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BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

COMMISSIONERS

**BOB STUMP - CHAIRMAN
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH**

2014 JUL -9 P 2:24

AT CORP COMMISSION
DOCKET CONTROL

**IN THE MATTER OF THE
REORGANIZATION OF UNS ENERGY
CORPORATION**

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

ORIGINAL

**POST-HEARING BRIEF
OF
UNS ENERGY CORPORATION AND FORTIS INC.**

July 9, 2014

Arizona Corporation Commission
DOCKETED

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DOCKETED BY 

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1 UNS Energy Corporation¹ (“UNS Energy”) and Fortis Inc.² (“Fortis”) (together “Joint
2 Applicants”) submit their Post-Hearing Brief in support of the merger transaction set forth in the
3 Joint Notice of Intent to Reorganize dated January 10, 2014 (“Joint Notice”)³ and the Settlement
4 Agreement dated May 16, 2014 (“Settlement Agreement”) (the “Merger Transaction”).⁴

5 **I. INTRODUCTION.**

6 The record in this case clearly establishes that the Merger Transaction between
7 Fortis and UNS Energy, including the 66 conditions set forth in the Settlement Agreement, is in
8 the public interest, will not impair the financial status of TEP, UNS Electric or UNS Gas (together
9 “Regulated Utilities”) or their ability to provide safe, reliable and adequate service and, therefore,
10 should be approved by the Arizona Corporation Commission (“Commission”). Fortis is a
11 financially strong, long-term investor in regulated utilities in North America. Following the
12 Merger Transaction, UNS Energy and the Regulated Utilities will continue to be operated by
13 existing local management; and, as a result of the merger, UNS Energy and the Regulated Utilities
14 will have improved access to financial and other resources necessary to address the significant
15 challenges facing energy utilities today.

16 The Settlement Agreement represents a resolution of the issues raised in this docket and is
17 supported by a diverse range of interests, including Joint Applicants, Commission Utilities
18 Division Staff (“Staff”), the Residential Utility Consumer Office (“RUCO”), labor unions, low
19 income customer advocates, home builders, solar installers and representatives of large industrial
20 and mining customers. The Settlement Agreement resulted from an open, transparent and fair
21 process. No party to the docket filed any opposition to the Settlement Agreement.

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25 ¹ On behalf of itself and its affiliates UniSource Energy Services, Inc., Tucson Electric Power Company
26 (“TEP”), UNS Electric, Inc. (“UNS Electric”) and UNS Gas, Inc. (“UNS Gas”).

27 ² On behalf of itself and its affiliates FortisUS Holdings Nova Scotia Limited, FortisUS Inc. (“FortisUS”) and Color Acquisition Sub Inc.

³ Hearing Exhibit (“Ex.”) JA-1.

⁴ Ex. JA-5.

1 The Merger Transaction and Settlement Agreement provide real and significant benefits to
2 the Regulated Utilities' customers and employees and the communities they serve. The more
3 significant benefits include:

- 4 • The Regulated Utilities will become part of a larger, financially stronger corporate
5 family;
- 6 • The Regulated Utilities will have improved, ready access to capital on more
7 favorable terms, which should translate to lower debt costs and lower customer
8 rates in the future;
- 9 • Fortis will inject \$220 million of new equity into the Regulated Utilities shortly
10 after the close of the Merger Transaction;
- 11 • The Regulated Utilities and Fortis will provide direct, tangible benefits to their
12 customers in the form of \$30 million of bill credits over the next five years,
13 commencing October 1, 2014; and
- 14 • Numerous conditions of approval in the Settlement Agreement provide for
15 enhanced Commission oversight and also provide that the Regulated Utilities and
16 their customers will be protected from unforeseen adverse impacts associated with
17 the merger.

18 The Merger Transaction enhances the Regulated Utilities' ability to address emerging
19 energy industry challenges while at the same time improving their access to capital and helping
20 them to maintain safe, reliable service for customers across Arizona. Accordingly, the Merger
21 Transaction is in the public interest and the Commission should approve the Merger Transaction
22 consistent with the terms and conditions of the related Settlement Agreement.

23 **II. OVERVIEW OF THE MERGER TRANSACTION.**

24 **A. Challenges Facing UNS Energy.**

25 UNS Energy and the Regulated Utilities have worked hard to provide safe and reliable
26 electric and gas service to more than 650,000 customers in Arizona.⁵ The Regulated Utilities have

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⁵ Ex. JA-1 (Joint Notice) at 2.

1 successfully managed their costs and operations even though sales levels have remained relatively
2 flat over the past seven years.⁶ During this time, the Regulated Utilities have gradually improved
3 their credit ratings while charging just and reasonable rates.⁷

4 However, the electric utility landscape continues to change rapidly, and those changes
5 create numerous challenges for relatively small local utilities. In the near future, UNS Energy and
6 the Regulated Utilities must address significant issues including: (i) sales growth that is lower
7 than historical levels, including periods where sales are expected to be relatively flat, as
8 consumption is reduced by improvements in energy efficiency and increased distributed
9 generation; (ii) the need to balance generation portfolios by replacing coal resources with natural
10 gas, renewables and energy efficiency; (iii) impacts of existing and anticipated environmental
11 regulations addressing, among other things, regional haze, carbon dioxide emissions and coal ash;
12 (iv) innovations in the nature of delivery and usage of electricity service; (v) integration of
13 distributed generation and other technology resources into the utility grid; (vi) increased cyber-
14 security and physical security requirements; and (vii) investing to enhance and expand the
15 transmission and distribution system in order to reduce reliance on carbon-intensive generation
16 and deliver increased renewable energy to customers.⁸ These challenges are in addition to the
17 ongoing intensive capital needs to maintain and upgrade the Regulated Utilities' infrastructure to
18 maintain safe and reliable service.⁹

19 Addressing these challenges will require, among other things, access to significant capital.
20 The Regulated Utilities have budgeted significant capital investments over the next five years to
21 meet their infrastructure needs. The capital investment budget for UNS Energy on a consolidated
22 basis for the period 2014-2018 exceeds \$2.0 billion.¹⁰ Many of these capital needs will persist
23 regardless of load growth in the Regulated Utilities' service areas.¹¹ The capital requirements of

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⁶ Ex. JA-6 (Bonavia Direct) at 3.

