

TUCSON ELECTRIC POWER CO

Form 10-Q

October 31, 2011

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 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 File Number	Registrant; State of Incorporation; Address; and Telephone Number	IRS Employer Identification Number
1-13739	UNISOURCE ENERGY CORPORATION (An Arizona Corporation) One South Church Avenue, Suite 100 Tucson, AZ 85701 (520) 571-4000	86-0786732
1-5924	TUCSON ELECTRIC POWER COMPANY (An Arizona Corporation) One South Church Avenue, Suite 100 Tucson, AZ 85701 (520) 571-4000	86-0062700

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 No
Tucson Electric Power Company (1) Yes No

(1) Tucson Electric Power Company is not required to file reports under the Exchange Act. However, Tucson Electric Power Company has filed all Exchange Act reports for the preceding 12 months.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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).

UniSource Energy Corporation Yes No
Tucson Electric Power Company Yes No

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 Accelerated filer Non-accelerated filer Smaller reporting company

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(Do not check if a smaller reporting
company)

Tucson Electric Power Company

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting
company)

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

As of October 20, 2011, 36,922,643 shares of UniSource Energy Corporation Common Stock, no par value (the only class of Common Stock), were outstanding. As of October 20, 2011, Tucson Electric Power Company had 32,139,434 shares of common stock outstanding, no par value, all of which were held by UniSource Energy Corporation.

This combined Form 10-Q is separately filed by UniSource Energy Corporation and Tucson Electric Power Company. Information contained in this document relating to Tucson Electric Power Company is filed by UniSource Energy Corporation and separately by Tucson Electric Power Company on its own behalf. Tucson Electric Power Company makes no representation as to information relating to UniSource Energy Corporation or its subsidiaries, except as it may relate to Tucson Electric Power Company.

Table of Contents

Table of Contents

Definitions iv

PART I

Reports of Independent Registered Public Accounting Firm 1

Item 1. Financial Statements 3

UniSource Energy Corporation

Condensed Consolidated Statements of Income 3

Condensed Consolidated Statements of Cash Flows 4

Condensed Consolidated Balance Sheets 5

Condensed Consolidated Statement of Changes in Stockholders' Equity and Comprehensive Income 7

Tucson Electric Power Company

Condensed Consolidated Statements of Income 8

Condensed Consolidated Statements of Cash Flows 9

Condensed Consolidated Balance Sheets 10

Condensed Consolidated Statement of Changes in Stockholders' Equity and Comprehensive Income 12

Notes to Condensed Consolidated Financial Statements - Unaudited 13

Note 1. Nature of Operations and Basis of Accounting Presentation 13

Note 2. Regulatory Matters 18

Note 3. Business Segments 19

Note 4. Debt and Credit Facilities 22

Note 5. Income Taxes 23

Note 6. Commitments, Contingencies and Proposed Environmental Matters 23

Note 7. Employee Benefit Plans 30

Note 8. Share-Based Compensation Plans 30

Note 9. Fair Value Measurements 31

Table of Contents 4

<u>Note 10. UniSource Energy Earnings Per Share</u>	36
<u>Note 11. Stockholders' Equity</u>	38
<u>Note 12. Recently Issued Accounting Pronouncements</u>	38
<u>Note 13. Supplemental Cash Flow Information</u>	39
<u>Note 14. Accounting for Derivative Instruments, Trading Activities and Hedging Activities</u>	40
<u>Note 15. Review by Independent Registered Public Accounting Firm</u>	43
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	44
<u>UniSource Energy Consolidated</u>	44
<u>Overview of Consolidated Business</u>	44
<u>Outlook and Strategies</u>	45
<u>Results of Operations</u>	45
<u>Liquidity and Capital Resources</u>	47
<u>Tucson Electric Power Company</u>	51
<u>Results of Operations</u>	51
<u>Factors Affecting Results of Operations</u>	59
<u>Liquidity and Capital Resources</u>	63
<u>UNS Gas</u>	66
<u>Results of Operations</u>	66
<u>Factors Affecting Results of Operations</u>	68
<u>Liquidity and Capital Resources</u>	69
<u>UNS Electric</u>	71
<u>Results of Operations</u>	71
<u>Factors Affecting Results of Operations</u>	73
<u>Liquidity and Capital Resources</u>	74
<u>Other Non-Reportable Business Segments</u>	76

<u>Results of Operations</u>	76
<u>Factors Affecting Results of Operations</u>	77
<u>Critical Accounting Estimates</u>	77

Table of Contents

<u>Recently Issued Accounting Pronouncements</u>	77
<u>Safe Harbor for Forward-Looking Statements</u>	78
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	78
<u>Item 4. Controls and Procedures</u>	81

PART II OTHER INFORMATION

<u>Item 1. Legal Proceedings</u>	81
<u>Item 1A. Risk Factors</u>	81
<u>Item 2. Unregistered Sale of Equity Securities and Use of Proceeds</u>	81
<u>Item 5. Other Information</u>	82
<u>Ratio of Earnings to Fixed Charges</u>	82
<u>Environmental Matters</u>	82
<u>Item 6. Exhibits</u>	85
<u>Signatures</u>	86
<u>Exhibit Index</u>	87

<u>Exhibit 12(a)</u>	
<u>Exhibit 12(b)</u>	
<u>Exhibit 15</u>	
<u>Exhibit 31(a)</u>	
<u>Exhibit 31(b)</u>	
<u>Exhibit 31(c)</u>	
<u>Exhibit 31(d)</u>	
<u>Exhibit 32</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	
<u>EX-101 DEFINITION LINKBASE DOCUMENT</u>	

Table of Contents

DEFINITIONS

The abbreviations and acronyms used in the 2011 third quarter report on Form 10-Q are defined below:

2008 TEP Rate Order	A rate order issued by the ACC resulting in a new retail rate structure for TEP, effective December 1, 2008
2010 TEP Reimbursement Agreement	Reimbursement Agreement, dated December 14, 2010, between TEP, as borrower, and a group of financial institutions
ACC	Arizona Corporation Commission
AFUDC	Allowance for Funds Used During Construction
AMT	Alternative Minimum Tax
AOCI	Accumulated Other Comprehensive Income
APS	Arizona Public Service Company
Augusta	Augusta Resources Corporation
BART	Best Available Retrofit Technology
BMGS	Black Mountain Generating Station
Btu	British thermal unit(s)
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 megawatts
CCRs	Coal combustion residuals
CO ₂	Carbon dioxide
Common Stock	UniSource Energy's common stock, without par value
Company	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 Energy Efficiency Standards
El Paso	El Paso Electric Company
Emission Allowance(s)	An allowance issued by the Environmental Protection Agency which permits emission of one ton of sulfur dioxide or one ton of nitrogen oxide. These

allowances can be bought and sold

Energy	The amount of power produced over a given period of time measured in MWh
EPA	Environmental Protection Agency
FERC	Federal Energy Regulatory Commission
Four Corners	Four Corners Generating Station
GAAP	Generally Accepted Accounting Principles
Gas EE Standards	Gas Energy Efficiency Standards
GBtu	Billion British thermal units
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
IDBs	Industrial Development Bonds
IRS	Internal Revenue Service
kWh	Kilowatt-hour(s)
LIBOR	London Interbank Offered Rate
Luna	Luna Generating Station
Millennium	Millennium Energy Holdings, Inc., a wholly-owned subsidiary of UniSource Energy
MMBtu	Million British thermal units
Mortgage Bonds	Mortgage Bonds issued under the 1992 Mortgage
MW	Megawatt(s)
MWh	Megawatt-hour(s)
Navajo	Navajo Generating Station
O&M	Operations and Maintenance Expense
NTUA	Navajo Tribal Utility Authority
NOL	Net Operating Loss
PGA	Purchased Gas Adjuster, a retail rate mechanism designed to recover the cost of gas purchased for retail gas customers

