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)

x **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 File Number	Registrant; State of Incorporation; Address; and Telephone Number	IRS Employer Identification Number
1-13739	**UNISOURCE ENERGY CORPORATION** (An Arizona Corporation) 88 E. Broadway Boulevard Tucson, AZ 85701	86-0786732

(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 x	No ¨
Tucson Electric Power Company	Yes ¨	No x

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 ¨	No x
Tucson Electric Power Company	Yes ¨	No x

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 x	No ¨
Tucson Electric Power Company	Yes x	No ¨

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).

UniSource Energy Corporation	Yes x	No ¨
Tucson Electric Power Company	Yes x	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. x

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 x Smaller Reporting Company ¨	Accelerated Filer ¨	Non-accelerated filer ¨	
Tucson Electric Power Company	Large Accelerated Filer ¨ Smaller Reporting Company ¨	Accelerated Filer ¨	Non-accelerated filer x	

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 x
Tucson Electric Power Company	Yes ¨	No x

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

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

Table of Contents

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

Item 9B. Other Information 154

Table of Contents

PART III

Item 10. Directors, Executive Officers and Corporate Governance of the Registrants 155

Item 11. Executive Compensation 157

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters 157

Item 13. Certain Relationships and Related Transactions and Director Independence 158

Item 14. Principal Accountant Fees and Services 158

PART IV

Item 15. Exhibits and Financial Statement Schedules 158
Signatures 159
Exhibit Index 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
SO2	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 expecta beliefs 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

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.

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:

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.

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	September 30, Unit No.	September 30, Location	September 30, Date In Service	September 30, Fuel Type	September 30, Net Capability MW	September 30, Operating Agent	September 30, TEP s Share %	September 30, TEP s Share 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.

(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.

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*.

Peak Demand and Resources

Peak Demand	September 30, 2011	September 30, 2010	September 30, 2009	September 30, 2008	September 30, 2007
			-MW-		
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

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

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, Average Cost per MMBtu Consumed			September 30, Percentage of Total Btu Consumed		
	2011	2010	2009	2011	2010	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	San Juan Coal Co.	1,217	2017	0.8%	Federal and State Agencies
Navajo	Peabody Coalsales	529	2019	0.4%	Navajo and Hopi Indian 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

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.

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

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

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 (SO_2), 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 SO_2 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_2) and other greenhouse gases (GHGs) are air pollutants under the Clean Air Act. In 2009, the EPA issued a final Endangerment Finding stating that GHGs endanger public health and welfare. The EPA issued final GHG regulations for new motor vehicles in 2010, triggering GHG permitting requirements for power plants under the Clean Air Act. As of January 2, 2011, air quality permits for new sources and modifications of existing sources must include an analysis for GHG controls. In the near term, based on our current construction plans, we do not expect the new permitting requirements to impact TEP or UNS Electric.

While the debate over the direction of domestic climate policy continues on the national level, several states have developed state-specific policies or regional initiatives to reduce GHG emissions. In 2007, the governors of several western states, including the then-governor of Arizona, signed the Western Regional Climate Action Initiative (the Western Climate Initiative) which directed their respective states to develop a regional target for reducing greenhouse gases. The states in the Western Climate Initiative announced a target of reducing greenhouse gas emissions by 15% below 2005 levels by 2020. In 2008, the Western Climate Initiative participants submitted their design recommendation for the Western Climate Initiative cap-and-trade program for greenhouse gas emissions, with an implementation date set for 2012.

In 2010, New Mexico adopted regulations limiting GHG emissions from power plants and providing for participation in the Western Climate Initiative. Several parties filed petitions to repeal those regulations and the New Mexico Environmental Improvement Board held hearings on the repeal petitions in November and December 2011. In February 2012, the New Mexico Environmental Improvement Board repealed some, but not all, of the GHG regulations and will deliberate on the repeal of the remaining regulations in March 2012. We cannot predict if, or when, the remaining regulations will impact the generating output or cost of operations at San Juan and Luna.

Based on the competing proposals to regulate GHG emissions by federal, state, and local regulatory and legislative bodies and uncertainty in the regulatory and legislative processes, the scope of such requirements and initiatives and their effect on our operations cannot be determined at this time.

Regional Haze Rules

The EPA s regional haze rules require emission controls known as Best Available Retrofit Technology (BART) for certain industrial facilities emitting air pollutants that reduce visibility. The rules call for all states to establish goals and emission reduction strategies for improving visibility in national parks and wilderness areas and to submit a state implementation plan to the EPA for approval. Navajo and Four Corners are located on the Navajo Indian Reservation and therefore are not subject to state regulatory jurisdictions. The EPA is the lead regulatory agency for these plants in terms of regional haze planning.

Compliance with the EPA s BART determinations, coupled with the financial impact of future climate change legislation, other environmental regulations and other business considerations, could jeopardize the economic viability of the San Juan, Four Corners and Navajo plants or the ability of individual participants to meet their obligations and maintain participation in these plants. TEP cannot predict the ultimate outcome of these matters.

San Juan

In August 2011, EPA Region VI issued a Federal Implementation Plan (FIP) establishing new emission limits for NOx, SO_2 and sulfuric acid emissions at the San Juan Generating Station. The FIP requires the installation of Selective Catalytic Reduction (SCR) technology with sorbent injection on all four units within five years in order to reduce NOx and control sulfuric acid emissions. San Juan is able to meet the FIP s SO_2 limit with current emissions control equipment. Based on two cost analyses commissioned by PNM, TEP s share of the cost to install SCR with sorbent injection is estimated to be between $180 and $200 million.

Table of Contents

In September 2011, PNM filed a petition to review the Federal Implementation Plan with the 10th Circuit Court of Appeals challenging various aspects of that plan. In addition, PNM filed a request with the EPA to stay the five-year installation timeframe for environmental upgrades ordered by the Federal Implementation Plan until the 10th Circuit considers and rules on the petition to review.

In October 2011, PNM filed a Petition for Reconsideration of the Federal Implementation Plan. PNM also filed a Request to Stay the effective date of the final BART Federal Implementation Plan under the Clean Air Act with the EPA. In November 2011, PNM filed with the 10th Circuit a Motion to Stay the Federal Implementation Plan. WildEarth Guardians, Dine Citizens against Ruining our Environment, National Parks Conservation Association, New Energy Economy, San Juan Citizens Alliance and Sierra Club were granted leave to intervene in PNM s petition to review in the 10th Circuit. Neither the Petition in the 10th Circuit, nor the Petition for Reconsideration by the EPA delays the implementation timeframe unless a stay is granted. WildEarth Guardians filed a separate appeal against the EPA challenging the five-year, rather than three-year, implementation schedule. PNM was granted leave to intervene in that appeal.

