UNISOURCE ENERGY CORP
Form DEFM14A
February 24, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934

Filed by the Registrant ý

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement

o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

ý Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material Pursuant to Rule 14a-12

UniSource Energy Corporation

(Name of Registrant as Specified In Its Charter)

N/A

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

o No fee required.

ý Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:
Shares of common stock, no par value per share, of UniSource Energy Corporation

(2) Aggregate number of securities to which transaction applies:
37,272,666 shares.

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
The proposed maximum aggregate value of the transaction is $941,134,817 (which is the product of 37,272,666 (the number of shares of UniSource Energy Corporation common stock to be converted in the merger) and $25.25 (the per share consideration)). The filing fee is $119,242 (which is the product of the proposed maximum aggregate value of the transaction and $126.70 per million pursuant to Fee Rate Advisory No. 7 for Fiscal Year 2004).

(4) Proposed maximum aggregate value of transaction:
$941,134,817

(5) Total fee paid:
$119,242

ý Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

One South Church Avenue
Tucson, Arizona 85701

February 23, 2004

PROPOSED ACQUISITION YOUR VOTE IS IMPORTANT

James S. Pignatelli (520) 571-4000
Chairman of the Board

Dear Shareholders:

On November 21, 2003, we entered into an acquisition agreement with Saguaro Acquisition Corp., which is a wholly owned indirect subsidiary of Saguaro Utility Group L.P. The acquisition agreement provides that Saguaro Utility Group L.P. will acquire us by merging Saguaro Acquisition Corp. with and into us. We will survive the merger as a wholly owned indirect subsidiary of Saguaro Utility Group L.P.

You are cordially invited to attend a special meeting of our shareholders to consider and vote upon a proposal to approve the acquisition agreement. The special meeting will be held on Monday, March 29, 2004, at the Westin La Paloma Resort, 3800 East Sunrise Drive, Tucson, Arizona 85718. The special meeting will begin promptly at 10:00 a.m., local time. No admission tickets will be required for attendance at the special meeting.

Upon completion of the acquisition, you will be entitled to receive $25.25 in cash, without interest, for each share of our common stock that you own. This price represents a 30% premium over the closing price per share on the last trading day prior to the public announcement of the acquisition. The receipt of cash in exchange for your shares as part of the acquisition will constitute a taxable transaction for you for U.S. federal income tax purposes.

The accompanying proxy statement contains important information about the acquisition and other related matters. We urge you to carefully read the entire proxy statement, including the acquisition agreement and fairness opinion of Morgan Stanley & Co. Incorporated which are attached as Appendix A and Appendix B, respectively, to the proxy statement.

Our board of directors believes the acquisition and the acquisition agreement are advisable and fair to, and in the best interests of, our company and our shareholders. Our board of directors recommends that you vote "for" the proposal to approve the acquisition agreement.

The acquisition cannot be completed unless the acquisition agreement is approved by a majority of our outstanding shares entitled to be cast. Whether or not you plan to attend the special meeting, please take the time to vote, sign, date and mail the enclosed proxy card as soon as possible. You may also vote by telephone or the internet, as explained on the enclosed proxy card. If you sign, date and mail your proxy card without indicating how you want to vote, your proxy will be voted and counted in favor of the proposal. If you attend the special meeting and wish to vote your shares in person, you may revoke your proxy at any time. **The failure of any shareholder to vote will have the same effect as a vote against the proposal.**

Your interest and continued support of UniSource Energy Corporation are much appreciated.

Sincerely,

UNISOURCE ENERGY CORPORATION

James S. Pignatelli
Chairman of the Board, President and
Chief Executive Officer

NOTICE OF SPECIAL MEETING OF SHAREHOLDERS

To the Holders of Common Stock of
UniSource Energy Corporation

We will hold a special meeting of our shareholders on Monday, March 29, 2004, 10:00 a.m., local time, at the Westin La Paloma Resort, 3800 East Sunrise Drive, Tucson, Arizona 85718.

The purpose of the meeting will be to consider and vote upon a proposal to approve the Agreement and Plan of Merger between us and Saguaro Acquisition Corp., which agreement provides that Saguaro Utility Group L.P., an Arizona limited partnership, will acquire us by merging its wholly owned indirect subsidiary, Saguaro Acquisition Corp., with and into us. Subject to the terms and conditions of the acquisition agreement, at the effective time of the acquisition, each outstanding share of our common stock will be converted into the right to receive $25.25 in cash, without interest.

The proposal described above may be considered at the special meeting at the time and date specified above or at any time and date to which the special meeting may be properly adjourned or postponed.

Only shareholders of record at the close of business on February 23, 2004 are entitled to vote at the special meeting or any postponements or adjournments thereof.

Additional information about the acquisition and the Agreement and Plan of Merger may be found in the accompanying proxy statement, which is first being sent or given to our shareholders on or about February 26, 2004. Your proxy is being solicited by our board of directors.

Our board of directors believes the acquisition and the Agreement and Plan of Merger are advisable and fair to, and in the best interests of, our company and our shareholders. Our board of directors recommends that you vote "for" the proposal to approve the Agreement and Plan of Merger.

The acquisition cannot be completed unless the Agreement and Plan of Merger is approved by a majority of our outstanding shares entitled to be cast. Whether or not you plan to attend the special meeting, please take the time to vote, sign, date and mail the enclosed proxy card as soon as possible. You may also vote by telephone or the internet, as explained on the enclosed proxy card. If you sign, date and mail your proxy card without indicating how you want to vote, your proxy will be voted and counted in favor of the proposal. If you attend the special meeting and wish to vote your shares in person, you may revoke your proxy at any time. **The failure of any shareholder to vote will have the same effect as a vote against the proposal.**

By Order of the Board of Directors,

Catherine A. Nichols
Corporate Secretary

Dated: February 23, 2004

EACH SHAREHOLDER IS URGED TO COMPLETE, SIGN, DATE AND RETURN PROMPTLY THE ENCLOSED PROXY CARD BY MAIL, OR TO VOTE BY TELEPHONE OR THE INTERNET, AS EXPLAINED ON THE ENCLOSED PROXY CARD. IF THE MAIL OPTION IS SELECTED, USE THE ENCLOSED ENVELOPE, WHICH DOES NOT REQUIRE POSTAGE IF MAILED IN THE UNITED STATES. RETURNING A SIGNED PROXY WILL NOT PROHIBIT YOU FROM ATTENDING THE SPECIAL MEETING AND VOTING IN PERSON IF YOU SO DESIRE. PLEASE DO NOT SEND STOCK CERTIFICATES WITH YOUR PROXY.

One South Church Avenue
Tucson, Arizona 85701

SPECIAL SHAREHOLDERS' MEETING
PROXY STATEMENT

Special Meeting March 29, 2004, 10:00 a.m., local time — Westin La Paloma Resort, 3800 East Sunrise Drive, Tucson, Arizona 85718

Record Date

The record date is February 23, 2004. If you were a shareholder of record at the close of business on that date you may vote at the special meeting. Each share is entitled to one vote. At the close of business on the record date, we had 34,019,401 shares of our common stock outstanding.

Agenda

To consider and vote upon a proposal to approve the Agreement and Plan of Merger between us and Saguaro Acquisition Corp. pursuant to which Saguaro Utility Group L.P. will acquire us by merging its wholly owned indirect subsidiary, Saguaro Acquisition Corp., with and into us. In this proxy statement we sometimes refer to Saguaro Utility Group L.P. as Saguaro Utility and the Agreement and Plan of Merger as the acquisition agreement.

Proxies

We will follow your voting instructions. If no instructions are included we will vote "for" the proposal.

A form of proxy card is enclosed. The shares represented by an executed proxy card will be voted "for" or "against" the proposal in accordance with the instructions in the proxy. If no instructions are included in an executed proxy, the proxy will be voted in favor of approval of the proposal. If you do not vote, it will have the same effect as a vote against the proposal. Our board of directors or the proxy holders will use their discretion on other matters that are incident to the conduct of the special meeting.

Proxies Solicited By

Our board of directors.

First Mailing Date

We anticipate first mailing this proxy statement and the proxy card on or about February 26, 2004.

Voting Procedures

You can vote by telephone, the internet, mail or in person. We encourage you to vote by telephone or the internet.

You can vote your shares by telephone, the internet, mail or in person at the special meeting. Your proxy card contains instructions for voting by telephone or the internet, which are the least expensive and fastest methods of voting. To vote by mail, complete, sign and date your proxy card, or your broker's voting instruction card if your shares are held by your broker, and return it in the enclosed return envelope.

Under Arizona law, a majority of the shares entitled to vote on any single matter which may be brought before the special meeting will constitute a quorum. Business may be conducted once a quorum is represented.

Arizona law requires that the proposal be approved by a majority of the shares entitled to be cast. Any "abstentions" and broker "non-votes" will have the same effect as shares voted against the proposal.

Revoking Your Proxy

You can revoke your proxy by following these procedures.

Any shareholder giving a proxy has the right to revoke it by giving us notice in writing directed to the Corporate Secretary, UniSource Energy Corporation, One South Church Avenue, Suite 1820, Tucson, Arizona 85701, or in person at the special meeting at any time before the proxy is exercised.

Proxy Solicitation

We will bear the entire cost of the solicitation of proxies. Solicitations will be made primarily by mail. Additional solicitation of brokers, banks, nominees and institutional investors may be made pursuant to a special engagement of DF King & Co., Inc., at a cost of approximately $10,000 plus reasonable out-of-pocket expenses. Solicitations may also be made by telephone, facsimile or personal interview to obtain reasonable representation of shareholders at the special meeting. Our employees may solicit proxies for no additional compensation. We will request brokers or other persons holding stock in their names, or in the names of their nominees, to forward proxy materials to the beneficial owners of such stock or request authority for the execution of the proxies. We will reimburse those individuals for reasonable expenses they incur in sending these proxy materials.

Additional Questions

If you have more questions about the acquisition or how to submit your proxy, or if you need additional copies of this proxy statement or the enclosed proxy card or voting instructions, you should contact DF King & Co., Inc. at 48 Wall Street, New York, New York 10005, or by telephone at (800) 549-6746.

You may also obtain additional copies of this proxy statement or proxy card from our Corporate Secretary at our executive offices at One South Church Avenue, Tucson, Arizona 85701, or by telephone at

(520) 571-4000.

PLEASE VOTE YOUR VOTE IS IMPORTANT

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QUESTIONS AND ANSWERS ABOUT THE ACQUISITION

Q.

Why am I receiving this proxy statement?

A.

As provided by the acquisition agreement, Saguaro Utility will acquire us by merging its subsidiary, Saguaro Acquisition Corp., with and into us. We will be the surviving corporation, but will become a wholly owned indirect subsidiary of Saguaro Utility. In order for the acquisition to occur, we must obtain shareholder approval of the acquisition agreement as required by Arizona law. As discussed throughout this proxy statement, we will hold a special meeting of our shareholders to obtain this approval. Your vote is important regardless of how many shares you own.

Q.

What will be the effect of the acquisition and what will I receive for my shares?

Upon completion of the acquisition, you will cease to own your shares and any ownership interest in our company, because your shares will be converted into the right to receive $25.25 in cash, without interest, for each share of our common stock owned at the time of the acquisition. Saguaro Utility will become the indirect owner of all of our shares. We will no longer be publicly held, and our common stock will cease to be traded on the New York Stock Exchange and the Pacific Stock Exchange.

Q.

Why has UniSource Energy decided to propose this acquisition?

A.

We entered into the acquisition agreement because our board of directors believes, after careful consideration, that the acquisition and the acquisition agreement are advisable and fair to, and in the best interests of, our company and our shareholders since, among other reasons, the acquisition consideration represents a significant premium over the historical trading price of our common stock. The $25.25 cash acquisition consideration represents a 30% premium over the closing price per share on the last trading day prior to the public announcement of the acquisition. Please read the more detailed description of our reasons for the acquisition beginning on page 25.

Q.

When do you expect to complete the acquisition?

A.

The parties are working to complete all aspects of the acquisition as quickly as possible. We cannot, however, predict the exact timing of the completion of the acquisition because it is subject to governmental and regulatory processes and other conditions. We currently anticipate that the acquisition will be completed in the last half of 2004.

Q.

Who must approve the acquisition?

A.

In addition to the approval by our board of directors, which has already been obtained, the acquisition agreement must be approved by the holders of a majority of the outstanding shares of our common stock. Also, several regulatory approvals must be obtained, most notably the approval of the acquisition by the Arizona Corporation Commission, the Federal Energy Regulatory Commission and the Securities and Exchange Commission. Please read the more detailed description of the required regulatory approvals beginning on page 32.

Q.

Besides shareholder approval and regulatory approvals, are there any other significant conditions to the closing of the acquisition?

A.

Yes. The acquisition agreement includes other significant conditions to the closing of the acquisition, including, but not limited to the following:

- the absence of any material adverse effect on the business, properties, assets, condition, prospects or results of operations of UniSource Energy and its subsidiaries taken together as a whole;

- that no final order with respect to any regulatory approval necessary to complete the acquisition either (i) has or could reasonably be expected to have a material adverse effect on us or Saguaro Utility or (ii) causes or could reasonably be expected to cause the rates of any of our utility subsidiaries to be less favorable than the rates that were in effect on the date of the acquisition agreement;

- that any restrictions on the ability of Tucson Electric Power Company, our largest subsidiary, to pay dividends on all of its net income be effectively eliminated; and

- that Saguaro Acquisition Corp. receives its financing for the acquisition on terms and conditions that, in the reasonable judgment of Saguaro Acquisition Corp., are comparable to, or more favorable to Saguaro Acquisition Corp. in the aggregate than, the terms and conditions contemplated by the acquisition agreement.

Please read the more detailed description of the conditions to the closing of the acquisition beginning on page 49.

Q.

What will happen if the required shareholder approval is not obtained?

A.

If the required shareholder approval is not obtained so that the acquisition does not occur, our management and our board of directors will continue to operate our company as before and may consider other strategic alternatives. We will, however, be required to pay Saguaro Acquisition Corp. up to $10 million to reimburse it for its expenses incurred in connection with the proposed acquisition. We may also be required to pay Saguaro Acquisition Corp. an additional $15 million termination fee in certain circumstances as described under "THE ACQUISITION AGREEMENT Termination Fees and Expenses" beginning on page 52.

Q.

Are there dissenters' rights of appraisal in connection with the acquisition?

A.

No. Under Arizona law, you do not have dissenters' rights of appraisal in connection with the acquisition since our stock is registered on the New York Stock Exchange and the Pacific Stock Exchange.

Q.

How does UniSource Energy's board of directors recommend that I vote?

A.

Our board of directors recommends that you vote "for" the proposal to approve the acquisition agreement.

Q.

How do I vote?

A.

After you carefully read this proxy statement, you can vote by completing, signing, dating and mailing the enclosed proxy card in the enclosed return envelope. You can also vote by telephone or the internet, as explained on the enclosed proxy card.

Q.

What happens if I do not vote?

A.

We cannot consummate the acquisition unless shareholders representing a majority of our outstanding shares approve the acquisition agreement. If you do not vote, it will have the same effect as voting "against" the proposal to approve the acquisition agreement. We, therefore, urge you to vote.

Q.

What happens if I do not instruct a broker handling my shares on how to vote?

A.

If a broker holds your shares as nominee, he or she will not be able to vote them without instructions from you. If you do not instruct your broker on how to vote, your shares will have the effect of a vote "against" the proposal to approve the acquisition agreement.

Q.

Can I change my vote after I have mailed in my signed and dated proxy card?

A.

Yes. If you would like to revoke your proxy, you must deliver, at any time before the vote has been taken at the special meeting, a written revocation directed to the Corporate Secretary, UniSource Energy Corporation, One South Church Avenue, Suite 1820, Tucson, Arizona 85701. Alternatively, you may attend the special meeting in person and revoke your proxy orally by notifying the Corporate Secretary before the vote takes place.

Q.

When and where is the special meeting?

A.

The special meeting is scheduled for Monday, March 29, 2004, 10:00 a.m. local time, at the Westin La Paloma Resort, 3800 East Sunrise Drive, Tucson, Arizona 85718.

Q.

Should I send in my stock certificates now?

A.

No. If the acquisition agreement is approved and the acquisition completed, the surviving corporation will send you written instructions for submitting your stock certificates. You must follow those instructions and return your stock certificates accordingly. You will receive your cash payment as soon as reasonably practicable after the surviving corporation receives your stock certificates along with any other documents reasonably requested to be submitted in those instructions.

Q.

What happens to my future dividends?

A.

