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MEMORANDUM

TO: Docket Control

FROM: Steve M. Olea
Director
Utilities Division

DATE: April 28, 2010

RE: STAFF REPORT FOR TUCSON ELECTRIC POWER COMPANY
APPLICATION FOR A FINANCING ORDER AUTHORIZING VARIOUS
FINANCING TRANSACTIONS (DOCKET NO. E-01933A-09-0476)

Attached is the Staff Report for Tucson Electric Power Company's application requesting authorization for various financing transactions.

Staff recommends conditional approval of the various financing transactions.

Any party who wishes may file comments to the Staff Report with the Commission's Docket Control by 4:00 p.m. on or before May 7, 2010.

SMO:PMC:kdh

Originator: Pedro M. Chaves

Attachment: Original and thirteen copies

Arizona Corporation Commission

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Service List for: Tucson Electric Power Company
Docket No. E-01933A-09-0476

Mr. Michael Patten
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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

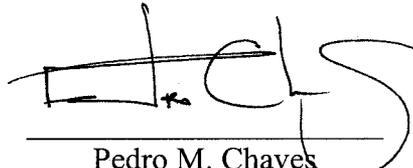
**TUCSON ELECTRIC POWER COMPANY
DOCKET NO. E-01933A-09-0476**

**APPLICATION FOR A FINANCING ORDER
AUTHORIZING VARIOUS FINANCING TRANSACTIONS**

APRIL 27, 2010

STAFF ACKNOWLEDGMENT

The Staff Report for Tucson Electric Power Company, Docket No. E-01933A-09-0476 is the responsibility of the Staff members listed below. Pedro M. Chaves was responsible for the financial review and analysis. Prem Bahl was responsible for the engineering review and analysis.



Pedro M. Chaves
Public Utilities Analyst III



Prem Bahl
Utilities Engineer - Electrical

**EXECUTIVE SUMMARY
TUCSON ELECTRIC POWER COMPANY
DOCKET NO. E-01933A-09-0476**

On October 2, 2009, Tucson Electric Power Company ("TEP" or "Company"), a wholly owned subsidiary of UniSource Energy Corporation ("UNS"), filed an application with the Arizona Corporation Commission ("Commission") requesting authorization of various financing transactions.

In summary, TEP requests the following approvals:

1. To increase its long-term debt threshold by \$300 million, from \$1.0 billion to \$1.3 billion;
2. To increase the amount of revolving credit facilities by \$50 million, from \$150 million to \$200 million;
3. To receive up to an additional \$250,000,000 of equity contributions from UNS; and
4. To enter into the financing transactions listed above on or before December 31, 2014.

Staff concludes that incurrence of the long-term debt (including revolving credit facilities) for which TEP requests authorization, is within its corporate powers, is compatible with the public interest, would not impair its ability to provide services and would be consistent with sound financial practices if subsequent to any debt issuance (1) common equity represents no less than 30 percent of total capital (common equity, preferred stock, capital leases - including current obligations, long-term debt - including current maturities less investments in capital lease debt) and (2) cash coverage ratio ("CCR") is equal to or greater than 1.75 when equity is between 30 and 40 percent of total capital or is equal to or greater than 1.25 when equity is 40 percent or higher of total capital.

Staff recommends that the Commission condition the issuance of long-term indebtedness under the authority set forth in (1) above upon TEP having equity equal to at least 30 percent of its total capital and a cash coverage ratio of at least 1.75 when equity is between 30 and 40 percent of total capital, or a CCR of 1.25 if equity is 40 percent or higher of total capital.

Staff further recommends authorization of the revolving credit facilities threshold proposed by TEP.

Staff further recommends that all unused authorizations to incur long-term debt subject to the \$1.3 billion long-term debt threshold expire on December 31, 2014.

Staff further recommends that all authorizations to refinance and amend the revolving credit facilities expire on December 31, 2014, and that all existing facilities at that date incurred

under lawful authorization that expire prior to January 1, 2017, shall remain valid through their maturity dates.

Staff further recommends authorization for TEP to receive up to an additional \$250 million of equity capital contributions from TEP's parent company, UniSource Energy Corporation.

Staff further recommends authorization of the other financing requests made by TEP in this application except as otherwise specified.

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Introduction

On October 2, 2009, Tucson Electric Power Company (“TEP” or “Company”) filed an application with the Arizona Corporation Commission (“Commission”) requesting authorization of various financing transactions.

On April 1, 2010, TEP filed a supplement to its financing application with information responsive to A.A.C. R14-2-803(A). TEP further waived any applicable time limits as set forth in A.A.C. 14-2-803(B).

Notice

On January 12, 2010, TEP filed affidavits of publication verifying public notice of the financing application. TEP published notice of its financing application in *The Daily Territorial* and *The Arizona Daily Star* on December 14, 2009. The affidavit of publication is attached along with a copy of the Notice.

Compliance

TEP is current with its compliance filings, which are currently under review by Staff.

Background

TEP is a wholly owned subsidiary of the UniSource Energy Corporation (“UNS”), and a for-profit Class “A” Arizona public service corporation located in Tucson, Arizona. TEP is UNS’ largest operating subsidiary. TEP’s electric utility operations contributed 79% of UNS’ operating revenues and comprised 81% of its assets.¹ TEP generates, transmits and distributes electricity to approximately 401,000 retail electric customers in a 1,155 square mile area in Tucson, the surrounding Pima County area and to Fort Huachuca in Cochise County.

