

TUCSON ELECTRIC POWER CO
Form 10-K
February 28, 2012
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to .

Commission

Registrant; State of Incorporation;

IRS Employer

File Number

Address; and Telephone Number

Identification Number

1-13739

UNISOURCE ENERGY CORPORATION

86-0786732

(An Arizona Corporation)

88 E. Broadway Boulevard

Tucson, AZ 85701

Edgar Filing: TUCSON ELECTRIC POWER CO - Form 10-K

(520) 571-4000

1-5924

TUCSON ELECTRIC POWER COMPANY 86-0062700

(An Arizona Corporation)

88 E. Broadway Boulevard

Tucson, AZ 85701

(520) 571-4000

Securities registered pursuant to Section 12(b) of the Exchange Act:

Registrant	Title of Each Class	Name of Each Exchange on Which Registered
UniSource Energy Corporation	Common Stock, no par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Exchange Act:

Registrant	Title of Each Class	Name of Each Exchange on Which Registered
Tucson Electric Power Company	Common Stock, without par value	N/A

Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933.

UniSource Energy Corporation	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
Tucson Electric Power Company	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (Exchange Act).

UniSource Energy Corporation	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>
Tucson Electric Power Company	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

UniSource Energy Corporation	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
Tucson Electric Power Company	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Edgar Filing: TUCSON ELECTRIC POWER CO - Form 10-K

UniSource Energy Corporation Yes No
 Tucson Electric Power Company Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of each registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

UniSource Energy Corporation	Large Accelerated Filer <input checked="" type="checkbox"/>	Accelerated Filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>
	Smaller Reporting Company <input type="checkbox"/>		
Tucson Electric Power Company	Large Accelerated Filer <input type="checkbox"/>	Accelerated Filer <input type="checkbox"/>	Non-accelerated filer <input checked="" type="checkbox"/>
	Smaller Reporting Company <input type="checkbox"/>		

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

UniSource Energy Corporation Yes No
 Tucson Electric Power Company Yes No

The aggregate market value of UniSource Energy Corporation voting Common Stock held by non-affiliates of the registrant was \$1,361,485,759 based on the last reported sale price thereof on the consolidated tape on June 30, 2011.

At February 21, 2012, 37,956,169 shares of UniSource Energy Corporation Common Stock, no par value (the only class of Common Stock), were outstanding.

At February 21, 2012, 32,139,434 shares of Tucson Electric Power Company's Common Stock, no par value, were outstanding, all of which were held by UniSource Energy Corporation.

Tucson Electric Power Company meets the conditions set forth in General Instructions (I)(1)(a) and (b) on Form 10-K and is therefore filing this report with the reduced disclosure format.

Documents incorporated by reference: Specified portions of UniSource Energy Corporation's Proxy Statement relating to the 2012 Annual Meeting of Shareholders are incorporated by reference into Part III.

Table of Contents**Table of Contents**

<u>Definitions</u>		iv
<u>PART I</u>		
<u>Item 1. Business</u>		1
<u>Overview of Consolidated Business</u>		1
<u>TEP</u>		2
<u>Service Area and Customers</u>		2
<u>Generating and Other Resources</u>		4
<u>Fuel Supply</u>		7
<u>Transmission Access</u>		8
<u>Rates and Regulation</u>		9
<u>TEP's Utility Operating Statistics</u>		11
<u>Environmental Matters</u>		12
<u>UNS Gas</u>		15
<u>Service Territory and Customers</u>		15
<u>Gas Supply and Transmission</u>		15
<u>Rates and Regulation</u>		15
<u>Environmental Matters</u>		17
<u>UNS Electric</u>		17
<u>Service Territory and Customers</u>		17
<u>Power Supply and Transmission</u>		17
<u>Rates and Regulation</u>		18
<u>Environmental Matters</u>		19
<u>Other Non-Reportable Segments</u>		19
<u>Millennium</u>		19
<u>Employees</u>		19
<u>Executive Officers of the Registrants</u>		20
<u>SEC Reports Available on UniSource Energy's Website</u>		21
<u>Item 1A. Risk Factors</u>		21
<u>Item 1B. Unresolved Staff Comments</u>		27
<u>Item 2. Properties</u>		27
<u>TEP Properties</u>		27
<u>UES Properties</u>		28
<u>Item 3. Legal Proceedings</u>		28
<u>Item 4. Mine Safety Disclosures</u>		29
<u>PART II</u>		
<u>Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Common Equity</u>		29
<u>Item 6. Selected Consolidated Financial Data</u>		31
<u>UniSource Energy</u>		31
<u>TEP</u>		32
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>		33
<u>UniSource Energy Consolidated</u>		33
<u>Outlook and Strategies</u>		33
<u>Results of Operations</u>		34
<u>Liquidity and Capital Resources</u>		36
<u>Tucson Electric Power Company</u>		41
<u>Results of Operations</u>		41
<u>Factors Affecting Results of Operations</u>		48
<u>Liquidity and Capital Resources</u>		51

Table of Contents

<u>UNS Gas</u>	56
<u>Results of Operations</u>	56
<u>Factors Affecting Results of Operations</u>	57
<u>Liquidity and Capital Resources</u>	58
<u>UNS Electric</u>	60
<u>Results of Operations</u>	60
<u>Factors Affecting Results of Operations</u>	62
<u>Liquidity and Capital Resources</u>	63
<u>Other Non-Reportable Business Segments</u>	65
<u>Results of Operations</u>	65
<u>Factors Affecting Results of Operations</u>	66
<u>Critical Accounting Policies</u>	66
<u>Recently Issued Accounting Pronouncements</u>	70
<u>Safe Harbor for Forward-Looking Statements</u>	71
<u>Item 7A. Quantitative and Qualitative Disclosures about Market Risk</u>	71
<u>Item 8. Consolidated Financial Statements and Supplementary Data</u>	77
<u>Management's Reports on Internal Controls Over Financial Reporting</u>	77
<u>Reports of Independent Registered Public Accounting Firm</u>	78
<u>UniSource Energy Corporation</u>	
<u>Consolidated Statements of Income</u>	80
<u>Consolidated Statements of Cash Flows</u>	81
<u>Consolidated Balance Sheets</u>	82
<u>Consolidated Statements of Capitalization</u>	84
<u>Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income</u>	85
<u>Tucson Electric Power Company</u>	
<u>Consolidated Statements of Income</u>	86
<u>Consolidated Statements of Cash Flows</u>	87
<u>Consolidated Balance Sheets</u>	88
<u>Consolidated Statements of Capitalization</u>	90
<u>Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income</u>	91
<u>Notes to Consolidated Financial Statements</u>	
<u>Note 1. Nature of Operations and Summary of Significant Accounting Policies</u>	92
<u>Note 2. Regulatory Matters</u>	101
<u>Note 3. Segment and Related Information</u>	108
<u>Note 4. Commitments, Contingencies, and Proposed Environmental Matters</u>	111
<u>Note 5. Utility Plant and Jointly-Owned Facilities</u>	118
<u>Note 6. Debt, Credit Facilities, and Capital Lease Obligations</u>	119
<u>Note 7. Stockholders' Equity</u>	125
<u>Note 8. Income Taxes</u>	126
<u>Note 9. Employee Benefit Plans</u>	129
<u>Note 10. Share-Based Compensation Plan</u>	137
<u>Note 11. Fair Value Measurements</u>	140
<u>Note 12. UniSource Energy Earnings Per Share (EPS)</u>	145
<u>Note 13. Millennium Investments</u>	146
<u>Note 14. Recently Issued Accounting Pronouncements</u>	146
<u>Note 15. Supplemental Cash Flow Information</u>	147
<u>Note 16. Accounting for Derivative Instruments and Hedging Activities</u>	149
<u>Note 17. Quarterly Financial Data (Unaudited)</u>	151
<u>Schedule II Valuation and Qualifying Accounts</u>	153
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	154
<u>Item 9A. Controls and Procedures</u>	154

