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OPEN MEETING

MEMORANDUM

Arizona Corporation Commission

DOCKETED

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2015 MAR 17 P 3: 52

TO: Docket Control

FROM: Steve M. Olea
Director
Utilities Division

MAR 17 2015

AZ CORP COMMISSION
DOCKET CONTROL

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Date: March 17, 2015

RE: IN THE MATTER OF THE APPLICATION OF 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-04230A-14- 0011 AND E-01933A-14-0011)

SUBJECT: COMPLIANCE FILING REGARDING CODE OF CONDUCT AND POLICIES AND PROCEDURES.

On October 9, 2014, in compliance the Settlement Agreement approved in Decision No. 74689 dated August 12, 2014, UNS Energy Corporation (UNS Energy) and Fortis Inc. submitted the proposed code of conduct regarding UNS Energy's and its regulated utility subsidiaries' affiliate transactions ("Code of Conduct") and the related proposed procedures for valuing and allocating intercompany transactions related to the transfer of assets and the provision of goods and services between affiliates ("Policies and Procedures").

Staff has reviewed the Code of Conduct and the Policies and Procedures and has made some clarifications which are reflected on the attached. Staff recommends that the Commission approve the Code of Conduct and the Policies and Procedures as attached to the Proposed Order.

Interested parties may file comments to the recommendation(s) of the proposed order by filing an original and thirteen (13) copies of the comments with the Commission's Docket Control by 4:00 p.m. on or before April 3, 2015.

SMO:GWB:vsc\BES

Originator: Gerald Becker

ORIGINAL

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BEFORE THE ARIZONA CORPORATION COMMISSION

SUSAN BITTER SMITH
Chairman
BOB STUMP
Commissioner
BOB BURNS
Commissioner
DOUG LITTLE
Commissioner
TOM FORESE
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-04230A-14-0011 & E-
01933A-14-0011

DECISION NO. _____
ORDER

Open Meeting
April 14-15, 2015
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. On October 9, 2014, in compliance with Conditions 6 and 58 of the Settlement Agreement approved in Decision No. 74689 dated August 12, 2014, UNS Energy Corporation ("UNS Energy") and Fortis Inc. ("Fortis") submitted its proposed code of conduct regarding UNS Energy's and its regulated utility subsidiaries' affiliate transactions ("Code of Conduct") and the related proposed procedures for valuing and allocating intercompany transactions related to the transfer of assets and the provision of goods and services between affiliates ("Policies and Procedures"). The Code of Conduct updates UNS Energy's previously approved Code of Conduct to reflect the current conditions, including the acquisition of UNS Energy by Fortis.

2. UNS Energy and Fortis state that the Policies and Procedures reflect the long-standing valuation and cost allocation practices that have been in place since UNS Energy's acquisition of the Citizens Utilities' assets in 2002. They underlie the rates approved by the Commission for Tucson

1 Electric Power Company, UNS Electric, Inc. and UNS Gas, Inc. The Policies and Procedures also
2 have been updated to reflect the current conditions in Arizona, including the acquisition of UNS
3 Energy by Fortis.

4 3. Fortis and UNS Energy request Commission approval of the Code of Conduct and the
5 Policies and Procedures to the extent required by Decision No. 74689 and the related Settlement
6 Agreement.

7 4. Staff has reviewed the Code of Conduct and the Policies and Procedures and has made
8 some clarifications as shown on the attached. Staff recommends that the Commission approve the
9 Code of Conduct and the Policies and Procedures as contained in Attachments A and B.

10 CONCLUSIONS OF LAW

11 1. UNS Energy and its regulated affiliates are public service corporation within the
12 meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-250 and 40-251.

13 2. The Commission has jurisdiction over UNS Energy and its regulated affiliates and of
14 the subject matter of the Docket.