The acquisition agreement allows us to continue to pay regular quarterly cash dividends until the closing of the acquisition. Our board of directors currently expects to continue to pay regular quarterly cash dividends on our common stock until the closing of the acquisition, subject, however, to our board of directors' evaluation of our financial condition, earnings, cash flows and dividend policy. Thus, while our board of directors anticipates that regular quarterly cash dividends will be declared and paid until the closing of the acquisition, no assurance can be made that such dividends will be declared and paid.

Q.

What are the tax consequences of the acquisition to shareholders?

A.

In general, a shareholder will recognize gain or loss for federal income tax purposes to the extent of the difference between the cash received and the holder's tax basis in the shares of our common stock converted into the right to receive cash.

Q.

What will happen with respect to UniSource Energy's outstanding stock options?

A.

Immediately prior to the effective time of the acquisition, all of our outstanding stock options will be deemed canceled. As a result, our stock option holders will receive at or as soon as practicable after the acquisition an amount in cash equal to the product of (i) the total number of shares of our common stock underlying a holder's options, and (ii) the excess of $25.25 over the exercise price per share of the shares of our common stock underlying such options.

Q.

Whom should I call with questions or if I want to request an additional copy of this proxy statement or the proxy card?

A.

You should call DF King & Co., Inc. at (800) 549-6746 with any questions you may have about the acquisition or how to submit your proxy, or if you need additional copies of this proxy statement or the enclosed proxy card or voting instructions. If your broker holds your shares, you should also call your broker for additional information.

SUMMARY

The following summary highlights information contained elsewhere in this proxy statement. However, this summary does not contain all of the information that may be important to you. For a more complete understanding of the acquisition and the terms and provisions of the acquisition agreement, we encourage you to carefully read the entire proxy statement and its appendices. Each item in this summary includes a page reference directing you to a more complete description of that item.

The Parties (see page 14)

On November 21, 2003, we entered into an acquisition agreement with Saguaro Acquisition Corp. The acquisition agreement provides that Saguaro Utility will acquire us by merging its wholly owned indirect subsidiary, Saguaro Acquisition Corp., with and into us. We will survive the merger as a wholly owned indirect subsidiary of Saguaro Utility.

UniSource Energy Corporation

UniSource Energy Corporation
One South Church Avenue
Tucson, Arizona 85701
(520) 571-4000

We are a holding company that owns substantially all of the outstanding common stock of Tucson Electric Power Company, and all of the outstanding common stock of UniSource Energy Services, Inc., Millennium Energy Holdings, Inc. and UniSource Energy Development Company. In this proxy statement, we sometimes refer to Tucson Electric Power as TEP, UniSource Energy Services as UES, UniSource Energy Development Company as UED and Millennium Energy Holdings, Inc. as Millennium.

TEP provides electric service to the community of Tucson, Arizona. UES provides gas and electric service through its utility subsidiaries to 30 communities in northern and southern Arizona. Millennium invests in unregulated businesses. UED engages in developing generating resources and other project development activities.

Saguaro Acquisition Corp.

Saguaro Acquisition Corp.
4201 North 24th Street, Suite 100
Phoenix, Arizona 85016

Saguaro Acquisition Corp., a Delaware corporation, is a wholly owned indirect subsidiary of Saguaro Utility, an Arizona limited partnership, whose general partner is Sage Mountain, L.L.C. and whose limited partners include investment funds affiliated with Kohlberg Kravis Roberts & Co., L.P., J.P. Morgan Partners, LLC and Wachovia Capital Partners.

The sole manager of Sage Mountain is Frederick B. Rentschler, former president and chief executive officer of Armour-Dial, Beatrice Companies and Northwest Airlines.

The Special Meeting (see cover page)

Date, Time and Place.

The special meeting will be held on Monday, March 29, 2004, at the Westin La Paloma Resort, 3800 East Sunrise Drive, Tucson, Arizona 85718, commencing at 10:00 a.m., local time.

Purpose.

At the special meeting, our shareholders will consider and vote upon a proposal to approve the acquisition agreement.

Record Date; Shares Entitled to Vote.

Only holders of record at the close of business on February 23, 2004, are entitled to vote at the special meeting. On such date, there were 34,019,401 shares of our common stock outstanding, each of which is entitled to one vote on the matter to be voted upon at the special meeting.

Vote Required.

Under Arizona law, approval of the acquisition agreement requires the affirmative vote of a majority of the outstanding shares of our common stock.

Voting and Revocation of Proxies.

You can vote by completing, signing, dating and mailing the enclosed proxy card in the enclosed return envelope. You can also vote by telephone or the internet, as explained on the enclosed proxy card. You can also vote in person at the special meeting, but we encourage you to submit your proxy now in any event.

If a broker holds your shares as nominee, he or she will not be able to vote them without instructions from you. If you do not vote at all, mark your proxy "abstain" or do not instruct your broker on how to vote, your shares will have the same effect as voting "against" the proposal to approve the acquisition agreement.

You can revoke your proxy at any time before the vote has been taken at the special meeting. To revoke your proxy, please follow the instructions included on the cover page of this proxy statement.

Share Ownership of Management (see pages 54 - 55)

At the close of business on February 18, 2004, our directors and executive officers and their affiliates beneficially owned 1,525,703 shares of our common stock, which represents 4.5% of the outstanding shares of our common stock.

The Acquisition

General Description and Effect of the Acquisition (see page 15).

The acquisition agreement provides that Saguaro Utility will acquire us by merging its wholly owned indirect subsidiary, Saguaro Acquisition Corp., with and into us. We will be the surviving company, but will continue to conduct our business as a wholly owned indirect subsidiary of Saguaro Utility. We will no longer be a publicly held company. In connection with the acquisition, each outstanding share of our common stock will be converted into the right to receive $25.25 in cash, without interest.

Recommendation of Our Board of Directors (see pages 25 - 26).

After careful consideration, our board of directors approved the acquisition because our board of directors determined that the acquisition and the acquisition agreement were fair to, and in the best interests of, our company and our shareholders. Likewise, our board of directors recommends that our shareholders vote "for" the proposal to approve the acquisition agreement.

See "THE ACQUISITION Background of the Acquisition" and "THE ACQUISITION Our Reasons for the Acquisition; Recommendation of Our Board of Directors" in this proxy statement beginning on page 15 and 25, respectively. You should carefully consider all of the factors that our board of directors considered.

Fairness Opinion (see pages 26 - 31).

In connection with the acquisition, Morgan Stanley & Co. Incorporated acted as a financial advisor to our board of directors. On November 21, 2003, Morgan Stanley delivered its written opinion to our board of directors to the effect that, as of that date and subject to and based upon the assumptions and other considerations set forth in its written opinion, the $25.25 in cash per share to be received by our shareholders pursuant to the acquisition agreement was fair from a financial point of view to those shareholders (other than Saguaro Utility and its affiliates). The opinion does not constitute a recommendation as to how any of our shareholders should vote with respect to the proposal to approve the acquisition agreement or any other matter.

The full text of the written opinion of Morgan Stanley, which sets forth assumptions made, matters considered and limitations on the review undertaken in connection with its written opinion, is attached hereto as Appendix B. We recommend that our shareholders read the entire opinion carefully. We have agreed to pay Morgan Stanley a transaction fee of up to $4 million in connection with the acquisition.

Financing for the Acquisition (see page 34).

In connection with the acquisition, Saguaro Acquisition Corp. will pay approximately $880 million in cash to our shareholders and holders of stock options and other performance based awards awarded under our performance incentive plans. The cash purchase price and other expenses related to the acquisition are expected to be funded by a combination of equity contributions by the partners of Saguaro Utility and borrowings and issuances of debt securities by another wholly owned subsidiary of Saguaro Utility.

Saguaro Acquisition Corp. will not be required to complete the acquisition unless it has received the debt financing as contemplated by the acquisition agreement. As a result, even if we receive the required shareholder and regulatory approvals to complete the acquisition, Saguaro Acquisition Corp. might not be obligated to complete the acquisition if it does not receive this financing.

Regulatory Approvals (see pages 32 - 34).

Several regulatory approvals are required in order for the acquisition to close. We must obtain regulatory approval from the Arizona Corporation Commission. In addition, we and Saguaro Acquisition Corp. must (i) file certain notification forms with the Antitrust Division of the Department of Justice and the Federal Trade Commission and (ii) obtain the approval of the Federal Energy Regulatory Commission under the Federal Power Act. Finally, Saguaro Acquisition Corp. must obtain the approval of the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935.

Interests of Certain Persons in the Acquisition (see pages 34 - 38).

In considering our board of directors' recommendation to vote "for" the proposal to approve the acquisition agreement, shareholders should be aware that some of our directors and members of our management may have interests in the acquisition that are different from, or in addition to, the interests of our shareholders generally. In general, these interests include certain indemnification rights, incentive compensation and severance payments due to the acquisition and the vesting of stock options and other stock based incentive awards upon the consummation of the acquisition. Although no agreement, arrangement or understanding currently exists, it is generally expected that our existing

management will remain after the acquisition is completed, which means that members of our existing management may, prior to the closing of the acquisition, enter into new agreements or arrangements with Saguaro Utility or its affiliates regarding employment with, or the right to purchase or participate in the equity of, the surviving corporation. Our board of directors was aware of these interests and considered them, among other factors, in approving the acquisition agreement.

Material Federal Income Tax Consequences (see pages 38 - 40).

The acquisition will be a taxable transaction for you. For United States federal income tax purposes, you will recognize gain or loss in the acquisition in an amount equal to the difference between the cash you receive and your tax basis in your shares. We urge you to consult your own tax advisor to understand fully how the acquisition will affect you in light of your individual circumstances.

Dissenters' Rights of Appraisal (see page 40).

Under Arizona law, you are not entitled to dissenters' rights of appraisal because our common stock is registered on the New York Stock Exchange and the Pacific Stock Exchange.

The Acquisition Agreement

The acquisition agreement is the legal document that governs the acquisition. The acquisition agreement is attached as Appendix A to this proxy statement. We encourage you to carefully read the entire acquisition agreement.

Acquisition Consideration (see page 41).

Upon completion of the acquisition, each of your shares of our common stock will be converted into the right to receive $25.25 in cash, without interest.

Certain Covenants (see pages 43 - 48).

In general, we and our subsidiaries must carry on business in the ordinary course consistent with past practice and use all commercially reasonable efforts to preserve substantially intact the present business organization and present regulatory, business and employee relationships. In addition, the acquisition agreement contains certain specific restrictions or limitations on the activities of each of us and our subsidiaries, subject to the receipt of Saguaro Acquisition Corp.'s prior written consent, which consent cannot be unreasonably withheld and which consent must be given or withheld as soon as reasonably practicable, including the issuance or repurchase of capital stock, the amendment of charters and bylaws, acquisitions and dispositions of assets, capital expenditures, incurrence of indebtedness, modification of employee compensation and benefits, changes in accounting methods, discharging of liabilities, and matters relating to our investment in Millennium.

In addition, we have agreed not to solicit or encourage any proposal from any person to acquire us or our assets, but we may respond, in certain circumstances, to unsolicited written bona fide proposals that we receive.

Conditions to the Acquisition (see pages 49 - 51).

Completion of the acquisition depends upon the satisfaction, or waiver, of a number of closing conditions. In addition to customary conditions relating to compliance with the acquisition agreement, these conditions include the following:

- the absence of any material adverse effect in the business, properties, assets, condition, prospects or results of operations of UniSource Energy and its subsidiaries taken together as a whole;

- the receipt of the required shareholder approval;
- the receipt of required regulatory approvals;
- that no final order with respect to any regulatory approval necessary to effect the acquisition either (i) has or could reasonably be expected to have a material adverse effect on us or Saguaro Utility or (ii) causes or could reasonably be expected to cause the rates of any of our utility subsidiaries to be less favorable than the rates that were in effect on the date of the acquisition agreement;

that restrictions on the ability of TEP to pay dividends of all of its net income be effectively eliminated; and

that Saguaro Acquisition Corp. receives its financing for the acquisition on terms and conditions that, in the reasonable judgment of Saguaro Acquisition Corp., are comparable to, or more favorable to Saguaro Acquisition Corp. in the aggregate than, the terms and conditions contemplated by the acquisition agreement.

Manner and Basis of Converting Shares (see pages 41 - 42).

At the effective time of the acquisition, each issued and outstanding share of our common stock will automatically be converted into the right to receive $25.25 in cash, without interest. This conversion will occur by virtue of the merger of Saguaro Acquisition Corp. with and into us and without any action on the part of any of our shareholders.

In order to receive the cash amount of $25.25 per share, shareholders must surrender for exchange their certificates representing their shares. At or as soon as reasonably practicable after the acquisition, Saguaro Utility will cause the surviving corporation to deposit with a paying agent (i.e., a bank or trust company) an amount of cash sufficient to pay for all of our common stock.

As soon as reasonably practicable after the effective time of the acquisition, the surviving corporation will instruct the paying agent to mail to each shareholder of record immediately prior to the effective time of the acquisition (i) a form of letter of transmittal and (ii) instructions for surrendering certificates in exchange for payment of the acquisition consideration.

Termination (see pages 51 - 52).

The acquisition agreement may be terminated by either us or Saguaro Acquisition Corp. in certain circumstances as provided in the acquisition agreement. The most notable circumstances in which the acquisition agreement may be terminated by one or both parties, and the acquisition abandoned, are as follows:

if the acquisition is not completed on or before March 31, 2005, so long as the failure to complete the acquisition is not the result of the failure of the terminating party to comply with the terms of the acquisition agreement;

if either party materially breaches the acquisition agreement and fails to cure such breach in accordance with the terms of the acquisition agreement;

if any state or federal law, regulation or order is adopted or issued, and cannot be appealed, that has the effect of prohibiting the acquisition, or if any such regulation or order does not satisfy the applicable closing conditions or prevents the applicable closing conditions from being capable of being satisfied;

if the required shareholder approval is not obtained at the special meeting;

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if Saguaro Acquisition Corp. cannot obtain its financing for the acquisition in the manner and on the terms contemplated by the acquisition agreement;

if, prior to the shareholders meeting, we receive and accept a superior proposal in accordance with the terms of the acquisition agreement; or

if our board of directors (i) withdraws or changes its recommendation to our shareholders to approve the acquisition agreement or (ii) fails to confirm its recommendation in favor of the acquisition agreement (a) in connection with an alternative proposal to acquire us or (b) upon request from Saguaro Acquisition Corp. to do so.

Termination Fees and Expenses (see pages 52 - 53).

In certain circumstances, upon the termination of the acquisition agreement, we would be required to pay Saguaro Acquisition Corp.'s expenses and a termination fee in an aggregate amount of up to $25 million.

MARKET PRICES OF OUR COMMON STOCK

Our common stock is listed and traded on the New York Stock Exchange and the Pacific Stock Exchange under the symbol "UNS." The following table provides trading and dividend information for our common stock for the periods indicated. The share prices set forth in this section represent our common stock price on the consolidated tape for transactions on the New York Stock Exchange as reported by Dow Jones.

	HIGH	LOW	DIVIDEND
2001			
First Quarter	$ 21.00	$ 15.13	$ 0.10
Second Quarter	$ 25.99	$ 20.15	$ 0.10
Third Quarter	$ 24.05	$ 13.80	$ 0.10
Fourth Quarter	$ 19.30	$ 13.80	$ 0.10
2002			
First Quarter	$ 20.60	$ 16.74	$ 0.125
Second Quarter	$ 20.75	$ 17.91	$ 0.125
Third Quarter	$ 18.89	$ 14.05	$ 0.125
Fourth Quarter	$ 17.90	$ 13.69	$ 0.125
2003			
First Quarter	$ 18.10	$ 16.00	$ 0.15
Second Quarter	$ 19.27	$ 17.05	$ 0.15
Third Quarter	$ 19.80	$ 17.65	$ 0.15
Fourth Quarter	$ 24.90	$ 19.01	$ 0.15
2004			
First Quarter through February 20	$ 24.74	$ 24.34	$ 0.16

On November 21, 2003, the last full trading day before the public announcement of the execution of the acquisition agreement, the closing price per share of our common stock for transactions on the New York Stock Exchange was $19.40.

On February 20, 2004 the most recent practicable date for which quotations were available prior to the printing of this proxy statement, the closing price per share of our common stock for transactions on the New York Stock Exchange was $24.45.

On February 6, 2004, our board of directors declared a quarterly dividend on shares of our common stock in the amount of $0.16 per share (as reflected in the table above) to be paid on March 10, 2004 to holders of our common stock of record as of February 17, 2004.

THE PARTIES

UniSource Energy Corporation
One South Church Avenue
Tucson, Arizona 85701
(520) 571-4000

We are an exempt holding company under the Public Utility Holding Company Act of 1935. We have no significant operations of our own, but own substantially all of the outstanding common stock of TEP, and all of the outstanding common stock of UES, Millennium and UED.

