UNS Energy Corp
Form 10-K
February 25, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)

ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2013
OR

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to .

Commission File Number	Registrant; State of Incorporation; Address; and Telephone Number	IRS Employer Identification Number
1-13739	UNS ENERGY CORPORATION (An Arizona Corporation) 88 East Broadway Boulevard Tucson, AZ 85701 (520) 571-4000	86-0786732
1-5924	TUCSON ELECTRIC POWER COMPANY (An Arizona Corporation) 88 East Broadway Boulevard Tucson, AZ 85701 (520) 571-4000	86-0062700

Securities registered pursuant to Section 12(b) of the Exchange Act:

Registrant	Title of Each Class	Name of Each Exchange on Which Registered
UNS Energy Corporation	Common Stock, no par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Exchange Act:

Registrant	Title of Each Class	Name of Each Exchange on Which Registered
Tucson Electric Power Company	Common Stock, without par value	N/A

Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933.

UNS Energy Corporation	Yes x	No ¨
Tucson Electric Power Company	Yes ¨	No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (Exchange Act).

UNS Energy Corporation	Yes ¨	No x
Tucson Electric Power Company	Yes ¨	No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

UNS Energy Corporation Yes x No ¨

Tucson Electric Power Company Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

UNS Energy Corporation Yes x No ¨

Tucson Electric Power Company Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of each registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

UNS Energy Corporation	Large Accelerated Filer	x	Accelerated Filer	¨
	Non-accelerated Filer	¨	Smaller Reporting Company	¨
Tucson Electric Power Company	Large Accelerated Filer	¨	Accelerated Filer	¨
	Non-accelerated Filer	x	Smaller Reporting Company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

UNS Energy Corporation	Yes ¨	No x
Tucson Electric Power Company	Yes ¨	No x

The aggregate market value of UNS Energy Corporation voting Common Stock held by non-affiliates of the registrant was $1,855,552,035 based on the last reported sale price thereof on the consolidated tape on June 30, 2013.

As of February 14, 2014, 41,633,535 shares of UNS Energy Corporation Common Stock, no par value (the only class of Common Stock), were outstanding. As of February 14, 2014, Tucson Electric Power Company had 32,139,434 shares of common stock outstanding, no par value, all of which were held by UNS Energy Corporation.

Tucson Electric Power Company meets the conditions set forth in General Instructions (I)(1)(a) and (b) on Form 10-K and is therefore filing this report with the reduced disclosure format.

Documents incorporated by reference: Specified portions of UNS Energy Corporation's Proxy Statement relating to the 2014 Annual Meeting of Shareholders are incorporated by reference into Part III.

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DEFINITIONS

The abbreviations and acronyms used in the 2013 Form 10-K are defined below:

ACC	Arizona Corporation Commission
APS	Arizona Public Service Company
BART	Best Available Retrofit Technology
Base O&M	A non-GAAP financial measure that represents the fundamental level of operating and maintenance expense related to our business
Base Rates	The portion of TEP's and UNS Electric's Retail Rates attributed to generation, transmission, distribution costs, and customer charge; and UNS Gas' delivery costs and customer charge. Base Rates exclude costs that are passed through to customers for fuel and purchased energy costs
Btu	British thermal unit(s)
Cooling Degree Days	An index used to measure the impact of weather on energy usage calculated by subtracting 75 from the average of the high and low daily temperatures
DSM	Demand Side Management
ECA	Environmental Compliance Adjustor
Entegra	a subsidiary of Entegra Power Group LLC
FERC	Federal Energy Regulatory Commission
FVRB	Fair Value Rate Base
Fortis	FortisUS, Inc., a Delaware corporation whose ultimate parent company is Fortis Parent
Fortis Parent	Fortis, Inc., a corporation incorporated under the Corporations Act of Newfoundland and Labrador, Canada
Four Corners	Four Corners Generating Station
GBtu	Billion British thermal units
GWh	Gigawatt-hour(s)
Gila River Unit 3	Unit 3 of the Gila River Generating Station
Heating Degree Days	An index used to measure the impact of weather on energy usage calculated by subtracting the average of the high and low daily temperatures from 65
kV	Kilo-volt
kWh	Kilowatt-hour(s)
LFCR	Lost Fixed Cost Recovery Mechanism
Millennium	Millennium Energy Holdings, Inc., a wholly-owned subsidiary of UNS Energy Corporation
MMBtu	Million British thermal units
MW	Megawatt(s)
MWh	Megawatt-hour(s)
Navajo	Navajo Generating Station
NTUA	Navajo Tribal Utility Authority
OATT	Open Access Transmission Tariff
OCRB	Original Cost Rate Base
PGA	Purchased Gas Adjustor, a Retail Rate mechanism designed to recover the cost of gas purchased for retail gas customers
PNM	Public Service Company of New Mexico
PPA	Power Purchase Agreement
PPFAC	Purchased Power and Fuel Adjustment Clause
REC	Renewable Energy Credit
RES	Renewable Energy Standard

Regional Haze Rules	Rules promulgated by the EPA to improve visibility at national parks and wilderness areas

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Retail Rates	Rates designed to allow a regulated utility an opportunity to recover its reasonable operating and capital costs and earn a return on its utility plant in service
San Juan	San Juan Generating Station
SCR	Selective Catalytic Reduction
SJCC	San Juan Coal Company
SNCR	Selective Non-Catalytic Reduction
Springerville	Springerville Generating Station
Springerville Coal Handling Facilities Leases	Coal handling facilities at Springerville used in common by all four Springerville units
Springerville Common Facilities	Facilities at Springerville used in common by all four Springerville units
Springerville Common Facilities Leases	Leveraged lease arrangements relating to an undivided one-half interest in certain Springerville Common Facilities
Springerville Unit 1	Unit 1 of the Springerville Generating Station
Springerville Unit 1 Leases	Leveraged lease arrangement relating to Springerville Unit 1 and an undivided one-half interest in certain Springerville Common Facilities
Springerville Unit 2	Unit 2 of the Springerville Generating Station
Springerville Unit 3	Unit 3 of the Springerville Generating Station
Springerville Unit 4	Unit 4 of the Springerville Generating Station
SRP	Salt River Project Agricultural Improvement and Power District
Sundt	H. Wilson Sundt Generating Station
Sundt Unit 4	Unit 4 of the H. Wilson Sundt Generating Station
TCA	Transmission Cost Adjustor
TEP	Tucson Electric Power Company, the principal subsidiary of UNS Energy Corporation
Therm	A unit of heating value equivalent to 100,000 Btus
Tri-State	Tri-State Generation and Transmission Association, Inc.
UED	UniSource Energy Development Company, a wholly-owned subsidiary of UNS Energy Corporation
UES	UniSource Energy Services, Inc., a wholly-owned subsidiary of UNS Energy, and intermediate holding company established to own the operating companies UNS Electric and UNS Gas
UNS Electric	UNS Electric, Inc., a wholly-owned subsidiary of UES
UNS Energy	UNS Energy Corporation (formerly known as UniSource Energy Corporation)
UNS Gas	UNS Gas, Inc., a wholly-owned subsidiary of UES

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PART I

This combined Form 10-K is being filed separately by UNS Energy Corporation (UNS Energy) and Tucson Electric Power Company (TEP) (collectively, the Registrants). Information contained herein relating to any individual registrant is filed by such registrant on its own behalf. TEP does not make any representation as to information relating to any other subsidiary of UNS Energy.

This Annual Report on Form 10-K contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. You should read forward-looking statements together with the cautionary statements and important factors included elsewhere in this Form 10-K (See Item 7. – Management's Discussion and Analysis of Financial Condition and Results of Operations, Safe Harbor for Forward-Looking Statements). Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions. Forward-looking statements are not statements of historical facts. Forward-looking statements may be identified by the use of words such as "anticipates," "estimates," "expects," "intends," "plans," "predicts," "projects," and similar expressions. We express our expectations, beliefs, and projections in good faith and believe them to have a reasonable basis. However, we make no assurances that management's expectations, beliefs, or projections will be achieved or accomplished. In addition, UNS Energy and TEP disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of this report.

ITEM 1. – BUSINESS

OVERVIEW OF CONSOLIDATED BUSINESS

UNS Energy is a utility services holding company engaged, through its subsidiaries, in the electric generation and energy delivery business. Each of UNS Energy's subsidiaries is a separate legal entity with its own assets and liabilities. UNS Energy owns 100% of TEP, UniSource Energy Services, Inc. (UES), Millennium Energy Holdings, Inc. (Millennium), and UniSource Energy Development Company (UED).

TEP is a regulated utility and UNS Energy's largest operating subsidiary, representing approximately 83% of UNS Energy's total assets at December 31, 2013. TEP generates, transmits and distributes electricity to approximately 413,000 retail electric customers in a 1,155 square mile area in southeastern Arizona. TEP also sells electricity to other utilities and power marketing entities, located primarily in the western United States. In addition, TEP operates Springerville Generating Station (Springerville) Unit 3 on behalf of Tri-State Generation and Transmission Association, Inc. (Tri-State) and Springerville Unit 4 on behalf of Salt River Project Agriculture Improvement and Power District (SRP).

UES holds the common stock of two regulated utilities, UNS Electric, Inc. (UNS Electric) and UNS Gas, Inc. (UNS Gas). UNS Electric is a regulated utility, which generates, transmits and distributes electricity to approximately 93,000 retail customers in Mohave and Santa Cruz counties in Arizona. UNS Gas is a regulated gas distribution company, which services approximately 150,000 retail customers in Mohave, Yavapai, Coconino, Navajo, and Santa Cruz counties in Arizona.

UED and Millennium's investments in unregulated businesses represent less than 1% of UNS Energy's assets as of December 31, 2013.

References in this report to "we" and "our" are to UNS Energy and its subsidiaries, collectively.

AGREEMENT AND PLAN OF MERGER

In December 2013, UNS Energy entered into an Agreement and Plan of Merger (the Merger Agreement) with FortisUS Inc., a Delaware corporation (Fortis), Color Acquisition Sub Inc., an Arizona corporation and a wholly owned subsidiary of Fortis (Merger Sub), and, solely for the purposes of Sections 5.5(c) and 8.15 of the Merger Agreement, Fortis Inc., a corporation incorporated under the Corporations Act of Newfoundland and Labrador and the parent company of Fortis (Fortis Parent).

The Merger Agreement provides for a business combination whereby Merger Sub will merge with and into UNS Energy (the Merger). As a result of the Merger, the separate corporate existence of Merger Sub will cease and UNS Energy will continue as a wholly owned subsidiary of Fortis. The Boards of Directors of each of UNS Energy and Fortis Parent have approved the Merger.

Under the Merger Agreement, at the effective time of the Merger, each outstanding share of UNS Energy common stock (other than shares owned by UNS Energy, Fortis Parent, Fortis or Merger Sub or their subsidiaries) will be converted into the right to receive $60.25 in cash (the Merger Consideration). At the effective time and as a result of the Merger, each outstanding option to acquire UNS Energy common stock issued by UNS Energy will be converted into the right to receive the difference between

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the Merger Consideration and the exercise price of the option, on a per-share basis, and each outstanding share of restricted stock, restricted stock unit, performance share and other equity-based awards will vest and be converted into the right to receive the Merger Consideration.

The Merger is subject to the approval of stockholders holding a majority of the outstanding shares of UNS Energy and other customary closing conditions, including, among other things:

- the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended;
- approvals of the Arizona Corporation Commission (ACC) and the Federal Energy Regulatory Commission (FERC);
- confirmation of review, without unresolved concerns, from the Committee on Foreign Investment in the United States; and
- the absence of any injunction, order or other law prohibiting the Merger.

The obligations of each party to close the Merger are also subject to the accuracy of representations and warranties of, and compliance with covenants by, the other parties as set forth in the Merger Agreement, and, in the case of Fortis, the absence of any material adverse effect on UNS Energy.

The Merger Agreement provides that Fortis and UNS Energy may mutually agree to terminate the Merger Agreement before completing the Merger. In addition, either Fortis or UNS Energy may decide to terminate the Merger Agreement if, among other things:

- the Merger is not consummated by December 11, 2014, subject to extension to June 11, 2015 if regulatory approvals have not been obtained (or further if approvals have been obtained but have not yet become final orders), but other closing conditions have been satisfied or waived;
- UNS Energy stockholders fail to adopt the Merger Agreement;
- a court or other governmental entity issues a final and nonappealable order prohibiting the Merger; or
- the other party breaches the Merger Agreement in a way that would entitle the party seeking to terminate the Merger Agreement not to consummate the Merger, subject to the right of the breaching party to cure the breach.

UNS Energy may also terminate the Merger Agreement prior to receiving stockholder approval, after complying with certain procedures set forth in the Merger Agreement, in order to accept a superior takeover proposal upon payment of a termination fee of approximately $64 million (Termination Fee). Fortis may terminate the Merger Agreement and require payment of the Termination Fee if UNS Energy enters into an agreement with respect to a superior takeover proposal, or if the Board of Directors of UNS Energy recommends or proposes to approve or recommend any alternative takeover proposal with a third party, or withdraws, modifies or proposes publicly to withdraw or modify its approval or recommendation with respect to the Merger Agreement. The Merger Agreement further provides that, upon termination under certain other circumstances, UNS Energy may be obligated to reimburse up to $12.5 million of Fortis' expenses with respect to the transaction and, if another takeover proposal is agreed or consummated, pay Fortis the Termination Fee (net of any expense reimbursement previously paid).

Fortis has agreed to maintain UNS Energy's community involvement efforts and charitable donations for five years following the closing and to keep UNS Energy's headquarters in Tucson, Arizona. Fortis has also agreed to retain four of UNS Energy's current directors on the board of UNS Energy following the closing.

UNS Energy and Fortis have agreed to customary representations, warranties and covenants in the Merger Agreement, including, among others, covenants (i) with respect to the conduct of its business during the interim period between the execution of the Merger Agreement and consummation of the Merger, (ii) not to solicit proposals regarding alternative business combination transactions and (iii) not to engage in certain kinds of transactions during such period. UNS Energy and Fortis have agreed to use their reasonable best efforts to obtain required governmental approvals to effect the transaction.

On February 18, 2014, we filed definitive proxy materials with the SEC. We expect UNS Energy's shareholders to formally consider a proposal to approve the Merger Agreement at a meeting on March 26, 2014.

In January 2014, UNS Energy and Fortis Parent filed an application and supporting testimony with the ACC requesting approval of the Merger. The ACC administrative law judge (ALJ) assigned to this matter issued a procedural order that provides for settlement discussions to commence on April 28, 2014, and a hearing before the ALJ to commence on June 16, 2014. In February 2014, we filed an application with FERC requesting approval of the

Merger. The Merger is expected to close by the end of 2014.

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BUSINESS SEGMENT CONTRIBUTIONS

The table below shows the contributions to our consolidated after-tax earnings by our three business segments.

	2013	2012	2011
	Millions of Dollars		
TEP	$101	$65	$85
UNS Electric	12	17	18
UNS Gas	11	9	10
Other Non-Reportable Segments and Adjustments[1]	3	—	(3)
Consolidated Net Income	$127	$91	$110

(1) Includes: UNS Energy parent company expenses, Millennium, UED, and intercompany eliminations.

See Note 4 for additional financial information regarding our business segments.

Rates and Regulation of TEP, UNS Electric, and UNS Gas

The ACC regulates portions of TEP's, UNS Electric's, and UNS Gas' utility accounting practices and energy rates. The ACC has authority over rates charged to retail customers, the issuance of securities, and transactions with affiliated parties. Our regulated utility rates for retail electric and natural gas service are determined on a “cost of service” basis. Retail Rates are designed to provide, after recovery of allowable operating expenses, an opportunity for our utility businesses to earn a reasonable return on rate base. Rate base is generally determined by reference to the original cost (net of depreciation) of utility plant in service to the extent deemed used and useful, and to various adjustments for deferred taxes and other items, plus a working capital component. Over time, additions to utility plant in service increase rate base while depreciation of utility plant reduces rate base.

The rates charged to retail customers also include pass-through mechanisms that allow each utility to recover the prudently incurred actual costs of its fuel, transmission, and energy purchases.

The FERC regulates the terms and prices of transmission services and wholesale electricity sales, wholesale transport and purchases of natural gas, and portions of our accounting practices. TEP and UNS Electric have FERC tariffs to sell power at market-based rates.

TEP

TEP was incorporated in the State of Arizona in 1963. TEP is the principal operating subsidiary of UNS Energy. In 2013, TEP’s electric utility operations contributed 81% of UNS Energy’s operating revenues and comprised 83% of its assets at year end.

SERVICE AREA AND CUSTOMERS

TEP is a vertically integrated utility that provides regulated electric service to approximately 413,000 retail customers in southeastern Arizona. TEP’s service territory covers 1,155 square miles and includes a population of approximately one million people in the greater Tucson metropolitan area in Pima County, as well as parts of Cochise County. TEP also sells electricity to other entities in the western United States.

Retail Customers

TEP provides electric utility service to a diverse group of residential, commercial, industrial, and public sector customers. Major industries served include copper mining, cement manufacturing, defense, health care, education, military bases, and other governmental entities. TEP’s retail sales are influenced by several factors, including economic conditions, seasonal weather patterns, demand side management (DSM) initiatives and the increasing use of energy efficient products, and opportunities for customers to generate their own electricity.

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Customer Base

The table below shows the percentage distribution of TEP's energy sales by major customer class over the last three years. In 2014, the retail energy consumption by customer class is expected to be similar to the historical distribution.

	2013		2012		2011	
Residential	42	%	41	%	42	%
Commercial	23	%	24	%	23	%
Non-mining Industrial	23	%	23	%	23	%
Mining	12	%	12	%	12	%

Local, regional, and national economic factors can impact the growth in the number of customers in TEP's service territory. In 2013, 2012, and 2011, TEP's average number of retail customers increased by less than 1% in each year. We expect the number of TEP's retail customers to increase at a rate of approximately 1% in 2014 and 2015.

Two of TEP's largest retail customers are in the copper mining industry. TEP's kilowatt-hour (kWh) sales to mining customers depend on a variety of factors including the market price of copper, the electricity rate paid by mining customers, and the mines' potential development of their own electric generation resources. TEP's kWh sales to mining customers decreased by 1.2% in 2013 due in part to a higher occurrence of planned and unplanned maintenance at the mines that reduced the mines' demand for electricity.

See Part II, Item. 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power, Factors Affecting Results of Operations, Sales to Mining Customers.

Retail Sales Volumes

During the past three years, economic conditions and state requirements for energy efficiency and distributed generation have negatively affected retail electricity sales. TEP's retail sales volumes in 2013 were approximately 9,279 Gigawatt-hours (GWh). These volumes were 0.1% below 2010 levels.

Wholesale Sales

TEP's electric utility operations include the wholesale marketing of electricity to other utilities and power marketers. Wholesale sales transactions are made on both a firm and interruptible basis. A firm contract requires TEP to supply power on demand (except under limited emergency circumstances), while an interruptible contract allows TEP to stop supplying power under defined conditions. See Generating and Other Resources, Purchases and Interconnections, below.

Generally, TEP commits to future sales based on expected excess generating capability, forward prices, and generation costs, using a diversified portfolio approach to provide a balance between long-term, mid-term, and spot energy sales. TEP's wholesale sales consist primarily of two types of sales:

Long-Term Sales

Long-term wholesale sales contracts cover periods of more than one year. TEP typically uses its own generation to serve the requirements of its long-term wholesale customers. TEP's two primary long-term contracts are with Salt River Project Agriculture Improvement and Power District (SRP) and the Navajo Tribal Utility Authority (NTUA).

See Item 7. – Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power Company, Factors Affecting Results of Operations, Long-Term Wholesale Sales.

Short-Term Sales

Forward contracts commit TEP to sell a specified amount of capacity or energy at a specified price over a given period of time, typically for one-month, three-month, or one-year periods. TEP also engages in short-term sales by selling energy in the daily or hourly markets at fluctuating spot market prices and making other non-firm energy sales. All revenues from short-term wholesale sales offset fuel and purchased power costs and are passed through to TEP's retail customers. TEP uses short-term wholesale sales as part of its hedging strategy to reduce customer exposure to fluctuating power prices. See Rates and Regulation, below.