PNM

Public Service Company of New Mexico

PPA

Power purchase agreement

Table of Contents

PPFAC	Purchased Power and Fuel Adjustment Clause
RES	Renewable Energy Standard
San Juan	San Juan Generating Station
SCR	Selective Catalytic Reduction
SES	Southwest Energy Solutions
Springerville	Springerville Generating Station
Springerville Common Facilities	Facilities at Springerville used in common by all four Springerville units
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
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
Staff Accounting Bulletin 108	Staff Accounting Bulletin No. 108 (ASC 250-10), Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements
Sundt	H. Wilson Sundt Generating Station
Sundt Unit 4	Unit 4 of the H. Wilson Sundt Generating Station
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
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 Btus
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
UED Credit Agreement	Credit agreement between UED and a syndicate of banks, dated as of March 26, 2009, as amended, and guaranteed by UniSource Energy. Repaid on July 1, 2011
UES	UniSource Energy Services, Inc., an intermediate holding company established to own the operating companies UNS Gas and UNS Electric
UniSource Credit Agreement	Second Amended and Restated Credit Agreement between UniSource Energy and a syndicate of banks, dated as of November 9, 2010
UniSource Energy	UniSource Energy Corporation
UNS Electric	UNS Electric, Inc., a wholly-owned subsidiary of UES
UNS Electric Credit Agreement	Credit Agreement among UNS Electric, as borrower, and Union Bank, N.A., 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, UES as guarantor, and a syndicate of banks, dated as of November 9, 2010
USFS	United States Forest Service

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
UniSource Energy Corporation:

We have reviewed the accompanying condensed consolidated balance sheet of UniSource Energy Corporation and its subsidiaries (the Company) as of September 30, 2011, and the related condensed consolidated statements of income for the three and nine-month periods ended September 30, 2011 and 2010, the condensed consolidated statement of changes in stockholders' equity and comprehensive income for the nine-month period ended September 30, 2011 and the condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2011 and 2010. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole.

Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2010, and the related consolidated statements of income, of cash flows, of capitalization, and of changes in stockholders' equity and comprehensive income for the year then ended (not presented herein), and in our report dated March 1, 2011, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2010, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Phoenix, Arizona

October 31, 2011

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholder of
Tucson Electric Power Company:

We have reviewed the accompanying condensed consolidated balance sheet of Tucson Electric Power Company and its subsidiaries (the Company) as of September 30, 2011, and the related condensed consolidated statements of income for the three and nine-month periods ended September 30, 2011 and 2010, the condensed consolidated statement of changes in stockholder's equity and comprehensive income for the nine-month period ended September 30, 2011, and the condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2011 and 2010. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole.

Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2010, and the related consolidated statements of income, of cash flows, of capitalization, and of changes in stockholder's equity and comprehensive income for the year then ended (not present herein), and in our report dated March 1, 2011, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2010, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Phoenix, Arizona

October 31, 2011

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

UNISOURCE ENERGY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Three Months Ended September 30, 2011 2010 (Unaudited) -Thousands of Dollars- (Except Per Share Amounts)		Nine Months Ended September 30, 2011 2010 (Unaudited) -Thousands of Dollars- (Except Per Share Amounts)	
		Operating Revenues	
\$ 363,385	\$ 360,028	\$ 856,216	\$ 824,714
41,847	36,838	121,506	102,397
			(2,970)
16,831	16,140	99,041	96,598
28,884	25,824	88,624	76,053
450,947	438,830	1,165,387	1,096,792
		Operating Expenses	
98,962	89,874	252,103	219,192
88,734	93,889	233,344	243,285
(1,354)	3,380	4,612	8,688
(3,576)	(11,735)	(5,174)	(34,260)
182,766	175,408	484,885	436,905
90,781	88,936	281,888	258,979
33,553	32,450	99,653	95,773
7,882	7,177	22,513	20,797
12,205	11,334	36,579	35,559
327,187	315,305	925,518	848,013
123,760	123,525	239,869	248,779
		Other Income (Deductions)	
1,919	2,011	3,739	5,891
1,678	2,196	7,155	9,334
(1,412)	(2,456)	(2,830)	(9,359)
2,185	1,751	8,064	5,866

Interest Expense

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17,945	15,928	Long-Term Debt	54,240	46,984
10,248	11,616	Capital Leases	30,108	35,124
(88)	(1,726)	Other Interest Expense, Net of Interest Capitalized	(1,118)	(1,213)
28,105	25,818	Total Interest Expense	83,230	80,895
97,840	99,458	Income Before Income Taxes	164,703	173,750
38,128	43,793	Income Tax Expense	62,916	72,018
\$ 59,712	\$ 55,665	Net Income	\$ 101,787	\$ 101,732
		Weighted-Average Shares of Common Stock Outstanding (000)		
37,053	36,533	Basic	36,930	36,321
41,777	41,141	Diluted	41,577	40,923
		Earnings per Share		
\$ 1.61	\$ 1.52	Basic	\$ 2.76	\$ 2.80
\$ 1.46	\$ 1.38	Diluted	\$ 2.53	\$ 2.57
\$ 0.42	\$ 0.39	Dividends Declared per Share	\$ 1.26	\$ 1.17

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**UNISOURCE ENERGY CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Nine Months Ended September 30,	
	2011	2010
	(Unaudited)	
	-Thousands of Dollars-	
Cash Flows from Operating Activities		
Cash Receipts from Electric Retail Sales	\$ 876,960	\$ 848,308
Cash Receipts from Electric Wholesale Sales	137,029	138,236
Cash Receipts from Gas Sales	125,913	124,922
Cash Receipts from Operating Springerville Units 3 & 4	80,558	67,593
Cash Receipts from Gas Wholesale Sales	12,404	
Performance Deposits Received	6,340	16,200
Interest Received	5,400	9,029
Income Tax Refunds Received	3,819	
Other Cash Receipts	16,830	21,557
Purchased Energy Costs Paid	(246,452)	(286,314)
Payment of Other Operations and Maintenance Costs	(220,625)	(178,123)
Fuel Costs Paid	(212,791)	(182,703)
Taxes Other Than Income Taxes Paid, Net of Amounts Capitalized	(123,166)	(106,701)
Wages Paid, Net of Amounts Capitalized	(92,924)	(94,490)
Interest Paid, Net of Amounts Capitalized	(56,060)	(49,751)
Capital Lease Interest Paid	(31,558)	(37,106)
Wholesale Gas Costs Paid	(11,822)	
Performance Deposit Paid	(3,840)	(17,200)
Income Taxes Paid	(700)	(11,246)
Other Cash Payments	(4,828)	(6,678)
Net Cash Flows Operating Activities	260,487	255,533
Cash Flows from Investing Activities		
Capital Expenditures	(263,153)	(208,042)
Purchase of Sundt Unit 4 Lease Asset		(51,389)
Purchase of Intangibles Renewable Energy Credits	(4,102)	(6,241)
Prepayment Deposit on UED Debt		(3,188)
Other Cash Payments	(578)	(820)
Return of Investment in Springerville Lease Debt	38,353	25,615
Proceeds from Sale of Land and Buildings	2,512	
Other Cash Receipts	11,050	10,933
Net Cash Flows Investing Activities	(215,918)	(233,132)
Cash Flows from Financing Activities		
Proceeds from Borrowings Under Revolving Credit Facilities	238,000	231,000
Proceeds from Issuance of Long-Term Debt	91,080	39,570

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Proceeds from Stock Options Exercised	7,487	8,896
Other Cash Receipts	3,057	8,777
Repayments of Borrowings Under Revolving Credit Facilities	(189,000)	(199,000)
Payments of Capital Lease Obligations	(74,381)	(55,970)
Repayment of Long-Term Debt	(79,665)	(19,445)
Common Stock Dividends Paid	(46,382)	(42,326)
Payment of Debt Issue/Retirement Costs	(759)	(2,099)
Other Cash Payments	(1,168)	(1,827)
Net Cash Flows Financing Activities	(51,731)	(32,424)
Net Increase (Decrease) in Cash and Cash Equivalents	(7,162)	(10,023)
Cash and Cash Equivalents, Beginning of Year	67,599	76,922
Cash and Cash Equivalents, End of Period	\$ 60,437	\$ 66,899

See Note 13 for supplemental cash flow information.
See Notes to Condensed Consolidated Financial Statements.