In October 2011, Governor Susana Martinez of New Mexico and the New Mexico Environment Department filed a Petition for Review of the EPA s final Federal Implementation Plan determination in the 10th Circuit and a Petition for Reconsideration of the rule with the EPA. In November 2011, the New Mexico Governor and Environment Department filed a motion with the 10th Circuit to stay the rule. These appeals and motions are all currently pending.

Four Corners

In February 2011, the EPA supplemented the proposed FIP for the BART determination at Four Corners that it had originally issued in 2010. If approved, the revised plan would require the installation of SCR on Units 4 and 5 by 2018. TEP s estimated share of the capital costs to install SCR is approximately $35 million.

Navajo

The EPA is expected to issue a proposed rule establishing the BART for Navajo following the consideration of a report by the National Renewable Energy Laboratory (NREL) in partnership with the Department of the Interior and the Department of Energy. The report addresses potential energy, environmental and economic issues related to compliance with the regional haze rule. The report was submitted to the EPA in January 2012. A final BART rule is expected later in 2012. If the EPA determines that SCR is required at Navajo, the capital cost impact to TEP is estimated to be $42 million. In addition, the installation of SCR at Navajo could increase the plant s particulate emissions, necessitating the installation of baghouses. If baghouses are required, TEP s estimated share of the capital expenditure for the required baghouses would be approximately $43 million. The cost of required pollution controls will not be known until final determinations are made by the regulatory agencies. TEP anticipates that if the EPA finalizes a BART rule for Navajo that requires SCR, the owners would have five years to achieve compliance.

Coal Combustion Residuals

In 2010, the EPA published its proposed regulations governing the handling and disposal of coal ash and other coal combustion residuals (CCRs). The EPA has proposed regulating CCRs as either non-hazardous solid waste or hazardous waste. The hazardous waste alternative would require additional capital investments and operational costs associated with storage and handling at plants and transportation to the disposal locations. Both the hazardous waste and non-hazardous solid waste alternatives would require liners for new ash landfills or expansions to existing ash landfills. The rules will apply to CCRs produced by all of TEP s coal-fired generating assets. San Juan may also be subject to separate regulations being drafted by the Office of Surface Mining Reclamation and Enforcement because it disposes of CCRs in surface mine pits.

The EPA has not yet indicated a preference for an alternative. Each option would allow CCRs to be beneficially reused or recycled as components of other products. The EPA has indicated that it will issue a final rule by the end of 2012. The financial impact of this rulemaking to TEP, if any, cannot be determined at this time.

Table of Contents

Ozone National Ambient Air Quality Standard

In September 2011, President Obama ordered the EPA to withdraw its reconsideration of the 2008 National Ambient Air Quality Standard for Ozone. The ozone standard is scheduled to be updated in 2013 as required by the Clean Air Act.

UNS GAS

SERVICE TERRITORY AND CUSTOMERS

UNS Gas is a gas distribution company serving approximately 148,000 retail customers in Mohave, Yavapai, Coconino, and Navajo counties in northern Arizona, as well as Santa Cruz County in southeastern Arizona. These counties comprise approximately 50% of the territory in the state of Arizona, with a population of approximately 700,000. UNS Gas customer base is primarily residential. Sales to residential customers provided approximately 60% of total revenues in 2011, while sales to other retail customer classes accounted for about 36% of total revenues.

UNS Gas annual retail customer growth rate was less than 1% from 2009 through 2011. In 2012, we expect UNS Gas retail customer base to increase by less than 1%.

GAS SUPPLY AND TRANSMISSION

UNS Gas directly manages its gas supply and transportation contracts. The market price for gas varies based upon the period during which the commodity is purchased and is affected by weather, supply issues, the economy and other factors. UNS Gas hedges its gas supply prices by entering into fixed price forward contracts and financial swaps at various times during the year to provide more stable prices to its customers. These purchases and hedges are made up to three years in advance with the goal of hedging at least 45% of the expected monthly gas consumption with fixed prices prior to entering into the month.

UNS Gas buys most of the gas it distributes from the San Juan Basin in the Four Corners region. The gas is delivered on the EPNG and Transwestern Pipeline Company (Transwestern) interstate pipeline systems under firm transportation agreements with combined capacity sufficient to meet UNS Gas customers demands.

With EPNG, the average daily capacity right of UNS Gas is approximately 655,000 therms per day, with an average of 1,095,000 therms per day in the winter season (November through March) to serve its northern and southern Arizona service territories. UNS Gas has capacity rights of 250,000 therms per day on the San Juan Lateral and Mainline of the Transwestern pipeline. The Transwestern pipeline principally delivers gas to the portion of UNS Gas distribution system serving customers in Flagstaff and Kingman and also the Griffith Power Plant in Mohave County.

UNS Gas signed a separate agreement with Transwestern for transportation capacity rights on the Phoenix Lateral Extension Line. The 15-year agreement began in 2009, when construction of that pipeline was completed. UNS Gas average daily capacity right is 126,100 therms per day, with an average of 221,900 therms per day in the winter season (November through March).

See *Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, UNS Gas, Liquidity and Capital Resources, Contractual Obligations, UNS Gas Supply Contracts*, for more information.

RATES AND REGULATION

2011 UNS Gas Rate Filing

Due to increases in capital and operating costs, UNS Gas filed a general rate case with the ACC in April 2011 requesting higher Base Rates. The proposed Retail Rates include a higher fixed service charge and a decoupling mechanism to assist in recovering the company s authorized fixed costs under the EE Standards. The table below summarizes UNS Gas request.

Table of Contents

Test year 12 months ended Dec. 31, 2010	Initial Request by UNS Gas
Original cost rate base	$184 million
Revenue deficiency	$5.6 million
Total rate increase (over test year revenues)	3.8%
Cost of equity	10.5%
Actual capital structure	51% equity / 49% debt
Weighted average cost of capital	8.7%

In January 2012, the ACC Staff filed testimony recommending a Base Rate increase of $2.7 million as well as a mechanism to enable UNS Gas to recover lost fixed-cost revenues as a result of implementing the ACC s EE Standards. In February 2012, UNS Gas filed testimony indicating that management is willing to agree with ACC Staff s recommendations in the context of this rate proceeding. Hearings before an ACC administrative law judge concluded in February 2012. UNS Gas expects the ACC to issue a final order in the second quarter of 2012. If the proposed Base Rate increase is approved, UNS Gas indicated that it would file a proposal with the ACC requesting to return the over-collected PGA bank balance to customers. See *Purchased Gas Adjustor (PGA),* below, for more information.

2010 UNS Gas Rate Order

Effective April 2010, UNS Gas implemented a Base Rate increase of $3 million, or 2%.