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GENERATING AND OTHER RESOURCES

At December 31, 2013, TEP owned or leased 2,240 MW of generating capacity, as set forth in the following table:

Generating Source	Unit No.	Location	Date In Service	Resource Type	Capacity MW	Operating Agent	TEP's Share %	TEP's Share MW
Springerville Station[1]	1	Springerville, AZ	1985	Coal	387	TEP	100.0	387
Springerville Station	2	Springerville, AZ	1990	Coal	390	TEP	100.0	390
San Juan Station	1	Farmington, NM	1976	Coal	340	PNM	50.0	170
San Juan Station	2	Farmington, NM	1973	Coal	340	PNM	50.0	170
Navajo Station	1	Page, AZ	1974	Coal	750	SRP	7.5	56
Navajo Station	2	Page, AZ	1975	Coal	750	SRP	7.5	56
Navajo Station	3	Page, AZ	1976	Coal	750	SRP	7.5	56
Four Corners Station	4	Farmington, NM	1969	Coal	784	APS	7.0	55
Four Corners Station	5	Farmington, NM	1970	Coal	784	APS	7.0	55
Luna Generating Station	1	Deming, NM	2006	Gas	555	PNM	33.3	185
Sundt Station	1	Tucson, AZ	1958	Gas/Oil	81	TEP	100.0	81
Sundt Station	2	Tucson, AZ	1960	Gas/Oil	81	TEP	100.0	81
Sundt Station	3	Tucson, AZ	1962	Gas/Oil	104	TEP	100.0	104
Sundt Station	4	Tucson, AZ	1967	Coal/Gas	156	TEP	100.0	156
Sundt Internal Combustion Turbines		Tucson, AZ	1972-1973	Gas/Oil	50	TEP	100.0	50
DeMoss Petrie		Tucson, AZ	1972	Gas/Oil	75	TEP	100.0	75
North Loop		Tucson, AZ	2001	Gas	95	TEP	100.0	95
Springerville Solar Station		Springerville, AZ	2002-2010	Solar	6	TEP	100.0	6
Tucson Solar Projects		Tucson, AZ	2010-2012	Solar	12	TEP	100.0	12
Total TEP Capacity [2]								2,240

[1] Leased asset as of December 31, 2013.

[2] Excludes 683 MW of additional resources, which consist of certain capacity purchases and interruptible retail load. At December 31, 2013, total owned capacity was 1,853 MW and leased capacity was 387 MW.

Springerville Generating Station

TEP leases Unit 1 of the Springerville Generating Station and an undivided one-half interest in certain Springerville Common Facilities (collectively Springerville Unit 1) under seven separate lease agreements (Springerville Unit 1 Leases) that are accounted for as capital leases. The leases expire in January 2015 and include fair market value renewal and purchase options. TEP owns a 14.1% undivided ownership interest in Springerville Unit 1, representing approximately 55 megawatts (MW) of capacity.

Unit 2 of the Springerville Generating Station (Springerville Unit 2) is owned by San Carlos Resources, Inc. (San Carlos), a wholly-owned subsidiary of TEP. TEP's other interests in the Springerville Generating Station (Springerville) include leasehold interests in the Springerville Coal Handling Facilities and in a one-half interest in certain other facilities at Springerville used in common by all four Springerville units (Springerville Common Facilities).

Springerville Unit 1 Leases

TEP leases Unit 1 of the Springerville Generating Station and an undivided one-half interest in certain Springerville Common Facilities (collectively Springerville Unit 1) under seven separate lease agreements (Springerville Unit 1 Leases) that are accounted for as capital leases. The leases expire in January 2015 and include fair market value renewal and purchase options. In 2006, TEP purchased a 14.1% undivided ownership interest in Springerville Unit 1, representing approximately 55 MW of capacity.

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During 2013, TEP agreed to purchase leased interests of 35.4% or 137 MW of Springerville Unit 1, for an aggregate purchase price of approximately $65 million. TEP expects to complete the purchases in December 2014 and in January 2015. See Item 7. – Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power Company, Factors Affecting Results of Operations, Springerville Unit 1.

Springerville Common Facilities Leases

The leveraged lease arrangements relating to an undivided one-half interest in certain Springerville Common Facilities (Springerville Common Facilities Leases), which expire in 2017 and 2021, have fair market value renewal options as well as a fixed-price purchase provision. The fixed prices to acquire the leased interests in the Springerville Common Facilities are $38 million in 2017 and $68 million in 2021.

Springerville Coal Handling Facilities Lease

In 1984, TEP sold and leased back the Springerville Coal Handling Facilities. Since entering the lease, TEP purchased a 13% ownership interest in the Springerville Coal Handling Facilities. The terms of the Springerville Coal Handling Facilities Leases expire in April 2015 but have fixed-rate renewal options if certain conditions are satisfied as well as a fixed-price purchase provision of $120 million.

See Note 6 and Item 7. – Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power Company, Liquidity and Capital Resources, Contractual Obligations.

Sundt Generating Station

The H. Wilson Sundt Generating Station (Sundt) and the internal combustion turbines located in Tucson are designated as "must-run generation" facilities. Must-run generation units are required to run in certain circumstances to maintain distribution system reliability and to meet local load requirements.

Future Generating Resources

Gila River Generating Station Unit 3

In December 2013, TEP and UNS Electric entered into an agreement (the Purchase Agreement) with a subsidiary of Entegra Power Group LLC (Entegra) to purchase Unit 3 of the Gila River Generating Station (Gila River Unit 3). The purchase price of $219 million is subject to adjustments to prorate certain fees and expenses through the closing and in respect of certain operational matters. Gila River Unit 3 is a gas-fired combined cycle unit with a capacity rating of 550 MW, located in Gila Bend, Arizona.

It is anticipated that TEP will purchase a 75% undivided interest in Gila River Unit 3 (413 MW) for approximately $164 million and UNS Electric will purchase the remaining 25% undivided interest (137 MW) for approximately $55 million, although TEP and UNS Electric may modify the percentage ownership allocation between them. We expect the transaction to close in December 2014. See TEP, Factors Affecting Results of Operations, Gila River Generating Station Unit 3 and UNS Electric, Factors Affecting Results of Operations, Gila River Generating Station Unit 3. See also Note 8.

The purchase of Gila River Unit 3, which would replace the expiring coal-fired leased capacity from Springerville Unit 1 and the expected reduction of coal-fired generating capacity from San Juan Unit 2, is consistent with TEP's strategy to diversify its generation fuel mix. For more information on San Juan Unit 2, see Environmental Matters, Regional Haze Rules, San Juan, below.

Renewable Energy Resources

Owned Resources

As of December 31, 2013, TEP owned 18 MW of photovoltaic (PV) solar generating capacity. The Springerville solar system, which is located near the Springerville Generating Station, has a total capacity of 6 MW. TEP's remaining 12 MW of PV solar generating capacity is located in the Tucson area.

In 2014, TEP expects to complete solar projects providing capacity of 20 MW at Ft. Huachuca, Arizona and 10 MW in Springerville, Arizona.

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Power Purchase Agreements

In order to meet the ACC's renewable energy requirements, TEP has power purchase agreements (PPAs) for 124 MW of capacity from solar resources, 102 MW of capacity from wind resources and 4 MW of capacity from a landfill gas generation plant. At December 31, 2013, approximately 88 MW of contracted solar resources and 51 MW of contracted wind resources were operational. The remaining resources are expected to be developed over the next several years. The solar PPAs contain options that allow TEP to purchase all or part of the related project at a future period. See Rates and Regulation, Renewable Energy Standard and Tariff, below.

Purchases and Interconnections

TEP purchases power from other utilities and power marketers. TEP may enter into contracts: (a) to purchase energy under long-term contracts to serve retail load and long-term wholesale contracts, (b) to purchase capacity or energy during periods of planned outages or for peak summer load conditions, and (c) to purchase energy for resale to certain wholesale customers under load and resource management agreements.

TEP typically uses generation from its gas-fired units, supplemented by power purchases, to meet the summer peak demands of its retail customers. Some of these power purchases are price-indexed to natural gas. Due to its increasing seasonal gas and purchased power usage, TEP hedges a portion of its total natural gas exposure with fixed price contracts for a maximum of three years. TEP also purchases energy in the daily and hourly markets to meet higher than anticipated demands, to cover unplanned generation outages, or when doing so is more economical than generating its own energy.

TEP is a member of a regional reserve-sharing organization and has reliability and power sharing relationships with other utilities. These relationships allow TEP to call upon other utilities during emergencies, such as plant outages and system disturbances, and reduce the amount of reserves TEP is required to carry.

As a result of the Energy Policy Act of 2005, owners and operators of bulk power transmission systems, including TEP, are subject to mandatory reliability standards that are developed and enforced by the North American Electric Reliability Corporation (NERC) and subject to the oversight of the FERC. TEP periodically reviews its operating policies and procedures to ensure continued compliance with these standards.

Springerville Units 3 and 4

Springerville Units 3 and 4 are each approximately 400 MW coal-fired generating facilities that are operated, but not owned by TEP. These facilities are located at the same site as Springerville Units 1 and 2. The owners of Springerville Units 3 and 4 compensate TEP for operating the facilities and pay an allocated portion of the fixed costs related to the Springerville Common Facilities and Coal Handling Facilities. See Item 7. – Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power Company, Factors Affecting Results of Operations, Springerville Units 3 and 4.

Peak Demand and Resources

Peak Demand	2013	2012	2011	2010	2009
	MW				
Retail Customers	2,230	2,290	2,334	2,333	2,354
Firm Sales to Other Utilities	484	286	322	340	385
Coincident Peak Demand (A)	2,714	2,576	2,656	2,673	2,739
Total Generating Resources	2,240	2,267	2,262	2,245	2,229
Other Resources [(1)]	775	683	1,009	799	781
Total TEP Resources (B)	3,015	2,950	3,271	3,044	3,010
Total Margin (B) – (A)	301	374	615	371	271
Reserve Margin (% of Coincident Peak Demand)	11 %	15 %	23 %	14 %	10 %

(1) Other Resources include firm power purchases and interruptible retail and wholesale loads.

Peak demand occurs during the summer months due to the cooling requirements of TEP's retail customers. Retail peak demand varies from year-to-year due to weather, economic conditions, and other factors. TEP's retail peak demand declined over the period of 2009 to 2013 due primarily to weak economic conditions and the implementation of energy efficiency programs.

The chart above shows the relationship over a five-year period between TEP's peak demand and its energy resources. TEP's total margin is the difference between total energy resources and coincident peak demand, and the reserve margin is the ratio of

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margin to coincident peak demand. TEP's reserve margin in 2013 was in compliance with reliability criteria set forth by the Western Electricity Coordinating Council, a regional council of NERC.

Forecasted retail peak demand for 2014 is 2,253 MW compared with actual peak demand of 2,230 MW in 2013. TEP's 2014 estimated retail peak demand is based on weather patterns observed over a 10-year period. TEP believes existing generation capacity and power purchase agreements are sufficient to meet expected demand in 2014.

FUEL SUPPLY

Fuel and Purchased Power Summary

Resource information is provided below:

	Average Cost per kWh (cents per kWh)			Percentage of Total kWh Resources					
	2013	2012	2011	2013		2012		2011	
Coal	2.66	2.54	2.56	75	%	72	%	73	%
Gas	4.57	4.54	5.99	8	%	11	%	7	%
Purchased Power	4.83	3.44	3.94	17	%	17	%	20	%
All Sources	3.54	3.19	3.30	100	%	100	%	100	%

Coal

TEP's principal fuel for electric generation is low-sulfur, bituminous or sub-bituminous coal from mines in Arizona and New Mexico. More than 90% of TEP's coal supply is purchased under long-term contracts, which results in more predictable prices. The average cost per ton of coal, including transportation, was $48.51 in 2013, $45.84 in 2012, and $46.64 in 2011.

Station	Coal Supplier	2013 Coal Consumption (tons in 000's)	Contract Expiration	Avg. Sulfur Content	Coal Obtained From[1]
Springerville	Peabody Coalsales	3,172	2020	1.0%	Lee Ranch Coal Co.
Four Corners[2]	BHP Billiton	381	2016	0.8%	Navajo Indian Tribe
San Juan	San Juan Coal Co.	1,306	2017	0.8%	Federal and State Agencies
Navajo	Peabody Coalsales	560	2019	0.6%	Navajo and Hopi Indian Tribes

(1) Substantially all of the suppliers' mining leases extend at least as long as coal is being mined in economic quantities.

(2) Beginning in July 2016 through June 2031, the coal for Four Corners will be purchased from the Navajo Transitional Energy Company (NTEC). NTEC purchased the mine located near Four Corners from BPH Billiton and will begin operating the mine in 2016.

TEP Operated Generating Facilities

The coal supplies for Springerville Units 1 and 2 are transported approximately 200 miles by railroad from northwestern New Mexico. TEP expects coal reserves to be sufficient to supply the estimated requirements for Springerville Units 1 and 2 for their presently estimated remaining lives.

Prior to 2010, Sundt Unit 4 was predominantly fueled by coal; however, the generating station also can be operated with natural gas. Both fuels are combined with methane, a renewable energy resource, delivered from a nearby landfill. Since 2010, TEP has fueled Sundt Unit 4 with both coal and natural gas depending on which resource is most economic. In 2014, TEP expects to fuel Sundt Unit 4 primarily with existing coal supplies at the site. See Note 7.

Generating Facilities Operated by Others

TEP also participates in jointly-owned coal-fired generating facilities at the Four Corners Generating Station (Four Corners), the Navajo Generating Station (Navajo), and the San Juan Generating Station (San Juan). Four Corners, which is operated by Arizona Public Service (APS), and San Juan, which is operated by Public Service Company of New Mexico (PNM), are mine-mouth generating stations located adjacent to the coal reserves. Navajo, which is operated by SRP, obtains its coal supply from a nearby coal mine and a dedicated rail delivery system. The coal supplies are under long-term contracts administered by the

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operating agents. TEP expects the available coal reserves of the suppliers to these three jointly-owned generating facilities to be sufficient for the remaining estimated lives of the stations.

Natural Gas Supply

TEP typically uses generation from its facilities fueled by natural gas, in addition to energy from its coal-fired facilities and purchased power, to meet the summer peak demands of its retail customers and local reliability needs. TEP purchases gas from Southwest Gas Corporation under a retail tariff for North Loop's 95 MW of internal combustion turbines and receives distribution service under a transportation agreement for DeMoss Petrie, a 75 MW internal combustion turbine. TEP purchases capacity from El Paso Natural Gas (EPNG) for transportation from the San Juan and Permian Basins to its Sundt plant under firm transportation agreements and buys gas from third-party suppliers for Sundt and DeMoss Petrie.

TEP also purchases gas transportation for Luna Generating Station (Luna) from EPNG from the San Juan and Permian Basins, utilizing firm transportation agreements with EPNG.

TRANSMISSION ACCESS

TEP has transmission access and power transaction arrangements with over 140 electric systems or suppliers. TEP also has various ongoing projects that are designed to increase access to the regional wholesale energy market and improve the reliability, capacity and efficiency of its existing transmission and distribution systems.

TEP is participating in the continuation of the 500 kV transmission line from the Pinal West substation to the Pinal Central substation. This project is expected to be in service in 2014. TEP is also finalizing the engineering design for a 40-mile 500-kV transmission line from the Pinal Central substation to TEP's Tortolita substation northwest of Tucson to further enhance its ability to access the region's energy resources. TEP expects the Pinal Central to Tortolita line to be in service in 2016. As a result of these transmission additions, TEP expects that its ability to import energy into its service territory would increase by at least 250 MW.

Discontinued Transmission Project

TEP and UNS Electric are parties to a transmission line project initiated in response to an order by the ACC to UNS Electric to improve the reliability of electric service in Nogales, Arizona. TEP had previously capitalized $11 million related to the project, including $2 million to secure land and land rights. UNS Electric had previously capitalized $0.4 million related to the project.

TEP and UNS Electric will not proceed with the project based on the estimated cost of the proposed line, the difficulty in reaching agreement with the Forest Service on a path for the line, and concurrence by the ACC of transmission plans filed by TEP and UNS Electric supporting the elimination of this project. In 2012, TEP and UNS Electric wrote off a portion of the capitalized costs believed not probable of recovery and recorded a regulatory asset for the balance deemed probable of recovery. TEP and UNS Electric believe it is probable that we will recover at least $5 million and $0.2 million, respectively, of costs incurred through 2013. See Note 7.

RATES AND REGULATION

2013 TEP Rate Order

In June 2013, the ACC issued an order (2013 TEP Rate Order) that resolved the rate case filed by TEP in July 2012, which was based on a test year ended December 31, 2011. The 2013 TEP Rate Order approved new rates effective July 1, 2013. See Item 7. - Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power, Factors Affecting Results of Operations, 2013 TEP Rate Order.

Purchased Power and Fuel Adjustment Clause

The Purchased Power and Fuel Adjustment Clause (PPFAC) allows TEP to recover its fuel, transmission, and purchased power costs, including demand charges, and the prudent costs of contracts for hedging fuel and purchased power costs for its retail customers. The PPFAC consists of a forward component and a true-up component.

The true-up component will reconcile any over/under collected amounts from the preceding 12-month period and will be credited to or recovered from customers in the subsequent year.

TEP's PPFAC also includes the recovery of the following costs and/or credits: lime costs used to control SO2 emissions, net of sulfur credits received from TEP's coal suppliers; broker fees; 100% of short-term wholesale revenues and all of the proceeds from the sale of SO2 allowances.

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The 2013 TEP Rate Order approved a new PPFAC rate, effective July 1, 2013, which is a credit to retail customers of 0.14 cents per kWh. This PPFAC rate will be in effect until the rate is reset by the ACC in the second quarter of 2014.
TEP’s current PPFAC rate includes:

- a reduction in the PPFAC bank balance, recorded in June 2013 as an increase to fuel expense, of $3 million related to prior sulfur credits; and
- a transfer of $10 million, recorded in June 2013, from the PPFAC bank balance to a new regulatory asset to defer coal costs related to the San Juan mine fire. These costs will be eligible for recovery through the PPFAC upon final insurance settlement.

Beginning on July 1, 2013, net lime expense is recovered through the PPFAC; these expenses were previously recorded in O&M expense.
At December 31, 2013, TEP had under-collected fuel and purchased power costs on a billed-to-customer basis of $14 million.
In February 2014, TEP filed a request with the ACC to reset the PPFAC in order to collect the under-collected balance from customers.

Renewable Energy Standard and Tariff

The ACC’s Renewable Energy Standard (RES) requires TEP, UNS Electric, and other affected utilities to increase their use of renewable energy each year until it represents at least 15% of their total annual retail energy requirements in 2025. Affected utilities must file annual RES implementation plans for review and approval by the ACC. The approved cost of carrying out those plans is recovered from retail customers through the RES surcharge. In 2010, the ACC approved a funding mechanism that allows TEP to recover operating costs, depreciation, property taxes, and a return on investments in company-owned solar projects through RES funds until such costs are reflected in TEP’s Base Rates.
In October 2013, the ACC approved TEP's 2014 RES implementation plan. Under the plan, TEP expects to collect approximately $34 million from retail customers during 2014 to fund the following: the above market cost of renewable energy purchases; performance based incentives for customer installed distributed generation; a return on and of TEP's investments in company-owned solar projects; and various other program costs. The plan includes approval for a TEP investment of $28 million in 2014 for company-owned solar projects and an additional $12 million in 2015. TEP met the 2013 RES renewable energy target of 4.0% of retail kWh sales and expects to meet the 2014 target of 4.5%.

Electric Energy Efficiency Standards

In 2010, the ACC approved new Electric EE Standards designed to require electric utilities to implement cost-effective programs to reduce customers' energy consumption. The Electric EE Standards require increasing annual targeted retail kWh savings equal to 22% by 2020. Since the implementation of the Electric EE Standards, TEP’s cumulative annual energy savings is approximately 4.4% of retail kWh sales.
DSM programs approved by the ACC, direct load control programs, and energy efficient building codes are acceptable means to meet the Electric EE Standards as set forth by the ACC.
The 2013 TEP Rate Order approved (i) a Lost Fixed Cost Recovery (LFCR) mechanism that will allow TEP to recover certain non-fuel costs that would otherwise go unrecovered due to reduced kWh sales attributed to energy efficiency programs and distributed generation, and (ii) an energy efficiency provision that included a 2013 calendar year budget to fund programs that support the ACC's Electric EE Standards as well as a new performance incentive.
See Item. 7-Management’s Discussion and Analysis of Financial Condition and Result of Operations, Tucson Electric Power, Factors Affecting Results of Operations, 2013 TEP Rate Order.

