OPEN MEETING ITEM

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COMMISSIONERS
KRISTIN K. MAYES – Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

ORIGINAL

ARIZONA CORPORATION COMMISSION

DATE: SEPTEMBER 28, 2010

DOCKET NOS: E-04204A-09-0582 and G-04204A-09-0582

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Jane L. Rodda. The recommendation has been filed in the form of an Order on:

UNS ELECTRIC, INC. and UNS GAS, INC.
(FINANCE)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00** p.m. on or before:

OCTOBER 4, 2010

The parties have waived the 10 days for filing of exceptions

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Working Session and Open Meeting to be held on:

OCTOBER 7, 2010

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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

IN THE MATTER OF THE APPLICATION OF UNS ELECTRIC, INC. AND UNS GAS, INC. FOR A FINANCING ORDER AUTHORIZING VARIOUS FINANCING TRANSACTIONS.	DOCKET NO. E-04204A-09-0582 DOCKET NO. G-04204A-09-0582 DECISION NO. ______________ **ORDER**

Open Meeting
October 7, 2010
Phoenix, Arizona

BY THE COMMISSION:

* * * * * * * * * *

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

FINDINGS OF FACT

1. On December 29, 2009, UNS Electric, Inc. ("UNS Electric") and UNS Gas, Inc. ("UNS Gas"), (collectively "Applicants"), filed a joint application with the Commission requesting authorization of various financing transactions including: 1) allowing both UNS Gas and UNS Electric to enter into one or more revolving credit facility agreements with a combined $100 million limit; 2) allowing UNS Gas to refinance $50 million of long-term debt that matures in August 2011; 3) allowing both UNS Gas and UNS Electric to issue up to $50 million of new long-term debt (in addition to the revolving credit facility); 4) pre-approving authority to subsequently refinance the revolving credit facility agreements; 5) allowing both entities to enter into security agreements that grant liens on some or all of their properties; and 6) granting authority to enter into these transactions on or before December 31, 2014.

2. On March 16, 2010, Applicants filed affidavits of publication verifying public notice of their joint financing application. The Applicants published notice of their financing application in the *Arizona Daily Star*, the *Prescott Courier*, the *Holbrook Tribune-News*, the *Nogales International*, the *Sedona Red Rock News*, the *Verde Independent* and the *White Mountain Independent* on February 19, 2010; in the *Camp Verde Journal*, the *Chino Valley Review*, the *Prescott Valley Tribune* and the *Williams-Grand Canyon News* on February 24, 2010; and in the *Kingman Daily Miner* and the *Today's News-Herald* on February 25, 2010.

3. On July 27, 2010, the Commission's Utilities Division ("Staff") filed a Staff Report recommending conditional approval of the various financing transactions.

4. On August 9, 2010, Applicants filed Comments and Objection to the Staff Report ("Comments"). Applicants stated they agree with the vast majority of Staff's findings and recommendations, but that they objected to the recommendation that the Applicants satisfy financial ratio tests for each draw on the revolving credit facility on the grounds that the requirement is not practical, and is potentially burdensome and detrimental. In addition, the Applicants modified their financing request and asked that the Commission issue an Order expeditiously in order to allow them to take advantage of economies of scale that are expected to result from a joint refinancing effort with Tucson Electric Power Company ("TEP") and its parent UniSource Energy Services, Inc. ("UES") both of which have credit facilities that expire in August 2011.

5. On August 17, 2010, Staff filed Staff's Response to the Applicants' Comments and Objection ("Response"). In its Response, Staff recommends approval of the alternative financing request proposed by the Applicants in their Comments.

6. On August 24, 2010, Staff filed a Notice of Errata, which included a schedule of UNS Electric's Capital Budget which had inadvertently been omitted from the July 27, 2010 Staff Report.

7. By Procedural Order dated August 25, 2010, the Applicants and Staff were requested to provide additional information related to the Application.

8. On August 27, 2010, in response to the Procedural Order, UNS Gas provided a summary of its proposed capital budget for the period 2010-2014.