TEP, a regulated public utility, is our largest operating subsidiary and represented approximately 86% of our assets as of September 30, 2003. TEP has provided electric service to the community of Tucson, Arizona for over 100 years. UES, which we established recently as described below, provides gas and electric service to 30 communities in northern and southern Arizona. Millennium invests in unregulated businesses, including a developer of thin-film batteries and a developer and manufacturer of thin-film photovoltaic cells. UED engages in developing generating resources and other project development activities, including facilitating the expansion of TEP's Springerville Generating Station.

On August 11, 2003, we completed the purchase of the Arizona gas and electric system assets from Citizens Communications Company ("Citizens"). This acquisition added approximately 127,000 retail gas customers and 80,000 retail electric customers in Arizona to our customer base. We formed two new operating companies called UNS Gas, Inc. ("UNS Gas") and UNS Electric, Inc. ("UNS Electric") to acquire these assets, as well as an intermediate holding company, UES, to hold the common stock of UNS Gas and UNS Electric.

Each of TEP, UNS Electric and UNS Gas are regulated by the Arizona Corporation Commission (the "ACC"), and TEP and UNS Electric are also regulated by the Federal Energy Regulatory Commission (the "FERC").

We file reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC") that are available free of charge at the SEC's website at http://www.sec.gov. You may also obtain information about us from our internet site at http://www.unisourceenergy.com.

Saguaro Acquisition Corp.
4201 North 24th Street, Suite 100
Phoenix, Arizona 85016

Saguaro Acquisition Corp. was organized solely for the purpose of entering into the acquisition agreement and consummating the transactions contemplated thereby and has not carried on any activities to date other than activities incident to its formation and in connection with the transactions contemplated by the acquisition agreement. Saguaro Acquisition Corp. is a Delaware corporation and a wholly owned indirect subsidiary of Saguaro Utility, an Arizona limited partnership, whose general partner is Sage Mountain, L.L.C. and whose limited partners include investment funds affiliated with Kohlberg Kravis Roberts & Co., L.P. ("KKR"), J.P. Morgan Partners, LLC ("JPMP") and Wachovia Capital Partners ("WCP"). Frederick B. Rentschler, former president and chief executive officer of Armour-Dial, Beatrice Companies and Northwest Airlines, is the managing member of Sage Mountain, L.L.C.

THE ACQUISITION

We are furnishing this proxy statement to each of our shareholders in connection with the proposed acquisition of our company by Saguaro Utility. If completed, the acquisition will be carried out as provided in the acquisition agreement, a copy of which is attached as Appendix A to this proxy statement.

General Description and Effect of the Acquisition

At the effective time of the acquisition, Saguaro Utility will acquire us by merging its wholly owned indirect subsidiary, Saguaro Acquisition Corp., with and into us. We will continue as the surviving corporation, but will be a wholly owned indirect subsidiary of Saguaro Utility. Trading in our stock on the New York Stock Exchange and the Pacific Stock Exchange will cease immediately as of the effective time of the acquisition. After that time, the surviving corporation will delist our shares from the New York Stock Exchange and the Pacific Stock Exchange and deregister our shares under the Securities Exchange Act of 1934. Each of our shareholders will thereafter receive $25.25 in cash, without interest, for each share of our common stock owned at the effective time of the acquisition. Each such shareholder, however, will no longer have an opportunity to continue their ownership interest in us as an ongoing corporation and therefore will not share in our future earnings and potential growth.

Background of the Acquisition

Consistent with our board of directors' overall fiduciary duties to our shareholders, our board of directors has been willing to consider potential strategic transactions, including business combinations with other utilities or energy companies, in addition to pursuing strategies that

maximize our value as an independent company. In that connection, we engaged New Harbor Incorporated ("New Harbor") in 1998 to advise us on an ongoing basis with respect to strategic transactions. New Harbor is a financial advisory and investment banking firm which specializes in advising companies in the utility industry. New Harbor has worked closely with management to identify strategic opportunities for us.

During the period from 1998 through 2002, our senior management engaged in preliminary discussions with a number of third parties, including JPMP and KKR, regarding strategic transactions, including potential business combinations. However, none of these parties engaged in any discussions that progressed to the point that it was determined that detailed involvement of our board of directors was appropriate.

Beginning in July 2002, JPMP and another private equity firm (the "JPMP Group") spoke with members of our management to explore the possibility of a range of potential transactions, including financing transactions, investments and a potential acquisition of our company. With respect to a potential acquisition of our company, the JPMP Group's preliminary indication of interest suggested an acquisition price of up to $20 per share. The JPMP Group also requested permission to conduct a due diligence investigation of us.

In September 2002, our management advised our board of directors that we had received a preliminary indication of interest from the JPMP Group to explore a potential financing transaction with, private investment in, or an acquisition of, our company and the request that they be permitted to conduct a comprehensive due diligence investigation of our company.

At a meeting on September 16, 2002, our board of directors discussed the preliminary indication of interest from the JPMP Group. At this time, we were also in the process of negotiating a definitive agreement to acquire the Arizona electric and gas utility assets of Citizens. In considering whether to pursue the preliminary indication of interest received from the JPMP Group, our board of directors discussed other strategic initiatives that we were exploring, including the transaction with Citizens. Our

board of directors also engaged in a preliminary discussion of the feasibility of concurrently seeking and obtaining approval from the ACC of both the Citizens transaction and any transaction with the JPMP Group. After instructing management to advise the JPMP Group that the purchase price in any transaction would have to be higher than the $20 per share price included in the preliminary indication of interest, our board of directors authorized James S. Pignatelli, our Chairman, President and Chief Executive Officer, to allow the JPMP Group's due diligence investigation to proceed. On the date of this meeting, our common stock closed at $19.22 on the New York Stock Exchange.

During the week of October 14, 2002, representatives of the JPMP Group met with members of our senior management and received a presentation on our business and financial condition at our offices in Tucson, Arizona. Also in attendance at this meeting were representatives from WCP, a private equity firm that had joined the JPMP Group.

At a meeting held on October 17, 2002, our board of directors continued its discussion of the preliminary indication of interest from the JPMP Group. Prior to commencing this discussion, Larry Bickle, a director of our company, advised our board of directors of a potential conflict of interest he believed might exist with respect to any transaction involving JPMP. Mr. Bickle is a Managing Director of an investment fund in which a JPMP affiliate has a significant investment and in which we have also invested. As a result of these transactions, Mr. Bickle advised our board of directors that he would not vote on any potential transaction involving JPMP (see "   Transactions with Management and Others"). Our board of directors then received a general review from our counsel, Thelen Reid & Priest LLP, on the directors' fiduciary responsibilities in the context of a potential acquisition transaction in which we would cease to be a public company. Following this presentation, Jay Beatty of New Harbor presented an update on the state of the equity and debt markets in general and on the utility industry and us in particular, offered comments on the current market price of our common stock and generally addressed approaches that our board of directors might take in valuing our common stock in connection with a potential acquisition. Mr. Beatty noted that the market price of our common stock had spiked in 2001. Mr. Beatty attributed this to a significant increase in our earnings at such time due to substantial wholesale marketing activities at a time of strong demand and high wholesale prices in the Western United States. Following this spike in our earnings and stock price, average market prices for energy declined sharply, returning to historical price levels and the market price of our common stock had correspondingly declined (see "MARKET PRICES OF OUR COMMON STOCK"). After a request for an indication from our board of directors of its preliminary interest in continuing discussions with the JPMP Group, the directors, with Mr. Bickle abstaining, reached a consensus that we should continue discussions with the JPMP Group, but also reached a consensus that the pursuit of an acquisition transaction with the JPMP Group should not be permitted to adversely affect our negotiations with Citizens, which were anticipated to be completed in the near future.

On October 29, 2002, we executed a definitive agreement with Citizens to acquire its Arizona electric and gas utility properties for approximately $230 million, subject to the terms and conditions contained in such agreement.

In late October 2002, we were advised that the other party working with JPMP and WCP had determined that it did not wish to pursue an acquisition, but that the private equity firm of KKR (JPMP, KKR, WCP, Sage Mountain, LLC and their affiliates are collectively referred to as

the "Investor Group") had expressed interest in joining JPMP and WCP to pursue an acquisition transaction. On November 2, 2002, representatives of the Investor Group and their advisors, J.P. Morgan Securities, Inc. ("JPMSI"), met with members of our senior management and received a presentation on our business and financial condition and the pending Citizens acquisition.

In early November 2002, based on the direction provided by our board of directors in their October 17, 2002 meeting, we determined to discontinue further exploration of an acquisition transaction until closer to the time that the Citizens acquisition was expected to close. Although

representatives of the Investor Group continued to speak with Mr. Pignatelli and other members of our senior management from time to time, there were no significant developments with respect to a possible transaction between us and the Investor Group until July 2003.

On July 14, 2003, Mr. Pignatelli and Kevin P. Larson, our Vice President, Treasurer and Chief Financial Officer, met with representatives of the Investor Group in New York City. At that meeting, the Investor Group's representatives expressed a desire to renew their consideration of the possible acquisition of our company for an unspecified price that would be in excess of $20 per share of our common stock. On the date of this meeting, our common stock closed at $18.85 on the New York Stock Exchange.

On July 30, 2003, representatives of the Investor Group and JPMSI met with members of our senior management and New Harbor at our executive offices in Tucson, Arizona to receive a presentation about current developments in our business, including the impact of the expected completion of the Citizens acquisition and to discuss regulatory and other issues in connection with a potential acquisition transaction.

At a meeting on August 4, 2003, our board of directors was advised that the Investor Group had expressed renewed interest in acquiring us. At that meeting, our board of directors concluded that the price to be received by shareholders in any potential acquisition transaction was of primary concern, but also generally discussed the potential impact of any acquisition transaction on customers and communities served, employees and other constituencies and noted that our directors would need to assess carefully the regulatory impact of an acquisition.

On August 11, 2003, we completed the purchase of the Arizona gas and electric system assets from Citizens.

On September 9, 2003, representatives of the Investor Group met with Messrs. Pignatelli and Larson. At this meeting, the Investor Group's representatives provided a general outline of their proposal. In particular, the Investor Group expressed its interest in acquiring us for a purchase price of $23 per share in cash. Under this proposal, our shareholders would have retained ownership of Millennium because we would have distributed all of the shares of Millennium to our shareholders (a "spin-off") concurrently with the closing of the acquisition. On the date of this meeting, our common stock closed at $19.40 on the New York Stock Exchange.

Following the meeting of September 9th, Messrs. Pignatelli and Larson arranged for a meeting of the Investor Group's representatives with John L. Carter, a director of our company.

On September 16, 2003, representatives of the Investor Group met with Messrs. Pignatelli, Larson and Carter and Mr. Beatty of New Harbor in New York City. At this meeting, the Investor Group's representatives reiterated their interest to acquire us and the general outline of their proposal. The Investor Group's representatives stated that their due diligence investigation to date had reinforced their desire to pursue a transaction. The Investor Group's representatives stated that their belief was based upon the quality of our management team, record of excellent customer service and commitment to the communities we serve, positive relationships with regulatory authorities, attractive, growing service territory and low-cost generation. The Investor Group's representatives presented an overview of the Investor Group, their transaction experience, their community involvement and the history of their due diligence investigation and discussions up until that time. The Investor Group's representatives also provided the general terms of their proposal, as described above.

On September 30, 2003, our board of directors met to discuss, among other things, the Investor Group's renewed proposal. At the beginning of the meeting, Daniel Fessler advised our board of directors that he was submitting his resignation from our board of directors because he would not be able to provide sufficient time and attention to being a director at this time. Mr. Pignatelli then reported to our board of directors regarding the meeting with the Investor Group on September 16,

2003, at which the Investor Group had made the renewed proposal to acquire us. Mr. Pignatelli also reported to our board of directors that the Investor Group generally indicated that it expected to retain existing management, but that no specific discussion had taken place regarding any employment arrangements or equity investment by management in the entity to be formed by the Investor Group to effectuate the proposed acquisition.

At this meeting, our board of directors received a general presentation from Vincent Nitido, Jr., our Vice President, General Counsel and Chief Administrative Officer, regarding our board of directors' responsibilities under Arizona law. Mr. Nitido also generally addressed the standards applicable to determining whether our management or directors had a conflict of interest with respect to the transaction. Following Mr. Nitido's presentation, Thelen Reid & Priest described certain enhanced rules that apply when an acquired company will no longer be publicly traded as a result of a transaction with affiliates and certain procedures that could be implemented by a board of directors when faced with such a "going-private" transaction. Thelen Reid & Priest advised our board of directors that they were not aware of any facts which would suggest that the pending transaction would be subject to such rules or that such procedures would be required. During this meeting, Mr. Bickle reminded our board of directors of his potential conflict of interest with respect to any transaction including JPMP and that he would not vote on matters relating to the potential acquisition (see " Transactions with Management and Others").

At the same meeting, Mr. Carter then reported to our board of directors regarding the meeting held on September 16, 2003 with the Investor Group and described the Investor Group's preliminary proposal. Mr. Nitido then reviewed for our board of directors certain legal and structural considerations associated with the proposal by the Investor Group to "spin-off" Millennium in connection with the transaction.

Steven J. Glaser, Senior Vice President and Chief Operating Officer of TEP, then generally discussed the regulatory standards applicable to the approval by the ACC of a transaction of the nature proposed by the Investor Group. In addition, the terms of TEP's existing rate settlement with the ACC were reviewed. The rate settlement provides that TEP's retail rates may not be raised during the term of the settlement, which expires in 2008. Although the rate settlement contemplates market-based rates for power after that time, utility regulators throughout the country, including the ACC, are reconsidering whether rates related to generation should be market-based or determined on a more traditional cost-of-service basis, which creates uncertainty with respect to TEP's rates in respect of TEP's generation facilities after 2008. Mr. Larson and Kent Grant, General Manager (Finance) of TEP, then reviewed our company's financial position and prospects. In particular, they noted that forecasting earnings after the expiration of TEP's rate settlement in 2008 is itself uncertain due to the uncertainty concerning how retail rates will be set in respect of TEP's generation facilities. The board of directors and management then discussed, in light of the foregoing, the consequent risk related to our future earnings and the market price of our common stock.

Mr. Beatty then made a presentation to our board of directors regarding merger and acquisition activity in the utility industry generally, the Investor Group, Millennium and the possible valuation of our company excluding Millennium. Mr. Beatty noted that any attempt to value Millennium would be complex and uncertain because Millennium had approximately 10 separate businesses or investments in the technology, energy services and finance areas and that many of these businesses were in the developmental stages. Although comprising less than 6% of our consolidated assets, the unregulated businesses of Millennium have contributed significant losses to date. Directors expressed concerns regarding the potential viability of Millennium as a stand-alone entity and whether a "spin-off" of Millennium was appropriate, or even feasible, at this time. A discussion ensued with New Harbor as to whether Millennium was an appropriate candidate for a "spin-off" and with counsel regarding issues associated with a potential "spin-off" of Millennium.

At the conclusion of the discussion, the non-management members of our board of directors met in executive session, and, with Messrs. Carter, Lawrence, Aldrich and Bickle abstaining from voting, our board of directors did not approve continuation of discussions on the terms presented by the Investor Group. Our board of directors expressed particular concern regarding a "spin-off" of Millennium.

Following the meeting on September 30, 2003, Mr. Pignatelli advised the Investor Group of the decision of our board of directors and described the principal concerns of our board of directors. In response, the Investor Group requested an opportunity to present a revised preliminary proposal directly to our board of directors that addressed these concerns.

On October 13, 2003, our board of directors met to hear the Investor Group's presentation. The Investor Group's representatives reviewed the reasons for the Investor Group's interest in us and what the Investor Group believed to be the benefits to our shareholders, including the premium of the proposed purchase price over the then current market price of our common stock, the opportunity for holders of large blocks of our common stock to obtain liquidity for their shares, the Investor Group's access to the high-yield debt markets and the Investor Group's belief that it could consummate a transaction quickly. They also described the Investor Group's commitment to maintaining and improving our relationships with our key constituencies, including management, employees, customers, communities served and regulators. The Investor Group's representatives told our board of directors that they believed that private equity capital has become a more attractive source of capital for us. In particular, the Investor Group's representatives discussed their perceptions regarding potential significant changes in the capital markets that could adversely impact our strategic situation as a publicly-traded utility holding company, noting particularly that companies with

comparatively small market capitalization might not receive appropriate valuation in the public equity markets or obtain access to well-priced capital. They also discussed the possible adverse impact of diminished investor research analyst coverage on the market prices of shares of smaller companies and other burdens connected with remaining a listed public company. The Investor Group's representatives recalled for our board of directors that the Investor Group had conducted a substantial due diligence investigation of our company in the fall of 2002 and had renewed its discussion regarding a possible transaction in July 2003. Among the favorable factors that caused them to seek to renew discussions, they cited the acquisition of the Citizens assets, the anticipated completion of the Springerville Unit 3 project and improving conditions in the financial markets which were expected to lower the cost of financing an acquisition.