The Federal Energy Regulatory Commission (“FERC”) and the Commission regulate portions of TEP’s utility accounting practices and electricity rates. The Commission has authority over TEP’s rates charged to retail customers, the issuance of securities, and transactions with affiliated parties.²

TEP’s current retail rates were established under a settlement agreement authorized in Decision No. 70628, dated December 1, 2008. Under the settlement agreement, TEP agreed to a base rate increase moratorium through December 31, 2012.³

¹ TEP’s annual report (Form 10-K) for the quarterly period ended December 31, 2009, page K-2.

² *Ibid.*

³ Settlement Agreement, page 13.

Description of Proposed Financing

The Company asks that the Commission issue an order:

1. Finding and concluding that the approval of its financing application is in the public interest;
2. Authorizing TEP to issue long-term indebtedness provided that, after giving effect to the issuance of such indebtedness, the aggregate outstanding principal amount of long-term indebtedness of TEP (including current maturities thereof), shall not exceed \$1.3 billion. Such limit does not include capital lease obligations, indebtedness arising under TEP's credit and reimbursement agreements and the principal amount of long-term debt being refinanced by newly issued debt being issued pursuant to such authority;
3. Authorizing TEP to enter into any refinancings, refundings, renewals, reissuances and rollovers of any outstanding indebtedness, as well as the incurrence or issuance of any additional long-term indebtedness, and the amendment or revision of any terms or provisions of or relating to any long-term indebtedness, so long as total long-term indebtedness outstanding, after giving effect to such issuance, does not exceed the levels set forth in (2) above;
4. Authorizing TEP to enter into one or more credit or reimbursement agreements, and to enter into agreements to refinance any such credit or reimbursement agreements, which may consist of one or more revolving credit facilities so long as, after giving effect to the entry of such a facility, TEP's revolving credit facilities do not exceed \$200 million in the aggregate and enter into one or more letter of credit facilities which provide letters of credit to support tax-exempt bonds which have been or in the future will be issued pursuant to lawful authority;
5. Authorizing TEP to provide security for any such financing transactions by the issuance of mortgage bonds under its Mortgage and Deed of Trust;
6. Authorizing TEP to receive additional equity contributions of up to \$250 million from UNS;
7. Requiring TEP, when refinancing long-term indebtedness under the authority set forth in (2) above in circumstances where the issuance of the refinancing debt would result in total long-term indebtedness exceeding the \$1.3 billion level set forth in (2) above if the principal amount of the debt being refinanced were considered to be included in total long-term indebtedness, to repay the debt being refinanced within 90 days of the new debt issuance;
8. Conditioning the issuance of long-term indebtedness under the authority set forth in (2) above (other than in the case of refinancing long-term indebtedness) upon TEP having

equity⁴ equal to at least 30 percent of its total capital and a cash coverage ratio (“CCR”)⁵ of at least 1.75 when equity is between 30 and 40 percent of total capital,⁶ or a CCR of 1.0 if equity is 40 percent or higher of total capital. The equity ratio and the CCR shall be determined on a pro forma basis after giving effect to the issuance of the long-term debt to be issued pursuant to the authority and the discharge of any long-term debt being refunded or refinanced thereby. For purposes of the order, TEP requests that future changes in generally accepted accounting principles (“GAAP”) that have the effect of lowering TEP’s equity be exempted from the equity and cash coverage ratios tests until the Commission makes a determination. TEP shall make a filing with the Commission requesting such a determination within 30 days after the Company files its quarterly report on Form 10-Q or its annual report on Form 10-K with the Securities and Exchange Commission following the end of the fiscal quarter in which the GAAP change occurs. Incurring obligations under authorized credit or reimbursement agreements is not considered to be the incurrence of long-term indebtedness which is subject to the conditions set forth in this (8);

9. Authorizing the execution, delivery and performance by TEP of all contracts, agreements, and other instruments which are incidental to any or all of the foregoing or otherwise deemed by TEP to be necessary, desirable or appropriate in connection therewith;
10. Ordering that the authorization to issue long-term debt, enter into one or more credit agreements for revolving credit facilities and receive additional equity contributions in the order shall replace the existing authorizations of Decisions No. 69946 and 69182, that those authorizations terminate upon the effective date of the order, and that all existing obligations incurred under lawful authorizations shall remain valid;
11. Ordering that the order be deemed effective upon issuance and that TEP may enter into the transactions authorized under the order through December 31, 2014; and
12. Granting any other relief that the Commission determines to be appropriate and in the public interest at this time.

⁴ For purposes of the order, TEP requests that the equity ratio be the ratio of (a) common stock equity to (b) total capitalization, using the most recently audited financial statements as adjusted for capital contributions, distributions, and issuances, repayment or purchases of debt or equity occurring after the most recently audited financial statements.

⁵ For purposes of the order, TEP requests that the cash coverage ratio be the ratio of (a) the sum of operating income, depreciation and amortization expense for the twelve-month period ending on the last day of the period covered by the most recently audited financial statements, to (b) interest expense for the twelve-month period ending on the last day of such period minus interest expense for such period for any indebtedness being refinanced or refunded with the proceeds of long-term debt being issued plus interest expenses for twelve months on the indebtedness being issued (calculated, in the case of indebtedness bearing a floating rate of interest, at the rate initially in effect on the date of the issuance thereof).

