

ORIGINAL NEW APPLICATION



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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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AZ CORP COMMISSION
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E-04204A-06-0493
G-04204A-06-0493

IN THE MATTER OF THE APPLICATION) DOCKET NOS. E-04204A-06-
OF UNS ELECTRIC, INC. AND UNS GAS, INC.) G-04204A-06-
FOR A FINANCING ORDER AUTHORIZING) APPLICATION FOR FINANCING
VARIOUS FINANCING TRANSACTIONS) ORDER

UNS Electric, Inc. ("UNS Electric") and UNS Gas, Inc. ("UNS Gas"), through undersigned counsel, and pursuant to A.R.S. §§ 40-285, 40-301 and 40-302, hereby respectfully request that the Arizona Corporation Commission ("Commission") issue an order authorizing UNS Electric and UNS Gas to enter into various financing transactions, as described more fully herein. In support hereof, UNS Electric and UNS Gas state as follows:

I. INTRODUCTION.

UNS Electric and UNS Gas are Arizona public service corporations with their principal offices and places of business in Tucson, Arizona. UNS Electric and UNS Gas are subsidiaries of UniSource Energy Services, Inc. ("UES"), which in turn is a subsidiary of UniSource Energy Corporation ("UniSource Energy"). UNS Electric and UNS Gas were established in 2003 when UniSource Energy purchased the Arizona gas and electric system assets from Citizens Communications Company ("Citizens"). UNS Electric is an electric transmission and distribution company serving approximately 91,000 retail customers in Mohave and Santa Cruz Counties. UNS Gas is a gas distribution company serving approximately 142,000 retail customers in Mohave, Yavapai, Coconino, and Navajo Counties in northern Arizona, as well as Santa Cruz County in southeast Arizona.

1 In Decision No. 66028 (July 3, 2003), the Commission authorized the purchase of the electric
2 and gas assets from Citizens and approved various financing arrangements, including bond financing
3 and revolving credit financing. In order to finance the purchase in August 2003, UNS Electric
4 issued \$60 million in Senior Notes due in 2008, and UNS Gas issued \$100 million in Senior Notes,
5 due in 2011 and 2015. Subsequently, in April 2005, UNS Electric and UNS Gas entered into a
6 Credit Agreement (“the 2005 Credit Agreement”) to provide a \$40 million Revolving Credit Facility
7 (the “Facility”) to be used by both companies for working capital purposes.
8

9 In this Application for Financing Order (“Application”), UNS Electric and UNS Gas are
10 jointly requesting authority to:

- 11 1) extend the maturity of the Facility;
- 12 2) increase the amount of the Facility from \$40 million to \$60 million; and
- 13 3) enter into similar amendments or refinancings to extend the Facility during the
14 subsequent three-year period, should favorable opportunities arise.
15

16 Furthermore, UNS Electric is requesting authority to:

- 17 1) refinance its \$60 million of Senior Notes due in August 2008 by issuing new long-
18 term debt;
- 19 2) increase the amount of such long-term debt from \$60 million to up to \$100 million;
20 and
21 3) enter into indentures or security agreements which grant liens on some or all of the
22 UNS Electric properties.
23

24 UNS Electric and UNS Gas believe that the financing transactions described in this
25 Application are prudent and in the public interest. Accordingly, UNS Electric and UNS Gas request
26 that the Commission approve this Application and grant the relief requested herein.¹
27

28
29 ¹ UNS Electric and UNS Gas have attached hereto as Exhibit A, a proposed Form of Order for the Commission to
30 consider.

1 **II. UNS ELECTRIC AND UNS GAS CREDIT AGREEMENT.**

2 In Decision No. 66028 (July 3, 2003), the Commission authorized the purchase of the electric and
3 gas assets from Citizens and approved various financing arrangements, including bond financing and
4 revolving credit financing. On April 15, 2005, UNS Electric and UNS Gas (each a "Borrower")
5 entered into the 2005 Credit Agreement consisting of the \$40 million Facility. Each Borrower is
6 authorized to borrow up to a maximum of \$30 million; however, the total combined amount
7 borrowed cannot exceed \$40 million. This Facility matures on April 15, 2008. The Facility is used
8 to provide liquidity for general corporate purposes. Borrowings under the Facility bear interest at a
9 variable interest rate consisting of a spread over the London Interbank Offered Rate ("LIBOR") or an
10 Alternate Base Rate (similar to a prime rate). The available commitment may also be used by the
11 Borrowers to issue Letters of Credit, subject to the terms and conditions within the 2005 Credit
12 Agreement. As of June 30, 2006, the applicable borrowing rate was LIBOR plus 1.50%. UNS
13 Electric and UNS Gas also pay an annual commitment fee of 0.45% on the unused portion of the
14 Facility. As of June 30, 2006, UNS Electric had \$5 million outstanding at an interest rate of 6.81%
15 and UNS Gas had zero outstanding under the Facility. During 2006, UNS Electric's peak borrowing
16 amount was \$12 million and UNS Gas' peak borrowing amount was \$5 million.