Purchased Gas Adjustor (PGA)

The PGA mechanism is intended to address the volatility of natural gas prices and allow UNS Gas to recover its actual commodity costs, including transportation, through a price adjustor. The difference between UNS Gas actual monthly gas and transportation costs and the rolling 12-month average cost of gas and transportation is deferred and recovered or returned to customers through the PGA mechanism.

The PGA mechanism has two components, the PGA factor and the PGA surcharge or surcredit. The PGA factor is a mechanism that calculates the twelve-month rolling weighted average gas cost and automatically adjusts monthly, subject to limitations on how much the price per therm may change in a 12-month period. The annual cap on the maximum increase in the PGA factor is $0.15 per therm in a 12-month period.

At any time UNS Gas PGA balancing account, called the PGA bank balance, is under-recovered, UNS Gas may request a PGA surcharge with the goal of collecting the amount deferred from customers over a period deemed appropriate by the ACC. When the PGA bank balance reaches an over-collected balance of $10 million on a billed-to-customers basis, UNS Gas is required to make a filing with the ACC to determine how the over-collected balance should be returned to customers. On December 31, 2011, the PGA bank balance was over-collected by $8 million on a billed-to-customers basis.

Gas Utility Energy Efficiency Standards and Decoupling

In August 2010, the ACC approved new Gas Utility Energy Efficiency Standards (Gas EE Standards) designed to require UNS Gas and other affected utilities to implement cost-effective DSM programs. In 2011, the Gas EE Standards targeted total retail therm savings equal to 0.5% of 2010 sales; UNS Gas estimates its total savings in 2011 were 0.25%. Targeted savings increase annually in subsequent years until they reach a cumulative annual reduction in retail therm sales of 6% by 2020.

The Gas EE Standards can be met by: new and existing DSM programs, renewable energy technology that displaces gas, and by a portion of energy efficient building codes. The Gas EE Standards provide for the recovery of costs incurred to implement DSM programs. UNS Gas DSM programs and Retail Rates charged to customers for these programs are subject to ACC approval.

In December 2010, the ACC approved a policy statement recognizing the need to adopt rate decoupling or another mechanism to make Arizona s Gas EE Standards viable. For more information about decoupling, see *TEP, Rates and Regulation, Electric Energy Efficiency Standards and Decoupling*, above.

Table of Contents

ENVIRONMENTAL MATTERS

UNS Gas is subject to environmental regulation of air and water quality, resource extraction, waste disposal and land use by federal, state and local authorities. UNS Gas facilities are in substantial compliance with existing regulations. See *Item. 1 Business, TEP, Environmental Matters*, for more information.

UNS ELECTRIC

SERVICE TERRITORY AND CUSTOMERS

UNS Electric is a vertically integrated electric utility company serving approximately 91,000 retail customers in Mohave and Santa Cruz counties. These counties have a combined population of approximately 240,000. The average number of retail customers grew by less than 1% in 2009, 2010 and 2011. We estimate that UNS Electric s retail customer base will increase by less than 1% in 2012. UNS Electric s customer base is primarily residential, with some small commercial and both light and heavy industrial customers. Peak demand for 2011 was 438 MW.

POWER SUPPLY AND TRANSMISSION

Purchased Energy

UNS Electric relies on a portfolio of long, intermediate and short-term purchases to meet customer load requirements.

Generating Resources

UNS Electric owns and operates Black Mountain Generating Station (BMGS), a 90 MW gas-fired facility located near Kingman, Arizona. In July 2011, UNS Electric purchased BMGS from UED. UNS Gas purchases and transports natural gas to BMGS for UNS Electric under long-term natural gas transportation and sales agreements. See *Rates and Regulation, 2010 UNS Electric Rate Order*, below for more information.

UNS Electric also owns and operates the Valencia Power Plant (Valencia), located in Nogales, Arizona. Valencia consists of four gas and diesel-fueled combustion turbine units and provides approximately 62 MW of peaking resources. The facility is directly interconnected with the distribution system serving the city of Nogales and the surrounding areas.

Renewable Energy Resources

UNS Electric has agreed to purchase the output of a combined wind farm and solar generating facility located near Kingman. The above-market cost of energy purchased through the 20-year PPA will be recovered through the RES surcharge. For more information see *Rates and Regulation, Renewable Energy Standard and Tariff* below.

Future Generating Resources

UNS Electric invested $5 million in 2011 in company-owned solar PV capacity and expects to invest approximately $5 million annually from 2012 through 2014 to build about 1.25 MW per year in company-owned solar PV capacity. See *Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, UNS Electric, Factors Affecting Results of Operations, Renewable Energy Standard and Tariff* for more information.

Transmission

UNS Electric imports the power generated at BMGS into its Mohave County and Santa Cruz County service territories over Western Area Power Administration s (WAPA) transmission lines. UNS Electric has a network transmission service agreement for its primary transmission capacity with WAPA for the Parker-Davis system that expires in August 2016. UNS Electric also has a long-term electric point-to-point transmission capacity agreement with WAPA for the Southwest Intertie system that expires in June 2016.

UNS Electric plans to upgrade the existing 115 kV transmission line serving Santa Cruz County to 138 kV by October 2014 to improve service reliability. This upgrade is included in UNS Electric s current capital expenditures forecast. See *Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, UNS Electric, Liquidity and Capital Resources* for more information.

Table of Contents

RATES AND REGULATION

2010 UNS Electric Rate Order

In 2010, the ACC authorized a Base Rate increase of $7.4 million, or 4%, effective October 1, 2010.

The 2010 UNS Electric Rate Order approved UNS Electric s purchase of BMGS from UED, subject to FERC approval and other conditions. FERC approved the purchase in June 2011.

The 2010 UNS Electric Rate Order also approved a plan for UNS Electric to invest $5 million each year from 2011 through 2014 in solar projects that would be owned by UNS Electric. See *Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, UNS Electric, Factors Affecting Results of Operations, Renewable Energy Standard and Tariff*, for more information.

In compliance with the 2010 Rate Order, UNS Electric expects to file a rate case in the second half of 2012.

Purchased Power and Fuel Adjustment Clause

The PPFAC allows UNS Electric 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 June 1 of each year. The forward component is based on the forecasted fuel, transmission, and purchased power costs for the 12-month period from June 1 of the current year to May 31 of the following year, less the base fuel, transmission, and purchased power costs embedded in Base Rates. The cap on the PPFAC forward component, over the 6.77 cents per kWh in Base Rates, is 1.845 cents per kWh.

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.

Renewable Energy Standard and Tariff

The ACC s RES requires UNS Electric, TEP 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 costs of carrying out those plans are recovered from retail customers through the RES surcharge. Any surcharge collections above or below the costs incurred to implement the plans are deferred and reflected in UNS Electric s financial statements as a regulatory asset or liability.

In 2011, UNS Electric spent $5 million on RES implementation and met the 2011 renewable energy target of 3%. UNS Electric expects to collect $8 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%.