Table of Contents

PART III

<u>Item 10. Directors, Executive Officers and Corporate Governance of the Registrants</u>	155
<u>Item 11. Executive Compensation</u>	157
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	157
<u>Item 13. Certain Relationships and Related Transactions and Director Independence</u>	158
<u>Item 14. Principal Accountant Fees and Services</u>	158

PART IV

<u>Item 15. Exhibits and Financial Statement Schedules</u>	158
<u>Signatures</u>	159
<u>Exhibit Index</u>	162

Table of Contents**DEFINITIONS**

The abbreviations and acronyms used in the 2011 Form 10-K are defined below:

1992 Mortgage	TEP's Indenture of Mortgage and Deed of Trust, dated as of December 1, 1992, to the Bank of New York Mellon, successor trustee, as supplemented
1999 Settlement Agreement	TEP's Settlement Agreement approved by the ACC in November 1999 that provided for electric retail competition and transition asset recovery
2008 TEP Rate Order	A rate order issued by the ACC resulting in a new retail rate structure for TEP, effective December 1, 2008
ACC	Arizona Corporation Commission
AMT	Alternative Minimum Tax
AOCI	Accumulated Other Comprehensive Income
APS	Arizona Public Service Company
ARO	Asset Retirement Obligation
BART	Best Available Retrofit Technology
Base O&M	A non-GAAP financial measure that represents the fundamental level of operating and maintenance expense related to our business
Base Rates	The portion of TEP's and UNS Electric's Retail Rates attributed to generation, transmission, distribution costs and customer charge; and UNSGas' delivery costs and customer charge
BMGS	Black Mountain Generating Station
Btu	British thermal unit(s)
CCRs	Coal combustion residuals
Capacity	The ability to produce power; the most power a unit can produce or the maximum that can be taken under a contract; measured in MWs
CO2	Carbon dioxide
Common Stock	UniSource Energy's common stock, without par value
Company or UniSource Energy	UniSource Energy Corporation
Cooling Degree Days	An index used to measure the impact of weather on energy usage calculated by subtracting 75 from the average of the high and low daily temperatures
DSM	Demand side management
EE Standards	Electric and Gas Energy Efficiency Standards
Emission Allowance(s)	An allowance issued by the Environmental Protection Agency which permits emission of one ton of sulfur dioxide or one ton of nitrogenoxide; allowances can be bought and sold
Energy	The amount of power produced over a given period of time; measured in MWh
EPA	The Environmental Protection Agency
EL Paso	El Paso Electric Company
EPNG	El Paso Natural Gas Company
ESP	Energy Service Provider
Express Line	A dedicated 345-kV transmission line from Springerville Unit 2 to TEP's retail service area
FERC	Federal Energy Regulatory Commission
Fixed CTC	Competition Transition Charge that was included in TEP's retail rate for the purpose of recovering TEP's TRA; approximately \$58 million is being credited to customers through the PPFAC
Four Corners	Four Corners Generating Station
GAAP	Generally Accepted Accounting Principles
Gas EE Standards	Gas Utility Energy Efficiency Standards
GHG	Greenhouse gases
GWh	Gigawatt-hour(s)
Haddington	Haddington Energy Partners II, LP, a limited partnership that funds energy-related investments
Heating Degree Days	An index used to measure the impact of weather on energy usage calculated by subtracting the average of the high and low daily temperatures from 65

Table of Contents

IDBs	Industrial development revenue or pollution control revenue bonds
IRS	Internal Revenue Service
kWh	Kilowatt-hour(s)
kV	Kilovolt(s)
LIBOR	London Interbank Offered Rate
Long-Term Wholesale Margin Revenues	A non-GAAP measure that demonstrates the underlying profitability of TEP's long-term wholesale sales contracts
Luna	Luna Energy Facility
Mark-to-Market Adjustments	Forward energy sales and purchase contracts that are considered to be derivatives and are adjusted monthly by recording unrealized gains and losses to reflect the market prices at the end of each month
Millennium	Millennium Energy Holdings, Inc., a wholly-owned subsidiary of UniSource Energy
MMBtu	Million British Thermal Units
Mortgage Bonds	Bonds issued under the 1992 Mortgage
MW	Megawatt(s)
MWh	Megawatt-hour(s)
Navajo	Navajo Generating Station
NERC	North American Electric Reliability Corporation
NOx	Nitrogen oxide
NTUA	Navajo Tribal Utility Authority
O&M	Operations and Maintenance Expense
PGA	Purchased Gas Adjuster, a retail rate mechanism designed to recover the cost of gas purchased for retail gas customers
Pima Authority	The Industrial Development Authority of the County of Pima
PNM	Public Service Company of New Mexico
PPA	Power Purchase Agreement
PPFAC	Purchased Power and Fuel Adjustment Clause
PV	Photovoltaic
RES	Renewable Energy Standard and Tariff
Reimbursement Agreement	Reimbursement Agreement dated as of December 14, 2010 among TEP as borrower and a group of financial institutions
Retail Margin Revenues	A non-GAAP financial measure that demonstrates the underlying revenue trend and performance of our core utility businesses.
Retail Rates	Rates designed to allow a regulated utility an opportunity to recover its reasonable operating and capital costs and earn a return on its utility plant in service
Rules	Retail Electric Competition Rules
Sabinas	Carboelectrica Sabinas, S. de R.L. de C.V., a Mexican limited liability company; prior to June 2009, Millennium owned 50% of Sabinas
San Carlos	San Carlos Resources Inc., a wholly-owned subsidiary of TEP
San Juan	San Juan Generating Station
SERP	Supplemental Executive Retirement Plan
SCR	Selective catalytic reduction
SES	Southwest Energy Solutions, a wholly-owned subsidiary of Millennium
SO ₂	Sulfur dioxide
Springerville	Springerville Generating Station
Springerville Coal Handling Facilities Leases	Leveraged lease arrangements relating to the coal handling facilities serving Springerville
Springerville Common Facilities	Facilities at Springerville used in common with Springerville Unit 1 and Springerville Unit 2
Springerville Common Facilities Leases	Leveraged lease arrangements relating to an undivided one-half interest in certain Springerville Common Facilities.
Springerville Unit 1	Unit 1 of the Springerville Generating Station
Springerville Unit 1 Leases	Leveraged lease arrangement relating to Springerville Unit 1 and an undivided one-half interest in certain Springerville Common Facilities