17
18
19 The obligations of each Borrower are several and not joint so neither Borrower guarantees the
20 obligations of the other Borrower. The obligations of each Borrower under the 2005 Credit
21 Agreement are guaranteed by UES. The 2005 Credit Agreement contains two financial covenants
22 and certain other restrictive covenants. The financial covenants are measured at the end of each
23 calendar quarter and require that UNS Electric and UNS Gas each maintain:
24

- 25 1) A minimum Cash Coverage Ratio of 2.25 to 1.00. The Cash Coverage Ratio is a
26 measure of each Borrower's ability to cover its interest payments with its cash
27 flow. As of March 31, 2006, UNS Electric's Cash Coverage Ratio was 4.62 to
28 1.00 and UNS Gas's Cash Coverage Ratio was 3.38 to 1.00; and
29 2) A maximum Debt-to-Capitalization Ratio of 0.65 to 1.00 for UNS Electric and
30 0.67 to 1.00 for UNS Gas. As of March 31, 2006, UNS Electric's Debt-to-

1 Capitalization Ratio was 0.59 to 1.00, and UNS Gas' Debt-to-Capitalization Ratio
2 was 0.54 to 1.00.

3
4 Other restrictive covenants include limitations on indebtedness, liens, asset sales and
5 mergers. UNS Electric and UNS Gas are in compliance with the terms of their 2005 Credit
6 Agreement.

7 **III. AUTHORITY TO AMEND THE 2005 CREDIT AGREEMENT.**

8 UNS Electric and UNS Gas are seeking Commission authority to amend the 2005 Credit
9 Agreement to: (i) extend the maturity of the Facility; and (ii) increase the amount of the Facility from
10 \$40 million to \$60 million. As part of such amendments, UNS Electric and UNS Gas expect to
11 receive lower fees and interest rates on the Facility due to favorable changes in the bank credit
12 markets. UNS Electric and UNS Gas anticipate that the other terms and conditions of their proposed
13 Credit Agreement will remain substantially the same as currently exist in the 2005 Credit
14 Agreement.
15

16 **A. Extension of Maturity Date.**

17 Conditions in the bank credit markets have continued to improve from the time that UNS
18 Electric and UNS Gas entered into the 2005 Credit Agreement. Companies with similar credit
19 profiles to UNS Electric and UNS Gas are currently entering into new financings at rates below what
20 UNS Electric and UNS Gas are now paying. Therefore, UNS Electric and UNS Gas believe that
21 they have an opportunity to obtain similar reduced pricing, and at the same time to extend the term of
22 the Facility.
23

24 UNS Electric and UNS Gas currently expect the new interest rate spread on borrowings to be
25 approximately 50 basis points ("bps") lower than their existing interest rate spread. The new
26 commitment fee on the Facility is currently expected to be 30 bps lower. The benefit of extending
27 the term of the 2005 Credit Agreement is that it extends the date by which UNS Electric and UNS
28 Gas would need to refinance the Facility, thereby reducing refinancing risk and locking in lower rates
29 and fees for the extended term.
30

1 **B. Increase Amount of the Facility.**

2 UNS Electric and UNS Gas are also seeking to increase the amount of the Facility from \$40
3 million to \$60 million in order to increase their access to funds for short-term liquidity and working
4 capital purposes. For several reasons, UNS Electric and UNS Gas believe that it would be prudent to
5 increase the size of the Facility. UNS Electric's and UNS Gas' service territories are growing by 4-
6 5% annually, which require significant capital expenditures to build and maintain the infrastructure
7 required to support this growth. For the fiscal years ended December 31, 2004 and 2005, UNS
8 Electric spent a total of \$49 million and UNS Gas spent a total of \$42 million for capital
9 expenditures. The Facility also serves as a source of liquidity for both UNS Electric and UNS Gas
10 for seasonal working capital requirements. Another potential need for increased borrowing capacity
11 will be to issue letters of credit as credit enhancement for energy purchases by UNS Electric and gas
12 supply and hedging arrangements for UNS Gas. UNS Electric's full requirements power purchase
13 contract with Pinnacle West Capital Corporation expires in 2008 and UNS Electric may be required
14 to provide credit enhancement under future power purchase arrangements. UNS Gas purchases a
15 portion of its gas supply on a forward basis in order to hedge against commodity price volatility. In
16 the future, UNS Gas' gas suppliers or financial hedging counterparties may require credit
17 enhancement in the form of letters of credit.