Competition

Retail Electric Competition Rules

In 1999, the ACC approved the Retail Electric Competition Rules (Rules) that provided a framework for the introduction of retail electric competition in Arizona. Certain portions of the Rules that enabled Electric Service Providers (ESPs) to compete in the retail market were invalidated by an Arizona Court of Appeals decision in 2004. During 2012 and 2013, several companies filed applications for a Certificate of Convenience and Necessity (CC&N)

with the ACC to provide competitive

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retail electric services in TEP's service territory as an ESP. Unless and until the ACC clarifies the Rules and/or grants a CC&N to an ESP, it is not possible for TEP's retail customers to use an alternative ESP.

In May 2013, the ACC considered the possibility of opening Arizona to retail electric competition. After receiving comments from various parties, the ACC voted to close the docket in September 2013 and did not take any steps to implement retail electric competition. See Item. 7—Management’s Discussion and Analysis of Financial Condition and Result of Operations, Tucson Electric Power, Factors Affecting Results of Operations, Competition, Retail Electric Competition Rules.

Technological Developments and Energy Efficiency

New technological developments and the implementation of the Electric EE Standards have reduced energy consumption by TEP's retail customers. TEP's customers also have the ability to install renewable energy technologies and conventional generation units that could reduce their reliance on TEP's services.

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TEP'S UTILITY OPERATING STATISTICS

	2013	2012	2011	2010	2009
Generation and Purchased Power – kWh (000)					
Remote Generation	10,586,972	10,284,612	10,005,127	9,077,032	9,134,183
Local Tucson Generation (Oil, Gas, & Coal)	674,443	803,146	906,496	1,492,885	1,131,399
Renewable Generation	38,206	44,930	28,049	24,511	23,712
Purchased Power	2,328,581	2,328,420	2,686,918	2,846,005	3,809,890
Total Generation and Purchased Power	13,628,202	13,461,108	13,626,590	13,440,433	14,099,184
Less Losses and Company Use	885,026	789,613	822,220	879,423	936,206
Total Energy Sold	12,743,176	12,671,495	12,804,370	12,561,010	13,162,978
Sales – kWh (000)					
Residential	3,866,665	3,820,637	3,888,011	3,869,540	3,905,696
Commercial	2,187,095	2,187,617	2,184,241	2,171,694	2,205,045
Industrial	2,113,659	2,132,214	2,145,163	2,138,749	2,160,946
Mining	1,079,150	1,092,518	1,083,071	1,079,327	1,064,830
Other	32,350	31,833	31,621	32,478	34,226
Total – Electric Retail Sales	9,278,919	9,264,819	9,332,107	9,291,788	9,370,743
Electric Wholesale Sales	3,464,257	3,406,676	3,472,263	3,269,222	3,792,235
Total Electric Sales	12,743,176	12,671,495	12,804,370	12,561,010	13,162,978
Operating Revenues ($000)					
Residential	$400,999	$387,840	$383,908	$372,212	$377,761
Commercial	252,547	247,157	241,044	233,567	236,836
Industrial	164,433	166,739	164,024	159,937	163,720
Mining	65,094	66,158	65,720	62,112	61,033
Other	2,809	2,693	2,601	2,593	2,723
RES, DSM, ECA and LFCR	48,475	45,292	46,633	37,767	25,443
Total – Electric Retail Sales	934,357	915,879	903,930	868,188	867,516
Wholesale Revenue- Long-Term	26,203	24,910	41,056	55,653	48,249
Wholesale Revenue- Short-Term	91,467	71,257	72,798	71,435	84,410
California Power Exchange Provision for Wholesale Refunds	—	—	—	(2,970)	(4,172)
Transmission	14,830	15,793	16,392	20,863	18,974
Other Revenues	129,833	133,821	122,210	112,098	84,361
Total Operating Revenues	$1,196,690	$1,161,660	1,156,386	$1,125,267	$1,099,338
Customers (End of Period)					
Residential	372,411	369,480	367,396	366,217	365,157
Commercial	37,913	37,672	37,536	37,215	37,027
Industrial	617	632	636	635	629
Mining	4	4	4	4	4
Public Authorities	1,857	1,833	1,814	1,829	1,839
Total Retail Customers	412,802	409,621	407,386	405,900	404,656
Average Retail Revenue per kWh Sold (cents)					
Residential	10.4	10.2	9.9	9.6	9.7
Commercial	11.5	11.3	11.0	10.8	10.7
Industrial and Mining	7.2	7.2	7.1	6.9	7.0
	9.5	9.4	9.2	8.9	9.0

Average Retail Revenue per kWh Sold (excludes RES, DSM, ECA and LFCR)					
Average Revenue per Residential Customer	$1,077	$1,050	$1,045	$1,016	$1,035
Average kWh Sales per Residential Customer	10,383	10,341	10,583	10,566	10,696

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ENVIRONMENTAL MATTERS

Environmental Regulation

The Environmental Protection Agency (EPA) limits the amount of sulfur dioxide (SO2), nitrogen oxide (NOx), particulate matter, mercury and other emissions released into the atmosphere by power plants. TEP may incur added costs to comply with future changes in federal and state environmental laws, regulations, and permit requirements at its power plants. Complying with these changes may reduce operating efficiency. TEP expects to recover the cost of environmental compliance from its customers.

Hazardous Air Pollutant Requirements

The Clean Air Act requires the EPA to develop emission limit standards for hazardous air pollutants that reflect the maximum achievable control technology. In February 2012, the EPA issued final rules to set the standards for the control of mercury emissions and other hazardous air pollutants from power plants.

Navajo

Based on the EPA’s standards, Navajo may require mercury and particulate matter emission control equipment by 2015. TEP’s share of the estimated capital cost of this equipment is less than $1 million for mercury control and about $43 million if the installation of baghouses to control particulates is necessary. The operator of Navajo is currently analyzing the need for baghouses under various regulatory scenarios, which will be affected by final Best Available Retrofit Technology (BART) rules when issued. TEP expects its share of the annual operating costs for mercury control and baghouses to be less than $1 million each.

San Juan

TEP expects San Juan’s current emission controls to be adequate to comply with the EPA’s final standards.

Four Corners

Based on the EPA’s final standards, Four Corners may require mercury emission control equipment by 2015. TEP's share of the estimated capital cost of this equipment is less than $1 million. TEP expects its share of the annual operating cost of the mercury emission control equipment to be less than $1 million.

Springerville Generating Station

Based on the EPA’s final standards, Springerville Generating Station (Springerville) may require mercury emission control equipment by 2015. The estimated capital cost of this equipment for Springerville Units 1 and 2 is about $5 million. TEP expects the annual operating cost of the mercury emission control equipment to be about $3 million. TEP will own 49.5% of Springerville Unit 1 upon close of the lease option purchases by early 2015; after the completion of such purchases, 50.5% of environmental costs attributed to Springerville Unit 1 will be reimbursed by third party owners.

Sundt Generating Station

TEP expects the final EPA standards will have little effect on capital expenditures at Sundt Generating Station (Sundt).

Regional Haze Rules

The EPA's Regional Haze Rules require emission controls known as BART for certain industrial facilities emitting air pollutants that reduce visibility in national parks and wilderness areas. The rules call for all states to establish goals and emission reduction strategies for improving visibility. States must submit these goals and strategies to the EPA for approval. BART applies to plants built between August 1962 and August 1977. Because Navajo and Four Corners are located on the Navajo Indian Reservation, they are not subject to state oversight; the EPA oversees regional haze planning for these power plants.

Complying with the EPA’s BART findings, and with other future environmental rules, may make it economically impractical to continue operating the Navajo, San Juan, and Four Corners power plants or for individual owners to continue to participate in these power plants. TEP cannot predict the ultimate outcome of these matters.

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Navajo

In January 2013, the EPA proposed a BART determination that would require the installation of Selective Catalytic Reduction (SCR) technology on all three units at Navajo by 2023. In July 2013, SRP, along with other stakeholders including impacted government agencies, environmental organizations, and tribal representatives, submitted an agreement to the EPA that would achieve greater NOx emission reductions than the EPA's proposed BART rule. In September 2013, the EPA issued a supplemental proposal incorporating the provisions of the agreement as a better-than-BART alternative.

Among other things, the agreement calls for the shut-down of one unit or an equivalent reduction in emissions by 2020. The shutdown of one unit will not impact the total amount of energy delivered to TEP from Navajo. Additionally, the remaining Navajo participants would be required to install SCR or an equivalent technology on the remaining two units by 2030. As part of the agreement, the current owners have committed to cease their operation of conventional coal-fired generation at Navajo no later than December 2044. The Navajo Nation can continue operation after 2044 at its election. If SCR technology is ultimately implemented at Navajo, TEP estimates its share of the capital cost will be $42 million. Also, the installation of SCR technology at Navajo could increase the power plant's particulate emissions which may require that baghouses be installed. TEP estimates that its share of the capital expenditure for baghouses would be about $43 million. TEP's share of annual operating costs for SCR and baghouses is estimated at less than $1 million each. The EPA could issue their decision as early as mid-2014.

San Juan

In August 2011, the EPA issued a Federal Implementation Plan (FIP) establishing new emission limits for air pollutants at San Juan. These requirements are more stringent than those proposed by the State of New Mexico. The FIP requires the installation of SCR technology with sorbent injection on all four units to reduce NOx and control sulfuric acid emissions by September 2016. TEP estimates its share of the cost to install SCR technology with sorbent injection to be between $180 million and $200 million. TEP expects its share of the annual operating costs for SCR technology to be approximately $6 million.

In 2011, Public Service Company of New Mexico (PNM) filed a petition for review of, and a motion to stay, the FIP with the United States Court of Appeals for the Tenth Circuit (Tenth Circuit). In addition, the operator filed a request for reconsideration of the rule with the EPA and a request to stay the effectiveness of the rule pending the EPA's reconsideration and review by the Tenth Circuit. The State of New Mexico filed similar motions with the Tenth Circuit and the EPA. Several environmental groups were granted permission to join in opposition to PNM's petition to review in the Tenth Circuit. In addition, WildEarth Guardians filed a separate appeal against the EPA challenging the FIP's five-year implementation schedule. PNM was granted permission to join in opposition to that appeal. In March 2012, the Tenth Circuit denied PNM's and the State of New Mexico's motion for stay. Oral argument on the appeal was heard in October 2012.

In February 2013, the State of New Mexico, the EPA, and PNM signed a non-binding agreement (Settlement Agreement) that outlines an alternative to the FIP. The terms of the Settlement Agreement include: the retirement of San Juan Units 2 and 3 by December 31, 2017; the replacement by PNM of those units with non-coal generation sources; and the installation of Selective Non-Catalytic Reduction technology (SNCR) on San Juan Units 1 and 4 by January 2016 or later depending on the timing of EPA approvals. The New Mexico Environmental Department (NMED) prepared a revision to the regional haze State Implementation Plan (SIP) incorporating the provisions of the Settlement Agreement, and in September 2013, the New Mexico Environmental Improvement Board approved the SIP revision. The SIP revision now awaits final EPA approval. The EPA is expected to issue a final BART determination in the second or third quarter of 2014. TEP estimates its share of the cost to install SNCR technology on San Juan Unit 1 would be approximately $35 million. TEP's share of incremental annual operating costs for SNCR is estimated at $1 million. TEP owns 340 MW, or 50%, of San Juan Units 1 and 2. If San Juan Unit 2 is retired, TEP's coal-fired generating capacity would be reduced by 170 MW.

In connection with the implementation of the SIP revision and the retirement of San Juan Units 2 and 3, some of the San Juan owner participants (Participants) have expressed a desire to exit their ownership in the plant. As a result, the Participants are attempting to negotiate a restructuring of the ownership in San Juan, as well as addressing the obligations of the exiting Participants for plant decommissioning, mine reclamation, environmental matters, and

certain ongoing operating costs, among other items. The Participants have engaged a mediator to assist in facilitating the resolution of these matters among the owners. The owners of the affected units also may seek approvals of their utility commissions or governing boards. We are unable to predict the outcome of the negotiations and mediation.

On October 17, 2013, the Tenth Circuit ruled on a motion filed by PNM for abatement of the pending petitions for review and seeking deferral of briefing on a simultaneously-filed motion to stay the FIP. The Tenth Circuit placed the pending petitions for

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review in abeyance and set a schedule for the parties to file status reports. The court ruled that, if at any time the Settlement Agreement is not implemented as contemplated, any party to the litigation may file a motion seeking to lift the abatement.

At December 31, 2013, the book value of TEP's share of San Juan Unit 2 was $113 million. If Unit 2 is retired early, we expect to request ACC approval to recover, over a reasonable time period, all costs associated with the early closure of the unit. TEP cannot predict the ultimate outcome of this matter.

Four Corners

In 2012, the EPA finalized the regional haze FIP for Four Corners. The final FIP requires SCR technology to be installed on all five units by 2017. In December 2013, APS (the operator) decided to shut down Units 1-3 and install SCRs on Units 4 and 5. Under this scenario, the installation of SCR technology can be delayed until July 2018. TEP's estimated share of the capital costs to install SCR technology on Units 4 and 5 is approximately $35 million. TEP's share of incremental annual operating costs for SCR is estimated at $2 million.

Springerville

The BART provisions of the Regional Haze Rules requiring emission control upgrades do not apply to Springerville Units 1 and 2 since they were constructed in the 1980s which is after the time frame as designated by the rules. Other provisions of the Regional Haze Rule requiring further emission reduction are not likely to impact Springerville operations until after 2018.

Sundt

In July 2013, the EPA rejected the Arizona state implementation plan determination that Sundt Unit 4 is not subject to the BART provisions of the Regional Haze Rule and developed a timeline to issue a federal implementation plan for emissions sources including Sundt Unit 4. While TEP does not agree that Sundt Unit 4 is subject to BART, it submitted a better-than-BART proposal in November 2013 which called for the elimination of coal as a fuel source at Sundt by 2017. In January 2014, the EPA issued a BART proposal that would require TEP to either (i) install, by mid-2017, SNCR and other equipment if Sundt Unit 4 continues to use coal as a fuel source, or (ii) permanently eliminate coal as a fuel source as a better-than-BART alternative by the end of 2017. TEP estimates that the cost to install SNCR and other necessary equipment would be approximately $12 million, and the incremental annual operating costs would be $5 million to $6 million. Under the proposal, TEP would be required to notify the EPA of its decision by July 31, 2015. The EPA is expected to issue a final BART determination by July 2014. At December 31, 2013, the net book value of the Sundt coal handling facilities was $27 million. If the coal handling facilities are retired early, we expect to request ACC approval to recover, over a reasonable time period, all the remaining costs of the coal handling facilities.

Greenhouse Gas Regulation

In June 2013, President Obama directed the EPA to move forward with carbon emission regulations for both new and existing fossil-fueled power plants.

In January 2014, the EPA published a re-proposed rule for new power plants. UNS Energy does not anticipate that a final rule related to new fossil-fueled power plant sources will have a significant impact on operations.

For existing power plants, the President ordered the EPA to:

- propose carbon emission standards by June 1, 2014;
- finalize those standards by June 1, 2015; and
- require states to submit their implementation plans to meet the standards by June 30, 2016.

UNS Energy will continue to work with federal and state regulatory agencies to promote compliance flexibility in the rules impacting existing fossil-fuel fired power plants. We cannot predict the ultimate outcome of these matters.

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The table below provides a summary of the estimated impact of pending environmental regulations on TEP's annual O&M expense and capital expenditures.

Generating Facility	Estimated Annual O&M Expense	Estimated Capital Expenditures	Regulation (Compliance Date)	Upgrades
	Millions of Dollars			
Springerville Units 1 & 2[1]	$3	$5	MATS (2015)	Mercury Controls
San Juan Unit 1	1 - 6	35 - 200	Regional Haze/BART (2016)	SNCRs or SCRs
Navajo Units 1-3	3	86	MATS (2015) Regional Haze/BART (2030)	Mercury Controls; SCRs; Baghouses
Four Corners Units 4 & 5	3	36	MATS (2015) Regional Haze/BART (2018)	Mercury Controls; SCRs
Sundt Unit 4	5 - 6	12	Regional Haze (2017)	SNCR

(1) TEP will own 49.5% of Springerville Unit 1 upon close of the lease option purchases by early 2015; after the completion of such purchases, 50.5% of environmental costs attributed to Springerville Unit 1 will be reimbursed by third party owners.

Certain environmental costs and investments can be recovered by TEP through a retail rate mechanism, called the Environmental Cost Adjustor, that was approved in the 2013 TEP Rate Order. See Item 7. – Management's Discussion and Analysis of Financial Condition and Results of Operations, TEP, Factors Affecting Results of Operations, 2013 TEP Rate Order.

Coal Combustion Residuals

In 2010, the EPA proposed a rule to regulate the handling and disposal of coal ash and other Coal Combustion Residuals (CCRs). The EPA has proposed regulating CCRs as either non-hazardous solid waste or hazardous waste. The hazardous waste alternative would require additional capital investments and operational costs for both storage and handling at plants and transportation to disposal locations. Both the hazardous waste and non-hazardous solid waste alternatives would require liners for new ash landfills or expansions to existing ash landfills. The rules will apply to CCRs produced by all of TEP's coal-fired generating assets. San Juan may also be subject to separate regulations being drafted by the Office of Surface Mining Reclamation and Enforcement because it disposes of CCRs in surface mine pits.

The EPA has not yet indicated a preference for regulating CCRs. Each option would allow CCRs to be beneficially reused or recycled as components of other products. We expect the EPA to issue a final rule in late 2014. TEP cannot predict the outcome of this matter.

UNS ELECTRIC

SERVICE TERRITORY AND CUSTOMERS

UNS Electric is a vertically integrated electric utility company serving approximately 93,000 retail customers in Mohave and Santa Cruz counties. These counties have a combined population of approximately 250,000. UNS Electric's annual retail customer growth rate was less than 1% from 2010 through 2013. We estimate that UNS Electric's retail customer base will increase by less than 1% in 2014. UNS Electric's customer base is primarily residential, with some commercial and industrial customers. Peak demand for 2013 was 423 MW.

POWER SUPPLY AND TRANSMISSION

Purchased Energy

UNS Electric relies on a portfolio of long, intermediate, and short-term power purchases to meet customer load requirements.

Generating Resources

UNS Electric owns and operates Black Mountain Generating Station (BMGS), a 90 MW gas-fired facility located near Kingman, Arizona. In July 2011, UNS Electric purchased BMGS from UED. UNS Gas purchases and transports

natural gas to BMGS for UNS Electric under long-term natural gas transportation and sales agreements.

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UNS Electric also owns and operates the Valencia Power Plant (Valencia), located in Nogales, Arizona. Valencia consists of four gas and diesel-fueled combustion turbine units and provides approximately 62 MW of peaking resources. The facility is directly interconnected with the distribution system serving the city of Nogales and the surrounding areas.

Renewable Energy Resources

UNS Electric agreed to purchase the output of a combined wind farm and solar generating facility located near Kingman. The above-market cost of energy purchased through the 20-year PPA will be recovered through the RES surcharge. For more information see Rates and Regulation, Renewable Energy Standard and Tariff below.

Future Generating Resources

Gila River Generating Station Unit 3

In December 2013, UNS Electric entered into an agreement to purchase 25% of Gila River Unit 3 (137 MW) for approximately $55 million, with TEP purchasing the remaining 75% interest (413 MW). The purchase price is subject to adjustments to prorate certain fees and expenses through the closing and in respect of certain operational matters. TEP and UNS Electric may also modify the percentage ownership allocation between them. We expect the transaction to close in December 2014.

The purchase of a 25% interest of Gila River Unit 3 would be consistent with UNS Electric's strategy to reduce its reliance on wholesale market purchases to meet retail customer demand.

See TEP, Generating and Other Resources, Future Generating Resources, Gila River Generating Station Unit 3, above, and Note 8.

Renewable Energy Resources

UNS Electric expects to invest approximately $7 million in 2014 in company-owned solar PV capacity. See Note 3.

Transmission

UNS Electric imports the power generated at BMGS into its Mohave County service territory over Western Area Power Administration’s (WAPA) transmission lines. UNS Electric has transmission service agreements with WAPA for its transmission capacity that expire in June 2016.

UNS Electric imports the power generated at Valencia into its Santa Cruz County service territory over its own transmission lines.

