

OPEN MEETING ITEM

ORIGINAL
COMMISSIONERS
Bob Bitter, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH



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ARIZONA CORPORATION COMMISSION RECEIVED

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ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

DATE: JANUARY 11, 2013

DOCKET NO.: E-01933A-12-0176

TO ALL PARTIES:

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

TUCSON ELECTRIC POWER COMPANY
(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:

JANUARY 22, 2013

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 Open Meeting to be held on:

JANUARY 30, 2013 and JANUARY 31, 2013

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.

Arizona Corporation Commission

DOCKETED

JAN 11 2013



Jodi A. Jerich
JODI JERICH
EXECUTIVE DIRECTOR

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 BOB STUMP - Chairman
4 GARY PIERCE
5 BRENDA BURNS
6 BOB BURNS
7 SUSAN BITTER SMITH

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

DOCKET NO. E-01933A-12-0176

DECISION NO. _____

ORDER

12 Open Meeting
13 January 30, and 31, 2013
14 Phoenix, Arizona

15 **BY THE COMMISSION:**

16 * * * * *

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

19 **FINDINGS OF FACT**

20 **I. Procedural History**

21 1. On May 15, 2012, Tucson Electric Power Company ("TEP" or "Company") filed an
22 application with the Commission requesting authorization of various financing transactions
23 ("Financing Application").

24 2. On June 13, 2012, TEP filed an Affidavit of Publication verifying that public notice of
25 its Financing Application was published in *The Arizona Daily Star* on June 11, 2012.

26 3. On November 2, 2012, the Commission's Utilities Division ("Staff") filed a Staff
27 Report that recommended approval of TEP's request to increase its long-term debt threshold through
28 2016, subject to specified conditions.

4. On November 8, 2012, TEP notified the Commission that it would be filing
Comments to the Staff Report, stated that it had made arrangements to discuss its concerns with Staff,

1 and would be filing Comments no later than November 16, 2012.

2 5. On November 14, 2012, TEP filed Comments to the Staff Report. TEP requested that
3 its Financing Application be considered at a Commission Open Meeting no later than January 2013.
4 Of Staff's 21 recommendations, TEP agreed with 11, and expressed concerns and proposed
5 modifications to the other ten.

6 6. On December 4, 2012, Staff filed a Supplemental Staff Report in reply to TEP's
7 Comments. As a result of TEP's concerns expressed in its Comments, Staff either agreed to TEP's
8 proposed modification/clarifications or proposed revised recommendations.

9 7. In response to continued TEP concern, on January 4, 2013, Staff filed a second
10 Supplemental Staff Report in which Staff further refines its Recommendation (1).

11 8. On January 7, 2013, TEP filed a Reply to Staff's January 4, 2013 Supplemental Staff
12 Report. TEP states that it is amenable to 9 of 10 of Staff's modified recommendations as set forth in
13 Staff's December 4, 2012 Supplemental Staff Report. TEP explains that after the December 4, 2012
14 Supplemental Staff Report, it still had concerns with Recommendation (1), but that it can agree with
15 the version of Recommendation (1) as set forth in the January 4, 2013, Supplemental Staff Report.
16 TEP reiterated its request to have the matter considered at its January 30-31, 2013, Regular Open
17 Meeting.

18 9. With the Staff's modified recommendations filed on December 4, 2012, and January
19 4, 2013, there are no disputes between the parties.

20 **II. Background**

21 10. TEP is a wholly owned subsidiary of UniSource Energy Corporation ("UNS"), and a
22 for-profit Class "A" Arizona public service corporation located in Tucson, Arizona. TEP's operations
23 contributed 77 percent of UNS's operating revenues and accounted for 82 percent of its assets in
24 2011.

25 11. TEP's service territory encompasses 1,155 square miles that includes the greater
26 Tucson metropolitan area in Pima County, as well as Fort Huachuca in Cochise County. TEP's total
27 customers grew from approximately 350,950 in 2001 to 404,300 in 2011, an average annual increase
28 of 1.52 percent over the ten year period. Between 2007 and 2012, TEP's average number of retail

1 customers grew by slightly less than 1 percent, compared to average annual increases of between 2
2 and 3 percent from 2002 to 2006. TEP expects retail customer growth to remain at slightly less than
3 1 percent annually over the next several years.

4 12. From 2001 to 2011, TEP's annual peak retail load grew from 1,840 MW to 2,334
5 MW, an average annual increase of approximately 2.68 percent over the ten year period. TEP expects
6 its peak retail load to grow at approximately 2.48 percent over the next ten years, but because of
7 anticipated distributed generation and energy efficiency impacts, the net peak retail demand is
8 expected to grow at 0.92 percent. Retail energy sales increased from 8,346,839 MWh in 2001 to
9 9,332,107 MWh in 2011, an average annual increase of 1.18 percent, and the Company projects retail
10 sales will also grow at slightly less than 1 percent.

11 13. TEP's current retail rates were established in Decision No. 70628 (December 1, 2008)
12 which adopted a settlement agreement. Pursuant to the settlement agreement, TEP was subject to a
13 base rate increase moratorium through December 31, 2012. On July 2, 2012, TEP filed an
14 application for, *inter alia*, a base rate increase of \$127,760,000, or 15.3 percent.

15 14. TEP's previous financing authority was approved in Decision No. 71788 (July 12,
16 2010). In that Decision, the Commission authorized TEP to issue long-term debt in an amount not to
17 exceed a threshold of \$1.3 billion (excluding existing capital lease obligations and indebtedness
18 arising under credit and reimbursement agreements).

19 15. As of March 31, 2012, TEP had total outstanding long-term indebtedness (excluding
20 existing capital lease obligations and indebtedness arising under credit and reimbursement
21 agreements) in an aggregate principal amount of \$1.075 billion.

22 16. The Commission's Compliance Section indicates that TEP is current with its
23 compliance filings.

24 **III. The Finance Request**

25 17. In its current Financing Application, TEP seeks a Commission Order that:

- 26
27 (1) Authorizes TEP to issue long-term indebtedness provided that after giving effect
28 to such issuance, the aggregate outstanding principal amount of long-term

1 indebtedness (including current maturities thereof), does not exceed \$1.7 billion;
2 such limit not to include capital lease obligations, indebtedness arising under
3 TEP's credit and reimbursement agreements and the principal amount of long-
4 term debt being refinanced by newly issued debt being issued pursuant to such
5 authority;

6 (2) Authorizes TEP to enter into any refinancings, refundings, renewals, reissuances
7 and rollovers of any outstanding indebtedness, as well as the incurrence or
8 issuance of any additional long-term indebtedness, and the amendment or
9 revision of any terms or provisions or relating to any long-term indebtedness, so
10 long as total long-term indebtedness outstanding, after giving effect to such
11 issuance, does not exceed the levels set forth in (1) above;

12 (3) Authorizes TEP to enter into one or more credit or reimbursement agreements
13 with terms of up to five years, and to enter into agreements to refinance any such
14 credit or reimbursement agreements with new terms of up to five years, which
15 may consist of one or more revolving credit facilities, so long as, after giving
16 effect to the entry of such a facility, TEP's revolving credit facilities do not
17 exceed \$300 million in the aggregate; and to enter into one or more letter of
18 credit facilities which provide letters of credit to support tax-exempt bonds
19 which have been, or in the future will be, issued pursuant to lawful authority;

20 (4) Authorizes TEP to provide security for any such financing transactions by the
21 issuance of mortgage bonds under its Mortgage and Deed of Trust;

22 (5) Authorizes TEP to secure short-term debt issued pursuant to A.R.S. §40-302.D
23 with mortgage bonds under its Mortgage and Deed of Trust;