18 **C. Authority to Subsequently Amend UNS Electric's and UNS Gas' Credit**
19 **Agreement.**

20 Similar to authority that was granted in Decision No. 66174 to Tucson Electric Power
21 Company, UNS Electric and UNS Gas request authority to enter into amendments or refinancings
22 over the course of the next three (3) years to extend the term of the Facility, should such
23 opportunities arise. When market conditions are advantageous, there may be similar opportunities to
24 extend the term of the Facility through a simple amendment to the Credit Agreement, rather than
25 refinancing the entire Agreement. However, there may be opportunities to obtain better terms by
26 refinancing the entire Agreement. If the Commission was to provide "pre-approval" for such
27 transactions, UNS Electric and UNS Gas could take advantage of such opportunities in a timely
28
29
30

1 manner. UNS Electric and UNS Gas understand that the Commission may want to impose certain
2 restrictions upon UNS Electric's and UNS Gas' ability to amend or refinance their 2005 Credit
3 Agreement in future periods and therefore suggest that the following restrictions be attached to future
4 "pre-approved" refinancing transactions:
5

- 6 1. The authority to amend or refinance its 2005 Credit Agreement will be limited to a
7 period of three (3) years, after which, UNS Electric and UNS Gas must return to the
8 Commission to renew the authorization.
- 9 2. The authority shall be limited such that UNS Electric and UNS Gas cannot exceed the
10 aggregate amount of the 2005 Credit Agreement as shall be amended by the authority
11 requested herein.
12

13 Within 90 days of entering into such amendments or refinancings to the 2005 Credit
14 Agreement, UNS Electric and UNS Gas would make a compliance filing with the Commission in
15 which UNS Electric and UNS Gas would certify that their compliance with the restrictions
16 described above have been complied with. In addition, in such filings UNS Electric and UNS Gas
17 would be required to explain the business rationale for such amendment or refinancing, including a
18 demonstration that the rates and terms received by UNS Electric and UNS Gas were fair and
19 reasonable under prevailing market conditions.
20

21 In addition to the proposed Credit Agreement amendments or refinancing described above,
22 UNS Electric and UNS Gas would expect to enter into agreements and amend other existing
23 transaction documents to reflect the terms of the Credit Agreement amendments or refinancing. To
24 the extent that the Commission deems that UNS Electric and UNS Gas must receive authorization
25 to enter into any of these agreements, UNS Electric and UNS Gas request that such authority be
26 granted in the order approving this Application.

27 Finally, UNS Electric and UNS Gas are not requesting that the Commission approve or
28 disapprove any resulting expense derived hereby for purposes of establishing just and reasonable
29 rates.
30

1 **IV. AUTHORITY TO REFINANCE UNS ELECTRIC'S SENIOR NOTES DUE IN 2008.**

2 UNS Electric is seeking Commission authority to refinance its \$60 million in Senior Notes
3 due in August 2008, by issuing new long-term debt in an increased amount of up to \$100 million.
4

5 The existing Senior Notes were issued on August 11, 2003 to finance the purchase of the
6 electric system assets from Citizens. The Senior Notes bear interest at 7.61% and mature on August
7 11, 2008. The Senior Notes are guaranteed by UES. The Senior Notes were issued in a private
8 placement to a group of insurance company investors and are governed by a Note Purchase and
9 Guaranty Agreement.

10 The Note Purchase and Guaranty Agreement contains one financial covenant and certain
11 other restrictive covenants. The financial covenant is measured at the end of each calendar quarter
12 and requires that UNS Electric and UES each maintain a minimum level of Consolidated Net Worth:
13

- 14 1) The Consolidated Net Worth of UNS Electric may not fall below \$26 million. As of
15 March 31, 2006, the Consolidated Net Worth of UNS Electric was \$49.9 million.
16 2) The Consolidated Net Worth of the Guarantor, UES may not fall below \$50 million.
17 As of March 31, 2006, the Consolidated Net Worth of UES was \$130 million.