The Investor Group's representatives then outlined two alternative transaction structures. The first structure involved the acquisition of all of our outstanding shares of common stock for a price of $24.50 to $25.00 per share in cash. The second structure involved the purchase of all of our outstanding shares of common stock for $23.00 per share in cash plus a note to be issued by us ("Participating Notes") having a principal amount based upon a percentage of a valuation of Millennium at the time when the Participating Notes became payable, but with a payment at that time of at least $2.00 per share of our common stock. The Investor Group's representatives provided a general description of the terms of the Participating Notes, which contemplated that the Participating Notes would not bear interest and would generally be payable in five years, but could entitle holders to receive more than $2.00 per share, depending upon the value of Millennium at the time the Participating Notes became payable. If the value per share of Millennium after five years exceeded $2.00, the holders of the Participating Notes would have been entitled to the sum of $2.00 per Participating Note plus 60% of the excess of the per share appraised value of Millennium over $2.00. We would have retained the remaining value of Millennium. The Investor Group's representatives noted that the specific terms and provisions of the Participating Notes would have to be negotiated if our board of directors determined to proceed with discussions, and that the Participating Notes were proposed as an alternative to the Millennium "spin-off."

After the Investor Group's representatives left the meeting, our board of directors received a presentation from Mr. Nitido concerning its fiduciary duties and responsibilities in connection with its consideration of the revised proposal. Our board of directors also discussed the advisability of independent legal counsel and financial advice in light of the proposed acquisition transaction from the Investor Group. A representative of Fennemore Craig, P.C. attended portions of the meeting to discuss certain issues under Arizona corporate law regarding fiduciary duties, conflicts of interest, changes of control and the implications of "going-private" rules, and the advantages of obtaining special counsel and financial advice to our board of directors when considering the acquisition proposal from the Investor Group.

Mr. Beatty then made a presentation to our board of directors which included a review of the principal points covered during his presentation to our board of directors on September 30, 2003. Mr. Beatty advised our board of directors that the general terms included in the revised proposal from the Investor Group were sufficient from a financial point of view to merit our board of directors authorizing continued discussion of the transaction. Mr. Beatty also noted that our board of directors, at this early stage, did not need to choose between the alternative transaction structures.

Our board of directors then discussed certain regulatory issues, including what conditions the Investor Group might require with respect to regulatory proceedings, and other potential transaction structures. Our board of directors discussed the procedures to be followed in reviewing the potential transaction with the Investor Group, including the advisability of forming a committee of independent directors and the retention for the board of directors of separate counsel and a financial advisor who had not been involved in the discussions that led up to the potential transaction with the Investor Group.

Our board of directors, with Messrs. Pignatelli and Bickle abstaining, unanimously authorized management to continue discussions with the Investor Group and retained Fennemore Craig to act as special counsel to our board of directors in connection with our board of directors' consideration of the proposal. In addition, our board of directors determined to use Thelen Reid & Priest to represent us in the capacity of transaction and securities counsel and Roshka Heyman & DeWulf, PLC to represent us as Arizona regulatory counsel. Our board of directors also determined to investigate and consider the engagement of a financial advisor to our board of directors who had not previously advised us on strategic transactions for the purpose of rendering financial advice and issuing a fairness opinion in the event that the discussions resulted in a definitive agreement.

At the conclusion of the meeting, our board of directors appointed a committee (the "Strategic Transaction Advisory Committee" or "Committee") to deliberate, analyze and negotiate the revised proposal and to ultimately make a recommendation to our board of directors on whether or not to approve, and recommend to the shareholders, an acquisition transaction with the Investor Group. The Strategic Transaction Advisory Committee was composed of the following directors: Mr. Carter (Chairman), and Harold Burlingame, Robert Elliott, Kenneth Handy and Warren Jobe.

On October 17, 2003, Simpson Thacher & Bartlett LLP, transaction counsel to the Investor Group, delivered to us and our counsel an initial draft of the acquisition agreement and a summary of terms of the Participating Notes.

On October 20, 2003, our board of directors, acting by written consent, provided that the Strategic Transaction Advisory Committee would not be subject to any direction or control by our board of directors in its consideration of any action concerning the Investor Group's proposal, although the Committee would not have the power, without the affirmation of our board of directors, to bind us to any part of the Investor Group's proposal. Our board of directors' resolutions determined, based upon disclosures made by members of our board of directors and upon the advice of counsel, that the previously appointed members of the Committee were all "disinterested" and "qualified," as each term is defined under Arizona law. Our board of directors' resolutions also authorized the Committee to

seek the assistance of legal, financial, tax and other professional advisors and other advisors of their own selection which would report only to the Committee and otherwise specifically defined the power and authority of the Committee. On October 20, 2003, our board of directors, acting by written consent, authorized the Committee to engage the services of Fennemore Craig as special counsel to the Committee (in addition to acting as special counsel to the board of directors) and concluded that it would be desirable to engage a financial advisor which had not previously advised us on strategic transactions to provide financial advice to the Committee and our board of directors and, if requested, to provide an opinion regarding the fairness of the consideration to be received by our shareholders from a financial point of view.

On October 21, 2003, representatives of the Investor Group, JPMSI and Simpson Thacher & Bartlett met with our representatives, New Harbor and Thelen Reid & Priest, in New York City to discuss general issues presented by the initial draft of the acquisition agreement. On October 24, 2003, attorneys from Simpson Thacher & Bartlett and Thelen Reid & Priest met separately to discuss the draft acquisition agreement in detail and to discuss tax, corporate and securities issues in connection with the proposed Participating Notes.

At meetings held on October 24 and October 29, 2003, the Strategic Transaction Advisory Committee interviewed candidates for retention as a financial advisor to the Committee and our board of directors in connection with the potential transaction with the Investor Group. At the meeting held on October 24, 2003, the Committee was advised by its counsel, Fennemore Craig, as to the fiduciary duties and responsibilities of members of our board of directors when considering an acquisition proposal, the provisions of Arizona law regarding conflicting interests and changes of control and the issues presented by the draft of the acquisition agreement received from the Investor Group.

At its meeting on October 29, 2003, the Strategic Transaction Advisory Committee also received an update from Mr. Pignatelli regarding certain of Millennium's investments. The Committee, in consultation with its counsel and representatives of New Harbor, also identified certain issues in connection with the transaction, including price, the proposed Participating Notes, regulatory conditions, financing of the transaction and the request by the Investor Group for reimbursement of expenses if the acquisition failed to receive regulatory approval. The Committee also discussed, in the event any arrangements or understandings were to be entered into between management and the Investor Group, the significance of such arrangements and understandings. The Committee discussed under what circumstances the proposed transaction could be subject to the enhanced disclosure rules applicable to "going-private" transactions.

On October 31, 2003, the Strategic Transaction Advisory Committee unanimously voted to engage Morgan Stanley to act as the financial advisor to the Committee and our board of directors in connection with the transaction. The Committee also instructed Fennemore Craig to review, consider and make recommendations regarding potential conflicting interests, if any, of the members of our board of directors.

On October 31, 2003, our representatives and the Investor Group's representatives and our and their counsel met to discuss the regulatory approval process for a potential transaction.

On November 4, 2003, the Strategic Transaction Advisory Committee met with representatives of Morgan Stanley and Fennemore Craig. The Committee emphasized to Morgan Stanley that there had been no agreement or understanding to pursue an acquisition transaction and that, for our board of directors to approve and recommend a definitive agreement with the Investor Group, appropriate steps should be taken to assure that the best price reasonably available for our shareholders had been obtained, that management and employee interests had been appropriately considered, that we would continue to benefit the communities we serve and that our utility operations would continue to provide safe and reliable service. Morgan Stanley's representatives discussed certain issues in connection with the transaction, including the nature and identity of the entity to be formed by the Investor Group to

effectuate the acquisition, the status of the Investor Group's financing arrangements and the Investor Group's position that their costs and expenses should be reimbursed by us in the case of a termination of the acquisition agreement as a consequence of a failure to receive required regulatory approvals. The Strategic Transaction Advisory Committee also discussed with Fennemore Craig and Morgan Stanley the advisability of ascertaining whether parties other than the Investor Group might have an interest in acquiring us and potential strategic parties that might be interested and concluded that checking if any third parties were interested in acquiring us was advisable. The Committee considered the need to maintain confidentiality and instructed Morgan Stanley to proceed with contacting third parties that may have been interested in acquiring us after obtaining information from New Harbor as to the identity of any parties New Harbor may have previously contacted.

The Strategic Transaction Advisory Committee also received an update from Mr. Pignatelli regarding certain of Millennium's investments and Mr. Beatty provided a summary of developments in the negotiations of the acquisition agreement. The Committee also compared the proposed all-cash transaction with the proposal that included the Participating Notes and a price of $1.50 to $2.00 per share less cash at closing than the all-cash transaction. The Committee received from Fennemore Craig a review of the status of the acquisition agreement and the various terms and conditions that were the subject of negotiation.

On November 11, 2003, our board of directors received a presentation from Fennemore Craig regarding the fiduciary duties and responsibilities of directors under Arizona law and during a potential change of control transaction, potential director conflicts of interest with respect to the proposed acquisition and the benefits and desirability of having directors who did not have a potential conflict of interest participate to the greatest extent possible in the evaluation and negotiation of the transaction and the assessment of alternatives. Fennemore Craig, after considering disclosures by members of our board of directors, recommended to our board of directors that Messrs. Pignatelli, Bickle and Aldrich and Ms. Elizabeth Bilby abstain from voting on the proposed acquisition transaction with the Investor Group, but confirmed that all of the members of the Strategic Transaction Advisory Committee were "qualified" and "disinterested," as those terms are defined under Arizona law.

Following the presentation by Fennemore Craig, Mr. Pignatelli advised the other members of our board of directors that while it is possible that specific discussions may take place in the future, he had not engaged in any specific discussions with the Investor Group regarding the terms of equity participation of management in the acquisition transaction or regarding the terms of his employment following the closing of the proposed acquisition. Mr. Pignatelli expressed his belief that his existing ownership of our common stock and other equity-based compensation was designed to align his interests with that of our shareholders. He stated, however, that in order to avoid any perception of conflict of interest with respect to the proposed acquisition, he would not vote, in his capacity as a director, regarding the proposed acquisition. Mr. Bickle confirmed that he would continue to abstain from voting as a director on the matter for the reasons set forth above. Mr. Aldrich and Ms. Bilby each expressed their beliefs, with respect to themselves, that their respective transactions with us, which are described in " Transactions with Management and Others", did not give rise to actual conflicts of interest that would preclude their being "qualified" and "disinterested" in the consideration of the acquisition transaction.

At the November 11, 2003 meeting, representatives of New Harbor described the current progress of the negotiation of the acquisition agreement and the financing structure contemplated by the Investor Group. New Harbor advised our board of directors that, in its opinion, a "spin-off" of Millennium or the use of the Participating Notes as consideration presented undue complications and risk, without providing corresponding value to our shareholders, and advised that an all-cash transaction would provide the most value to our shareholders. In particular, New Harbor representatives noted that there was no assurance that the Participating Notes would ever be worth more than $2.00 each, the minimum payment under the Participating Notes in five years. New Harbor

representatives also expressed concern regarding the liquidity of the Participating Notes and the related value implications. New Harbor also advised our board of directors that, while it may be possible to negotiate a purchase price in excess of the range of $24.50 to $25.00 per share currently proposed by the Investor Group, it was unlikely that the Investor Group would increase its proposed purchase price significantly. Representatives of Morgan Stanley were introduced to our board of directors and Morgan Stanley reviewed with our board of directors the purpose and scope of Morgan Stanley's engagement and reviewed the discussions that Morgan Stanley had conducted with other parties regarding the acquisition of our company for a price which would represent a significant premium over the current market price of our common stock. Morgan Stanley reported that it had completed contacting potential interested third parties and that none of the contacted parties had expressed interest in acquiring us at a significant premium over the current market price of our common stock.

At a meeting of the Strategic Transaction Advisory Committee held immediately following the board of directors meeting on November 11, 2003, Morgan Stanley further described its discussions with third parties regarding possible interest in acquiring us at a significant premium over the current market price of our common stock and also presented a general overview of potential transactions with private equity investors such as the Investor Group. In that regard, it was noted by members of the Committee that, in the past three years, other private equity firms had explored the possible acquisition of our company, but that discussions with those firms had all terminated without a transaction. The Strategic Transaction Advisory Committee also discussed Millennium and received a presentation from Fennemore Craig regarding the current status of

the negotiations of the acquisition agreement. In particular, the Committee, in consultation with Fennemore Craig and Morgan Stanley, discussed price, the financing condition, conditions to closing, the provisions regarding the solicitation of other offers and the ability of each party to terminate the agreement, and the termination provisions regarding the payment of costs and expenses.

At the conclusion of these discussions, the Strategic Transaction Advisory Committee determined to authorize the negotiations with the Investor Group to continue for an all-cash transaction rather than a transaction involving a "spin-off" of Millennium or the use of the Participating Notes, with the goal of seeking further improvements regarding price and the other terms and conditions prior to the meeting of our board of directors scheduled to be held on November 18, 2003.

Following this meeting, Mr. Carter, Fennemore Craig and Morgan Stanley met with Thelen Reid & Priest and New Harbor to discuss the proposed acquisition transaction and the acquisition agreement. On November 13, 2003, Thelen Reid & Priest delivered detailed comments on the most recent draft of the acquisition agreement to Simpson Thacher & Bartlett. The next day, Messrs. Larson and Nitido, representatives of Morgan Stanley and New Harbor and Thelen Reid & Priest met with the representatives of the Investor Group and Simpson Thacher & Bartlett in New York City to engage in further negotiations. Negotiations continued through November 16, 2003.

On November 18, 2003, the Strategic Transaction Advisory Committee met to review the status of the negotiations with the Investor Group. At that meeting, New Harbor presented a brief history of the discussions with the Investor Group and presented a list of the parties with which New Harbor had engaged in discussions regarding the acquisition of our company over the previous five years. New Harbor also noted that none of these parties had expressed interest in engaging in a transaction that would provide a significant premium to our shareholders. Thelen Reid & Priest described the progress made in the negotiations and listed the principal issues that remained unresolved in the draft acquisition agreement. Morgan Stanley's representatives reviewed with the Committee their preliminary valuation of our company as well as various transaction issues. Mr. Glaser reported on the provisions of the acquisition agreement relating to the regulatory approval process and discussed the anticipated timing regarding ACC approval of the acquisition. Mr. Pignatelli advised the Strategic Transaction Advisory Committee that he supported the proposed acquisition. In stating the reasons for his recommendation, Mr. Pignatelli noted in particular that the acquisition could provide us with a more

stable and secure future. The members of the Committee each indicated that they were prepared to recommend the transaction and the acquisition agreement to our board of directors for approval subject to reaching agreement on the price and the other remaining unresolved issues under the acquisition agreement.

Following the meeting of the Strategic Transaction Advisory Committee, our board of directors met to receive a report of the Committee regarding the proposed transaction. Mr. Carter reported that, in light of the progress that had been made, and subject to the attainment of agreement on the remaining unresolved issues, the Committee was prepared to unanimously recommend that we proceed with the proposed transaction with the Investor Group. Thelen Reid & Priest presented an overview of the acquisition agreement, drafts of which had previously been circulated to our board of directors, including the transaction structure, the financing arrangements, the regulatory approvals required to consummate the transaction, the terms under which our board of directors may respond to bona fide written proposals from third parties and termination provisions. Thelen Reid & Priest then summarized for our board of directors the major points that remained unresolved in the acquisition agreement. Our board of directors then discussed with Morgan Stanley various transaction and valuation issues. New Harbor then made a presentation regarding the history of the negotiations similar to that delivered earlier to the Committee. Our board of directors then discussed the remaining unresolved issues and Mr. Glaser responded to questions from directors regarding the ACC approval process.

Following the meeting of our board of directors, the Strategic Transaction Advisory Committee reconvened to discuss the remaining open issues and to develop a proposal to the Investor Group with respect to the remaining unresolved issues and instructed Morgan Stanley to present the proposal to the Investor Group. In particular, the Committee requested that Morgan Stanley seek an increase in the purchase price to $25.25 per share from the range previously discussed ($24.50 to $25.00) and authorized Morgan Stanley to accept, contingent on the price increase, the Investor Group's proposal that we reimburse their expenses if the acquisition fails to receive the required Arizona regulatory approval.

On November 19, 2003, the Investor Group accepted our proposal. In particular, the Investor Group agreed to a purchase price of $25.25 per share and termination fees and expenses in an amount up to $25 million in the aggregate on the terms stated in the acquisition agreement.