For more information see *Power Supply and Transmission*, *Renewable Energy Resources,* above, and *Item 7. Management s Discussion and Analysis, UNS Electric, Factors Affecting Results of Operations, Renewable Energy Standard and Tariff.*

Energy Efficiency Standards and Decoupling

In 2010, the ACC approved EE Standards designed to require UNS Electric, TEP, and other affected electric utilities to implement cost effective DSM programs. For more information, see *TEP, Rates and Regulation, Electric Energy Efficiency Standards and Decoupling*, above.

Table of Contents

ENVIRONMENTAL MATTERS

UNS Electric is subject to environmental regulation of air and water quality, resource extraction, waste disposal and land use by federal, state and local authorities. UNS Electric believes that its facilities are in substantial compliance with all existing regulations and will be in compliance with expected environmental regulations. See *Item. 1 Business, TEP, Environmental Matters*, for more information.

OTHER NON-REPORTABLE SEGMENTS

Millennium

As of December 31, 2011, Millennium had assets of $20 million including a $15 million note receivable (see *Sabinas* below), and cash and cash equivalents of $5 million. In total, Millennium s assets represented less than 1% of UniSource Energy s total consolidated assets. See *Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, Other Non-Reportable Business Segments,* for more information.

Sabinas

In 2009, Millennium sold its 50% interest in Sabinas and recorded a $6 million pre-tax gain on the sale.

Millennium received an upfront $5 million cash payment in January 2009. Other key terms of the transaction included a three-year, 6% interest-bearing, collateralized $15 million note, which matures in June 2012.

SES

SES, a wholly owned subsidiary of Millennium, provides electrical contracting and meter reading services in Arizona, as well as other services at the Springerville Generating Station.

EMPLOYEES (As of December 31, 2011)

TEP had 1,391 employees, of which approximately 51% are represented by the International Brotherhood of Electrical Workers (IBEW) Local No. 1116. A collective bargaining agreement between the IBEW and TEP expires in January 2013.

UNS Gas had 187 employees, of which 108 employees were represented by IBEW Local No. 1116 and 5 employees were represented by IBEW Local No. 387. The agreements with the IBEW Local No. 1116 and No. 387 expire in June 2012 and February 2014, respectively.

UNS Electric had 154 employees, of which 27 employees were represented by the IBEW Local No. 387 and 96 employees were represented by the IBEW Local No. 769. The existing agreements with the IBEW Local No. 387 and No. 769 expire in February 2014 and June 2013, respectively.

SES had 272 employees, of which approximately 96% are represented by unions. Of the employees represented by unions, 236 are represented by IBEW Local No. 1116 and 25 by IBEW Local No. 570; these agreements expire on December 31, 2012, and May 31, 2012, respectively.

Table of Contents

EXECUTIVE OFFICERS OF THE REGISTRANTS

Executive Officers UniSource Energy and TEP

Executive Officers of UniSource Energy and TEP, who are elected annually by UniSource Energy s Board of Directors and TEP s Board of Directions, respectively, are as follows:

Name	September 30, Age	September 30, Position(s) Held	September 30, Executive Officer Since
Paul J. Bonavia	60	Chairman and Chief Executive Officer	2009
David G. Hutchens	45	President	2007
Michael J. DeConcini	47	Senior Vice President, Operations	1999
Kevin P. Larson	55	Senior Vice President and Chief Financial Officer(1)	2000
Philip J. Dion III	43	Vice President, Public Policy	2008
Kentton C. Grant	53	Vice President, Finance and Rates(2)	2007
Todd C. Hixon	45	Vice President and General Counsel	2011
Arie Hoekstra	64	Vice President, Generation	2007
Karen G. Kissinger	57	Vice President, Controller and Chief Compliance Officer	1998
Thomas A. McKenna	63	Vice President, Engineering	2007
Catherine E. Ries	52	Vice President, Human Resources	2007
Herlinda H. Kennedy	50	Corporate Secretary	2006

(1) Mr. Larson is also Treasurer at UniSource Energy.

(2) Mr. Grant is also Treasurer at TEP.

Paul J. Bonavia Mr. Bonavia has served as Chairman and Chief Executive Officer of UniSource Energy and TEP since January 2009; he also served as President from January 2009 to December 2011. Prior to joining UniSource Energy, Mr. Bonavia served as President of the Utilities Group of Xcel Energy. Mr. Bonavia previously served as President of Xcel Energy s Commercial Enterprises business unit and President of the company s Energy Markets unit.

David G. Hutchens Mr. Hutchens has served as President of UniSource Energy and TEP since December 2011. In March 2011, Mr. Hutchens was named Executive Vice President of UniSource Energy and TEP. In May 2009, Mr. Hutchens was named Vice President of Energy Efficiency and Resource Planning. In January 2007, Mr. Hutchens was elected Vice President of Wholesale Energy at UniSource Energy and TEP. Mr. Hutchens joined TEP in 1995.

Michael J. DeConcini Mr. DeConcini has served as Senior Vice President, Operations of UniSource Energy since May 2010 and Senior Vice President and Chief Operating Officer of TEP from May 2009 to December 2011 when his title at TEP was changed to Senior Vice President, Operations. Mr. DeConcini joined TEP in 1988 and was elected Senior Vice President and Chief Operating Officer of the Energy Resources business unit of TEP, effective January 1, 2003. In August 2006, he was named Senior Vice President and Chief Operating Officer, Transmission and Distribution.

Kevin P. Larson Mr. Larson has served as Senior Vice President and Chief Financial Officer of UniSource Energy and TEP since September 2005. Mr. Larson is also Treasurer of UniSource Energy. Mr. Larson joined TEP in 1985 and thereafter held various positions in its finance department and investment subsidiaries. He was elected Treasurer in August 1994 and Vice President in March 1997. In October 2000, he was elected Vice President and Chief Financial Officer.

Philip J. Dion III

Mr. Dion has served as Vice President of Public Policy of UniSource Energy and TEP since April 2010. Mr. Dion joined UniSource Energy in February 2008 as Vice President of Legal and Environmental Services. Prior to joining UniSource Energy, Mr. Dion was chief of staff and chief legal advisor to Commissioner Marc Spitzer of the FERC. Mr. Dion previously worked in various roles at the ACC, including as an administrative law judge and as an advisor to Mr. Spitzer, prior to his appointment to FERC.