Table of Contents

Springerville Unit 2	Unit 2 of the Springerville Generating Station
Springerville Unit 3	Unit 3 of the Springerville Generating Station
Springerville Unit 4	Unit 4 of the Springerville Generating Station
SRP	Salt River Project Agricultural Improvement and Power District
Sundt	H. Wilson Sundt Generating Station (formerly known as the Irvington Generating Station)
Sundt Lease	The leveraged lease arrangement relating to Sundt Unit 4
Sundt Unit 4	Unit 4 of the H. Wilson Sundt Generating Station
SWG	Southwest Gas Corporation
TEP	Tucson Electric Power Company, the principal subsidiary of UniSource Energy
TEP Credit Agreement	Second Amended and Restated Credit Agreement between TEP and a syndicate of Banks, dated as of November 9, 2010 (as amended)
TEP Letter of Credit Facility	Letter of credit facility under the TEP Credit Agreement
TEP Revolving Credit Facility	Revolving credit facility under the TEP Credit Agreement
Therm	A unit of heating value equivalent to 100,000 British thermal units (Btu)
TRA	Transition Recovery Asset, a \$450 million regulatory asset established in TEP's 1999 Settlement Agreement that was fully recovered in May 2008
Transwestern	Transwestern Pipeline Company
Tri-State	Tri-State Generation and Transmission Association
UED	UniSource Energy Development Company, a wholly-owned subsidiary of UniSource Energy, which engages in developing generation resources and other project development services and related activities
UES	UniSource Energy Services, Inc., an intermediate holding company established to own the operating companies (UNS Gas and UNS Electric) which acquired the Citizens Arizona gas and electric utility assets in 2003
UniSource Credit Agreement	Second Amended and Restated Credit Agreement between UniSource Energy and a syndicate of banks, dated as of November 9, 2010 (as amended)
UniSource Energy	UniSource Energy Corporation
UNS Electric	UNS Electric, Inc., a wholly-owned subsidiary of UES
UNS Electric Term Loan	Four-year \$30 million term loan agreement dated as of August 10, 2011.
UNS Gas	UNS Gas, Inc., a wholly-owned subsidiary of UES
UNS Gas/UNS Electric Revolver	Revolving credit facility under the Second Amended and Restated Credit Agreement among UNS Gas and UNS Electric as borrowers, and UES as guarantor, and a syndicate of banks, dated as of November 9, 2010 (as amended)
Valencia	Valencia power plant owned by UNS Electric
VEBA	Voluntary Employee Beneficiary Association
WAPA	Western Area Power Administration

Table of Contents

PART I

This combined Form 10-K is being filed separately by UniSource Energy Corporation and Tucson Electric Power Company (collectively, the Registrants). Information contained herein relating to any individual registrant is filed by such registrant on its own behalf. TEP does not make any representation as to information relating to any other subsidiary of UniSource Energy.

This Annual Report on Form 10-K contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. You should read forward-looking statements together with the cautionary statements and important factors included elsewhere in this Form 10-K. (See *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Safe Harbor for Forward-Looking Statements*). Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions. Forward-looking statements are not statements of historical facts. Forward-looking statements may be identified by the use of words such as anticipates, estimates, expects, intends, plans, predicts, projects, and similar expressions. We express our expectations and projections in good faith and believe them to have a reasonable basis. However, we make no assurances that management's expectations, beliefs or projections will be achieved or accomplished. In addition, UniSource Energy and TEP disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of this report.

ITEM 1. BUSINESS
OVERVIEW OF CONSOLIDATED BUSINESS

UniSource Energy is a holding company with no significant operations of its own. UniSource Energy's operating subsidiaries are separate legal entities with their own assets and liabilities. UniSource Energy owns the outstanding common stock of Tucson Electric Power Company (TEP), UniSource Energy Services, Inc. (UES), UniSource Energy Development Company (UED), and Millennium Energy Holdings, Inc. (Millennium).

Our business includes three primary business segments: TEP; UNS Gas, Inc. (UNS Gas); and UNS Electric, Inc. (UNS Electric). TEP is an electric utility serving the community of Tucson, Arizona. UES provides gas and electric service to more than 30 communities in northern and southern Arizona through its two operating subsidiaries, UNS Gas and UNS Electric.

Other subsidiaries include UED, which developed the Black Mountain Generating Station (BMGS) in northwestern Arizona in 2008. The facility, which includes two natural gas-fired combustion turbines, initially provided energy to UNS Electric through a power sales agreement. In July 2011, UNS Electric purchased BMGS from UED, leaving UED with no significant remaining assets. This transaction did not impact UniSource Energy's consolidated financial statements.

Millennium has existing investments in unregulated businesses that represented less than 1% of UniSource Energy's total assets as of December 31, 2011. We have no new investments planned for Millennium. Southwest Energy Solutions (SES) is a subsidiary of Millennium that provides supplemental labor and meter reading services to TEP, UNS Gas, and UNS Electric.

UniSource Energy was incorporated in the state of Arizona in 1995 and obtained regulatory approval to form a holding company in 1997. TEP and UniSource Energy exchanged shares of stock in 1998, making TEP a subsidiary of UniSource Energy.

Table of Contents**BUSINESS SEGMENT CONTRIBUTIONS**

The table below shows the contributions to our consolidated after-tax earnings by our three business segments.

	September 30, 2011	September 30, 2010	September 30, 2009
	-Millions of Dollars-		
TEP	\$ 85	\$ 108	\$ 91
UNS Gas	10	9	7
UNS Electric	18	15	11
Other ⁽¹⁾	(3)	(19)	(3)
Consolidated Net Income	\$ 110	\$ 113	\$ 106

⁽¹⁾ Includes: UniSource Energy parent company expenses; interest expense (net of tax) on UniSource Energy Convertible Senior Notes and on the UniSource Credit Agreement; Millennium; and UED.

See Note 3 for additional financial information regarding our business segments.

References in this report to we and our are to UniSource Energy and its subsidiaries, collectively.

Rates and Regulation of TEP, UNS Gas and UNS Electric

The Arizona Corporation Commission (ACC) regulates portions of TEP, UNS Gas and UNS Electric's utility accounting practices and energy rates. The ACC has authority over rates charged to retail customers, the issuance of securities, and transactions with affiliated parties. Our regulated utility Retail Rates for retail electric and natural gas service are determined on a cost of service basis. Retail Rates are designed to provide, after recovery of allowable operating expenses, an opportunity for our utility businesses to earn a reasonable return on rate base. Rate base is generally determined by reference to the original cost (net of depreciation) of utility plant in service to the extent deemed used and useful, and to various adjustments for deferred taxes and other items plus a working capital component. Over time, additions to utility plant in service increase rate base while depreciation and retirements of utility plant reduce rate base.