On November 21, 2003, the Strategic Transaction Advisory Committee met to consider the proposed acquisition agreement and reviewed the conclusion of the negotiations. Morgan Stanley delivered its opinion to the effect that, as of that date, and subject to and based upon the considerations set forth in its written opinion, the $25.25 in cash per share to be received by our shareholders pursuant to the acquisition agreement was fair from a financial point of view to those shareholders (other than Saguaro Utility and its affiliates). The Committee then unanimously adopted resolutions recommending that our board of directors approve the acquisition agreement.

Immediately following the meeting of the Strategic Transaction Advisory Committee, our board of directors met to receive the recommendation of the Committee and the fairness opinion of Morgan Stanley. Our board of directors, with Messrs. Burlingame, Carter, Elliott, Handy and Jobe voting in favor of the proposal, then adopted resolutions authorizing the execution of the acquisition agreement and authorizing and recommending that our shareholders vote in favor of the acquisition. The remaining four directors, Messrs. Pignatelli, Bickle and Aldrich, and Ms. Bilby, after consultation with the Board's special counsel, Fennemore Craig, abstained from voting on the acquisition in order to avoid any appearance of a conflict of interest. These four directors, however, advised the board that they agreed with the recommendation of the Strategic Transaction Advisory Committee and that they would have voted to approve the acquisition.

The acquisition agreement was executed and delivered in the evening of Friday, November 21, 2003 and the execution and delivery of the acquisition agreement was publicly announced prior to the opening of business on Monday, November 24, 2003.

Our Reasons for the Acquisition; Recommendation of Our Board of Directors

In determining to approve the acquisition and to recommend that you vote to approve the acquisition agreement, and in reaching its determination that the acquisition and the acquisition agreement are fair to and in the best interests of our company and our shareholders, our board of directors held discussions with our executive officers and our financial and legal advisors. Our board of directors reached its recommendation after careful consideration over time and also considered the recommendation of the Strategic Transaction Advisory Committee. Our board of directors and the Strategic Transaction Advisory Committee considered numerous factors, including, without limitation, the following:

- the review and analysis of our business, current and future financial condition, current earnings and earnings prospects, as well as the current and prospective regulatory environment;

- the relationship of the acquisition consideration to the historical trading levels of our common stock including the fact that the cash consideration of $25.25 per share of our common stock to be paid to shareholders in the acquisition represents a premium of approximately 30% over the per share closing price on November 21, 2003, the last trading day prior to the execution and delivery of the acquisition agreement;

- the acquisition allows our shareholders to immediately realize a fair value, in cash, for their investment and is preferable to the shareholders continuing to hold shares of common stock indefinitely;

- the uncertainty over whether and when the businesses which Millennium is developing will be successful;

- the fact that rates that may be charged by TEP may not be raised prior to 2008 and that the regulatory environment following that time is subject to uncertainty;

- the acquisition presents a means for holders of large blocks of shares of our common stock to receive a premium price in cash for their holdings without adversely affecting the market price for shares of our common stock;

- the presentation of Morgan Stanley, including its opinion dated November 21, 2003, to the Strategic Transaction Advisory Committee and our board of directors as to the fairness of the consideration to be received by our shareholders from a financial point of view (see " Opinion of Financial Advisor to our Board of Directors");

- the discussions with third parties conducted on our behalf by Morgan Stanley (see " Background of the Acquisition") and a review of the possible alternatives to the acquisition at this time, including remaining a public company and the timing and likelihood of actually achieving additional value from such alternatives;

our board of directors' belief that the Investor Group is motivated to operate our company and its businesses successfully, by meeting the needs of our customers, employees and other constituencies;

our board of directors' belief that that the Investor Group will continue our strategy of providing safe and reliable service to our utility customers and that the Investor Group's plans for us will enable us to have adequate capital for utility operations and to meet expansion requirements;

our board of directors' belief that the Investor Group will be sensitive to the needs of the communities we serve and will cause us to continue to be a good corporate citizen;

our board of directors' belief that the Investor Group will cause us to provide an attractive working environment for our employees;

the commitment by the Investor Group to maintain our headquarters in Tucson, Arizona;

the terms of the acquisition agreement, including the right of our board of directors, prior to the shareholders' approving the acquisition, (i) to change its recommendation to our shareholders regarding the acquisition in the exercise of its fiduciary duties and (ii) to terminate the acquisition agreement to accept a proposal superior to that made by the Investor Group (see "THE ACQUISITION AGREEMENT No Solicitation of Alternative Proposals");

the likelihood of consummation of the acquisition, including an assessment of the risks associated with obtaining required approvals from federal and state regulatory authorities; and

the delivery by the Investor Group of letters setting forth the commitments regarding the equity financing and commitments and other arrangements regarding the debt financing necessary to enable the Investor Group to consummate the acquisition, subject to usual conditions for financing of this type (see " Financing for the Acquisition").

In view of the wide variety of factors considered by the Strategic Transaction Advisory Committee and our board of directors in connection with their evaluation of the proposed acquisition, neither the Committee nor our board of directors found it practicable to quantify or otherwise assign relative weights to the foregoing factors. The Strategic Transaction Advisory Committee and our board of directors viewed their respective positions and recommendations as being based upon the totality of the information presented to and considered by them. While the foregoing discussion of the information and factors considered by the Committee and our board of directors is not intended to be all-inclusive, it does constitute a summary of all of the material information considered by the Committee and our board of directors in determining to recommend approval of the acquisition agreement.

The Strategic Transaction Advisory Committee and our board of directors believe that each of the factors listed above supported their respective conclusions that the acquisition and the acquisition agreement are advisable and in the best interests of our company and our shareholders.

The Strategic Transaction Advisory Committee unanimously determined that the acquisition and the acquisition agreement are fair to and in the best interests of the holders of our common stock, and unanimously recommended that our board of directors approve the acquisition agreement.

Our board of directors, with Messrs. Burlingame, Carter, Elliott, Handy and Jobe voting in favor of the proposal, recommends that our shareholders vote "FOR" approval of the Agreement and Plan of Merger between Saguaro Acquisition Corp. and us. The remaining four directors, Messrs. Pignatelli, Bickle and Aldrich, and Ms. Bilby, after consultation with our board of directors' special counsel, Fennemore Craig, abstained from voting on the acquisition in order to avoid any appearance of a conflict of interest. These directors, however, advised the board that they agreed with the recommendation of the Strategic Transaction Advisory Committee and that they would have voted to recommend the approval of the acquisition agreement.

Opinion of Financial Advisor to Our Board of Directors

Under an engagement letter dated as of November 3, 2003, we retained Morgan Stanley to provide us with financial advisory services (including structuring, planning and negotiating services) and a financial opinion letter in connection with the acquisition. At the meeting of our board of directors, including the members of the Strategic Transaction Advisory Committee, on November 21, 2003, Morgan Stanley rendered its oral opinion to the board of directors, subsequently confirmed in writing,

to the effect that, as of November 21, 2003 and subject to and based upon the assumptions and other considerations set forth in its written opinion, the acquisition consideration to be received by our common stock shareholders pursuant to the acquisition agreement was fair from a financial point of view to our shareholders (other than Saguaro Utility and its affiliates).

The full text of the written opinion of Morgan Stanley, dated November 21, 2003, is attached hereto as Appendix B. The opinion sets forth, among other things, the assumptions made, procedures followed, matters considered and limitations on the scope of the review undertaken by Morgan Stanley in rendering its opinion. We recommend that you read the entire opinion carefully. Morgan Stanley's opinion is addressed to our board of directors and to the members of the Strategic Transaction Advisory Committee and addresses only the fairness, from a financial point of view, of the consideration to be received by our shareholders (other than Saguaro Utility and its affiliates) pursuant to the acquisition agreement as of the date of the opinion. It does not address any other aspects of the acquisition and does not constitute a recommendation to any holder of our common stock as to how such shareholder should vote with respect to the acquisition or any other matter. The summary of the opinion of Morgan Stanley set forth in this document is qualified in its entirety by reference to the full text of the opinion.

In connection with rendering its opinion, Morgan Stanley, among other things:

- reviewed certain publicly available financial statements and other information about us;
- reviewed certain internal financial statements and other financial and operating data concerning us, prepared by our management;
- reviewed certain financial forecasts prepared by our management;
- discussed our past and current operations and financial condition and our prospects with our senior executives;
- reviewed the reported prices and trading activity for our common stock;
- compared our financial performance and the prices and trading activity of our common stock with that of certain other publicly-traded companies comparable to us and their securities;
- reviewed the financial terms, to the extent publicly available, of certain comparable acquisition transactions;
- participated in discussions and/or negotiations among our representatives, Saguaro Utility and certain other parties and their financial and legal advisors;
- reviewed the debt letters and the equity commitment letter referred to in the acquisition agreement;
- reviewed the acquisition agreement and certain related documents; and

performed such other analyses and considered such other factors as Morgan Stanley deemed appropriate.

Morgan Stanley assumed and relied upon, without independent verification, the accuracy and completeness of the information reviewed by it for the purposes of its opinion. With respect to the financial projections, Morgan Stanley assumed that they were reasonably prepared on bases reflecting the best currently available estimates and judgments of our future financial performance. In addition, Morgan Stanley has assumed that the acquisition will be consummated in accordance with the terms set forth in the acquisition agreement. Morgan Stanley has not made any independent valuation or appraisal of our assets or liabilities, nor has it been furnished with any such appraisals. As is known by us, Morgan Stanley is not a legal or regulatory expert and has relied upon the assessments of other of our advisors with respect to such issues. Morgan Stanley's opinion was necessarily based on economic, regulatory, market and other conditions as in effect on, and the information made available to Morgan Stanley as of, November 21, 2003.

Morgan Stanley was not asked to consider, and Morgan Stanley's opinion does not address, the relative merits of the acquisition as compared to any alternative strategies or transactions that might exist for us or the effect of such strategies or transactions, whether or not such strategies or transactions may be available.

Morgan Stanley expressed no opinion or recommendation as to how our shareholders should vote at the special meeting.

The following is a summary of the material financial analyses performed by Morgan Stanley in connection with its oral opinion and the preparation of its written opinion. Some of these summaries of financial analyses include information presented in tabular format. In order to fully understand the financial analyses used by Morgan Stanley, the tables must be read together with the text of each summary. The tables alone do not constitute a complete description of the financial analyses.

Comparative Stock Price Performance.

Morgan Stanley reviewed the recent stock price performance of our common stock and compared the performance with that of the following indices:

Standard & Poor's 500 Index;

Standard & Poor's 500 Utilities Index; and

An index of selected comparable companies to us, including Avista Corporation, Cleco Corporation, Duquesne Light Holdings, Inc., Pinnacle West Capital Corporation, PNM Resources, Inc. and Puget Energy, Inc.

The comparable companies were chosen on the basis of several criteria including business mix, service territory characteristics, relative size, growth prospects and capitalization. Morgan Stanley concluded that the characteristics of these companies, taken as a group, are similar in many respects to our characteristics.

The following table presents the change in value for these indices, as compared to the change in the share price of our common stock over the periods from November 20, 2000 to November 18, 2003 and May 19, 2003 to November 18, 2003:

	Percentage Change for the Period 11/20/2000 to 11/18/2003	Percentage Change for the Period 05/19/2003 to 11/18/2003
Standard & Poor's Electric Utility Index	(47.6)%	2.8%
Standard & Poor's 500 Index	(23.0)%	12.3%
Selected Comparable Companies	(23.4)%	10.6%
UniSource Energy	30.2%	7.3%

Comparable Public Company Analysis.

As part of its analysis, Morgan Stanley compared our financial information with that of the same selected comparable companies as in the comparative stock price performance analysis. The table below presents, as of November 18, 2003, the representative range for each of the ratios of stock price to each of forecasted fiscal 2003 and 2004 earnings per share, stock price to book value per share as of September 30, 2003, stock price to the latest twelve-month ("LTM") earnings per share, and the aggregate value to LTM earnings before interest, taxes, depreciation and amortization ("EBITDA") multiple.

	Price to Forecasted 2003 Earnings	Price to Forecasted 2004 Earnings	Price to Book Value	Price to LTM Earnings	Aggregate Value to LTM EBITDA
Comparable Companies	12.5-14.5	11.5-13.5	1.2-1.4	13.5-15.5	7.0-7.5
UniSource Energy	16.7	11.4	1.3	27.2	6.9

No company utilized in the comparable public company analysis as a comparison is identical to us. In evaluating the companies, Morgan Stanley made judgments and assumptions with regard to industry performance, general business, economic, market and financial conditions and other matters, many of which are beyond our control such as the impact of competition on our business and the industry generally, industry growth and the absence of any material adverse change in our financial condition and prospects or the industry or in the financial markets in general. Mathematical analysis, such as determining an average or a median, is not in itself a meaningful method of using comparable public company data.

Morgan Stanley calculated the implied per share trading values for our common stock based on the appropriate financial results and projections and the range of multiples for the comparable companies. The resulting implied trading values were: $14.53 $16.78 based on stock price to forecasted 2003 earnings per share, $19.31 $22.47 based on stock price to forecasted 2004 earnings per share, $17.78 $20.55 based on stock price to book value per share as of September 30, 2003, $9.67 $11.10 based on stock price to LTM earnings per share and $20.45 $25.55 based on aggregate value to LTM EBITDA.

Discounted Cash Flow Analysis.

Given the different nature of businesses in which we participate, Morgan Stanley performed a sum-of-the-parts discounted cash flow analysis. Morgan Stanley's discounted cash flow analysis was based on subsidiary and consolidated financial projections provided by our management for the period 2004 through 2012. Unlevered free cash flows were calculated as net income available to common shareholders plus the aggregate of preferred stock dividends, depreciation and amortization, deferred taxes, and other noncash expenses and after-tax net interest expense less the sum of capital expenditures and investment in noncash working capital for each operating subsidiary. Morgan Stanley calculated the values of each subsidiary as of the end of the period for which projections were provided by our management, also referred to as the terminal value, by applying a range of net income multiples to the forecasted net income as of the last year for which projections were provided by our management, and the cash flow streams and terminal values were then discounted to the date of the opinion using a range of discount rates representing an estimated range of the weighted average cost of capital for each subsidiary. The ranges of discount rates utilized for the valuation were 7.0% to 8.0% for our regulated utility subsidiaries and 20.0% to 30.0% for our other non-regulated subsidiary businesses. The range of net income multiples applied for this analysis was 12.5x to 14.5x for our regulated utility subsidiaries, which is based upon trading multiples of the comparable companies, and 15.0x to 20.0x for our non-regulated subsidiary businesses which is based upon Morgan Stanley's judgment of an appropriate trading range for a seasoned non-regulated power technology company.

Based on this analysis, Morgan Stanley calculated per share trading values for us ranging from $22.17 to $25.80.

Analysis of Selected Precedent Transactions.

Using publicly available information, Morgan Stanley considered 6 announced or completed precedent transactions in the regulated electric utility industry comparable in certain respects to the acquisition. These precedent transactions included:

- The AES Corporation's acquisition of IPALCO Enterprises Inc. (announced July 2000);
- Powergen PLC's acquisition of LG&E Energy Corp. (announced February 2000);
- SW Acquisition L.P.'s acquisition of TNP Enterprises, Inc. (announced May 1999);

National Grid Transco PLC's acquisition of New England Electric System (announced December 1998);

The AES Corporation's acquisition of Cilcorp Inc. (announced November 1998);

CalEnergy Company, Inc.'s acquisition of MidAmerican Energy Holdings Company (announced August 1998).

Morgan Stanley compared publicly available financial and market statistics of the precedent transactions. The table below presents the representative range for each of the ratios of price paid in the precedent transactions to forecasted earnings for the first and second fiscal years after the announcement of the transactions, price paid to latest reported book value, price paid to the LTM earnings, premium paid to the unaffected stock price, and the aggregate value paid to LTM EBITDA multiple.

	Price Paid to Forward FY1E Earnings	**Price Paid to Forward FY2E Earnings**	**Price Paid to Book Value**	**Price Paid to LTM Earnings**	**Premium to Unaffected Price**	**Aggregate Value to LTM EBITDA**
Precedent Transactions	15.5-17.5	14.5-16.5	1.8-2.3	16.5-18.5	25%-35%	7.0-8.0

Morgan Stanley calculated the per share transaction values for our common stock based on the appropriate financial results and projections and the range of multiples for the precedent transactions. The per share transaction values calculated were: $17.86 $20.02 based on price paid to the FY1E earnings, $24.05 $27.21 based on price paid to FY2E earnings, $22.78 $28.79 based on price paid to adjusted book value, $11.82 $13.25 based on price paid to LTM earnings, $24.00 $25.92 based on premium paid to unaffected stock price, and $20.45 $30.66 based on aggregate value to LTM EBITDA.