Tucson to Nogales 138kV Transmission Line

UNS Electric completed construction of a 138kV transmission line from Tucson to Nogales at the end of 2013. This project replaces a 115kV transmission line that previously linked UNS Electric's load to the WAPA system. The new transmission line now connects UNS Electric's load in Nogales directly to TEP’s high voltage transmission system. The connection to TEP’s system eliminates a requirement to run local generation in Nogales that was required due to limitations on the WAPA system.

RATES AND REGULATION

2013 UNS Electric Rate Order

In December 2013, the ACC issued an order (2013 UNSE Rate Order) that resolved the rate case filed by UNSE in December 2012, which was based on a test year ended June 30, 2012. The 2013 UNSE Rate Order approved a $3 million non-fuel base rate increase and a new rate structure effective January 1, 2014. See Item 7. – Management’s Discussion and Analysis of Financial Condition and Results of Operations, UNS Electric, Factors Affecting Results of Operations, 2013 UNS Electric Rate Order.

Purchased Power and Fuel Adjustment Clause

The PPFAC, which is reset monthly, allows UNS Electric to recover its fuel, transmission, and purchased power costs, including demand charges, broker fees, and the prudent costs of contracts for hedging fuel and purchased power costs for its retail customers.

If the PPFAC bank balance becomes over collected by more than $10 million, UNS Electric must file for a PPFAC rate adjustment or justify why an adjustment is not necessary at this time. UNS Electric can request a surcharge to recover costs if

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the PPFAC bank balance is under-collected. At December 31, 2013, the PPFAC bank balance was over-collected by $14 million on a billed-to-customer basis. See Note 3.

Renewable Energy Standard and Tariff

As part of a rate order issued in 2010, the ACC authorized UNS Electric to recover operating costs, depreciation, property taxes, and a return on its investment in company-owned solar projects through RES funds until these costs are reflected in its Base Rates.

In October 2013, the ACC approved UNS Electric's 2014 RES implementation plan. Under the plan, UNS Electric will collect approximately $6 million from customers during 2014 to fund the following: the above market cost of renewable energy purchases; incentives for customer installed distributed generation; a return on and of UNS Electric's investments in company-owned solar projects; and various other program costs. The plan includes approval for a UNS Electric investment of $7 million in 2014 for company-owned solar projects.

Energy Efficiency Standards

Since the implementation of the Electric EE Standards in 2010, UNS Electric saved cumulative annual energy equal to approximately 4.7% of retail kWh sales. See TEP, Rates and Regulation, Electric Energy Efficiency Standards, above.

The 2013 UNS Electric Rate Order approved a LFCR mechanism that will allow UNS Electric to recover certain non-fuel costs that would otherwise go unrecovered due to reduced kWh sales attributed to energy efficiency programs and distributed generation. See Item. 7-Management’s Discussion and Analysis of Financial Condition and Results of Operations, UNS Electric, Factors Affecting Results of Operations, 2013 UNS Electric Rate Order.

In December 2013, the ACC approved UNS Electric’s 2013-2014 Energy Efficiency implementation plan that included a 2014 calendar year budget to fund programs that support the ACC’s Electric EE Standards as well as a new performance incentive.

ENVIRONMENTAL MATTERS

UNS Electric is subject to environmental regulation of air and water quality, resource extraction, waste disposal, and land use by federal, state, and local authorities. UNS Electric believes that its facilities are in substantial compliance with all existing regulations and will be in compliance with expected environmental regulations. See Note 7.

UNS GAS

SERVICE TERRITORY AND CUSTOMERS

UNS Gas is a gas distribution company serving approximately 150,000 retail customers in Mohave, Yavapai, Coconino, Navajo, and Santa Cruz counties in Arizona. These counties comprise approximately 50% of the territory in the state of Arizona, with a population of approximately 700,000. UNS Gas’ customer base is primarily residential. Sales to residential customers provided approximately 61% of total revenues in 2013.

UNS Gas’ annual retail customer growth rate was less than 1% from 2010 through 2013. In 2014, we expect UNS Gas’ retail customer base to increase by less than 1%.

GAS SUPPLY AND TRANSPORTATION

UNS Gas directly manages its gas supply and transportation contracts. The market price for gas varies based upon the period during which the commodity is purchased and is affected by weather, production issues, the economy, and other factors. UNS Gas hedges its gas supply prices by entering into physical fixed price forward agreements and financial contracts in order to provide more stable prices to its customers. These purchases are made up to three years in advance with the goal of hedging at least 60% of the price of expected monthly gas consumption. UNS Gas hedged approximately 65% of its expected monthly consumption for the 2013/2014 winter season (November through March). Additionally, UNS Gas has approximately 60% of its expected gas consumption hedged for April through October 2014, and 40% hedged for the 2014/2015 winter season.

UNS Gas buys most of the gas it distributes from the San Juan Basin. The gas is delivered on the El Paso Natural Gas (EPNG) and Transwestern Pipeline Company (Transwestern) interstate pipeline systems under firm transportation agreements with combined capacity sufficient to meet UNS Gas’ customers’ demands.

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UNS Gas has average capacity rights of approximately 655,000 therms per day on the EPNG pipeline system, with an average of 1,095,000 therms per day in the winter season (November through March) to serve its service territories.
UNS Gas has average capacity rights of 230,000 therms per day on the San Juan Lateral and Mainline of the Transwestern pipeline. The Transwestern pipeline principally delivers gas to the portion of UNS Gas' distribution system serving customers in Flagstaff and Kingman.
UNS Gas has a separate agreement with Transwestern for transportation capacity rights on the Phoenix Lateral Extension Line that expires in 2024. UNS Gas' average daily capacity right is 126,000 therms per day, with an average of 222,000 therms per day in the winter season.
See Item 7. – Management's Discussion and Analysis of Financial Condition and Results of Operations, UNS Gas, Liquidity and Capital Resources, Contractual Obligations.

RATES AND REGULATION

2012 UNS Gas Rate Order

In April 2012, the ACC approved a Base Rate increase of $2.7 million as well as a partial decoupling mechanism to recover lost fixed cost revenues as a result of implementing the Gas Energy Efficiency Standards (Gas EE Standards).
See Item 7. – Management's Discussion and Analysis of Financial Condition and Results of Operations, UNS Gas, Factors Affecting Results of Operations, 2012 UNS Gas Rate Order.

Purchased Gas Adjustor

The PGA mechanism is intended to address the volatility of natural gas prices and allow UNS Gas to recover its actual commodity costs, including transportation, through a price adjustor. The difference between UNS Gas' actual monthly gas and transportation costs and the rolling 12-month average cost of gas and transportation is deferred and recovered or returned to customers through the PGA mechanism.
At any time UNS Gas' PGA balancing account, called the PGA bank balance, is under-recovered, UNS Gas may request a PGA surcharge with the goal of collecting the amount deferred from customers over a period deemed appropriate by the ACC. When the PGA bank balance reaches an over-collected balance of $10 million on a billed-to-customer basis, UNS Gas is required to make a filing with the ACC to determine how the over-collected balance should be returned to customers.
In October 2013, the ACC approved an increase to the existing customer PGA credit from 4.5 cents per therm to 10 cents per therm in order to reduce the over-collected PGA bank balance. The PGA credit will be effective for the period November 1, 2013 through April 30, 2014. At December 31, 2013, the PGA bank balance was over-collected by $10 million on a billed-to-customer basis.

Gas Energy Efficiency Standards and Decoupling

In 2010, the ACC approved Gas EE Standards which are designed to require UNS Gas and other affected utilities to implement cost-effective DSM programs. The Gas EE standards require increasing annual targeted retail therm savings equal to 6% by 2020. Since the implementation of the Gas EE Standards in 2010, UNS Gas' customers have saved cumulative energy equal to approximately 0.5% of total retail therm sales.
New and existing DSM programs, renewable energy technology that displaces gas, and certain energy efficient building codes are acceptable means to meet the Gas EE Standards. The Gas EE Standards provide for the recovery of costs incurred to implement DSM programs. UNS Gas' DSM programs and rates charged to retail customers for these programs are subject to ACC approval.
In June 2013, the ACC approved the UNS Gas 2011-2012 Gas Energy Efficiency implementation plan with modifications and amendments. The approval included an annual energy efficiency budget of approximately $2 million and a waiver of the Gas EE Standards through 2013.

ENVIRONMENTAL MATTERS

UNS Gas is subject to environmental regulation of air and water quality, resource extraction, waste disposal, and land use by federal, state, and local authorities. UNS Gas' facilities are in substantial compliance with existing regulations.

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EMPLOYEES (At December 31, 2013)

TEP had 1,398 employees, of which approximately 678 were represented by the International Brotherhood of Electrical Workers (IBEW) Local No. 1116. A new collective bargaining agreement between the IBEW and TEP was entered into in January 2013 and expires in January 2016.

UNS Electric had 143 employees, of which 27 employees were represented by the IBEW Local No. 387 and 87 employees were represented by the IBEW Local No. 769. The existing agreements with the IBEW Local No. 387 and No. 769 expire in February 2017 and June 2016, respectively.

UNS Gas had 188 employees, of which 109 employees were represented by IBEW Local No. 1116 and 5 employees were represented by IBEW Local No. 387. The agreements with the IBEW Local No. 1116 and No. 387 expire in June 2015 and February 2017, respectively.

SES had 248 employees, of which 216 are represented by IBEW Local No. 1116 and 19 by IBEW Local No. 570. These agreements expire in December 2014 and May 2016, respectively.

EXECUTIVE OFFICERS OF THE REGISTRANTS

Executive Officers – UNS Energy and TEP

Executive Officers of UNS Energy and TEP, who are elected annually by UNS Energy's Board of Directors and TEP's Board of Directors, are as follows:

Name	Age	Position(s) Held	Executive Officer Since
Paul J. Bonavia	62	Chairman and Chief Executive Officer	2009
David G. Hutchens	47	President and Chief Operating Officer	2007
Kevin P. Larson	57	Senior Vice President and Chief Financial Officer[1]	2000
Philip J. Dion III	45	Senior Vice President, Public Policy and Customer Solutions	2008
Kentton C. Grant	55	Vice President, Finance and Rates[2]	2007
Todd C. Hixon	47	Vice President and General Counsel	2011
Karen G. Kissinger	59	Vice President and Chief Compliance Officer	1991
Mark C. Mansfield	58	Vice President, Energy Resources	2012
Frank P. Marino	49	Vice President and Controller	2013
Thomas A. McKenna	65	Vice President, Energy Delivery	2007
Catherine E. Ries	54	Vice President, Human Resources and Information Technology	2007
Herlinda H. Kennedy	52	Corporate Secretary	2006

(1) Mr. Larson is also Treasurer at UNS Energy.

(2) Mr. Grant is also Treasurer at TEP.

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Paul J. Bonavia	Mr. Bonavia has served as Chairman and Chief Executive Officer of UNS Energy and TEP since January 2009. He also served as President from January 2009 to December 2011. Prior to joining UNS Energy, Mr. Bonavia served as President of the Utilities Group of Xcel Energy. Mr. Bonavia previously served as President of Xcel Energy's Commercial Enterprises business unit and President of the company's Energy Markets unit.
David G. Hutchens	Mr. Hutchens has served as President and Chief Operating Officer of UNS Energy and TEP since August 2013. In December 2011 Mr. Hutchens was named President of UNS Energy and TEP. In March 2011, Mr. Hutchens was named Executive Vice President of UNS Energy and TEP. In May 2009, Mr. Hutchens was named Vice President of Energy Efficiency and Resource Planning. In January 2007, Mr. Hutchens was elected Vice President of Wholesale Energy at UNS Energy and TEP. Mr. Hutchens joined TEP in 1995.
Kevin P. Larson	Mr. Larson has served as Senior Vice President and Chief Financial Officer of UNS Energy and TEP since September 2005. Mr. Larson is also Treasurer of UNS Energy. Mr. Larson joined TEP in 1985 and thereafter held various positions in its finance department and investment subsidiaries. He was elected Treasurer in August 1994 and Vice President in March 1997. In October 2000, he was elected Vice President and Chief Financial Officer.
Philip J. Dion III	Mr. Dion has served as Senior Vice President, Public Policy and Customer Solutions of UNS Energy and TEP since August 2013. Mr. Dion was named Vice President, Public Policy in April 2010. Mr. Dion joined UNS Energy in February 2008 as Vice President of Legal and Environmental Services. Prior to joining UNS Energy, Mr. Dion was chief of staff and chief legal advisor to Commissioner Marc Spitzer of the FERC. Mr. Dion previously worked in various roles at the ACC, including as an administrative law judge and as an advisor to Mr. Spitzer, prior to his appointment to the FERC.
Kentton C. Grant	Mr. Grant has served as Vice President of Finance and Rates of UNS Energy and TEP since January 2007. Mr. Grant also serves as Treasurer of TEP. Mr. Grant joined TEP in 1995.
Todd C. Hixon	Mr. Hixon has served as Vice President and General Counsel of UNS Energy and TEP since May 2011. Mr. Hixon joined TEP's legal department in 1998 and served in a variety of capacities, most recently serving as Associate General Counsel.
Karen G. Kissinger	Ms. Kissinger has served as Vice President and Chief Compliance Officer of UNS Energy and TEP since August 2013. Ms. Kissinger served as Vice President, Controller, and Chief Compliance Officer from 2001 to 2013. Ms. Kissinger joined TEP as Vice President and Controller in January 1991.
Mark C. Mansfield	Mr. Mansfield has served as Vice President, Energy Resources since 2012. He joined the company in 2008, most recently serving as Senior Director of Generation. Prior to joining TEP, Mr. Mansfield held various leadership positions at PacifiCorp Energy from 1992-2008.
Frank P. Marino	Mr. Marino has served as Vice President and Controller of UNS Energy and TEP since August 2013. Mr. Marino joined UNS Energy as Assistant Controller in January 2013. Prior to joining UNS Energy, he served various roles at the AES Corporation, a global power company. In 2012 he served as AES' Vice President for Business Demand and Outsourcing Management, and from 2007-2011 he served as Chief Financial Officer for two different business units.
Thomas A. McKenna	Mr. McKenna has served as Vice President, Energy Delivery since August 2013. Mr. McKenna was named Vice President, Engineering in January 2007. Mr. McKenna joined Nations Energy Corporation (a then wholly-owned subsidiary of Millennium) in 1998.
Catherine E. Ries	Ms. Ries has served as Vice President, Human Resources and Information Technology, since May 2013. Ms. Ries joined UNS Energy and TEP as Vice President of Human Resources in June 2007. Prior to joining UNS Energy, Ms. Ries worked for Clopay Building Products, a division of Griffon Corporation, from 2000 to 2007, and held the position of Vice President of Human Resources.

Herlinda H. Kennedy	Ms. Kennedy has served as Corporate Secretary of UNS Energy and TEP since September 2006. Ms. Kennedy joined TEP in 1980 and was named assistant Corporate Secretary in 1999.

SEC REPORTS AVAILABLE ON UNS ENERGY'S WEBSITE

UNS Energy and TEP make available their annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practical after they electronically file them with, or furnish them to, the Securities and Exchange Commission (SEC). These reports are available free of charge through UNS Energy's website address: http://www.uns.com. A link from UNS Energy's website to these SEC reports is accessible as follows: At the UNS Energy main page, select Investors from the menu shown at the top of the page; next select SEC filings from the menu shown on the Investor Relations page. UNS Energy's code of ethics, which applies to the Board of Directors and all officers and employees of UNS Energy and its subsidiaries, and any amendments or any waivers made to the code of ethics, is also available on UNS Energy's website.

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UNS Energy and TEP are providing the address of UNS Energy's website solely for the information of investors and do not intend the address to be an active link. Information contained at UNS Energy's website is not part of any report filed with the SEC by UNS Energy or TEP.

ITEM 1A. – RISK FACTORS

The business and financial results of UNS Energy and TEP are subject to a number of risks and uncertainties, including those set forth below and in other documents we file with the SEC. These risks and uncertainties fall primarily into six major categories: the proposed Merger, revenues, regulatory, environmental, financial, and operational.

RISKS RELATED TO THE PROPOSED MERGER WITH FORTIS

The Proposed Merger with Fortis May Not Be Completed.

The proposed Merger with Fortis requires approval by UNS Energy shareholders, the FERC, the Committee on Foreign Investment in the United States, and the ACC. Such approvals may not be obtained. For example, the ACC may not approve the Merger or may seek to impose conditions on the completion of the transaction, which could cause the conditions to the Merger to not be satisfied or which could delay or increase the cost of the transaction. In addition, the occurrence of a material adverse effect or the failure to satisfy other closing conditions could result in a termination of the Merger Agreement by Fortis.

Termination Fee

UNS Energy will be obligated to reimburse up to $12.5 million of Fortis' expenses if (i) Fortis or UNS Energy terminates the Merger Agreement because the acquisition has not been completed by December 11, 2014 (which may be extended under certain circumstances) or Fortis terminates the Merger Agreement based on a breach of the Merger Agreement by UNS Energy, and (ii) a competing proposal has been made or publicly disclosed and not withdrawn prior to the termination of the Merger Agreement or applicable breach. In addition, if within twelve months after such termination, a definitive agreement providing for an acquisition transaction is entered into, or an acquisition transaction is consummated by UNS Energy with, the person who made the acquisition proposal prior to such termination or applicable breach or with any other third party making an acquisition proposal within three months following such termination, UNS Energy will be obligated to pay Fortis a termination fee of approximately $64 million (less any expense reimbursement previously paid). In no event will more than one termination fee be payable.

Access to Capital and Market Value of UNS Energy Common Stock

Failure to complete the Merger could: (i) affect the value of UNS Energy's common stock, including by reducing it to a level at or below the trading range preceding the announcement of the Fortis transaction; and (ii) negatively affect our access to and cost of both equity and debt financing.

REVENUES

National and local economic conditions can negatively affect on the results of operations, net income, and cash flows at TEP, UNS Electric, and UNS Gas.

Economic conditions have contributed significantly to a reduction in TEP's retail customer growth and lower energy usage by the company's residential, commercial, and industrial customers. As a result of weak economic conditions, TEP's average retail customer base grew by less than 1% in each year from 2009 through 2013 compared with average increases of approximately 2% in each year from 2004 to 2008. In 2013, total retail kWh sales were 0.2% above 2012 levels. TEP estimates that a 1% change in annual retail sales could impact pre-tax net income and pre-tax cash flows by approximately $6 million.

Similar impacts were felt at UNS Electric and UNS Gas. Annual average increases in the number of retail customers at both companies remained below 1% in 2009 through 2013 compared with average annual growth rates of 3% from 2004 to 2008. We estimate that a 1% change in annual retail sales at UNS Electric and UNS Gas could impact pre-tax net income and pre-tax cash flows by approximately $1 million.

New technological developments and the implementation of new Energy Efficiency Standards will continue to have a significant impact on retail sales, which could negatively impact UNS Energy's results of operations, net income, and cash flows.

Research and development activities are ongoing for new technologies that produce power or reduce power consumption. These technologies include renewable energy, customer-owned generation, and appliances and equipment. TEP and UNS

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Electric also are promoting DSM programs designed to help customers reduce their energy use, and these efforts will increase significantly under energy efficiency rules approved in 2010 by the ACC. Further development and use of these technologies and implementation of these rules would negatively impact the results of operations, net income, and cash flows of TEP and UNS Electric.

The revenues, results of operations, and cash flows of TEP, UNS Electric, and UNS Gas are seasonal, and are subject to weather conditions and customer usage patterns, which are beyond the companies' control.

TEP typically earns the majority of its operating revenue and net income in the third quarter because retail customers increase their air conditioning usage during the summer. Conversely, TEP's first quarter net income is typically limited by relatively mild winter weather in its retail service territory. UNS Electric's earnings follow a similar pattern, while UNS Gas' sales peak in the winter during home heating season. Cool summers or warm winters may reduce customer usage at all three companies, adversely affecting operating revenues, cash flows, and net income by reducing sales.

TEP and UNS Electric are dependent on a small segment of large customers for future revenues. A reduction in the electricity sales to these customers would negatively affect our results of operations, net income, and cash flows.

TEP and UNS Electric sell electricity to mines, military installations, and other large industrial customers. In 2013, 35% of TEP's retail kWh sales, and 14% of UNS Electric's retail kWh sales, were to industrial and mining customers. Retail sales volumes and revenues from these customer classes could decline as a result of, among other things: economic conditions; decisions by the federal government to close military bases; the effects of energy efficiency and distributed generation; or the decision by customers to self-generate all or a portion of the energy needs. A reduction in retail kWh sales to TEP's and UNS Electric's large customers would negatively affect our results of operations, net income, and cash flows.