Retail Rates charged by TEP, UNS Gas and UNS Electric also include pass-through mechanisms that allow each utility to recover the actual costs of its fuel, transmission, and energy purchases.

The Federal Energy Regulatory Commission (FERC) regulates the terms and prices of transmission services and wholesale electricity sales, wholesale transport and purchases of natural gas and portions of our accounting practices. TEP and UNS Electric have FERC tariffs to sell power at market-based rates.

TEP

TEP was incorporated in the State of Arizona in 1963. TEP is the principal operating subsidiary of UniSource Energy. In 2011, TEP's electric utility operations contributed 77% of UniSource Energy's operating revenues and comprised 82% of its assets.

SERVICE AREA AND CUSTOMERS

TEP is a vertically integrated utility that provides regulated electric service to approximately 404,000 retail customers in southeastern Arizona. TEP's service territory covers 1,155 square miles and includes a population of approximately one million people in the greater Tucson metropolitan area in Pima County, as well as parts of Cochise County. TEP also sells electricity to other utilities and power marketing entities in the western United States.

Retail Customers

Edgar Filing: TUCSON ELECTRIC POWER CO - Form 10-K

TEP provides electric utility service to a diverse group of residential, commercial, industrial, and public sector customers. Major industries served include copper mining, cement manufacturing, defense, health care, education, military bases and other governmental entities. TEP's retail sales are influenced by several factors, including economic conditions, seasonal weather patterns, demand side management (DSM) initiatives and increasing use of energy efficient products, and opportunities for customers to generate their own electricity.

K-2

Table of Contents**Customer Base**

The table below shows the percentage distribution of TEP's energy sales by major customer class over the last three years. Over the next several years, the retail energy consumption by customer class is expected to be similar to the historical distribution.

	September 30, 2011	September 30, 2010	September 30, 2009
Residential	42%	42%	42%
Commercial	21%	21%	21%
Non-mining Industrial	23%	23%	23%
Mining	11%	12%	11%
Public Authority	3%	2%	3%

Local, regional, and national economic factors can impact the growth in the number of customers in TEP's service territory. In 2009, 2010 and 2011, TEP's average number of retail customers increased by less than 1% per year.

Two of TEP's largest retail customers are in the copper mining industry. TEP's kilowatt-hour (kWh) sales to mining customers depend on a variety of factors including the market price of copper, the Retail Rate paid by mining customers, and the mines' potential development of their own electric generation resources. TEP's kWh sales to mining customers increased by 0.3% in 2011 and 1.4% in 2010 as a result of increased production due to high copper prices.

We expect the number of TEP's retail customers to increase at a rate of approximately 0.5% in 2012 and approximately 0.9% in 2013.

Sales Volumes

Weak economic conditions and the implementation of energy efficiency programs have had a negative impact on electricity sales. In 2009 and 2010, TEP's retail kWh sales declined by 1.4% and 0.8%, respectively. In 2011, TEP's retail kWh sales were 0.4% above 2010 due in part to a 0.3% increase in the average number of retail customers. In 2012, we expect kWh sales to TEP's retail customers to be near the same level as 2011.

Energy Service Providers

Although the ACC's Retail Electric Competition Rules contemplated that TEP's retail customers may be eligible to choose an alternative energy service provider (ESP), portions of those Rules have been invalidated by the Arizona courts and there are no ESPs currently authorized to provide alternative retail electric service to TEP's customers. See *Rates and Regulation*, below for more information regarding the status of retail competition in Arizona.

Wholesale Business

TEP's electric utility operations include the wholesale marketing of electricity to other utilities and power marketers. Wholesale sales transactions are made on both a firm and interruptible basis. A firm contract requires TEP to supply power on demand (except under limited emergency circumstances), while an interruptible contract allows TEP to stop supplying power under defined conditions. See *Generating and Other Resources, Purchases and Interconnections*, below.

Generally, TEP commits to future sales based on expected excess generating capability, forward prices and generation costs, using a diversified portfolio approach to provide a balance between long-term, mid-term and spot energy sales. When TEP expects to have excess generating capacity and energy (usually in the first, second and fourth calendar quarters), its wholesale sales consist primarily of two types of sales:

Long-Term Sales

Long-term wholesale sales contracts cover periods of more than one year. TEP typically uses its own generation to serve the requirements of its long-term wholesale customers. TEP currently has long-term contracts with three entities to sell energy:

Edgar Filing: TUCSON ELECTRIC POWER CO - Form 10-K

From January 1, 2012 through the end of the contract in May 2016, SRP is required to purchase 500,000 MWh of on-peak energy per year. TEP does not receive a demand charge and the price of energy is based on a discount to the Palo Verde Market Index. Prior to June 1, 2011, TEP received an annual demand charge of approximately \$22 million.

K-3

Table of Contents

Navajo Tribal Utility Authority (NTUA) expires in December 2015. TEP serves the portion of NTUA's load that is not served by the authority's allocation of federal hydroelectric power. Over the last three years, sales to NTUA averaged 225,000 MWh per year. Since 2010, the price of 50% of the MWh sales to NTUA from June to September has been based on the Palo Verde Market Index. In 2011, approximately 12% of the total energy sold to NTUA was priced based on the Palo Verde Market Index. The remaining power sales occur at a fixed price under TEP's contract with NTUA.

Tohono O'odham Utility Authority 2 MW, expires in 2014.

Short-Term Sales

Forward contracts commit TEP to sell a specified amount of capacity or energy at a specified price over a given period of time, typically for one-month, three-month or one-year periods. TEP also engages in short-term sales by selling energy in the daily or hourly markets at fluctuating spot market prices and making other non-firm energy sales. All revenues from short-term wholesale sales offset fuel and purchased power costs and are passed through to TEP retail customers. TEP uses short-term wholesale sales as part of its hedging strategy to reduce customer exposure to fluctuating power prices. See *Rates and Regulation*, below.

See *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power Company, Factors Affecting Results of Operations*, for additional discussion of TEP's wholesale marketing activities.

