition within the Board of Directors of Central Hudson to increase members from New York State and the Hudson Valley within one year.

Q. How does the acquisition of CH Energy Group compare with the proposed purchase of UNS Energy?

A. Based on information contained in Fortis' 8-K disclosure, the total assets associated with the CH Energy Group are approximately $1.8 billion and the total assets of UNS Energy are projected to be $4.3 billion, or almost 2.4 times the asset value of the CH Energy Group. See Attachment A.

Q. Is Staff aware of any other recent transactions?

A. Yes. On May 29, 2013, Berkshire Hathaway announced its plans to acquire NV Energy for $23.75 per share, approximately 23.2 percent more than the closing price of $19.28 on the previous day.

Q. Has Staff reviewed the valuation of the proposed acquisition by Fortis?

A. Yes. Information regarding the proposed reorganization became publicly available on or about December 12, 2013. A review of publicly available closing prices for UNS Energy on the New York Stock Exchange indicates a closing price of $45.84 per share on December 11, 2013 and $58.51 on December 12, 2013. After some small additional increases, the subsequent price of the stock has hovered around $60 per share.

UNS Energy has approximately 41.7 million shares of stock outstanding, which when multiplied by the stated purchase price of $60.25 approximates the $2.5 billion to be paid for the presently issued and outstanding share of UNS stock.

Q. What is the estimated premium on the price of the stock?

A. Based on a review of the last known price of the stock prior to the announcement of the reorganization, Staff estimates the premium to be approximately $600 million, or 31.4 percent of the previous market value of the stock, based on a comparison of the collective value of the outstanding shares at $60.25 per share, or approximately $2.5 billion, as compared with the valuation at $45.84 per share, or approximately $1.9 billion.

Number of Shares			Estimated Premium
Outstanding:	41,700,000	41,700,000	
Price	$60.25	$45.84	
Estimated Value	$2,512,425,000	$1,911,528,000	$600,897,000, or 31.4%

Q. Please explain the reasons that a valuation of the estimated premium is important.

A. Staff presents this information to quantify the benefits that will accrue directly to the existing shareholders of the UNS Energy as a result of the proposed transaction. The value of this benchmark serves as a point of reference to value the benefits that should be shared with the ratepayers as a result of this transaction.

Q. Please describe the benefits expected for the ratepayers, per the application.

A. The application states that the ratepayers will benefit by UNS Energy being owned by a larger company with better access to capital. UNS Energy states that this *should* reduce future borrowing costs. However, this is not guaranteed in any way by Fortis or UNS Energy.

Q. Does Staff believe that the application presents tangible and guaranteed benefits to the ratepayers?

A. No. The claim of reduced borrowing that should happen in the future is tenuous and not guaranteed or quantified. Furthermore, there are no known operational or financial challenges facing UNS Energy to be solved by the acquisition.

Q. What is Staff's recommendation?

A. Given the magnitude of the premium being paid the existing shareholders of $600 million and the lack of any other known benefits, Staff recommends that UNS Energy be required to establish a regulatory liability in the amount of $60 million for the benefit of the ratepayers in future proceedings. This would be intended to represent a 90 percent / 10 percent sharing of the benefits to be derived from the proposed transaction between the shareholders and the ratepayers, respectively.

The recommended benefit of $60 million is only 20 percent higher than the estimated ratepayer benefits associated with the acquisition of the Central Hudson Group. The asset value of UNS Energy is almost 2.4 times the asset value of the Central Hudson Group.

Staff further notes that the premium proposed in the UNS acquisition is 31.4 percent which compares with the 23.2 percent recently paid by Berkshire Hathaway for NV Energy. Fortis' willingness to pay a premium of this level further emphasizes the value accruing to the shareholders by the proposed transaction and supports the appropriateness of sharing those benefits with the ratepayers.

