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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED

AUG 13 2003

DOCKETED BY

COMMISSIONERS

MARC SPITZER, Chairman
JIM IRVIN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON

IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR A FINANCING ORDER AUTHORIZING VARIOUS FINANCING TRANSACTIONS.

DOCKET NO. E-01933A-03-0307

DECISION NO. **66174**

ORDER

Open Meeting
August 12 and 13, 2003
Phoenix, Arizona

BY THE COMMISSION:

Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

1. On May 13, 2003, Tucson Electric Power Company ("TEP" or "Company") filed an application with the Commission requesting authorization to replace its current credit agreement with new credit facilities in a maximum amount of $401 million, and to replace or renew the authorized replacement facilities from time to time with new credit facilities in an amount not to exceed those replaced ("Application").

2. TEP published notice of the Application in the June 6, 2003 editions of *The Arizona Daily Star* and *The Daily Territorial*.

3. On July 25, 2003, the Commission's Utilities Division Staff ("Staff") filed a Staff Report recommending approval of TEP's current financing request, approval of the issuance of up to $200 million in long-term tax-exempt bonds under certain conditions, and denial of TEP's request for authorization now to refinance the requested replacement facilities in the future without Commission review.

4. TEP is a wholly owned subsidiary of Unisource Energy Corporation.

5. TEP owns and operates facilities for the generation, purchase, transmission,

distribution and sale of electricity in the City of Tucson, surrounding areas of Pima County and to Fort Huachuca in Cochise County.

6. In Decision No. 65209 (September 20, 2002), the Commission approved TEP's current credit agreement ("Current Agreement"). The Current Agreement consists of three facilities: (1) a $60 million revolving credit facility that matures on November 13, 2003; (2) a $135 million "Tranche A" letter of credit facility that matures on January 31, 2006; and (3) a $206 million "Tranche B" letter of credit facility that matures on November 13, 2006. The $60 million revolving credit facility is used to provide liquidity for general utility corporate purposes. The letter of credit facilities provide support for TEP's variable-rate tax-exempt bonds. The Current Agreement's three facilities are secured by the $401 aggregate principal amount of TEP's second mortgage bonds.

7. TEP proposes to refinance existing debt under the Current Agreement prior to November 13, 2003, in order to replace the three credit facilities with one or more new credit facilities that would provide TEP with a revolving credit commitment and letters of credit from participating banks and lending institutions in an aggregate amount not to exceed $401 million. TEP must refinance the revolving credit facility that matures November 13, 2003, and also desires to replace the letter of credit facilities, which are not immediately due, in order to obtain more favorable pricing and thereby reduce the annual interest expense TEP must pay on its credit facilities.

8. Borrowings under the Current Agreement revolving credit facility bear interest tied to the London Interbank Offer Rate ("LIBOR") or an alternate base rate ("ABR"), which is the greater of the prime rate, the CD rate plus 1.0 percent per annum, or the Federal Funds rate plus 0.50 percent per annum. As of March 31, 2003, the applicable borrowing rates would have been LIBOR plus 4.0 percent or ABR plus 3.0 percent. TEP also pays an unused facility fee of 0.35 percent per annum for amounts of the line not utilized. At May 13, 2003, the outstanding balance on the revolving credit facility was $20 million. Fees payable on the Tranche A letter of credit facility are tied to the pricing grid and based on the ratings of TEP's senior secured debt. Fees on the Tranche B letter of credit facility are fixed at a rate of 5.5 percent. TEP also pays a letter of credit fronting fee of 0.25 percent to the two banks that are the issuers of the letters of credit.

9. The Current Agreement contains three financial covenants and certain other restrictive

covenants that require TEP to maintain the following:

(a) A minimum consolidated tangible net worth equal to the sum of $270 million plus 40 percent of cumulative consolidated net income since June 30, 2002. As of December 31, 2002, the required minimum net worth was $286 million and TEP's actual net worth was $337 million;

(b) A minimum cash coverage ratio of 1.70 in 2002 and increasing to 2.00 in 2006. The cash coverage ratio is a measure of the company's ability to cover its interest payments with its cash flow. As of December 31, 2002, TEP's cash coverage ratio was 2.36; and

(c) A maximum leverage ratio of 5.75 in 2002, decreasing to 4.50 in 2006. The leverage ratio is a measure of the company's total indebtedness (including capital lease obligations) divided by its cash flow. As of December 31, 2002, TEP's leverage ratio was 4.69.