25 ⁷ Ex. JA-1 (Joint Notice) at 2.

26 ⁸ Ex. JA-1 (Joint Notice) at 3; Ex. JA-6 (Bonavia Direct) at 3-5; Hearing Transcript ("Tr.")(Hutchens) at 261-64.

27 ⁹ Ex. JA-1 (Joint Notice) at 3; Tr. (Hutchens) at 264.

¹⁰ Ex. JA-13 (Hutchens Settlement) at 3-4.

¹¹ Ex. JA-1 (Joint Notice) at 4.

1 the Regulated Utilities are not unique, and are expected to be further affected by additional factors
2 such as the potential for increased customer growth in their service areas (more consistent with
3 historical levels) and TEP's ownership of significant coal generation assets.¹²

4 In response to the changing landscape, the energy utility industry is consolidating. In the
5 mid-1990s, there were approximately 100 separate shareholder-owned electric utilities in the
6 United States.¹³ Now there are fewer than 50, and new mergers continue to be announced on a
7 regular basis.¹⁴ As a result of this trend, UNS Energy and the Regulated Utilities must compete
8 for capital with utilities having much larger balance sheets and a wider geographic reach.¹⁵ While
9 the Regulated Utilities have recently achieved investment grade credit ratings – and those ratings
10 now approach the industry average – the Regulated Utilities will face continuing challenges due in
11 part to the limited size and scope of their operations absent the Merger Transaction.¹⁶

12 **B. The Merger Transaction.**

13 The Merger Transaction will result in UNS Energy becoming an indirect wholly-owned
14 subsidiary of Fortis.¹⁷ Pursuant to the Agreement and Plan of Merger (“Merger Agreement”), an
15 acquisition subsidiary of Fortis will merge with UNS Energy. UNS Energy will be the surviving
16 entity, becoming a wholly-owned subsidiary of FortisUS, with Fortis as UNS Energy's ultimate
17 parent.¹⁸ In effect, UNS Energy's existing shareholders will be replaced by Fortis.

18 The common shares of Fortis are traded on the Toronto Stock Exchange under the ticker
19 symbol “FTS” and are widely held with the majority (approximately 60-70%) being held by a
20 diverse group of retail shareholders.¹⁹ No single shareholder owns, controls or directs more than
21 10% of Fortis' issued and outstanding common shares.²⁰

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¹² Ex. JA-1 (Joint Notice) at 4.

24 ¹³ See Ex. JA-11 (Reed Direct) at 3, 5.

25 ¹⁴ See Ex. JA-11 (Reed Direct) at 3, 5.

26 ¹⁵ Ex. JA-1 (Joint Notice) at 4; see Ex. JA-11 (Reed Direct) at 5-9.

27 ¹⁶ Ex. JA-1 (Joint Notice) at 4; see Ex. JA-6 (Bonavia Direct) at 5-6.

¹⁷ Ex. JA-1 (Joint Notice) at 1-2, 13.

¹⁸ Ex. JA-1 (Joint Notice) at 1-2, 13.

¹⁹ Ex. JA-12 (Perry Settlement) at 5.

²⁰ Ex. JA-12 (Perry Settlement) at 5; Tr. (Perry) at 104-05.

1 Upon the close of the Merger Transaction, direct ownership of the Regulated Utilities will
2 remain at UNS Energy and thus, will not be changed by the merger.²¹ As part of the Fortis group
3 of regulated utilities, UNS Energy and the Regulated Utilities will continue to be operated,
4 managed and governed locally and will maintain their headquarters in Tucson.²² Fortis
5 expects that UNS Energy's current management will continue in their roles after the acquisition.
6 Within one year after the Merger Transaction is finalized, Fortis will appoint a UNS Energy Board
7 of Directors with oversight over UNS Energy and the Regulated Utilities; a majority of board
8 members shall be independent, and a majority shall be residents of Arizona.²³ All decisions
9 pertaining to the operations of UNS Energy and the Regulated Utilities will continue to be
10 made by the local management team and the independent UNS Energy Board of Directors.²⁴
11 These decisions will include, but will not be limited to: capital and operating plans;
12 establishment of dividend policy (consistent with the Settlement Agreement); determination of
13 financing requirements; employment levels, union negotiations and relationships, and hiring
14 practices; the design and delivery of low-income customer assistance, energy efficiency and
15 renewable energy programs; and community involvement.²⁵ Local management also will
16 continue to represent the Regulated Utilities in all future regulatory matters before the
17 Commission.²⁶

18 As a result of the merger, UNS Energy and the Regulated Utilities will enjoy improved
19 access to capital on more favorable terms.²⁷ Also, as part of a federation of well-run North
20 American electric and gas utilities, UNS Energy will be able to draw upon expanded
21 technical, operational, financial and regulatory expertise while remaining a strong, locally-

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23 ²¹ Ex. JA-1 (Joint Notice) at 2.

24 ²² Ex. JA-12 (Perry Settlement) at 8; Tr. (Perry) at 108.

25 ²³ Ex. JA-12 (Perry Settlement) at 8. As part of the transition to a new board of directors, and as referred
26 to in Sections 1.1(c) and 5.14(c) of the Merger Agreement, four (4) UNS Energy board members as of the
27 date of closing will remain members of the UNS Energy Board of Directors following the close. Ex. JA-12
(Perry Settlement) at 8.

²⁴ Ex. JA-12 (Perry Settlement) at 8; Tr. (Perry) at 101.