18 Other restrictive covenants include limitations on indebtedness, liens, asset sales and
19 mergers. In order to issue additional debt or pay dividends, UNS Electric must comply with an
20 Interest Coverage Ratio and a Leverage Test and maintain:
21

- 22 1) A minimum Interest Coverage Ratio of 2.50 to 1.00. The Interest Coverage Ratio is a
23 measure of the UNS Electric's ability to cover its interest payments with its cash flow.
24 As of March 31, 2006, UNS Electric's Interest Coverage Ratio was 4.62 to 1.00.
25 2) A maximum Debt-to-Capitalization Ratio of 0.65 to 1.00. As of March 31, 2006,
26 UNS Electric's Debt-to-Capitalization Ratio was 0.59 to 1.00.

27 UNS Electric is in compliance with the terms of its Note Purchase and Guaranty Agreement.

28 **V. AUTHORITY TO ISSUE NEW LONG-TERM DEBT.**

29 UNS Electric is seeking Commission authority to issue new long-term debt to refinance the
30 \$60 million in Senior Notes that mature in 2008. UNS Electric requests authority to issue up to \$100

1 million in new long-term debt to: (i) pay off the existing \$60 million in Senior Notes; and (ii)
2 provide additional long-term capital to support its growth. UNS Electric expects to borrow under its
3 Facility to fund some of its capital needs between now and 2008. UNS Electric anticipates that it
4 would use the proceeds from the increase in long-term debt to pay off any outstanding borrowings
5 under the revolver at that time.
6

7 UNS Electric expects that it will issue new long-term debt with a maturity of five to twenty
8 years. The interest rate on the new long-term debt will depend upon market conditions at the time,
9 as well as the lenders' assessment of the creditworthiness of UNS Electric. If the Senior Notes are
10 refinanced prior to the August 2008 maturity date, there is a "Make-Whole Amount" due to holders
11 of the Senior Notes calculated by discounting the remaining scheduled payments on the Senior Notes
12 by a rate equal to a U.S. Treasury security having a remaining life equal to the remaining term of the
13 notes. Any refinancing that UNS Electric undertakes would take this cost into effect.
14

15 Although the Senior Notes are not due until August 2008, UNS Electric is requesting
16 authority a year in advance of this maturity date in order to begin testing the market and to obtain
17 proposals from various lenders or arrangers of debt. If UNS Electric believes it is prudent and cost-
18 effective to refinance the Senior Notes prior to maturity, it will be able to act quickly with the
19 Commission's prior approval.
20

21 In addition to the proposed debt issuance and refinancing described above, UNS Electric may
22 need to enter into agreements and other transaction documents to reflect the terms of the debt
23 issuance. To the extent that the Commission deems that UNS Electric must receive authorization to
24 enter into any of these agreements, UNS Electric requests that such authority be granted in the order
25 approving this Application.

26 UNS Electric is not requesting that the Commission approve or disapprove any resulting
27 expense derived hereby for purposes of establishing just and reasonable rates.

28 **VI. AUTHORITY OF UNS ELECTRIC TO GRANT LIENS ON ITS PROPERTIES.**

29 UNS Electric is seeking Commission authority to enter into indentures or security agreements
30 which grant liens on some or all of its properties to provide security in connection with the financing

1 transactions authorized hereby. UNS Electric's obligations under the 2005 Credit Agreement and the
2 existing Senior Notes are unsecured. In the 2005 Credit Agreement and the Note Purchase and
3 Guaranty Agreement, UNS Electric covenants that it will not allow any lien to exist securing
4 indebtedness for borrowed money on any of its properties (unless it makes provisions to equally and
5 ratably secure the obligations covered by such agreements with the other indebtedness secured
6 thereby). UNS Electric does not anticipate that it will need to incur a lien on its properties in
7 connection with the amendments to the 2005 Credit Agreement described herein. However, as a
8 result of market conditions existing at the time of the issuance of the new long-term debt for which
9 UNS Electric is requesting authority or the subsequent amendment or refinancing of UNS Electric's
10 obligations under the Credit Agreement, it may be desirable to achieve lower interest rates, or
11 necessary to complete the financing, for UNS Electric to issue secured debt. The lien of such
12 secured debt could attach to some or all of UNS Electric's properties, including property acquired
13 after the date the initial lien is granted. In connection therewith, UNS Electric may enter into
14 indentures or security agreements granting such liens and providing for the issuance of the secured
15 debt. If, at the time that such a lien were granted to secure the new indebtedness, UNS Electric
16 continued to be bound by covenants which required existing indebtedness to be equally and ratably
17 secured, UNS Electric would need to make arrangements to cause the existing indebtedness to be
18 equally and ratably secured. Those arrangements could include the issuance of mortgage bonds for
19 the benefit of the holders of existing indebtedness to collateralize the existing indebtedness. So, in
20 addition to seeking Commission authority to incur liens to secure the obligations of UNS Electric
21 under the new long-term debt or Credit Agreements described herein, UNS Electric is also seeking
22 the authority for such liens to secure any other of its obligations which will need to be secured in
23 connection with the grant of such liens. To the extent that the Commission deems that UNS Electric
24 must receive authorization to enter into any of these indentures or security agreements or other
25 agreements and transaction documents in connection therewith, UNS Electric requests that such
26 authority be granted in the order approving this Application.
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1 UNS Electric is not requesting that the Commission approve or disapprove any resulting
2 expense derived hereby for purposes of establishing just and reasonable rates.