24 (6) Authorizes TEP to receive additional equity contributions of up to \$400 million
25 from its parent, UNS;
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- 1 (7) Requires TEP, when refinancing long-term indebtedness under the authority set
2 forth in (1) above in circumstances where the issuance of the refinancing debt
3 would result in total long-term indebtedness exceeding the \$1.7 billion level set
4 forth in (1) above if the principal amount of the debt being refinanced were
5 considered to be included in total long-term indebtedness, to repay the debt
6 being refinanced within 90 days of the new debt issuance;
- 7 (8) Conditions the issuance of long-term indebtedness under the authority set forth
8 in (1) above (other than in the case of refinancing long-term indebtedness) upon
9 TEP having equity of at least 30 percent of its total capital and a cash coverage
10 ratio of at least 1.75 when equity is between 30 and 40 percent of total capital.
11 The equity ratio and the cash coverage ratio to be determined on a pro forma
12 basis after giving effect to the issuance of the long-term debt to be issued
13 pursuant to the authority and the discharge of any long-term debt being refunded
14 or refinanced thereby;¹
- 15 (9) Authorizes the execution, delivery and performance by TEP of all contracts,
16 agreements, and other instruments which are incidental to any or all of the
17 foregoing or otherwise deemed by TEP to be necessary, desirable, or appropriate
18 in connection therewith;
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21 ¹ TEP proposes that for purposes of this Order, the equity ratio shall be the ratio of (a) common stock equity to (b) total
22 capitalization, using the most recently audited financial statements as adjusted for capital contributions, distributions, and
23 issuances, repayment or purchases of debt or equity occurring after the most recently audited financial statements. For
24 the purposes of the Order, total capitalization is defined as the sum of common stock equity, long-term debt (including
25 current maturities thereof), capital lease obligations (including current obligations under capital leases), less TEP's
26 investments in capital lease debt. For purposes of the Order, the cash coverage ratio is the ratio of (a) the sum of
27 operating income, depreciation and amortization expense for the twelve month period ending on the last day of the period
28 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). 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 to be considered to be the incurrence of long-term indebtedness which is subject to the conditions set
for in (7).

- 1 (10) Provides that the issuance of long-term debt, and to enter into one or more credit
2 agreements for revolving credit facilities and receive additional equity
3 contributions in this Order shall replace the existing authorizations of December
4 No. 71788, that the authorizations of Decision No. 71788 terminate upon the
5 effective date of this Order, and that all existing obligations incurred under
6 lawful authorizations shall remain valid;
- 7 (11) Authorizes TEP to enter into the transactions authorized under this Order
8 through December 31, 2016;
- 9 (12) Permits any credit or reimbursement agreement, or any agreement to refinance
10 any such credit or reimbursement agreement, entered into under lawful authority
11 on or before December 31, 2016, to remain valid through its final maturity date,
12 which in any case shall not extend beyond December 31, 2021;
- 13 (13) Approves the interest rate hedging program relating to planned issuances of
14 long-term debt as described in the Financing Application;
- 15 (14) Finds that the financing described in TEP's Financing Application is reasonable
16 and appropriate for the purposes described in the Financing Application and that
17 such purposes are not, wholly or in part, reasonably chargeable to operating
18 expenses or to income;
- 19 (15) Authorizes TEP to pledge, mortgage, lien and/or encumber its real property;
- 20 (16) Finds that the financing described in TEP's Financing Application is for lawful
21 purposes within TEP's corporate powers, compatible with the public interest,
22 with sound financing practices, and with proper performance by TEP of service
23 as a public service corporation, and will not impair TEP's ability to perform such
24 service; and
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1 (17) Grants any other relief that the Commission determines to be appropriate and in
2 the public interest.

3 18. TEP proposes that within 90 days of the completion of any financing transaction made
4 pursuant to the authority granted in the requested Commission Order, TEP would make a compliance
5 filing to provide copies of the relevant agreements and provide a description of the business rationale
6 for such financing or refinancing, including a demonstration that the rates and terms received by TEP
7 were fair and reasonable under prevailing conditions.

8 **A. Long-Term Debt**

9 19. TEP intends to use the proceeds from the issuance of new long-term indebtedness to:
10 (i) refinance long-term indebtedness; (ii) finance a portion of TEP's capital expenditures; (iii) finance
11 the purchase of Springerville Generating Station ("SGS") Unit 1 and SGS coal handling facilities;
12 and, (iv) pay-off outstanding borrowings under TEP's revolving credit facilities.

13 20. TEP's forecasts of required capital spending have increased due to anticipated
14 environmental upgrades at its coal-fired generating facilities, planned investments in renewable
15 energy projects and required upgrades to the Company's transmission and distribution facilities.
16 From 2012 to 2016, TEP expects that approximately \$1.8 billion in capital expenditures will be
17 required in order to maintain safe and reliable service and to remain in compliance with
18 environmental regulations. The Company believes that purchasing the SGS Unit 1 at the end of its
19 current lease in 2015 will provide benefits to customers.

20 21. TEP states that it needs to increase its long-term debt cap to \$1.7 billion in order to
21 accommodate the financing of plant additions needed over the next several years to continue to
22 provide safe and reliable electrical service. Before year-end 2012, TEP expects to issue an additional
23 \$130 million in long-term debt to finance plant additions and repay revolving credit borrowings,
24 which will increase outstanding long-term debt to \$1.205 billion, and leave less than \$100 million of
25 available long-term debt issuance capacity under TEP's existing authority.

26 **1. Issuance of New Tax-Exempt Long-Term Debt.**

27 22. As a local furnishing utility, whose retail service area is confined to a contiguous two-
28 county area, TEP has been able to finance a substantial portion of its utility plant assets with tax-

1 exempt revenue bonds issued by governmental entities on TEP's behalf. If TEP wishes to cause new
2 tax-exempt bonds to be issued, it must apply for a Private Activity Bond ("PAB") volume cap
3 allocation from the State of Arizona. If TEP is awarded a PAB volume cap allocation, it may cause
4 tax-exempt bonds to be issued for the local furnishing of electricity during the following three-year
5 period. These tax-exempt local furnishing bonds would likely be issued by the Pima County
6 Industrial Development Authority ("Pima Authority").

7 23. Most recently, TEP was awarded a PAB volume cap allocation in 2008, which it used
8 in October 2010, to cause \$100 million of 5.25 percent fixed-rate bonds maturing in 2040 to be issued
9 through the Pima Authority. TEP states that it does not have any near-term plans to apply for a new
10 PAB volume cap because the interest on new private activity bonds is now subject to alternative
11 minimum tax ("AMT"), which has resulted in investors demanding a significant yield premium for
12 new private activity bonds subject to the AMT.

13 24. TEP asserts that it has the ability to cause up to \$150 million of tax-exempt bonds to
14 be issued to refinance bonds that it purchased and holds "in treasury." In December 2011, TEP
15 purchased \$150 million of its variable rate tax-exempt bonds with proceeds from a new taxable bond
16 issuance. TEP choose not to retire these bonds, but instead, as owner of the bonds, holds them in
17 treasury. TEP continues to pay interest on these bonds, and the interest is returned to TEP, as owner
18 of the bonds, on the same day. TEP states that this allows TEP to maintain the tax-exempt status of
19 the bonds to allow for future refinancing, such that when TEP causes these bonds to be refinanced,
20 the proceeds will go to TEP. Because the old bonds are held in treasury, TEP states they are not
21 included on TEP's balance sheet and therefore are not included in the \$1.075 billion in outstanding
22 long-term debt reported as of March 31, 2012. However, when the bonds are refinanced, it will
23 increase the amount of long-term indebtedness on TEP's balance sheet. TEP expects that interest on
24 the new bonds would not be subject to AMT since the bonds held in treasury were originally issued
25 in 1983 and 1985.

26 25. TEP states that decisions regarding the maturity date, interest rate (e.g. fixed versus
27 floating), security, letter of credit support, and other key terms of any new tax-exempt long-term
28 notes, would be subject to market conditions and other factors at the time of issuance. TEP's ability

1 to finance on a tax-exempt basis depends on the availability of a PAB volume cap allocation (except
2 in the case of the refinancing of the tax-exempt bonds held in treasury), will require continuing
3 compliance with applicable tax laws and other requirements, and will be dependent on the state of the
4 tax-exempt debt market.

5 **2. Issuance of New Taxable Long-Term Debt.**

6 26. In November 2011, TEP issued taxable long-term debt for the first time since 1998.
7 Market conditions in the second half of 2011 were such that interest rates on taxable debt were
8 comparable to rates on tax-exempt debt not subject to AMT, and significantly lower than rates on tax-
9 exempt debt subject to AMT. TEP used this opportunity to issue \$250 million of taxable unsecured
10 10-year notes at a rate of 5.15 percent. Proceeds of the issuance were used to repurchase \$150
11 million of variable rate tax-exempt bonds discussed above; redeem approximately \$22 million of
12 fixed rate bonds with a coupon of 6.10 percent; and repay \$78 million on TEP's revolving credit
13 facility.