²⁵ Ex. JA-12 (Perry Settlement) at 8.

²⁶ Ex. JA-12 (Perry Settlement) at 8.

²⁷ Ex. JA-12 (Perry Settlement) at 8.

1 based utility.²⁸ While this is not a synergy driven transaction, cost savings from realized
2 synergies that result from the acquisition and that are directly attributable to the Regulated Utilities
3 – including but not limited to, anticipated reduced or eliminated public company costs and reduced
4 insurance costs – will be passed through to customers in future rate cases.²⁹

5 The Merger Transaction offers UNS Energy and the Regulated Utilities an opportunity to
6 maintain their service quality, community support and other benefits created through continued
7 local control of their ongoing utility operations while gaining new financial strength to address
8 their future challenges.

9 **C. Fortis is Well-Qualified to be the Holding Company of the Regulated Utilities.**

10 Fortis is an established utility holding company that provides regulated electricity and gas
11 services to approximately 2.5 million customers in New York State, five Canadian provinces and
12 two Caribbean countries.³⁰ The regulated utilities of Fortis account for approximately 90% of its
13 total assets.³¹

14 The financial position of Fortis is strong and stable. Fortis is the largest investor-owned
15 electric and gas distribution utility in Canada with total assets of approximately C\$18.6 billion as
16 of March 31, 2014, and fiscal 2013 revenues exceeding C\$4.0 billion.³² The common shares of
17 Fortis have a current market capitalization of approximately C\$7.0 billion.³³ The current
18 enterprise value of Fortis, which includes common and preferred equity and debt, is in excess of
19 C\$16 billion.³⁴ Fortis has excellent access to capital markets and has raised substantial capital to
20 fund the equity needs of its regulated utilities.³⁵ Since the beginning of 2013, Fortis has raised
21 approximately \$3.3 billion in the capital markets.³⁶

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²⁸ Ex. JA-12 (Perry Settlement) at 8.

24 ²⁹ Ex. JA-12 (Perry Settlement) at 8-9.

25 ³⁰ Ex. JA-12 (Perry Settlement) at 2.

26 ³¹ Ex. JA-12 (Perry Settlement) at 2.

27 ³² Ex. JA-12 (Perry Settlement) at 4. C\$ signifies Canadian dollars.

28 ³³ Ex. JA-12 (Perry Settlement) at 4.

29 ³⁴ Ex. JA-12 (Perry Settlement) at 5.

30 ³⁵ Tr. (Perry) at 105-06.

31 ³⁶ Ex. JA-12 (Perry Settlement) at 4.

1 As a publicly traded company in Canada, Fortis is subject to financial reporting and
2 continuous disclosure requirements which have been established by the Canadian Securities
3 Administrators (“CSA”), and which are substantially similar to those of the Securities and
4 Exchange Commission in the United States (“SEC”).³⁷ These similar disclosure requirements
5 effectively require that Fortis adhere to a standard with respect to public reporting and
6 transparency that is consistent with the SEC standard.³⁸ The SEC and CSA have adopted a
7 Multijurisdictional Disclosure System which permits eligible Canadian and U.S. issuers to raise
8 capital in cross-border public financings, conduct various cross-border M&A transactions and
9 make continuous disclosure filings while complying primarily with their home country securities
10 regulations, including disclosure and procedural rules.³⁹

11 Fortis has one of the highest credit ratings among utility holding companies in North
12 America.⁴⁰ This is evidence of its strong financial standing and stable risk profile. Fortis has an
13 A- credit rating by Standard & Poor’s (“S&P”) and an A(low) rating by Dominion Bond Rating
14 Service (“DBRS”).⁴¹ The ratings categories and methodologies of S&P, DBRS, Moody’s Investor
15 Services (“Moody’s”) and Fitch Ratings (“Fitch”) are substantially similar.⁴² The Fortis ratings
16 are at least two notches above the credit ratings of UNS Energy and TEP.⁴³

17 Fortis’ acquisition of UNS Energy reflects Fortis’ longstanding business philosophy of
18 investing in well-run North American regulated utilities. The long-term business objective of
19 Fortis is to manage and grow its investment in regulated electric and gas utilities and to provide a
20 framework for the provision of safe, reliable electricity and gas service to customers within the
21 service territories of its regulated utility subsidiaries.⁴⁴ Indeed, Fortis has never sold a utility that
22 it has purchased.⁴⁵

23 ³⁷ Ex. JA-12 (Perry Settlement) at 5.

24 ³⁸ Ex. JA-12 (Perry Settlement) at 5.

25 ³⁹ Ex. JA-12 (Perry Settlement) at 5.

26 ⁴⁰ Ex. JA-12 (Perry Settlement) at 5; Tr. (Perry) at 105.

27 ⁴¹ Ex. JA-12 (Perry Settlement) at 5; Tr. (Perry) at 105.

⁴² Ex. JA-12 (Perry Settlement) at 5.

⁴³ Tr. (Perry) at 106; Tr. (Hutchens) at 265.

⁴⁴ Ex. JA-12 (Perry Settlement) at 2.

⁴⁵ Tr. (Perry) at 113.

