UNS

UNS Energy Corp.

88 E. Broadway Boulevard
Tucson, AZ 85701

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ORIGINAL

September 16, 2014

Arizona Corporation Commission
DOCKETED
SEP 16 2014
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Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

Re: Notice of Filing
Docket Nos. E-04230A-14-0011 and E-01933A-14-0011

Pursuant to Condition No. 45 of the Settlement Agreement approved by the Commission in Decision No. 74689 (August 12, 2014), Fortis Inc. and UNS Energy Corporation shall report to the Commission and RUCO any changes in the credit ratings of Fortis Inc., and UNS Energy Corporation or the Regulated Utilities.

If you have any questions, please contact me at (520) 884-3680.

Best regards,

Jessica Bryne
Regulatory Services

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Attachment

cc: Pat Quinn, Director, RUCO

FitchRatings

Fitch Upgrades Tucson Electric Power Co. to 'BBB'; Outlook Stable Ratings Endorsement Policy

15 Aug 2014 4:08 PM (EDT)

Fitch Ratings-New York-15 August 2014: Fitch Ratings has upgraded the Issuer Default Rating (IDR) of Tucson Electric Power Co. (TEP) to 'BBB' from 'BBB-' and assigned a Stable Rating Outlook. With this rating action Fitch has removed TEP from Rating Watch Positive where it was placed on Dec. 13, 2013. Fitch has also upgraded TEP's short-term IDR to 'F2' from 'F3'. A complete list of ratings appears at the end of this release.

Fortis Inc. closed today on its previously announced acquisition of UNS Energy Corp., (UNS) the ultimate parent company of Tucson Electric Power Co. following the regulatory approval of the Arizona Corporation Commission (ACC). The ACC unanimously approved the merger on August 12. Per the terms of the merger approval, regulated retail customers of UNS will receive bill credits totaling $30 million over five years. Upon closing, UNS Energy will be managed as a standalone company under Fortis and TEP will remain headquartered in Tucson under local control of current management. Fortis is Canada's largest investor-owned gas and electric distribution utility.

The upgrade reflects the utility's improved access to capital due to Fortis' financial strength and the expectation that Fortis will support TEP's growth objectives and provide appropriate financing support as needed.

KEY RATING DRIVERS
--Acquisition by Fortis;
--Expectation for Financial Support from Parent;
--Constructive outcome of 2012 General Rate Case (GRC);
--High leverage (including capital lease obligations).

Acquisition by Fortis: Fortis will acquire all of the outstanding common stock of UNS for $60.25 per share in cash, representing an aggregate purchase price of approximately US$4.5 billion, including the assumption of approximately US$2 billion of debt. For the latest 12 months (LTM) ending June 30, 2014, the acquisition price reflects an EBITDAR multiple of 8.8x, in line with and lower than other acquisitions in the industry. After closing, Fortis will inject $220 million of equity into UNS to strengthen its balance sheet and help fund the planned purchase of Unit 3 at the natural gas-fired Gila River Power Plant. Gila River Unit 3 is a 550MW gas-fired combined cycle unit owned by Entegra Power Group LLC. The purchase of Gila River Unit 3 would be consistent with TEP's strategy to diversify its generation fuel mix. TEP's improved access to capital due to Fortis' financial strength will help TEP facilitate the transition towards cleaner generation resources.

Ring-Fencing Measures Adopted; Dividend Restriction: Per the terms of the merger, dividends to UNS from the regulated utilities cannot exceed 60% of annual net income for a period of five years or until their respective equity-to-total capitalization ratios reach 50%. The settlement agreement also stipulates that UNS Energy be overseen by an independent board of directors, a majority of whom are Arizona residents.

TEP is the primary and core operating utility subsidiary of its corporate parent, UNS Energy Corporation (UNS), and represented 81% of revenue, 86% of EBITDAR, and 85% of UNS's consolidated total assets as of June 30, 2014. Going forward, UNS will remain a standalone utility in the Fortis model, with no planned changes to current management, existing operations or rates.