14 27. TEP states that it would like to retain the ability to issue long-term taxable corporate
15 debt. TEP asserts that because any new tax-exempt bonds issued under a PAB allocation would be
16 subject to AMT under current tax law, the taxable corporate bond market is a cost effective source of
17 new long-term debt capital for TEP. According to TEP, the debt under this option could be unsecured
18 or secured, depending on market conditions and TEP's credit ratings, and could include mortgage
19 bonds issued under TEP's Mortgage and Deed of Trust. Variables such as maturity, interest rate,
20 discount rates or placement fees, security, public versus private offering, and timing, among other
21 things, would be dependent on market conditions.

22 **3. Refinancing of Long-Term Debt**

23 28. As of March 21, 2012, approximately \$215 million of TEP's outstanding long-term
24 debt consisted of variable rate tax-exempt bonds. TEP states that in recent years, it has reduced its
25 exposure to variable interest rate risk by refinancing variable-rate obligations on a fixed-rate basis,
26 and by entering into a fixed-for-floating interest rate swap agreement in 2009, that led to fixing the
27 rate on \$50 million of variable-rate bonds. TEP desires to continue to manage its exposure to variable
28 interest rate risk.

1 29. In addition, TEP states that it may have opportunities to refinance existing fixed-rate
2 bonds to achieve a lower interest rate. TEP identified \$91 million of tax-exempt bonds with a fixed
3 interest rate of 6.375 percent which may be redeemed at par in 2013. TEP states that based on
4 current market conditions, it would be economical for TEP to refinance these bonds with new fixed-
5 rate refunding bonds that would not be subject to AMT under current tax law. Alternatively, TEP
6 states it could refinance these bonds in the floating-rate tax-exempt market, and hedge a portion of
7 the new bonds with an interest rate swap agreement if TEP's mix of fixed and floating-rate debt
8 warranted. TEP asserts that refinancing opportunities would depend on market conditions and
9 available terms.

10 **B. Credit and Reimbursement Agreements**

11 30. In Decision No. 71788, the Commission authorized TEP to enter into one or more
12 credit reimbursement agreements, and enter into one or more revolving credit facilities, so long as
13 TEP's revolving credit facilities do not exceed \$200 million in the aggregate. The Commission also
14 authorized TEP to enter into one or more letter of credit ("LOC") facilities to support its tax-exempt
15 bonds.

16 31. TEP's existing Credit Agreement consists of two facilities: (a) a \$200 million
17 revolving credit facility and (b) a \$186 million LOC facility. The credit facilities are secured by \$386
18 million in mortgage bonds issued under TEP's Mortgage and Deed of Trust. Borrowings under the
19 revolving credit facility bear interest at a variable rate consisting of a spread over the London
20 Interbank Offered Rate ("LIBOR") or an Alternate Base Rate (similar to a prime rate). The spread
21 over LIBOR or Alternate Base Rate is determined based on a pricing grid that is, in turn, based upon
22 the ratings of the credit facilities established by Standard and Poors ("S&P") and Moody's Investor
23 Service ("Moody's"). As of March 31, 2012, TEP's applicable borrowing rate was LIBOR plus 1.125
24 percent. TEP also pays a commitment fee of 0.125 percent on the unused portion of the revolving
25 credit facility. As of March 31, 2012, TEP had \$105 million in outstanding loans under its revolving
26 credit facility at an average interest rate of 1.37 percent.²

27 ² TEP amended its Credit Agreement dated August 11, 2006 ("Credit Agreement") in November 2010, to increase its
28 revolving credit facility from \$150 million to \$200 million, and to extend the maturity of the revolving credit facility and
its \$341 million LOC facility from August 2011, to November 2014. In November 2011, TEP amended its Credit

1 32. TEP states that the revolving credit facility under the Credit Agreement is used as a
2 source of liquidity for seasonal working capital needs, for financing temporary balances of under-
3 recovered fuel and purchased power costs, and for general corporate purposes, and may also be used
4 to issue letters of credit to provide credit enhancement for TEP's energy procurement and hedging
5 activities.

6 33. TEP requests authority to increase the aggregate size of its revolving credit facilities
7 by up to \$100 million to provide it with greater liquidity as the Company continues to grow. TEP
8 states that in light of recent volatility in the banking and credit markets, the Company believes it is
9 essential that it has financing authority in place to allow for a refinancing of its revolving credit and
10 letter of credit facilities. TEP requests that any new or amended credit facilities be allowed to have a
11 term of up to five years.

12 34. The LOC facility under the Credit Agreement provides \$186 million of LOCs that
13 support three series of TEP's tax-exempt variable rate debt obligations. The LOCs support \$179
14 million aggregate principal amount of bonds and up to \$7 million to cover varying number of days of
15 accrued interest on such obligations. Fees payable on the LOC facility are also tied to the pricing
16 grid that is based upon the investor ratings of the credit facilities. As of March 31, 2012, the
17 applicable LOC fee was 1.125 percent. TEP also pays an "LOC Fronting Fee" of 0.20 percent to
18 0.25 percent to the banks that issue the LOCs.

19 35. In December 2010, under the general financing authority granted in Decision No.
20 71788, TEP caused the Coconino County Pollution Control Corporation to issue \$36.7 million of
21 variable rate tax-exempt bonds on its behalf. In connection therewith, a Reimbursement Agreement,
22 dated December 2010 (the "LOC Reimbursement Agreement"), was entered into which consists of a
23 \$37.2 million LOC facility to provide credit support for the principal of the bonds and up to \$0.5
24 million of accrued interest. The LOC Reimbursement Agreement is supported by \$37.2 million of
25

26 Agreement to achieve lower pricing and to extend the maturity of its facilities to November 2016. In December 2011,
27 TEP reduced the amount of its LOC facility from \$341 million to \$186 million as a result of the termination of three
28 LOCs totaling \$155 million. TEP was able to terminate the LOCs because it purchased \$150 million of variable rate tax-
exempt bonds in late 2011. In addition, TEP entered into a \$37 million letter of credit and reimbursement agreement to
support the issuance of new variable rate tax-exempt bonds in 2010, which agreement expires in December 2014.

1 mortgage bonds issued under TEP's Mortgage and Deed of Trust. The LOC Reimbursement
2 Agreement expires in December 2014. As of March 31, 2012, the applicable LOC fee under the
3 LOC Reimbursement Agreement was 1.50 percent.

4 36. TEP seeks authority to enter into one or more credit or reimbursement agreements and
5 to enter into agreements to amend or refinance such credit or reimbursement agreements. TEP
6 requests that the Commission increase the authorized amount of revolving credit facilities from \$200
7 million to up to \$300 million in the aggregate. TEP states that it may also need to refinance the LOC
8 Reimbursement Agreement prior to its expiration in December 2014. TEP states that the term of any
9 new credit or reimbursement agreement or the length of any extension of the existing Credit
10 Agreement or LOC Reimbursement Agreement would depend on market conditions at the time the
11 new agreement or extension was executed, and TEP expects any such credit or reimbursement
12 agreement to have a term of five years or less.

13 37. TEP does not propose to limit the amount of LOC facilities issued to support tax-
14 exempt bonds to a specific amount because the tax-exempt bonds constitute a portion of TEP's
15 authorized long-term debt issued pursuant to lawful authority. The LOCs supporting these bonds do
16 not provide cash to TEP, but are a component of the tax-exempt debt financing arrangements which
17 does not increase the amount of outstanding long-term debt, but is a way to provide credit support for
18 such bonds.

19 38. TEP states that it is generally not possible to obtain LOCs with maturities that match
20 the maturities of the bonds, so renewals or replacements of such LOC facilities are needed
21 periodically to maintain the financings. In addition, TEP states that if market conditions warrant,
22 future issuances of tax-exempt bonds may be issued with LOC support which would require
23 additional LOC facilities.³

24 **C. Equity Capital Contributions**

25 39. Decision No. 71788 authorized TEP to receive additional equity contributions of up to
26 \$250 million from UNS for the purpose of augmenting TEP's equity ratio. In the Financing
27

28 ³ The interest rates on all of TEP's variable rate tax-exempt bonds are currently reset weekly. As of March 31, 2012, the average variable interest rate on such bonds was 0.18 percent on an annualized basis.