9. On September 3, 2010, Staff filed a Supplemental Staff Report in response to the

August 25, 2010 Procedural Order. Staff specifically addressed the Applicants' pro forma financial metrics and recommended approval of the alternative financing request proposed by UNS Electric and UNS Gas in their Comments. Staff originally designated its schedules showing its pro forma financial analysis as "Confidential," however, the Applicants confirmed that they have no objection to publicly disclosing Staff's financial analysis.

10. In their Comments, Applicants asserted that Staff's original recommendation that the Applicants must satisfy financial ratio tests for each draw on the revolving credit facility is not practical. The Applicants stated the revolving credit facility is used for working capital and credit support of wholesale energy procurement, which both require quick access to available credit. Applicants argued that the precondition of satisfying financial ratio tests prior to each draw will greatly increase the length of the process and prevent quick access to credit. Applicants stated that they do not object to financial ratio tests when they are set at reasonable levels and are not unduly burdensome or restrictive, and they have no objection to Staff's proposed financial ratio tests for the issuance of long-term debt.

11. Applicants further asserted that imposing financial ratio tests on the revolving credit facilities would be administratively burdensome and could adversely impact the Applicants' ability to make timely draws. They stated the conditions proposed by Staff would result in the Applicants and their lenders being unable to determine at the time the revolving credit facilities are initially entered into whether borrowing that will occur in the future is authorized. Applicants stated that the determination of whether they have Commission authority would need to be made at the time of each draw under the facilities and each issuance of an LOC. Applicants believe such determination may require Applicants to provide new representations, certification and opinions of counsel. Applicants stated they are not aware of any other utility subject to such limitations, and that they do not know whether lenders have the administrative processes in place to accommodate these on-going determinations. However, Applicants stated that even if procedures can be worked out with lenders, it is reasonable to assume that any such procedures would be cumbersome and could impede their ability to draw upon the revolving credit facilities in a timely manner.

12. The Applicants also expressed a fear that requiring the equity test and CCR to be

satisfied for each borrowing upon the revolving credit facilities and each issuance of an LOC could be perceived by the financial community as jeopardizing the Applicants' liquidity and as adversely affecting their financial condition. They stated that if their ability to utilize the revolving credit facilities is conditioned upon meeting the tests upon each borrowing and LOC issuance, the facilities may not be considered as being available to satisfy liquidity needs. They worry that rather than enhancing their financial condition, the conditions may adversely impact their financial condition.

13. Applicants argued that Staff's recommended financial ratio test is not necessary because in order to prevent over-leverage, the revolving credit agreements are likely to include limitations on the use of those facilities and will subject the Applicants to financial covenants measured on a quarterly basis.

14. As an alternative to Staff's recommendation, the Applicants state that they are willing to agree to (1) limiting the amount that either company 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 could issue (other than refinancing) from $50 million to $30 million.

15. In its Response, Staff recommends approving the Applicants' alternative proposal. Staff states that it believes that Applicants' proposal to limit the amount that either company could draw on the revolving credit facility to $70 million and to reduce the amount of additional long-term indebtedness from $50 million to $30 million, offers an acceptable pro forma financial metric that warrants eliminating the need to impose the financial ratio tests that Staff originally proposed on the revolving credit facilities.

16. In its Response, Staff modifies its recommendations to reflect the scaled back requested financing authority and to exclude application of the financial ratio tests to draws on the revolving credit facilities.

Background

17. Applicants are wholly owned subsidiaries of UES, headquartered in Tucson, Arizona. UES was created to own the operating companies UNS Gas and UNS Electric, which acquired the Arizona gas and electric utility assets of Citizens in 2003. UNS Gas and UNS Electric are sister companies to TEP.

18. UNS Electric is an electric transmission and distribution company serving approximately 90,000 customers in Mohave and Santa Cruz Counties, and maintains a service office in Kingman.

19. UNS Gas is a gas distribution company that serves approximately 146,000 customers in Mohave, Yavapai, Coconino, Navajo and Santa Cruz Counties and maintains a service office in Flagstaff.

20. UNS Electric's current retail rates were established in Decision No. 70360 (May 27, 2008). UNS Electric has a pending rate case under Docket No. E-04204A-09-0206.

21. UNS Gas' current retail rates were established in Decision No. 71623 (April 14, 2010).

<u>Applicants' Request</u>

22. Applicants seek an Order from the Commission that:

(a) Finds and concludes that the financing application is in the public interest.