GENERATING AND OTHER RESOURCES

At December 31, 2011, TEP owned or leased 2,262 MW of net generating capability, as set forth in the following table:

Generating Source	Unit No.	Location	Date In Service	Fuel Type	Net Capacity MW	Operating Agent	TEP's Share %	September 30, MW
Springerville Station ⁽¹⁾	1	Springerville, AZ	1985	Coal	401	TEP	100.0	401
Springerville Station	2	Springerville, AZ	1990	Coal	403	TEP	100.0	403
San Juan Station	1	Farmington, NM	1976	Coal	340	PNM	50.0	170
San Juan Station	2	Farmington, NM	1973	Coal	340	PNM	50.0	170
Navajo Station	1	Page, AZ	1974	Coal	750	SRP	7.5	56
Navajo Station	2	Page, AZ	1975	Coal	750	SRP	7.5	56
Navajo Station	3	Page, AZ	1976	Coal	750	SRP	7.5	56
Four Corners Station	4	Farmington, NM	1969	Coal	784	APS	7.0	55
Four Corners Station	5	Farmington, NM	1970	Coal	784	APS	7.0	55
Luna Energy Facility	1	Deming, NM	2006	Gas	555	PNM	33.3	185
Sundt Station	1	Tucson, AZ	1958	Gas/Oil	81	TEP	100.0	81
Sundt Station	2	Tucson, AZ	1960	Gas/Oil	81	TEP	100.0	81
Sundt Station	3	Tucson, AZ	1962	Gas/Oil	104	TEP	100.0	104
Sundt Station	4	Tucson, AZ	1967	Coal/Gas	156	TEP	100.0	156
Sundt Internal								
Combustion Turbines		Tucson, AZ	1972-1973	Gas/Oil	50	TEP	100.0	50
DeMoss Petrie		Tucson, AZ	1972	Gas/Oil	75	TEP	100.0	75
North Loop		Tucson, AZ	2001	Gas	95	TEP	100.0	95
Springerville Solar Station		Springerville, AZ	2002-2010	Solar	6	TEP	100.0	6
Community Solar Projects		Tucson, AZ	2010	Solar	7	TEP	100.0	7
Total TEP Capacity ⁽²⁾								2,262

⁽¹⁾ Leased asset as of December 31, 2011.

Edgar Filing: TUCSON ELECTRIC POWER CO - Form 10-K

- ⁽²⁾ Excludes 1,009 MW of additional resources, which consist of certain capacity purchases and interruptible retail load. At December 31, 2011, total owned capacity was 1,861 MW and leased capacity was 401 MW.

K-4

Table of Contents

Springerville Generating Station

Springerville Unit 1 is leased by TEP and Unit 2 is owned by San Carlos, a wholly-owned subsidiary of TEP. TEP's other interests in the Springerville Generating Station include the Springerville Coal Handling Facilities and the Springerville Common Facilities.

The terms of the Springerville Unit 1 Leases, which include a 50% interest in the Springerville Common Facilities, expire in 2015 but have optional fair market value renewal and purchase provisions. In 1985, TEP sold and leased back the remaining 50% interest in the Springerville Common Facilities.

In December 2011, TEP and the owner participants of the Springerville Unit 1 Leases completed a formal appraisal procedure to determine the fair market value purchase price. The formal appraisal process was completed in accordance with the Springerville Unit 1 lease agreements. The purchase price was determined to be \$478 per kW of capacity. TEP has until September 2013 to give notice that it will exercise its purchase option, with the purchase occurring in January 2015. TEP can choose to exercise this option to purchase any or all of the lease interests not currently owned by TEP; TEP currently owns a 14% undivided interest in Springerville Unit 1. If TEP chooses to purchase all of the remaining interests in Springerville Unit 1 from the owner participants, the aggregate purchase price would be \$159 million.

The Springerville Common Facilities Leases, which expire in 2017 and 2021, have optional fair market value renewal options as well as a fixed-price purchase provision. The fixed prices to acquire the leased interests in the Springerville Common Facilities are \$38 million in 2017 and \$68 million in 2021.

In 1984, TEP sold and leased back the Springerville Coal Handling Facilities. Since entering the lease, TEP purchased a 13% ownership interest in the Springerville Coal Handling Facilities. The terms of the Springerville Coal Handling Facilities Leases expire in 2015 but have optional fixed-rate renewal options if certain conditions are satisfied as well as a fixed-price purchase provision of \$120 million.

See Note 6 and Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power Company, Liquidity and Capital Resources, Contractual Obligations*, for more information regarding the Springerville leases.

Sundt Generating Station

The Sundt Generating Station and the internal combustion turbines located in Tucson are designated as must-run generation facilities. Must-run generation units are required to run in certain circumstances to maintain distribution system reliability and to meet local load requirements.

In 2010, TEP purchased 100% of the equity interest in the Sundt Unit 4 lease for approximately \$51 million, redeemed the outstanding Sundt Unit 4 lease debt of \$5 million, and terminated the lease agreement.

Renewable Energy Resources

Owned Resources

As of December 31, 2011, TEP's owned photovoltaic (PV) solar generating capacity totaled 13 MW. The Springerville Generating Station solar system, which is located near TEP's Springerville coal-fired facility in eastern Arizona, includes 43,380 PV modules, with a total capacity of 6 MW. TEP's remaining 7 MW of PV solar generating capacity is located in the city of Tucson.

Power Purchase Agreements

In order to meet the ACC's renewable energy requirements, TEP has power purchase agreements (PPAs) for 130 MW of capacity from solar resources, 50 MW of capacity from wind resources and 2 MW of capacity from a landfill gas generation plant. As of December 31, 2011, approximately 2 MW of contracted solar resources and 50 MW of contracted wind resources were operational. The remaining resources are expected to be developed over the next several years. The solar PPAs contain options that would allow TEP to purchase all or part of the related project at a future period. See *Rates and Regulation, Renewable Energy Standard and Tariff* below for more information.

Table of Contents

Purchases and Interconnections

TEP purchases power from other utilities and power marketers. TEP may enter into contracts: (a) to purchase energy under long-term contracts to serve retail load and long-term wholesale contracts, (b) to purchase capacity or energy during periods of planned outages or for peak summer load conditions, and (c) to purchase energy for resale to certain wholesale customers under load and resource management agreements.

TEP typically uses generation from its gas-fired units, supplemented by purchased power, to meet the summer peak demands of its retail customers. Some of these PPAs are price-indexed to natural gas prices. Due to its increasing seasonal gas and purchased power usage, TEP hedges a portion of its total natural gas exposure with fixed price contracts for a maximum of three years. TEP also purchases energy in the daily and hourly markets to meet higher than anticipated demands, to cover unplanned generation outages, or when doing so is more economical than generating its own energy.

TEP is a member of a regional reserve-sharing organization and has reliability and power sharing relationships with other utilities. These relationships allow TEP to call upon other utilities during emergencies, such as plant outages and system disturbances, and reduce the amount of reserves TEP is required to carry.

As a result of the Energy Policy Act of 2005, owners and operators of bulk power transmission systems, including TEP, are subject to mandatory reliability standards that are developed and enforced by the North American Electric Reliability Corporation (NERC) and subject to the oversight of the FERC. TEP periodically reviews its operating policies and procedures to ensure continued compliance with these standards.

Springerville Units 3 and 4

Springerville Units 3 and 4 are each approximately 400 MW coal-fired generating facilities that are operated, but not owned by TEP. These facilities are located at the same site as TEP's Springerville Units 1 and 2. The owners of Units 3 and 4 compensate TEP for operating the facilities and pay an allocated portion of the fixed costs related to the Springerville Common Facilities and Coal Handling Facilities. See *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power Company, Factors Affecting Results of Operations, Springerville Units 3 and 4.*

Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power Company, Factors Affecting Results of Operations, Springerville Units 3 and 4.