1 Application, TEP requests authority to obtain up to \$400 million of additional equity contribution
2 from its parent company over the next several years in order to maintain a balanced capital structure.
3 TEP asserts that reducing its debt leverage in recent years has resulted in significant improvements in
4 TEP's bond ratings which have allowed the Company to obtain more favorably priced capital in the
5 debt markets.

6 **D. Short-Term Debt Issued Pursuant to A.R.S. §40-302.D**

7 40. A.R.S. § 40-302.D allows TEP to issue short-term debt in an amount not to exceed 7
8 percent of its capitalization without Commission approval. However, Commission approval would be
9 required if TEP needs to provide security for such short-term debt. Because the Company's revolving
10 credit facility is currently secured by mortgage bonds, TEP believes that any additional short-term
11 debt issued outside of its revolving credit facility would need to be secured in order to obtain
12 reasonable terms. Thus, in order for TEP to make cost effective use of the authority already granted
13 by statute, the Company requests that the Commission allow it to secure short-term debt incurred
14 pursuant to A.R.S. §40-302.D with mortgage bonds under its Mortgage and Deed of Trust.⁴

15 **E. Extension of Time Period**

16 41. TEP requests that the Commission extend the time period to enter into the transactions
17 for which it requests authority by two years, from the current expiration on December 31, 2014, to
18 December 31, 2016. TEP asserts that the extension would give it time to complete the financing for
19 the purchase of SGS Unit 1 and the SGS coal handling facilities at the end of their lease terms in
20 2015, and would allow TEP to refinance its existing revolving credit facility before it matures in
21 November 2016.

22 42. TEP requests that the Commission permit any credit or reimbursement agreement or
23 any refinancing of such agreement entered into on or before December 31, 2016, to have a maturity
24 date up to five years from the date such agreement was entered into or refinanced, but in no case
25 extending beyond December 31, 2021.

26
27 _____
28 ⁴ Borrowings under TEP's authorized revolving credit facilities are not considered short-term debt for purposes of A.R.S. §40-302B because such borrowings are due upon the expiration of the facilities, which can be up to five years from the date a facility is entered into.

1 **F. Interest Rate Hedging Program**

2 43. TEP states that it expects to issue long-term debt to fund a substantial portion of its
3 capital expenditure requirements over the next several years, and with interest rates near all-time
4 lows, believes that it is a good time to implement an interest rate hedging program to produce long-
5 term interest savings. TEP asserts that interest rate hedging for new issuances of long-term debt is a
6 common practice among utilities and other corporate borrowers with large financing needs.

7 44. According to TEP, under the most common interest rate hedging program, the impact
8 of fluctuating rates is mitigated when the borrower enters into a forward-starting interest rate swap
9 agreement or a U.S. Treasury rate-lock agreement with a highly rated financial institution. Typically,
10 the company enters into a derivative interest rate contract, the value of which will fluctuate with
11 changes in either the forward swap market for 3-month LIBOR or the yield on U.S. Treasury bonds.
12 At the time the long-term bonds or notes are issued, the value of the derivative contract would be
13 settled in cash with the financial counter-party.⁵ TEP states that assuming the hedge qualifies for cash
14 flow hedge accounting under Accounting Standards Codification 815 ("ASC 815"), the cash
15 settlement would be accounted for similar to the cost of issuance (either positive or negative) and
16 amortized over the terms of the bonds or notes issued.

17 45. TEP does not believe that interest rate swap agreements or U.S. Treasury rate-lock
18 agreements represent an issuance of securities that require Commission approval, however, the
19 Company is seeking Commission approval of a hedging program for planned issuances of taxable
20 long-term debt. Specifically, TEP requests the Commission approve an interest rate hedging program
21

22 ⁵ For example, if TEP were going to issue \$100 million of new fixed-rate 10-year taxable bonds in June of 2013, the
23 Company would be exposed to interest rate volatility between now and the date of issuance. To hedge that risk, TEP
24 could enter into a forward-starting 10-year LIBOR swap agreement with an effective date of June 2013, or later. On the
25 bond issuance date, if the 10-year LIBOR swap rate had increased above the rate specified in the swap agreement, the
26 swap agreement would be unwound and TEP would receive a cash settlement from the financial counter-party. The cash
27 settlement would be based on the net present value of the difference between the market swap rate and the contractual
28 swap rate applied to the notional amount of the hedge. The cash settlement would be viewed as additional proceeds
received from the sale of bonds, and lower the effective cost or yield-to-maturity of the bonds issued. TEP states that by
lowering the cost of debt in this manner, the hedge would serve to offset the increase in market interest rates that occurred
between the hedge date and the bond issuance date. If market interest rates were to fall between the hedge date and the
bond issuance date, the Company would have to pay cash to the financial counter-party in order to settle the swap
agreement. According to TEP, the cash settlement would be viewed as a reduction in proceeds received from the sale of
bonds, which increases the effective cost or yield-to-maturity of the bonds issued. TEP states the increased cost would
serve to offset the reduction in market interest rates that occurred between the hedge date and the bond issuance date. TEP
asserts that under either scenario, the hedge would mitigate the impact of changes in market rates between the hedge date
and the bond issuance date.

1 that contemplates to hedge, through the use of one or more forward-starting interest rate swap
2 agreements, U.S. Treasury rate-lock agreements, or other similar derivative interest rate contracts, up
3 to 50 percent of the planned principal amount of any issuance of fixed-rate taxable long-term debt
4 having a final maturity of five years or longer and up to 18 months in advance of the planned
5 issuance date of the long-term debt. Additionally, TEP requests that the cash settlement of any such
6 hedging contracts be treated as a cost of issuance (either positive or negative) when calculating the
7 Company's cost of debt in future rate proceedings.

8 **IV. Staff Review and Recommendations**

9 **A. Engineering Analysis**

10 46. TEP's construction work plan ("CWP") for 2012 through 2016 includes \$1.2 billion
11 for generation, \$191 million for general plant, and \$651 million for transmission and distribution
12 projects, for a total of approximately \$2.024 billion.

13 47. Staff states that TEPs' ability to serve its native load reliably and cost effectively is
14 contingent upon the Company upgrading existing electric facilities, replacing certain equipment and
15 adding new transmission and distribution infrastructure. Staff concludes that TEP's capital
16 improvement plan is appropriate and the expenditure levels associated with the projects appear to be
17 reasonable. However, Staff states that it is making no determination regarding any ratemaking
18 treatment pertaining to the projects and that no ratemaking treatment should be inferred.⁶

19 **B. Financial Analysis**

20 48. Staff supports approval of the requested new debt limits which negate the necessity for
21 TEP to file finance applications whenever it needs to enter into a new debt agreement, and which
22 would provide TEP with the flexibility to take advantage of any favorable conditions in the financial
23 markets when capital needs arise. However, Staff believes that the general nature of the request calls
24 for financial parameters to prevent TEP from incurring an excessive amount of debt. Furthermore,
25 because the borrowing authority threshold would be ongoing, Staff asserts that the financial
26 parameters used as conditions for future debt issuances must also be ongoing in nature.⁷ Staff also
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28 ⁶ Staff Report at 5.

⁷ Staff Report at 5.

1 believes that an expiration date, at a date certain, is necessary to maintain oversight over TEP's
2 capital financing by requiring it to seek reauthorization.

3 49. Staff recommends conditioning TEP's ability to issue debt under the authority on
4 maintaining its equity-to-total capitalization and its cash coverage ratio ("CCR") above minimum
5 thresholds.⁸

6 50. As of December 31, 2011, TEP's capital structure consisted of 0.4 percent short-term
7 debt, 3.3 percent current obligations under capital leases, 15.0 percent capital lease obligations, 46.1
8 percent long-term debt, and 35.2 percent equity.

9 51. Staff states that although TEP has made progress in recent years in improving its
10 equity position, in Staff's opinion, TEP's current 35 percent equity is a minimally acceptable level.
11 Staff states that it usually considers 40 percent equity of total capital to be the minimum for a
12 financially prudent investor-owned utility. Staff argues that TEP should continue to increase its
13 equity until it achieves and can maintain a capital structure with no less than 40 percent equity.