(b) Authorizes UNS Electric and UNS Gas to enter into one or more revolving credit facilities or to refinance any such 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 $70 million in the aggregate.

(c) Authorizes UNS Gas to refinance its $50 million in long-term indebtedness that comes due in August 2011.

(d) Authorizes UNS Electric and UNS Gas to each issue up to $30 million in additional long-term indebtedness.

(e) Authorizes UNS Electric and UNS Gas to provide security for any such financing transactions.

(f) Authorizes 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.

(g) Provides that the authorization to issue long-term debt and to enter into one or more credit agreements for revolving credit facilities replaces the existing authorization of Decision No. 69395 (March 22, 2007), that the authorization of Decision No. 69395 terminates upon the effective date of this Order, and that all existing obligations incurred under lawful authorizations shall remain valid.

(h) Provides that the authority granted in this Order be deemed effective upon issuance, and that UNS Electric and UNS Gas may enter into the transactions authorized under this Order through December 31, 2014.

(i) Grants any other relief that the Commission determines to be appropriate and in the public interest.

Revolving Credit Facility

23. In Decision No. 69395 the Commission authorized UNS Electric and UNS Gas to refinance or amend their credit agreement dated August 11, 2006 ("Credit Agreement"). The Credit Agreement consists of a $60 million joint revolving credit facility that expires in August 2011. Under the Credit Agreement, UNS Electric and UNS Gas are each authorized to borrow under the facility up to a maximum of $45 million; however, the total combined amount borrowed under the Credit Agreement cannot exceed $60 million.

24. The obligations of UNS Electric and UNS Gas under the Credit Agreement are several and joint, so neither company is liable for the obligations of the other. The Credit Agreement is unsecured but is guaranteed by UES.

25. UNS Electric and UNS Gas use the revolving credit facility as a source of liquidity for working capital purposes, for general corporate purposes and to issue letters of credit ("LOCs") to provide credit enhancement to counterparties for Applicants' energy procurement and hedging activities.

26. Borrowings under the Credit Agreement bear interest at a variable interest rate. As of December 31, 2009, the applicable borrowing rate for Applicants was the London Interbank Offered Rate ("LIBOR") or an Alternate Base Rate plus 1.0 percent. Applicants also pay a commitment fee of 0.19 percent on the unused portion of the revolving credit facility. As of December 31, 2009, neither UNS Electric nor UNS Gas had any loans outstanding under the Credit Agreement.

27. The current Credit Agreement has a sublimit for the issuance of LOCs. Up to $30 million of the total Credit Agreement amount of $60 million may be used to issue LOCs to provide credit support for the energy procurement and hedging activities. Fees are payable on the notional amount of the outstanding LOCs. As of October 31, 2009, the applicable LOC fee was 1.00 percent. In addition, UNS Electric and UNS Gas pay an "LOC Fronting Fee" of 0.15 percent to the banks that issue the LOCs. As of October 31, 2009, UNS Electric had $10.5 million of LOCs issued under the Credit Agreement and UNS Gas had no LOCs issued under the Credit Agreement.

28. Applicants request authorization to increase the size of their revolving credit facility from $60 million to $70 million to provide them with greater liquidity. They also request authorization to either enter into amendments to their existing facility or to refinance by entering into new agreements. The Applicants expect any revolving credit agreements to have a term of five years or less and request authority to enter into such agreements through December 31, 2014, which means that under these parameters, a new or extended credit agreement could expire as late as December 31, 2019. Applicants believe such refinancing authority would allow them to take advantage of opportunities to obtain better terms in a timely manner as opportunities arise.

29. The Applicants state the term of any new revolving credit agreements, or the length of any extension of the existing Credit Agreement, would depend on market conditions at the time the new agreement or extension is executed.

30. UNS Electric and UNS Gas state that they currently pay rates under the Credit Agreement that are based on market conditions and rates in effect in 2006, when the bank credit market was highly liquid and competitive. Applicants assert that in early 2008 the bank credit markets were still liquid, but more expensive to access, and that subsequently the bank credit markets have experienced extreme turmoil and volatility. The Applicants state that recent rate quotes indicate that if UNS Electric and UNS Gas were to refinance their credit facilities, they would have to pay a spread of approximately 3.0 percent over LIBOR, compared to the 1.0 percent they currently pay under the Credit Agreement. Applicants state that they cannot predict what the rates will be like at the time they are authorized to refinance their facility, but it is likely that they will have to pay a higher rate than they do currently.