No transaction utilized as a comparison in the analysis of selected precedent transactions is identical to the acquisition, accordingly, an analysis of the results of the foregoing necessarily involves complex considerations and judgments concerning differences in our financial and operating characteristics and other factors that would affect the acquisition value of the companies to which it is being compared. In evaluating the precedent transactions, Morgan Stanley made judgments and assumptions with regard to conditions and other matters, many of which are beyond our control, such as the impact of competition on us and the industry generally, industry growth and the absence of any adverse material change in our financial conditions and prospects or the industry or in the financial markets in general. Mathematical analysis, such as determining the mean or median, is not, in itself, a meaningful method of using precedent transactions data.

In connection with the review of the acquisition by our board of directors and the Strategic Transaction Advisory Committee, Morgan Stanley performed a variety of financial and comparative analyses for purposes of rendering its opinion. The preparation of a fairness opinion is a complex process and does not lend itself to a partial analysis or summary description. In arriving at its opinion, Morgan Stanley considered the results of all of its analyses as a whole and did not attribute a specific weight to any single method of analysis or factor it considered. Morgan Stanley believes that relying solely on a portion of its analyses, without considering all of its analyses as a whole, would create an incomplete view of the process underlying its analyses and opinion. While Morgan Stanley did not rely solely on any single method of analysis or factor, Morgan Stanley may have given various analyses and factors more or less weight than other analyses and factors, and may have deemed various assumptions more or less probable than other assumptions. None of these valuations, however, should be taken to be Morgan Stanley's view of our actual value. In performing its analyses, Morgan Stanley made numerous assumptions with respect to industry performance, general business and economic conditions and other matters. Many of these assumptions are beyond our control. Any estimates contained in Morgan Stanley's analyses are not necessarily indicative of future results or actual values, which may be significantly more or less favorable than those suggested by such estimates.

Morgan Stanley conducted the analyses described above solely as part of its analysis of the fairness of the consideration to be received pursuant to the acquisition agreement from a financial point of view

to holders in the aggregate of shares of our common stock (other than Saguaro Utility and its affiliates) and in connection with the delivery of its opinion to the board of directors and the Strategic Transaction Advisory Committee. These analyses do not purport to be appraisals or to reflect the prices at which shares of our common stock might actually trade. We did not impose any limitations on the scope of the information received or reviewed by Morgan Stanley in connection with its delivery of the opinion.

The consideration to be received pursuant to the acquisition agreement was determined through arm's length negotiations between us and Saguaro Acquisition Corp. and was approved by our board of directors and the Strategic Transaction Advisory Committee. Morgan Stanley provided advice to our board of directors and the Strategic Transaction Advisory Committee during these negotiations. Morgan Stanley did not, however, recommend any specific consideration amount to the board of directors or the Strategic Transaction Advisory Committee or that any specific consideration amount constituted the only appropriate amount.

In addition, Morgan Stanley's opinion and its presentation to our board of directors and the Strategic Transaction Advisory Committee was one of many factors taken into consideration by our board of directors and the Strategic Transaction Advisory Committee in deciding to approve the acquisition. Consequently, the analyses as described above should not be viewed as determinative of the opinion of the board of directors or the Strategic Transaction Advisory Committee with respect to the acquisition consideration or of whether our board of directors or the Strategic Transaction Advisory Committee would have been willing to agree to a different amount.

As discussed in the section entitled, "Background of the Acquisition", after considering and interviewing another investment banking firm, our board of directors retained Morgan Stanley based upon Morgan Stanley's qualifications, experience and expertise and the fact that Morgan Stanley had not previously advised us on strategic transactions. Morgan Stanley is an internationally recognized investment banking and advisory firm. Morgan Stanley, as part of its investment banking and financial advisory business, is continuously engaged in the valuation of businesses and securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements and valuations for corporate, estate and other purposes. In the ordinary course of business, Morgan Stanley or its affiliates may from time to time trade in our securities or other indebtedness for its own account, the accounts of investment funds and other clients under the management of Morgan Stanley and for the account of customers and, accordingly, may hold long or short positions in these securities or indebtedness.

Under the engagement letter, our board of directors agreed that we would pay Morgan Stanley a fee of up to $4 million for providing its financial advisory services in connection with the acquisition, payable in installments. A portion of the fee was a fixed amount attributable to Morgan Stanley's services with respect to the preparation and delivery of its opinion. The final portion of the fee is an amount based on the scope of work performed by Morgan Stanley not to exceed a fixed amount. Under the engagement letter, we have agreed to reimburse Morgan Stanley for its expenses incurred in performing its services. In addition, we have agreed to indemnify Morgan Stanley and its affiliates, their respective directors, officers, agents and employees and each person, if any, controlling Morgan Stanley or any of its affiliates against certain liabilities and expenses, including certain liabilities under the federal securities laws, related to or arising out of Morgan Stanley's engagement. In the past, Morgan Stanley and its affiliates have provided financing services for us and have received fees for the rendering of those services.

Effective Time of the Acquisition

The acquisition will become effective when we and Saguaro Acquisition Corp. file the acquisition agreement and articles of merger with the ACC in accordance with the Arizona Business Corporation

Act and the acquisition agreement or a certificate of merger with the Secretary of State of Delaware in accordance with the Delaware General Corporation Law. The acquisition will not become effective before the date of the special meeting. If the acquisition agreement is approved at the special meeting, the effective time will occur as soon as practicable after satisfaction or waiver of the remaining conditions to the acquisition contained in the acquisition agreement, including the receipt of regulatory approvals.

Regulatory Approvals

Several regulatory approvals are required in order for the acquisition to close. Although there can be no guarantee these approvals will be obtained on a timely basis, or at all, we currently believe that the necessary approvals can be obtained in sufficient time to allow the acquisition to be completed in the second half of 2004. In the acquisition agreement, we and Saguaro Acquisition Corp. have agreed to use all commercially reasonable efforts to obtain regulatory approvals necessary or advisable to complete the acquisition. For additional information regarding these regulatory approvals and their impact on the parties' obligations to consummate the acquisition, see "THE ACQUISITION AGREEMENT Conditions to Each Party's Obligation to Effect the Acquisition."

Arizona Corporation Commission.

The ACC must approve the acquisition under Arizona Administrative Code R14-2-801 *et seq.* Under this rule, any public utility or affiliate intending to reorganize a public utility holding company must notify the ACC of such intent, and the ACC may reject the plan of reorganization if the ACC determines that the reorganization would impair the financial status of the public utility, otherwise prevent the public utility from

attracting capital at fair and reasonable terms, or would impair the ability of the public utility to provide safe, reasonable and adequate service. Under these rules, "reorganize" is defined to include the acquisition of a financial interest in an affiliate or utility. Thus, since we are a holding company for TEP, UNS Gas and UNS Electric, and Saguaro Utility is acquiring an interest in these public utilities, this approval is required. We made the requisite filing with the ACC for approval of the acquisition on December 29, 2003.

The Public Utility Holding Company Act of 1935.

In connection with the acquisition, Saguaro Utility and its affiliates must obtain SEC approval under Section 9(a)(2) of the Public Utility Holding Company Act of 1935, as amended ("PUHCA"). Section 9(a)(2) requires SEC approval for any person to acquire, directly or indirectly, 5% or more of the outstanding voting securities of a public utility company if such person owns, directly or indirectly, 5% or more of the outstanding voting securities of any other public utility company or will, by virtue of such acquisition, own, directly or indirectly, 5% or more of the voting securities of more than one public utility company. Since Saguaro Utility will be indirectly acquiring in excess of 5% of our three public utility subsidiaries, TEP, UNS Gas and UNS Electric, this approval is required. Saguaro Utility expects to file an application with the SEC seeking this approval prior to the special meeting.

Under the applicable standards of PUHCA, the SEC may not approve a proposed acquisition if it finds that:

- the acquisition would tend towards detrimental interlocking relations or a detrimental concentration of control of public utilities;

- the consideration to be paid in connection with the acquisition is not reasonable;

- the acquisition would unduly complicate the capital structure or be detrimental to the proper functioning of the utility's holding company system; or

- the acquisition would violate applicable state law, or be detrimental to the carrying out of the integration provisions of PUHCA.

In addition, the SEC must affirmatively find that a proposed acquisition will serve the public interest by tending towards the economical and efficient development of an integrated public utility system.

Saguaro Utility's obligations under the acquisition agreement are further conditioned upon the following:

- the SEC granting Saguaro Utility and its affiliates an exemption under Section 3(a)(1) from all provisions of PUHCA other than Section 9(a)(2); and

- Saguaro Utility and its limited partners receiving evidence satisfactory to them in their reasonable judgment that none of the limited partners nor any of their respective affiliates will become a "holding company" or a "subsidiary company" or an "affiliate" of a "holding company" within the meaning of that Act or under any similar federal or Arizona law coming into effect after the date of the acquisition agreement that imposes regulation material to Saguaro Utility or any of its affiliates as a result of the transactions contemplated by the acquisition agreement.

In this regard, Saguaro Utility expects to seek exemptive relief and a "no action" letter from the SEC prior to the special meeting.

Federal Energy Regulatory Commission.

Under Section 203 of the Federal Power Act, the FERC has jurisdiction when a public utility sells or otherwise disposes of facilities, including securities, that are subject to its jurisdiction. A disposition is deemed made when there is a change of control of the public utility that owns the facilities. Certain of TEP's and UNS Electric's transmission facilities and services are subject to the FERC's jurisdiction. For this reason, the prior approval of the FERC is required in order to complete the acquisition. We and Saguaro Acquisition Corp. plan to file a joint

application with the FERC prior to the special meeting, requesting that the FERC approve the acquisition.

In reviewing an acquisition, the FERC generally evaluates the effect of a proposed acquisition on competition and on rates and whether the proposed acquisition will impair the effectiveness of regulation.

Hart-Scott-Rodino Antitrust Improvements Act.

The acquisition is subject to the requirements of the Hart-Scott-Rodino Antitrust Improvements Act of 1976, and the rules and regulations thereunder, which provide that certain acquisition transactions may not be completed until specified information has been furnished to the Antitrust Division of the Department of Justice and the Federal Trade Commission and until certain waiting periods have been terminated or have expired. This information has not yet been furnished, but we expect that such information will be furnished to these governmental agencies prior to the date of the special meeting. The expiration or earlier termination of the Hart-Scott Act waiting period would not preclude the Antitrust Division or the Federal Trade Commission from challenging the acquisition on antitrust grounds. We and Saguaro Acquisition Corp. do not believe that the acquisition will violate federal antitrust laws. If the acquisition is not completed within 12 months after the expiration or earlier termination of the initial Hart-Scott Act waiting period, the parties would be required to submit new information to the Antitrust Division and the Federal Trade Commission, and a new waiting period would have to expire or be earlier terminated before the acquisition could be completed.

Injunctions.

The obligation of each party to complete the acquisition is subject to the condition that there be no law, regulation or injunction in effect that would prohibit the completion of the acquisition.

Financing for the Acquisition

Upon consummation of the acquisition, Saguaro Utility will cause the surviving corporation to pay approximately $880 million in cash to our shareholders and holders of stock options and performance shares awarded under our performance incentive plans. In addition, Saguaro Utility has informed us that, in connection with the closing of the acquisition, it intends to cause the surviving corporation (i) to repay a $95 million intercompany loan to us from TEP and (ii) to contribute up to $168 million to TEP. We expect that TEP will use a significant portion of these proceeds to retire some of its outstanding debt. These transactions are expected to improve TEP's ratio of debt capitalization to equity capitalization (as determined by the ACC) from approximately $^{70}/_{30}$ to $^{60}/_{40}$ (excluding capital lease obligations).

It is expected that the proceeds for all of the above mentioned payments will come from a combination of equity contributions by the partners of Saguaro Utility and borrowings and issuances of debt securities by another affiliate of Saguaro Acquisition Corp. It is expected that the partners of Saguaro Utility will contribute approximately $557 million as common and/or preferred equity to Saguaro Utility, which will contribute the net proceeds to Saguaro Acquisition Corp. immediately prior to the acquisition. We also expect the remaining proceeds necessary to finance this transaction will be obtained by Saguaro Acquisition Corp.'s affiliate, at the closing of the acquisition, through a $360 million borrowing from a syndicate of lenders and an issuance of $300 million in notes. In connection with the execution of the acquisition agreement, Saguaro Acquisition Corp. and its affiliate obtained commitments from lenders for the $360 million in borrowings. In addition, Saguaro Acquisition Corp. and its affiliate obtained commitments for (i) a $50 million revolving credit facility for general corporate purposes, (ii) a $40 million revolving credit facility for UES, UNS Gas and UNS Electric and (iii) a $220 million loan to refinance TEP's existing credit facility (which we expect to be increased to a $400 million loan). Each of these commitments expires February 21, 2005, and is subject to various closing conditions customary for bank commitment letters in connection with an acquisition of this type. Saguaro Acquisition Corp. and an affiliate also obtained a letter from a group of investment banks that they were highly confident that they could arrange for the sale of up to $300 million in notes of the affiliate through a private sale and/or a public offering. The letter from the investment banks relating to the sale of the $300 million in notes is not a commitment or undertaking by such banks to underwrite, place or purchase the notes or otherwise provide financing. Because the receipt of the borrowings and issuance of the notes is a condition to the closing of the acquisition, each condition to funding set forth in the commitment letters is effectively a condition to Saguaro Acquisition Corp.'s obligation to effect the acquisition. There are numerous conditions to these financings. Consequently, there can be no assurance that these conditions will be satisfied or waived or that such financings will be made available.

Interests of Certain Persons in the Acquisition

In considering the recommendation of our board of directors, our shareholders should be aware that members of our board of directors and management will receive benefits from the acquisition that will be in addition to or different from the benefits our shareholders receive generally. Our directors knew about these additional interests and considered them when they approved the acquisition.

Indemnification and Insurance.

In the acquisition agreement, Saguaro Acquisition Corp. agreed that the surviving corporation would indemnify, after the effective time of the acquisition, each of our directors and officers with

respect to claims arising from facts or events that occurred prior to the effective time of the acquisition. These rights to indemnification will continue for at least six years after the effective time of the acquisition.

In addition, the surviving corporation has agreed to obtain "tail" insurance policies at the effective time of the acquisition that provide, for at least six years after such time, insurance coverage with respect to directors' and officers' liability for claims arising from facts or events that occurred prior to such time. The amount and scope of the coverage will be at least as favorable as the terms of our policies in effect as of the date of the acquisition agreement.

Existing Employment Arrangements.

Our subsidiary, TEP, has change in control agreements (each, a "Change-in-Control Agreement") with all of its officers. Each Change-in-Control Agreement is in effect until the later of: (i) five years after the date either TEP or the officer gives written notice of termination of the Change-in-Control Agreement, or (ii) if a change in control occurs during the term of the Change-in-Control Agreement, five years after the change in control. For the purpose of the Change-in-Control Agreements, a change in control includes the acquisition of beneficial ownership of 30% of our common stock or approval by our shareholders of certain, acquisitions, mergers or consolidations. Upon the approval of the acquisition agreement at the special meeting, a change in control will have occurred for purposes of the Change-in-Control Agreements irrespective of whether or not the acquisition is completed. The Change-in-Control Agreements provide that each officer shall be employed by TEP or one of its subsidiaries or affiliates in a position comparable to his or her current position, with compensation and benefits, which are at least equal to their then current compensation and benefits, for a period of five years after a change in control, subject to earlier termination due to the officer's acceptance of a position with another company or termination by TEP for "cause," as that term is defined in the applicable Change-in-Control Agreement.

Following a change in control, in the event that the officer's employment is terminated by TEP (other than a termination due to the officer's acceptance of another position with TEP or for "cause"), or if the officer terminates employment because of a reduction in position, responsibility, compensation or for certain other stated reasons, the officer is entitled to severance benefits in the form of:

- a lump sum payment equal to the present value of three times annual salary and bonus compensation; plus
- the present value of the additional amount the officer would have received under our retirement plan if the officer had continued to be employed for the five-year period after a change in control occurs; plus
- the present value of any employee awards under the 1994 Omnibus Stock and Incentive Plan or any successor plan, which are outstanding at the time of the officer's termination (whether vested or not), prorated based on length of service.

Such officer would also be entitled to continue to participate in our health, death and disability benefit plans for five years after the termination. The Change-in-Control Agreements further require TEP to make a payment to the officer to offset any excise taxes that may become payable under certain conditions. Any payments made in respect of such excise taxes are not deductible by us.