Table of Contents

Kentton C. Grant	Mr. Grant has served as Vice President of Finance and Rates of UniSource Energy and TEP since January 2007. Mr. Grant also serves as Treasurer of TEP. Mr. Grant joined TEP in 1995.
Todd C. Hixon	Mr. Hixon has served as Vice President and General Counsel of UniSource Energy and TEP since May 2011. Mr. Hixon joined TEP s legal department in 1998 and served in a variety of capacities, most recently serving as Associate General Counsel.
Arie Hoekstra	Mr. Hoekstra has served as Vice President of Generation of UniSource Energy and TEP since January 2007. Mr. Hoekstra joined TEP in 1979 and thereafter served in various positions at TEP s generating stations in Tucson and Springerville.
Karen G. Kissinger	Ms. Kissinger has served as Vice President, Controller and Principal Accounting Officer of UniSource Energy and TEP since January 1998 and has served as Chief Compliance Officer since 2003. Ms. Kissinger joined TEP as Vice President and Controller in January 1991.
Thomas A. McKenna	Mr. McKenna has served as Vice President of Engineering of UniSource Energy and TEP since January 2007. Mr. McKenna joined Nations Energy Corporation (a wholly-owned subsidiary of Millennium) in 1998.
Catherine E. Ries	Ms. Ries has served as Vice President of Human Resources of UniSource Energy and TEP since June 2007. Prior to joining UniSource Energy, Ms. Ries worked for Clopay Building Products, a division of Griffon Corporation, from 2000 to 2007, and held the position of Vice President of Human Resources.
Herlinda H. Kennedy	Ms. Kennedy has served as Corporate Secretary of UniSource Energy and TEP since September 2006. Ms. Kennedy joined TEP in 1980 and was named assistant Corporate Secretary in 1999.

SEC REPORTS AVAILABLE ON UNISOURCE ENERGY S WEBSITE

UniSource Energy and TEP make available their annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practical after they electronically file them with, or furnish them to, the Securities and Exchange Commission (SEC). These reports are available free of charge through UniSource Energy s website address: http://www.uns.com. A link from UniSource Energy s website to these SEC reports is accessible as follows: At the UniSource Energy main page, select Investors from the menu shown at the top of the page; next select SEC filings from the menu shown on the Investor Relations page. UniSource Energy s code of ethics, which applies to the Board of Directors and all officers and employees of UniSource Energy and its subsidiaries, and any amendments or any waivers made to the code of ethics, is also available on UniSource Energy s website.

Information contained at UniSource Energy s website is not part of any report filed with the SEC by UniSource Energy or TEP.

ITEM 1A. RISK FACTORS

The business and financial results of UniSource Energy and TEP are subject to a number of risks and uncertainties, including those set forth below and in other documents we file with the SEC. These risks and uncertainties fall primarily into five major categories: revenues, regulatory, environmental, financial and operational.

Table of Contents

REVENUES

National and local economic conditions can have a significant impact on the results of operations, net income and cash flows at TEP, UNS Gas and UNS Electric.

Economic conditions have contributed significantly to a reduction in TEP s retail customer growth and lower energy usage by the company s residential, commercial and industrial customers. As a result of weak economic conditions, TEP s average retail customer base grew by less than 1% per year in 2008 through 2011 compared with average increases of approximately 2% per year from 2003 to 2007. In 2011, total retail kWh sales were 0.4% above 2010 levels. TEP estimates that a 1% decrease in annual retail sales could reduce pre-tax net income and pre-tax cash flows by approximately $6 million.

Similar impacts were felt at UNS Gas and UNS Electric. Annual increases in the number of retail customers at both companies remained below 1% in 2008 through 2011 compared with average annual growth rates of 3% from 2003 to 2007. We estimate that a 1% decrease in annual retail sales at UNS Gas and UNS Electric could reduce pre-tax net income and pre-tax cash flows by less than $1 million.

TEP s Base Rates are frozen through December 31, 2012, which could limit our ability to cope with the impact of risks and uncertainties and negatively affect TEP s results of operations, net income and cash flows.

Under the terms of the 2008 TEP Rate Order, TEP is prohibited from submitting an application for new Base Rates before June 30, 2012. New Base Rates would not be in effect until approval by the ACC, which is not anticipated to occur before the third quarter of 2013. If the cost of serving TEP s customers rises more quickly than the revenues it collects from customers, TEP s results of operations, net income and cash flows could be negatively impacted.

New technological developments and the implementation of new Energy Efficiency Standards may have a significant impact on retail sales, which could negatively impact UniSource Energy s results of operations, net income and cash flows.

Heightened awareness of energy costs has increased demand for products intended to reduce consumers use of electricity. TEP and UNS Electric also are promoting DSM programs designed to help customers reduce their energy use, and these efforts will increase significantly under new energy efficiency rules approved in 2010 by the ACC. Unless the ACC makes a specific provision for the recovery of usage-based revenues lost to these energy efficiency programs, the reduced retail sales that would result from the success of these efforts would negatively impact the results of operations, net income and cash flows of TEP and UNS Electric.

The revenues, results of operations and cash flows of TEP, UNS Gas and UNS Electric are seasonal, and are subject to weather conditions and customer usage patterns, which are beyond the companies control.

TEP typically earns the majority of its operating revenue and net income in the third quarter because retail customers increase their air conditioning usage during Tucson s hot summer weather. Conversely, TEP s first quarter net income is typically limited by relatively mild winter weather in its retail service territory. UNS Electric s earnings follow a similar pattern, while UNS Gas sales peak in the winter during home heating season. Cool summers or warm winters may reduce customer usage at all three companies, adversely affecting operating revenues, cash flows and net income by reducing sales. TEP estimates that a 1% decrease in annual retail sales could reduce pre-tax net income and pre-tax cash flows by approximately $6 million. We estimate that a 1% decrease in annual retail sales at UNS Gas and UNS Electric could reduce pre-tax net income and pre-tax cash flows by less than $1 million.

REGULATORY

TEP, UNS Gas and UNS Electric are subject to regulation by the ACC, which sets the companies Retail Rates and oversees many aspects of their business in ways that could negatively affect the companies results of operations, net income and cash flows.

The ACC is a constitutionally created body composed of five elected commissioners. Commissioners are elected state-wide for staggered four-year terms and are limited to serving a total of two terms. As a result, the composition of the commission, and therefore its policies, are subject to change every two years.

Table of Contents

The ACC is charged with setting retail electric and gas rates that provide utility companies with an opportunity to recover their costs of service and earn a reasonable rate of return. The decisions these elected officials make on such matters impact the net income and cash flows of TEP, UNS Gas and UNS Electric.

Changes in federal energy regulation may negatively affect the results of operations, net income and cash flows of TEP, UNS Gas and UNS Electric.

TEP, UNS Gas and UNS Electric are subject to the impact of comprehensive and changing governmental regulation at the federal level that continues to change the structure of the electric and gas utility industries and the ways in which these industries are regulated. UniSource Energy s electric utility subsidiaries are subject to regulation by the FERC. The FERC has jurisdiction over rates for electric transmission in interstate commerce and rates for wholesale sales of electric power, including terms and prices of transmission services and sales of electricity at wholesale prices.