Long-term Debt

31. Decision No. 69395 also authorized UNS Electric to borrow up to $100 million of long-term debt.

32. In addition, Decision No. 70360 (May 27, 2008) (UNS Electric's previous rate case) authorized UNS Electric to borrow up to $40 million in either long-term and/or short to intermediate-term debt and to receive up to $40 million in equity from UniSource Energy Corporation (the parent company of UES) for the purpose of acquiring the Black Mountain Generating Station ("BMGS"). To date, UNS Electric has not acquired the BMGS.

33. UNS Electric has $100 million of senior unsecured notes outstanding, consisting of $50 million of 6.50 percent notes due in 2015, and $50 million of 7.10 percent notes due August 2023. UES guarantees the notes. The proceeds of the long-term debt were used to: (1) refinance $50 million in 7.61 percent senior notes that matured in August 2008; (b) pay off outstanding borrowings under its revolving credit facility; and c) for general corporate purposes.

34. The note purchase agreement for UNS Electric contains certain restrictive covenants, including restrictions on transactions with affiliates, mergers, liens to secure indebtedness, restricted payments and incurrence of indebtedness. According to the Staff Report, as of December 31, 2009, UNS Electric was in compliance with the terms of its note purchase agreement.

35. UNS Gas has $100 million of 6.23 percent senior unsecured notes outstanding, of which $50 million matures in 2011, and $50 million matures in 2015. UES guarantees the notes. The note purchase agreement for UNS Gas restricts transactions with affiliates, mergers, liens, restricted payments and incurrence of indebtedness, and also contains a minimum net worth test. Staff states that as of December 31, 2009, UNS Gas was in compliance with the terms of its note purchase agreement.

36. Currently, there is no existing financing authority for UNS Gas to refinance these notes when they mature, and this Application is intended to provide UNS Gas with the necessary authority.

37. Applicants request authority to issue up to $30 million of additional long-term debt at each company to meet their on-going capital expenditure needs and to provide financial flexibility.

Applicants state that the specific terms of any long-term debt to be issued under the requested authority would depend on market conditions at the time of issuance, the credit ratings of each respective company, and other factors such as the maturity dates of other outstanding indebtedness and the mix of fixed and floating rate debt at each company.

38. Applicants state that the new long-term debt could be issued on either a secured or unsecured basis and other terms, such as maturity, interest rate, discount rates or placement fees, security, the nature of the offering and timing of issuance, would be determined closer to the time of issuance, and that all transaction-specific terms would be dependent on market conditions and would be negotiated with the intent of obtaining favorable terms to UNS Electric and UNS Gas.

39. Applicants stated that they intend to use the proceeds from the issuance of new long-term indebtedness: (1) to refinance existing long-term indebtedness; (2) to finance a portion of their respective capital expenditure programs for the next five years; and (3) to pay-off any outstanding borrowings under their revolving credit facility.

40. UNS Electric anticipates capital expenditures of over $100 million for the period 2010-2013. UNS Electric's projected Capital Budget for 2010-2014 is $111,744,022, and is summarized as follows:

UNS Electric – Capital Budget
Financing Project Summary 2010-2014

Project	2010	2011	2012	2013	2014
Production Equipment	$851,071	$467,890	$474,526	$499,672	$503,798
General Equipment	2,668,129	2,096,818	2,861,316	2,699,626	3,980,125
New Customer Services	2,195,505	119,728	262,512	891,247	1,585,485
System Reinforcement*	20,282,199	22,236,641	27,170,785	9,180,104	10,716,844
Total	25,996,904	24,921,077	30,769,139	13,270,649	16,786,252

* The System Reinforcement category includes the following large, discrete projects:

	2010	2011	2012	2013	2014
Stockton Hill 69 kV Trans Ln King	$2,045,734	--	--	--	--
Vail T3 345/138kV Xfmr Addition	--	--	$2,214,386	--	--
Valencia T2 Replacement Nog	6,264	$358,718	1,909,332	--	--
Vail to Nog Tap 138 kV Line	--	1,083,519	1,524,106	--	--
N Navasu Sub T3 Addition LH	2,685,605	--	--	--	--
Griffith T2 Add 230-69kV	2,399,808	1,900,082	--	--	--
Nog Tap – Val 115-138kV Rbld	137,136	6,240,062	12,347,433	--	--
Vail to Valencia 138kVLn-L&E	2,181,711	3,291,314	59,804	36,308	--

41. Staff reviewed UNS Electric's application and capital budget, and believes that the requested financing arrangement would help fund UNS Electric's proposed capital projects that are needed to serve UNS Electric's growing service territory and to meet increasing reliability needs in accordance with its proposed 2010-2014 Construction Work Plan ("CWP"). Staff states that the CWP will enable UNS Electric to provide reliable electric service to its customers during the 2010-2014 time period.

42. Staff states that UNS Electric's projected Transmission and Distribution capital projects and expenditures "appear to be appropriate and reasonable given the level of load growth projected as well as new demands that will be placed on UNS Electric related to increasingly stringent Western Electricity Coordinating Council ('WECC') reliability criteria as approved by North American Electric Reliability Corporation ('NERC') and Federal Energy Regulatory Commission ('FERC')."[1] Staff states that 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. Staff states that UNS Electric's ability to serve its native load reliably is contingent upon the company upgrading existing electric facilities, replacing certain equipment and adding new Transmission and

[1] Attachment A to July 27, 2010, Staff Report at 2.

Distribution infrastructure.

43. Staff states further that its review of UNS Electric's proposed projects and expenditures does not imply a specific treatment of rate base for rate making purposes in future rate filings.

44. UNS Gas reports a total capital budget for 2010-2014 of $81,002,734. A summary of UNS Gas' proposed capital budget by year follows:

Project	2010	2011	2012	2013	2014
General – Communication	$105,299	$78,388	$18,821	$19,789	$44,359
General – Facilities	79,311	23,066	21,376	22,641	22,900
General – Info Tech	326,667	211,173	251,720	272,087	244,609
General – Other	231,757	263,826	106,063	109,050	108,203
General – Fleet Equip	725,039	1,490,283	1,779,152	1,483,098	2,141,927
Growth *	5,856,822	7,434,920	10,294,529	10,299,048	11,750,340
Public/cap improvement	2,200,598	4,479,749	1,854,018	1,804,352	1,804,784
Reinforcement/Replacement	4,207,679	2,216,846	2,251,624	2,112,320	2,254,501
Total	13,733,172	16,198,251	16,577,303	16,122,385	18,371,623

* "Growth" includes expenditures for the installation of meters, mains, regulators and similar equipment to serve new customers.

45. In its Engineering Report, Staff states that it analyzed UNS Gas' Application and reviewed its capital budget, which provides monies for infrastructure development, including new distribution mains and services, upgrades to the existing systems and installation of new equipment such as measurement and pressure regulating stations.[2] Staff states that based on its review of UNS Gas' Application and budget, Staff believes the company's proposed capital expenditures are appropriate to meet the projected needs of UNS Gas' existing and new customers and to ensure system reliability. Staff further concludes that the expenditure levels associated with the projects proposed by UNS Gas appear to be reasonable, however, this does not imply a specific treatment of

[2] Attachment B to July 27, 2010, Staff Report.

rate base for rate making purposes in a future rate filing.

Financial Analysis

46. Staff expressed the belief that the general and on-going nature of the Applicants' requests calls for the imposition of a combination of balance sheet and income statement financial conditions to prevent the Applicants from incurring an excessive amount of debt under changing circumstances.[3] Staff believes equity-to-total capitalization is an effective parameter for providing a balance sheet perspective of financial leverage and risk. In addition, Staff believes that requiring a minimum cash coverage ratio ("CCR") will provide a check on the borrowers' ability to pay interest expenses with operating cash flow. Staff believes applying a minimum CCR, in conjunction with a minimum equity-to-total capitalization to Applicants' proposed borrowing, would effectively limit Applicants ability to incur excessive debt levels.

