

ORIGINAL



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MEMORANDUM

TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

DATE: August 17, 2010

RE: STAFF'S RESPONSE TO UNS ELECTRIC, INC. AND UNS GAS, INC. COMMENTS AND OBJECTION TO THE STAFF REPORT FOR UNS ELECTRIC, INC. AND UNS GAS, INC. APPLICATION FOR A FINANCING ORDER AUTHORIZING VARIOUS FINANCING TRANSACTIONS DOCKET NOS.: E-04204A-09-0582 AND G-04204A-09-0582.

Arizona Corporation Commission

DOCKETED

AUG 17 2010

DOCKETED BY

Attached is Staff's response to UNS Electric, Inc. and UNS Gas, Inc. comments and objection to the Staff Report for UNS Electric, Inc. and UNS Gas, Inc.'s joint application requesting authorization for various financing transactions.

Staff recommends approval of the alternative proposed in the UNS Electric, Inc. and UNS Gas, Inc. comments and objection to the Staff Report, Exhibit A.

Any party who wishes may file comments to the Staff response with the Commission's Docket Control by 4:00 p.m. on or before August 27, 2010.

SMO:PMC:tdp

Originator: Pedro M. Chaves

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2010 AUG 17 P 2:30
AZ CORP COMMISSION
DOCKET CONTROL

Service List for: UNS Electric, Inc. and UNS Gas, Inc.
Docket Nos. E-04204A-09-0582 and G-04204A-09-0582

Mr. Philip Dion
Unisource Energy Corporation
One South Church Avenue, Suite 200
Tucson, Arizona 85701-1623

Mr. Michael W. Patten
Roshka Heyman & DeWulf, PLC.
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

**STAFF'S RESPONSE TO
COMMENTS AND OBJECTION
TO THE STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**UNS ELECTRIC, INC. and UNS GAS, INC.
DOCKET NOS. E-04204A-09-0582 & G-04204A-09-0582**

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

AUGUST 17, 2010

STAFF ACKNOWLEDGMENT

Staff's response to UNS Electric, Inc. and UNS Gas, Inc. comments and objection to the Staff Report for UNS Electric, Inc. and UNS Gas, Inc., Docket Nos. E-04204A-09-0582 and G-04204A-09-0582, respectively, is the responsibility of the Staff members listed below. Pedro M. Chaves is responsible for the financial review and analysis.

A handwritten signature in black ink, appearing to read 'Pedro M. Chaves'.

Pedro M. Chaves
Public Utilities Analyst III

EXECUTIVE SUMMARY
UNS ELECTRIC, INC. AND UNS GAS, INC.
DOCKET NOS. E-04204A-09-0582 & G-04204A-09-0582

On December 29, 2009, UNS Electric, Inc. ("UNS Electric") and UNS Gas, Inc. ("UNS Gas"), collectively ("Applicants"), filed a joint application with the Arizona Corporation Commission ("Commission") requesting authorization of various financing transactions including: UNS Gas to refinance \$50 million of long-term debt maturing in August 2011; both entities to issue up to \$50 million of new long-term debt (in addition to the revolving credit facility); both entities to enter into revolving credit facility agreements with a combined \$100 million limit; pre-approved authority to subsequently refinance revolving credit facility agreements; and both entities to enter into security agreements granting liens on some or all of their properties.

On July 27, 2010, Staff filed a Staff Report concluding that the financing transactions proposed by the Applicants were reasonable, within their corporate powers, compatible with the public interest, would not impair their ability to provide services and would be consistent with sound financial practices if subsequent to any long-term debt issuance (other than in the case of refinancing long-term indebtedness) (1) common equity represents no less than 33 percent of total capital (common equity, preferred stock, capital leases - including current obligations, long-term debt - including current maturities) and (2) cash coverage ratio ("CCR") is equal to or greater than 1.75 when equity is between 33 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 (calculated using the most recent audited financial statements adjusted to reflect subsequent changes to outstanding debt and capital contributions or distributions).