1 Fortis also believes that the effective management of regulated energy distribution systems
2 requires local management and decision making.⁴⁶ The regulated utilities of Fortis are governed,
3 managed, operated and financed on a standalone basis.⁴⁷ The operating philosophy of Fortis and
4 its regulated utilities is to maintain strong relationships with their regulators and communities, to
5 provide a high level of customer service and to maintain a strong financial position.⁴⁸ The local
6 management and board of directors of each of Fortis' utility subsidiaries are responsible for
7 executing this operating philosophy.⁴⁹

8 Each of the principal regulated utilities of Fortis has its own board of directors. In the cases
9 of FortisBC Energy, FortisBC Electric, FortisAlberta, Maritime Electric, Newfoundland Power,
10 Central Hudson Gas & Electric and Caribbean Utilities, the majority of the directors are
11 independent and most reside in the jurisdiction served by the utility.⁵⁰

12 Each of Fortis' regulated utilities also has its own senior management team that lives in the
13 area served by the utility and stands accountable to that utility's own board of directors.⁵¹ Those
14 senior management teams also serve as the direct contacts and decision-making authorities in all
15 regulatory matters.⁵² Each of Fortis' regulated utilities has the physical, financial and human
16 resources required to discharge its obligation to provide safe, reliable service.⁵³ There is no shared
17 services company within the Fortis group.⁵⁴ However, Fortis utilities are encouraged to share best
18 operating practices through collaboration with other utilities within the group where
19 practical.⁵⁵ In this regard, the board of directors of each Fortis-owned utility typically
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22 ⁴⁶ Ex. JA-12 (Perry Settlement) at 3; Tr. (Perry) at 101-02.

23 ⁴⁷ Ex. JA-12 (Perry Settlement) at 3.

24 ⁴⁸ Ex. JA-12 (Perry Settlement) at 3.

25 ⁴⁹ Ex. JA-12 (Perry Settlement) at 3.

26 ⁵⁰ Ex. JA-12 (Perry Settlement) at 3. The small regulated utilities owned by Fortis in Ontario and in the
27 Turks and Caicos Islands do not have independent boards. Ex. JA-12 (Perry Settlement) at 3.

⁵¹ Ex. JA-12 (Perry Settlement) at 3.

⁵² Ex. JA-12 (Perry Settlement) at 3.

⁵³ Ex. JA-12 (Perry Settlement) at 3.

⁵⁴ Ex. JA-12 (Perry Settlement) at 3.

⁵⁵ Ex. JA-12 (Perry Settlement) at 3.

1 includes at least one CEO from an affiliated regulated utility, which helps in the sharing of
2 best practices.⁵⁶

3 Fortis is respectful of regulatory oversight and believes that responsiveness to, and
4 cooperation with, regulators is critical to successful utility operations and the overall success of
5 the enterprise.⁵⁷ Fortis has met every commitment it has made to a regulatory body in the course
6 of seeking, and subsequent to obtaining, approval to acquire a public utility.⁵⁸ It is a key
7 expectation of Fortis that local management deal respectfully and responsively with local
8 regulators.⁵⁹ This expectation is a cornerstone of the Fortis standalone operating philosophy.

9 Fortis also believes that public utilities should be key contributors to the economic
10 development and well-being of the communities they serve.⁶⁰ Fortis companies annually
11 contribute considerable hours and millions of dollars in sponsorships and in-kind donations to
12 local charitable causes.⁶¹ Employee volunteer efforts are also encouraged, supported and
13 recognized.⁶²

14 Staff has confirmed that Fortis is well qualified to own regulated utilities.⁶³ RUCO also
15 believes that Fortis is well qualified to own the Regulated Utilities, noting particularly the Fortis
16 management approach and track record of ownership.⁶⁴

17 **III. THE SETTLEMENT AGREEMENT.**

18 On May 16, 2014, Joint Applicants, Staff, RUCO and eight other intervenors docketed the
19 Settlement Agreement, which addressed the issues raised in this docket and recommends approval
20 of the Merger Transaction subject to the terms of the Settlement Agreement.

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⁵⁶ Ex. JA-12 (Perry Settlement) at 3-4.

24 ⁵⁷ Ex. JA-12 (Perry Settlement) at 4.

25 ⁵⁸ Ex. JA-12 (Perry Settlement) at 4; Tr. (Perry) at 103.

26 ⁵⁹ Ex. JA-12 (Perry Settlement) at 4.

27 ⁶⁰ Ex. JA-12 (Perry Settlement) at 4; Tr. (Perry) at 103-04.

⁶¹ Ex. JA-12 (Perry Settlement) at 4.

⁶² Ex. JA-12 (Perry Settlement) at 4.

⁶³ Tr. (Olea) at 205-06.

⁶⁴ Tr. (Quinn) at 354-55.

1 **A. The Settlement Process was Open, Transparent and Fair.**

2 The testimony and exhibits in the record of this proceeding establish that the settlement
3 negotiations were open and transparent, providing all interested parties an opportunity to
4 participate and to be heard on the terms and conditions of the Settlement Agreement. This process
5 has greatly contributed to ensuring that the final Settlement Agreement is balanced, fair, just and
6 reasonable, and in the public interest.⁶⁵

7 The testimony in this docket also confirms that the negotiation process was fair, open and
8 transparent.⁶⁶ In addition to the Joint Applicants, Staff and RUCO, there were 16 intervenors
9 (eight of whom ultimately became signatories to the Settlement Agreement (“Signatories”))
10 representing a broad range of interests in various aspects of the Merger Transaction. The
11 settlement negotiations were open to all parties; parties that could not attend in person were able to
12 participate telephonically and were given access to all of the documents discussed at the
13 meetings.⁶⁷

14 Moreover, even though representatives of the City of Nogales advised that they were
15 unable to participate in the May 5, 2014 settlement meeting, UNS Energy arranged to meet with
16 them twice – once in Tucson and once in Nogales – to discuss the issues they had raised in the
17 City’s Direct Testimony.⁶⁸

18 The open and transparent nature of the negotiation process provided a forum where parties
19 were able to raise, discuss and resolve a broad range of issues.⁶⁹ The Settlement Agreement is the
20 end result of a fair process that fostered a full resolution of the relevant issues by Signatories with
21 disparate constituencies and interests.⁷⁰ Although not all parties became signatories to the
22 Settlement Agreement, even those parties that did not sign the Settlement Agreement do not
23 oppose the Settlement Agreement or the Commission’s approval of the merger.