10. With this application, TEP is requesting total finance authority for $401 million, comprised of a revolving line of credit and letter of credit facility to support its tax-exempt bonds. The pricing and terms of the proposed refinancing are subject to negotiation between TEP and the participating banks. The ultimate pricing and terms will depend on the final collateral package, the agreed-upon covenants, the amount and maturity of the commitment and the prevailing market conditions. Staff believes that TEP should be granted authority to refinance the debt under the Current Agreement as long as the terms of the refinancing enable TEP to realize positive enhancements to its cash flow.

11. In addition to requesting authority to refinance the debt under the Current Agreement, TEP also seeks authority to replace or renew the proposed replacement credit facilities in the future, in an aggregate amount not to exceed the amount of the facilities so replaced. TEP states that such authority would allow it to refinance up to $200 million of the aggregate principal amount of its tax-exempt variable rate debt obligations, which are currently backed by letters of credit under the Current Agreement, thus reducing the balance of its letter of credit facilities. TEP presently contemplates that such a refinancing would be on a fixed-rate and unsecured basis. However, to the extent that security is necessary or desirable, TEP would propose to issue one or more series of second mortgage bonds as collateral.

12. Staff indicated that TEP's request to refinance the new credit facilities in the future

lacked adequate restrictions. We find that adequate restrictions can and should be imposed on TEP's request to refinance the new credit agreements authorized in this Order. Those restrictions are:

(1) The authority to refinance the new credit agreements shall be for a period of two (2) years, after which TEP must return to the Commission if it desires to renew the authorization.

(2) Authorization to refinance is conditioned on there being no decrease in Standard and Poor's (currently BBB-) and Moody's (currently Ba2) ratings of senior secured mortgage bonds.

(3) The authority to refinance the new credit agreements shall be conditioned upon TEP obtaining rates and terms resulting in net savings to TEP inclusive of all transaction costs, or other lawful corporate purposes.

(4) The authority shall be limited such that TEP cannot exceed the aggregate amount of the new credit agreements that are replaced.

(5) TEP shall file a report of each transaction in this docket. Each report shall include a schedule of each loan including rate, term, transaction costs, and savings to be realized in the first year and over the life of the newly refinanced loans. Such report(s) are to be made within thirty (30) days of the completion of any refinancing transaction.

(6) Any refinancing transaction pursuant to this authority shall be subject to review in the first TEP rate case after the completion of the transaction.

Staff also believes that due to the expense of the supporting letters of credit under the Current Agreement which impart "investment grade" ratings to its variable-rate tax-exempt bonds, it may be advantageous for TEP to issue tax-exempt fixed-rate bonds to refinance its variable rate tax exempt bonds. Staff therefore recommends that the Commission authorize TEP to issue up to $200 million of tax exempt bonds with a maturity not to exceed forty years, secured or unsecured, to refinance variable rate tax exempt bonds currently supported by the letter of credit facilities, and to reduce the letter of credit facilities by the amount of the bond issuance.

13. As of December 31, 2002, TEP's capital structure consisted of approximately 83.5

percent long-term debt and 14.6 percent equity.[1] Staff states that the proposed replacement of the credit facilities under the Current Agreement will have no effect on the Company's capital structure.

14. For the 12 months ending December 31, 2002, Staff calculates that TEP had a Times Interest Earned Ratio ("TIER") of 5.76 and a Debt Service Coverage ("DSC") ratio of 5.22. Staff states that if TEP can refinance under better terms than those under the Current Agreement, TEP's TIER and DSC ratios will increase.

15. Staff concludes that an aggregate $401 million refinancing of the facilities under the Current Agreement is compatible with sound financial practices, is in the public interest, and will not impair TEP's ability to perform its duty as a public service corporation. Staff recommends that the Commission grant the Company's request for authorization to refinance $401 million in credit facilities under the Current Agreement.