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ORDER

IT IS THEREFORE ORDERED that UNS Energy Corporation Code of Conduct and Policies and Procedures, attached hereto as Attachment A and Attachment B, respectively, are hereby approved.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____, 2015.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT: _____

DISSENT: _____

SMO:GB:sms/BES

Decision No. _____

1 SERVICE LIST FOR: UNS Energy Corporation
DOCKET NOS. E-04230A-14-0011 & E-01933A-14-0011

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Attachment A

Code of Conduct

UNS Energy Corporation
and
Regulated Utilities

October 2014

Decision No. _____

I. Purpose.

The purpose of this Code of Conduct is to govern the transactions between and among UNS Energy, the Regulated Utilities and their Affiliates. The Code of Conduct sets forth the procedures for managing intercompany transactions, including procedures for valuing and allocating intercompany transactions related to the transfer of assets and to the provision of goods and services between and among UNS Energy, the Regulated Utilities and their Affiliates. This Code of Conduct and related Policies and Procedures are intended to implement Conditions 6 and 58 of the Settlement Agreement approved by Decision No. 74689 (August 12, 2014). The Code of Conduct is not intended to supersede the obligations of UNS Energy or its Affiliates under Arizona statutes and/or the Commission's rules, regulations and orders.

II. Definitions.

"Affiliate" means a separate legal entity that is controlled by, controls, or is under common control with a Regulated Utility.

"Assets" means real property, depreciable personal property and intangible property.

"Commission" means the Arizona Corporation Commission.

"Confidential Customer Information" means any non-public customer specific information obtained by a Regulated Utility as a result of providing regulated services to the customer.

"Depreciable personal property" means vehicles, machinery, furniture, fixtures not attached to land, equipment, computer hardware and related software applications and any other tangible property, which are not goods or real property.

"Depreciated Cost" means the Fully Allocated Cost of an asset less appropriate depreciation.

"Fully Allocated Costs" means the sum of direct costs plus an appropriate share of indirect costs.

"Goods" means non-depreciable personal property, such as inventory, materials and supplies.

"Intangible property" means any asset having no physical existence, its value being set by the rights and anticipated benefits that an owner obtains by possessing it.

"Policies and Procedures" means those policies and procedures developed by UNS Energy and the Regulated Utilities to implement this Code of Conduct.

"Regulated Utilities" means TEP, UNS Electric, and UNS Gas (individually "Regulated Utility").

"TEP" means Tucson Electric Power Company as it currently exists, as its name may be changed, or as any successor enterprise.

"UNS Electric" means UNS Electric, Inc. as it currently exists, as its name may be changed, or as any successor enterprise.

"UNS Energy" means UNS Energy Corporation as it currently exists, as its name may be changed, or as any successor enterprise.

"UNS Gas" means UNS Gas, Inc. as it currently exists, as its name may be changed, or as any successor enterprise.

III. **Applicability of Code of Conduct.**

The Code of Conduct applies to UNS Energy and its interactions with Affiliates and the Regulated Utilities and their interactions with Affiliates.

All employees and authorized agents of UNS Energy and the Regulated Utilities shall comply with this Code of Conduct. Failure to comply with this Code of Conduct will subject the employee to disciplinary actions as described in Section VII.

IV. **Affiliate Transactions.**

A. **Transfer of Assets between Affiliates.**

1. All transfers of assets between the Regulated Utilities shall be at Depreciated Cost.
2. All transfers of assets from the Regulated Utilities to their Affiliates (other than Regulated Utilities) shall be at the higher of Depreciated Cost or fair market value.

3. All transfers of assets to the Regulated Utilities from their Affiliates (other than Regulated Utilities) shall be at the lower of Depreciated Cost or fair market value.

B. Transfer of Goods and Services between Affiliates.

1. The Regulated Utilities' tariffed goods and services shall be provided to their Affiliates and third parties at the rates and under the terms and conditions set forth in the tariff.
2. All transfers of non-tariffed goods and services between the Regulated Utilities shall be at Fully Allocated Costs.
3. All transfers of non-tariffed goods and services from the Regulated Utilities to their Affiliates (other than Regulated Utilities) shall be at the higher of Fully Allocated Costs or fair market value.
4. All transfers of goods and services to the Regulated Utilities from their Affiliates (other than Regulated Utilities) shall be at the lower of Fully Allocated Costs or fair market value.

V. Accounting for and Allocation of Costs between Affiliates.

- A. UNS Energy and the Regulated Utilities shall account for and allocate costs in compliance with the Policies and Procedures attached hereto as Exhibit B.
- B. UNS Energy and the Regulated Utilities may not make and implement any material change to the Policies and Procedures without seeking the prior approval of the Commission. Once notification is made of an intended modification, if no action is taken by the Commission within 30 days of its filing, the modification shall be deemed approved.

VI. Use of Customer Information.

The Regulated Utilities shall not provide Confidential Customer Information to any Affiliate or third party except in compliance with applicable Commission rules, regulations or orders.