14 52. In the Staff Report, Staff concluded that the incurrence of the long-term debt
15 (including revolving credit facilities) for which TEP requests authorization, is within the Company's
16 corporate powers, is compatible with the public interest, would not impair its ability to provide
17 services and would be consistent with sound financial practices as long as subsequent to any debt
18 issuance subject to the long-term debt threshold: (1) common equity represents no less than the
19 following percentages of total capital by year: 2013, 36 percent; 2014, 37 percent; 2015, 38 percent;
20 and 2016, 39 percent; and (2) CCR is equal to or greater than 1.75.⁹

21 **C. Credit Agreement**

22 53. Staff concluded that TEP's request not to limit the amount of LOC's pursuant to its
23 Credit Agreement is appropriate since the LOCs are self-limiting to the amount of the tax-exempt
24 debt authorized and the related accrued interest.¹⁰

25
26
27 ⁸ Cash Coverage Ratio 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.

28 ⁹ Staff Report at 6.

¹⁰ Staff Report at 8.

1 **D. Encumbrance**

2 54. Staff states that pledging assets as security typically provides benefits in the way of
3 increased access to capital funds or preferable interest rates.

4 **E. Equity Contributions**

5 55. Arizona Administrative Code (A.A.C.) R14-2-803.A provides that “[a]ny utility or
6 affiliate intending to organize a public utility holding company or reorganize an existing public utility
7 holding company will notify the Commission’s Utility Division in writing at least 120 days prior
8 thereto.”¹¹ Decision No. 58063 (November 3, 1992) finds that a public utility holding company
9 increasing or decreasing its financial interest in an affiliate would be considered a reorganization, and
10 therefor would be subject to A.A.C. R14-2-803. Decision No. 58063 also exempts a public utility
11 holding company from the requirement of A.A.C. R14-2-803 when the holding company increases or
12 decreases its financial interest in an affiliated or utility by an amount not exceeding designated
13 “exempt amounts” based on pre-existing utility assets in all jurisdictions including Arizona. Staff
14 concludes that the current application would be exempt if the equity investment from UNS to TEP
15 did not exceed \$50 million in one calendar year. However, because TEP’s Financing Application
16 requests authority to receive up to \$400 million in equity from UNS, Staff believes that it is subject to
17 the notice of intent requirements of A.A.C. R14-2-803.A.

18 56. Staff concludes that the information provided in the Financing Application
19 satisfactorily serves as adequate notice under A.A.C. R14-2-803.A.¹²

20 57. Staff calculated that a pro forma capital structure recognizing a \$400 million equity
21 contribution would be composed of a 0.4 percent short-term debt, 3.3 percent current obligations
22 under capital leases, 14.8 percent capital lease obligations, 45.3 percent long-term debt, and 36.2
23 percent equity. Staff states that since this pro forma capital structure includes less than 40 percent
24 equity, TEP’s request to receive additional equity would serve to provide equity enhancement. Staff
25 concludes that there is no reason to deny TEP’s request to receive up to \$400 million of equity
26 contributions from UNS for the purpose of enhancing its equity position.¹³

27 _____
¹¹ Staff Report at 9.

¹² Staff Report at 9.

¹³ Staff Report at 9.

1 **F. Interest Rate Hedging.**

2 **1. Forward-Starting Swaps**

3 58. Staff concludes that forward-starting swaps are effective for managing interest rate
4 risk and for assisting management in planning and budgeting for future capital improvement
5 expenditures. Staff believes that authorizing forward-starting swaps is appropriate, however, Staff
6 believes that TEP has presented no good reason to pre-determine the treatment of those costs outside
7 of a rate case.¹⁴

8 **2. Interest Rate Swaps and Variable Interest Debt**

9 59. Staff states that while TEP may not believe that interest rate swap agreements or U.S.
10 Treasury rate-lock agreements represent an issuance of securities that requires Commission approval,
11 Staff believes that such financial instruments become an integral component of debt issuances, and
12 that it is in the public interest to control the use of these financial instruments. Staff hypothesizes a
13 scenario whereby the Commission would approve a fixed interest rate loan, but deny approval of a
14 floating rate loan; if TEP can enter into interest rate swap agreements without Commission
15 authorization, the Company could circumvent the Commission's wishes by applying for a fixed rate
16 loan, and then subsequent to receiving approval, enter into an interest rate swap to effectively convert
17 the loan to a floating interest rate loan in spite of the Commission's intent. Accordingly, Staff
18 concludes that any general authorization granted to TEP to issue long-term debt under a threshold
19 should be subject to conditions that effectively control the Company's use of derivative financial
20 instruments.¹⁵

21 60. An interest rate swap is an agreement between two parties to exchange different
22 streams of interest payments. For example, assume Utility A plans to issue \$100 million of bonds
23 payable in 20 years, and wants to limit its exposure to changes in interest rates. If Utility A finds that
24 the cost to issue the bonds at a fixed rate exceeds the cost to issue variable rate bonds plus the cost of
25 an interest rate swap with Counterparty B, Utility A might agree to pay Counterparty B a fixed
26 stream of interest payments for 20 years based on a \$100 million notional amount in return for

27 _____
¹⁴ Staff Report at 11.

28 ¹⁵ Staff states that due to the unrestricted authorizations for various types of refinancings granted in Decision No. 71788, TEP's use of a fixed-for-floating interest rate swap in 2009 may have been indirectly authorized.

1 Counterparty B paying Utility A a stream of variable interest payments based on changes in LIBOR.
2 By issuing the variable interest rate bonds and negotiating an interest rate swap with Counterparty B,
3 Utility A can effectively achieve its objective – to pay interest at a fixed rate and reduce its costs
4 compared to issuing fixed interest bonds. In this example, Staff notes, a financial derivative is used to
5 reduce interest rate risk and exposure and to reduce costs by establishing a fixed net payment and
6 protecting Utility A from interest rate increases.

7 61. However, Staff states that by executing the interest rate swap described above, Utility
8 A created a credit exposure – the possibility that Counterparty B will default on its variable interest
9 payments to Utility A. Staff notes that Utility A could enter into yet another financial derivative, a
10 credit default swap, and pay a periodic protection fee to a third party, to mitigate the credit exposure.
11 Staff asserts that Utility A will also incur other financial costs related to issuing derivatives, e.g.,
12 payroll and overhead costs for financial, legal and other personnel to manage its derivatives, as well
13 an non-financial impacts – e.g. adding to the number of issues that the Company must manage in
14 addition to its core business activities.¹⁶

15 62. Staff believes that using derivatives for managing interest rate risk differs from
16 managing risks associated with energy transactions. Staff states that in the case of energy
17 transactions, derivatives address costs that typically vary widely in short periods of time and are
18 passed through to ratepayers via an adjustor mechanism that provides a true-up, while interest costs
19 are only measured and included in rates during rate cases which usually occur years apart.

20 63. Staff argues that the market for debt instruments is reasonably robust and competitive
21 and has resulted in fixed and floating/variable rate debt instruments having similar costs on a risk-
22 adjusted basis. Staff notes that while variable rate debt may initially be lower, the floating nature
23 presents financial risk and exposure. Staff states that the nature of providing utility service places a
24 strong value on cost stability such that the adverse impacts of variable costs should be managed to
25 prefer cost stability over the risk of floating cost instruments.

26 64. Staff asserts that under a multi-year general authority to issue securities in excess of a
27 billion dollars, it is prudent to limit the risk and exposure of variable cost financial instruments. In

28 ¹⁶ Staff Report at 12.

1 the Staff Report, Staff concluded that the aggregate outstanding value of floating cost long-term debt
2 threshold for TEP should not exceed \$250 million.¹⁷

3 65. Staff states that for purposes of calculating the aggregate outstanding balance of
4 floating cost financing, any fixed cost security effectively converted to a floating cost security by
5 issuance of a financial derivative instrument or any other means should be deemed a floating cost
6 security. Further, Staff concluded that the Commission should not grant TEP authorization to enter
7 into any derivative financial instrument that effectively converts a long-term fixed cost security into a
8 long-term floating cost security, nor should the Company enter into any such agreement without
9 Commission authority.

10 66. On the other hand, Staff concludes that TEP should be granted authority to enter into
11 derivative financial instruments that convert floating cost long-term securities to long-term fixed
12 costs securities. For purposes of calculating the aggregate outstanding balance of floating cost
13 financing, any floating cost security effectively converted to a fixed cost security by issuance of a
14 financial derivative instrument or any other means should be deemed a fixed cost security.