3 **VII. CONCLUSION.**

4 UNS Electric and UNS Gas believe that amending or refinancing the 2005 Credit Agreement
5 is consistent with sound financial practices, their duties as public service corporations, and is in the
6 public interest. UNS Electric also believes that the refinancing of its Senior Notes is consistent with
7 sound financial practices, its duties as a public service corporation, and is in the public interest.
8

9 WHEREFORE, for all of the foregoing reasons, UNS Electric and UNS Gas request that the
10 Commission issue an Order:

- 11 1) Approving this Application;
- 12 2) Authorizing UNS Electric and UNS Gas to enter into amendment(s) and agreement(s)
13 necessary to extend the term of their 2005 Credit Agreement and increase the size of
14 their Credit Agreement as described herein;
- 15 3) Authorizing UNS Electric and UNS Gas from time to time thereafter over the next
16 three years to enter into similar amendments to or refinancings of the Facility to
17 extend the maturity;
- 18 4) Authorizing the execution, delivery and performance by UNS Electric and UNS Gas
19 of all contracts, agreements, and other instruments which are incidental to any or all
20 of the foregoing or otherwise deemed by UNS Electric and UNS Gas to be necessary,
21 desirable or appropriate in connection therewith;
- 22 5) Authorizing UNS Electric to issue new long-term debt to refinance the UNS Electric
23 Senior Notes due in 2008, including an increase in the amount of the Notes of up to
24 \$100 million;
- 25 6) Authorizing UNS Electric to grant a lien on some or all of its properties, including
26 properties acquired after the date of the grant of the lien, to secure its obligations
27 under the long-term debt and Credit Agreements for which authorization is sought
28
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1 and to secure any other obligations of UNS Electric existing at the time such lien is
2 granted which need to be secured if such lien is granted;

- 3
4 7) Authorizing the execution, delivery and performance by UNS Electric of all contracts,
5 agreements, and other instruments which are incidental to any or all of the foregoing
6 or otherwise deemed by UNS Electric to be necessary, desirable or appropriate in
7 connection therewith;
8 8) Ordering that the Order be deemed effective upon issuance; and
9 9) Granting any other relief that the Commission determines to be appropriate and in the
10 public interest at this time.

11 Finally, UNS Electric and UNS Gas respectfully request that the Commission consider this
12 Application on an expedited basis and that the Commission, in its discretion, approve this
13 Application, without a hearing, at the earliest date possible.
14

15 RESPECTFULLY SUBMITTED this 28th day of July 2006.

16
17 UNS ELECTRIC, INC.
18 UNS GAS, INC.

19
20 By *Michelle Livengood*
21 Michelle Livengood
22 Attorney for UniSource Energy Services
23 One South Church Avenue
24 P.O. Box 711
25 Tucson, Arizona 85702

26 and

27 Michael W. Patten
28 ROSHKA DEWULF & PATTEN, PLC.
29 One Arizona Center
30 400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

1 Original and 15 copies of the foregoing
2 filed this 28th day of July, 2006, with:

3 Docket Control
4 ARIZONA CORPORATION COMMISSION
5 1200 West Washington Street
6 Phoenix, Arizona 85007

7 Copy of the foregoing hand-delivered
8 this 28th day of July, 2006, to:

9 Chairman Jeff Hatch-Miller
10 Arizona Corporation Commission
11 1200 West Washington Street
12 Phoenix, Arizona 85007

13 Commissioner William A. Mundell
14 Arizona Corporation Commission
15 1200 West Washington Street
16 Phoenix, Arizona 85007

17 Commissioner Mike Gleason
18 Arizona Corporation Commission
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Mary Ippolito