RING FENCING

Q. Please describe the specific ring-fencing measures and their necessity.

A. Ring fencing is defined as the legal walling off of a certain assets or liabilities within a corporation, as in a company forming a new subsidiary to protect (ring-fence) specific assets from creditors.[6] Ring fencing as a concept includes a number of measures that may be implemented to protect the economic viability of utility companies and their affiliates within a holding company structure. Ring-fencing measures are intended to insulate a regulated utility from the potentially riskier activities of an unregulated affiliate.[7] Insulating the utility is intended to ensure the financial stability of the utility and the reliability of its service.[8]

Viability concerns can arise when vertically integrated generation-transmission-distribution companies change their corporate structure to conform to new market structures and regulatory requirements. Consequently, customers may be placed at risk in terms of continued reliable and reasonably price ("just and reasonable") electric or gas service.[9]

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[6] *Ring Fencing Mechanisms for Insulating a Utility in a Holding Company System,* prepared on behalf of the NARUC Staff Subcommittee on Accounting and Finance by Timothy Devlin, Florida Public Service Commission; Rebecca Phillips, Kentucky Public Service Commission; and Thomas Ferris, Wisconsin Public Service Commission; with the assistance of Chancy Bittner of the Iowa Utilities Board, David Hodgden and Joseph Buckley of the Ohio Public Utilities Commission, Charles Christiansen of the California Public Utilities Commission, and Terri Carlock of Idaho Public Utilities Commission. Available at: http:// regulationbodyofknowledge.org/wp-content/uploads/2013/03/Devlin_Ring_Fencing_Mechanisms.pdf

[7] Id.

[8] Id.

[9] Id.

Q. Does Staff believe that ring-fencing measures are appropriate in this case?

A. Yes. Fortis operates using a holding company structure and invests in regulated and unregulated enterprises. Accordingly, the ratepayers served by the regulated entities should be protected against any undue risk posed by Fortis' unregulated enterprises.

Q. Please identify and explain those recommendations that Staff would categorize as supporting ring-fencing.

A. Ring-fencing measures include maintaining a separate capital structure, capital structure requirements, establishing a 'golden share' held by an independent director whose consent would be required to file for or be included in any voluntary bankruptcy proceeding, the establishment and maintenance of a separate Board of Directors for UNS Energy (the majority of whom shall reside in Arizona), monitoring and limiting the payment of dividends by UNS Energy, prohibitions on debt guaranteed by UNS Energy on behalf of Fortis or any of Fortis' affiliates and that Fortis takes full notice of statutes and Commission rules including but not limited to the issuance of debt and equity and the disposition of any utility assets.

Separate capital structure –A separate capital structure helps to ensure the separateness of the utility from the parent and the effects of the parent's other regulated and unregulated businesses. This helps to establish its own Board of Directors separate from the Board of Directors for the parent company and enables the utility the ability to manage its own affairs.

Capital Structure Restrictions – The application predicts post acquisition equity percentages of 44.1 percent, 45.0 percent, and 49.5 percent for UNS Energy (consolidated), Tucson Electric Power, and UNS Electric capital structures, respectively. Staff recommends that UNS Energy be required to maintain a capital structure for itself and its regulated subsidiaries that has no less equity than is predicted to exist at closing. UNS Energy would be required to docket a report defining its actual capital structure for itself and its subsidiaries within 60 days after the close of the transaction.

The establishment of a 'golden share' held by an independent director – The 'golden share' would serve to appoint an independent director with the fiduciary authority and sole authority under the charter, articles of incorporation, by-laws, or other governing documents of the utility to engage the utility in a voluntary filing for bankruptcy, in his or her sole discretion.

Separate Board of Directors – To ensure local control and to enhance local interest, Staff recommends that UNS Energy have a separate Board of Directors, the majority of whom shall reside in Arizona. The application proposes that Fortis shall within one year of closing, appoint a Board of Directors for UNS Energy, the majority whom shall be independent with the majority of the independent directors shall reside in Arizona.[10] Since the proposed majority of a majority may not be able to exert control over Board's decisions, Staff recommends that the Board of Directors consist of an overall majority residing in the state of Arizona.

Limitations on payments of dividends – To ensure that the regulated entities remain solvent and able to fund any capital needs appropriately from internally generated funds, Staff recommends that UNS Energy and its regulated entities shall each obtain Commission approval before distributing any monies from the regulated entities to UNS Energy or Fortis above a specified amount. Staff has not yet determined the appropriate amount. Staff will supplement its pre-filed testimony to provide a specified amount for each entity. This shall apply for a period of 5 years after closing.

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[10] Company application, testimony of Barry V. Perry, exhibit BVP-7 at 21.

Guarantees of debt – UNS Energy shall not lend to, guarantee or financially support Fortis or any of its other regulated or unregulated affiliates, or any subsidiary or joint venture of any affiliate, without the approval of the Commission.