⁶ For the purposes of the order, TEP requests that total capitalization be defined as the sum of common stock equity, long-term debt (including current maturities thereof), capital lease obligations (including current obligations under capital leases), less TEP’s investments in capital lease debt.

Purpose

TEP indicates that it will use the proceeds from the issuance of new long-term indebtedness to (1) refinance existing long-term indebtedness, (2) finance a portion of the Company's capital expenditure program, (3) pay-off outstanding borrowings under TEP's revolving credit facility. TEP indicates that it intends to use its revolving credit facility (1) as a source of liquidity for working capital purposes, (2) to issue letters of credit to provide credit enhancement to counterparties for the Company's energy procurement and hedging activities; and (3) for other lawful corporate purposes. TEP asserts that it intends to use receipts of equity capital contributions from UNS to maintain a balanced capital structure over the next several years.

Engineering Analysis

The expenditure levels associated with the projects proposed by the Company are reasonable. However, Staff makes no determination regarding any ratemaking treatment pertaining to these projects nor should any ratemaking treatment be inferred (see Attachment A).

Financial Analysis

TEP requests permission to establish a long-term debt threshold. This request asks for general authorization to take on new debt in unspecified amounts over time. The general nature of this request calls for financial parameters to place conditions on the borrowings to prevent TEP from incurring an excessive amount of debt. As thresholds are ongoing in nature, the financial parameters employed as conditions for future borrowings must also be ongoing in nature. A combination of cash flow and balance sheet parameters is needed to provide a reasonably complete financial perspective. Equity-to-total capitalization is an effective parameter for providing a balance sheet perspective of financial leverage and risk. CCR provides a measure of a borrower's ability to pay interest expenses with operating cash flow. CCR combined with equity-to-total capitalization can be effective for monitoring appropriate indebtedness. Accordingly, Staff concludes that equity-to-total capitalization and CCR parameters are effective for placing conditions on debt issuances within a framework of threshold authorizations.

Capital Structure

At December 31, 2009, TEP's capital structure consisted of 1.7 percent short-term debt, 1.9 percent current obligations under capital leases, 23.1 percent capital lease obligations, 42.8 percent long-term debt, and 30.5 percent equity (Table 1, below). Staff usually considers equity at 40 percent of total capital as the minimum financially prudent capital structure for an investor owned utility with access to the capital markets. As TEP continues to progress from its historically compromised financial position, Staff considers a minimum 30 percent equity acceptable for TEP.

Table 1

TEP's Capital Structure as of December 31, 2009 ⁷ (in '000's)		
Short-term Debt	\$35,000	1.7%
Current Obligations Under Capital Leases	\$40,332	1.9%
Capital Lease Obligations	\$488,311	23.1%
Long-term Debt	\$903,615	42.8%
Common Equity	\$643,144	30.5%
Total Capital	<u>\$2,110,402</u>	<u>100.0%</u>

Staff concludes that any authorization of the long-term debt threshold proposed by TEP should be subject to the condition that, subsequent to any debt issuance subject to the \$1.3 billion long-term debt threshold, common equity represents at least 30 percent of total capital, as defined herein.

Approval of the requested new debt limits would negate the necessity of TEP to file financial applications whenever it has the need to enter into any new debt agreements. Approval of the requested debt threshold would provide TEP with the flexibility to take advantage of any favorable conditions in the financial markets when capital needs arise. Accordingly, authorization to increase the long-term debt is appropriate, but should include an expiration date at a date certain to maintain reasonable oversight of TEP's capital financing by compelling it to seek reauthorization.

Cash Coverage Ratio

CCR represents the number of times internally generated cash covers required interest payments on short-term and long-term debt. A CCR greater than 1.0 means that operating cash flow is greater than interest expense.

Staff concludes that any authorization of the long-term debt threshold proposed by TEP should be subject to the condition that, subsequent to any debt issuance subject to the \$1.3 billion long-term debt threshold, TEP has a CCR equal to or greater than 1.75 if equity represents less than 40 percent of total capital, otherwise the minimum CCR is 1.25.

⁷ TEP's annual report (Form 10-K) for the quarterly period ended December 31, 2009, pages K-95 and K-96.

Credit Agreement

Commission Decision No. 69182, dated December 8, 2006, authorized TEP to refinance or amend its Credit Agreement. The Credit Agreement consists of two credit facilities: 1) a \$150 million revolving credit facility (“Revolver”) and 2) a letter of credit facility (“LOC”). TEP’s peak borrowing under the Revolver has been \$110 million. The Company requests to increase the amount of revolving credit facilities under its Revolver by \$50 million to \$200 million.

The proposed increase in the Revolver would provide TEP with available lines of credit to cover unexpected cash requirements, to meet its seasonal working capital requirements, and to provide credit support for its energy procurement and hedging activities. TEP’s cash forecasts anticipate near-term Revolver borrowing requirements in excess of \$100 million. Maintaining adequate liquidity capacity gives TEP’s investors, bondholders, bankers, and rating agencies comfort that it may withstand and react quickly to unexpected circumstances and turmoil in the capital markets. Due to the potential for unexpected cash requirements, Staff concludes that it is prudent to reserve a portion of the revolver for these potential needs.