EXHIBIT

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER - CHAIRMAN
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES
BARRY WONG

IN THE MATTER OF THE APPLICATION	}	DOCKET NOS. E-04204A-06-_____
OF UNS ELECTRIC, INC. AND UNS GAS, INC.		G-04204A-06-_____
FOR A FINANCING ORDER AUTHORIZING	}	DECISION NO. _____
VARIOUS FINANCING TRANSACTIONS		ORDER

BY THE COMMISSION:

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

Introduction

1. UNS Electric, Inc. ("UNS Electric") and UNS Gas, Inc. ("UNS Gas") (collectively, the "Companies"), are Arizona corporations with their principal offices in Tucson, Arizona. The Companies are subsidiaries of UniSource Energy Services, Inc. ("UES"), which in turn is a subsidiary of UniSource Energy Corporation ("UniSource Energy"), with its principal office located in Tucson, Arizona.

2. On _____, 2006, the Companies filed with the Arizona Corporation Commission ("Commission") an application requesting that the Commission issue a financing order.

3. On _____, 2006, the Companies provided notice of the application to its customers by publishing notice in the *Arizona Republic*, *Arizona Daily Sun*, *Holbrook Tribune-News*, *Kingman Daily Miner*, *Nogales International*, *Prescott Newspapers, Inc.*, *Sedona Red Rock*

1 *News, The Verde Independent, Today's News Herald, White Mountain Independent, Williams-*
2 *Grand Canyon News, and Northern Arizona Newspapers, Inc. dba Winslow Mail newspapers.*

3 4. On _____, 2006, the Commission's Utilities Division ("Staff") filed a Staff
4 Report recommending that UNS Electric's and UNS Gas' application be approved.

5 **Revolving Credit Facility**

6 5. Decision No. 66028 (July 3, 2003) authorized the Companies to have a revolving
7 credit facility of up to \$50 million. The Companies have a Revolving Credit Facility in the
8 amount of \$40 million. The Companies request that they be authorized to increase the Revolving
9 Credit Facility to \$60 million. The Companies also request that they be granted authority to
10 extend the maturity of the Revolving Credit Facility.

11 6. The Companies state that the Revolving Credit Facility is used to provide liquidity
12 for general corporate purposes. Borrowings under the Revolving Credit Facility bear interest at a
13 variable interest rate consisting of a spread over the London Interbank Offered Rate ("LIBOR") or
14 an Alternate Base Rate (similar to a prime rate). The available commitment may also be used by
15 the Borrowers to issue Letters of Credit, subject to the terms and conditions within the 2005 Credit
16 Agreement. As of June 30, 2006, the applicable borrowing rate was LIBOR plus 1.50%. UNS
17 Electric and UNS Gas also pay an annual commitment fee of 0.45% on the unused portion of the
18 Facility.

19 7. The Companies state that conditions in the bank credit markets have improved, and
20 companies with credit profiles similar to UNS Electric's and UNS Gas' ratings are currently
21 entering into new financings at rates below what the Companies are now paying. The Companies
22 anticipate that they will be able to obtain a reduced interest rate spread, as well as a reduced
23 commitment fee.

24 8. The Companies also state that they have an opportunity to extend the term of the
25 Revolving Credit Facility. Extending the term of the Revolving Credit Facility will reduce
26 refinancing risk and lock in the lower rates and fees for the extended term.

27 9. The Companies believe that it would be prudent to increase the amount of the

1 Revolving Credit Facility from \$40 million to \$60 million. The Companies state that this increase
2 will improve their access to funds for short-term liquidity and working capital purposes. For
3 several reasons, the Companies believe that it would be prudent to increase the size of the
4 Revolving Credit Facility. The Companies service territories are growing by 4-5% annually,
5 which requires significant capital expenditures to build and maintain the infrastructure required to
6 support this growth. For the fiscal years ended December 31, 2004 and 2005, UNS Electric spent
7 a total of \$49 million and UNS Gas spent a total of \$42 million for capital expenditures. The
8 Revolving Credit Facility also serves as a source of liquidity for both UNS Electric and UNS Gas
9 for seasonal working capital requirements. Another potential need for increased borrowing
10 capacity will be to issue letters of credit as credit enhancement for energy purchases by UNS
11 Electric and gas supply and hedging arrangements for UNS Gas. UNS Electric's full requirements
12 power purchase contract with Pinnacle West Capital Corporation expires in 2008 and UNS
13 Electric may be required to provide credit enhancement under future power purchase
14 arrangements. UNS Gas purchases a portion of its gas supply on a forward basis in order to hedge
15 against commodity price volatility. In the future, UNS Gas' gas suppliers or financial hedging
16 counterparties may require credit enhancement in the form of letters of credit.