Table of Contents**UNISOURCE ENERGY CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 30, 2011	December 31, 2010
	(Unaudited)	
	- Thousands of Dollars -	
ASSETS		
Utility Plant		
Plant in Service	\$ 4,634,661	\$ 4,452,928
Utility Plant Under Capital Leases	582,669	583,374
Construction Work in Progress	222,235	210,971
Total Utility Plant	5,439,565	5,247,273
Less Accumulated Depreciation and Amortization	(1,859,610)	(1,824,843)
Less Accumulated Amortization of Capital Lease Assets	(472,683)	(460,932)
Total Utility Plant Net	3,107,272	2,961,498
Investments and Other Property		
Investments in Lease Debt and Equity	66,103	103,844
Other	34,413	61,676
Total Investments and Other Property	100,516	165,520
Current Assets		
Cash and Cash Equivalents	60,437	67,599
Accounts Receivable - Customer	122,916	98,333
Unbilled Accounts Receivable	49,087	53,084
Allowance for Doubtful Accounts	(5,521)	(6,125)
Fuel Inventory	25,170	29,216
Materials and Supplies	70,073	65,832
Derivative Instruments	9,811	5,214
Regulatory Assets - Current	76,146	56,962
Deferred Income Taxes - Current	17,884	30,822
Other	39,431	30,091
Total Current Assets	465,434	431,028
Regulatory and Other Assets		
Regulatory Assets - Noncurrent	158,439	192,966
Derivative Instruments	3,946	9,806
Other Assets	27,762	30,425
Total Regulatory and Other Assets	190,147	233,197

Total Assets **\$ 3,863,369** \$ 3,791,243

See Notes to Condensed Consolidated Financial Statements.

(Continued)

Table of Contents**UNISOURCE ENERGY CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 30, 2011	December 31, 2010
	(Unaudited)	
	- Thousands of Dollars -	
CAPITALIZATION AND OTHER LIABILITIES		
Capitalization		
Common Stock Equity	\$ 893,669	\$ 830,756
Capital Lease Obligations	350,912	429,074
Long-Term Debt	1,454,615	1,352,977
Total Capitalization	2,699,196	2,612,807
Current Liabilities		
Current Obligations Under Capital Leases	77,060	60,347
Borrowings Under Revolving Credit Facility	5,000	
Current Maturities of Long-Term Debt		57,000
Accounts Payable Trade	104,695	108,950
Interest Accrued	23,126	39,120
Accrued Taxes Other than Income Taxes	56,188	39,140
Accrued Employee Expenses	26,520	26,969
Customer Deposits	31,450	29,795
Regulatory Liabilities Current	44,725	69,483
Derivative Instruments	27,695	30,574
Other	5,248	1,678
Total Current Liabilities	401,707	463,056
Deferred Credits and Other Liabilities		
Deferred Income Taxes Noncurrent	297,767	246,466
Regulatory Liabilities Noncurrent	228,825	201,329
Derivative Instruments	19,668	22,969
Pension and Other Postretirement Benefits	113,330	127,343
Other	102,876	117,273
Total Deferred Credits and Other Liabilities	762,466	715,380
Commitments, Contingencies and Proposed Environmental Matters (Note 6)		
Total Capitalization and Other Liabilities	\$ 3,863,369	\$ 3,791,243

See Notes to Condensed Consolidated Financial Statements.

(Concluded)

Table of Contents

UNISOURCE ENERGY CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY AND
COMPREHENSIVE INCOME

	Common Shares Outstanding*	Common Stock	Accumulated Earnings (Unaudited)	Accumulated Other Comprehensive Loss	Total Stockholders Equity
			(Unaudited)		
			-Thousands of Dollars-		
Balances at December 31, 2010	36,542	\$ 715,688	\$ 124,837	\$ (9,769)	\$ 830,756
Comprehensive Income:					
2011 Year-to-Date Net Income			101,787		101,787
Unrealized Loss on Cash Flow Hedges (net of \$2,109 income taxes)				(3,222)	(3,222)
Reclassification of Realized Losses on Cash Flow Hedges to Net Income (net of \$1,153 income taxes)				1,761	1,761
Employee Benefit Obligations Amortization of SERP Net Prior Service Cost Included in Net Periodic Benefit Cost (net of \$141 income taxes)				223	223
Total Comprehensive Income					100,549
Dividends, Including Non-Cash Dividend Equivalents			(46,664)		(46,664)
Shares Issued for Stock Options	281	7,487			7,487
Shares Issued under Stock Compensation Plans	57				
Other		1,541			1,541
Balances at September 30, 2011	36,880	\$ 724,716	\$ 179,960	\$ (11,007)	\$ 893,669

* UniSource Energy has 75 million authorized shares of Common Stock.
See Notes to Condensed Consolidated Financial Statements.

Table of Contents**TUCSON ELECTRIC POWER COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

Three Months Ended September 30, 2011		2010				Nine Months Ended September 30, 2011		2010	
		(Unaudited)				(Unaudited)			
- Thousands of Dollars -						-Thousands of Dollars-			
				Operating Revenues					
\$	308,924	\$	300,348		Electric Retail Sales	\$	714,278	\$	685,322
	29,608		26,731		Electric Wholesale Sales		96,623		96,997
					California Power Exchange (CPX) Provision for Wholesale Refunds				(2,970)
	31,313		27,559		Other Revenues		93,765		81,066
	369,845		354,638		Total Operating Revenues		904,666		860,415
				Operating Expenses					
	95,977		85,174		Fuel		246,563		209,843
	40,509		47,909		Purchased Power		84,189		105,900
	(4,266)		972		Transmission		(2,339)		2,818
	1,115		(12,724)		Increase (Decrease) to Reflect PPFAC Recovery Treatment		(5,146)		(23,023)
	133,335		121,331		Total Fuel and Purchased Energy		323,267		295,538
	79,837		74,687		Other Operations and Maintenance		246,423		219,664
	26,541		25,190		Depreciation		78,124		74,143
	8,798		8,153		Amortization		25,282		23,963
	9,855		9,222		Taxes Other Than Income Taxes		29,803		28,903
	258,366		238,583		Total Operating Expenses		702,899		642,211
	111,479		116,055		Operating Income		201,767		218,204
				Other Income (Deductions)					
	1,666		1,725		Interest Income		2,983		5,111
	229		2,018		Other Income		4,597		4,351
	(2,754)		(2,468)		Other Expense		(7,751)		(7,352)
	(859)		1,275		Total Other Income (Deductions)		(171)		2,110
				Interest Expense					
	12,081		10,223		Long-Term Debt		36,493		30,255
	10,248		11,614		Capital Leases		30,107		35,118
	(44)		(1,683)		Other Interest Expense, Net of Interest Capitalized		(881)		(1,641)

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22,285	20,154	Total Interest Expense	65,719	63,732
88,335	97,176	Income Before Income Taxes	135,877	156,582
34,423	37,472	Income Tax Expense	52,104	58,447
\$ 53,912	\$ 59,704	Net Income	\$ 83,773	\$ 98,135