TEP has a \$341 million LOC. The LOC does not provide cash proceeds to TEP. The LOC is used to provide credit support for tax-exempt bonds. TEP does not propose to limit the amount of LOC facilities issued to support tax-exempt bonds. TEP pays fees related to the LOC. TEP’s LOC fee, as of December 31, 2009, was 0.45 percent per annum and amounts drawn under a letter of credit would bear interest at London Inter-Bank Offer Rate (“LIBOR”) plus 0.45 percent per annum. TEP has the option of paying interest on borrowings under the revolving credit facility at LIBOR plus 0.45 percent or the greater of the federal funds rate plus 0.5 percent or the agent bank’s reference.⁸ TEP’s application notes that it pays an “LOC Fronting Fee” to the banks that are issuers of the LOCs. Staff concludes that TEP’s request not to limit the amount of LOCs is appropriate since the LOCs are self-limiting to the amount of tax-exempt debt authorized and related accrued interest.

Encumbrance

TEP requests authorization to provide security by the issuance of mortgage bonds under its mortgage and deed of trust for the financing transactions requested herein.

A.R.S. § 40-285 requires public service corporations to obtain Commission authorization to encumber certain utility assets. The statute serves to protect captive customers from a utility’s act to dispose of any of its assets that are necessary for the provision of service, thus, it serves to preempt any service impairment due to disposal of assets essential for providing service.

Pledging assets as security typically provides benefits to the borrower in the way of increased access to capital funds or preferable interest rates.

⁸ TEP’s annual report (Form 10-K) for the quarterly period ended December 31, 2009, page K-136.

Equity Contributions

A.A.C. R14-2-803.A states that, "Any utility or affiliate intending to organize a public utility holding company or reorganize an existing public utility holding company will notify the Commission's Utility Division in writing at least 120 days prior thereto." Decision No. 58063, dated November 3, 1992, states that a public utility holding company increasing or decreasing its financial interest in an affiliate would be considered a reorganization and therefore would be subject to A.A.C. R14-2-803.

Decision No. 58063 also exempts a public utility holding company from the requirement of A.A.C. R14-2-803 when the holding company increases or decreases its financial interest in an affiliate or utility by an amount not exceeding designated "exempt amounts" based on pre-existing utility assets in all jurisdictions including Arizona. Staff concludes that the current application would be exempt if the reorganization (i.e., equity investment from UNS to TEP) did not exceed \$50 million in one calendar year.

A.A.C. R14-2-803.A directs the Company to include certain information related to the reorganization in its notice of intent. Staff finds that the information provided by the Company in the supplement to the application is satisfactory.

A.A.C. R14-2-803.B states, "The Commission staff will, within 30 days after receipt of the notice of intent, notify the Applicant of any questions which it has concerning the notice or supporting information. The Commission will, within 60 days from the receipt of the notice of intent, determine whether to hold a hearing on the matter or approve the organization or reorganization without a hearing." TEP's supplement to the application states that it waives any applicable time limits as set forth in A.A.C. 14-2-803.B.

A.A.C. R14-2-803.C states, "[T]he Commission may reject the proposal if it determines that it would impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service."

The application requests authority to receive additional equity capital contributions from UNS for the purpose of maintaining a balanced capital structure. As discussed above, at December 31, 2009, TEP's capital structure consisted of 1.7 percent short-term debt, 1.9 percent current obligations under capital leases, 23.1 percent capital lease obligations, 42.8 percent long-term debt, and 30.5 percent equity, and Staff usually considers equity at 40 percent of total capital as the minimum financially prudent capital structure for an investor-owned utility with access to the capital markets. Accordingly, TEP should continue increasing the proportion of equity in its capital structure until it represents at least 40 percent of total capital. As TEP issues additional debt, the Company will need to grow equity to maintain its current proportion of equity. A pro forma capital structure recognizing a \$250 million equity contribution is composed of 1.5 percent short-term debt, 1.7 percent current obligations under capital leases, 20.7 percent capital lease obligations, 38.3 percent long-term debt, and 37.8 percent equity.

Since this pro forma capital structure includes less than 40 percent equity, TEP's request to receive additional equity should only serve to provide needed equity enhancement. Therefore, Staff concludes that there is no reason to deny TEP's request to receive up to \$250 million of equity contributions from its parent for the purpose of enhancing its equity position.

Conclusions and Recommendations

Staff concludes that incurrence of the long-term debt (including revolving credit facilities) for which TEP requests authorization, is within its corporate powers, is compatible with the public interest, would not impair its ability to provide services and would be consistent with sound financial practices if subsequent to any debt issuance (1) common equity represents no less than 30 percent of total capital (common equity, preferred stock, capital leases - including current obligations, long-term debt - including current maturities less investments in capital lease debt) and (2) CCR is equal to or greater than 1.75 when equity is between 30 and 40 percent of total capital or is equal to or greater than 1.25 when equity is 40 percent or higher of total capital.