Issuances of debt and equity and sale or transfer of assets – Fortis takes full notice of Arizona Revised Statutes and Commission rules, regulations and policies including but not limited to the issuance of debt and equity and the sale of utility assets, without Commission approval. Staff further recommends that there shall be no sale or transfer of ownership of UNS Energy or any of its components for at least 5 years after the closing. Fortis acknowledges that Commission approval must be obtained in advance for any sale or transfer of ownership after 5 years.

EQUITY

Q. Please describe the planned equity infusion to occur as a result of the reorganization.

A. The application indicates that Fortis will infuse $200 million in equity to cover certain planned expenditures. The total major planned expenditures of $357 million include $219 million for the purchase of Gila River Block 3 in December 2014, $65 million for the purchase of Springerville Unit 1 in January 2015, and $73 million for Springerville coal handling facilities in April 2015. The $200 million equity infusion would be combined with $157 million of debt to fund the $357 million of expenditures, and according to the application, the pre-acquisition and post- acquisition equity percentages would be 42.6 percent and 44.1 percent, respectively[11].

[11] Per the Company's calculations which do not consider obligations under capital leases as part of the overall indebtedness and results in the Company's equity percentage being higher.

Q. Does Staff have any comments regarding the equity infusion and capital structures?

A. Yes. Staff is concerned that the proposed equity percentages are not calculated in a manner that is consistent with the method used in a recent TEP financing application.[12] In Staff's analysis in Docket No. E-01933A-12-0176, Staff includes amounts owed under capital lease obligations as part of the overall equity structure and the Applicants did not.

Q. Does Staff have recommendations regarding the amount of equity to be infused?

A. Yes. Staff recommends that Fortis be required to infuse the full amount that would be needed to include $219 million for the purchase of Gila River Block 3, $65 million for the purchase of Springerville Unit 1, and $73 million for Springerville coal handling facilities. Staff further recommends that the resulting equity percentages be recalculated in a manner that is consistent with the analysis set forth in the Staff report in Docket No. E-01933A-12-0176. Staff will file supplemental testimony to provide the recalculated equity percentages.

Using the Company's methodology, this would increase the post-acquisition equity percentage from 44.1 percent, per the application, to 49.3 percent.

Q. Based on the above, is Staff recommending that the Commission order the regulated entities and/or Fortis to make these purchases?

A. No, that would be a management decision. The Commission will determine the prudency of such purchases, if they are completed, in future rate proceedings.

[12] See Docket No. E-01933A-12-0176. Staff report at 6, docketed November 2, 2012.

CODE OF CONDUCT

Q. Does Staff have any comments regarding a Code of Conduct policy?

A. Yes. Staff recommends that Fortis and UNS Energy file for Commission approval within 30 days after the close of the proposed transaction their proposed procedures for valuing and allocating intercompany transactions related to the transfer of assets and to the provision of goods and services to and between affiliates. The proposed procedures could involve making appropriate updates to Tucson Electric Power Company's existing Commission approved Code of Conduct.

QUALITY OF SERVICE

Q. Does Staff have any comments regarding Quality of Service?

A. Yes. UNS Energy's regulated entities shall maintain their quality of service based upon the following criteria until otherwise directed by the Commission: Tucson Electric Power and UNS Electric shall maintain a rolling three year average SAIDI, SAIFI, and CAIDI at a maximum of the three year averages for each of those measures for the period 2011 through 2013 as reported to the Commission in Docket Nos. E-00000A-11-01113 and E-00000V-13-0070. UNS Gas shall maintain a rolling three year average number of customer complaints with the Commission's Consumer Services group at a maximum of the three year average of number of complaints for the period 2011 through 2013.

Q. Does this conclude your direct testimony?

A. Yes, it does.

The Fortis Family of Regulated Utilities

	Customers	Total Assets
Fortis BC	1,100,000	$7.4B
UNS Energy*	654,000	$4.3B
Fortis Alberta	508,000	$3.0B
Central Hudson	375,000	$1.8B
Newfoundland Power	251,000	$1.4B
Maritime Electric	76,000	$0.5B
Fortis Ontario	64,000	$0.3B
Caribbean Utilities	27,000	$0.5B
Fortis Turks and Caicos	12,000	$0.3B

*Prospective