15 67. Staff further concludes that there should be no predetermination that any gain or loss
16 pertaining to fixed-to-floating or floating-to-fixed interest rate transactions or other financial
17 derivative instruments or similar contracts used to manage interest rate risk and/or exposure will be
18 reflected in the net interest rate of the financing instruments to which those transactions relate, and
19 instead that such determination should be deferred to a rate case.

20 **G. Staff's Recommendations**

21 68. As of January 4, 2013, Staff recommends that the Commission:

- 22 1. Authorize TEP through December 31, 2016, to issue long-term indebtedness
23 provided that after giving effect to the issuance of such indebtedness, the aggregate
24 outstanding principal amount of long-term indebtedness of TEP (including current
25 maturities thereof), shall not exceed \$1.7 billion (including up to \$250 million of
26 which is available for TEP to exercise its option to acquire SGS Unit 1 and the
27

28 ¹⁷ Staff Report at 13.

1 SGS coal handling facilities or other similar generation and/or transmission
2 facilities and the remainder available for other purposes including for generation
3 and transmission purposes other than SGS), except as provided in (6) below and
4 limiting to \$350 million the aggregate portion thereof authorized as
5 floating/variable cost rate debt. The general authorization threshold does not
6 include existing capital lease obligations or indebtedness arising under TEP's
7 credit and reimbursement agreements;¹⁸

8
9 2. Authorize TEP to enter into any refinancings, refundings, renewals, reissuances
10 and rollovers of any outstanding indebtedness, as well as the incurrence or
11 issuance of any additional long-term indebtedness, and the amendment or revision
12 of any terms or provisions of, or relating to, any long-term indebtedness, so long as
13 total long-term indebtedness outstanding after giving effect to such issuance, does
14 not exceed the levels set forth in (1) above and such financings are in compliance
15 with other provisions of the Order;¹⁹

16 3. Authorize TEP through December 31, 2016, to enter into one or more credit or
17 reimbursement agreements with terms of up to five years, and to enter into
18 agreements to refinance any such credit or reimbursement agreements, which may
19 consist of one or more revolving credit facilities as long as, after giving effect to
20 the entry of such a facility, TEP's revolving credit facilities do not exceed \$300
21 million in the aggregate, and enter into one or more letter of credit facilities which
22 provide letters of credit to support tax-exempt bonds which have been or in the
23 future will be issued pursuant to lawful authority;²⁰

24
25
26 ¹⁸ Per January 4, 2013, Supplemental Staff Report. In its November 14, 2012, Comments, TEP had expressed concerns
27 with Staff's original Recommendation (1) and suggested a revision. TEP continued to have concerns with the modified
28 recommendation contained in the December 4, 2012, Supplemental Staff Report. Both parties agree that the version of
Staff's Recommendation (1) as set forth in the January 4, 2013, Supplemental Staff Report provides TEP with the
flexibility it needs to make effective use of the authority granted in the this Order, but places appropriate limits on such
authority.

¹⁹ Per November 2, 2012, Staff Report.

²⁰ Per November 2, 2012, Staff Report.

- 1 4. Authorize TEP to provide security for any financing transactions authorized in this
2 proceeding and for short-term debt issued pursuant to A.R.S. §40-302(D) by the
3 issuance of mortgage bonds under its Mortgage and Deed of Trust;²¹
4
- 5 5. Authorize TEP to receive subsequent to the effective date of the Decision in this
6 case, additional equity contributions of up to \$400 million from UNS to maintain
7 and augment its equity ratio;²²
8
- 9 6. Authorize TEP to exceed the long-term debt threshold level and the limitation on
10 long-term variable rate debt set forth in (1) above for a period not to exceed 90
11 days in circumstances where that threshold or limit is exceeded due to the effect of
12 recognizing both the issuance of refinancing debt and the existing debt to be
13 refinanced;²³
14
- 15 7. Condition the issuance of long-term indebtedness under the authority set forth in
16 (1) above (other than in the case of refinancing long-term indebtedness):
17
- 18 i. Upon TEP having equity equal to at least the following percentages
19 of its total capital by year: 2013, 30 percent; 2014, 32 percent;
20 2015, 34 percent; and 2016, 39 percent and a cash coverage ratio of
21 at least 1.75. In future financing approvals for TEP, the
22 Commission may require TEP's equity to be 40 percent or greater.
23
- 24 ii. For purposes of the Order, the equity ratio and the CCR shall be
25 determined on a pro forma basis after giving effect to the issuance
26 of the long-term debt to be issued pursuant to the authority and the
27 discharge of any long-term debt being refunded or refinanced
28 thereby.

²¹ Per November 2, 2012, Staff Report.

²² Per November 2, 2012, Staff Report.

²³ Per TEP November 14, 2012, Comments and December 4, 2012, Supplemental Staff Report. TEP proposed a modification to Staff's original Recommendation (6) which Staff agreed is reasonable.

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- iii. For purposes of the Order, the equity ratio shall be the ratio of (a) common shareholders 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.

- iv. For purposes of the Order, total capitalization shall be defined as the sum of common shareholders 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.

- v. 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 for the long-term debt being or having been issued subsequent to such period plus interest expense 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) and where interest expense is adjusted to reflect the effects of any derivative financial securities or similar instruments.

- vi. For purposes of the Order, future changes in GAAP that have the

1 effect of lowering TEP's equity will be exempted from the equity
 2 and cash coverage ratios tests until the Commission makes a
 3 determination only if TEP makes a filing with the Commission
 4 requesting such a determination within 30 days after the Company
 5 files its quarterly report on Form 10-Q or its annual report on Form
 6 10-K with the Securities and Exchange Commission following the
 7 end of the fiscal quarter in which the GAAP change occurs.

8
 9 vii. For purposes of the Order, incurring obligations under authorized
 10 credit or reimbursement agreements is not considered to be the
 11 incurrence of long-term indebtedness which is subject to the
 12 conditions set forth in this paragraph;²⁴

13 8. Direct TEP not to enter into any agreement/contract for any financial derivative
 14 security or similar instrument other than those authorized by the Commission, and
 15 establishing that execution by TEP of any such transaction shall be grounds for
 16 summary revocation by the Commission of the general authorization to issue long-
 17 term indebtedness authorized in this proceeding. (This provision is not intended to
 18 place any restriction on hedging activities pertaining to energy procurement);²⁵

19 9. Deny the interest hedging program as proposed by TEP;²⁶

20
 21 10. Direct TEP not to enter into any floating-for-fixed interest rate swap agreements
 22 (i.e., pay floating rate and receive fixed rate) that have the economic effect of
 23

24 ²⁴ In its November 14, 2012, Comments TEP agreed with most of Staff Recommendation (7) as set forth in the November
 25 2, 2012, Staff Report, but proposed a modification to subpart (i) because TEP thought that Staff's recommended
 26 minimum equity ratios gave it little breathing room to allow it to take advantage of the financing authority. Staff
 27 originally recommended that TEP should be required to maintain equity equal to at least the following percentages of its
 28 total capital by year: 2013, 36 percent; 2014, 37 percent; 2015, 38 percent; and 2016, 39 percent and a CCR of at least
 1.75. TEP proposed the following: "Upon TEP having equity equal to at least the following percentages of its total
 capital by year: 2013, 30 percent; 2014, 32 percent; 2015, 34 percent; and 2016, 36 percent and a cash coverage ratio
 ("CCR") of at least 1.75." In its December 4, 2012 Supplemental Staff Report, Staff recommended the current version of
 this condition which gives TEP additional flexibility with respect to its equity ratios in the early years of the authority as
 long as TEP achieves a 39 percent equity ratio by 2016.

²⁵ Per December 4, 2012, Supplemental Staff Report.

²⁶ Per November 2, 2012, Staff Report.