Staff further concludes that:

1. The expenditure levels associated with the projects included in the construction work plan are reasonable;
2. TEP should be authorized to incur up to \$1.3 billion (in addition to existing capital leases and revolving credit facility obligations) in long-term indebtedness;
3. TEP should be authorized to enter into one or more credit or reimbursement agreements, increase the amount of revolving credit facilities to \$200 million and use letter of credit facilities as desirable and beneficial to support tax-exempt bonds which have been or in the future will be issued pursuant to lawful authority;
4. TEP should be authorized to provide security where it is desirable and beneficial for any financing transactions authorized in this proceeding by the issuance of mortgage bonds under its Mortgage and Deed of Trust;
5. TEP should be authorized to conduct the activities enumerated in the application that are necessary to secure and maintain debt;
6. The \$1.3 billion long-term debt threshold authorized in this proceeding should expire on December 31, 2014;
7. All authorizations to refinance and amend the revolving credit facilities should expire on December 31, 2014, and all existing revolving credit facilities that expire before January 1, 2017, incurred under lawful authorization shall remain valid through their maturity dates; and
8. There is no financial basis under A.A.C. R14-2-803.C. to reject the Company's recapitalization plan. TEP should be authorized to receive up to \$250 million in additional equity capital from its parent company UniSource Energy Corporation to improve and maintain its capital structure.

Staff recommends that the Commission:

1. Find and conclude that the approval of TEP's financing application is in the public interest;
2. Authorize TEP to issue long-term indebtedness provided that, after giving effect to the issuance of such indebtedness, the aggregate outstanding principal amount of long-term indebtedness of TEP (including current maturities thereof), shall not exceed \$1.3 billion except as provided for in (7) below. Such limit does not include existing capital lease obligations, indebtedness arising under TEP's credit and reimbursement agreements;
3. Authorize TEP to enter into any refinancings, refundings, renewals, reissuances and rollovers of any outstanding indebtedness, as well as the incurrence or issuance of any additional long-term indebtedness, and the amendment or revision of any terms or provisions of or relating to any long-term indebtedness, so long as total long-term indebtedness outstanding, after giving effect to such issuance, does not exceed the levels set forth in (2) above;
4. Authorize TEP to enter into one or more credit or reimbursement agreements, and to enter into agreements to refinance any such credit or reimbursement agreements, which may consist of one or more revolving credit facilities so long as, after giving effect to the entry of such a facility, TEP's revolving credit facilities do not exceed \$200 million in the aggregate and enter into one or more letter of credit facilities which provide letters of credit to support tax-exempt bonds which have been or in the future will be issued pursuant to lawful authority;
5. Authorize TEP to provide security for any such financing transactions by the issuance of mortgage bonds under its Mortgage and Deed of Trust;
6. Authorize TEP to receive additional equity contributions of up to \$250 million from UNS;
7. Authorize TEP to exceed the \$1.3 billion long-term debt threshold level set forth in (2) above for a period not to exceed 90 days in circumstances where that threshold is exceeded due to the effect of recognizing both the issuance of refinancing debt and the existing debt to be refinanced;
8. Condition the issuance of long-term indebtedness under the authority set forth in (2) above (other than in the case of refinancing long-term indebtedness) upon TEP having equity equal to at least 30 percent of its total capital and a cash coverage ratio of at least 1.75 when equity is between 30 and 40 percent of total capital, or a CCR of 1.25 if equity is 40 percent or higher of total capital. The equity ratio and the CCR shall be determined on a pro forma basis after giving effect to the issuance of the long-term debt to be issued pursuant to the authority and the discharge of any long-term debt being refunded or

refinanced thereby. For purposes of the order, the equity ratio shall be the ratio of (a) common stock equity to (b) total capitalization, using the most recently audited financial statements as adjusted for capital contributions, distributions, and issuances, repayment or purchases of debt or equity occurring after the most recently audited financial statements. For the purposes of the order, total capitalization shall be defined as the sum of common stock equity, preferred stock, long-term debt (including current maturities thereof), capital lease obligations (including current obligations under capital leases), less TEP's investments in capital lease debt. For purposes of the order, the CCR shall be the ratio of (a) the sum of operating income, depreciation and amortization expense for the twelve-month period ending on the last day of the period covered by the most recently audited financial statements, to (b) interest expense for the twelve-month period ending on the last day of such period minus interest expense for such period for any indebtedness being or having been refinanced or refunded with the proceeds of long-term debt being or having been issued subsequent to such period plus interest expenses for twelve months on the indebtedness being or having been issued subsequent to such period (calculated, in the case of indebtedness bearing a floating rate of interest, at the rate initially in effect on the date of the issuance thereof). For purposes of the order, future changes in GAAP that have the effect of lowering TEP's equity will be exempted from the equity and cash coverage ratios tests until the Commission makes a determination. TEP shall make a filing with the Commission requesting such a determination within 30 days after the Company files its quarterly report on Form 10-Q or its annual report on Form 10-K with the Securities and Exchange Commission following the end of the fiscal quarter in which the GAAP change occurs. Incurring obligations under authorized credit or reimbursement agreements is not considered to be the incurrence of long-term indebtedness which is subject to the conditions set forth in this (8);

9. Authorize the execution, delivery and performance by TEP of all contracts, agreements, and other instruments which are incidental to any or all of the foregoing or otherwise deemed by TEP to be necessary, desirable or appropriate in connection therewith;
10. Order that the authorization to issue long-term debt, enter into one or more credit agreements for revolving credit facilities and receive additional equity contributions shall replace the existing authorizations of Decisions No. 69946 and 69182, that those authorizations expire upon the effective date of the Order, and that all existing obligations incurred under lawful authorizations shall remain valid;
11. Ordering that the Order in this case be deemed effective upon issuance and that TEP may enter into the transactions authorized under the Order through December 31, 2014, and that all existing letter of credit facilities and all existing revolving credit facilities that expire before January 1, 2017, incurred under lawful authorization shall remain valid through their maturity dates; and
12. Order that within 90 days of the completion of any financing transaction under the authority set forth in (2), TEP make a compliance filing with the Commission in which

TEP provides copies of the relevant agreements and provides a description of the business rationale for such financing or refinancing, including a demonstration that the rates and terms received by TEP were fair and reasonable under prevailing market conditions.