Peak Demand and Resources

Peak Demand	September 30, 2011	September 30, 2010	September 30, 2009 -MW-	September 30, 2008	September 30, 2007
Retail Customers	2,334	2,333	2,354	2,376	2,386
Firm Sales to Other Utilities	322	340	385	394	369
Coincident Peak Demand (A)	2,656	2,673	2,739	2,770	2,755
Total Generating Resources	2,262	2,245	2,229	2,204	2,204
Other Resources ⁽¹⁾	1,009	799	781	966	785
Total TEP Resources (B)	3,271	3,044	3,010	3,170	2,989
Total Margin (B) (A)	615	371	271	400	234
Reserve Margin (% of Coincident Peak Demand)	23%	14%	10%	14%	8%

⁽¹⁾ Other Resources include firm power purchases and interruptible retail and wholesale loads. Additional firm power purchases were made in 2009 and 2010 to displace more expensive owned gas generation.

Peak demand occurs during the summer months due to the cooling requirements of TEP's retail customers. Retail peak demand varies from year-to-year due to weather, economic conditions and other factors. TEP's retail peak demand declined from 2008 to 2010 due primarily to weak

Edgar Filing: TUCSON ELECTRIC POWER CO - Form 10-K

economic conditions and the implementation of energy efficiency programs.

The chart above shows the relationship over a five-year period between TEP's peak demand and its energy resources. TEP's total margin is the difference between total energy resources and coincident peak demand, and

K-6

Table of Contents

the reserve margin is the ratio of margin to coincident peak demand. TEP's reserve margin in 2011 was in compliance with reliability criteria set forth by the Western Electricity Coordinating Council, a regional council of NERC.

Forecasted retail peak demand for 2012 is 2,269 MW, compared with actual peak demand of 2,334 MW in 2011 when cooling degree days exceeded the ten-year average by 4%. TEP's 2012 estimated retail peak demand is based on normal weather patterns. TEP believes existing generation capacity and power purchase agreements are sufficient to meet expected demand in 2012.

Future Generating Resources

TEP will add generating resources and/or import capability to meet forecasted retail and firm wholesale load. TEP anticipates that additional import capacity and/or additional local peaking resources of 75 to 150 MW may be required by 2018. TEP expects to add approximately 5 MW of new solar PV resources in 2012.

FUEL SUPPLY**Fuel Summary**

Fuel cost and usage information is provided below:

	September 30, 2011	September 30, Average Cost per MMBtu Consumed 2010	September 30, 2009	September 30, 2011	September 30, Percentage of Total Btu Consumed 2010	September 30, 2009
Coal	\$ 2.42	\$ 2.23	\$ 2.11	92%	90%	90%
Gas	\$ 5.20	\$ 4.69	\$ 4.51	8%	10%	10%
All Fuels	\$ 2.65	\$ 2.47	\$ 2.34	100%	100%	100%

Coal

TEP's principal fuel for electric generation is low-sulfur, bituminous or sub-bituminous coal from mines in Arizona, New Mexico and Colorado. More than 90% of TEP's coal supply is purchased under long-term contracts, which results in more predictable prices. The average cost per ton of coal, including transportation, for 2011, 2010 and 2009 was \$46.64, \$41.99, and \$39.81, respectively.

Station	September 30, Coal Supplier	September 30, 2011 Coal Consumption (tons in 000 s)	September 30, Contract Expiration	September 30, Avg. Sulfur Content	September 30, Coal Obtained From (A)
Springerville	Peabody Coalsales	3,123	2020	0.9%	Lee Ranch Coal Co.
Four Corners	BHP Billiton	387	2016	0.8%	Navajo Indian Tribe
San Juan					Federal and State
	San Juan Coal Co.	1,217	2017	0.8%	Agencies
Navajo					Navajo and Hopi Indian
	Peabody Coalsales	529	2019	0.4%	Tribes
Sundt	Peabody Coalsales	265	2012	0.5%	Twentymile Mine

(A) Substantially all of the suppliers' mining leases extend at least as long as coal is being mined in economic quantities.
TEP Operated Generating Facilities

Edgar Filing: TUCSON ELECTRIC POWER CO - Form 10-K

TEP is the operator, and sole owner (or lessee), of the Springerville Units 1 and 2 and Sundt Unit 4. The coal supplies for Springerville Units 1 and 2 are transported approximately 200 miles by railroad from northwestern New Mexico. TEP expects coal reserves to be sufficient to supply the estimated requirements for Springerville Units 1 and 2 for their presently estimated remaining lives.

The coal supplies for Sundt are transported approximately 1,300 miles by railroad from Colorado. Prior to 2010, Sundt Unit 4 was predominantly fueled by coal; however, the generating station also can be operated with natural gas. Both fuels are combined with methane, a renewable energy resource, piped in from a nearby landfill. Since 2010, TEP has fueled Sundt Unit 4 with both coal and natural gas depending on which resource is most economic. In 2012, TEP expects to fuel Sundt Unit 4 with natural gas. See Note 4 for more information.

K-7

Table of Contents

Generating Facilities Operated by Others

TEP also participates in jointly-owned coal-fired generating facilities at the Four Corners Generating Station (Four Corners), the Navajo Generating Station (Navajo) and the San Juan Generating Station (San Juan). Four Corners, which is operated by Arizona Public Service (APS), and San Juan, which is operated by PNM, are mine-mouth generating stations located adjacent to the coal reserves. Navajo, which is operated by SRP, obtains its coal supply from a nearby coal mine and a dedicated rail delivery system. The coal supplies are under long-term contracts administered by the operating agents. TEP expects coal reserves available to these three jointly-owned generating facilities to be sufficient for the remaining presently estimated lives of the stations.

Natural Gas Supply

TEP typically uses generation from its facilities fueled by natural gas, in addition to energy from its coal-fired facilities and purchased power, to meet the summer peak demands of its retail customers and local reliability needs. TEP purchases gas from Southwest Gas Corporation under a retail tariff for North Loop's 95 MWs of internal combustion turbines and receives distribution service under a transportation agreement for DeMoss Petrie, a 75 MW internal combustion turbine. TEP purchases capacity from El Paso Natural Gas Company (EPNG) for transportation from the San Juan and Permian Basins to its Sundt plant under a contract that expires in April 2013, with right-of-first-refusal for continuation thereafter. TEP also buys gas from third-party suppliers for Sundt and DeMoss Petrie.

TEP purchases gas transportation for Luna from EPNG from the Permian Basin to the plant site under an agreement effective through January 2017, with right-of-first-refusal for continuation thereafter. TEP purchases gas for its share of Luna from various suppliers in the Permian Basin region.

TRANSMISSION ACCESS

TEP has transmission access and power transaction arrangements with over 120 electric systems or suppliers. TEP also has various ongoing projects that are designed to increase access to the regional wholesale energy market and improve the reliability, capacity and efficiency of its existing transmission and distribution systems.