On August 9, 2010, the Applicants filed comments and objections to the Staff Report. The Applicants request approval of the initially requested long-term debt and revolving credit facility authorizations and to exclude application of the financial ratio tests proposed by Staff to draws on the revolving credit facilities. In the alternative, the Applicants would be willing to agree to (1) limiting the amount that either borrowing entity could draw upon the proposed credit facilities to \$70 million; and (2) reducing the amount of additional long-term indebtedness that UNS Electric and UNS Gas would each be authorized to issue (other than refinancing) from the proposed \$50 million to \$30 million to avoid application of the financial ratio tests to draws on the revolving credit facilities.

Staff concludes that the Applicants' alternate proposal to limit the amount that either of the borrowing entities could draw upon the proposed credit facilities to \$70 million and to reduce the amount of additional long-term indebtedness that UNS Electric and UNS Gas would each be authorized to issue (other than refinancing) from the proposed \$50 million to \$30 million, presents acceptable pro forma financial metrics that do not necessitate imposition of the financial ratio tests proposed by Staff to draws on the revolving credit facilities.

Therefore, Staff updates its recommendations to reflect authorization for UNS Electric and UNS Gas to each issue up to \$30 million in additional long-term indebtedness and to limit each of the Applicants to draw a maximum of \$70 million from the revolving credit facility and to exclude application of the financial ratio tests proposed by Staff to draws on the revolving credit facilities.

TABLE OF CONTENTS

	<u>PAGE</u>
INTRODUCTION	1
STAFF REPORT.....	1
APPLICANTS' COMMENTS TO THE STAFF REPORT	3
STAFF'S RESPONSE TO THE APPLICANTS' COMMENTS	4
CONCLUSIONS AND RECOMMENDATIONS	4

INTRODUCTION

UNS Electric, Inc. ("UNS Electric") and UNS Gas, Inc. ("UNS Gas") (collectively as "Applicants") filed a joint application with the Arizona Corporation Commission ("Commission") on December 29, 2009, requesting authorization for various financing transactions.

In summary, the Applicants requested the following approvals:

1. To refinance their revolving credit facility that expires in August 2011;
2. To increase the amount of joint revolving credit by \$40 million, from \$60 million to \$100 million;
3. To refinance UNS Gas' \$50 million long-term indebtedness maturing in August 2011;
4. To issue up to \$50 million of new long-term debt (in addition to the revolving credit facility) at each company;
5. To enter into these financings on or before December 31, 2014.

STAFF REPORT

On July 27, 2010, Staff filed a Staff Report concluding that the financing transactions proposed by the Applicants were reasonable, within their corporate powers, compatible with the public interest, would not impair their ability to provide services and would be consistent with sound financial practices if subsequent to any long-term debt issuance, including borrowings under the revolving line of credit, (other than in the case of refinancing long-term indebtedness) (1) common equity represents no less than 33 percent of total capital (common equity, preferred stock, capital leases - including current obligations, long-term debt - including current maturities) and (2) cash coverage ratio ("CCR") is equal to or greater than 1.75 when equity is between 33 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 (calculated using the most recent audited financial statements adjusted to reflect subsequent changes to outstanding debt and capital contributions or distributions).

Staff recommended that the Commission:

1. Find and conclude that approval of the financing authorizations recommended by Staff is in the public interest;
2. Authorize UNS Electric and UNS Gas to enter into one or more credit 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, UNS Electric's and UNS Gas' revolving credit facilities do not exceed \$100 million in the aggregate and to specify that this newly granted authority is a replacement for the authority granted in Decision No. 69395 to amend or refinance the revolving credit facility and to affirm that all existing agreements and obligations incurred under lawful authorizations shall remain valid;

3. Authorize UNS Gas to refinance its \$50 million in long-term indebtedness that comes due in August 2011;
4. Authorize UNS Electric and UNS Gas to each issue up to \$50 million in additional long-term indebtedness;
5. Authorize UNS Electric and UNS Gas to provide security for any such financing transactions;
6. Authorize the execution, delivery and performance by UNS Electric and UNS Gas of all contracts, agreements, and other instruments which are incidental to any or all of the foregoing or otherwise deemed by UNS Electric and UNS Gas to be necessary, desirable or appropriate in connection therewith; and
7. Authorize UNS Electric and UNS Gas to enter into the transactions authorized in this proceeding through December 31, 2014, with the condition that credit agreements (i.e., those pertaining to revolving credit facilities) in all forms authorized in this proceeding shall have expiration dates before January 1, 2017.