MEMORANDUM

TO: Pedro M. Chaves
Public Utility Analyst III
Utilities Division

FROM: Prem Bahl 
Electric Utilities Engineer
Utilities Division

DATE: March 8, 2010

RE: TUCSON ELECTRIC POWER COMPANY'S FINANCING APPLICATION
(DOCKET NO. E-01933A-09-0476)

Tucson Electric Power Company ("TEP" or "Company") submitted an application ("Application") to the Arizona Corporation Commission ("Commission") for authorization for various financing transactions as detailed in the Application. The purpose of this Application is to refinance existing long-term debt maturities and obligations (currently \$903 million), and to provide additional financing authority (\$300 million) to help fund TEP's proposed capital projects required to serve TEP's growing service territory and increasing reliability needs in accordance with its proposed 2010-2014 Construction Work Plan¹ ("CWP" or "Plan").

Customer and Load Growth

In 2009, TEP provided electric power to approximately 401,600 retail customers in its 1,155 square mile service territory including the metropolitan Tucson area in Pima County, as well as parts of Cochise County. The number of residential customers was approximately 365,160, which was approximately 90.9 percent of the retail customer group, whereas approximately 36,450 commercial and industrial customers accounted for 9.1 percent of that group. With approximately 359,400 total customers in 2002, this reflects an average annual increase of 1.7 percent in customer growth in TEP's service territory over a seven-year period. As a result of weak economic conditions, TEP's average retail customers grew by less than 1 percent in 2008 and 2009, compared with average annual increases of 2 percent from 2002 to 2007. TEP expects retail customer growth of approximately 1 percent annually over the next several years.

Historically, the Company's annual peak retail load grew from 1,946 MW in 2002 to 2,376 MW in 2008, an average annual increase of approximately 3.38 percent. TEP expects its retail kWh sales to grow at an average rate of 1 to 2 percent over the next several years. In 2014, the Company projects its annual peak retail load to increase to 2,648 MW, an average annual increase of approximately 2.08 percent over the 6 year period. As a result of weak economic

¹ Work Plan was provided by TEP in response to Staff's Data Request PMC 1.4 under confidentiality

conditions in 2008 and 2009, TEP's retail kWh sales decreased by 1.4 percent in 2008 and 2009. TEP's average annual increase in retail kWh sales was 4 percent from 2003 to 2007.

Existing and Future Generation Resources

TEP owns approximately 1,410 MW of coal fired generation and 809 MW of gas fired generation. TEP's thermal generating capacity and ownership share is shown in Table 1 below:

Table 1- TEP Generating Capacity Table

Generating Capacity	Share of Unit	Capacity (MW)
Four Corners	7%	110
Navajo	7.5%	168
San Juan	50%	322
Springerville	100%	810
Coal Resources		1,410
Sundt	100%	422
Luna Energy Facility	33%	190
DeMoss Petrie CT	100%	68
North Loop CT 1-4	100%	85
Sundt CT 1-2	100%	44
Natural Gas Resources		809
Total Resource Capacity		2,219

TEP is the Operating Agent for the coal fired Springerville generating station, with four units. The Company owns or leases 100 percent of Units 1 and 2. Unit 3 is owned by Tri-State Generation & Transmission Association ("Tri-State"). The construction of the fourth Springerville unit was completed in December 2009. Springerville Unit 4 is 100 percent owned by Salt River Project ("SRP").

TEP owns or leases four steam units at the Sundt Generating Station. Units 1, 2 & 3 are gas fired and Unit 4 can be run on either coal or gas. TEP also owns two combustion turbines at Sundt, four combustion turbines at North Loop and a combustion turbine unit at DeMoss Petrie. All of these generating units are located in the Tucson Metropolitan area.

The Company has a one third ownership (190 MW) in the 570 MW Luna Energy Facility, a combined cycle generating unit, located in southern New Mexico, with Public Service Company of New Mexico ("PNM") and Phelps Dodge as co-owners. TEP also owns 50 percent of San Juan Units 1 & 2 (332 MW); 7.5 percent of Navajo Units 1, 2 & 3 (168 MW); and 7 percent of Four Corners Units 4 & 5 (110 MW).

Due to the current surplus of merchant generating capacity in the region, TEP actively procures firm resource capacity in the form of short-term purchase power agreements (“PPAs”) to meet TEP’s summer peak capacity requirements. In addition, TEP maintains two separate Reserve Sharing Agreements with other utilities and is also a participant in the Southwest Reserve Sharing Group which provides additional backup capacity during system contingencies.