24

25 ⁶⁵ See, e.g., Ex. RUCO-1 (Quinn Settlement) at 3, 5; Ex. S-2 (Olea Settlement) at 7-8.
26 ⁶⁶ See, e.g., Ex. S-2 (Olea Settlement) at 4.
27 ⁶⁷ See, e.g., Ex. RUCO-1 (Quinn Settlement) at 2-3;
⁶⁸ See Tr. (Hutchens) at 311-12.
⁶⁹ See, e.g., IBEW-2 (Grijalva Settlement) at 1; Ex. S-2 (Olea Settlement) at 5.
⁷⁰ Ex. S-2 (Olea Settlement) at 5.

1 **B. Summary of the Settlement Agreement Terms.**

2 The Settlement Agreement has three main provisions. First, the Settlement Agreement sets
3 forth 66 conditions. Second, it addresses how approval of the Merger Transaction and the 66
4 conditions in the Settlement Agreement (“Settlement Conditions”) will impact the 1997 TEP
5 Holding Company Order. Third, the Signatories to the Settlement Agreement request
6 Commission approval of the Settlement Agreement no later than September 18, 2014, which will
7 allow the Merger Transaction to close by September 30, 2014.

8 **1. The 66 Conditions.**

9 Attachment A to the Settlement Agreement sets forth the Settlement Conditions.
10 Generally, the Settlement Conditions address: customer benefits and protections; credit quality
11 and capital requirements; quality of service; customer programs; corporate governance; financial
12 transparency and reporting requirements; acknowledgment of Arizona laws and procedures; and
13 other miscellaneous issues.

14 The 66 Settlement Conditions represent a combination of the conditions proposed by Staff,
15 RUCO and other intervenors in their Direct Testimonies as well as the 24 conditions that Joint
16 Applicants initially proposed in the Joint Notice (to the extent they were not addressed by
17 conditions proffered by other parties).⁷¹ Moreover, the Settlement Conditions include applicable
18 conditions from the 1997 TEP Holding Company Order.⁷²

19 The Settlement Conditions do not attempt to address issues that are generally considered to
20 be policy matters within the Commission’s purview.⁷³ They also do not seek to revisit issues the
21 Commission has addressed in the past or to address issues that are clearly outside the scope of this
22 docket.⁷⁴ However, the Settlement Conditions do address the vast majority of comments raised in
23 the Direct Testimony filed by the parties.⁷⁵

24 Finally, the Signatories agree that the Settlement Conditions represent a fair balancing of

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⁷¹ Ex. JA-13 (Hutchens Settlement) at 5, 8.

26 ⁷² See Tr. (Olea) at 229; Ex. JA-13 (Hutchens Settlement) at 8, 14-15.

27 ⁷³ Ex. JA-13 (Hutchens Settlement) at 8-9; see Tr. (Olea) at 210-11.

⁷⁴ Ex. JA-13 (Hutchens Settlement) at 8-9.

⁷⁵ Ex. JA-13 (Hutchens Settlement) at 8. See also Section III.C below at page 13.

1 interests. For example, Staff believes that the Settlement Agreement is fair, balanced and in the
2 public interest.⁷⁶ RUCO stated that “the [Settlement] Agreement satisfies the public interest by
3 providing a fair and balanced approach in supporting the acquisition of UNS [Energy] by
4 Fortis.”⁷⁷ IBEW testified that the terms and conditions of the Settlement Agreement “are just,
5 reasonable and in the public interest.”⁷⁸ Both the Southern Arizona Homebuilders Association
6 (“SAHBA”) and Noble Americas Energy Solutions (“Noble Solutions”) noted that the Settlement
7 Agreement, including the Settlement Conditions, “reflects the result of good faith and arms length
8 negotiations and balancing of interests among most of the parties to this proceeding.”⁷⁹

9 **2. Treatment of the 1997 TEP Holding Company Order.**

10 The 1997 TEP Holding Company Order approved the creation of UniSource Energy
11 Corporation (since renamed UNS Energy) as a holding company for TEP. It contains a variety of
12 conditions that were relevant 17 years ago given the circumstances that existed at that time. Since
13 then, significant changes at UNS Energy and across the utility industry have rendered certain
14 conditions meaningless, ineffective or inappropriate. The Commission has modified some of
15 those conditions in the past to reflect such changes.⁸⁰ There have been additional changes to
16 circumstances since 2009, and the acquisition will further affect the appropriateness and
17 applicability of other outdated or no longer relevant conditions.

18 As part of the settlement process, certain Signatories – and particularly Staff -- carefully
19 reviewed the 1997 TEP Holding Company Order conditions and agreed upon which conditions
20 should continue in force.⁸¹ Those conditions are included in the 66 Settlement Conditions.⁸²
21 Moreover, many of the 1997 conditions that were not expressly carried over have been effectively
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23 ⁷⁶ Ex. S-2 (Olea Settlement) at 7-8.

24 ⁷⁷ Ex. RUCO-1 (Quinn Settlement) at 6-7.

25 ⁷⁸ Ex. IBEW-2 (Grijalva Settlement) at 1.

26 ⁷⁹ Ex. SAHBA-2 (Godlewski Settlement) at 2; Ex. NS-2 (Bass Settlement) at 2.

27 ⁸⁰ See Decision No. 71256 (September 3, 2009); Decision No. 62103 (November 30, 1999). It should be noted that the 1997 TEP Holding Company Order pre-dates UNS Energy’s acquisition of UNS Electric and UNS Gas from Citizens.

⁸¹ See Tr. (Olea) at 229.

⁸² See Tr. (Olea) at 229; see also Ex. JA-17 (1997 Condition Matrix).

1 addressed in other Settlement Conditions that reflect current circumstances.⁸³

2 As a result of this process and the breadth of the 66 Settlement Conditions, Section 3 of the
3 Settlement Agreement provides that the conditions adopted in this docket shall supersede the
4 conditions of the 1997 TEP Holding Company Order and that such superseded conditions will be
5 vacated.