Staff further recommended that:

8. The Commission condition the authorities set forth in (2) and (4) above, other than in the case of refinancing long-term indebtedness, upon the borrowing entity having equity equal to at least 33 percent of its total capital and a cash coverage ratio of at least 1.75 when equity is between 33 and 40 percent of total capital, or a CCR of 1.25 if equity is 40 percent or higher of total capital;
9. 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;
10. 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;

11. 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) and capital lease obligations (including current obligations under capital leases);
12. 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 and having been refinanced or refunded with the proceeds of long-term debt being and having been issued subsequent to such period plus interest expense for twelve months on the indebtedness being and 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);
13. For purposes of the order, future changes in generally accepted accounting principles ("GAAP") that have the effect of lowering the borrowing entity's equity will be exempted from the equity and cash coverage ratios tests until the Commission makes a determination. The borrowing entity shall make a filing with the Commission requesting such a determination within 30 days after the borrowing entity files or the borrowing entity's affiliate (when the borrowing entity's affiliate includes the borrowing entity's results from operation and financial position) 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; and
14. Within 90 days of the completion of the financing transactions authorized in (3) and (4) above and the initial and subsequent refinancing under the authority set forth above in (2), the borrowing entity make a compliance filing with Docket Control providing copies of relevant documents and an explanation of the business rationale for the transaction and a demonstration that the rates and terms were fair, reasonable, and consistent with those generally available to comparable entities at the time.

APPLICANTS' COMMENTS TO THE STAFF REPORT

On August 9, 2010, the Applicants filed comments and objections to the Staff Report. Although the Applicants support the majority of Staff's recommendations, the Applicants request approval of the initially requested long-term debt and revolving credit facility authorizations and to exclude application of the financial ratio tests proposed by Staff to draws on the revolving credit facilities. In the alternative, the Applicants are willing to agree to (1) limit the amount that either Applicant could draw upon the proposed credit facilities to \$70 million; and (2) reduce the amount of additional long-term indebtedness that UNS Electric and UNS Gas would each be

authorized to issue (other than refinancing) from the proposed \$50 million to \$30 million to avoid application of the financial ratio tests to draws on the revolving credit facilities.¹

STAFF'S RESPONSE TO THE APPLICANTS' COMMENTS

As indicated on the Staff Report, the general nature of the Applicants' various financial requests calls for financial parameters to place conditions on the borrowings to prevent the Applicants from incurring an excessive amount of debt.²

Staff is aware that application of its proposed CCR and equity-to-total capital ratio tests for each credit facility draw may be administratively burdensome as noted by the Applicants; however, the level of debt authorization requested by the Applicants in its filing warrant imposition of this requirement. On the contrary, Staff concludes that the Applicants' alternate proposal that limits the amount that either of the borrowing entities could draw upon the proposed credit facilities to \$70 million and reduces the amount of additional long-term indebtedness that UNS Electric and UNS Gas would each be authorized to issue (other than refinancing) from the proposed \$50 million to \$30 million, presents acceptable pro forma financial metrics that do not necessitate imposition of the financial ratio tests proposed by Staff to draws on the revolving credit facilities.

Accordingly, Staff concludes that the Applicants' proposal to limit the amount that either of the borrowing entities could draw upon the proposed credit facilities to \$70 million and to reduce the amount of additional long-term indebtedness that UNS Electric and UNS Gas would each be authorized to issue (other than refinancing) from the proposed \$50 million to \$30 million, presents acceptable pro forma financial metrics that do not necessitate imposition of the financial ratio tests proposed by Staff to draws on the revolving credit facilities.

CONCLUSIONS AND RECOMMENDATIONS

Staff concludes that the financing transactions proposed by the Applicants (as modified by the alternative proposal) are reasonable, are within their corporate powers, are compatible with the public interest, would not impair their ability to provide services and would be consistent with sound financial practices if subsequent to any long-term debt issuance (other than in the case of refinancing long-term indebtedness and excluding borrowings/transactions under the revolving credit facility) common equity represents at least 33 percent of total capital (common equity, preferred stock, long-term debt, including current maturities, and capital lease obligations, including current obligations under capital leases) for the borrowing entity.