REGULATORY

TEP, UNS Electric, and UNS Gas are subject to regulation by the ACC, which sets the companies' Retail Rates and oversees many aspects of their business in ways that could negatively affect the companies' results of operations, net income, and cash flows.

The ACC is a constitutionally created body composed of five elected commissioners. Commissioners are elected state-wide for staggered four-year terms and are limited to serving a total of two terms. As a result, the composition of the commission, and therefore its policies, are subject to change every two years.

The ACC is charged with setting retail electric and gas rates that provide utility companies with an opportunity to recover their costs of service and earn a reasonable rate of return. As part of the ACC's process of establishing the retail electric and gas rates charged by TEP, UNS Electric and UNS Gas, the ACC could disallow the recovery of certain costs, such as: (i) the write-down of assets due to changes in federal regulations or due to applicable accounting rules; or (ii) any other expenses the ACC determines were not prudently incurred. The decisions made by the ACC on such matters impact the net income and cash flows of TEP, UNS Electric, and UNS Gas.

Changes in federal energy regulation may negatively affect the results of operations, net income, and cash flows of TEP, UNS Electric, and UNS Gas.

TEP, UNS Electric, and UNS Gas are subject to the impact of comprehensive and changing governmental regulation at the federal level that continues to change the structure of the electric and gas utility industries and the ways in which these industries are regulated. UNS Energy's electric utility subsidiaries are subject to regulation by the FERC. The FERC has jurisdiction over rates for electric transmission in interstate commerce and rates for wholesale sales of electric power, including terms and prices of transmission services and sales of electricity at wholesale prices.

As a result of the Energy Policy Act of 2005, owners and operators of bulk power transmission systems, including TEP, are subject to mandatory transmission standards developed and enforced by NERC and subject to the oversight of FERC. Compliance with modified or new transmission standards may subject TEP to higher operating costs and increased capital costs. Failure to comply with the mandatory transmission standards could subject TEP to sanctions, including substantial monetary penalties.

ENVIRONMENTAL

UNS Energy's utility subsidiaries are subject to numerous environmental laws and regulations that may increase their cost of operations or expose them to environmentally-related litigation and liabilities. Many of these regulations could have a significant impact on TEP due to its reliance on coal as its primary fuel for energy generation.

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Numerous federal, state, and local environmental laws and regulations affect present and future operations. Those laws and regulations include rules regarding air emissions, water use, wastewater discharges, solid waste, hazardous waste, and management of coal combustion residuals.

These laws and regulations can contribute to higher capital, operating, and other costs, particularly with regard to enforcement efforts focused on existing power plants and new compliance standards related to new and existing power plants. These laws and regulations generally require us to obtain and comply with a wide variety of environmental licenses, permits, authorizations, and other approvals. Both public officials and private individuals may seek to enforce applicable environmental laws and regulations. Failure to comply with applicable laws and regulations may result in litigation, and the imposition of fines, penalties, and a requirement for costly equipment upgrades by regulatory authorities.

We cannot provide assurance that existing environmental laws and regulations will not be revised or that new environmental laws and regulations will not be adopted or become applicable to our facilities. Increased compliance costs or additional operating restrictions from revised or additional regulation could have an adverse effect on our results of operations, particularly if those costs are not fully recoverable from our customers. TEP's obligation to comply with the EPA's BART determinations as a participant in the San Juan, Four Corners, and Navajo plants, coupled with the financial impact of future climate change legislation, other environmental regulations and other business considerations, could jeopardize the economic viability of these plants or the ability of individual participants to meet their obligations and continue their participation in these plants. TEP cannot predict the ultimate outcome of these matters.

TEP also is contractually obligated to pay a portion of the environmental reclamation costs incurred at generating stations in which it has a minority interest and is obligated to pay similar costs at the mines that supply these generating stations. While TEP has recorded the portion of its costs that can be determined at this time, the total costs for final reclamation at these sites are unknown and could be substantial.

New federal regulations to limit greenhouse gas emissions could increase TEP's cost of operations and result in a change in the composition of TEP's coal-dominated generating fleet.

Based on the finding by the EPA in December 2009 that emissions of greenhouse gases endanger public health and welfare, the agency is in the process of regulating greenhouse gas emissions. In addition, there are proposals and ongoing studies at the state, federal, and international levels to address global climate change that could also result in the regulation of CO_2 and other greenhouse gases. Any future regulatory actions taken to address global climate change represent a business risk to our operations. In 2013, 80% of TEP's total energy resources came from its coal-fueled generating facilities.

Reductions in CO_2 emissions to the levels specified by some proposals could be materially adverse to our financial position or results of operations if associated costs of control or limitation cannot be recovered from customers. Any future legislation or regulation addressing climate change could produce a number of other results including costly modifications to, or reexamination of the economic viability of, our existing coal plants; changes in the overall fuel mix of our generating fleet; or additional costs to fund energy efficiency activities. The impact of legislation or regulation to address global climate change would depend on the specific terms of those measures and cannot be determined at this time.

FINANCIAL

Volatility or disruptions in the financial markets, or unanticipated financing needs, could: increase our financing costs; limit our access to the credit markets; affect our ability to comply with financial covenants in our debt agreements; and increase our pension funding obligations. Such outcomes may adversely affect our liquidity and our ability to carry out our financial strategy.

We rely on access to the bank markets and capital markets as a significant source of liquidity and for capital requirements not satisfied by the cash flow from our operations. Market disruptions such as those experienced in 2008 and 2009 in the United States and abroad may increase our cost of borrowing or adversely affect our ability to access sources of liquidity needed to finance our operations and satisfy our obligations as they become due. These disruptions may include turmoil in the financial services industry, including substantial uncertainty surrounding particular lending institutions and counterparties we do business with, unprecedented volatility in the markets where

our outstanding securities trade, and general economic downturns in our utility service territories. If we are unable to access credit at competitive rates, or if our borrowing costs dramatically increase, our ability to finance our operations, meet our short-term obligations, and execute our financial strategy could be adversely affected.

Changing market conditions could negatively affect the market value of assets held in our pension and other retiree plans and may increase the amount and accelerate the timing of required future funding contributions.

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UNS Energy's net income and cash flows can be adversely affected by rising interest rates.

At December 31, 2013, TEP had $215 million of tax-exempt variable rate debt obligations, $50 million of which was hedged with a fixed-for-floating interest rate swap through September 2014. The interest rates are set weekly or monthly. The average interest rates ranged from 0.06% to 0.48% in 2013. A 100 basis point increase in the average interest rates on this debt over a twelve-month period would increase TEP's interest expense by approximately $2 million.

UNS Energy, TEP, UNS Electric, and UNS Gas also are subject to risk resulting from changes in the interest rate on their borrowings under revolving credit facilities. Revolving credit borrowings may be made on a spread over London Interbank Offer Rate (LIBOR) or an Alternate Base Rate. Each of these agreements is a committed facility and expires in November 2016.

If capital market conditions result in rising interest rates, the resulting increase in the cost of variable rate borrowings would negatively impact our results of operations, net income, and cash flows.

The expected purchase of Gila River and certain of TEP's leased assets, as well as the cost of significant investments in TEP's transmission system could require significant outlays of cash, which could be difficult to finance.

During 2013, TEP notified certain owner participants and their lessors that TEP elected to purchase their undivided ownership interests in Springerville Unit 1 upon the expiration of the lease term in January 2015. In total, TEP elected to purchase leased interests comprising 35.4% of Springerville Unit 1, representing 137 MW of capacity. In December 2014 and January 2015, TEP will be required to fund the purchase price of $65 million.

The Springerville Coal Handling Facilities can be purchased in April 2015 for a fixed price of $120 million. TEP also leases a 50% undivided interest in Springerville Common Facilities with primary lease terms ending in 2017 and 2021. Upon expiration of the Springerville Coal Handling and Common Facilities Leases (whether at the end of the initial term or any renewal term), TEP has the obligation under agreements with the owners of Springerville Units 3 and 4 to purchase such facilities. Upon acquisition by TEP, the owner of Springerville Unit 3 has the option and the owner of Springerville Unit 4 has the obligation to purchase from TEP a 14% interest in the Common Facilities and a 17% interest in the Coal Handling Facilities.

In December 2013, TEP and UNS Electric entered into a purchase agreement to acquire Unit 3 of the Gila River Generating Station (Gila River Unit 3). Gila River Unit 3 is a gas-fired combined cycle unit with a capacity rating of 550 MW. The transaction is expected to close in late 2014, upon which TEP and UNS Electric will be required to fund the purchase amount of $219 million.

In 2014 and 2015, TEP's capital expenditures related to investments in its high voltage transmission system are expected to be $147 million.

Debt levels, liquidity, regulatory rules, and other restrictions could limit the ability of TEP, UNS Electric, and UNS Gas to make distributions to UNS Energy.

As a holding company, UNS Energy has no operations of its own and derives all of its revenues and cash flow from its subsidiaries. TEP, UNS Electric, and UNS Gas could experience reduced levels of liquidity, or face other restrictions, which could adversely impact their ability to pay dividends to UNS Energy.

The debt levels at TEP, UNS Electric, and UNS Gas:

- require UNS Energy's subsidiaries to dedicate a substantial portion of their cash flow to pay principal and interest on their debt, which could reduce the funds available for working capital, capital expenditures, acquisitions, and other general corporate purposes; and
- could limit their ability to borrow additional amounts for working capital, capital expenditures, acquisitions, dividends, debt service requirements, execution of their business strategy, or other purposes.

TEP, UNS Electric, and UNS Gas may be required to post margin under their power and fuel supply agreements which could negatively impact their liquidity. The agreements under which we contract for power and fuel include requirements to post credit enhancement in the form of cash or letters of credit (LOCs) under certain circumstances, including changes in market prices which affect contract values, or a change in creditworthiness of the respective companies. In order to post such credit enhancement, TEP, UNS Electric, and UNS Gas would have to use available cash, draw under their revolving credit agreements, or issue LOCs under their revolving credit agreements.

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Regulatory rules and other restrictions include:

- TEP's, UNS Electric's, and UNS Gas' inability to lend to affiliates without ACC approval; and
- TEP, UNS Electric, and UNS Gas must be in compliance with their respective debt agreements to make dividend payments to UNS Energy.

OPERATIONAL

The operation of electric generating stations, and transmission and distribution systems, involves risks that could result in reduced generating capability or unplanned outages that could adversely affect TEP’s or UNS Electric’s results of operations, net income, and cash flows.

The operation of electric generating stations, and transmission and distribution systems, involves certain risks, including equipment breakdown or failure, fires and other hazards, interruption of fuel supply, and lower than expected levels of efficiency or operational performance. Unplanned outages, including extensions of planned outages due to equipment failure or other complications, occur from time to time and are an inherent risk of our business. If TEP’s or UNS Electric’s generating stations and transmission and distribution systems operate below expectations, TEP or UNS Electric’s operating results could be adversely affected.

The lack of access to sufficient supplies of water could have a material adverse impact on TEP’s business and results of operations.

Natural gas and coal-fired generating plants require continuous water supply for their operation. The region in which our power plants are located is prone to drought conditions, which could potentially affect the plants’ water supplies. Any material reduction in the water supply for such facilities would limit the ability of TEP and UNS Electric to produce and market electricity from such facilities and could have a material adverse impact on our results of operations. Further, any change in regulations or the level of regulation with regard to use, treatment and discharge of water, or the licensing of water rights in the jurisdictions where TEP and UNS Electric operate, could have a material adverse impact on our results of operations.

TEP receives power from certain generating facilities that are jointly owned and operated by third parties. Therefore, TEP may not have the ability to affect the management or operations at such facilities which could adversely affect TEP’s results of operations, net income, and cash flows.

Certain of the generating stations from which TEP receives power are jointly owned with, or are operated by, third parties. TEP may not have the sole discretion or any ability to affect the management or operations at such facilities. As a result of this reliance on other operators, TEP may not be able to ensure the proper management of the operations and maintenance of the plants. Further, TEP may have no ability or a limited ability to make determinations on how best to manage the changing regulations which may affect such facilities. In addition, TEP will not have sole discretion as to how to proceed in the face of requirements relating to environmental compliance which could require significant capital expenditures or the closure of such generating stations. A divergence in the interests of TEP and the co-owners or operators, as applicable, of such generating facilities could negatively impact the business and operations of TEP.

The nature of our gas operations presents inherent risks of loss that could adversely affect our results of operations.

The operation of UNS Gas’ transmission and distribution systems involves certain risks, including gas leaks, fires, natural disasters, catastrophic accidents, explosions, pipeline ruptures, and other hazards and risks that may cause unforeseen interruptions, personal injury, or property damage. Any such incident could have an adverse effect on UNS Gas.

We may be subject to physical and/or cyber attacks.

As operators of critical energy infrastructure, we may face a heightened risk of physical and/or cyber attacks. Our electric generation, transmission, and distribution systems may be vulnerable to disability or failures as a result of physical or cyber acts of war or terrorism, vandalism or other causes.

Our corporate and information technology systems may be vulnerable to unauthorized access due to hacking, viruses, acts of war or terrorism, and other causes. In addition, our utility business requires access to sensitive customer data, including personal and credit information, in the ordinary course of business.

If, despite our security measures, a significant physical attack or cyber breach occurred, we could have our operations disrupted, property damaged, and customer information stolen; experience substantial loss of revenues, response costs,

and

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other financial loss; and be subject to increased regulation, litigation, and damage to our reputation, any of which could have a negative impact on our business and results of operations.

TEP or UNS Electric might not be able to secure adequate right-of-way to construct transmission lines and distribution-related facilities, and could be required to find alternate ways to provide adequate sources of energy and maintain reliable service for their customers.

TEP and UNS Electric rely on federal, state, and local governmental agencies to secure right-of-way and siting permits to construct transmission lines and distribution-related facilities. If adequate right-of-way and siting permits to build new transmission lines cannot be secured, TEP and UNS Electric may need to rely on more costly alternatives to provide energy to their customers, may not be able to maintain reliability in their service areas, or their ability to provide electric service to new customers may be negatively impacted.

ITEM 1B. – UNRESOLVED STAFF COMMENTS

None.

ITEM 2. – PROPERTIES

TEP PROPERTIES

Transmission facilities owned by TEP and by third parties, are located in Arizona and New Mexico and transmit the output from TEP's remote electric generating stations at Four Corners, Navajo, San Juan, Springerville, and Luna to the Tucson area for use by TEP's retail customers. The transmission system is interconnected at various points in Arizona and New Mexico with other regional utilities. TEP has arrangements with approximately 140 companies to interchange generation capacity and transmission of energy. See Item 1. Business, TEP, Generating and Other Resources.

At December 31, 2013, TEP owned or participated in an overhead electric transmission and distribution system consisting of:

- 564 circuit-miles of 500-kV lines;
- 1,088 circuit-miles of 345-kV lines;
- 413 circuit-miles of 138-kV lines;
- 481 circuit-miles of 46-kV lines; and
- 2,605 circuit-miles of lower voltage primary lines.

TEP's underground electric distribution system includes 4,442 cable-miles of lines. TEP owns approximately 77% of the poles on which its lower voltage lines are located. Electric substation capacity consists of 104 substations with a total installed transformer capacity of 14,879,950 kilovolt amperes.

The electric generating stations (except as noted below), administrative headquarters, warehouse and service center are located on land owned by TEP. The electric distribution and transmission facilities owned by TEP are located:

- on property owned by TEP;
- under or over streets, alleys, highways, and other places in the public domain, as well as in national forests and state lands, under franchises, easements, or other rights which are generally subject to termination;
- under or over private property as a result of easements obtained primarily from the record holder of title; or
- over American Indian reservations under grant of easement by the Secretary of Interior or lease by American Indian tribes.

It is possible that some of the easements, and the property over which the easements were granted, may have title defects or liens existing at the time the easements were acquired.

Springerville is located on property held by TEP under a long-term surface ownership agreement with the State of Arizona.

Four Corners and Navajo are located on properties held under easements from the United States and under leases from the Navajo Nation. TEP, individually and in conjunction with PNM in connection with San Juan, has acquired land rights,

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easements and leases for the plant, transmission lines and a water diversion facility located on land owned by the Navajo Nation. TEP also has acquired easements for transmission facilities related to San Juan, Four Corners, and Navajo across the Zuni, Navajo, and Tohono O'dham American Indian Reservations. TEP, in conjunction with PNM and Freeport McMoRan, holds an undivided ownership interest in the property on which Luna is located.

TEP's rights under these various easements and leases may be subject to defects such as:

- possible conflicting grants or encumbrances due to the absence of, or inadequacies in, the recording laws or record systems of the Bureau of Indian Affairs (BIA) and the American Indian tribes;
- possible inability of TEP to legally enforce its rights against adverse claimants and the American Indian tribes without Congressional consent; or
- failure or inability of the American Indian tribes to protect TEP's interests in the easements and leases from disruption by the U.S. Congress, Secretary of the Interior, or other adverse claimants.

These possible defects have not interfered, and are not expected to materially interfere, with TEP's interest in and operation of its facilities.

TEP, under separate sale and leaseback arrangements, leases the following generation facilities (which do not include land):

- Springerville Coal Handling Facilities;
- a 50% undivided interest in the Springerville Common Facilities; and
- Springerville Unit 1 and the remaining 50% undivided interest in the Springerville Common Facilities.

See Item 7. – Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power Company, Factors Affecting Results of Operations, Springerville Unit 1 and Note 6.

UES PROPERTIES

At December 31, 2013, UNS Electric's transmission and distribution system consisted of approximately 60 circuit-miles of 138-kV transmission lines, 274 circuit-miles of 69-kV transmission lines, and 3,651 circuit-miles of underground and overhead distribution lines. UNS Electric also owns the 62 MW Valencia plant, the 90 MW BMGS, as well as 40 substations having a total installed capacity of 1,549,000 kilovolt amperes.

At December 31, 2013, UNS Gas' transmission and distribution system consisted of approximately 31 miles of steel transmission mains, 4,238 miles of steel and plastic distribution piping, and 138,951 customer service lines.

The gas and electric distribution and transmission facilities owned by UNS Electric and UNS Gas are located:

- on property owned by UNS Electric or UNS Gas;
- under or over streets, alleys, highways, and other places in the public domain, as well as national forests and state lands, under franchises, easements, or other rights which are generally subject to termination; or
- under or over private property as a result of easements obtained primarily from the record holder of title.

ITEM 3. – LEGAL PROCEEDINGS

Shareholder Lawsuits

Five putative shareholder class action lawsuits challenging the merger have been filed, four in the Superior Court of Pima County, Arizona: (i) Phillip Malenovshy v. UNS Energy Corporation, et al. (Case No. C20136942); (ii) Paul Parshall v. UNS Energy Corporation, et al. (Case No. C20136943); (iii) Hillary Kramer v. Paul J. Bonavia, et al. (Case No. C2014-0026); and (iv) Vandermeer Trust U/A DTD 03/11/1997 v. UNS Energy Corporation, et al. (Case No. C2014-0107); and one in federal court in the United States District Court for the District of Arizona: Milton Pfeiffer v. Paul J. Bonavia, et al. (Case No. 4:13-CV-02619-JGZ).

The lawsuits generally allege, among other things, that the directors of UNS Energy breached their fiduciary duties to shareholders of UNS Energy purportedly by agreeing to a transaction pursuant to an inadequate process and for failing to

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obtain the highest value for UNS Energy shareholders. The lawsuits allege that the Fortis entities also aided and abetted the directors of UNS Energy in the alleged breach of their fiduciary duties.

The lawsuits seek, in general, and among other things, (i) injunctive relief enjoining the transactions contemplated by the merger agreement, (ii) rescission or an award of rescissory damages in the event a merger is consummated, (iii) an award of plaintiffs' costs including reasonable attorneys' and experts' fees, (iv) an accounting by the defendants to plaintiffs for all damages caused by the defendants, and (v) such further relief as the court deems just and proper.

These lawsuits are at a preliminary stage. UNS Energy, its directors and the other defendants believe that these lawsuits are without merit and intend to defend against them vigorously.