6 **3. Approval by September 18, 2014.**

7 In Section 1.9 of the Settlement Agreement, the Signatories request that the Commission
8 approve the Merger Transaction and Settlement Agreement no later than September 18, 2014.
9 This will allow the Merger Transaction to close by September 30, 2014, thereby providing
10 benefits as described in Section V below.

11 **C. Benefits of the Merger Transaction and Settlement Agreement.**

12 As set forth in Section 1.8 of the Settlement Agreement, the Signatories agree that
13 approval of the Merger Transaction, subject to the Settlement Agreement, balances the interests of
14 the public, UNS Energy, the Regulated Utilities and their customers and employees, and Fortis,
15 and provides substantial and material benefits.

16 As acknowledged in the Settlement Agreement, the Merger Transaction will create
17 substantial benefits by financially strengthening UNS Energy and the Regulated Utilities when
18 they become part of a larger, more diverse and financially secure company with a stronger credit
19 rating.⁸⁴ This will enhance the Regulated Utilities' ability to provide safe and reliable service,
20 improve their individual capital structures, and preserve or improve their credit ratings.⁸⁵
21 Moreover, the Regulated Utilities will gain improved access to capital markets, enhancing their
22 ability to obtain sufficient capital to meet their needs, including access to debt capital at lower
23 cost, as a result of the merger.⁸⁶

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25 _____
⁸³ See Ex. JA-17 (1997 Condition Matrix).

26 ⁸⁴ Ex. JA-5 (Settlement Agreement), Section 1.8; see also Tr. (Hutchens) at 265-66.

27 ⁸⁵ Ex. JA-5 (Settlement Agreement), Section 1.8; Ex. JA-13 (Hutchens Settlement) at 16; Tr. (Hutchens) at 266.

⁸⁶ Ex. JA-5 (Settlement Agreement), Section 1.8; Ex. JA-13 (Hutchens Settlement) at 3.

1 This improved financial strength is reflected in several ways. For example, Fortis will
2 inject \$220 million of new equity into the Regulated Utilities upon closing.⁸⁷ This equity will
3 assist TEP and UNS Electric with several immediate capital investment needs, including:

4 (i) TEP's and UNS Electric's \$219 million purchase of Gila River Unit 3, anticipated to close in
5 December 2014; (ii) TEP's \$65 million purchase of a 35% interest in Unit 1 of the Springerville
6 Generating Station ("SGS"), anticipated to close in December 2014 and January 2015; and (iii)
7 TEP's \$73 million purchase of SGS fuel handling facilities, anticipated to close in April 2015.⁸⁸

8 Further, it is anticipated that TEP will receive a credit rating upgrade shortly after the close
9 of the transaction.⁸⁹ S&P and Fitch Ratings Inc. indicated that TEP's ratings could be raised by
10 one notch if the acquisition is approved, while Moody's acknowledged the benefit of joining an
11 established utility company of Fortis' size and scope.⁹⁰

12 As set forth in Section 2.2 of the Settlement Agreement, the Signatories agree that "the
13 Merger Transaction is expected to improve the financial status of UNS Energy and the Regulated
14 Utilities, improve their access to capital at more favorable terms and enhance the ability of the
15 Regulated Utilities to continue providing safe, reasonable and adequate service to their
16 customers."

17 Moreover, the present management team at the Regulated Utilities will remain in place
18 after the Merger Transaction and operations will be business as usual.⁹¹ As noted by RUCO, this
19 continuity will mean the Merger Transaction should not even be noticed by customers of the
20 Regulated Utilities.⁹²

21 The 66 Settlement Conditions also provide substantial benefits and protections for
22 customers of the Regulated Utilities beyond the increased financial strength of the Regulated
23 Utilities and their enhanced ability to provide safe and reliable service, including:

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25 ⁸⁷ Ex. JA-13 (Hutchens Settlement) at 9.

26 ⁸⁸ Ex. JA-13 (Hutchens Settlement) at 3-4, 10-11.

27 ⁸⁹ Ex. JA-13 (Hutchens Settlement) at 4-5; Tr. (Hutchens) at 266.

⁹⁰ Ex. JA-13 (Hutchens Settlement) at 4-5.

⁹¹ See Ex. JA-12 (Perry Settlement) at 8; Tr. (Perry) at 108; Tr. (Hutchens) at 266.

⁹² Tr. (Quinn) at 358.

- 1 • customer credits of \$30 million over 5 years, including \$10 million of credits in the
- 2 first year, commencing October 1, 2014;
- 3 • protections against any adverse rate impact from costs associated with the Merger
- 4 Transaction;
- 5 • credit quality and capital structure provisions;
- 6 • support of existing levels of contributions to charitable and community programs;
- 7 • maintenance of existing low-income customer assistance programs;
- 8 • maintenance of existing employment and employee benefit levels for a period of at
- 9 least four years after the conclusion of the acquisition;
- 10 • maintenance of the existing local management of UNS Energy and the Regulated
- 11 Utilities and their control over operations;
- 12 • maintenance of the headquarters of UNS Energy and the Regulated Utilities in Tucson;
- 13 • requirements that the new UNS Energy Board of Directors have a majority of
- 14 independent board members and that a majority of board members will reside in
- 15 Arizona;
- 16 • financial transparency and reporting requirements; and
- 17 • corporate governance requirements to protect the Regulated Utilities from any potential
- 18 adverse impacts of the acquisition.⁹³

19 The diverse interests represented by the Signatories agree that the Settlement Conditions
20 provide substantial benefits and address the issues raised by those interests with respect to the
21 Merger Transaction. For example:

- 22 1. Staff sought to ensure that the Regulated Utilities' financial position was strengthened
- 23 and protected by the establishment of strong ring fencing and other financial provisions.
- 24 Settlement Conditions 16, 17, 18, 23, 24, 25, 36 and 45 provide such protections.⁹⁴

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27 ⁹³ Ex. JA-13 (Hutchens Settlement) at 5-6; see also Ex. S-2 (Olea Settlement) at 6-7; Ex. RUCO-1 (Quinn Settlement) at 5-6.