47. In their Application, Applicants report that as of September 30, 2009, UNS Electric had Total Equity to Total Capitalization of 47.0 percent, and UNS Gas had Total Equity to Total Capitalization of 50.0 percent. The Applicants reported further that Moodys Investor Service rated the $100 million of UNS Electric guaranteed senior notes, $100 million of UNS Gas guaranteed senior notes and the UNS Electric/UNS Gas revolving credit facility, as Baaa3.

48. Staff's pro forma financial analysis indicates that based on December 31, 2009, financial results, if UNS Electric issued $30 million of additional long-term debt and drew $70 million on its revolving credit facility, its Total Equity would drop from 47.2 percent of Total Capital to 30.9 percent, its Debt Service Coverage ratio ("DSC") would drop from 4.42 to 3.13 and its CCR would drop from 4.42 to 3.38.

49. Staff's pro forma analysis indicates that based on December 31, 2009, financial results, if UNS Gas issued $30 million of new long-term debt and drew $70 million on its revolving credit facility, its Total Equity would drop from 51 percent to 34.2 percent, its DSC would drop from 4.02 to 2.80 and its CCR would drop from 4.02 to 3.04.[4]

50. Based on its pro forma analysis, Staff concludes that Applicants are able to service the

[3] July 27, 2010 Staff Report at 5.
[4] Staff analysis is based on Applicants' modified finance request as set forth in Applicants' Comments.

proposed debt and Staff recommends approval of the modified financing request. Staff concluded that Applicants' pro forma financial metrics were sufficient and that it is not necessary to impose the financial ratio tests to draws on the revolving credit facilities.[5]

51. A.R.S. §40-285 requires public service corporations to obtain Commission authorization to encumber certain utility assets. Staff states that this statute serves to protect captive customers from a utility disposing of any of its assets that are necessary for the provision of service, and it serves to preempt any service impairment due to disposal of assets essential for providing service.

52. Staff states further that pledging assets as security typically provides benefits to the borrower by way of increased access to capital funds or preferable interest rates.

53. Staff concludes that the financing transactions proposed by the Applicants are reasonable, are within their corporate powers, are compatible with the public interest, and would not impair their ability to provide services, but that it would be inconsistent with sound financial practices if subsequent to any long-term debt issuance (excluding the refinancing of long-term indebtedness) common equity is less than 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.

54. Staff further concludes that:[6]

(a) It is appropriate to 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 $70 million in the aggregate.

(b) It is appropriate to authorize UNS Gas to refinance its $50 million in long-term indebtedness that comes due in August 2011.

(c) It is appropriate to authorize UNS Electric and UNS Gas to each issue up to

[5] September 3, 2010 Supplemental Staff Report at 2.
[6] Based on Staff's revised recommendation as set forth in its Supplemental Staff Report.

$30 million in additional long-term indebtedness.

(d) It is appropriate to authorize UNS Electric and UNS Gas to provide security for any such financing transactions.

(e) Any authority granted in this proceeding to issue long-term debt and to enter into one of 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.

(f) UNS Electric and UNS Gas should be authorized to enter into the transactions authorized in this proceeding through December 31, 2014.

(g) Revolving credit agreements in all forms authorized in this proceeding shall have expiration dates on or before January 1, 2017.

(h) The financing transactions authorized in (b) and (c) above and the initial and subsequent refinancings in (a) 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.

55. Staff recommends that:

(a) The Commission find and conclude that approval of the financing authorizations recommended by Staff is in the public interest.

(b) The Commission 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 facility, UNS Electric's and UNS Gas' revolving credit facilities do not exceed $70 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.

(c) The Commission authorize UNS Gas to refinance its $50 million in long-term indebtedness that comes due in August 2011.

(d) The Commission authorize UNS Electric and UNS Gas to each issue up to $30 million in additional long-term indebtedness.

(e) The Commission authorize UNS Electric and UNS Gas to provide security for any such financing transactions.

(f) The Commission 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.

(g) The Commission condition the authority to issue new long-term debt (i.e. excluding the refinance long-term indebtedness) upon the borrowing entity having equity equal to at least 33 percent of its total capital and a CCR of at least 1.75 when equity is between 33 and 40 percent of total capital, or a CCR of at least 1.25 if equity is 40 percent or higher of total capital.

(h) 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.