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**TUCSON ELECTRIC POWER COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Nine Months Ended September 30,	
	2011	2010
	(Unaudited)	
	-Thousands of Dollars-	
Cash Flows from Operating Activities		
Cash Receipts from Electric Retail Sales	\$ 723,107	\$ 704,027
Cash Receipts from Electric Wholesale Sales	114,061	140,207
Cash Receipts from Operating Springerville Units 3 & 4	80,558	67,593
Cash Receipts from Gas Wholesale Sales	11,825	
Reimbursement of Affiliate Charges	13,928	13,781
Interest Received	5,361	8,986
Income Tax Refunds Received	4,360	3,369
Performance Deposits Received	1,640	5,040
Other Cash Receipts	12,466	13,738
Payment of Other Operations and Maintenance Costs	(215,896)	(171,624)
Fuel Costs Paid	(208,675)	(173,796)
Taxes Other Than Income Taxes Paid, Net of Amounts Capitalized	(93,444)	(88,390)
Purchased Power Costs Paid	(82,321)	(137,051)
Wages Paid, Net of Amounts Capitalized	(76,739)	(76,637)
Interest Paid, Net of Amounts Capitalized	(34,161)	(28,841)
Capital Lease Interest Paid	(31,558)	(37,099)
Wholesale Gas Cost Paid	(11,822)	
Income Taxes Paid	(2,346)	(14,865)
Performance Deposit Paid	(1,640)	(5,040)
Other Cash Payments	(3,160)	(2,487)
Net Cash Flows Operating Activities	205,544	220,911
Cash Flows from Investing Activities		
Capital Expenditures	(193,714)	(171,813)
Purchase of Sundt Unit 4 Lease Asset		(51,389)
Purchase of Intangibles Renewable Energy Credits	(4,000)	(7,073)
Other Cash Payments	(558)	(1)
Return of Investment in Springerville Lease Debt	38,353	25,615
Other Cash Receipts	6,648	6,863
Net Cash Flows Investing Activities	(153,271)	(197,798)
Cash Flows from Financing Activities		
Proceeds from Borrowings Under Revolving Credit Facility	120,000	177,000
Proceeds from Issuance of Long-Term Debt	11,080	30,000
Equity Investment from UniSource Energy		15,000
Other Cash Receipts	1,051	1,831

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Repayments of Borrowings Under Revolving Credit Facility	(115,000)	(157,000)
Payments of Capital Lease Obligations	(74,343)	(55,889)
Dividends Paid to UniSource Energy		(30,000)
Other Cash Payments	(1,019)	(2,682)
Net Cash Flows Financing Activities	(58,231)	(21,740)
Net Increase (Decrease) in Cash and Cash Equivalents	(5,958)	1,373
Cash and Cash Equivalents, Beginning of Year	19,983	22,418
Cash and Cash Equivalents, End of Period	\$ 14,025	\$ 23,791

See Note 13 for supplemental cash flow information.
See Notes to Condensed Consolidated Financial Statements.

Table of Contents**TUCSON ELECTRIC POWER COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 30, 2011	December 31, 2010
	(Unaudited)	
	- Thousands of Dollars -	
ASSETS		
Utility Plant		
Plant in Service	\$ 4,014,702	\$ 3,863,431
Utility Plant Under Capital Leases	582,669	582,669
Construction Work in Progress	140,036	153,981
Total Utility Plant	4,737,407	4,600,081
Less Accumulated Depreciation and Amortization	(1,748,845)	(1,729,747)
Less Accumulated Amortization of Capital Lease Assets	(472,683)	(460,257)
Total Utility Plant Net	2,515,879	2,410,077
Investments and Other Property		
Investments in Lease Debt and Equity	66,103	103,844
Other	32,598	43,588
Total Investments and Other Property	98,701	147,432
Current Assets		
Cash and Cash Equivalents	14,025	19,983
Accounts Receivable - Customer	104,812	78,200
Unbilled Accounts Receivable	39,817	32,217
Allowance for Doubtful Accounts	(3,779)	(4,106)
Accounts Receivable - Due from Affiliates	3,289	5,444
Fuel Inventory	24,887	29,209
Materials and Supplies	58,910	54,732
Derivative Instruments	2,104	1,318
Regulatory Assets - Current	56,642	34,023
Deferred Income Taxes - Current	21,324	32,077
Other	22,352	26,467
Total Current Assets	344,383	309,564
Regulatory and Other Assets		
Regulatory Assets - Noncurrent	147,169	182,304
Derivative Instruments	1,360	1,834
Other Assets	22,354	24,767

Total Regulatory and Other Assets	170,883	208,905
Total Assets	\$ 3,129,846	\$ 3,075,978

See Notes to Condensed Consolidated Financial Statements.

(Continued)

Table of Contents**TUCSON ELECTRIC POWER COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 30, 2011	December 31, 2010
	(Unaudited)	
	- Thousands of Dollars -	
CAPITALIZATION AND OTHER LIABILITIES		
Capitalization		
Common Stock Equity	\$ 792,451	\$ 709,884
Capital Lease Obligations	350,912	429,074
Long-Term Debt	1,003,615	1,003,615
Total Capitalization	2,146,978	2,142,573
Current Liabilities		
Current Obligations Under Capital Leases	77,060	60,309
Borrowings Under Revolving Credit Facility	5,000	
Accounts Payable Trade	79,693	77,021
Accounts Payable Due to Affiliates	7,669	3,990
Interest Accrued	20,525	31,771
Accrued Taxes Other than Income Taxes	46,414	29,873
Accrued Employee Expenses	23,713	23,710
Customer Deposits	22,716	21,191
Derivative Instruments	5,432	7,288
Regulatory Liabilities Current	30,534	58,936
Other	3,735	3,379
Total Current Liabilities	322,491	317,468
Deferred Credits and Other Liabilities		
Deferred Income Taxes Noncurrent	269,968	227,615
Regulatory Liabilities Noncurrent	195,052	170,223
Derivative Instruments	13,049	11,650
Pension and Other Postretirement Benefits	107,957	120,590
Other	74,351	85,859
Total Deferred Credits and Other Liabilities	660,377	615,937
Commitments, Contingencies and Proposed Environmental Matters (Note 6)		
Total Capitalization and Other Liabilities	\$ 3,129,846	\$ 3,075,978

See Notes to Condensed Consolidated Financial Statements.

(Concluded)

Table of Contents

**TUCSON ELECTRIC POWER COMPANY
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY AND
COMPREHENSIVE INCOME**

	Common Stock	Capital Stock Expense	Accumulated Deficit (Unaudited)	Accumulated Other Comprehensive Loss	Total Stockholders Equity
			- Thousands of Dollars -		
Balances at December 31, 2010	\$ 858,971	\$ (6,357)	\$ (132,961)	\$ (9,769)	\$ 709,884
Comprehensive Income:					
2011 Year-to-Date Net Income			83,773		83,773
Unrealized Loss on Cash Flow Hedges (net of \$2,088 income taxes)				(3,190)	(3,190)
Reclassification of Realized Losses on Cash Flow Hedges to Net Income (net of \$1,153 income taxes)				1,761	1,761
Employee Benefit Obligations Amortization of SERP Net Prior Service Cost Included in Net Periodic Benefit Cost (net of \$141 income taxes)				223	223
Total Comprehensive Income					82,567
Balances at September 30, 2011	\$ 858,971	\$ (6,357)	\$ (49,188)	\$ (10,975)	\$ 792,451

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

NOTE 1. NATURE OF OPERATIONS AND BASIS OF ACCOUNTING PRESENTATION

UniSource Energy Corporation (UniSource Energy) is a utility services holding company engaged, through its subsidiaries, in the electric generation and energy delivery business. Each of UniSource Energy's subsidiaries is a separate legal entity with its own assets and liabilities. UniSource Energy owns 100% of Tucson Electric Power Company (TEP), UniSource Energy Services, Inc. (UES), Millennium Energy Holdings, Inc. (Millennium), and UniSource Energy Development Company (UED).