TEP is participating in the continuation of the 500 kV transmission line from the Pinal West substation to the Pinal Central substation. TEP is also in the process of obtaining permits to build a 40-mile 500-kV transmission line from the Pinal Central substation to the Tortolita substation northwest of Tucson to further enhance its ability to access the region's energy resources. TEP expects the transmission lines to be in service in 2014. As a result of these high-voltage transmission additions, TEP anticipates that its ability to import energy into its service territory should increase by at least 250 MW.

Tucson to Nogales Transmission Line

TEP and UNS Electric are parties to a project development agreement initiated in 2000 for the joint construction of a 60-mile 345kV transmission line from Tucson to Nogales, Arizona. The project development agreement was initiated in response to an order by the ACC to improve reliability to UNS Electric's retail customers in Nogales and surrounding Santa Cruz County by building a second transmission line to Nogales. TEP received approval from the ACC for construction along a specific route in 2002. However, due to an impasse with the US Forest Service, UNS Electric has taken alternative steps towards improving service reliability in the area.

As of December 31, 2011, TEP had capitalized \$11 million related to the project, including \$2 million of land and land rights. If TEP does not receive the required approvals or abandons the project, TEP believes that cost recovery is probable for prudent and reasonably incurred costs related to the project as a consequence of the ACC's requirement for a second transmission line serving Santa Cruz County.

Table of Contents

RATES AND REGULATION

Purchased Power and Fuel Adjustment Clause

The PPFAC allows TEP to recover its fuel, transmission, and purchased power costs, including demand charges, and the prudent costs of contracts for hedging fuel and purchased power costs from its retail customers. The PPFAC consists of a forward component and a true-up component.

The forward component is updated on April 1 of each year. The forward component is based on the forecasted fuel and purchased power costs for the 12-month period from April 1 to March 31 of the following year, less the base fuel, transmission, and purchased power costs embedded in Base Rates.

The true-up component will reconcile any over/under collected amounts from the preceding 12-month period and will be credited to or recovered from customers in the subsequent year.

For the 12 month period ending March 31, 2012, the PPFAC rate of 0.5 cents per kWh includes a forward component charge of 0.1 cents per kWh and the true-up component charge of 0.4 cents per kWh.

As part of the reconciliation of fuel and purchased power costs and PPFAC revenues, TEP credits, among other things, 100% of short-term wholesale revenues against the recoverable costs.

As part of the 2008 Rate Order, TEP was required to credit \$58 million of previously collected revenues to customers through the PPFAC. As a result, the PPFAC charge has been zero since it became effective in January 2009. As of November 2011, the \$58 million was fully refunded to customers and TEP began deferring the PPFAC eligible costs until a new PPFAC rate is approved by the ACC.

In February 2012, TEP filed its annual PPFAC update report with the ACC. TEP is requesting an increase in the total PPFAC rate from approximately 0.5 cents per kWh to 0.8 cents per kWh. The proposed PPFAC rate includes a forward component charge of approximately 0.3 cents per kWh and a true-up component charge of approximately 0.5 cents per kWh. TEP's proposed PPFAC rate, including the forward component, is expected to collect approximately \$77 million of under-collected fuel and purchased power costs. If the ACC approves TEP's PPFAC filing, it is anticipated that the new PPFAC rate would be implemented on April 1, 2012.

Base Rate Increase Moratorium

TEP's Base Rates are frozen through December 31, 2012. TEP is prohibited from submitting an application for new Base Rates before June 30, 2012. The test year to be used in TEP's next Base Rate application must conclude no earlier than December 31, 2011.

Notwithstanding the Base Rate increase moratorium, Base Rates and adjustor mechanisms may be changed in emergency conditions beyond TEP's control if the ACC concludes such changes are required to protect the public interest. The moratorium does not preclude TEP from seeking rate relief in the event of the imposition of a federal carbon tax or related regulations.

Renewable Energy Standard and Tariff

The ACC's Renewable Energy Standard and Tariff (RES) requires TEP, UNS Electric and other affected utilities to increase their use of renewable energy each year until it represents at least 15% of their total annual retail energy requirements in 2025. Affected utilities must file annual RES implementation plans for review and approval by the ACC. The approved cost of carrying out those plans is recovered from retail customers through the RES surcharge. Any RES surcharge collections above or below the costs incurred to implement the plans are deferred and reflected in TEP's financial statements as a regulatory asset or liability.

In 2011, TEP spent \$34 million on its 2011 RES implementation and met the 2011 renewable energy target of 3%. TEP expects to collect \$30 million in surcharges from retail customers in 2012 to implement its RES plan and expects to meet the 2012 renewable energy target of 3.5%.

Table of Contents

For more information, see *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, Tucson Electric Power Company, Factors Affecting Results of Operations, Renewable Energy Standard and Tariff.*

Electric Energy Efficiency Standards and Decoupling

In August 2010, the ACC approved EE Standards designed to require TEP, UNS Electric and other affected electric utilities to implement cost-effective programs to reduce customers' energy consumption. In 2011, TEP estimates its programs saved energy equal to 1.4% of its 2010 sales. In 2012, the EE Standards target total kWh savings of 3.0% of 2011 sales. The EE Standards increase annually thereafter up to a targeted cumulative annual reduction in retail kWh sales of 22% by 2020.

In January 2012, TEP filed a modification to its Energy Efficiency Implementation Plan with the ACC. The proposal includes a request for an increase in the performance incentive based on TEP's ability to meet the EE targets for 2012 and for 2013. TEP's proposed annual performance incentive for 2012 and 2013 ranges from \$6 million to \$8 million. TEP expects the ACC to issue a decision on this matter in the first quarter of 2012.

The EE Standards can be met by new and existing DSM programs, direct load control programs and energy efficient building codes. The EE Standards provide for the recovery of costs incurred to implement DSM programs. TEP's programs and rates charged to customers for such programs are subject to annual approval by the ACC.

Decoupling

In December 2010, the ACC issued a policy statement recognizing the need to adopt rate decoupling or another mechanism to make Arizona's EE Standards viable. A decoupling mechanism is designed to encourage energy conservation by restructuring utility Retail Rates to separate the recovery of fixed costs from the level of energy consumed. The policy statement allows affected utilities to file rate decoupling proposals in their next general rate case. TEP expects to file its next general rate case on or after June 30, 2012.

Retail Electric Competition Rules

In 1999, the ACC approved the Retail Electric Competition Rules (Rules) that provided a framework for the introduction of retail electric competition in Arizona. Certain portions of the ACC Rules that enabled ESPs to compete in the retail market were invalidated by an Arizona Court of Appeals decision in 2005. In 2008, the ACC opened an administrative proceeding to address the Rules. Unless and until the ACC clarifies the Rules or authorizes alternative ESPs to provide retail electric service, and ESPs offer to provide energy in TEP's service area, it is not possible for TEP's retail customers to use alternative ESPs. We cannot predict what changes, if any, the ACC will make to the Rules.