17 10. Staff recommends that the Commission approve the Companies' request to (i)
18 extend the term of the Revolving Credit Facility; and (ii) increase the amount of the Revolving
19 Credit Facility to \$60 million.

20 **Refinancing Authority**

21 11. The Companies request that we grant them "pre-approval" authority for a period of
22 three years to amend the 2005 Credit Agreement or to enter into a future Credit Agreement. The
23 Companies explain that this pre-approval authority will enable them to take advantage of
24 opportunities in a timely matter. The Companies suggest that the Commission impose the
25 following conditions on the pre-approval authority:
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- 1) The authority to amend or refinance the 2005 Credit Agreement will be limited to a period of three (3) years, after which the Companies must return to the Commission if they desire to renew the authorization;
- 2) The authority shall be limited such that the Companies cannot exceed the aggregate amount of the \$60 million.

12. The Companies also recommend that they be directed to make a compliance filing within 90 days of entering into any transaction pursuant to the pre-approval authority discussed herein. The compliance filing would certify that the restrictions described above have been complied with. In addition, the compliance filing will contain an explanation of the business rationale for the transaction, including a demonstration that the rates and terms received by the Companies were fair and reasonable under prevailing market conditions.

13. The Companies also note that in addition to amending the 2005 Credit Agreement or entering into a future Credit Agreement, the Companies would expect to enter into agreements and to amend other transaction documents to reflect the terms of the amendment or refinancing, including the possible issuance of a new series of mortgage bonds to secure any such Credit Agreement. Accordingly, the Companies request that the Commission grant the Companies authority to execute or cause to be executed, deliver and perform all contracts, agreements, mortgage bonds, instruments or other documents (or modifications to any of the above) which are incidental to any or all of the foregoing or otherwise deemed by the Companies to be necessary, desirable or appropriate in connection therewith.

14. Staff recommends that the Commission grant the Companies pre-approval authority as discussed herein, subject to the conditions described in Findings of Fact No. 11 and the compliance requirement described in Findings of Fact No. 12.

Authority to Issue New Long-Term Debt

1
2 15. UNS Electric is seeking Commission authority to refinance its \$60 million in
3 Senior Notes due in August 2008, by issuing new long-term debt in an increased amount of up to
4 \$100 million.

5 16. The existing Senior Notes were issued on August 11, 2003 to finance the purchase
6 of the electric system assets from Citizens. The Senior Notes bear interest at 7.61% and mature on
7 August 11, 2008. The Senior Notes are guaranteed by UES. The Senior Notes were issued in a
8 private placement to a group of insurance company investors and are governed by a Note Purchase
9 and Guaranty Agreement.

10 17. The Note Purchase and Guaranty Agreement contains one financial covenant and
11 certain other restrictive covenants. The financial covenant is measured at the end of each calendar
12 quarter and requires that UNS Electric and UES each maintain a minimum level of Consolidated
13 Net Worth:

14 1) The Consolidated Net Worth of UNS Electric may not fall below \$26
15 million. As of March 31, 2006, the Consolidated Net Worth of UNS
16 Electric was \$49.9 million.

17 2) The Consolidated Net Worth of the Guarantor, UES may not fall below \$50
18 million. As of March 31, 2006, the Consolidated Net Worth of UES was
19 \$130 million.

20 18. Other restrictive covenants include limitations on indebtedness, liens, asset sales
21 and mergers. In order to issue additional debt or pay dividends, UNS Electric must comply with
22 an Interest Coverage Ratio and a Leverage Test and maintain:

23 1) A minimum Interest Coverage Ratio of 2.50 to 1.00. The Interest Coverage
24 Ratio is a measure of the UNS Electric's ability to cover its interest
25 payments with its cash flow. As of March 31, 2006, UNS Electric's Interest
26 Coverage Ratio was 4.62 to 1.00.

1 the Credit Agreement, it may be desirable or necessary for UNS Electric to issue secured debt to
2 achieve lower interest rates, or complete the financing.

3 25. The lien related to secured debt could attach to some or all of UNS Electric's
4 properties, including property acquired after the date the initial lien is granted. In connection
5 with these transactions, UNS Electric may enter into indentures or security agreements granting
6 such liens and providing for the issuance of the secured debt.