(i) 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.

(j) 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).

(k) 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).

(l) 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

(m) Within 90 days of the completion of the financing transaction authorized in (c) and (d) above and the initial and subsequent refinancings under the authority set forth above in (b), 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.

56. We concur with Staff's revised conclusions and recommendations. The Applicants' agreed modification to their original financing request addresses the concern that under a general finance authority, Applicants could incur more debt than might be reasonable or prudent under changing circumstances. Their agreement to reduce the amount of debt that they can incur, plus the safeguards imposed by lenders, should adequately address this concern, while allowing them the access to liquidity they require for working capital and fuel procurement activities. Staff's financial analysis assumes Applicants completely draw down their revolving credit facility and issue all of the long term debt at one time, and are based on December 31, 2009 financial results. The pro forma financial analysis shows that the Applicants can service the proposed debt, and supports a finding that

the proposed authority, as conditioned by Staff, is in the public interest.

57. Staff's recommendations, as revised, are reasonable and should be adopted.

CONCLUSIONS OF LAW

1. UNS Gas and UNS Electric are public service corporations within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-301, 40-302, and 40-303.

2. The Commission has jurisdiction over UNS Gas and UNS Electric and of the subject matter of the application.

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

4. The financing as conditioned and approved herein is for lawful purposes within UNS Gas' and UNS Electric's corporate powers, is compatible with the public interest, with sound financial practices, and with the proper performance by UNS Gas and UNS Electric of service as public service corporations, and will not impair either UNS Gas' or UNS Electric's ability to perform the service.

5. The financing approved herein is for the purposes stated in the Application, is reasonably necessary for those purposes and such purposes are not reasonably chargeable to operating expenses or to income.

ORDER

IT IS THEREFORE ORDERED that UNS Electric, Inc. and UNS Gas, Inc. are hereby authorized 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 facility, the amount of credit available under such facilities to each company, individually, does not exceed $70 million.

IT IS FURTHER ORDERED that the authority granted herein replaces the authority granted in Decision No. 69395 to amend or refinance the revolving credit facility and that all existing agreements and obligations incurred under lawful authorizations shall remain valid.

IT IS FURTHER ORDERED that UNS Gas, Inc. is hereby authorized to refinance its $50 million in long-term indebtedness that comes due in August 2011.

IT IS FURTHER ORDERED that UNS Electric, Inc. and UNS Gas, Inc. are each authorized to issue up to $30 million in additional long-term indebtedness.

IT IS FURTHER ORDERED that UNS Electric, Inc. and UNS Gas, Inc. are hereby authorized to provide security for any such financing transactions.

IT IS FURTHER ORDERED that UNS Electric, Inc. and UNS Gas, Inc. are authorized to execute, deliver and perform all contracts, agreements, and other instruments which are incidental to any or all of the foregoing authorizations or otherwise deemed by UNS Electric, Inc. and UNS Gas, Inc. to be necessary, desirable or appropriate in connection therewith.

IT IS FURTHER ORDERED that UNS Electric, Inc. and UNS Gas, Inc. are hereby authorized 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.

IT IS FURTHER ORDERED that UNS Electric Inc.'s and UNS Gas, Inc.'s authority to issue up to $30 million in additional long-term debt is conditioned upon the borrowing entity having equity equal to at least 33 percent of its total capital, and a CCR of at least 1.75 when equity is between 33 and 40 percent of total capital, or a CCR of at least 1.25 if equity is 40 percent or higher of total capital.

IT IS FURTHER ORDERED that 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.

IT IS FURTHER ORDERED that for purposes of this 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.

IT IS FURTHER ORDERED that for the purposes of this 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).

IT IS FURTHER ORDERED that for purposes of this 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).

IT IS FURTHER ORDERED that for purposes of this 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.

IT IS FURTHER ORDERED that within 90 days of the completion of the financing transaction authorized hereinabove and the initial and subsequent refinancings under the authority set forth herein, the borrowing entity shall 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.

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

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

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, 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 __________, 2010.

____
ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT ______________________

DISSENT ______________________

SERVICE LIST FOR: UNS ELECTRIC, INC. and UNS GAS, INC.

DOCKET NOS.: E-04204A-09-0582 and G-04204A-09-0582

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