Right of Way Matters

TEP previously reported it was a defendant in a class action filed in February 2009 in the United States District Court in Albuquerque, New Mexico by members of the Navajo Nation. The plaintiffs alleged, among other things, that the rights of way for defendants' transmission lines on Navajo lands were improperly granted and that the compensation paid for such rights of way was inadequate. The plaintiffs were requesting, among other things, that the transmission lines on these lands be removed. In March 2010, the court entered a final judgment dismissing the case. The plaintiffs filed a Notice of Appeal with the Bureau of Indian Affairs (BIA) in May 2010, appealing the BIA's decision to grant the rights of way that were the subject of the now-dismissed complaint. In June 2010, the BIA found that the Notice of Appeal failed to meet the minimum filing requirements. In September 2010, the plaintiffs filed new Notices of Appeal concerning the same rights of way. In August 2013, the Interior Board of Indian Appeals dismissed the plaintiffs' appeal for failure to meet procedural requirements. TEP cannot predict if the plaintiffs will again attempt to appeal the BIA's decision to grant the rights of way.

In addition, see legal proceedings discussed in Note 7.

ITEM 4. – MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. – MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF COMMON EQUITY

Stock Trading

UNS Energy's Common Stock is traded under the ticker symbol UNS and is listed on the New York Stock Exchange. On February 14, 2014, the closing price was $60.21 with 7,392 shareholders of record.

TEP's common stock is wholly-owned by UNS Energy and is not listed for trading on any stock exchange.

Dividends

UNS Energy

UNS Energy's Board of Directors expects to continue to authorize the payment of regular quarterly cash dividends on our Common Stock; however, such dividends are subject to the Board's evaluation of our financial condition, earnings, cash flows, and dividend policy.

The merger agreement with Fortis allows UNS Energy's Board of Directors to authorize quarterly dividends of up to $0.48 per share until the merger is completed, including a pro rata dividend determined by the number of days from the last declared record date to the date the merger is completed. See Item. 1- Business, Overview of Consolidated Businesses, Agreement and Plan of Merger.

On February 24, 2014, UNS Energy declared a first quarter cash dividend of $0.48 per share of Common Stock. The first quarter dividend, totaling approximately $20 million, will be paid March 25, 2014 to shareholders of record at the close of business March 13, 2014. The table below summarizes UNS Energy's dividends paid in 2011 through 2013.

	2013	2012	2011
Quarterly Dividend Per Common Share	$0.435	$0.43	$0.42
Annual Dividend Per Common Share	$1.74	$1.72	$1.68
Common Stock Dividends Paid	$72 million	$70 million	$62 million

UNS Energy relies on dividends from its subsidiaries, primarily TEP, to declare and pay dividends to its shareholders.

TEP

TEP paid dividends to UNS Energy of $40 million in 2013 and $30 million in 2012. TEP did not pay any dividends to UNS Energy in 2011.

TEP can pay dividends if it maintains compliance with the TEP Credit Agreement and certain financial covenants. At December 31, 2013, TEP was in compliance with the terms of the TEP Credit Agreement.

UNS Electric

UNS Electric paid dividends to UNS Energy of $10 million in 2013 and 2012. UNS Electric did not pay any dividends to UNS Energy in 2011. UNS Electric's ability to pay future dividends will depend on the cash needs for capital expenditures and various other factors.

The note purchase agreement for UNS Electric contains restrictions on dividends. UNS Electric may pay dividends so long as (a) no default or event of default exists and (b) it could incur additional debt under the debt incurrence test. At December 31, 2013, UNS Electric was in compliance with the terms of its note purchase agreement.

UNS Gas

UNS Gas paid dividends to UNS Energy of $10 million in 2013, $20 million in 2012, and $10 million in 2011. UNS Gas' ability to pay future dividends will depend on the cash needs for capital expenditures and various other factors.

The note purchase agreement for UNS Gas contains restrictions on dividends. UNS Gas may pay dividends so long as (a) no default or event of default exists and (b) it could incur additional debt under the debt incurrence test. At December 31, 2013, UNS Gas was in compliance with the terms of its note purchase agreement.

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Other Non-Reportable Segments

Millennium paid dividends to UNS Energy of $1 million in 2013, $14 million in 2012 and $3 million in 2011.

UED did not pay any dividends to UNS Energy in 2013 or 2012. UED paid dividends to UNS Energy of $39 million in 2011, of which $28 million represented a return of capital.

See Item 7. – Management's Discussion and Analysis of Financial Condition and Results of Operations, UNS Energy Consolidated, Liquidity and Capital Resources, Dividends on Common Stock.

Common Stock Dividends and Price Ranges

	2013			2012		
	Market Price per Share of Common Stock [1]		Dividends Declared	Market Price per Share of Common Stock [1]		Dividends Declared
Quarter:	High	Low		High	Low	
First	$49.13	$43.10	$0.435	$38.66	$35.83	$0.43
Second	51.54	42.51	0.435	38.86	35.20	0.43
Third	51.86	43.81	0.435	42.71	38.43	0.43
Fourth	60.02	45.30	0.435	43.56	39.02	0.43
Total			$1.74			$1.72

[1] UNS Energy's Common Stock price as reported by the New York Stock Exchange.

Convertible Senior Notes

See Note 6.

Issuer Purchases of Common Equity

UNS Energy did not purchase any shares of Common Stock during 2013, 2012, or 2011.

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ITEM 6. – SELECTED FINANCIAL DATA

UNS Energy

	2013	2012	2011	2010	2009
	In Thousands (Except per Share Data)				
Income Statement Data					
Operating Revenues	$1,484,560	$1,461,766	$1,478,702	$1,425,947	$1,396,606
Net Income	127,478	90,919	109,975	112,984	105,901
Basic Earnings Per Share	3.06	2.25	2.98	3.10	2.95
Diluted Earnings Per Share	3.04	2.20	2.75	2.86	2.73
Shares of Common Stock Outstanding:					
Weighted Average	41,618	40,362	36,962	36,415	35,858
End of Year	41,538	41,344	36,918	36,542	35,851
Cash Dividends Declared per Share	$1.74	$1.72	$1.68	$1.56	$1.16
Balance Sheet Data					
Total Utility Plant – Net	$3,534,837	$3,300,363	$3,182,263	$2,961,498	$2,785,714
Total Investments in Lease Debt and Equity	36,194	45,457	65,829	103,844	132,168
Other Investments and Other Property	34,971	36,537	34,205	61,676	60,239
Total Assets	4,273,069	4,140,429	3,989,279	3,796,246	3,615,211
Long-Term Debt	$1,507,070	$1,498,442	$1,517,373	$1,352,977	$1,307,795
Non-Current Capital Lease Obligations	149,767	262,138	352,720	429,074	488,349
Common Stock Equity	1,130,784	1,065,465	888,474	830,756	759,329
Total Capitalization	2,787,621	2,826,045	2,758,567	2,612,807	2,555,473
Cash Flow Data					
Net Cash Flows From Operating Activities	$420,512	$348,109	$337,320	$346,920	$347,310
Capital Expenditures	(325,886)	(307,277)	(374,122)	(330,629)	(294,020)
Net Cash Flows From Financing Activities	(135,742)	(37,682)	(1,441)	(51,183)	(28,916)
Ratio of Earnings to Fixed Charges [1]	2.77	2.30	2.43	2.62	2.46

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TEP

	2013	2012	2011	2010	2009
	Thousands of Dollars				
Income Statement Data					
Operating Revenues	$1,196,690	$1,161,660	$1,156,386	$1,125,267	$1,099,338
Net Income	101,342	65,470	85,334	108,260	90,688
Balance Sheet Data					
Total Utility Plant – Net	$2,944,455	$2,750,421	$2,650,652	$2,410,077	$2,261,325
Total Investments in Lease Debt and Equity	36,194	45,457	65,829	103,844	132,168
Other Investments and Other Property	33,488	35,091	32,313	43,588	31,813
Total Assets	3,556,060	3,461,046	3,277,661	3,078,411	2,924,108
Long-Term Debt	1,223,070	1,223,442	1,080,373	1,003,615	903,615
Non-Current Capital Lease Obligations	149,767	262,138	352,720	429,074	488,311
Common Stock Equity	925,923	860,927	824,943	709,884	650,591
Total Capitalization	2,298,760	2,346,507	2,258,036	2,142,573	2,042,517
Cash Flow Data					
Net Cash Flows From Operating Activities	$346,191	$267,919	$268,294	$302,483	$268,064
Capital Expenditures	(252,848)	(252,782)	(351,890)	(277,309)	(240,079)
Net Cash Flows From Financing Activities	(140,937)	11,987	51,452	(51,882)	(29,320)
Ratio of Earnings to Fixed Charges [1]	2.67	2.10	2.40	2.74	2.56

(1) For purposes of this computation, earnings are defined as pre-tax earnings from continuing operations before minority interest, or income/loss from equity method investments, plus interest expense and amortization of debt discount and expense related to indebtedness. Fixed charges are interest expense, including amortization of debt discount, interest on operating lease payments, and expense on indebtedness.

See Item 7. – Management’s Discussion and Analysis of Financial Condition and Results of Operations.

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ITEM 7. – MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis explains the results of operations, the general financial condition, and the outlook for UNS Energy and its three primary business segments. It includes the following:

- outlook and strategies;
- operating results during 2013 compared with 2012, and 2012 compared with 2011;
- factors affecting our results and outlook;
- liquidity, capital needs, capital resources, and contractual obligations;
- dividends; and
- critical accounting estimates.

UNS ENERGY CORPORATION

UNS Energy is a utility services holding company engaged, through its primary subsidiaries, in the electric generation and energy delivery business. Each of UNS Energy's subsidiaries is a separate legal entity with its own assets and liabilities. UNS Energy owns 100% of TEP and UES.

References to "we" and "our" are to UNS Energy and its subsidiaries, collectively.

OUTLOOK AND STRATEGIES

Agreement and Plan of Merger

In December 2013, UNS Energy entered into an Agreement and Plan of Merger with Fortis Parent, Fortis and Merger Sub. The Boards of Directors of each of UNS Energy and Fortis Parent have approved the Merger. At the completion of the Merger, each outstanding share of UNS Energy common stock will be converted into the right to receive $60.25 in cash and UNS Energy will become a wholly-owned subsidiary of Fortis.

The Merger is subject to the approval of stockholders holding a majority of the outstanding shares of UNS Energy and other customary closing conditions, including, among other things:

- the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended;
- approvals of the Arizona Corporation Commission and the Federal Energy Regulatory Commission;
- confirmation of review, without unresolved concerns, from the Committee on Foreign Investment in the United States; and
- the absence of any injunction, order or other law prohibiting the Merger.

On February 18, 2014, we filed definitive proxy materials with the SEC. We expect UNS Energy's shareholders to formally consider a proposal to approve the Merger Agreement at a meeting on March 26, 2014.

In January 2014, UNS Energy and Fortis Parent filed an application and supporting testimony with the ACC requesting approval of the Merger. The ACC administrative law judge (ALJ) assigned to this matter issued a procedural order that calls for settlement discussions to commence on April 28, 2014, and a hearing before the ALJ to commence on June 16, 2014. In February 2014, we filed an application with FERC requesting approval of the Merger. The Merger is expected to close by the end of 2014. If the Merger is completed, UNS Energy expects to record approximately $22 million of expenses related to the Merger in 2014.

Operating Plans and Strategies

Our financial prospects and outlook are affected by many factors including: national, regional, and local economic conditions; volatility in the financial markets; environmental laws and regulations; and other regulatory factors. Our plans and strategies include the following:

- Completing the proposed Merger with Fortis including obtaining all necessary approvals;

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- Completing the purchases of Gila River Unit 3 and additional interests in Springerville Unit 1, which are both key components of our long-term diversification strategy for our generating portfolio. The focus of our resource strategy is to provide long-term rate stability for our customers, mitigate environmental impacts, comply with regulatory requirements, and leverage our existing utility infrastructure.
- Strengthening the underlying financial condition of our utility subsidiaries by achieving constructive regulatory outcomes, improving our capital structure and our credit ratings, and promoting economic development in our service territories.
- Developing strategic responses to new environmental regulations and potential new legislation, including potential limits on greenhouse gas emissions. We are evaluating TEP's existing mix of generation resources and defining steps to achieve environmental objectives that protect the financial stability of our utility businesses.
- Focusing on our core utility businesses through operational excellence, investing in utility rate base, emphasizing customer service, and maintaining a strong community presence.
- Expanding TEP's and UNS Electric's portfolio of renewable energy resources and programs to meet Arizona's Renewable Energy Standard (RES) while creating ownership opportunities for renewable energy projects that benefit customers, shareholders, and the communities we serve.
- Developing strategic responses to Arizona's Energy Efficiency Standards that protect the financial stability of our utility businesses and provide benefits to our customers.

RESULTS OF OPERATIONS

Contribution by Business Segment

The table below shows the contributions to our consolidated net income by business segment:

	2013	2012	2011
	Millions of Dollars		
TEP	$101	$65	$85
UNS Electric	12	17	18
UNS Gas	11	9	10
Other Non-Reportable Segments and Adjustments [1]	3	—	(3)
Consolidated Net Income	$127	$91	$110

[1] Includes: UNS Energy parent company expenses; Millennium; UED; and inter-company eliminations.

Executive Overview

2013 Compared with 2012

TEP

TEP reported net income of $101 million in 2013 compared with net income of $65 million in 2012. The increase in net income is due in part to: a $41 million increase in retail margin revenues related to a non-fuel base rate increase that was effective on July 1, 2013 and higher retail kWh sales resulting from favorable weather conditions; a $2 million increase in the margin on long-term wholesale sales due to higher market prices for wholesale power; and a $9 million decrease in interest expense due in part to a reduction in capital lease obligation balances; partially offset by a $12 million increase in Base O&M due in part to planned and unplanned maintenance on TEP's generating facilities, as well as merger-related expenses of $6 million recorded in December 2013; and a $3 million increase in taxes other than income taxes due in part to an increase in property tax rates and higher asset balances.

Additionally, TEP's net income in 2013 includes an income tax benefit of $11 million. In June 2013, we recorded a regulatory asset and corresponding reduction of income tax expense of $11 million to recover previously recorded income tax expense through future rates as a result of the 2013 TEP Rate Order. The regulatory asset will be amortized as income tax expense as the qualifying assets are depreciated. See Note 9. TEP's 2013 results also include additional fuel expense of $3 million related to a one-time credit to customers resulting from the 2013 TEP Rate Order. TEP's results in 2012 reflect a $3 million reduction

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to pre-tax income due to an unplanned outage at Springerville Unit 3 and a $5 million write-off of transmission related assets. See Tucson Electric Power Company, Results of Operations.

UNS Electric

UNS Electric reported net income of $12 million in 2013 compared with net income of $17 million in 2012. The decrease in net income was due in part to lower mining kWh sales during 2013 and the loss of an industrial customer in the second half of 2012. See UNS Electric, Results of Operations.

UNS Gas

UNS Gas reported net income of $11 million in 2013 compared with net income of $9 million in 2012. The increase in net income is due primarily to: higher sales volumes resulting from cold weather, which contributed to an improvement in retail margin revenues; and a non-fuel base rate increase that was effective in May 2012. See UNS Gas, Results of Operations.

2012 Compared with 2011

TEP

TEP reported net income of $65 million in 2012 compared with $85 million in 2011. The decrease in net income was due primarily to: a $7 million decline in retail margin revenues resulting from lower retail kWh sales due to milder summer weather than 2011, as well as the effects of the ACC's energy efficiency and distributed generation requirements; an $8 million decline in long-term wholesale margin revenues resulting primarily from a change in the pricing of energy sold under the SRP wholesale contract that was effective on June 1, 2011; an $11 million increase in depreciation and amortization expense as a result of an increase in utility plant-in-service; and a $5 million decrease in pre-tax income related to the partial write-off of transmission-related assets. These factors were partially offset by a decrease in TEP's Base O&M, resulting primarily from fewer planned generating plant outages. Net income in 2011 included the recognition of a $7 million pre-tax gain related to the settlement of a dispute with El Paso Electric.
See Tucson Electric Power, Results of Operations.

UNS Electric and UNS Gas

UNS Electric reported net income of $17 million in 2012 compared with net income of $18 million in 2011. See UNS Electric, Results of Operations.

UNS Gas reported net income of $9 million in 2012 compared with net income of $10 million in 2011. See UNS Gas, Results of Operations.

Operations and Maintenance Expense

The table below summarizes the items included in UNS Energy's Operations and Maintenance (O&M) expense. In 2013, Base O&M includes merger-related expenses of $7 million.

	2013	2012	2011
	Millions of Dollars		
UNS Energy Base O&M (Non-GAAP)[1]	$288	$266	$271
Reimbursed Expenses Related to Springerville Units 3 and 4	70	72	63
Expenses Related to Customer-Funded Renewable Energy and Demand Side Management (DSM) Programs[2]	32	46	45
Total UNS Energy O&M (GAAP)	390	$384	$379

(1) Base O&M, a non-GAAP financial measure, should not be considered as an alternative to O&M, which is determined in accordance with generally accepted accounting principles (GAAP). We believe Base O&M provides useful information to investors because it represents the fundamental level of operating and maintenance expense related to our core business. Base O&M excludes expenses that are directly offset by revenues collected from customers and other third parties.

(2) Represents expenses related to customer-funded renewable energy and DSM programs; these expenses are being collected from customers and the corresponding amounts are recorded in retail revenue.

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LIQUIDITY AND CAPITAL RESOURCES

UNS Energy Consolidated Liquidity

Cash flows may vary during the year, with cash flow from operations typically the lowest in the first quarter and highest in the third quarter due to TEP's summer peaking load. As a result of the varied seasonal cash flow, UNS Energy will use, as needed, its revolving credit facility to assist in funding its business activities. The table below provides a summary of the liquidity position of UNS Energy and each of its segments:

Balances at December 31, 2013	Cash and Cash Equivalents	Borrowings under Revolving Credit Facility[1]	Amount Available under Revolving Credit Facility
	Millions of Dollars		
UNS Energy Stand-Alone	$9	$54	$71
TEP	25	1	199
UNS Electric[2]	5	22	48
UNS Gas[2]	33	—	70
Other[3]	3	N/A	N/A
Total	$75		

(1) Includes Letters of Credit (LOCs) issued under revolving credit facilities.

(2) Either UNS Gas or UNS Electric may borrow up to a maximum of $70 million; the total combined amount borrowed by both companies cannot exceed $100 million.

(3) Includes cash and cash equivalents at Millennium and UED.

In March 2014, TEP expects to issue a $15 million LOC to a subsidiary of Entegra to satisfy a condition of the Gila River Unit 3 purchase agreement. TEP's borrowing capacity under the TEP Credit Agreement will be reduced by $15 million until the Gila River transaction closes and the LOC is terminated.

Dividends from UNS Energy's subsidiaries represent the parent company's main source of liquidity.

Dividends from Subsidiaries

UNS Energy received $40 million in dividends from TEP and $10 million in dividends from each of UNS Electric and UNS Gas in 2013, and $1 million from Millennium. In 2012, UNS Energy received dividends of $30 million from TEP, $20 million from UNS Gas, $14 million from Millennium, and $10 million from UNS Electric.

Short-term Investments

UNS Energy's short-term investment policy governs the investment of excess cash balances. We regularly review and update this policy in response to market conditions. At December 31, 2013, UNS Energy's short-term investments included highly-rated and liquid money market funds and certificates of deposit.

Access to Revolving Credit Facilities

We have access to working capital through revolving credit agreements with lenders. Each of these agreements is a committed facility that expires in November 2016. The TEP Revolving Credit Facility and UNS Electric/UNS Gas Revolver may be used for revolving borrowings as well as to issue LOCs. TEP, UNS Electric, and UNS Gas each issue LOCs from time to time to provide credit enhancement to counterparties for their energy procurement and hedging activities. The UNS Credit Agreement also may be used to issue LOCs for general corporate purposes.

We believe that we have sufficient liquidity under our revolving credit facilities to meet short-term working capital needs and to provide credit enhancement as necessary under energy procurement and hedging agreements. However, TEP will need to issue long-term debt or enter into additional short-term credit facilities by June 2014 to meet capital expenditure requirements and scheduled mid-year capital lease payments. See Item 7A Quantitative and Qualitative Disclosures about Market Risk.

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UNS Energy Consolidated Cash Flows

	Years Ended December 31,		
	2013	2012	2011
	Millions of Dollars		
Operating Activities	$421	$348	$337
Investing Activities	(334)	(263)	(327)
Financing Activities	(136)	(37)	(2)
Net Increase (Decrease) in Cash	(49)	48	8
Beginning Cash	124	76	68
Ending Cash	$75	$124	76

UNS Energy's operating cash flows are generated primarily by retail and wholesale energy sales at TEP, UNS Electric, and UNS Gas, net of the related payments for fuel and purchased power. Generally, cash from operations is lowest in the first quarter and highest in the third quarter due to TEP's summer-peaking load. TEP, UNS Electric, and UNS Gas typically use their revolving credit facilities to assist in funding their business activities during periods when sales are seasonally lower.