TEP is a regulated public utility and UniSource Energy's largest operating subsidiary, representing approximately 81% of UniSource Energy's total assets as of September 30, 2011. TEP generates, transmits and distributes electricity to approximately 404,000 retail electric customers in a 1,155 square mile area in southeastern Arizona. TEP also sells electricity to other utilities and power marketing entities, located primarily in the western U.S. In addition, TEP operates Springerville Unit 3 on behalf of Tri-State Generation and Transmission Association, Inc. (Tri-State) and Springerville Unit 4 on behalf of Salt River Project Agriculture Improvement and Power District (SRP).

UES holds the common stock of UNS Gas, Inc. (UNS Gas) and UNS Electric, Inc. (UNS Electric). UNS Gas is a gas distribution company with approximately 146,000 retail customers in Mohave, Yavapai, Coconino, and Navajo counties in northern Arizona, as well as in Santa Cruz County in southern Arizona. UNS Electric is an electric transmission and distribution company with approximately 91,000 retail customers in Mohave and Santa Cruz counties.

In 2008, UED developed the Black Mountain Generating Station (BMGS) in northwestern Arizona. The facility includes two natural gas-fired combustion turbines. Prior to July 2011, UNS Electric received energy from BMGS through a power sales agreement with UED. In July 2011, UNS Electric purchased BMGS from UED, leaving UED with no significant remaining assets. The transaction had no impact on UniSource Energy's consolidated financial statements.

Millennium's investments in unregulated businesses represent less than 1% of UniSource Energy's assets as of September 30, 2011. Millennium's \$13 million net loss for 2010, which reflected impairment losses, caused it to be a reportable segment at December 31, 2010. Millennium is not a reportable segment at September 30, 2011.

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

The accompanying quarterly financial statements of UniSource Energy and TEP are unaudited but reflect all normal recurring accruals and other adjustments which we believe are necessary for a fair presentation of the results for the interim periods presented. These financial statements are presented in accordance with the Securities and Exchange Commission's interim reporting requirements, which do not include all the disclosures required by generally accepted accounting principles (GAAP) in the United States of America for audited annual financial statements. UniSource Energy and TEP reclassified certain amounts in the financial statements to conform to the current year presentation.

The year-end condensed balance sheet data was derived from audited financial statements, but it does not include disclosures required by GAAP for audited annual financial statements. This quarterly report should be reviewed in conjunction with UniSource Energy's and TEP's 2010 Annual Report on Form 10-K.

Because weather and other factors cause seasonal fluctuations in the sales of TEP, UNS Gas and UNS Electric, quarterly results are not indicative of annual operating results.

REVISION OF PRIOR PERIOD FINANCIAL STATEMENTS

In the second quarter of 2011, we identified errors related to amounts recorded, at their dollar value, owed to or payable by TEP for electricity deliveries settled in-kind or to be settled in-kind during prior years under three of our transmission agreements. Transmission, interconnection and certain joint operating agreements typically provide that the parties to such agreements will monitor transmission and delivery losses and other energy imbalances and make payments to each other to compensate for any losses and imbalances. Payments for such losses and imbalances are made in-kind with energy (MWh) rather than cash. The amount of these losses and imbalances is typically a very low portion of the energy flows subject to these agreements and is usually settled on a one day or one month lag.

Separately, we also had identified errors in prior years in the calculation of income tax expense arising from not treating Allowance for Equity Funds Used During Construction (AFUDC) as a permanent book to tax difference. We assessed the materiality of these errors on prior period financial statements and concluded they were not material to

any prior annual or interim periods, but the cumulative impact, if recognized in 2011, could be material to the annual period ending December 31, 2011 and the interim period ended June 30, 2011. As a result, in accordance with Staff Accounting Bulletin 108 and as set forth in Note 1 to the Financial Statements in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, we revised our prior period financial statements to correct these errors.

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) Unaudited**

In the third quarter of 2011, we conducted a review of all of our remaining agreements that provided for in-kind payments for transmission and delivery losses or energy imbalances and identified additional errors related to recording, at their dollar value, amounts owed to or payable by TEP for electricity deliveries settled in-kind or to be settled in-kind during prior years. We also identified minor errors to prior year amounts billed to third parties for operations and maintenance expense. We assessed the materiality of these errors, considered together with the errors identified in the first half of 2011, on prior period financial statements and concluded that, while they were not material to any prior annual or interim periods, we should update the prior revision to reflect all of the errors identified in 2011.

The income tax adjustment affected fiscal years 2003 through 2010 for UniSource Energy and fiscal years 2009 and 2010 for TEP. The adjustment for transmission and delivery losses and energy imbalances settled in-kind or to be settled in-kind affected fiscal years 2004 through 2010. The operations and maintenance expense adjustment affected fiscal years 2006 through 2010. The updated revision increased UniSource Energy's net income by \$2 million for both the 2010 and 2009 annual periods and by \$3 million in 2008. The updated revision increased TEP's net income by \$1 million for both the 2010 and 2009 annual periods and by \$3 million in 2008. UniSource Energy's Accumulated Earnings increased by \$4 million for the periods prior to January 1, 2008, as a result of the revisions.

The revised amounts include reclassifications to conform to the current year presentation. TEP reclassified Other Operations and Maintenance costs of \$7 million in 2010, and \$6 million in 2009 to Other Expense to correctly account for the regulatory treatment of certain expenses. Additionally, for the nine months ended September 30, 2009, Unisource Energy and TEP reclassified Electric Wholesale Sales of \$2 million to Purchased Energy to correctly account for the net settlement of certain wholesale sales contracts.

The revision and reclassifications impacted statements of income and balance sheets as shown in the tables below:

	UniSource Energy					
	2011					
	Three Months Ended March 31,		Three Months Ended June 30,		Six Months Ended June 30,	
	As Reported	As Revised	As Reported	As Revised	As Reported	As Revised
	-Thousands of Dollars- (Except Per Share Amounts)					
Income Statement						
Electric Wholesale Sales	\$ 40,781	\$ 40,914	\$ 38,744	\$ 38,744	\$ 79,658	\$ 79,658
Fuel	72,137	71,192	82,563	81,949	154,692	153,141
Purchased Energy	77,640	78,274	66,336	66,336	144,610	144,610
Increase (Decrease) to Reflect PPFAC/PGA Recovery						
Treatment	(5,793)	(5,388)	3,227	3,790	(3,008)	(1,598)
Income Tax Expense	3,909	7,468	17,229	17,320	24,731	24,788
Net Income	16,992	13,472	28,574	28,604	41,990	42,076
Basic Earnings Per Share (EPS)	0.46	0.37	0.77	0.77	1.14	1.14
Diluted EPS	0.44	0.36	0.71	0.71	1.07	1.07
Balance Sheet						
Deferred Income Taxes						
Current	35,210	30,989	34,839	33,219	34,839	33,219
Accounts Receivable - Customer	73,350	88,050	94,618	103,102	94,618	103,102
Regulatory Assets - Noncurrent	191,238	186,812	166,311	161,131	166,311	161,131
Common Stock Equity	824,127	830,577	847,095	849,569	847,095	849,569
Accounts Payable - Trade	97,260	96,862	123,508	122,717	123,508	122,717

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) Unaudited**

	TEP 2011					
	Three Months Ended March 31,		Three Months Ended June 30,		Six Months Ended June 30,	
	As Reported	As Revised	As Reported	As Revised	As Reported	As Revised
	-Thousands of Dollars-					
Income Statement						
Electric Wholesale Sales	\$ 35,122	\$ 35,256	\$ 31,759	\$ 31,759	\$ 67,015	\$ 67,015
Fuel	71,315	70,370	80,831	80,217	152,138	150,587
Purchased Power	16,601	17,236	26,445	26,444	43,680	43,680
Increase (Decrease) to Reflect						
PPFAC Recovery Treatment	(9,342)	(8,937)	2,112	2,675	(7,671)	(6,262)
Income Tax Expense	208	2,528	15,133	15,154	17,624	17,682
Net Income	6,983	4,703	25,128	25,158	29,776	29,861
Balance Sheet						
Deferred Income Taxes						
Current	36,205	31,985	35,723	34,102	35,723	34,102
Accounts Receivable Customer	53,560	68,259	76,988	85,471	76,988	85,471
Regulatory Assets Noncurrent	180,723	176,296	156,345	151,165	156,345	151,165
Common Stock Equity	708,604	715,054	736,916	739,390	736,916	739,390
Accounts Payable Trade	71,276	70,879	98,251	97,458	98,251	97,458