ENVIRONMENTAL

UniSource Energy s utility subsidiaries are subject to numerous environmental laws and regulations that may increase their cost of operations or expose them to environmentally-related litigation and liabilities. Many of these regulations could have a significant impact on TEP due to its reliance on coal as its primary fuel for energy generation.

Numerous federal, state and local environmental laws and regulations affect present and future operations. Those laws and regulations include rules regarding air emissions, water use, wastewater discharges, solid waste, hazardous waste and management of coal combustion residuals.

These laws and regulations can contribute to higher capital, operating and other costs, particularly with regard to enforcement efforts focused on existing power plants and new compliance standards related to new and existing power plants. These laws and regulations generally require us to obtain and comply with a wide variety of environmental licenses, permits, authorizations and other approvals. Both public officials and private individuals may seek to enforce applicable environmental laws and regulations. Failure to comply with applicable laws and regulations may result in litigation, and the imposition of fines, penalties and a requirement for costly equipment upgrades by regulatory authorities.

We cannot provide assurance that existing environmental laws and regulations will not be revised or that new environmental laws and regulations will not be adopted or become applicable to our facilities. Increased compliance costs or additional operating restrictions from revised or additional regulation could have an adverse effect on our results of operations, particularly if those costs are not fully recoverable from our ratepayers. TEP s obligation to comply with the EPA s BART determinations as a participant in the San Juan, Four Corners and Navajo plants, coupled with the financial impact of future climate change legislation, other environmental regulations and other business considerations, could jeopardize the economic viability of these plants or the ability of individual participants to meet their obligations and continue their participation in these plants. TEP cannot predict the ultimate outcome of these matters.

TEP also is contractually obligated to pay a portion of the environmental reclamation costs incurred at generating stations in which it has a minority interest and is obligated to pay similar costs at the mines that supply these generating stations. While TEP has recorded the portion of its costs that can be determined at this time, the total costs for final reclamation at these sites are unknown and could be substantial.

New federal regulations to limit greenhouse gas emissions could increase TEP s cost of operations and result in a change in the composition of TEP s coal-dominated generating fleet.

Based on the finding by the EPA in December 2009 that emissions of greenhouse gases endanger public health and welfare, the agency is in the process of regulating greenhouse gas emissions. In addition, there are proposals and ongoing studies at the state, federal and international levels to address global climate change that could also result in the regulation of carbon dioxide (CO_2) and other greenhouse gases. Any future regulatory actions taken to address global climate change represent a business risk to our operations. In 2011, 73% of TEP s total energy resources came from its coal-fueled generating facilities.

Reductions in CO_2 emissions to the levels specified by some proposals could be materially adverse to our financial position or results of operations if associated costs of control or limitation cannot be recovered from customers.

Table of Contents

Any future legislation or regulation addressing climate change could produce a number of other results including costly modifications to, or reexamination of the economic viability of, our existing coal plants; changes in the overall fuel mix of our generating fleet; or additional costs to fund energy efficiency activities. The impact of legislation or regulation to address global climate change would depend on the specific terms of those measures and cannot be determined at this time.

FINANCIAL

Volatility or disruptions in the financial markets may increase our financing costs, limit our access to the credit markets and increase our pension funding obligations, which may adversely affect our liquidity and our ability to carry out our financial strategy.

We rely on access to the bank markets and capital markets as a significant source of liquidity and for capital requirements not satisfied by the cash flow from our operations. Market disruptions such as those experienced over the last four years in the United States and abroad may increase our cost of borrowing or adversely affect our ability to access sources of liquidity needed to finance our operations and satisfy our obligations as they become due. These disruptions may include turmoil in the financial services industry, including substantial uncertainty surrounding particular lending institutions and counterparties we do business with, unprecedented volatility in the markets where our outstanding securities trade, and general economic downturns in our utility service territories. If we are unable to access credit at competitive rates, or if our borrowing costs dramatically increase, our ability to finance our operations, meet our short-term obligations and execute our financial strategy could be adversely affected.

Changing market conditions could negatively affect the market value of assets held in our pension and other postretirement pension plans and may increase the amount and accelerate the timing of required future funding contributions.

UniSource Energy s net income and cash flows can be adversely affected by rising interest rates.

As of February 21, 2012, TEP had $215 million of tax-exempt variable rate debt obligations, $50 million of which was hedged with a fixed for floating interest rate swap through September 2014. The interest rates are set weekly with maximum interest rates of 20% on $178 million of debt obligations and 10% on the remaining $37 million. The average weekly interest rate ranged from 0.05% to 0.34% in 2011. A 100 basis point increase in the average interest rates on this debt over a twelve-month period would increase TEP s interest expense by approximately $2 million.

UniSource Energy, TEP, UNS Gas and UNS Electric also are subject to risk resulting from changes in the interest rate on their borrowings under revolving credit facilities. Revolving credit borrowings may be made on a spread over LIBOR or an Alternate Base Rate. Each of these agreements is a committed facility and expires in November 2016.

If capital market conditions result in rising interest rates, the resulting increase in the cost of variable rate borrowings would negatively impact UniSource Energy s, TEP s, UNS Gas and UNS Electric s results of operations, net income and cash flows.

TEP, UNS Gas and UNS Electric may be required to post margin under their power and fuel supply agreements, which could negatively impact their liquidity.

TEP, UNS Gas and UNS Electric secure power and fuel supply resources to serve their respective retail customers. The agreements under which TEP, UNS Gas and UNS Electric contract for such resources include requirements to post credit enhancement in the form of cash or letters of credit under certain circumstances, including changes in market prices which affect contract values, or a change in creditworthiness of the respective companies.

In order to post such credit enhancement, TEP, UNS Gas and UNS Electric would have to use available cash, draw under their revolving credit agreements, or issue letters of credit under their revolving credit agreements.

The maximum amount TEP may use under its revolving credit facility is $200 million. As of February 21, 2012, TEP had $114 million available to borrow under its revolving credit facility. The maximum amount UNS Gas or UNS Electric may use under their revolving credit facility is $70 million, so long as the combined amount drawn by

Table of Contents

both companies does not exceed $100 million. As of February 21, 2012, UNS Gas and UNS Electric had $64 million and $70 million, respectively, to borrow under their revolving credit facility. From time to time, TEP, UNS Gas and UNS Electric use their respective revolving credit facilities to post collateral. If additional collateral is required, it may negatively impact TEP, UNS Gas and/or UNS Electric s ability to fund their capital requirements. As of December 31, 2011, TEP and UNS Electric had posted $1 million, and $6 million, respectively, with counterparties in the form of cash or letters of credit.

UniSource Energy and its subsidiaries have debt which could adversely affect their business and results of operations.