7 26. In connection with its existing debt, UNS Electric is bound by certain covenants
8 which may require UNS Electric to grant equal and ratable liens for its existing debt if subsequent
9 debt is secured. In addition to seeking Commission authority to incur liens to secure the
10 obligations of UNS Electric under the new long-term debt or Credit Agreements described herein,
11 UNS Electric is also seeking the authority for such liens to secure any other of its obligations
12 which will need to be secured in connection with the grant of such liens.

13 27. Staff recommends that the Commission approve UNS Electric's request to enter
14 into indentures or security agreements which grant liens on some or all of its properties.

15 **Conclusion**

16 28. Staff concludes that the transactions described herein: (i) are lawful and within the
17 corporate powers of UNS Electric and UNS Gas; (ii) are compatible with sound financial
18 practices; (iii) are in the public interest; and (iv) will not impair UNS Electric's and UNS Gas'
19 ability to perform their duties as public service corporations. Staff recommends that the
20 Commission authorize the transactions described herein.

21 29. Staff's recommendations described in Findings of Fact Nos. 10, 14, 21, 27 and 28
22 are reasonable and should be adopted.

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CONCLUSIONS OF LAW

1. UNS Electric and UNS Gas are public service corporations within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-285, 40-301 and 40-302.
2. The Commission has jurisdiction over UNS Electric and UNS Gas and the subject matter of the application.
3. Notice of the application was given in accordance with the law.
4. The transactions and pre-approval authority approved herein are for lawful purposes within UNS Electric's and UNS Gas' corporate powers, are compatible with the public interest, with sound financial practices, and with the proper performance by UNS Electric and UNS Gas of service as public service corporations, and will not impair UNS Electric's and UNS Gas' ability to perform that service.
5. The financing approved herein is for the purposes stated in the application and are reasonably necessary for those purposes, and such purposes may, in part, be reasonably chargeable to operating expense or income.

ORDER

IT IS THEREFORE ORDERED that UNS Electric's and UNS Gas' application for a financing order is granted.

IT IS FURTHER ORDERED that UNS Electric and UNS Gas are hereby authorized to, as described herein: (i) extend the term of the Revolving Credit Facility; and (ii) increase the amount of the Revolving Credit Facility to \$60 million.

IT IS FURTHER ORDERED that UNS Electric is hereby authorized to refinance its \$60 million in Senior Notes by issuing new long-term debt in an increased amount of up to \$100 million.

IT IS FURTHER ORDERED that UNS Electric is authorized to enter into indentures or security agreements which grant liens on some or all of its properties.

1 IT IS FURTHER ORDERED that UNS Electric and UNS Gas are hereby authorized to
2 execute or cause to be executed, deliver and perform all contracts, agreements, instruments or
3 other documents (or modifications to any of the above) which are incidental to any or all of the
4 foregoing or otherwise deemed by UNS Electric and UNS Gas to be necessary, desirable or
5 appropriate in connection therewith.

6 IT IS FURTHER ORDERED that UNS Electric and UNS Gas shall file with the Director
7 of the Utilities Division one copy of the documents related to the transactions authorized herein
8 within 60 days of execution.

9 IT IS FURTHER ORDERED that UNS Electric's and UNS Gas' request for pre-approval
10 authority to amend or refinance the 2005 Credit Agreement, or to enter into a future Credit
11 Agreement, is granted subject to the conditions in Findings of Fact No. 11.

12 IT IS FURTHER ORDERED that UNS Electric and UNS Gas shall, within 90 days of
13 entering into any transaction pursuant to the pre-approval authority granted herein, file the
14 compliance filing described in Findings of Fact No. 12.

15 IT IS FURTHER ORDERED that UNS Electric and UNS Gas are authorized, in
16 connection with any transaction pursuant to the pre-approval authority granted herein, to execute
17 or cause to be executed, deliver and perform all contracts, agreements, mortgage bonds,
18 instruments or other documents (or modifications to any of the above) which are incidental to any
19 or all of the foregoing or otherwise deemed by UNS Electric and UNS Gas to be necessary,
20 desirable or appropriate in connection therewith.

21 IT IS FURTHER ORDERED that UNS Electric and UNS Gas shall use the Revolving
22 Credit Facility for the purposes set forth in the Application.

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

26 IT IS FURTHER ORDERED that this Decision shall become effective immediately.
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BY ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN	COMMISSIONER	COMMISSIONER
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COMMISSIONER	COMMISSIONER
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IN WITNESS WHEREOF, I Brian C. McNeil, Executive Director 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 ____ day of _____, 2006.

BRIAN C. McNEIL
Executive Director