VII. Dissemination, Education, and Compliance.

- A. Copies of this Code of Conduct shall be provided to employees of UNS Energy and the Regulated Utilities, and those authorized agents of UNS Energy and the Regulated Utilities. A copy of the Code of Conduct shall be maintained on UNS Energy's Intranet.
- B. Training on the provisions of the Code of Conduct and its implementation shall be provided to all employees of UNS Energy and the Regulated Utilities.
- C. Compliance with the Code of Conduct is mandatory. An employee's or agent's failure or refusal to abide by or to act according to such standards may subject the employee or agent to disciplinary action, up to and including discharge from employment or termination of the agent's relationship with UNS Energy and the Regulated Utilities.
- D. Questions regarding this Code of Conduct should be directed to the UNS Energy Legal Department.

VIII. Procedure to Modify the Code of Conduct.

UNS Energy, the Regulated Utilities or Commission Staff may request modifications to the Code of Conduct by filing an application with the Commission. The application shall set forth the proposed modifications and the reasons supporting them.

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Attachment B

UNS Energy Corporation
Code of Conduct Policies and Procedures

October 2014

Background

UNS Energy Corporation (“UNS Energy”)¹ is a wholly-owned subsidiary of Fortis, Inc. UNS Energy provides regulated electric utility and natural gas distribution service, and conducts non-regulated energy-related business activities through a number of affiliated entities. See **Exhibit 1** (the entities identified in Exhibit 1 are referred to as the “UNS System”). Tucson Electric Power Company (“TEP”) provides retail electric service to customers in Pima and Cochise Counties, and wholesale power to other utilities and power marketers. UniSource Energy Services (“UES”) provides retail electric service through UNS Electric, Inc. to customers in Mohave and Santa Cruz Counties, and local natural gas distribution service through UNS Gas, Inc. to customers located across Northern Arizona and in Santa Cruz County. The regulated utility operations of TEP, UNS Electric, Inc. and UNS Gas, Inc. (the “Regulated Utilities”) are subject to the jurisdiction of the Federal Energy Regulatory Commission (“FERC”) and the Arizona Corporation Commission (“Commission” or “ACC”).

The Regulated Utilities incur costs, both capital and operating, in connection with the provision of administrative support and other services to their electric and gas utility and non-utility business activities (to the extent offered), as well as to Affiliates. It is, therefore, necessary to develop, implement, and effectively administer an adequate and effective cost

¹ Capitalized terms not otherwise defined in these Policies and Procedures have the same definitions as set forth in the Code of Conduct.

allocation policy. The principal objectives of the intra-and inter-company cost allocation procedures are to:

- Prevent or minimize, to the extent practical, the potential for cross-subsidization of one activity or entity by another, and
- Achieve a proper balance between the desired precision of the cost allocation process with the cost of attaining such accuracy.

Rates charged for regulated energy utility service provided by the Regulated Utilities will be based solely on the reasonable and necessary costs incurred in connection with the provision of safe, reliable service to customers. Because the Regulated Utilities routinely incur administrative and other costs that benefit regulated and non-regulated operations and Affiliates, an appropriate cost allocation methodology is required. The cost assignment and allocation methodology described herein provides for the equitable assignment and allocation of costs to businesses, activities, and Affiliates, and prevents cross-subsidization.

The code of conduct and these cost allocation policies and procedures are intended to produce reasonable results that are consistent with applicable Arizona law, the reporting requirements of the Securities and Exchange Commission and FERC, and the Internal Revenue Code.

Cost Accounting Principles

As a general principal, UNS Energy and the Regulated Utilities support the use of an equitable, fully-distributed costing methodology for assigning costs between regulated and non-regulated business activities and between Affiliates, with emphasis on direct assignment and cost causation to the extent possible. The overriding goals of the cost accounting and

allocation process are to limit the possibility of cross-subsidization of any entity or activity by another, and to achieve the desired objectives as best as practicable.

Presently, most UNS System corporate services in Arizona (i.e. accounting, information systems, etc.) are performed by TEP, as needed by its regulated electric utility and its non-utility business activities, as well as by its other Affiliates located in Arizona. The objectives and procedures described herein, however, would apply equally to the extent that Affiliates of the UNS System provide services to TEP or other Affiliates.