Capital expenditures at TEP, UNS Electric, and UNS Gas represent the primary use of cash for investing activities. Cash used for investing and financing activities can fluctuate year-to-year depending on: capital expenditures; repayments and borrowings under revolving credit facilities; debt issuances or retirements; capital lease payments by TEP; and dividends paid by UNS Energy to its shareholders.

Operating Activities

In 2013, net cash flows from operating activities were $73 million higher than they were in 2012. The following items affected the year-over-year change in operating cash flows: a $23 million increase in cash receipts from retail and wholesale sales, net of fuel and purchased power costs paid, due to a non-fuel base rate increase that became effective on July 1, 2013, an increase in sales volumes from warmer weather compared to 2012, and higher market prices for wholesale power; a $27 million decrease in operations and maintenance costs and wages paid, net of amounts capitalized, due in part to renewable prepayments made in 2012; and a $6 million decrease in interest paid on capital lease obligations due to a decline in the balance of capital lease obligations.

Investing Activities

Net cash flows used for investing activities increased $71 million in 2013 compared with 2012 due in part to: a $19 million increase in capital expenditures; a $17 million increase in REC purchases due to an increase in renewable energy PPAs; a $15 million decrease in proceeds from a note receivable; and a $10 million decrease in the return of investment in Springerville lease debt.

Capital Expenditures

	Actual	Estimated				
	2013	2014	2015	2016	2017	2018
	Millions of Dollars					
TEP	$253	$528	$469	$223	$276	$218
UNS Electric	56	95	39	33	37	49
UNS Gas	17	13	13	14	15	16
UNS Energy Consolidated	$326	$636	$521	$270	$328	$283

TEP's estimated capital expenditures include:

- $164 million for the purchase of 75% of Gila River Unit 3 in 2014;
- $65 million for the purchase of 35.4% of Springerville Unit 1 in 2014 and 2015, and $73 million for TEP's share of the expected purchase of interests in the Springerville Coal Handling facilities in April 2015;
- $147 million for TEP-related transmission investments during 2014 and 2015;

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- $35 million for TEP's share of potential environmental expenditures related to the installation of SNCR at San Juan Unit 1. See Item 1 Business, TEP, Environmental Matters and Note 7; and
- $38 million for TEP's share of the expected purchase of the Springerville Common Facilities upon the expiration of one of the two leases in 2017.

UNS Electric's estimated capital expenditures include the purchase of 25% of Gila River Unit 3 for approximately $55 million in 2014.

These estimates are subject to continuing review and adjustment. Actual capital expenditures may differ from these estimates due to changes in business conditions, construction schedules, environmental requirements, state or federal regulations and other factors. See Tucson Electric Power Company, Liquidity and Capital Resources, Investing Activities, Capital Expenditures.

Financing Activities

Net cash flows used for financing activities were $98 million higher in 2013 when compared with 2012 due to: a $10 million increase in scheduled capital lease payments; a $3 million increase in dividends paid on Common Stock; and the issuance of $150 million of long-term debt by TEP in 2012.

Capital Contributions

UNS Energy made no capital contributions to its subsidiaries in 2013 and 2012.

In 2011, UNS Energy contributed $20 million in capital to UNS Electric to help fund its purchase of BMGS from UED.

Also in 2011, UNS Energy contributed $30 million in capital to TEP to help fund the purchase of TEP’s headquarters building.

See Tucson Electric Power Company, Liquidity and Capital Resources.

UNS Credit Agreement

The UNS Credit Agreement, which expires in November 2016, consists of a $125 million revolving credit and LOC facility. At December 31, 2013, there was $54 million outstanding at a weighted-average interest rate of 1.66%. The UNS Credit Agreement restricts additional indebtedness, liens, mergers, and sales of assets. The UNS Credit Agreement also requires UNS Energy to meet a minimum cash flow to debt service coverage ratio determined on a UNS Energy stand-alone basis. Additionally, UNS Energy cannot exceed a maximum leverage ratio determined on a consolidated basis. Under the terms of the UNS Credit Agreement, UNS Energy may pay dividends so long as it maintains compliance with the agreement. UNS Energy’s obligations under the agreement are secured by a pledge of the common stock of Millennium, UES, and UED.

At December 31, 2013, we were in compliance with the terms of the UNS Credit Agreement.

Interest Rate Risk

UNS Energy is subject to interest rate risk resulting from changes in interest rates on its borrowings under the revolving credit facility. The interest paid on revolving credit borrowings is variable. UNS Energy may be required to pay higher rates of interest on borrowings under its revolving credit facility if LIBOR and other benchmark interest rates increase. See Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

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Contractual Obligations

The following chart displays UNS Energy's consolidated contractual obligations by maturity and by type of obligation as of December 31, 2013:

	UNS Energy Contractual Obligations							
Payment Due in Years Ending December 31,	2014	2015	2016	2017	2018	Thereafter	Other	Total
	Millions of Dollars							
Long-Term Debt								
Principal[1]	$—	$130	$132	$—	$100	$1,146	$—	$1,508
Interest[2]	67	66	61	60	61	480	—	795
Capital Lease Obligations[3]	214	69	17	18	11	30	—	359
Operating Leases	4	4	3	2	2	14	—	29
Purchase Obligations[4]:								
Fuel[5]	103	83	80	75	49	345	—	735
Purchased Power	75	17	—	—	—	—	—	92
Transmission	7	13	12	12	11	27	—	82
Renewable Power Purchase Agreements [6]	36	37	37	37	37	485		669
RES Performance-Based Incentives[7]	9	9	9	9	9	85	—	130
Acquisition of Springerville Coal Handling & Common Facilities[8]	—	120	—	38	—	68	—	226
Other Long-Term Liabilities[9]:								
Pension & Other Post Retirement Obligations[10]	17	6	6	6	6	33	—	74
Unrecognized Tax Benefits	—	—	—	—	—	—	4	4
Total Contractual Obligations	$532	$554	$357	$257	$286	$2,713	$4	$4,703

(1) Certain of TEP's variable rate industrial development revenue bonds (IDBs) or pollution control revenue bonds are secured by LOCs issued pursuant to the TEP Credit Agreement, which expires in 2016, and the 2010 TEP Reimbursement Agreement, which expires in 2019. Although the $115 million of variable rate bonds mature between 2022 and 2032, the above maturity reflects a redemption or repurchase of such bonds as though the LOCs terminate without replacement upon expiration of the TEP Credit Agreement in 2016 (that supports $78 million of variable rate bonds) and the 2010 TEP Reimbursement Agreement in 2019 (that supports $37 million of variable rate bonds). Additionally, TEP's 2013 variable-rate IDBs, which mature in 2032, are subject to mandatory tender for purchase after the current five-year term and are therefore reflected as maturing in 2018. Excludes approximately $1 million of debt discount.

(2) Excludes interest on revolving credit facilities and includes interest on TEP's 2013 tax-exempt IDBs through the end of the current five-year term.

(3) Capital lease obligations include the purchase of Springerville Unit 1 in December 2014 and January 2015. See Note 6. Effective with commercial operation of Springerville Unit 3 in July 2006 and Unit 4 in December 2009, Tri-State and SRP are reimbursing TEP for various operating costs related to the common facilities on an ongoing basis, including a total of $14 million annually related to the Springerville Common and Springerville Coal Handling Facilities Leases. TEP remains the obligor under these capital leases, and Capital Lease Obligations do not reflect any reduction associated with this reimbursement.

(4) Excludes the acquisition of Gila River Unit 3 pending regulatory approvals. See Note 8.

(5) Excludes TEP's liability for final environmental reclamation at the coal mines which supply the Navajo, San Juan and Four Corners generating stations as the timing of payment has not been determined. See Note 7.

(6) TEP and UNS Electric have entered into 20-year PPAs with renewable energy generation producers to comply with the RES tariff. TEP and UNS Electric are obligated to purchase 100% of the output of these facilities. The

table above includes estimated future payments based on expected power deliveries under these contracts. TEP and UNS Electric have entered into additional long-term renewable PPAs to comply with the RES; however, TEP's and UNS Electric's obligations to accept and pay for electric power under these agreements does not begin until the facilities are operational.

(7) TEP and UNS Electric have entered into REC purchase agreements to purchase the environmental attributes from retail customers with solar installations. Payments for the RECs are termed Performance Based Incentives (PBIs) and are paid in contractually agreed upon intervals (usually quarterly) based on metered renewable energy production. PBIs are recoverable through the RES tariff. See Note 3.

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(8) TEP has agreed with the owners of Springerville Units 3 and 4 that, prior to expiration of the Springerville Coal Handling Facilities and Common Facilities Leases, TEP will either renew such leases or exercise its fixed price purchase option under such leases and acquire the leased facilities. TEP has the option of purchasing the facilities at the end of the initial lease term or after one or more renewal periods through 2025 for the Springerville Common Facilities and through 2035 for the Springerville Coal Handling Facilities. The table above reflects the purchase as if TEP exercised the fixed price purchase option at the end of the initial lease term. Upon such acquisitions by TEP, the owner of Springerville Unit 3 and the owner of Springerville Unit 4 have the obligation to purchase from TEP a 17% interest in the Springerville Coal Handling Facilities and a 14% interest in the Springerville Common Facilities.

(9) Excludes asset retirement obligations expected to occur through 2066.

(10) These obligations represent TEP's and UES' expected contributions to pension plans in 2014, TEP's expected benefit payments for its unfunded Supplemental Executive Retirement Plan (SERP), and TEP's expected retiree benefit costs to cover medical and life insurance claims as determined by the plans' actuaries. TEP and UES do not know and have not included pension and retiree benefit contributions beyond 2014 for their funded plans due to the significant impact that returns on plan assets and changes in discount rates might have on such amounts.

We have reviewed our contractual obligations and provide the following additional information:

- We do not have any provisions in any of our debt or lease agreements that would cause an event of default or cause amounts to become due and payable in the event of a credit rating downgrade.
- None of our contracts or financing arrangements contains acceleration clauses or other consequences triggered by changes in our stock price.

Income Tax Position

The 2010 Federal Tax Relief Act and the American Taxpayer Relief Act of 2012 include provisions that make qualified property placed in service between 2010 and 2013 eligible for bonus depreciation for tax purposes. In addition, the IRS issued new guidance related to the treatment of expenditures to maintain, replace, or improve property. These provisions are an acceleration of tax benefits UNS Energy and TEP otherwise would have received over 20 years. As a result of these provisions, UNS Energy and TEP do not expect to pay any federal or state income taxes through 2017.

TUCSON ELECTRIC POWER COMPANY

RESULTS OF OPERATIONS

TEP's financial condition and results of operations are the principal factors affecting the financial condition and results of operations of UNS Energy. The following discussion relates to TEP, unless otherwise noted.

2013 compared with 2012

TEP reported net income of $101 million in 2013 compared with net income of $65 million in 2012. The following factors affected TEP's results in 2013:

- a $41 million increase in retail margin revenues due to a non-fuel base rate increase that was effective on July 1, 2013, $2 million of LFCR revenues recorded in the fourth quarter of 2013, and favorable weather during 2013 compared with the same period last year. Favorable weather conditions contributed to a 0.2% increase in retail kilowatt-hour (kWh) sales during 2013;
- a $2 million increase in the margin on long-term wholesale sales due in part to an increase in the market price for wholesale power;
- a $3 million increase in pre-tax income related to the operation of Springerville Units 3 and 4. An unplanned outage at Springerville Unit 3 negatively affected results in 2012;
- a $9 million decrease in interest expense due to a reduction in the balance of capital lease obligations;
- an $11 million tax benefit related to a regulatory asset recorded in June 2013 to recover previously recorded income tax expense through future rates as a result of the 2013 TEP Rate Order. See Note 9; and

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- a $5 million increase in pre-tax income as a result of the 2012 write-off of a portion of the planned Tucson to Nogales transmission line;

partially offset by

- a charge of $3 million recorded to fuel and purchased energy expense resulting from the 2013 TEP Rate Order. See Factors Affecting Results of Operations, Purchased Power and Fuel Adjustor Clause, below;
- a $12 million increase in Base O&M due in part to higher planned and unplanned generating plant maintenance expense, as well as merger-related expenses of $6 million recorded in December 2013; and
- a $3 million increase in taxes other than income taxes due in part to an increase in property tax rates and higher asset balances.

2012 compared with 2011

TEP reported net income of $65 million in 2012 compared with net income of $85 million in 2011. The following factors contributed to the decrease in TEP's net income:

- a $7 million decline in retail margin revenues resulting from lower retail kWh sales due to milder summer weather than 2011, as well as the effects of the ACC's energy efficiency and distributed generation requirements;
- an $8 million decline in long-term wholesale margin revenues resulting primarily from a change in the pricing of energy sold under the SRP wholesale contract effective June 1, 2011;
- a $3 million decrease in pre-tax income related to the operation of Springerville Units 3 and 4. An unplanned outage at Springerville Unit 3 negatively affected results in 2012;
- a $7 million pre-tax gain recorded in 2011 related to the settlement of a dispute with El Paso Electric;
- an $11 million increase in depreciation and amortization expense as a result of an increase in utility plant-in-service; and
- a $5 million decrease in pre-tax income as a result of the write-off of a portion of the planned Tucson to Nogales transmission line;

partially offset by

- a $4 million decrease in Base O&M primarily due to lower planned generating plant maintenance expense at San Juan.

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Utility Sales and Revenues

The table below provides a summary of TEP's retail kWh sales, revenues, and weather data during 2013, 2012, and 2011:

	2013	2012	Percent[1]	2011	Percent[1]
Energy Sales, kWh (in Millions):					
Electric Retail Sales:					
Residential	3,867	3,821	1.2 %	3,888	(1.7)%
Commercial[2]	2,187	2,187	— %	2,184	0.2 %
Industrial	2,114	2,132	(0.9)%	2,145	(0.6)%
Mining	1,079	1,093	(1.2)%	1,083	0.9 %
Other[2]	32	32	1.6 %	32	0.7 %
Total Electric Retail Sales	9,279	9,265	0.2 %	9,332	(0.7)%
Retail Margin Revenues (in Millions):					
Residential	$271	$248	9.3 %	252	(1.4)%
Commercial	181	171	5.9 %	170	0.5 %
Industrial	97	93	5.4 %	95	(2.5)%
Mining	34	30	11.5 %	32	(3.8)%
Other	2	2	5.9 %	2	(15.0)%
Total Retail Margin Revenues (Non-GAAP)[3]	585	544	7.7 %	551	(1.2)%
Fuel and Purchased Power Revenues	300	327	(8.1)%	307	6.5 %
RES, DSM, ECA and LFCR Revenues	49	45	6.8 %	46	(2.6)%
Total Retail Revenues (GAAP)	$934	$916	2.0 %	904	1.3 %
Average Retail Margin Rate (Cents / kWh):[1]					
Residential	7.02	6.50	8.0 %	6.48	0.3 %
Commercial	8.28	7.82	5.9 %	7.80	0.3 %
Industrial	4.61	4.33	6.5 %	4.42	(2.0)%
Mining	3.14	2.78	12.9 %	2.92	(4.8)%
Other	5.56	5.34	4.1 %	6.32	(15.5)%
Average Retail Margin Revenue	6.31	5.87	7.5 %	5.90	(0.5)%
Average Fuel and Purchased Power Revenue	3.24	3.52	(8.0)%	3.29	7.0 %
Average RES, DSM, ECA and LFCR Revenue	0.52	0.49	6.1 %	0.50	(2.0)%
Total Average Retail Revenue	10.07	9.88	1.9 %	9.69	2.0 %
Weather Data:					
Cooling Degree Days					
Year Ended December 31,	1,631	1,556	4.8 %	1,528	1.8 %
10-Year Average	1,491	1,484	NM	1,473	NM
Heating Degree Days					
Year Ended December 31,	1,449	1,201	20.6 %	1,597	(24.8)%
10-Year Average	1,404	1,394	NM	1,417	NM

(1) Calculated on un-rounded data and may not correspond exactly to data shown in table.

(2) Retail kWh sales to commercial and other customers for 2012 and 2011 have been adjusted to reflect a change in the methodology for counting customers resulting from rate design changes from the 2013 TEP Rate Order.

(3) Retail Margin Revenues, a non-GAAP financial measure, should not be considered as an alternative to Total Retail Revenues, which is determined in accordance with GAAP. Retail Margin Revenues exclude: (i) revenues collected from retail customers that are directly offset by expenses recorded in other line items; and (ii) revenues collected from third parties that are unrelated to kWh sales to retail customers. We believe the change in Retail Margin Revenues between periods provides useful information to investors because it demonstrates the underlying revenue trend and performance of our core utility business. Retail Margin Revenues represents the portion of retail

operating revenues available to cover the non-fuel operating expenses of our core utility business.

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2013 compared with 2012

Residential

Residential kWh sales were 1.2% higher in 2013 due in part to favorable weather conditions compared with 2012. A non-fuel base rate increase effective July 1, 2013 and higher sales volumes led to an increase in residential margin revenues of 9.3%, or $23 million. The average number of residential customers grew by 0.7% in 2013 compared with 2012.

Commercial

Commercial kWh sales were the same when compared with 2012. A non-fuel base rate increase effective July 1, 2013 contributed to an increase in commercial margin revenues of 5.9%, or $10 million.

Industrial

Industrial kWh sales decreased by 0.9% compared with 2012. Lower sales due to certain customers changing their usage patterns were more than offset by a non-fuel base rate increase effective July 1, 2013, which led to an increase in industrial margin revenues of $4 million.

Mining

Mining kWh sales decreased by 1.2% compared with 2012. One of TEP's mining customers performed maintenance on its facilities resulting in a temporary decrease in production. A non-fuel base rate increase effective July 1, 2013 led to an increase in margin revenues from mining customers of 11.5%, or $4 million. See Factors Affecting Results of Operations, Sales to Mining Customers.

2012 compared with 2011

Residential

In 2012, residential kWh sales decreased by 1.7% compared with 2011 due in part to a decrease in the number of Cooling Degree Days during the summer months of 2012 compared with 2011. Other factors affecting TEP’s 2012 retail sales volumes included the ACC’s Electric EE Standards and distributed generation requirements, as well as the pace of economic recovery.

Residential margin revenues in 2012 decreased by $4 million when compared with 2011.

Commercial

Commercial kWh sales increased by 0.1% compared with 2011 due primarily to a 0.4% increase in the number of commercial customers. Commercial margin revenues increased by less than $1 million, or 0.1%, compared with 2011.

Industrial

Industrial kWh sales decreased by 0.6% in 2012 compared with 2011, while margin revenues declined by 2.5%. The decline in margin revenues resulted from a change in usage patterns by certain industrial customers that reduced their demand charges paid to TEP.

Mining

The continuation of high copper prices led to increased mining activity, resulting in a 0.9% increase in sales volumes in 2012 compared with 2011. However, margin revenues from mining customers decreased by 3.8% compared with 2011, due to changing usage patterns which resulted in lower demand charges paid to TEP.

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Wholesale Sales and Transmission Revenues

	2013	2012	2011
	Millions of Dollars		
Long-Term Wholesale Revenues:			
Long-Term Wholesale Margin Revenues (Non-GAAP)[1]	$7	$5	$13
Fuel and Purchased Power Expense Allocated to Long- Term Wholesale Revenues	19	20	28
Total Long-Term Wholesale Revenues	26	25	41
Transmission Revenues	15	16	16
Short-Term Wholesale Revenues	92	70	73
Electric Wholesale Sales (GAAP)	$133	$111	$130

(1) Long-term Wholesale Margin Revenues, a non-GAAP financial measure, should not be considered as an alternative to Electric Wholesale Sales, which is determined in accordance with GAAP. We believe the change in Long-Term Wholesale Margin Revenues between periods provides useful information to investors because it demonstrates the underlying profitability of TEP's long-term wholesale sales contracts. Long-Term Wholesale Margin Revenues represents the portion of long-term wholesale revenues available to cover the operating expenses of our core utility business.