Assuming that the acquisition results in a change in control under the terms of TEP's Change-in-Control Agreements that resulted in the immediate termination of our top six highly paid executive officers, which are named below under "Treatment of Stock Options," the total aggregate payment that would be made to these executive officers under their Change-in-Control Agreements would not be expected to exceed $17 million as of December 1, 2003.

New Employment Arrangements.

As of the date of this proxy statement, no member of our management has entered into any amendments or modifications to existing employment agreements with us or our subsidiaries in anticipation of the acquisition. Nor has any member of our management entered into any agreement, arrangement or understanding with Saguaro Utility or its affiliates regarding employment with, or the right to purchase or participate in the equity of, the surviving corporation. Although no such agreement, arrangement or understanding currently exists it is generally expected that our existing management will remain after the acquisition is completed, which means that members of our existing management may, prior to the closing of the acquisition, enter into new arrangements with Saguaro Utility or its affiliates regarding employment with, or the right to purchase or participate in the equity of, the surviving corporation.

Treatment of Stock Options.

Our board of directors has over time granted options to our executive officers and managers that allow those individuals to purchase our common stock at specified prices. Members of our board of directors have also over time received grants of options to purchase our common stock at specified prices. Upon the approval of the acquisition agreement at the special meeting, a change of control will have occurred for purposes of the outstanding stock options under our stock and incentive plans, with the effect of making all outstanding stock options immediately exercisable. In the acquisition agreement, Saguaro Acquisition Corp. has agreed to pay, with respect to all outstanding options, an amount in cash equal to the product of:

the total number of shares of our common stock underlying a holder's options, and

the excess of $25.25 over the exercise price per share of the shares of our common stock underlying such options.

Due to this provision, as of February 18, 2004, the directors and named executive officers listed in the chart that immediately follows this paragraph will be entitled to receive, at the effective time of the acquisition, the following cash payments, respectively, with respect to the cancellation of their options (assuming that the options outstanding as of February 18, 2004 are not exercised or canceled prior to the effective time):

Name and Title	Amount	
James S. Pignatelli (Chairman, President & Chief Executive Officer)	$	6,601,211
Lawrence J. Aldrich (Director)		63,748
Larry W. Bickle (Director)		106,786
Elizabeth T. Bilby (Director)		137,048
Harold W. Burlingame (Director)		106,786
John L. Carter (Director)		125,348
Robert A. Elliott (Director)		8,862
Kenneth Handy (Director)		46,116
Warren Y. Jobe (Director)		46,116
Steven J. Glaser (Senior Vice President and Chief Operating Officer, Transmission & Distribution TEP)		1,640,785
Dennis R. Nelson (Senior Vice President and Chief Operating Officer UES)		1,659,625
Michael J. DeConcini (Senior Vice President, Investments and Planning)		1,170,338
Kevin P. Larson (Vice President, Chief Financial Officer & Treasurer)		935,158
Vincent Nitido, Jr. (Vice President, General Counsel and Chief Administrative Officer)		1,218,788
All directors and executive officers as a group	$	17,402,834

Treatment Of Other Compensation.

We maintain a deferred compensation plan that permits officers and directors to defer a percentage of the compensation or fees that would otherwise be payable to the individual for their services to us. A participant in this plan may elect that his or her deferrals be credited in, among other things, the form of a deemed investment in shares of our common stock. A trust has been established that maintains a position in our common stock corresponding to the plan participants' deemed investment in our common stock. Distributions are made in stock or cash, at our discretion. Until the common stock is distributed, directors and officers are not the beneficial owners of such shares. The table that immediately follows the next paragraph sets forth the allocable amount of shares to be credited to the directors and named executive officers as of February 6, 2004.

Our board of directors has also, over time, granted our executive officers and managers other equity-based compensation awards, including performance shares, restricted stock units, stock units and dividend equivalent stock units, under our stock and incentive plans. Performance shares are distributed as shares of our common stock when and to the extent that performance goals during a specified performance period have been met. The other units are payable in cash in an amount determined by multiplying the market price of our common stock at the time the amount is payable by the number of such units. Upon the approval of the acquisition agreement at the special meeting, a change of control will have occurred for purposes of these awards and the awards will be fully vested, based upon, in the case of performance shares, the extent to which performance goals during the performance period have been met up to the date of the change of control, or at target, whichever is higher. Upon the change of control, all performance shares will be distributed and cash payments will be made in respect of the other units. The following table sets forth the amount of shares of our common stock allocable to such awards as of February 6, 2004.

Name and Title	Allocable Amount of Shares Under Deferred Compensation Plan	Allocable Amount of Shares Under Other Equity-Based Compensation Awards
James S. Pignatelli (Chairman, President & Chief Executive Officer)	28,431	126,423
Lawrence J. Aldrich (Director)		1,540
Larry W. Bickle (Director)		405
Elizabeth T. Bilby (Director)	2,811	1,540
Harold W. Burlingame (Director)		1,540
John L. Carter (Director)	9,868	405
Robert A. Elliott (Director)		405
Kenneth Handy (Director)	1,878	1,540
Warren Y. Jobe (Director)		1,540
Steven J. Glaser (Senior Vice President and Chief Operating Officer, Transmission & Distribution TEP)	2,100	35,700
Dennis R. Nelson (Senior Vice President and Chief Operating Officer UES)	2,163	32,283
Michael J. DeConcini (Senior Vice President, Investments and Planning)	419	30,771
Kevin P. Larson (Vice President, Chief Financial Officer & Treasurer)	769	6,736
Vincent Nitido, Jr. (Vice President, General Counsel and Chief Administrative Officer)	410	22,687
All directors and executive officers as a group	54,951	330,529

In addition, certain of our executive officers and managers have been awarded performance units, which are monetary awards based upon meeting performance goals within specified performance

periods. Although the amount of performance units is not determined in relation to the price of our common stock, the terms of such units also provide for their payment, upon the change of control which will be deemed to occur at the time the shareholders approve the acquisition agreement, based upon the same method of measuring performance goals as described above for performance shares.

Transactions with Management and Others

Millennium was authorized by its board of directors in 2000 to invest $15 million, in aggregate, over a three- to five-year period in Haddington Energy Partners II LP. Mr. Larry W. Bickle, a member of our board of directors, is a Managing Director of Haddington Ventures LLC, the general partner of Haddington Energy Partners II LP. As of December 31, 2003, Millennium had funded approximately $8.5 million under this commitment, $2.4 million of which was funded in 2003. A majority of the limited partner funds invested in Haddington Energy Partners' various limited partnerships have been contributed by investment funds affiliated with J.P. Morgan Partners, LLC. In addition, Mr. Bickle has personal investments in investment funds affiliated with J.P. Morgan Partners, LLC.

Millennium made a commitment of $5 million capital plus a share of expenses to Tucson Ventures, LLC, a venture capital fund, in 2000. Tucson Ventures, LLC merged with Valley Ventures III, LP, also a venture capital fund, in 2002. In connection with the merger of the funds, Millennium's commitment was increased to a total of $6 million, including expenses. Mr. Lawrence J. Aldrich, a member of our board of directors, is a general partner of the company that manages, and has invested in, Valley Ventures III, LP. As of December 31, 2003, Millennium had funded approximately $1.2 million under this commitment.

Mr. Stephen Alexander, an immediate family member of Mrs. Elizabeth T. Bilby, a member of our board of directors, is employed by Millennium. As Director of Energy Investments, Mr. Alexander assists in overseeing Millennium's investment portfolio. For his services in

2003, Mr. Alexander received compensation of approximately $150,000 from Millennium.

Material Federal Income Tax Consequences of the Acquisition

The following summary describes the material United States federal income tax consequences of the acquisition applicable to our shareholders as of the date hereof. Except where noted, it deals only with shares of our common stock held as a capital asset within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended (the "Code"), and does not deal with special situations, such as those of dealers or traders in securities or currencies, banks, financial institutions, tax-exempt organizations, insurance companies, real estate investment trusts, regulated investment companies, persons holding our common stock as a part of a hedging or conversion transaction or a straddle, persons who mark to market their securities, persons whose functional currency is not the United States dollar or former United States citizens or long-term residents who are subject to special rules on account of their loss of United States citizenship or resident alien status. In addition, this discussion does not address the tax consequences to persons who have purchased our common stock through the exercise of employee stock options or other compensation arrangements, or to persons who, prior or subsequent to the acquisition, actually or constructively own interests in Saguaro Utility. It also does not include any description of any alternative minimum tax consequences or the tax laws of any state, local or foreign jurisdiction.

The discussion below is based upon the provisions of the Code, Treasury Regulations promulgated thereunder, and administrative rulings and judicial decisions as of the date hereof, all of which may be repealed, revoked or modified at any time, with either forward-looking or retroactive effect, so as to result in United States federal income tax consequences different from those discussed below.

OUR SHAREHOLDERS ARE ADVISED TO CONSULT WITH THEIR TAX ADVISORS AS TO THE UNITED STATES FEDERAL INCOME TAX CONSEQUENCES OF THE ACQUISITION IN

LIGHT OF THEIR PARTICULAR CIRCUMSTANCES, AS WELL AS THE EFFECT OF ANY STATE, LOCAL OR OTHER TAX LAWS.

As used herein, a "United States Holder" means a beneficial owner of shares of our common stock that is a citizen or resident of the United States, a corporation, partnership or other entity created or organized in or under the laws of the United States or any political subdivision thereof, an estate, the income of which is subject to United States federal income taxation regardless of its source, or a trust, (i) the administration of which is subject to the primary supervision of a court within the United States and for which one or more United States persons have the authority to control all substantial decisions or (ii) that has a valid election in effect under applicable Treasury Regulations to be treated as a United States person. As used herein, the term "Non-United States Holder" means a beneficial owner of shares of our common stock that is not a United States Holder.

United States Holders.

Upon the conversion of our common stock into the right to receive the acquisition consideration, a United States Holder will recognize gain or loss equal to the difference between (i) the amount realized upon the conversion and (ii) the holder's adjusted tax basis in our common stock. The holder's adjusted tax basis in our common stock will be, in general, its initial purchase price for the common stock it is converting. If a holder acquired different blocks of our common stock at different times a holder's gain or loss will be calculated separately for each block of common stock converted. The gain or loss upon the conversion of the common stock will be capital gain or loss and will be long-term capital gain or loss if, at the time of conversion, the common stock is treated as having been held for more than one year. Under current law, the deductibility of capital losses is subject to limitations. Capital gain of a non-corporate United States Holder is generally taxed at a maximum rate of 15%, where the property is held for more than one year. For property held for one year or less, capital gain of a non-corporate United States Holder is generally taxed at rates applicable to ordinary income.

Non-United States Holders.

Non-United States Holders not Engaged in a Trade or Business within the United States.

A Non-United States Holder generally will not be subject to United States federal income tax with respect to gain recognized on the conversion of our common stock unless (1) the gain is effectively connected with the holder's trade or business in the United States (discussed below), (2) in the case of a Non-United States Holder who is an individual and holds shares of our common stock as a capital asset, the holder is present in the United States for 183 or more days in the taxable year of the sale or other disposition and certain other conditions are met or (3) we are or have been a "United States real property holding corporation" for United States federal income tax purposes and a Non-United

States Holder holds (or held at any time during the shorter of the five year period preceding the date of conversion or the holder's holding period) more than 5% of our common stock.

Non-United States Holders Engaged in a Trade or Business within the United States.

Gain recognized by a Non-United States Holder from the conversion of our common stock that is effectively connected with the conduct by the holder of a trade or business in the United States is generally taxed at the graduated rates that are applicable to United States persons. In the case of a Non-United States Holder that is a corporation, effectively connected income may also be subject to the United States federal branch profits tax.

Information Reporting and Backup Withholding.

Payments of acquisition consideration to United States Holders in exchange for our common stock are subject to information reporting unless the holder establishes an exemption.

Payments of acquisition consideration to United States Holders in exchange for our common stock may be subject to "backup withholding" tax if (i) the holder fails to certify his or her correct social security number or other taxpayer identification number to the payor responsible for backup withholding (for example, the holder's securities broker) on IRS Form W-9 or a substantially similar form signed under penalty of perjury, or (ii) the Internal Revenue Service notifies the payor that the holder is subject to backup withholding due to the holder's failure to properly report interest and dividends on his or her tax return. The backup withholding rate for years 2004 and 2005 is 28%.

Backup withholding does not apply to payments made to exempt recipients, such as corporations.

Non-United States Holders will be subject to backup withholding and information reporting with respect to payments of acquisition consideration unless (i) the holder provides a properly completed and signed IRS Form W-8BEN (or acceptable substitute) and the payor does not have actual knowledge or reason to know that the form is incorrect, or (ii) the beneficial owner otherwise establishes an exemption.

In addition, Non-United States Holders generally will not be subject to information reporting or backup withholding with respect to payments of acquisition consideration paid or collected by a foreign office of a custodian, nominee or other foreign agent on behalf of the holder. If, however, the foreign office acting for a Non-United States Holder is an office of a United States person, a controlled foreign corporation or a foreign person that derives 50% or more of its gross income for certain periods from the conduct of a United States trade or business, or a foreign partnership with certain connections to the United States, payments of acquisition consideration will be subject to information reporting unless (i) the custodian, nominee, agent or broker has documentary evidence that the beneficial owner is not a United States person and certain other conditions are met or (ii) the beneficial owner otherwise establishes an exemption. Payments that are subject to information reporting as described in the preceding sentence will not be subject to backup withholding unless the payor has actual knowledge or reason to know that the payee is a United States person.

Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules generally will be allowed as a credit or a refund against the holder's United States federal income tax liability, if certain required information is provided to the Internal Revenue Service.

Accounting Treatment

The acquisition will be accounted for as a purchase under generally accepted accounting principles.

Rights of Dissenting Shareholders

Under Arizona law, you are not entitled to dissenters' rights of appraisal since our common stock is registered on the New York Stock Exchange and the Pacific Stock Exchange.

Litigation Concerning the Acquisition

On November 24, 2003 two shareholder derivative lawsuits, McBride v. Pignatelli, et al. and Zetooney v. Pignatelli, et al., were filed in the Superior Court of the State of Arizona relating to the acquisition. In these two lawsuits, which are virtually identical, the plaintiffs allege that our board of directors, in its consideration and approval of the acquisition, breached its fiduciary duty to our shareholders by (i) acting in its own

interest rather than in the interests of our shareholders, (ii) failing to properly evaluate our company as an acquisition candidate, (iii) failing to act independently by appointing independent advisors and appointing directors who had no conflicts of interest to consider the acquisition, (iv) failing to address alleged conflicts of interest appropriately, (v) failing to disclose material non-public information regarding our company, and (vi) failing to submit the transaction to shareholders for approval. The plaintiffs, who request that their suits be permitted to proceed as class actions, seek damages and an order from the court declaring that our board of directors has breached its fiduciary duties to our shareholders, ordering that our board of directors take the steps specified in the complaint to correct the alleged breaches of fiduciary duty and enjoining the acquisition from proceeding. We believe that these lawsuits are without merit and will vigorously defend them.

THE ACQUISITION AGREEMENT

The following description is a summary of the material terms of the acquisition agreement. The provisions of the acquisition agreement are complicated and not easily summarized. This summary may not contain all of the information about the acquisition agreement that is important to you. This summary is qualified, in its entirety, by the actual provisions of the acquisition agreement, a copy of which is attached to this proxy statement as Appendix A. We urge you to carefully read the actual acquisition agreement in its entirety.

General

The acquisition agreement provides that Saguaro Utility will acquire us, subject to the terms and conditions set forth in the acquisition agreement, by merging its wholly owned indirect subsidiary, Saguaro Acquisition Corp., with and into us. We will survive the merger as a wholly owned indirect subsidiary of Saguaro Utility.

The closing of the acquisition will take place on the fifth business day after the satisfaction or waiver of the closing conditions to the acquisition, unless another time is agreed to by the parties. As soon as practicable after the satisfaction or waiver of the closing conditions to the acquisition, the parties will cause the acquisition to become effective by filing (i) the acquisition agreement and articles of merger with the ACC and (ii) the acquisition agreement or a certificate of merger with the Secretary of State of the State of Delaware. We currently expect that the closing of the acquisition will take place in the second half of 2004.

Treatment of Shares

Conversion of Common Stock into Acquisition Consideration.

Each share of our common stock issued and outstanding immediately before the acquisition (other than shares owned by us, Saguaro Utility and Saguaro Acquisition Corp.) will automatically be canceled and will cease to exist and will be converted into the right to receive $25.25 in cash, without interest. After the acquisition is effective, you will no longer have any rights with respect to the shares you hold or with respect to dividends, except for the right to receive the acquisition consideration.

Each share of common stock held by us, Saguaro Utility and Saguaro Acquisition Corp. at the time of the acquisition, will be canceled and no cash or other consideration will be delivered in exchange for such shares.

No Further Ownership Rights.