The funds requested in the Application are required for upgrading pollution control devices, replacing certain generation equipment, and for maintenance purposes relative to the aforementioned generation resources.

Transmission System

TEP owns approximately 366 miles of 138 kV lines, and is owner and part owner of 1,098 miles of 345 kV lines and 512 miles of 500 kV lines. In the current Application, TEP plans to upgrade several Extra High Voltage (“EHV”)² lines and also build new infrastructure as included in its 2010-2014 CWP. TEP’s transmission upgrades and expansion plans as included in its Application seem to be adequate and appropriate for meeting the future needs of the Company in providing for its projected load during the 2010-2014 Plan period.

TEP is actively participating in the regional and sub-regional transmission planning forums such as Western Electricity Coordinating Council (“WECC”); WestConnect, Southwest Area Transmission System (“SWAT”); and Southeast Area Transmission Study (“SATS”).

TEP is participating in the Central Arizona Transmission System (“CATS”) studies conducted by a stakeholder group on a collaborative basis. CATS is looking at the transmission alternatives in Central Arizona area from a planning perspective to meet future load growth in a reliable manner. As a result of this work, TEP, SRP, Arizona Public Service Company (“APS”), Santa Cruz Water and Power Districts (“SCW&P”) Association, and Southwest Transmission Cooperative (“SWTC”) have embarked upon the Hassayampa - Pinal West – Southeast Valley/Browning Station 500 kV line, which was approved for construction by the Commission in August 2005. In-service dates for different segments of this project were originally slated to be 2008-2011. The first segment of this 500 kV line, from Hassayampa to Pinal West, approved in Commission Decision No. 67012, was completed in 2008. TEP looped in the 345 kV Westwing-South line at the Pinal West Substation in 2008.

Review of 2010-2014 Capital Expenditures

In assessing the Company’s future capital expenditures, Staff utilized the following criteria:

- Does TEP adequately address the needs of the projected customer and load growth in TEP’s service territory?

² 345 kV and above.

- Do the capital expenditures on generation, transmission and distribution infrastructure upgrades and new additions appear appropriate and reasonable in meeting the Company's future native load requirements in a reliable and cost effective manner?

Staff has reviewed TEP's total capital expenditures for generation, Transmission and Distribution ("T&D") and General capital expenditures as included in its Application and as provided in its data responses to Staff's data requests.

Total generation expenditures for the 2010-2014 period, amounting to \$674 million, include expenses relative to maintenance, replacement of equipment and upgrades of facilities at the remote generating stations such as Four Corners, Navajo and San Juan and at the Springerville and Tucson generating stations. It also includes an estimated amount for the purchase of Sundt Unit 4 (\$62 million) at the lease expiration date in 2011, as well as amounts for the construction of new local generation in the Tucson area during 2012-2014. These expenditures appear to be appropriate and reasonable. TEP's General expenditures appear to be appropriate and reasonable.

TEP's projected T&D capital expenditures appear to be appropriate and reasonable given the level of load growth projected as well as new demands that will be placed on TEP related to increasingly stringent WECC reliability criteria³ as approved by NERC and FERC. These criteria result from the Energy Policy Act of 2005 as well as FERC's new Order 890 that impacts transmission expansion for all electric utilities.

The following Table No. 2 provides a Summary of TEP's forecasted Capital Expenditures for the period of 2010-2014.⁴

Table No. 2

Summary of TEP's Capital Expenditures (Dollars in millions, 2010-2014)	
Generation ⁵	674
General	159
Transmission & Distribution ⁶	607
Total	1,440

³ WECC has established more stringent reliability criteria for the western interconnection in terms of higher operational and maintenance standards and greater capital expenditures for installing additional equipment for substations such as protective relaying, voltage regulators, etc.

⁴ TEP's annual report (Form 10-K) for the quarterly period ended December 31, 2009, page K-54

⁵ Includes estimated costs of \$300 million in 2011-2014 to construct 75 to 150 MW of local generation that may be required in 2015.

⁶ Includes the estimated cost to construct proposed Tucson to Nogales, Arizona transmission line of \$120

According to TEP, the Company already has approximately \$903 million in outstanding debt, and is requesting the authority to have outstanding at any time up to \$1,300 million in long-term debt. That means that TEP could potentially issue up to \$397 million in long-term debt by December 2014 to finance a portion of new capital expenditures subject to Commission approval. The financing authority being requested in the Application is not associated with specific projects but is intended to fund a portion of all projects included in the Construction Work Plan.

Conclusions and Recommendations

Based on the aforementioned review of TEP's generation, transmission and distribution projects, Staff believes that the Company's proposed capital expenditures are appropriate to meet the projected needs of TEP's existing and new customers and ensure system reliability. TEP's ability to serve its native load reliably and cost effectively is contingent upon the Company's upgrading existing electric facilities, replacing certain equipment and adding new T&D infrastructure. The upgrades that TEP has planned should improve its system from a reliability perspective and will also help the Company to meet new reliability criteria developed by WECC and NERC and recently approved by FERC. Staff further concludes that the expenditure levels associated with the projects proposed by the Company are reasonable. However, this does not imply a specific treatment of rate base for rate making purposes in the Company's future rate filings.