	UniSource Energy 2010							
	Three Months Ended							
	March 31,		June 30,		September 30,		December 31,	
	As Reported	As Revised	As Reported	As Revised	As Reported	As Revised	As Reported	As Revised
	-Thousands of Dollars- (Except Per Share Amounts)							
Income Statement								
Electric Wholesale								
Sales	\$ 37,064	\$ 37,092	\$ 28,466	\$ 28,467	\$ 36,776	\$ 36,838	\$ 51,579	\$ 49,565
Fuel	60,448	60,167	69,304	69,151	90,493	89,874	76,793	76,460
Purchased Energy	82,805	82,805	66,591	66,591	93,889	93,889	66,137	64,003
Increase (Decrease) to								
Reflect PPFAC/PGA								
Recovery Treatment	(12,631)	(12,361)	(10,313)	(10,164)	(12,373)	(11,735)	4,230	4,638
Other Operations and								
Maintenance	82,908	82,909	87,134	87,134	88,936	88,936	111,089	111,058
Income Tax Expense	12,435	12,267	15,956	15,958	44,533	43,793	5,000	4,903
Net Income	19,972	20,178	25,886	25,889	54,883	55,665	11,082	11,252
Basic EPS	0.55	0.56	0.71	0.71	1.50	1.52	0.30	0.31
Diluted EPS	0.52	0.52	0.66	0.66	1.36	1.38	0.29	0.30
Balance Sheet								

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Deferred Income Taxes								
Current	51,106	46,948	50,066	45,906	54,705	50,528	32,386	30,822
Accounts Receivable								
Customer	69,543	80,005	78,626	91,776	110,014	123,750	91,556	98,333
Regulatory Assets								
Noncurrent	145,821	146,847	150,608	152,038	184,097	186,140	196,736	192,966
Common Stock Equity	757,939	766,607	772,833	781,851	816,533	826,334	828,368	830,756
Accounts Payable								
Trade	99,936	99,377	107,800	107,461	102,363	101,929	109,896	108,950
Deferred Income Taxes								
Noncurrent	233,681	235,197	244,441	246,183	290,772	293,008	246,466	246,466

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) Unaudited**

	TEP 2010							
	Three Months Ended							
	March 31,		June 30,		September 30,		December 31,	
	As Reported	As Revised	As Reported	As Revised	As Reported	As Revised	As Reported	As Revised
	-Thousands of Dollars-							
Income Statement								
Electric Wholesale								
Sales	\$ 40,962	\$ 40,989	\$ 29,276	\$ 29,276	\$ 26,669	\$ 26,731	\$ 46,121	\$ 44,107
Fuel	58,351	58,070	66,753	66,599	85,793	85,174	75,233	74,901
Purchased Power	24,654	24,655	33,337	33,337	47,909	47,909	14,950	12,815
Increase (Decrease) to Reflect PPFAC								
Recovery Treatment	(3,118)	(2,847)	(7,601)	(7,452)	(13,362)	(12,724)	1,073	1,482
Other Operations and Maintenance	70,365	70,364	74,613	74,613	76,277	74,687	99,096	96,961
Income Tax Expense	6,348	6,245	14,728	14,730	38,139	37,472	1,543	1,489
Net Income	10,349	10,490	27,938	27,941	58,993	59,704	9,999	10,125
Balance Sheet								
Deferred Income Taxes								
Current	49,881	45,724	50,319	46,159	55,323	51,147	33,640	32,077
Accounts Receivable								
Customer	54,957	65,615	63,627	76,777	92,197	105,933	71,425	78,200
Regulatory Assets								
Noncurrent	136,013	135,252	140,102	139,671	170,287	170,350	186,074	182,304
Common Stock Equity	666,963	674,551	692,729	700,621	720,063	728,666	707,495	709,884
Accounts Payable								
Trade	77,840	77,282	91,606	91,267	81,291	80,856	77,967	77,021
Deferred Income Taxes								
Noncurrent	221,098	221,908	230,241	231,247	268,385	269,839	227,615	227,615

	UniSource Energy 2010					
	Six Months Ended		Nine Months Ended		Year Ended	
	June 30,		September 30,		December 31,	
	As Reported	As Revised	As Reported	As Revised	As Reported	As Revised
	-Thousands of Dollars- (Except Per Share Amounts)					
Income Statement						
Electric Wholesale Sales	\$ 65,558	\$ 65,558	\$ 100,094	\$ 102,397	\$ 151,673	\$ 151,962
Fuel	129,909	129,318	220,187	219,192	296,980	295,652
Purchased Energy	149,396	149,396	241,151	243,285	307,288	307,288
Increase (Decrease) to Reflect PPFAC/PGA Recovery						
Treatment	(23,058)	(22,525)	(35,335)	(34,260)	(31,105)	(29,622)

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Other Operations and Maintenance	170,042	170,042	258,979	258,979	370,067	370,037
Income Tax Expense	28,201	28,225	73,266	72,018	78,266	76,921
Net Income	46,032	46,067	100,395	101,732	111,477	112,984
Basic EPS	1.27	1.27	2.76	2.80	3.06	3.10
Diluted EPS	1.18	1.18	2.53	2.57	2.82	2.86

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) Unaudited**

	TEP 2010					
	Six Months Ended June 30,		Nine Months Ended September 30,		Year Ended December 31,	
	As Reported	As Revised	As Reported	As Revised	As Reported	As Revised
	-Thousands of Dollars-					
Income Statement						
Electric Wholesale Sales	\$ 70,265	\$ 70,265	\$ 94,694	\$ 96,997	\$ 140,815	\$ 141,103
Fuel	125,260	124,669	210,838	209,843	286,071	284,744
Purchased Power	57,992	57,992	103,766	105,900	118,716	118,716
Increase (Decrease) to Reflect PPFAC Recovery Treatment Other Operations and Maintenance	(10,833)	(10,299)	(24,098)	(23,023)	(23,025)	(21,541)
Income Tax Expense	144,977	144,977	224,441	219,664	323,537	316,625
Net Income	20,953	20,975	59,514	58,447	61,057	59,936
	38,396	38,431	96,979	98,135	106,978	108,260

	UniSource Energy		TEP	
	Year Ended December 31, 2009			
	As Reported	As Revised	As Reported	As Revised
	-Thousands of Dollars- (Except Per Share Amounts)			
Income Statement				
Electric Wholesale Sales	\$ 130,904	\$ 131,255	\$ 152,955	\$ 153,306
Fuel	298,655	296,248	281,710	279,303
Purchased Energy	296,861	296,861	144,528	144,529
Increase (Decrease) to Reflect PPFAC/PGA Recovery Treatment	(17,091)	(14,553)	(20,724)	(18,186)
Other Operations and Maintenance	333,887	333,579	289,765	282,986
Income Tax Expense	64,348	63,232	55,130	54,220
Net Income	104,258	105,901	89,248	90,688
Basic EPS	2.91	2.95	N/A	N/A
Diluted EPS	2.69	2.73	N/A	N/A
Balance Sheet				
Deferred Income Taxes Current	52,355	48,213	50,789	46,647
Accounts Receivable Customer	80,191	92,781	62,508	75,099
Regulatory Assets Noncurrent	147,325	148,319	137,147	136,461
Common Stock Equity	750,865	759,329	643,144	650,591
Accounts Payable Trade	98,990	98,573	71,328	70,911
Deferred Income Taxes Noncurrent	227,199	228,596	217,316	218,049

UniSource Energy **TEP**
**Year Ended
December 31, 2008**

	As Reported	As Revised	As Reported	As Revised
	-Thousands of Dollars- (Except Per Share Amounts)			
Income Statement				
Electric Wholesale Sales	\$ 248,855	\$ 249,195	\$ 272,411	\$ 272,750
Fuel	299,987	295,802	289,985	285,799
Purchased Energy	454,765	454,765	250,580	250,580
Other Operations and Maintenance	295,658	295,478	256,584	256,404
Income Tax Expense	16,975	18,747	10,867	12,729
Net Income	14,021	16,955	4,363	7,206
Basic EPS	0.39	0.47	N/A	N/A
Diluted EPS	0.39	0.47	N/A	N/A

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) Unaudited****NOTE 2. REGULATORY MATTERS****ACCOUNTING FOR RATE REGULATION**

The Arizona Corporation Commission (ACC) and the Federal Energy Regulatory Commission (FERC) each regulate portions of the utility accounting practices and rates used by TEP, UNS Gas and UNS Electric. The ACC regulates rates charged to retail customers, the siting of generation and transmission facilities, the issuance of securities, and transactions with affiliated parties. The FERC regulates terms and prices of transmission services and wholesale electricity sales.

PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE (PPFAC) AND PURCHASED GAS ADJUSTMENT (PGA) MECHANISM

TEP's and UNS Electric's retail rates include a PPFAC. The PPFAC allows recovery of fuel and purchased power costs, including demand charges, transmission costs, and the prudent costs of contracts for hedging fuel and purchased power. UNS Gas' retail rates include a PGA mechanism that allows UNS Gas to recover its actual commodity costs, including transportation, through a price adjustor on a per therm basis. For each utility, the cumulative difference between its actual costs and those recovered through the PPFAC/PGA are tracked through the PPFAC/PGA Bank, a balancing account. The PPFAC balances factor into the formulas used to determine the PPFAC rates for TEP and UNS Electric, which are reset annually by the ACC each April for TEP and each June for UNS Electric. UNS Gas' PGA mechanism is adjusted monthly based on a formula that reflects actual commodity costs over the previous 12 months. UNS Gas is required to request ACC approval of a surcredit if the PGA Bank balance reflects an over-collection of \$10 million or more on a billed basis. UNS Gas is also authorized to request ACC approval of a surcharge if its PGA Bank reflects an under-collected balance.

The table below summarizes TEP's and UNS Electric's PPFAC surcharge (surcredit) in cents per kWh and UNS Gas' PGA surcredit in cents per therm:

	June - September	2011 April - May	First Quarter	June September	2010 April - May	First Quarter
TEP						
PPFAC	0.53	0.53	0.09	0.09	0.09	0.18
CTC ⁽¹⁾	(0.53)	(0.53)	(0.09)	(0.09)	(0.09)	(0.18)
Total PPFAC Rate						
UNS Electric	(0.88)	0.08	0.08	(0.28)	(1.06)	(1.06)
UNS Gas				(8.00)	(8.00)	(8.00)

⁽¹⁾ Competition Transition Charge

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) Unaudited TEP**

TEP offsets the PPFAC surcharge with CTC revenue to be refunded, resulting in a PPFAC rate of zero to customers. After the CTC revenue is fully refunded, which is expected to occur later this year, the PPFAC bank balance could increase until a new PPFAC rate becomes effective in April 2012.

The following table shows the changes in TEP's PPFAC-related accounts and the effects on revenue and expense:

	At September 30, 2011	At December 31, 2010	Nine Months Ended September 30, 2011	Reduction to Fuel and Purchased Power Expense
	Asset (Liability)		Increase to Revenue	
	-Millions of Dollars-			
PPFAC Fixed CTC Revenue to be Refunded (current)	\$ (5)	\$ (36)	\$ 31	
PPFAC (current and non-current)	59	54		\$ 5

For the three months ended September 30, 2011, there was a \$16 million increase to revenue and a \$1 million increase to fuel and purchased power expense.

PENDING UNS GAS RATE CASE

In April 2011, UNS Gas filed a general rate case (on a cost-of-service basis) with the ACC requesting a rate increase of 3.8% to cover a revenue deficiency of \$5.6 million, and requesting a change in depreciation rates that, if approved, is expected to reduce annual depreciation expense by \$1 million. The proposed rates include a higher fixed service charge and a decoupling mechanism, each of which serve to separate the recovery of fixed costs from the level of energy consumed. These changes are intended to provide adequate revenue recovery for declining sales due to the implementation of the state's energy efficiency standard, which encourages customers to reduce energy consumption.

UNS ELECTRIC PURCHASE OF BMGS

The ACC approved UNS Electric's purchase of BMGS from UED at book value, subject to FERC approval. FERC approved the sale in June 2011. On July 1, 2011, UNS Electric completed the purchase of BMGS for \$63 million. As of July 1, 2011, UNS Electric includes BMGS in rates through a revenue-neutral rate reclassification of approximately 0.7 cents per kWh from base power supply rate to non-fuel base rates.

NOTE 3. BUSINESS SEGMENTS

Based on the way we organize our operations and evaluate performance, we have three reportable segments:

- (1) TEP, a regulated vertically integrated electric utility and UniSource Energy's largest subsidiary;
- (2) UNS Gas, a regulated gas distribution utility business; and
- (3) UNS Electric, a regulated electric distribution utility business.

Results for the UniSource Energy and UES holding companies, Millennium and UED are included in Other below.

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) Unaudited**

In accordance with accounting rules related to the transfer of a business held under common control, we reflect UNS Electric's purchase of BMGS as if it occurred on January 1, 2009. The transaction increased UNS Electric's net income and reconciling adjustments in the table below by \$2 million for the three months ended September 30, 2010, and had no impact to the three months ended September 30, 2011. UNS Electric's net income and reconciling adjustments in the table below increased by \$2 million for the nine months ended September 30, 2011, and \$4 million for the nine months ended September 30, 2010. The transaction had no impact on UniSource Energy's consolidated financial statements.

We disclose selected financial data for our reportable segments in the following table:

		Reportable Segments				Reconciling	UniSource
		TEP	UNS Gas	UNS Electric	Other	Adjustments	Energy Consolidated
		-Millions of Dollars-					
Income Statement							
Three Months Ended							
September 30, 2011:							
Operating Revenues	External	\$ 366	\$ 17	\$ 68	\$	\$	\$ 451
Operating Revenues							
Intersegment		4	1		4	(9)	
Income (Loss) Before Income							
Taxes		88	(1)	11			98
Net Income (Loss)		54	(1)	7			60
Three Months Ended							
September 30, 2010:							
Operating Revenues	External	\$ 350	\$ 17	\$ 72	\$	\$	\$ 439
Operating Revenues							
Intersegment		5	2	1	8	(16)	
Income (Loss) Before Income							
Taxes		97	(2)	7	(1)	(2)	99
Net Income (Loss)		60	(1)	5	(6)	(2)	56
Nine Months Ended							
September 30, 2011:							
Operating Revenues	External	\$ 894	\$ 101	\$ 169	\$ 1	\$	\$ 1,165
Operating Revenues							
Intersegment		11	2	2	19	(34)	
Income Before Income Taxes		136	10	23		(4)	165
Net Income		84	6	14		(2)	102
Nine Months Ended							
September 30, 2010:							
Operating Revenues	External	\$ 837	\$ 99	\$ 160	\$ 1	\$	\$ 1,097
Operating Revenues							
Intersegment		23	4	2	21	(50)	
Income (Loss) Before Income							
Taxes		157	9	20	(6)	(6)	174
Net Income (Loss)		98	5	12	(9)	(4)	102

When UniSource Energy consolidates its subsidiaries, we have additional significant reconciling adjustments that include the elimination of investments in subsidiaries held by UniSource Energy.