⁹⁴ See Ex. S-2 (Olea Settlement) at 6, lines 22-30.

1 2. Staff and RUCO sought direct tangible benefits for customers, among other things. The
2 \$30 million in bill credits in Settlement Condition 1 and the return of tax benefits from treated coal
3 in Settlement Condition 3 provide direct, tangible benefits.⁹⁵

4 3. IBEW raised issues about employment levels, future union relations and the Regulated
5 Utilities' ability to continue to provide safe and reliable service. Settlement Conditions 27, 30 and
6 41(ii) address those issues.⁹⁶

7 4. SAHBA raised issues about the future of line extension tariffs and the local
8 composition of the UNS Energy Board. Settlement Conditions 32 and 37 address those issues.⁹⁷

9 5. Noble Solutions suggested that TEP and UNS Electric propose a pilot program for a
10 "buy through" tariff in future rate cases. Settlement Condition 31 addresses that suggestion.⁹⁸

11 6. Arizona Community Action Association raised concerns about the impact on low
12 income customers. Settlement Condition 35 commits to continued support for low income
13 customer assistance programs at or above current levels, including the \$150,000 annual
14 contribution by TEP for low-income assistance programs.⁹⁹ Moreover, the structure of the
15 monthly bill credit in Settlement Condition 1 provides that low income customers will receive a
16 slightly higher percentage refund.¹⁰⁰

17 Although not a Signatory to the Settlement Agreement, the City of Nogales raised issues
18 about improving service quality in Santa Cruz County. Settlement Conditions 28 and 29 address
19 those issues nonetheless.¹⁰¹

20 Overall, the Settlement Agreement presents a fair and balanced resolution of the issues
21 raised in this proceeding. As set forth in Section 2.3 of the Settlement Agreement, "The
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24 ⁹⁵ See Ex. S-2 (Olea Settlement) at 8; Ex. RUCO-1 (Quinn Settlement) at 7-8.

25 ⁹⁶ Ex. IBEW-2 (Grijalva Settlement) at 3-4.

26 ⁹⁷ Ex. SAHBA-2 (Godlewski Settlement) at 3-4.

27 ⁹⁸ Ex. Noble-2 (Bass Settlement) at 3-4. Moreover, counsel for AECC and Freeport-McMoran indicated
that his clients were also interested in Settlement Condition 31. Tr. at 73.

⁹⁹ Tr. (Hutchens) at 340-41.

¹⁰⁰ Tr. (Hutchens) at 317-18.

¹⁰¹ See Tr. (Hutchens) at 336.

1 Signatories agree that approval of the Merger Transaction, subject to the [Settlement] Conditions,
2 is in the public interest.”

3 **IV. THE MERGER TRANSACTION AND SETTLEMENT AGREEMENT SHOULD**
4 **BE APPROVED.**

5 In deciding whether to approve a reorganization under A.A.C. R14-2-803, the Commission
6 considers two standards: (i) whether the reorganization will impair the utilities and (ii) whether
7 the reorganization is in the public interest. Under both standards, based on the evidence in the
8 record from the diverse interests represented in this docket, the Commission should approve the
9 Merger Transaction. Indeed, the Signatories expressly agree that approval of the Merger
10 Transaction, subject to the Settlement Conditions, is in the public interest and meets the Rule
11 803.C standard.¹⁰² No evidence or objection to the contrary has been suggested by any of the
12 parties.

13 **A. The Merger Transaction Meets the Standard in Rule 803.C.**

14 A.A.C. R14-2-803(C) states that “At the conclusion of any hearing on the organization or
15 reorganization of a utility holding company, the Commission may reject the proposal if it
16 determines that it would impair the financial status of the public utility, otherwise prevent it from
17 attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide
18 safe, reasonable and adequate service.” The acquisition of UNS Energy and the Regulated
19 Utilities by Fortis will not impair the financial status of any of the Regulated Utilities, nor will it
20 prevent them from attracting capital at fair and reasonable terms. To the contrary, affiliation with
21 the financial strength of Fortis will **improve** the financial status of the Regulated Utilities and their
22 access to debt and equity capital on more favorable terms.¹⁰³

23 The acquisition of UNS Energy and the Regulated Utilities by Fortis also will not impair
24 the ability of any of the Regulated Utilities to provide safe, reasonable and adequate service. The
25 Regulated Utilities will continue to provide safe, reliable service to customers under their existing

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27 ¹⁰² Ex. JA-5 (Settlement Agreement), Sections 2.2 and 2.3.

¹⁰³ Ex. JA-5 (Settlement Agreement), Section 2.2; Ex. JA-13 (Hutchens Settlement) at 16; Tr. (Hutchens) at 272-73.

1 local management team in accordance with the standalone operating philosophy of Fortis while
2 also having access to the best practices of Fortis' other well-run utilities. The increased access to
3 the capital markets will help the Regulated Utilities make the investments needed to maintain a
4 high quality of service to their customers. Moreover, Fortis, UNS Energy and the Regulated
5 Utilities have committed to continuing their steady efforts to maintain and improve the current
6 quality of utility service. Indeed, the Merger Transaction will enhance the Regulated Utilities'
7 ability to continue providing safe and reliable service to their customers.¹⁰⁴

8 **B. The Merger Transaction is in the Public Interest.**

9 The financial and operational benefits of the Merger Transaction, coupled with the
10 extensive commitments embodied in the Settlement Conditions, will provide tangible benefits to
11 the customers and employees of the Regulated Utilities and to the communities served by the
12 Regulated Utilities. Moreover, Fortis has established a solid track record through its ownership of
13 well-run, locally managed utilities and is well qualified to become the holding company of the
14 Regulated Utilities. Finally, the 66 Settlement Conditions contain substantial provisions to protect
15 the Regulated Utilities and their customers and employees against potential adverse effects of the
16 merger and to provide the Commission with additional means by which to exercise its post-merger
17 regulatory oversight.