UniSource Energy has no operations of its own and derives all of its revenues and cash flow from its subsidiaries. At December 31, 2011, the ratio of total debt (including capital lease obligations net of investments in lease debt) to total capitalization for UniSource Energy and its subsidiaries was 67%. This debt level:

- requires UniSource Energy and its subsidiaries to dedicate a substantial portion of their cash flow to pay principal and interest on their debt, which could reduce the funds available for working capital, capital expenditures, acquisitions and other general corporate purposes; and

- could limit UniSource Energy and its subsidiaries ability to borrow additional amounts for working capital, capital expenditures, acquisitions, dividends, debt service requirements, execution of its business strategy or other purposes.

The cost of purchasing TEP s leased assets, or the cost of procuring alternate sources of generation or purchased power in 2015, could require significant outlays of cash in one year, which could be difficult to finance.

TEP leases the following generation facilities under separate sale and leaseback arrangements that expire in 2015:

Leased Asset	September 30, Expiration	September 30, Purchase Option
Springerville Unit 1	2015	Fair market value purchase option of $159 million
Springerville Coal Handling Facilities	2015	Fixed price purchase option of $120 million

TEP may renew the leases or purchase the assets when the leases expire in 2015. The renewal and purchase options for Springerville Unit 1 are for fair market value, with the fair market value purchase price having been determined in December 2011 through an appraisal process to be $159 million. The Springerville Coal Handling Facilities can be purchased in 2015 for a fixed price of $120 million. TEP also leases a 50% undivided interest in Springerville Common Facilities with primary lease terms ending in 2017 and 2021. Upon expiration of the Springerville Coal Handling and Common Facilities Leases (whether at the end of the initial term or any renewal term), TEP has the obligation under agreements with the owners of Springerville Units 3 and 4 to purchase such facilities. Upon acquisition by TEP, the owner of Springerville Unit 3 has the option and the owner of Springerville Unit 4 has the obligation to purchase from TEP a 14% interest in the Common Facilities and a 17% interest in the Coal Handling Facilities.

Regulatory rules and other restrictions limit the ability of TEP, UNS Gas and UNS Electric to make distributions to UniSource Energy.

As a holding company, UniSource Energy is dependent on the earnings and distributions of funds from its subsidiaries to service its debt and pay dividends to shareholders.

Restrictions include:

- TEP, UNS Gas and UNS Electric are restricted from lending to affiliates or issuing securities without ACC approval;

The Federal Power Act restricts electric utilities ability to pay dividends out of funds that are properly included in their capital account. TEP has an accumulated deficit rather than positive retained earnings. Although the terms of the Federal Power Act are unclear, we believe there is a reasonable basis for TEP to pay dividends from current year earnings; and

Table of Contents

TEP, UNS Gas and UNS Electric must be in compliance with their respective debt agreements to make dividend payments to UniSource Energy.

Unanticipated financing needs or reductions to net income could adversely impact our ability to comply with financial covenants in the UniSource Energy, TEP and UES Credit Agreements.

The UniSource Energy, TEP and UES credit and reimbursement agreements include a maximum leverage ratio. The leverage ratios are calculated as the ratio of total indebtedness to total capital. The ability to comply with these covenants could be adversely impacted by unanticipated borrowing needs or unexpected charges to earnings or shareholder equity. In the event that we seek to renegotiate these provisions to provide additional flexibility, we may need to pay fees or increased interest rates on borrowings as a condition to any amendments or waivers.

OPERATIONAL

The operation of electric generating stations involves risks that could result in unplanned outages or reduced generating capability that could adversely affect TEP s or UNS Electric s results of operations, net income and cash flows.

The operation of electric generating stations involves certain risks, including equipment breakdown or failure, interruption of fuel supply and lower than expected levels of efficiency or operational performance. Unplanned outages, including extensions of planned outages due to equipment failure or other complications, occur from time to time and are an inherent risk of our business. If TEP s or UNS Electric s generating stations operate below expectations, TEP or UNS Electric could be adversely affected.

The operation of electric transmission and distribution systems involves a risk of significant unplanned outages that could adversely affect TEP s and UNS Electric s businesses, results of operations, net income and cash flows.

The operation of electric transmission and distribution systems involves certain risks, including equipment failure and damage caused by storms, fires or other hazards. Unplanned outages occur from time to time and are an inherent risk of our business. If TEP s or UNS Electric s transmission and distribution systems experience a significant failure, TEP or UNS Electric could be adversely affected.

TEP could be subject to higher costs and the possibility of significant penalties as a result of mandatory transmission standards.

As a result of the Energy Policy Act of 2005, owners and operators of bulk power transmission systems, including TEP, are subject to mandatory transmission standards developed and enforced by NERC and subject to the oversight of FERC. Compliance with modified or new transmission standards may subject TEP to higher operating costs and increased capital costs. Failure to comply with the mandatory transmission standards could subject TEP to sanctions, including substantial monetary penalties.

We may be subject to cyber attacks and information security risks.

As operators of critical energy infrastructure, we may face a heightened risk of cyber attack, and our corporate and informational technology systems may be vulnerable to disability or failures as a result of unauthorized access due to hacking, viruses, acts of war or terrorism and other causes. In addition, our utility business requires access to sensitive customer data, including personal and credit information, in the ordinary course of business. If, despite our security measures, a significant or widely publicized breach occurred, we could have our operations disrupted, property damaged and customer information stolen; experience substantial loss of revenues, response costs and other financial loss; and be subject to increased regulation, litigation and damage to our reputation, any of which could have a negative impact on our business and results of operations.

TEP or UNS Electric might not be able to secure adequate right-of-way to construct transmission lines and distribution-related facilities, and could be required to find alternate ways to provide adequate sources of energy and maintain reliable service for their customers.

TEP and UNS Electric rely on federal, state and local governmental agencies to secure right-of-way and siting permits to construct transmission lines and distribution-related facilities. If adequate right-of-way and siting permits to build new transmission lines cannot be secured:

Table of Contents

TEP and UNS Electric may need to rely on more costly alternatives to provide energy to their customers;

TEP and UNS Electric may not be able to maintain reliability in their service areas; or

TEP and UNS Electric s ability to provide electric service to new customers may be negatively impacted.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

TEP PROPERTIES

TEP s transmission facilities, located in Arizona and New Mexico, transmit the output from TEP s remote electric generating stations at Four Corners, Navajo, San Juan, Springerville and Luna to the Tucson area for use by TEP s retail customers (see *Item 1. Business, TEP, Generating and Other Resources*). The transmission system is interconnected at various points in Arizona and New Mexico with other regional utilities. TEP has arrangements with approximately 140 companies to interchange generation capacity and transmission of energy.