Table of Contents**TEP S UTILITY OPERATING STATISTICS**

	September 30, 2011	September 30, 2010	September 30, 2009	September 30, 2008	September 30, 2007
Generation and Purchased Power kWh (000)					
Remote Generation	10,005,127	9,077,032	9,134,183	10,438,864	11,001,318
Local Tucson Generation (Oil, Gas & Coal)	906,496	1,492,885	1,131,399	1,016,254	1,065,778
Purchased Power	2,686,918	2,759,912	3,677,925	3,077,619	1,713,125
Total Generation and Purchased Power	13,598,541	13,329,829	13,943,507	14,532,737	13,780,221
Less Losses and Company Use	794,171	768,819	780,529	638,302	625,073
Total Energy Sold	12,804,370	12,561,010	13,162,978	13,894,435	13,155,148
Sales kWh (000)					
Residential	3,888,011	3,869,540	3,905,696	3,852,707	4,004,797
Commercial	1,972,526	1,963,469	1,988,356	2,034,453	2,057,982
Industrial	2,145,163	2,138,749	2,160,946	2,263,706	2,341,025
Mining	1,083,071	1,079,327	1,064,830	1,095,962	983,173
Public Authorities	243,336	240,703	250,915	255,817	247,430
Total Electric Retail Sales	9,332,107	9,291,788	9,370,743	9,502,645	9,634,407
Electric Wholesale Sales	3,472,263	3,269,222	3,792,235	4,391,790	3,520,741
Total Electric Sales	12,804,370	12,561,010	13,162,978	13,894,435	13,155,148
Operating Revenues (000)					
Residential	\$ 383,908	\$ 372,212	\$ 377,761	\$ 351,079	\$ 362,967
Commercial	223,621	217,032	219,694	211,639	213,364
Industrial	164,024	159,937	163,720	164,849	168,279
Mining	65,720	62,112	61,033	55,619	48,707
Public Authorities	20,024	19,128	19,865	19,146	18,332
RES and DSM	46,633	37,767	25,443	2,781	
Other				415	4,822
Total Electric Retail Sales	903,930	868,188	867,516	805,528	816,471
CTC To Be Refunded				(58,092)	
Wholesale Revenue- Long-Term	41,056	55,653	48,249	57,493	55,788
Wholesale Revenue- Short-Term	72,798	71,435	84,410	197,754	126,732
California Power Exchange					
Provision for Wholesale Refunds		(2,970)	(4,172)		
Transmission	16,392	20,863	18,974	17,173	14,842
Other Revenues	122,210	112,098	84,361	72,292	56,956
Total Operating Revenues	\$ 1,156,386	\$ 1,125,267	\$ 1,099,338	\$ 1,092,148	\$ 1,070,789
Customers (End of Period)					
Residential	367,396	366,217	365,157	363,861	361,945
Commercial	36,203	35,877	35,759	35,432	34,759
Industrial	636	635	629	633	641
Mining	2	2	2	2	2
Public Authorities	62	62	61	61	61

Edgar Filing: TUCSON ELECTRIC POWER CO - Form 10-K

Total Retail Customers	404,299	402,793	401,608	399,989	397,408
Average Retail Revenue per kWh Sold (cents)					
Residential	9.9	9.6	9.7	9.1	9.1
Commercial	11.3	11.1	11.0	10.4	10.4
Industrial and Mining	7.1	6.9	7.0	6.6	6.6
Average Retail Revenue per kWh Sold	9.7	9.3	9.3	8.5	8.5
Average Revenue per Residential Customer	\$ 1,047	\$ 1,018	\$ 1,036	\$ 968	\$ 1,009
Average kWh Sales per Residential Customer	10,606	10,579	10,708	10,621	11,129

K-11

Table of Contents

ENVIRONMENTAL MATTERS

Air and water quality, resource extraction, waste management and land use are regulated by federal, state and local authorities. TEP facilities are in substantial compliance with existing regulations.

Clean Air Act Requirements

TEP generating facilities are subject to Environmental Protection Agency (EPA) limits on the amount of sulfur dioxide (SO₂), nitrogen oxide (NOx) and other emissions released into the atmosphere. TEP capitalized \$8 million in 2011, \$18 million in 2010 and \$24 million in 2009 in construction costs to comply with environmental requirements, including TEP's share of new pollution control equipment installed at San Juan described below. TEP expects to capitalize environmental compliance costs of \$7 million in 2012 and \$25 million in 2013.

TEP recorded operating expenses of \$12 million in 2011, \$14 million in 2010 and \$13 million in 2009 related to environmental compliance. TEP expects to record \$14 million in operating expenses related to environmental compliance in 2012. TEP may incur additional costs to comply with future changes in federal and state environmental laws, regulations and permit requirements at existing electric generating facilities. Compliance with these changes may reduce operating efficiency.

TEP has sufficient Emission Allowances to comply with acid rain SO₂ regulations.

EPA Information Request

TEP has submitted its response to the request received in 2010 from the EPA under Section 114 of the Clean Air Act for information regarding projects and operations at the Sundt Generating Station. TEP owns and operates all four units at Sundt. Units 1, 2 and 3 can be operated on either natural gas or diesel oil. Unit 4 can be operated on either natural gas or coal.

The EPA uses information obtained from such requests to determine if additional action is necessary. TEP can neither predict whether the EPA will take further action at Sundt nor project the impact of any such action.

Hazardous Air Pollutant Requirements

The Clean Air Act requires the EPA to develop emission limit standards for hazardous air pollutants that reflect the maximum achievable control technology. In 2009, the EPA entered into a consent order through which it agreed to develop rules establishing standards for the control of emissions of mercury and other hazardous air pollutants from electric generating units. The EPA issued the final rule in December 2011.

Navajo

Based on the EPA's final standards, mercury and particulate emission control equipment may be required at Navajo by 2015. TEP's share of the estimated capital cost of this equipment for Navajo is less than \$1 million for mercury control and approximately \$43 million if the installation of baghouses to control particulates is necessary.

Springerville

Based on the EPA's final standards, mercury emission control equipment may be required at Springerville by 2015. The estimated capital cost of this equipment for Springerville Units 1 and 2 is approximately \$5 million. The annual operating cost associated with the mercury emission control equipment is expected to be approximately \$3 million.

San Juan

Current emission controls at San Juan are expected to be adequate to achieve compliance with the EPA's final standards.

Table of Contents

Sundt

TEP does not anticipate the final EPA rule will have a material impact on TEP's capital expenditures related to Sundt Unit 4.

Four Corners

Based on the EPA's final standards, mercury emission control equipment may be required at Four Corners by 2015. The estimated capital cost of this equipment is less than \$1 million. The annual operating cost associated with the mercury emission control equipment is expected to be less than \$1 million.

Climate Change

In 2007, the Supreme Court ruled in Commonwealth of Massachusetts, et al. v. EPA that carbon dioxide (CO