16. Staff further concludes that issuance of up to $200 million in long-term tax-exempt bonds, secured or unsecured, with corresponding reductions to the letters of credit under the Current Agreement and the tax-exempt variable-rate bonds supported by the letters of credit is in the public interest, consistent with sound financial practices, and within TEP's duties as a public service corporation as long as savings or other lawful corporate purpose is derived from such transactions.

17. Staff's recommendations are reasonable.

CONCLUSIONS OF LAW

1. TEP is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-301 and 40-302.

2. The Commission has jurisdiction over TEP and the subject matter of the application.

3. Notice of the application was given in accordance with the law.

4. The financing approved herein is for lawful purposes within TEP's corporate powers, is compatible with the public interest, with sound financial practices, and with the proper performance by TEP of service as a public service corporation, and will not impair TEP's ability to perform that service.

[1] Staff notes that TEP increased the percentage of equity in its capital structure from 11.4 percent to 14.6 percent in the 24 months ending December 31, 2002.

5. The financing approved herein is for the purposes stated in the application and is reasonably necessary for those purposes, and such purposes may, in part, be reasonably chargeable to operating expenses or to income.

ORDER

IT IS THEREFORE ORDERED that Tucson Electric Power Company is hereby authorized to enter into such agreements with participating banks and lending institutions for one or more credit facilities that would replace the credit facilities provided under the Current Agreement in an aggregate amount not to exceed $401 million, on the condition that the terms of such agreements will result in positive enhancements to Tucson Electric Power Company's cash flow.

IT IS FURTHER ORDERED that Tucson Electric Power Company's request for future financing authorization for the new credit agreements authorized herein is granted subject to the conditions and limitations contained in Finding of Fact No. 12.

IT IS FURTHER ORDERED that Tucson Electric Power Company is hereby authorized to issue up to $200 million in long-term tax-exempt bonds as described in its Application, secured or unsecured, with corresponding reductions to the letters of credit under the Current Agreement and the tax-exempt variable-rate bonds supported by those letters of credit, as long as savings or other lawful corporate purpose is derived from such transactions.

IT IS FURTHER ORDERED that Tucson Electric Power Company is hereby authorized to grant collateral to the lenders of the aforementioned replacement facilities in the form of first mortgage bonds, second mortgage bonds, collateral trust bonds secured by a deposit of mortgage bonds or a combination thereof, in an aggregate principal amount not exceeding the lesser of $401 million or the total commitment under the new credit agreements.

IT IS FURTHER ORDERED that Tucson Electric Power Company is authorized to engage in any transaction and to execute or cause to be executed any documents or modifications to existing documents to effectuate the authorization granted herein, including notes and bonds evidencing or securing the indebtedness authorized herein.

IT IS FURTHER ORDERED that Tucson Electric Power Company shall use the credit agreements for purposes set forth in the Application.

IT IS FURTHER ORDERED that Tucson Electric Power Company shall file with the Commission copies of executed documents and agreements of any kind in connection with the approved transactions within 60 days of execution, and shall include with the filing a statement that it is in compliance with all terms and conditions of any new or extended credit agreement.

IT IS FURTHER ORDERED that Tucson Electric Power Company shall file with the Commission, within 60 days of any refinancing transaction authorized herein, a synopsis of savings to be derived thereby, or if there are no savings, an explanation of any other lawful corporate purpose.

IT IS FURTHER ORDERED that approval of the financing set forth herein does not constitute or imply approval or disapproval by the Commission of any particular expenditure of the proceeds derived thereby for purposes of establishing just and reasonable rates.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER COMMISSIONER

COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, JAMES G. JAYNE, Interim Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 13th day of August, 2003.

JAMES G. JAYNE
INTERIM EXECUTIVE SECRETARY

DISSENT ______________

DISSENT ______________

TW:mlj

66174

DECISION NO. ______________

SERVICE LIST FOR: E-01933A-03-0307

DOCKET NO.: TUCSON ELECTRIC POWER COMPANY

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