As of December 31, 2011, TEP owned or participated in an overhead electric transmission and distribution system consisting of:

512 circuit-miles of 500-kV lines;

1,088 circuit-miles of 345-kV lines;

405 circuit-miles of 138-kV lines;

479 circuit-miles of 46-kV lines; and

2,615 circuit-miles of lower voltage primary lines.

TEP s underground electric distribution system includes 4,389 cable-miles. TEP owns approximately 76% of the poles on which its lower voltage lines are located. Electric substation capacity consists of 103 substations with a total installed transformer capacity of 13,266,850 kilovolt amperes.

Substantially all of the utility assets owned by TEP are subject to the lien of the 1992 Mortgage. Springerville Unit 2, which is owned by San Carlos Resources, is not subject to the lien.

The electric generating stations (except as noted below), administrative headquarters, warehouse and service center are located on land owned by TEP. The electric distribution and transmission facilities owned by TEP are located:

on property owned by TEP;

under or over streets, alleys, highways and other places in the public domain, as well as in national forests and state lands, under franchises, easements or other rights which are generally subject to termination;

under or over private property as a result of easements obtained primarily from the record holder of title; or

over American Indian reservations under grant of easement by the Secretary of Interior or lease by American Indian tribes.

It is possible that some of the easements, and the property over which the easements were granted, may have title defects or may be subject to mortgages or liens existing at the time the easements were acquired.

Springerville is located on property owned by TEP under a long-term surface ownership agreement with the State of Arizona.

Four Corners and Navajo are located on properties held under easements from the United States and under leases from the Navajo Nation, respectively. TEP, individually and in conjunction with PNM in connection with San Juan, has acquired easements and leases for transmission lines and a water diversion facility located on land owned by the Navajo Nation. TEP also has acquired easements for transmission facilities related to San Juan, Four Corners, and Navajo across the Zuni, Navajo and Tohono O dham Indian Reservations. TEP, in conjunction with PNM and Phelps Dodge, holds an undivided ownership interest in the property on which Luna is located.

Table of Contents

TEP s rights under these various easements and leases may be subject to defects such as:

- possible conflicting grants or encumbrances due to the absence of, or inadequacies in, the recording laws or record systems of the Bureau of Indian Affairs and the American Indian tribes;
- possible inability of TEP to legally enforce its rights against adverse claimants and the American Indian tribes without Congressional consent; or
- failure or inability of the American Indian tribes to protect TEP s interests in the easements and leases from disruption by the U.S. Congress, Secretary of the Interior, or other adverse claimants.

These possible defects have not interfered, and are not expected to materially interfere, with TEP s interest in and operation of its facilities.

TEP, under separate sale and leaseback arrangements, leases the following generation facilities (which do not include land):

- Springerville Coal Handling Facilities;
- a 50% undivided interest in the Springerville Common Facilities; and
- Springerville Unit 1 and the remaining 50% undivided interest in the Springerville Common Facilities.

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 additional information on TEP s capital lease obligations.

UES PRO PERTIES

UNS Gas

As of December 31, 2011, UNS Gas transmission and distribution system consisted of approximately 31 miles of steel transmission mains, 4,220 miles of steel and plastic distribution piping, and 137,160 customer service lines.

UNS Electric

As of December 31, 2011, UNS Electric s transmission and distribution system consisted of approximately 56 circuit-miles of 115-kV transmission lines, 274 circuit-miles of 69-kV transmission lines, and 3,616 circuit-miles of underground and overhead distribution lines. UNS Electric also owns the 65 MW Valencia plant, the 90 MW BMGS as well as 39 substations having a total installed capacity of 1,494,000 kilovolt amperes.

The gas and electric distribution and transmission facilities owned by UNS Gas and UNS Electric are located:

- on property owned by UNS Gas or UNS Electric;
- under or over streets, alleys, highways and other places in the public domain, as well as national forests and state lands, under franchises, easements or other rights which are generally subject to termination; or

under or over private property as a result of easements obtained primarily from the record holder of title.

ITEM 3. LEGAL PROCEEDINGS

Right of Way Matters

TEP was a defendant in a class action filed in February 2009 in the United States District Court in Albuquerque, New Mexico by members of the Navajo Nation. The plaintiffs alleged, among other things, that the rights of way for defendants transmission lines on Navajo lands were improperly granted and that the compensation paid for such rights of way was inadequate. The plaintiffs were requesting, among other things, that the transmission lines on these lands be removed. In June 2009, TEP and the other defendants filed motions to dismiss the lawsuit on procedural grounds. In March 2010, the Court granted several of the defendants motions to dismiss and entered a final judgment dismissing the case in April 2010. The plaintiffs filed a Notice of Appeal with the Bureau of Indian

Table of Contents

Affairs (BIA) in May 2010, appealing the BIA s decision to grant the rights of way that were the subject of the now-dismissed complaint. In June 2010, the BIA found that the Notice of Appeal failed to meet the minimum filing requirements. In September 2010, the plaintiffs filed new Notices of Appeal concerning the same rights of way. The appeals are currently pending. TEP cannot predict the outcome of these appeals.

In addition, see legal proceedings described in Note 4.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF COMMON EQUITY

Stock Trading

UniSource Energy s common stock is traded under the ticker symbol UNS and is listed on the New York Stock Exchange. On February 21, 2012, the closing price was $37.76, with 8,339 shareholders of record.

TEP s common stock is wholly-owned by UniSource Energy and is not listed for trading on any stock exchange.

Dividends

UniSource Energy

UniSource Energy s Board of Directors expects to continue to pay regular quarterly cash dividends on our common stock; however, such dividends are subject to the Board s evaluation of our financial condition, earnings, cash flows and dividend policy.

On February 24, 2012, UniSource Energy declared a first quarter cash dividend of $0.43 per share on its common stock. The first quarter dividend, totaling approximately $16 million, will be paid March 22, 2012, to shareholders of record at the close of business March 12, 2012. The table below summarizes UniSource Energy s dividends paid in 2009 through 2011.

	September 30, 2011	September 30, 2010	September 30, 2009
Quarterly Dividend Per Common Share	$ 0.42	$ 0.39	$ 0.29
Annual Dividend Per Common Share	$ 1.68	$ 1.56	$ 1.16
Common Stock Dividends Paid	$ 62 million	$ 57 million	$ 41 million

UniSource Energy is the sole shareholder of TEP s common stock and relies on dividends from its subsidiaries, primarily TEP, to declare and pay dividends. The TEP Board of Directors typically declares a dividend at the end of each year.

TEP

TEP did not pay any dividends to UniSource Energy in 2011. TEP declared and paid cash dividends to UniSource Energy of $60 million in 2010 and $60 million in 2009.

TEP can pay dividends if it maintains compliance with the TEP Credit Agreement and certain financial covenants. As of December 31, 2011, TEP was in compliance with t