¹ UNS Electric, Inc. and UNS Gas, Inc. comments and objection to the Staff Report, pages 6 – 7.

² Staff Report, Page 5.

Staff further concludes that:

1. Authorizing UNS Electric and UNS Gas to enter into one or more credit 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, the amount of credit available under such facilities to each company, individually, does not exceed \$70 million is appropriate.
2. Authorizing UNS Gas to refinance its \$50 million in long-term indebtedness that comes due in August 2011 is appropriate.
3. Authorizing UNS Electric and UNS Gas to each issue up to \$30 million in additional long-term indebtedness is appropriate.
4. Authorizing UNS Electric and UNS Gas to provide security for any such financing transactions is appropriate.
5. Any authority granted in this proceeding to issue long-term debt and to enter into one or more credit agreements for revolving credit facilities should replace the existing authorization of Decision No. 69395, and that the newly granted authorizations should supplant the prior authorizations from Decision No. 69395 upon the effective date of the order, and that all existing obligations incurred under lawful authorizations should remain valid.
6. UNS Electric and UNS Gas should be authorized to enter into the transactions authorized in this proceeding through December 31, 2014.
7. Credit agreements in all forms authorized in this proceeding shall have expiration dates on or before January 1, 2017.
8. The financing transactions authorized in (2) and (3) above and the initial and subsequent refinancing in (1) above should be supported by a filing with Docket Control providing copies of relevant documents and an explanation of the business rationale for the transaction and a demonstration that the rates and terms were consistent with those generally available to comparable entities at the time.

Staff recommends that the Commission:

1. Find and conclude that approval of the financing authorizations recommended by Staff is in the public interest;
2. Authorize UNS Electric and UNS Gas to enter into one or more credit 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, the amount of credit available under such facilities to each company, individually, does not exceed \$70 million, and to specify that this newly granted authority is a replacement for the authority granted in Decision No. 69395 to amend or refinance the revolving credit facility and to affirm that all existing agreements and obligations incurred under lawful authorizations shall remain valid;

3. Authorize UNS Gas to refinance its \$50 million in long-term indebtedness that comes due in August 2011;
4. Authorize UNS Electric and UNS Gas to each issue up to \$30 million in additional long-term indebtedness;
5. Authorize UNS Electric and UNS Gas to provide security for any such financing transactions;
6. Authorize the execution, delivery and performance by UNS Electric and UNS Gas of all contracts, agreements, and other instruments which are incidental to any or all of the foregoing or otherwise deemed by UNS Electric and UNS Gas to be necessary, desirable or appropriate in connection therewith; and
7. Authorize UNS Electric and UNS Gas to enter into the transactions authorized in this proceeding through December 31, 2014, with the condition that credit agreements (i.e., those pertaining to revolving credit facilities) in all forms authorized in this proceeding shall have expiration dates before January 1, 2017.

Staff further recommends that:

8. The Commission condition the authorities set forth in (4) above, upon the borrowing entity having equity equal to at least 33 percent of its total capital and a cash coverage ratio of at least 1.75 when equity is between 33 and 40 percent of total capital, or a CCR of 1.25 if equity is 40 percent or higher of total capital;
9. 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;
10. 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;
11. 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) and capital lease obligations (including current obligations under capital leases);

12. 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 and having been refinanced or refunded with the proceeds of long-term debt being and having been issued subsequent to such period plus interest expense for twelve months on the indebtedness being and 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);
13. For purposes of the order, future changes in GAAP that have the effect of lowering the borrowing entity's equity will be exempted from the equity and cash coverage ratios tests until the Commission makes a determination. The borrowing entity shall make a filing with the Commission requesting such a determination within 30 days after the borrowing entity files or the borrowing entity's affiliate (when the borrowing entity's affiliate includes the borrowing entity's results from operation and financial position) 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; and
14. Within 90 days of the completion of the financing transactions authorized in (3) and (4) above and the initial and subsequent refinancing under the authority set forth above in (2), the borrowing entity make a compliance filing with Docket Control providing copies of relevant documents and an explanation of the business rationale for the transaction and a demonstration that the rates and terms were fair, reasonable, and consistent with those generally available to comparable entities at the time.