Costs should be directly assigned to the benefiting activity or entity to the extent possible. Costs benefiting multiple activities or entities that cannot be directly assigned will be considered as common costs, and accumulated in homogeneous cost pools. Where possible, common costs should be allocated to the beneficiaries on the basis of causal relationships, identified by determining the factor which gives rise to the incurrence of the cost. Common costs for which a specifically identifiable causal relationship cannot be established should be allocated on a residual basis using the allocation methodology described later herein.

Utility Plant in Service and other fixed assets that benefit both regulated and non-regulated activities or Affiliates are considered in the cost allocation process through the inclusion of a return on the net investment, computed using the current authorized regulated rate of return. For this purpose, the net investment represents the gross original fixed asset cost less accumulated depreciation and related accumulated deferred income taxes.

Direct Costing

All incurred costs that directly and solely benefit a specific business activity or Affiliate are charged directly to the beneficiary. Costs may be directly assignable to: construction activities, utility operations, non-utility operations, or the business of other Affiliates in the UNS System. Directly assignable costs include such items as payroll and payroll related overhead costs, as well as identifiable non-labor costs. Employees are required to directly charge their time and expenses that they may identify as directly assignable in accordance with this reporting policy.

For accounting and billing purposes, directly assignable costs will be handled as follows:

- Basic payroll costs of both operating and administrative employees, and related payroll taxes, will be charged as follows:
 - Labor costs applicable to construction will be charged to the appropriate work order.
 - Labor costs applicable to non-utility operations will be charged to the appropriate below-the-line account.
 - Labor costs chargeable to Affiliates will be charged to the appropriate inter-company receivable account.
- Employee benefits and other costs relating to directly assignable labor costs will be charged to the same work orders, below-the-line accounts, or inter-company receivable to which such labor was charged.
- Directly assignable non-labor costs shall be charged to the appropriate work order, below-the-line accounts, or inter-company receivable account.

Fixed Labor Cost Distributions

Vice Presidents, Senior Vice Presidents, and the President of UNS Energy and of TEP will account for their time on an "exception" time basis. In connection therewith, each of the affected officers will use the same payroll cost account distribution (intra- and inter-company) percentages for all payroll periods throughout the year, unless there is a significant change in the individual's responsibilities or activities, at which time the distribution factors would be revised. To arrive at the respective fixed payroll allocation factors, an annual time study is prepared for the purpose of identifying the normal, recurring activities of each affected employee and the benefiting entities, with percentages derived therefrom being the basis for future fixed payroll cost assignment.

Allocated Costs

Incurred costs that cannot be directly assigned, but which benefit multiple activities and entities, both regulated and non-regulated, will be assigned to homogeneous cost pools for allocation. Where a sufficient degree of correlation can be reasonably identified, such allocations will be based on factors representing elements of cost causation. Detailed procedures for specific allocations by the Regulated Utilities based on cost causative factors shall be maintained by the Regulated Utilities and provided to the Commission upon request.

Where elements of cost causation cannot be reasonably or economically identified as the basis for cost allocation, a residual allocator will be applied to the allocation pool. The residual allocator used by members of the UNS System is a three-factor allocation methodology based on a weighted average of annual revenues, payroll costs, and plant

investment. It is widely-used and has been accepted by the FERC and state regulatory commissions.

General Office Buildings

Administrative and general corporate activities benefiting TEP and other members of the UNS System are performed by TEP employees located at the UNS Energy Headquarters Building ("HQ") and in the Operating Headquarters Building ("OH") and other facilities located at the Sundt Generating Station that are owned by TEP.

Since TEP's regulated and non-regulated operations and other UNS System Affiliates benefit from such services, there needs to be an accurate and equitable allocation of the capital and operating costs being incurred to the benefiting activities and entities. A key element of the cost allocation process is to equitably assign an appropriate portion of the capital and operating costs applicable to the general office buildings to benefiting activities and Affiliates. The allocation of building costs will be made via a per employee hourly payroll loading charge, based on an annual revenue requirement.

Fair Market Value

In transactions potentially requiring the determination of a fair market value, the Regulated Utilities shall act in a commercially reasonable and prudent manner in determining the fair market value of an asset, good or service, to the extent practicable, given the specific circumstances of the transaction.

Tariffed Services

Regulated utility services provided by any Regulated Utility will be priced at the existing tariffed rate for that service.

Revisions and Updating

These policies and code of conduct will be updated as necessary in the event of major changes in operations or regulatory conditions such as retail competition.

Exhibit 1

UNS System