18 The diverse Signatories to the Settlement Agreement also believe that the Merger
19 Transaction, including the 66 Settlement Conditions, is in the public interest.¹⁰⁵ For example,
20 Staff believes that the Settlement Agreement is fair, balanced and in the public interest because it
21 provides benefits for ratepayers and "balances the interests of the [Joint] Applicants and the
22 ratepayers, by ensuring that the Regulated Utilities have the tools and financial health to provide
23 safe, adequate and reliable service, while complying with Commission requirements of just and
24 reasonable rates and protecting the Regulated Utilities and the ratepayers from undue risk."¹⁰⁶

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26 ¹⁰⁴ Ex. JA-5 (Settlement Agreement), Section 2.2; Ex. JA-13 (Hutchens Settlement) at 16; Tr. (Hutchens) at
273.

¹⁰⁵ Ex. JA-5 (Settlement Agreement), Section 2.2.

¹⁰⁶ Ex. S-2 (Olea Settlement) at 7-8.

1 From RUCO's perspective, the Settlement Agreement provides benefits for customers while at the
2 same time mitigating the potential risks that RUCO had identified.¹⁰⁷ RUCO believes that
3 ratepayers will be better off as a result of the Fortis/UNS Energy merger.¹⁰⁸

4 Moreover, there is no opposition to the Settlement Agreement. No party filed any
5 opposition to the Settlement Agreement. Although the City of Nogales asserted concern as to the
6 inability of customers to make cash payments at the UNS Electric office in Nogales, the Vice-
7 Mayor of Nogales testified on the record that Fortis is a "very decent company," that the Merger
8 Transaction is "an excellent acquisition" that "would be good for the community" and that the
9 Merger Transaction overall "is good for the ratepayers" even if it does not result in UNS Electric
10 accepting cash payments in Nogales.¹⁰⁹

11 **V. THE MERGER TRANSACTION SHOULD BE APPROVED BY THE**
12 **COMMISSION AT A SEPTEMBER 2014 OPEN MEETING.**

13 In Section 1.9 of the Settlement Agreement, the Signatories request that the Commission
14 approve the Settlement Agreement no later than September 18, 2014. This will allow the Merger
15 Transaction to close by September 30, 2014.

16 Closing the Merger Transaction by September 30, 2014 would create several benefits.
17 First, the PPFAC credit provided by Settlement Condition 1 could go into effect on October 1,
18 2014, partially offsetting an increase in the TEP PPFAC scheduled to take effect on that day.¹¹⁰
19 Similarly, the PGA credit for UNS Gas customers can go into effect as bills begin to rise during
20 the winter home heating season.¹¹¹

21 Second, as a result of the acquisition, Fortis will infuse \$220 million of new equity into the
22 Regulated Utilities through UNS Energy. This equity infusion will reduce the amount and cost of
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24 ¹⁰⁷ Ex. RUCO-1 (Quinn Settlement) at 6.

25 ¹⁰⁸ Tr. (Quinn) at 352.

26 ¹⁰⁹ See Tr. (Hanessian) at 380, 382, 385. The issue regarding whether UNS Electric must accept cash
27 payments in Nogales is a good faith legal dispute over the interpretation of a franchise agreement that is
beyond the Commission's jurisdiction and is not relevant to the issues in this docket. See Tr. 152-53, 155,
385-86.

¹¹⁰ See Decision No. 74439 (April 18, 2014); Ex. JA-13 (Hutchens Settlement) at 15.

¹¹¹ Ex. JA-13 (Hutchens Settlement) at 15.

1 debt financing required for the purchase of Gila River Unit 3 and the SGS assets later this year and
2 early next year.¹¹² This infusion, coupled with an anticipated credit rating upgrade, will result in
3 lower interest costs and an improved financial profile for the Regulated Utilities.¹¹³

4 Finally, as the record shows, the Joint Applicants already have received all other regulatory
5 approvals necessary to close the Merger Transaction.¹¹⁴ Accordingly, the Merger Transaction will
6 be able to close upon Commission approval.

7 **VI. CONCLUSION AND RELIEF REQUESTED.**

8 For the foregoing reasons, Joint Applicants request that the Merger Transaction set forth in
9 the Joint Notice and Settlement Agreement be approved.

10 Joint Applicants respectfully request that the Administrative Law Judge issue a
11 Recommended Opinion and Order that:

- 12 1. Approves the Merger Transaction described in the Joint Notice of Intent to Reorganize
13 filed in this docket on January 10, 2014;
- 14 2. Approves the Settlement Agreement filed in this docket on May 16, 2014; and
- 15 3. Vacates the conditions set forth in Attachment A of Decision No. 60480 (November 25,
16 1997).

17 Joint Applicants further request that the Commission approve the Merger Transaction and
18 related Settlement Agreement no later than September 18, 2014 so that the Merger Transaction
19 may close by September 30, 2014.

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¹¹² Ex. JA-13 (Hutchens Settlement) at 15.

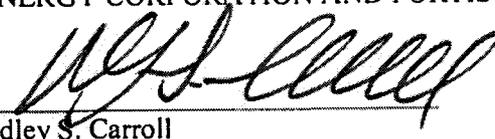
26 ¹¹³ Ex. JA-13 (Hutchens Settlement) at 15.

27 ¹¹⁴ Tr. (Hutchens) at 260-61, 315. The Joint Applicants also need to complete an administrative process
with the Federal Communications Commission (FCC) regarding FCC-issued licenses, but this is not a
condition precedent to close the transaction under the Merger Agreement. Tr. (Hutchens) at 260-61.

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RESPECTFULLY SUBMITTED this 9th day of July, 2014.

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