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BEFORE THE ARIZONA CORPORATE

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COMMISSIONERS

- KRISTIN K. MAYES - CHAIRMAN
- GARY PIERCE
- PAUL NEWMAN
- SANDRA D. KENNEDY
- BOB STUMP

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ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION) DOCKET NO. E-01933A-09-0476
 OF TUCSON ELECTRIC POWER COMPANY)
 FOR A FINANCING ORDER AUTHORIZING) **NOTICE OF FILING**
 VARIOUS FINANCING TRANSACTIONS) **AFFIDAVITS OF PUBLICATION**

Tucson Electric Power Company, through its undersigned counsel, hereby submits the attached affidavits of publication.

RESPECTFULLY SUBMITTED this 12th day of January 2010.

TUCSON ELECTRIC POWER COMPANY

By 
 Philip J. Dion
 Tucson Electric Power Company
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and

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 Phoenix, Arizona 85004

Arizona Corporation Commission
DOCKETED

JAN 12 2010

DOCKETED BY 

1 Original and 13 copies of the foregoing
filed this 12th day of January 2010 with:

2 Docket Control
3 Arizona Corporation Commission
1200 West Washington Street
4 Phoenix, Arizona 85007

5 Copy of the foregoing hand-delivered/mailed
this 12th day of January 2010 to:

6 Lyn Farmer, Esq.
7 Chief Administrative Law Judge
Hearing Division
8 Arizona Corporation Commission
1200 West Washington
9 Phoenix, Arizona 85007

10 Janice M. Alward, Esq.
Chief Counsel, Legal Division
11 Arizona Corporation Commission
1200 West Washington
12 Phoenix, Arizona 85007

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Director, Utilities Division
14 Arizona Corporation Commission
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TUCSON NEWSPAPERS

Tucson, Arizona

STATE OF ARIZONA)
COUNTY OF PIMA)

Debbie Capanear, being first duly sworn deposes and says: that she is the Legal Advertising Representative of TNI PARTNERS, commonly known as TUCSON NEWSPAPERS, a General Partnership organized and existing under the laws of the State of Arizona, and that it prints and publishes the Arizona Daily Star, a daily newspaper printed and published in the City of Tucson, Pima County, State of Arizona, and having a general circulation in said City, County, State and elsewhere, and that the attached

Legal Notice

was printed and published correctly in the entire issue of the said Arizona Daily Star on each of the following dates, to-wit:

December 14, 2009

Debbie Capanear

Subscribed and sworn to before me this 15 day of December, 2009

Notary Public

My commission expires

TNI AD NO. 6986243

PUBLIC NOTICE OF AN APPLICATION BY TUCSON ELECTRIC POWER COMPANY FOR A FINANCING ORDER AUTHORIZING VARIOUS FINANCING TRANSACTIONS DOCKET NO. E-01933A-09-0476

On October 2, 2009, Tucson Electric Power Company ("the Company" or "TEP") filed an Application with the Arizona Corporation Commission ("Commission") for an order authorizing the Company to enter into various financing transactions to issue new long-term indebtedness, refinance existing long-term indebtedness and credit facilities, and to receive equity contributions from its parent company. The requested order would allow TEP to: (1) increase the cap on its long-term indebtedness by \$300 million, from \$1 billion to \$1.3 billion; (2) increase the amount of its revolving credit facilities by \$50 million, from \$150 million to \$200 million; (3) increase the amount of equity contributions up to \$250 million from Unisource Energy Corporation ("Unisource Energy Corp."), the parent company of TEP; and (4) extend the period for TEP to enter into these financings through December 31, 2014.

Copies of the Application are available at the Company's offices at One South Church Avenue, Tucson, Arizona 85701 and the Commission's offices at 1200 West Washington, Phoenix, Arizona, for public inspection during regular business hours and on the internet via the Commission (www.azcc.gov) using the e-docket function.

Intervention in the proceeding on this matter shall be permitted to any person entitled by law to intervene and having a direct and substantial interest in the matter. The granting of motions to intervene shall be governed by A.A.C.R.14-3-105. Persons desiring to intervene must file a written Motion to Intervene with the Commission (original and thirteen copies), which Motion must also be served upon the Company and its counsel and to all parties of record, and which, at a minimum, contain the following information:

- 1. The name, address and telephone number of the proposed intervenor and of any party upon which service of documents is to be made if different than the intervenor.
2. A short statement of the proposed intervenor's interest in these proceedings (e.g., a customer of the Company, a shareholder of the Company, etc.).
3. Whether the proposed intervenor desires a formal evidentiary hearing on the application and the reasons for such a hearing.
4. A statement certifying that a copy of the Motion to Intervene has been mailed to the Company or its counsel. Failure to intervene will not preclude any customer from appearing at the hearing and making a statement on his or her behalf.

If you have any questions about this Application, you may contact the Company at 520-884-3742. If you wish to file written comments on the Application or want further information on intervention you may contact the Consumer Services Section of the Commission at 1200 W. Washington St., Phoenix, AZ

85007, or call 1-800-222-7000. The Commission does not discriminate on the basis of disability in admission to its public meetings. Persons with a disability may request a reasonable accommodation such as a sign language interpreter, as well as request this document in an alternative format, by contacting the ADA Coordinator Shaylin Berna, E-mail SA8Berna@azcc.gov, voice phone number 602-542-9931. Requests should be made as early as possible to allow time to arrange the accommodation.

Publish December 14, 2009 Arizona Daily Star