1 converting fixed cost long-term debt to floating/variable cost debt;²⁷

2
3 11. Direct that for purposes of calculating the \$350 million aggregate limit on the
4 outstanding balance of floating/variable cost rate long-term debt in (1) above, in
5 the event that the Commission authorizes the use of floating-for-fixed interest rate
6 swap agreements, the amount of floating/variable cost rate debt shall be deemed to
7 have been increased by the notional amount of any such swap agreements in effect
8 on the date of such determination;²⁸

9
10 12. Authorize TEP to enter into fixed-for-floating interest rate swap agreements (i.e.
11 pay fixed rate and receive floating rate) for the purpose of reducing interest rate
12 risk on its floating/variable cost rate debt. For purposes of calculating the \$350
13 million aggregate limit on the outstanding balance of floating/variable cost rate
14 debt in (1) above, the amount of floating/variable cost rate debt shall be deemed to
15 have been reduced by (i) the notional amount of any fixed-for-floating interest rate
16 swap agreements in effect on the date of such determination and (ii) the principal
17 amount of any floating/variable cost rate debt owned by TEP;²⁹

18
19 13. Find that it is in the public interest for the Commission to exercise oversight of the
20 use by TEP of interest rate swap agreements, U.S. Treasury rate-lock agreements,
21 and other interest rate derivatives through December 31, 2016;³⁰

22
23 14. Require TEP to file confirmation with the Commission Docket Control Center
24 within 90 days of the effective date of the Order certifying that it has established
25 an appropriate management policy/system of internal controls formally approved
26 by TEP's Board of Directors designed to govern the use of interest rate derivatives

27 ²⁷ Per November 14, 2012, TEP Comments and December 4, 2012, Supplemental Staff Report. TEP proposed language to clarify Staff's original Recommendation (10), to which Staff agreed.

28 ²⁸ Per November 14, 2012, TEP Comments and December 4, 2012, Supplemental Staff Report. Staff agreed to TEP's proposed modification to Recommendation (11) to be consistent with the modifications to Recommendation (1).

29 ²⁹ Per November 14, 2012, TEP Comments and December 4, 2012, Supplemental Staff Report. Staff agreed to TEP's proposed modification to Recommendation (12) to be consistent with the modifications to Recommendation (1).

30 ³⁰ Per November 14, 2012, TEP Comments and December 4, 2012, Supplemental Staff Report. Staff agreed that TEP's proposed language better reflects Staff's intent and Staff supports TEP's revised/modified language.

1 or other similar contracts to manage interest rate risk and/or exposure;³¹

2
3 15. Find that any authorization granted TEP to engage in financial derivative securities
4 or similar contracts to manage interest rate risk and/or exposure should specifically
5 exclude use of such authorization for speculative purposes;³²

6 16. Authorize TEP to issue forward-starting swaps based on LIBOR or U.S. Treasuries
7 and U.S. Treasury rate-locks for the purpose of hedging changes in interest rates
8 up to 18 months in advance of planned issuances of fixed-rate taxable long-term
9 debt having final maturity of five years or longer;³³

10 17. Decline to establish the ratemaking treatment for the cash settlement of any
11 hedging contracts, as requested by TEP in this docket, on the basis that such
12 determination is better made in the context of a rate case;³⁴

13
14 18. Authorize the execution, delivery and performance by TEP of all contracts,
15 agreements, and other instruments which are incidental to any or all of the
16 foregoing or otherwise deemed by TEP to be necessary, desirable or appropriate in
17 connection therewith;³⁵

18
19 19. Order that the authorizations to issue long-term debt, enter into one or more credit
20 agreements for the revolving credit facilities, and receive additional equity
21 contributions shall replace the existing authorizations of Decision No. 71788, that
22 those authorizations expire upon the effective date of this Order, and that all
23 existing obligations incurred under lawful authorizations shall remain valid;³⁶

24 ³¹ November 14, 2012, TEP Comments and December 4, 2012, Supplemental Staff Report. Staff had no objection to
25 TEP's proposed revision/modification to Staff's Recommendation (14). TEP's proposed language clarified the deadline
for filing compliance documentation.

³² November 2, 2012, Staff Report.

³³ November 2, 2012, Staff Report.

26 ³⁴ Per December 4, 2012, Supplemental Staff Report. Staff proposed this modification to its original Recommendation
27 (17) to clarify that TEP is responsible for recording transactions in accordance with GAAP and that Staff has no intention
to modify the method TEP uses to record these costs, but that the Commission will not address the ratemaking treatment
for hedging activities until a future rate case.

³⁵ Per November 2, 2012, Staff Report.

28 ³⁶ Per November 2, 2012, Staff Report.

1 20. Order that the Decision in this case be deemed effective upon issuance and that
2 TEP may enter into the transactions authorized under this Order through December
3 31, 2016, and that all existing letter of credit facilities and all existing revolving
4 credit facilities that expire before January 1, 2021, incurred under lawful
5 authorization shall remain valid through their maturity dates;³⁷ and

6 21. Order that within 90 days of the completion of any financing transaction under the
7 authority set forth in (1), TEP make a compliance filing with the Commission's
8 Docket Control Center in which TEP shall provide copies of a summary of the
9 transaction and a description of the business rationale for such financing or
10 refinancing, including a demonstration that the rates and terms received by TEP
11 were fair and reasonable under prevailing market conditions and provide to the
12 Utility Division Compliance Section a copy of the relevant agreements.³⁸

13 69. Staff and TEP agree with all of the conditions as set forth above.

14 **IV. Conclusion**

15 70. We find that the conditions set forth above are reasonable and in the public interest in
16 the context of this grant of general finance authority.

17 71. We find further that TEP's request for an on-going general authority to incur
18 additional long-term indebtedness as discussed and conditioned herein is reasonable and compatible
19 with sound financial practices, and with the proper performance by TEP of service as a public service
20 corporation and will not impair TEP's ability to perform that service and is compatible with the
21 public interest.

22 72. The general authority allows TEP to respond quickly to market conditions. The
23 conditions imposed ensure that the Commission retains effective oversight over TEP's financing
24 activities. Nothing herein prevents TEP from seeking specific financing authority for transactions that
25 may not fall under the general authority granted herein.

27
28 ³⁷ Per November 2, 2012, Staff Report.

³⁸ Per November 2, 2012, Staff Report.

CONCLUSIONS OF LAW

1
2 1. TEP is a public service corporation within the meaning of Article XV of the Arizona
3 Constitution and A.R.S. §§ 40-301, 40-302, and 40-303.

4 2. The Commission has jurisdiction over TEP and of the subject matter of the Financing
5 Application.

6 3. Notice of the Financing Application was given in accordance with the law.

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

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

ORDER

14
15 IT IS THEREFORE ORDERED that Tucson Electric Power Company is authorized through
16 December 31, 2016, to issue long-term indebtedness provided that, after giving effect of the issuance
17 of such indebtedness, the aggregate outstanding principal amount of long-term indebtedness
18 (including current maturities thereof), shall not exceed \$1.7 billion (including up to \$250 million of
19 which is available for TEP to exercise its option to acquire SGS Unit 1 and the SGS coal handling
20 facilities or other similar generation and/or transmission facilities and the remainder available for
21 other purposes including for generation and transmission purposes other than SGS), except as
22 provided below, and limiting to \$350 million the aggregate portion thereof authorized as
23 floating/variable cost rate debt. The general authorization threshold does not include existing capital
24 lease obligations or indebtedness arising under Tucson Electric Power Company's credit and
25 reimbursement agreements.

26 IT IS FURTHER ORDERED that Tucson Electric Power Company is authorized to enter into
27 any refinancings, refundings, renewals, reissuances and rollovers of any outstanding indebtedness, as
28 well as the incurrence or issuance of any additional long-term indebtedness, and the amendment or

1 revision of any terms or provisions of or relating to any long-term indebtedness, so long as total long-
2 term indebtedness outstanding after giving effect to such issuance, does not exceed the levels set
3 forth above and such financings are in compliance with other provisions of this Order.

4 IT IS FURTHER ORDERED that Tucson Electric Power Company is authorized through
5 December 31, 2016, to enter into one or more credit or reimbursement agreements with terms of up to
6 five years, and to enter into agreements to refinance any such credit or reimbursement agreements,
7 which may consist of one or more revolving credit facilities as long as, after giving effect to the entry
8 of such a facility, Tucson Electric Power Company's revolving credit facilities do not exceed \$300
9 million in the aggregate; and is authorized to enter into one or more letter of credit facilities which
10 provide letters of credit to support tax-exempt bonds which have been, or in the future will be, issued
11 pursuant to lawful authority.

12 IT IS FURTHER ORDERED that Tucson Electric Power Company is authorized to provide
13 security for any financing transactions authorized in this proceeding and for short-term debt issued
14 pursuant to A.R.S. §40-302(D) by the issuance of mortgage bonds under its Mortgage and Deed of
15 Trust.