	TEP	Reportable Segments		Other
		UNS Gas	UNS Electric	
-Millions of Dollars-				
Intersegment Revenue				
Three Months Ended September 30, 2011:				
Wholesale Sales TEP to UNS Electric ⁽⁴⁾	\$ 1	\$	\$	\$
Gas Revenue UNS Gas to UNS Electric ⁽⁵⁾		1		
Other Revenue TEP to Affiliates ⁽¹⁾	2			
Other Revenue Millennium to TEP, UNS Gas & UNS Electric ⁽²⁾				4
Other Revenue TEP to UNS Electric ⁽³⁾	1			
Total Intersegment Revenue	\$ 4	\$ 1	\$	\$ 4

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) Unaudited**

	Reportable Segments			
	TEP	UNS Gas	UNS Electric	Other
	-Millions of Dollars-			
Three Months Ended September 30, 2010:				
Wholesale Sales TEP to UNS Electric ⁽⁴⁾	\$ 2	\$	\$	\$
Wholesale Sales UNS Electric to TEP ⁽⁴⁾			1	
Wholesale Sales UED to UNS Electric ⁽⁵⁾				3
Gas Revenue UNS Gas to UNS Electric ⁽⁵⁾		2		
Other Revenue TEP to Affiliates ⁽¹⁾	2			
Other Revenue Millennium to TEP, UNS Gas & UNS Electric ⁽²⁾				5
Other Revenue TEP to UNS Electric ⁽³⁾	1			
Total Intersegment Revenue	\$ 5	\$ 2	\$ 1	\$ 8
Nine Months Ended September 30, 2011:				
Wholesale Sales TEP to UNS Electric ⁽⁴⁾	\$ 2	\$	\$	\$
Wholesale Sales UNS Electric to TEP ⁽⁴⁾			2	
Wholesale Sales UED to UNS Electric ⁽⁵⁾				6
Gas Revenue UNS Gas to UNS Electric ⁽⁵⁾		2		
Other Revenue TEP to Affiliate ⁽¹⁾	7			
Other Revenue Millennium to TEP, UNS Gas & UNS Electric ⁽²⁾				13
Other Revenue TEP to UNS Electric ⁽³⁾	2			
Total Intersegment Revenue	\$ 11	\$ 2	\$ 2	\$ 19
Nine Months Ended September 30, 2010:				
Wholesale Sales TEP to UNS Electric ⁽⁴⁾	\$ 15	\$	\$	\$
Wholesale Sales UNS Electric to TEP ⁽⁴⁾			2	
Wholesale Sales UED to UNS Electric ⁽⁵⁾				8
Gas Revenue UNS Gas to UNS Electric ⁽⁵⁾		4		
Other Revenue TEP to Affiliates ⁽¹⁾	6			
Other Revenue Millennium to TEP, UNS Gas & UNS Electric ⁽²⁾				13
Other Revenue TEP to UNS Electric ⁽³⁾	2			
Total Intersegment Revenue	\$ 23	\$ 4	\$ 2	\$ 21

(1) Common costs (systems, facilities, etc.) are allocated on a cost-causative basis and recorded as revenue by TEP. Management believes this method of allocation is reasonable.

(2) Millennium provides a supplemental workforce and meter-reading services to TEP, UNS Gas and UNS Electric. Millennium bases the charges on the costs of services performed. Management believes the charges are

reasonable for the services rendered.

- (3) TEP charges UNS Electric for control area services based on a FERC-approved tariff.
- (4) TEP and UNS Electric sell power to each other at prices based on the Dow Jones Four Corners Daily Index.
- (5) Transactions between non-registrant wholly-owned subsidiaries that eliminate in consolidation.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) Unaudited

NOTE 4. DEBT AND CREDIT FACILITIES

We have summarized below the significant changes to our debt from those reported in our 2010 Annual Report on Form 10-K. There have been no significant changes to our outstanding letters of credit.

UNISOURCE ENERGY CREDIT AGREEMENT

UniSource Energy had \$71 million in borrowings outstanding as of September 30, 2011 and \$27 million in borrowings outstanding as of December 31, 2010, under its revolving credit facility. The revolving loan balances are included in Long-Term Debt in the balance sheet.

TEP DEBT

TEP had \$5 million in borrowings outstanding under the TEP Credit Agreement as of September 30, 2011. TEP had no borrowings outstanding under the TEP Credit Agreement as of December 31, 2010. The revolving loan balances are included in Current Liabilities in the balance sheets.

UNS ELECTRIC TERM LOAN CREDIT AGREEMENT

In August 2011, UNS Electric entered into a four-year \$30 million variable rate term loan credit agreement. UNS Electric used the \$30 million in proceeds to repay borrowings under its revolving credit facility. The interest rate currently in effect is three-month LIBOR plus 1.25%. At the same time, UNS Electric entered into a fixed-for-floating interest rate swap in which UNS Electric will pay a fixed rate of 0.97% and receive a three-month LIBOR rate on a \$30 million notional amount over a four-year period ending August 10, 2015. The UNS Electric term loan credit agreement, included in Long-Term Debt in the balance sheet, is guaranteed by UES.

The term loan credit agreement contains certain restrictive covenants for UNS Electric and UES. The covenants include restrictions on transactions with affiliates, restricted payments, additional indebtedness, liens and mergers. UNS Electric must meet an interest coverage ratio to issue additional debt. However, UNS Electric may, without meeting these tests, refinance indebtedness and incur short-term debt in an amount not to exceed \$5 million. The credit agreement also requires UNS Electric to maintain a maximum leverage ratio, and allows UNS Electric to pay dividends so long as it maintains compliance with the credit agreement.

UNS GAS SENIOR GUARANTEED NOTES

In August 2011, UNS Gas issued \$50 million of senior guaranteed notes at 5.39%, due August 2026. UNS Gas used the proceeds to pay in full the \$50 million of UNS Gas 6.23% notes that matured in August 2011. UNS Gas notes are guaranteed by UES. The UNS Gas notes are included in Long-Term Debt in the balance sheet.

UNS Gas capitalized \$0.4 million of costs related to the issuance of the notes and will amortize these costs over the life of the notes.

The note purchase agreements contain certain restrictive covenants, including restrictions on transactions with affiliates, mergers, liens on secure indebtedness, restricted payments, and incurrence of indebtedness. UNS Gas must meet an interest coverage ratio and a maximum leverage ratio to issue additional debt and pay dividends. However, UNS Gas may, without meeting these tests, refinance indebtedness and incur short-term debt in an amount not to exceed \$5 million.

UED SECURED TERM LOAN

In July 2011, UED received \$63 million from UNS Electric for the sale of BMGS. UED used a portion of those funds to fully repay the \$27 million outstanding under its secured term loan.

COVENANT COMPLIANCE

As of September 30, 2011, UniSource Energy and its subsidiaries were in compliance with the terms of their respective loan and credit agreements and no amounts of net income were subject to dividend restrictions.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued) Unaudited

NOTE 5. INCOME TAXES

For the three and nine months ended September 30, 2011 and September 30, 2010, the effective tax rate differed from the federal rate, primarily due to state income taxes. In addition, the effective rate for the three and nine months ended September 30, 2010, was impacted by the domestic production activities deduction, deferred tax asset write-offs, and valuation allowance adjustments relating to Millennium's investments.

Deferred Tax Write-Offs and Valuation Allowance

For the three months ended September 30, 2010, UniSource Energy recorded a \$3 million out-of-period income tax expense. The out-of-period expense related to the write-off of a previously recorded deferred tax asset associated with the excess of tax over book basis in a consolidated Millennium investment. Management concluded that this out-of-period adjustment was not material to the current and prior period financial statements.

For the nine months ended September 30, 2010, UniSource Energy recorded a \$6 million valuation allowance against capital loss deferred tax assets. If capital losses remain unused after the 5-year carryforward period, they expire. A valuation allowance was recorded because management does not anticipate that UniSource Energy will generate future capital gains prior to the expiration date of the capital loss carryforward.

State Tax Rate Change