Pro forma the acquisition, UNS is expected to represent 28% of Fortis' operating earnings and 25% of Fortis' total assets. Fortis acquired CH Energy last year for $1.5 billion, including $500 million of assumed debt. CH Energy is the parent holding company of Central Hudson Gas and Electric (IDR: 'A-', Negative Outlook). Fitch expects the UNS and CH to be operated independently.

Constructive GRC Settlement: On June 11, 2013, the ACC issued a final order in TEP's 2012 general rate case (GRC) and authorized a nonfuel base-rate increase of $76 million dollars, approximately 59% of requested, predicated on a 10% return on equity (ROE; plus a 0.68% return on fair value increment of rate base) and an equity layer of 43.5% for rates effective July 1, 2013. Notably, the ACC approved two new cost recovery mechanisms, a lost fixed cost recovery (LFCR) mechanism and an environmental compliance adjustor (ECA). The LFCR is a partial revenue decoupling mechanism which is designed to recover non-fuel costs associated with the implementation of energy efficiency and distributed generation programs. The ECA is a recovery mechanism designed to recover compliance costs associated with environmental regulations, primarily for pollution control upgrades on TEP's coal-fired generation fleet. The rate order continues a recent trend of constructive regulatory outcomes by the ACC.

Solid Credit Metrics: For the LTM period ending June 30, 2014, TEP's EBITDAR coverage ratio improved to 5.2x as compared to 4.5x for 2013, largely due to new rates effective July 1 of last year. For the same period, TEP's funds from operations (FFO) coverage ratio trended flat at 4.7x as compared to 2013 and reflects milder summer weather in the company's service territory, lower interest expense due to amortizing capital lease obligations, and increased margins on wholesale sales due to higher power prices in the Palo Verde area. Leverage for the LTM ending June 30, 2014, as measured by debt-to-EBITDAR, trended relatively flat at 4.2x as compared to 4.1x for 2013. Going forward, EBITDAR coverage is expected to approximate over 5x through 2018, and leverage, as measured by debt-to-EBITDAR is expected to improve to less than 4x over the same period due to a combination of new rates, amortizing capital lease obligations, and improving economic conditions in TEP's service territory.

Sufficient Liquidity: TEP's liquidity needs are met through an unsecured credit agreement which includes a $200 million revolving credit facility (RCF) used to meet day-to-day working capital requirements and an $82 million letter-of-credit facility. TEP's credit agreement matures in November 2016. As of June 30, 2014, TEP had total available liquidity of $227 million under its credit agreement including $43 million of cash and cash equivalents and $184 million of available borrowing capacity under its RCF. TEP's RCF contains a maximum debt-to-capitalization covenant ratio of 70%, and as of June 30, 2014, TEP was in compliance with a debt-to-capitalization ratio of 63.8%. Fitch expects TEP's debt-to-capitalization ratio to improve to 59% in 2014 due to the equity infusion from Fortis.

RATING SENSITIVITIES

Positive Rating Action: No further positive rating actions are expected at this time; however, sustained debt-to-EBITDAR metrics below 3.8x over the forecast period could lead to a rating upgrade.

Negative Rating Action: An unexpected increase in leverage such as sustained debt-to-EBITDAR leverage metrics above 4.5x could cause a negative rating action.

Fitch has taken the following rating actions:

--Short-term IDR upgraded to 'F2' from 'F3'.

In addition, the following ratings have been upgraded and removed from Rating Watch Positive:

--IDR upgraded to 'BBB' from 'BBB-';
--Unsecured bank credit facility upgraded to 'BBB+' from 'BBB';
--Unsecured industrial revenue bonds upgraded to 'BBB+' from 'BBB';
--Unsecured pollution control revenue bonds upgraded to 'BBB+' from 'BBB';
--Unsecured notes upgraded to 'BBB+' from 'BBB'.

The Rating Outlook is Stable.

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Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:
--'Rating U.S. Utilities, Power and Gas Companies, March 7, 2014;
--'Corporate Rating Methodology', May 28, 2014;
--'Parent and Subsidiary Rating Linkage', Aug. 5, 2013.

Applicable Criteria and Related Research:
Parent and Subsidiary Rating Linkage
Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage
Rating U.S. Utilities, Power and Gas Companies (Sector Credit Factors)

Additional Disclosure
Solicitation Status