16 IT IS FURTHER ORDERED that Tucson Electric Power Company is authorized to receive
17 subsequent to the effective date of the Decision in this case, additional equity contributions of up to
18 \$400 million from UniSource Energy Corporation to maintain and augment its equity ratio.

19 IT IS FURTHER ORDERED that Tucson Electric Power Company is authorized to exceed
20 the long-term debt threshold level and the limitation on long-term variable rate debt, set forth above
21 for a period not to exceed 90 days in circumstances where that threshold is exceeded due to the effect
22 of recognizing both the issuance of refinancing debt and the existing debt to be refinanced.

23 IT IS FURTHER ORDERED that the issuance of long-term indebtedness under the authority
24 set forth above (other than in the case of refinancing long-term indebtedness) is conditioned upon: (i)
25 Tucson Electric Power Company having equity equal to at least the following percentages of its total
26 capital by year: 2013, 30 percent; 2014, 32 percent; 2015, 34 percent; and 2016, 39 percent and a
27 cash coverage ratio of at least 1.75. In future financing approvals for Tucson Electric Power
28 Company, the Commission may require Tucson Electric Power Company's equity to be 40 percent

1 or greater.

2 IT IS FURTHER ORDERED that for purposes of this Order, the equity ratio and the CCR
3 shall be determined on a pro forma basis after giving effect to the issuance of the long-term debt to
4 be issued pursuant to the authority and the discharge of any long-term debt being refunded or
5 refinanced thereby; the equity ratio shall be the ratio of (a) common shareholders equity to (b) total
6 capitalization, using the most recently audited financial statements as adjusted for capital
7 contributions, distributions, and issuances, repayment or purchases of debt or equity occurring after
8 the most recently audited financial statements; total capitalization shall be defined as the sum of
9 common shareholders equity, preferred stock, long-term debt (including current maturities thereof),
10 capital lease obligations (including current obligations under capital leases), less TEP's investments
11 in capital lease debt; the CCR shall be the ratio of (a) the sum of operating income, depreciation and
12 amortization expense for the twelve-month period ending on the last day of the period covered by
13 the most recently audited financial statements, to (b) interest expense for the twelve-month period
14 ending on the last day of such period minus interest expense for such period for any indebtedness
15 being or having been refinanced or refunded with the proceeds for the long-term debt being or
16 having been issued subsequent to such period plus interest expense for twelve months on the
17 indebtedness being or having been issued subsequent to such period (calculated, in the case of
18 indebtedness bearing a floating rate of interest, at the rate initially in effect on the date of the
19 issuance thereof) and where interest expense is adjusted to reflect the effects of any derivative
20 financial securities or similar instruments; future changes in GAAP that have the effect of lowering
21 Tucson Electric Power Company's equity will be exempted from the equity and cash coverage
22 ratios tests until the Commission makes a determination only if Tucson Electric Power Company
23 makes a filing with the Commission requesting such a determination within 30 days after it files its
24 quarterly report on Form 10-Q or its annual report on Form 10-K with the Securities and Exchange
25 Commission following the end of the fiscal quarter in which the GAAP change occurs; and incurring
26 obligations under authorized credit or reimbursement agreements is not considered to be the
27 incurrence of long-term indebtedness which is subject to the conditions set forth in this Order.

28 IT IS FURTHER ORDERED that Tucson Electric Power Company shall not enter into any

1 agreement/contract for any financial derivative security or similar instrument other than those
2 authorized by the Commission, and the execution by Tucson Electric Power Company of any such
3 transaction may be grounds for summary revocation by the Commission of the general authorization
4 to issue long-term indebtedness authorized in this proceeding. (This provision is not intended to place
5 any restriction on hedging activities pertaining to energy procurement).

6 IT IS FURTHER ORDERED that Tucson Electric Power Company shall not enter into the
7 interest hedging program as proposed by Tucson Electric Power Company in its Financing
8 Application.

9 IT IS FURTHER ORDERED that Tucson Electric Power Company shall not enter into any
10 floating-for-fixed interest rate swap agreements (i.e., pay floating rate and receive fixed rate) that
11 have the economic effect of converting fixed cost long-term debt to floating/variable cost debt.

12 IT IS FURTHER ORDERED that for purposes of calculating the \$350 million aggregate
13 limit on the outstanding balance of floating/variable cost rate long-term debt authorized above, in the
14 event that the Commission authorizes the use of floating-for-fixed interest rate swap agreements, the
15 amount of floating/variable cost rate debt shall be deemed to have been increased by the notional
16 amount of any such swap agreements in effect on the date of such determination.

17 IT IS FURTHER ORDERED that Tucson Electric Power Company may enter into fixed-for-
18 floating interest rate swap agreements (i.e. pay fixed rate and receive floating rate) for the purpose of
19 reducing interest rate risk on its floating/variable cost rate debt, and that for purposes of calculating
20 the \$350 million aggregate limit on the outstanding balance of floating/variable cost rate debt above,
21 the amount of floating/variable cost rate debt shall be deemed to have been reduced by (i) the
22 notional amount of any fixed-for-floating interest rate swap agreements in effect on the date of such
23 determination and (ii) the principal amount of any floating/variable cost rate debt owned by Tucson
24 Electric Power Company.

25 IT IS FURTHER ORDERED that it is in the public interest for the Commission to exercise
26 oversight of the use by Tucson Electric Power Company of interest rate swap agreements, U.S.
27 Treasury rate-lock agreements, and other interest rate derivatives through December 31, 2016.

28 IT IS FURTHER ORDERED that Tucson Electric Power Company shall file confirmation

1 with the Commission's Docket Control within 90 days of the effective date of this Order certifying
2 that it has established an appropriate management policy/system of internal controls formally
3 approved by Tucson Electric Power Company's Board of Directors designed to govern the use of
4 interest rate derivatives or other similar contracts to manage interest rate risk and/or exposure.

5 IT IS FURTHER ORDERED that any authorization granted Tucson Electric Power Company
6 to engage in financial derivative securities or similar contracts to manage interest rate risk and/or
7 exposure should specifically exclude use of such authorization for speculative purposes.

8 IT IS FURTHER ORDERED that Tucson Electric Power Company is authorized to issue
9 forward-starting swaps based on LIBOR or U.S. Treasuries and U.S. Treasury rate-locks for the
10 purpose of hedging changes in interest rates up to 18 months in advance of planned issuances of
11 fixed-rate taxable long-term debt having final maturity of five years or longer.

12 IT IS FURTHER ORDERED that this Order does not establish the ratemaking treatment for
13 the cash settlement of any hedging contracts, as requested by Tucson Electric Power Company in
14 this docket, on the basis that such determination is better made in the context of a rate case.

15 IT IS FURTHER ORDERED that Tucson Electric Power Company is authorized to execute,
16 deliver and perform all contracts, agreements, and other instruments which are incidental to any or
17 all of the foregoing authorizations or otherwise deemed by Tucson Electric Power Company to be
18 necessary, desirable or appropriate in connection therewith.

19 IT IS FURTHER ORDERED that the authorization to issue long-term debt into one or more
20 credit agreements for the revolving credit facilities and receive additional equity contributions shall
21 replace the existing authorizations of Decision No. 71788, that those authorizations expire upon the
22 effective date of the Order, and that all existing obligations incurred under lawful authorizations
23 shall remain valid.

24 IT IS FURTHER ORDERED that this Decision is be deemed effective upon issuance and
25 that Tucson Electric Power Company may enter into the transactions authorized under the Order
26 through December 31, 2016, and that all existing letter of credit facilities and all existing revolving
27 credit facilities that expire before January 1, 2021, incurred under lawful authorization shall remain
28 valid through their maturity dates.

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IT IS FURTHER ORDERED that within 90 days of the completion of any financing transaction under the authority set forth herein, Tucson Electric Power Company shall make a compliance filing with the Commission's Docket Control in which Tucson Electric Power Company shall provide copies of a summary of the transaction and provide a description of the business rationale for such financing or refinancing, including a demonstration that the rates and terms received by Tucson Electric Power Company were fair and reasonable under prevailing market conditions and provide to the Commission's Utilities Division Compliance Section a copy of the relevant agreements.

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, JODI JERICH, 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 _____ 2013.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

1 SERVICE LIST FOR: TUCSON ELECTRIC POWER COMPANY

2 DOCKET NO.: E-01933A-12-0176

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