Long-Term Wholesale Margin Revenues in 2013 were higher when compared with 2012 due in part to higher market prices for wholesale power. Long-Term Wholesale Margin Revenues in 2012 were lower when compared with 2011 due to a change in the pricing of energy sold under the SRP contract. See Factors Affecting Results of Operations, Long-Term Wholesale Sales, below.

Short-Term Wholesale Revenues

All revenues from short-term wholesale sales and 10% of the profits from wholesale trading activity are credited against the fuel and purchased power costs eligible for recovery in the PPFAC.

Other Revenues

	2013	2012	2011
	Millions of Dollars		
Revenue related to Springerville Units 3 and 4[1]	$102	$101	$97
Other Revenue	28	33	26
Total Other Revenue	$130	$134	$123

(1) Represents revenues and reimbursements from Tri-State and SRP, owners of Springerville Units 3 and 4, respectively, to TEP related to the operation of these plants.

In addition to reimbursements related to Springerville Units 3 and 4, TEP's other revenues include inter-company revenues from UNS Gas and UNS Electric for corporate services provided by TEP, and miscellaneous service-related revenues such as rent on power pole attachments, damage claims, and customer late fees.

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Operating Expenses

Fuel and Purchased Power Expense

TEP's fuel and purchased power expense and energy resources for 2013, 2012 and 2011 are detailed below:

	Generation and Purchased Power			Fuel and Purchased Power Expense		
	2013	2012	2011	2013	2012	2011
	Millions of kWh			Millions of Dollars		
Coal-Fired Generation	10,254	9,702	9,946	$273	$247	$254
Gas-Fired Generation	1,007	1,435	929	46	65	55
Renewable Generation	38	45	28	—	—	—
Reimbursed Fuel Expense for Springerville Units 3 and 4	—	—	—	7	7	8
Total Fuel	11,299	11,182	10,903	326	319	317
Total Purchased Power	2,329	2,328	2,687	112	80	106
Transmission and Other PPFAC Recoverable Costs	—	—	—	12	6	(1)
Increase (Decrease) to Reflect PPFAC Recovery Treatment	—	—	—	(12)	31	(6)
Total Resources	13,628	13,510	13,590	$438	$436	$416
Less Line Losses and Company Use	(885)	(839)	(786)			
Total Energy Sold	12,743	12,671	12,804			

Generation

Total generating output increased in 2013 when compared with 2012 due in part to higher retail kWh sales than the same period last year. Coal-fired generation increased by 6% in 2013 when compared with 2012 due in part to the use of coal to fuel Sundt Unit 4 instead of natural gas.

The table below summarizes TEP's average cost per kWh generated or purchased:

	2013	2012	2011
	cents per kWh		
Coal	2.66	2.54	2.56
Gas	4.57	4.54	5.99
Purchased Power	4.83	3.44	3.94
All Sources	3.54	3.19	3.30

O&M

The table below summarizes the items included in TEP's O&M expense.

	2013	2012	2011
	Millions of Dollars		
Base O&M (Non-GAAP)[1]	$246	$234	$238
O&M Recorded in Other Expense	(7)	(6)	(8)
Reimbursed Expenses Related to Springerville Units 3 and 4	70	72	63
Expenses Related to Customer Funded Renewable Energy and DSM Programs[2]	26	35	38
Total O&M (GAAP)	$335	$335	$331

(1) Base O&M is a non-GAAP financial measure and should not be considered as an alternative to O&M, which is determined in accordance with GAAP. TEP believes that Base O&M, which is O&M less reimbursed expenses and expenses related to customer-funded renewable energy and DSM programs, provides useful information to investors because it represents the fundamental level of operating and maintenance expense related to our core business.

(2) Represents expenses related to customer-funded renewable energy and DSM programs; these expenses are being collected from customers and the corresponding amounts are recorded in retail revenue.

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The table below summarizes TEP's pension and other retiree benefit expenses included in TEP's Base O&M in 2013, 2012, and 2011. See Note 10.

	2013	2012	2011
	Millions of Dollars		
Pension Expense Charged to O&M	$10	$10	$10
Retiree Benefit Expense Charged to O&M	5	5	4
Total	$15	$15	$14

FACTORS AFFECTING RESULTS OF OPERATIONS

2013 TEP Rate Order

In June 2013, the ACC issued an order (2013 TEP Rate Order) that resolved the rate case filed by TEP in July 2012, which was based on a test year ended December 31, 2011. The 2013 TEP Rate Order approved new rates effective July 1, 2013.

The provisions of the 2013 TEP Rate Order include, but are not limited to:

- an increase in non-fuel retail Base Rates of approximately $76 million over adjusted test year revenues;
- an Original Cost Rate Base (OCRB) of approximately $1.5 billion and a Fair Value Rate Base (FVRB) of approximately $2.3 billion;
- a return on equity of 10.0%, a long-term cost of debt of 5.18%, and a short-term cost of debt of 1.42%, resulting in a weighted average cost of capital of 7.26%;
- a capital structure of approximately 43.5% equity, 56.0% long-term debt, and 0.5% short-term debt;
- a 0.68% return on the fair value increment of rate base (the fair value increment of rate base represents the difference between OCRB and FVRB of approximately $800 million);
- a revision in depreciation rates from an average rate of 3.32% to 3.0% for generation and distribution plant regulated by the ACC, primarily due to revised estimates of asset removal costs, which will have the effect of reducing depreciation expense by approximately $11 million annually; and
- an agreement by TEP to seek recovery of costs related to the Nogales transmission line from the Federal Energy Regulatory Commission (FERC) before seeking rate recovery from the ACC.

The 2013 TEP Rate Order also approved the following cost recovery mechanisms:

- A Lost Fixed Cost Recovery mechanism (LFCR) that allows TEP to recover certain non-fuel costs that would otherwise go unrecovered due to reduced kWh sales attributed to energy efficiency programs and distributed generation. The LFCR rate will be adjusted annually and is subject to ACC review and a year-over-year cap of 1% of TEP's total retail revenues. TEP expects to file its first LFCR report with the ACC on or before May 15, 2014. We expect the new LFCR rate to become effective on July 1, 2014. TEP's 2015 LFCR report may include an estimated $6 million to $8 million of unrecovered non-fuel costs incurred during 2014. In the fourth quarter of 2013, TEP recorded LFCR revenues of $2 million for unrecovered non-fuel costs incurred during 2013.
- An Environmental Compliance Adjustor (ECA) mechanism that allows TEP to recover the costs of complying with environmental standards required by federal or other governmental agencies between rate cases. The ECA will be adjusted annually to recover environmental compliance costs and is subject to ACC approval and a cap of $0.00025 per kWh, which approximates 0.25% of TEP's total retail revenues. TEP expects to file its first ECA report on or before March 1, 2014. That report will include qualified investments and costs to be included in the ECA. TEP expects the new ECA rate to become effective on May 1, 2014. We estimate that the ECA could benefit pre-tax income by less than $1 million in 2014.
- An energy efficiency provision which includes a 2013 calendar year budget to fund programs that support the ACC's Electric Energy Efficiency Standards (Electric EE Standards), as well as a performance incentive. See Electric Energy Efficiency Standards, below.
- A new rate under TEP's PPFAC. See Purchased Power and Fuel Adjustment Clause, below.

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Competition

Retail Electric Competition Rules

In 1999, the ACC approved the Rules that provided a framework for the introduction of retail electric competition in Arizona. Certain portions of the ACC Rules that enabled Electric Service Providers (ESPs) to compete in the retail market were invalidated by an Arizona Court of Appeals decision in 2004. During 2012, several companies filed applications for a Certificate of Convenience and Necessity (CC&N) with the ACC to provide competitive retail electric services in TEP's service territory as an ESP. Unless and until the ACC clarifies the Rules and/or grants a CC&N to an ESP, it is not possible for TEP's retail customers to use an alternative ESP.

In May 2013, the ACC voted to commence a process to consider the possibility of opening Arizona to retail electric competition. The first step in the process was to solicit comments on questions raised by the ACC on the potential benefits and risks to Arizona electric customers associated with retail electric competition. In July 2013, various parties, including TEP and UNS Electric, filed comments. TEP and UNS Electric oppose opening Arizona to retail electric competition. Responsive comments from the parties were filed in August 2013. In September 2013, the ACC voted to close the docket and did not take any steps to implement retail electric competition. We cannot predict if the ACC will consider retail electric competition in the future.

Technological Developments and Energy Efficiency

New technological developments and the implementation of Electric EE Standards have reduced energy consumption by TEP's retail customers. TEP's customers also have the ability to install renewable energy technologies and conventional generation units that could reduce their reliance on TEP's services.

Coal-Fired Generating Resources

At December 31, 2013, approximately 70% of TEP's generating capacity was fueled by coal (of which 120 MW can be converted to 156 MW of natural gas capacity at Sundt Unit 4). Existing and proposed federal environmental regulations, as well potential changes in state regulation, may increase the cost of operating coal-fired generating facilities. TEP is evaluating various strategies for reducing the proportion of coal in its fuel mix. TEP's ability to reduce its coal-fired generating capacity will depend on several factors, including, but not limited to:

- the resolution of the non-binding agreement between the State of New Mexico, the EPA, and PNM as it relates to San Juan, see Note 7;
- TEP's future ownership interest in Springerville Unit 1, see Springerville Unit 1; and
- the potential purchase of a combined cycle natural gas plant, see Gila River Generating Station Unit 3.

Springerville Unit 1

TEP leases Unit 1 of the Springerville Generating Station and an undivided one-half interest in certain Springerville Common Facilities (collectively Springerville Unit 1) under seven separate lease agreements (Springerville Unit 1 Leases) that are accounted for as capital leases. The leases expire in January 2015 and include fair market value renewal and purchase options. In 2006, TEP purchased a 14.1% undivided ownership interest in Springerville Unit 1, representing approximately 55 MW of capacity.

In 2011, TEP and the owner participants of Springerville Unit 1 completed a formal appraisal procedure to determine the fair market value purchase price of Springerville Unit 1 in accordance with the Springerville Unit 1 Leases. The purchase price was determined to be $478 per kW of capacity based on a capacity rating of 387 MW.

In August 2013, TEP notified certain owner participants and their lessors that TEP elected to purchase their undivided ownership interests in Springerville Unit 1, at the appraised value upon the expiration of the lease term in January 2015. In total, TEP elected to purchase leased interests comprising 24.8% of Springerville Unit 1, representing 96 MW of capacity, for an aggregate purchase price of $46 million.

In October 2013, TEP agreed to purchase an additional 10.6% leased interest in Springerville Unit 1 for $20 million, the appraised value, with the purchase scheduled to occur in December 2014. The 10.6% ownership interest represents 41 MW of capacity.

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Upon the close of these lease option purchases, TEP will own 49.5% of Springerville Unit 1, or 192 MW of capacity. Due to TEP's purchase commitments, TEP and UNS Energy recorded an increase to both Utility Plant Under Capital Leases and Capital Lease Obligations on their balance sheets in the aggregate amount of approximately $55 million. TEP does not expect that its final undivided ownership interest in Springerville Unit 1 will exceed 49.5%, or 192 MW of capacity. The remaining 50.5% of Springerville Unit 1, or 195 MW of capacity, will be owned by third parties. TEP is not obligated to purchase any of the remaining power from Springerville Unit 1; however, TEP is obligated to operate Springerville Unit 1 for the remaining third-party owners following the expiration of the leases. TEP expects to replace the 195 MW of expiring leased capacity with the purchase of Gila River Unit 3. See Gila River Generating Station Unit 3, below.

Gila River Generating Station Unit 3

In December 2013, TEP and UNS Electric entered into an agreement (the Purchase Agreement) to purchase Gila River Unit 3 for $219 million from a subsidiary of Entegra. The purchase price is subject to adjustments to prorate certain fees and expenses through the closing and in respect of certain operational matters. It is anticipated that TEP will purchase a 75% undivided interest in Gila River Unit 3 (413 MW) for approximately $164 million and UNS Electric will purchase the remaining 25% undivided interest (137 MW) for approximately $55 million, although TEP and UNS Electric may modify the percentage ownership allocation between them. We expect the transaction to close in December 2014.

The Purchase Agreement is subject to, among other things:

- the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended;
- the approval of the FERC;
- an amendment satisfactory to TEP, UNS Electric and the owners of the other units of the Gila River Power Station of the agreement with the other unit owners to address the ownership, operations and maintenance of common facilities and future generation located at the station;
- the completion of certain other agreements associated with the operation of Gila River Unit 3; and
- other customary closing conditions.

TEP expects to provide a letter of credit in March 2014 for $15 million to satisfy a condition of the Purchase Agreement. The seller of Gila River Unit 3 would be entitled to draw upon the letter of credit and apply such amount as liquidated damages if it has validly terminated the Purchase Agreement as a result of misrepresentations by TEP and UNS Electric or the failure of TEP and UNS Electric to close the transaction when the closing conditions have been satisfied. Upon the close of the transaction, the letter of credit would be canceled.

The purchase of Gila River Unit 3, which would replace the expiring coal-fired leased capacity from Springerville Unit 1 and the expected reduction of coal-fired generating capacity from San Juan Unit 2, is consistent with TEP's strategy to diversify its generation fuel mix. See Note 7.

In December 2013, UNS Electric filed an application requesting the ACC to approve an accounting order that would authorize UNS Electric to defer for future recovery specific non-fuel operating costs associated with its anticipated ownership of 25% of Gila River Unit 3. See UNS Electric, Factors Affecting Results of Operations, Gila River Generating Station Unit 3 and Note 8.

Springerville Units 3 and 4

TEP receives annual benefits in the form of rental payments and other fees and cost savings from operating Springerville Unit 3 on behalf of Tri-State and Unit 4 on behalf of SRP.

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The table below summarizes the income statement line items in which TEP records revenues and expenses related to Springerville Units 3 and 4:

	2013	2012	2011
	Millions of Dollars		
Other Revenues	$102	$101	$97
Fuel Expense	(7)	(7)	(8)
O&M Expense	(69)	(72)	(63)
Taxes Other Than Income Taxes	(2)	(1)	(2)

Long-Term Wholesale Sales

TEP's two primary long-term wholesale contracts are with SRP and the Navajo Tribal Utility Authority (NTUA).

Salt River Project

From January 1, 2012, through the end of the contract in May 2016, SRP is required to purchase 500,000 MWh of on-peak energy per year. TEP does not receive a demand charge and the price of energy is based on a discount to the wholesale market price of on-peak power.

Navajo Tribal Utility Authority

TEP serves the portion of NTUA's load that is not served from NTUA's allocation of federal hydroelectric power. Over the last three years, sales to NTUA averaged 225,000 MWh. Prior to June 30, 2013, the power sold to NTUA was at a fixed price. In May 2013, TEP amended its contract with NTUA and extended the contract term from December 2015 to December 2022.

As a result of the amendment, on July 1, 2013, TEP began receiving monthly capacity payments in exchange for providing 15 MW from July to September (June to September beginning in 2014 and thereafter) and 50 MW for the remainder of each year. Starting in 2016, the July to September capacity increases to 25 MW. TEP prices the energy sold to NTUA at its monthly PPFAC eligible cost rate. Any energy sold in excess of the seasonal capacity amounts will be indexed to the wholesale market price of natural gas. TEP estimates that sales to NTUA will be approximately 225,000 MWh in 2014 and 2015.

Sales to Mining Customers

TEP's mining customers have indicated they are taking initial steps to increase production either through expansion of their current mining operations or by the re-opening of non-operational mine sites. If efforts to increase production are successful, TEP's mining load could increase by up to 100 MW over the next several years. The market price for copper and the ability to obtain necessary permits could affect the mining industry's expansion plans.

In addition to the mining customers that TEP currently serves, Augusta Resources Corporation filed a plan of operations with the United States Forest Service in 2007 for the proposed Rosemont Copper Mine near Tucson, Arizona. The Rosemont Copper Mine requires electric service from TEP via a 138 kilo-volt (kV) transmission line for the construction and ongoing operation of the mine. The state line siting committee approved a Certificate of Environmental Compatibility (CEC) in 2011 for the 138 kV transmission line. In 2012, the ACC finalized the CEC. If the Rosemont Copper Mine is constructed and reaches full production, it would be expected to become TEP's largest retail customer, with TEP serving the mine's estimated load of approximately 85 MW.

TEP cannot predict if or when existing mines will expand operations or new or re-opened mines will commence operations.

Interest Rates

TEP is exposed to interest rate risk resulting from changes in interest rates on certain of its variable rate debt obligations, as well as borrowings under its revolving credit facility. As a result, TEP may be required to pay significantly higher rates of interest on outstanding variable rate debt and borrowings under the TEP Revolving Credit Facility. At December 31, 2013, TEP had $215 million in tax-exempt variable rate debt outstanding. The interest rates on TEP's tax-exempt variable rate debt are reset weekly or monthly. In 2013, the average rates paid ranged from 0.06% to 0.48%.

TEP has a fixed-for-floating interest rate swap to hedge $50 million of its tax-exempt variable rate debt.

TEP is also subject to interest rate risk resulting from changes in interest rates on its borrowings under the TEP Revolving Credit Facility. The interest paid on revolving credit borrowings is variable. If LIBOR and other

benchmark interest rates

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increase, TEP may be required to pay higher rates of interest on borrowings under its revolving credit facility. See Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

LIQUIDITY AND CAPITAL RESOURCES

TEP Cash Flows

The tables below show TEP's net cash flows after capital expenditures, scheduled lease debt payments, and payments on capital lease obligations:

	2013	2012	2011
	Millions of Dollars		
Net Cash Flows – Operating Activities (GAAP)	$346	$268	$268
Less: Capital Expenditures	(253)	(253)	(352)
Net Cash Flows after Capital Expenditures (Non-GAAP)[1]	93	15	(84)
Less: Payments of Capital Lease Obligations	(100)	(89)	(74)
Plus: Proceeds from Investment in Lease Debt	9	19	38
Net Cash Flows after Capital Expenditures and Required Payments on Lease Debt and Capital Lease Obligations (Non-GAAP)[1]	$2	$(55)	$(120)

	2013	2012	2011
	Millions of Dollars		
Net Cash Flows – Operating Activities (GAAP)	$346	$268	$268
Net Cash Flows – Investing Activities (GAAP)	(260)	(228)	(312)
Net Cash Flows – Financing Activities (GAAP)	(141)	12	52
Net Increase (Decrease) in Cash	(55)	52	8
Beginning Cash	80	28	20
Ending Cash	$25	$80	$28

(1) Net Cash Flows after Capital Expenditures and Net Cash Flows after Capital Expenditures and Required Payments on Lease Debt and Capital Lease Obligations, both non-GAAP measures of liquidity, should not be considered as alternatives to Net Cash Flows—Operating Activities, which is determined in accordance with GAAP. We believe that Net Cash Flows after Capital Expenditures and Net Cash Flows after Capital Expenditures and Required Payments on Lease Debt and Capital Lease Obligations provide useful information to investors as measures of TEP's ability to fund capital requirements, make required payments on lease debt and capital lease obligations, and pay dividends to UNS Energy before consideration of financing activities.

Liquidity Outlook

Cash flows may vary during the year, with cash flow from operations typically the lowest in the first quarter and highest in the third quarter due to TEP's summer peaking load. As a result of the varied seasonal cash flow, TEP will use, as needed, its revolving credit facility to assist in funding its business activities.

Additionally, due to capital expenditure requirements and scheduled mid-year lease payments, TEP will need to issue long-term debt or enter into additional short-term credit facilities by June 2014. Due to additional purchase commitments for Gila River Unit 3 and Springerville Unit 1, additional external financing will be needed by year-end 2014.

If the Merger Agreement is approved by all necessary parties, Fortis will contribute $200 million of equity capital to UNS Energy upon closing. If the contribution is made by December 2014, UNS Energy may then contribute this capital to TEP and UNS Electric to help fund the Gila River Unit 3 and Springerville Unit 1 purchase commitments.

Operating Activities

In 2013, net cash flows from operating activities were $78 million higher than in 2012. The increase was due primarily to: a $34 million increase in cash receipts from retail and wholesale sales, net of fuel and purchased power costs paid, resulting from a base rate increase that became effective on July 1, 2013, an increase in retail sales volumes, and an increase in wholesale power prices; a $30 million decrease in operations and maintenance costs paid due in part to lower renewable prepayments, lower incentive payments under DSM programs, and lower payments for remote plants; and a $6 million decrease in capital

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lease interest paid due to a decline in capital lease obligation balances; partially offset by a $6 million increase in wages paid (net of amounts capitalized).

Investing Activities