After the effective time of the acquisition, each of our outstanding stock certificates will be deemed to only represent the right to receive the acquisition consideration. The acquisition consideration paid upon surrender of each certificate will be paid in full satisfaction of all rights pertaining to the shares of our common stock represented by such certificate. At the effective time of the acquisition, our share transfer books will be closed, and there will be no further registration of transfers of outstanding shares of our common stock on the share transfer books of the surviving corporation. If, after the effective time of the acquisition, certificates are presented to the surviving corporation or the paying agent for transfer or any other reason, they will be canceled and exchanged for the acquisition consideration.

Withholding Rights.

The surviving corporation or the paying agent will be entitled to deduct and withhold any applicable taxes from the acquisition consideration.

Paying Agent.

Prior to the effective time of the acquisition, Saguaro Acquisition Corp. will designate a paying agent reasonably acceptable to us to make payment of the acquisition consideration to our shareholders as contemplated by the acquisition agreement. Immediately following the acquisition or as soon as practicable thereafter, the surviving corporation will deposit in trust with the paying agent an amount of cash equal to the aggregate acquisition consideration.

Exchange and Payment Procedures.

As soon as reasonably practicable after the effective time of the acquisition, the paying agent will mail to each record holder of a certificate evidencing shares of our common stock (i) a form of letter of transmittal and (ii) instructions for use in surrendering certificates in exchange for the acquisition consideration. Upon surrender of a certificate for cancellation to the paying agent, together with a duly completed and executed letter of transmittal and such other documents as the paying agent may reasonably require, the holder of the certificate will be entitled to receive the acquisition consideration and the certificate(s) will be canceled. In the event of a transfer of shares of our common stock that is not registered in our share transfer books, the acquisition consideration may be paid to a person other than the person in whose name the corresponding certificate is registered if the certificate is properly endorsed or is otherwise in proper form for transfer. In addition, the person requesting payment must either pay any applicable stock transfer taxes or establish to the reasonable satisfaction of the surviving corporation that such stock transfer taxes have been paid or are not applicable. No interest will be paid or will accrue on the cash payable upon surrender of the certificates.

You should not forward your stock certificates to the paying agent without a letter of transmittal, and you should not return your stock certificates with the enclosed proxy card.

No Liability.

None of Saguaro Acquisition Corp., the surviving corporation and the paying agent will be liable to any person in respect of any cash delivered to a public official pursuant to any applicable abandoned property, escheat or similar law. Any portion of the acquisition consideration deposited with the paying agent that remains undistributed to the holders of certificates for six months after the effective time of the acquisition, will be delivered to the surviving corporation, upon demand. Any holders who do not surrender their certificates within six months after the effective time of the acquisition will be treated as general creditors of the surviving corporation with respect to their claim for cash, if any, to which they may be entitled.

Lost Certificates.

If any certificate is lost, stolen, defaced or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate to be lost, stolen, defaced or destroyed and, if required by the surviving corporation, the posting by that person of a bond in a reasonable amount determined by the surviving corporation, the paying agent will pay the acquisition consideration in respect of the lost, stolen, defaced or destroyed certificate.

Treatment of Stock Options

Immediately prior to the effective time of the acquisition, each outstanding option to acquire our common stock will be canceled, and, except as otherwise agreed by Saguaro Acquisition Corp. and the applicable option holder, each option holder will be entitled to receive at the effective time of the acquisition or as soon as practicable thereafter from the surviving corporation an amount in cash equal to the product of (i) the number of shares of our common stock previously subject to each option and (ii) the excess of $25.25 over the exercise price per share of our common stock previously subject to

such option, reduced by the amount of any applicable taxes. We agreed to take all actions necessary prior to the effective time of the acquisition to terminate all stock option plans.

Conduct of Our Business Pending the Acquisition

We have agreed that prior to the effective time of the acquisition, unless otherwise contemplated by the acquisition agreement or required by applicable law or unless Saguaro Acquisition Corp. gives its prior written consent (which consent cannot be unreasonably withheld and must be given or withheld as soon as reasonably practicable):

- we will conduct our business and the business of our subsidiaries in the ordinary course of business, in a manner consistent with past practice and in compliance with applicable laws; and

- we and our subsidiaries will each use commercially reasonable efforts to preserve substantially intact our business organization, to keep available the services of our employees, consultants, independent contractors and directors, to preserve our assets and properties in good repair and condition and to preserve our present relationships with governmental authorities, customers, suppliers and other persons with which we or any of our subsidiaries have business relations.

We have also agreed that prior to the effective time of the acquisition, unless otherwise contemplated by the acquisition agreement or required by applicable law or unless Saguaro Acquisition Corp. gives its prior written consent (which consent cannot be unreasonably withheld and must be given or withheld as soon as reasonably practicable), neither we nor any of our subsidiaries will do any of the following:

- amend or otherwise change organizational documents;

- issue, deliver, sell, lease, sell and leaseback, transfer, pledge, license, mortgage, encumber, dispose of or otherwise subject to any lien (i) any of our or our subsidiaries' securities or (ii) any of our or our subsidiaries' property or assets (whether tangible or intangible), other than, in each case, as provided in the acquisition agreement;

- declare, make, set aside or pay any dividends, other than (i) inter-company dividends and dividends by TEP to its shareholders and (ii) regular quarterly cash dividends with respect to our common stock, not in excess of $0.15 per share in 2003, $0.16 per share in 2004 and $0.17 per share in 2005;

- reclassify, combine, split, subdivide or redeem, purchase or otherwise acquire, directly or indirectly, any of our or our subsidiaries' securities, except for purchases of outstanding shares of our common stock pursuant to our Investment Plus Plan or any existing employee benefit plan in a manner consistent with past practice;

- repurchase, repay or incur any indebtedness or issue any securities in respect of indebtedness or assume, guarantee or endorse, or otherwise become responsible for the obligations or indebtedness of any person, other than certain permitted repayments and incurrences provided in the acquisition agreement;

- enter into or materially amend, terminate, cancel or renew certain specified types of contracts, including (i) material contracts, (ii) agreements between us and our employees, (iii) agreements related to indebtedness in excess of $100,000, (iv) agreements for the acquisition or disposition of assets or capital stock in excess of $500,000, (v) agreements containing dividend restrictions, (vi) agreements setting rates (vii) certain agreements for the purchase or sale of electricity, (viii) joint venture, limited liability company or partnership agreements and (ix) agreements, outside the ordinary course of business, involving expenditures, liabilities or revenues expected to exceed $1,000,000;

- enter into any contracts with insiders;

- acquire any assets (other than in the ordinary course of business), business, business organization or a division thereof, other than acquisitions having an aggregate consideration of not more than $500,000;

authorize or make any capital expenditures, except (i) as required by law, (ii) as we reasonably deem necessary to replace or repair property following unanticipated loss or damage, (iii) capital contributions by Millennium and its subsidiaries in the ordinary course of business in a manner consistent with past practice and (iv) as contemplated by our capital budget;

take any action that could reasonably be expected to jeopardize the qualification of the interest as tax-exempt on any tax-exempt bonds that relate to our or our subsidiaries assets;

engage in any activities that could reasonably be expected to cause us or our subsidiaries not to be exempt from all provisions of PUHCA (other than Section 9(a)(2) of that Act) pursuant to Section 3(a)(1) of that Act;

except as required by applicable law, the acquisition agreement or our subsidiaries' existing employee benefit plans, (i) increase or otherwise amend the compensation or fringe benefits of any of our or our subsidiaries' employees, consultants, independent contractors or directors (other than in the ordinary course of business in a manner consistent with past practice, and in an aggregate amount not to exceed $4 million), (ii) grant any retention, severance or termination pay not required to be paid under our or our subsidiaries' existing employee benefit plans to, or enter into or amend any employment, consulting or severance contract with, any of our or our subsidiaries' present or former employees, consultants, independent contractors or directors (other than in the ordinary course of business in a manner consistent with past practice), (iii) amend the terms of any outstanding options to purchase any of our or our subsidiaries' equity, or (iv) enter into, adopt, amend or terminate any employee benefit plan that would materially increase our or our subsidiaries' obligations;

fail to maintain books and records in accordance with generally accepted accounting principles or change material tax, pension, regulatory or financial accounting policies or procedures, unless required by a change in legal or accounting requirements;

(i) make, change or rescind any material tax election; (ii) fail to duly and timely file all material tax returns and other documents required to be filed with any governmental authority; (iii) extend the statute of limitations with respect to any tax; or (iv) except in the ordinary course of business, settle or compromise any material tax liability;

waive, release, assign, settle or compromise any pending or threatened claim or proceeding which is material, which relates to the acquisition or which is brought by any current, former or purported holder of any of our or our subsidiaries' securities in such capacity;

adopt a plan of complete or partial liquidation, dissolution, merger, consolidation, restructuring, recapitalization or other reorganization of us or our subsidiaries (other than the acquisition);

pay, discharge or satisfy any material claims, liabilities or obligations, other than the payment, discharge or satisfaction when due or otherwise in the ordinary course of business in a manner consistent with past practice of liabilities reflected or reserved against in our balance sheet or incurred in the ordinary course of business in a manner consistent with past practice after September 30, 2003;

effectuate a plant closing or mass layoff;

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make any loans, advances, capital contributions to or investments in, any other person other than to our wholly-owned subsidiaries (other than Millennium or any of its subsidiaries) that were in existence on the date of the acquisition agreement;

other than in the ordinary course of business and in a manner consistent with past practice or as required by applicable law, (i) materially modify the risk management policies related to any derivative financial instrument (other than modifications which are more restrictive to us and our subsidiaries) and (ii) enter into any derivative financial instrument other than as permitted by our trading policies;

fail to maintain in full force and effect adequate insurance policies covering us and our subsidiaries;

except as may be required by applicable law, take any action that could result in any of our representations and warranties becoming untrue in any material respect or any condition to the acquisition not being satisfied;

fail to take any action that could reasonably be expected to prevent or materially impair or delay the consummation of the acquisition, other than as provided in the acquisition agreement; or

take, make any commitment to or enter into any contract to take any of the foregoing actions.

Conduct of Business by Saguaro Acquisition Corp. Pending the Acquisition

Saguaro Acquisition Corp. has agreed that, prior to the effective time of the acquisition, it will not, without our prior written consent:

incur any liabilities or obligations other than in connection with the acquisition agreement; or

engage in any business activity or enter into any contract other than as contemplated by the acquisition agreement or relating to the transactions contemplated thereby (including obtaining financing for such transactions).

Cooperation, Notification

We have agreed to, and to cause our subsidiaries to, confer on a regular and frequent basis with representatives of Saguaro Acquisition Corp. to discuss, subject to applicable law, material operational and business matters, and to give prompt notice to Saguaro Acquisition Corp. of any of the following matters:

significant changes, developments, effects, conditions or occurrences in our and our subsidiaries' businesses, properties, assets, condition, prospects or results of operations;

any state of facts, change, development, event, effect, occurrence or condition that has had or could reasonably be expected to have a material adverse effect on the business, properties, assets, condition, prospects or results of operations of us and our subsidiaries taken as a whole or that could prevent or materially impair or delay our ability to perform our obligations under the acquisition agreement;

any notice from or communications with any person alleging that his or her consent is or may be required in connection with the acquisition;

any notice from or communications with (i) any governmental authority in connection with the acquisition or (ii) the SEC, ACC or any other public utility commission of any state or the FERC on any other material matter;

copies of all filings made by us or any of our subsidiaries with (i) any governmental authority in connection with the acquisition or (ii) the SEC, ACC or any other public utility commission of any other state or the FERC on any other material matter;

any representation or warranty made by us in the acquisition agreement becoming untrue or inaccurate in any material respect; or

the failure by us to comply with any covenant or agreement contained in the acquisition agreement.

In addition, we have agreed to, and to cause our subsidiaries to, discuss with Saguaro Acquisition Corp. any changes or proposed changes in our and our subsidiaries' regulated rates or charges or standards of service and to consult with Saguaro Acquisition Corp. prior to making any filing or effecting any contract with any governmental authority with respect to our and our subsidiaries' regulated rates or charges, standards of service or accounting, including providing Saguaro Acquisition Corp. an opportunity to review and comment upon any such filing, and including all reasonable comments proposed by Saguaro Acquisition Corp. We also have agreed that we and our subsidiaries will not make any filing with the ACC or any other public utility commission of any state or the FERC to change our rates or charges in any manner that could be inconsistent with the closing conditions contained in the acquisition agreement. For a description of these closing conditions, see " Conditions to the Obligation of Saguaro Acquisition Corp. to Effect the Acquisition."

Additional Agreements

Until the effective time of the acquisition, we have agreed to, and to cause our subsidiaries and our respective representatives to provide, subject to applicable law, Saguaro Acquisition Corp., its representatives and potential financing sources:

reasonable access at all reasonable times to our and our subsidiaries' officers, employees, agents, properties, offices, plants and other facilities and to the books, personnel, contracts and records, and

information concerning our and our subsidiaries' business, properties, contracts, liabilities and personnel as reasonably requested.

The above information and any other non-public information will be held in confidence as provided in the acquisition agreement.

We and Saguaro Acquisition Corp. have agreed to cooperate and use commercially reasonable efforts to obtain the regulatory approvals necessary to consummate the acquisition. Neither party, however, is obligated or permitted to consent to any agreement or undertaking or to incur any liability or obligation not contemplated by the acquisition agreement without the consent of the other party. In addition, Saguaro Acquisition Corp. and its affiliates are not required to pay or commit to pay any cash or other consideration, make any commitment or incur any liability or other obligation in connection with obtaining any required regulatory approval. Furthermore, we have agreed to cooperate with Saguaro Acquisition Corp. to prepare and file all documents necessary to complete the acquisition.

For the period ending on the last day of the calendar year in which the acquisition occurs, Saguaro Acquisition Corp. has agreed to provide employee benefit plans, programs and arrangements to our employees which are no less favorable than those provided by us immediately prior to the acquisition.

Saguaro Acquisition Corp. has agreed to use commercially reasonable efforts to arrange the debt financing for the acquisition on terms and conditions that are, in Saguaro Acquisition Corp.'s reasonable judgment, comparable to, or more favorable to, Saguaro Acquisition Corp. in the aggregate than the terms and conditions contemplated by the acquisition agreement. If any portion of the debt financing becomes unavailable in the manner or from the sources contemplated in the acquisition

agreement, Saguaro Acquisition Corp. shall use reasonable best efforts to arrange any such portion from alternative sources on terms and conditions that, in Saguaro Acquisition Corp.'s reasonable judgment, are comparable to, or more favorable to, Saguaro Acquisition Corp. than, the terms and conditions contemplated by the acquisition agreement.

In connection with the arrangement of the debt financing we have agreed to, and to cause our subsidiaries to, provide all cooperation reasonably necessary. The debt financing, however, may not require us to pay any commitment or other fee or impose any other liability on us prior to the effective time of the acquisition. In addition, we have agreed subject to certain limitations, at the request of Saguaro Acquisition Corp., to call or cause our subsidiaries to call for prepayment or redemption, or to prepay, redeem and/or renegotiate any of our or our subsidiaries' existing indebtedness.

No Solicitation of Alternative Proposals

We have agreed that neither we nor any of our subsidiaries or representatives will, directly or indirectly, initiate, solicit, encourage or otherwise facilitate any inquiries or the making or implementation of any "alternative proposal." For purposes of the acquisition agreement, "alternative proposal" means any:

- merger, reorganization, share exchange, tender offer, exchange offer, consolidation, business combination, recapitalization, liquidation, dissolution, joint venture or similar transaction involving us or our subsidiaries; or

- purchase or sale of more than 10% of our and our subsidiaries' assets taken as a whole or any our or our subsidiaries' securities.

We have further agreed that neither we nor any of our subsidiaries or representatives will, directly or indirectly, have any discussion with or provide any confidential information or data to any person relating to an alternative proposal, or engage in any negotiations concerning an alternative proposal, or otherwise facilitate any effort or attempt to make or implement an alternative proposal or accept an alternative proposal.

Notwithstanding these agreements, prior to the special meeting, we or our board of directors are permitted to engage in any discussions or negotiations with, or provide any information or data to, any person in response to an unsolicited bona fide written alternative proposal, if each of the following conditions is satisfied:

- our board of directors concludes in good faith, after consultation with its outside legal counsel, that the failure to take such action could reasonably be expected to constitute a breach of its fiduciary duties to our shareholders;

- our board of directors concludes in good faith, in consultation with its financial advisors, that the alternative proposal constitutes or could reasonably be expected to result in a "superior proposal," as such term is defined below;

- our board of directors receives from the person making the alternative proposal an executed confidentiality agreement on terms substantially similar and no less favorable to us than those contained in the confidentiality agreement related to the acquisition; and

- we and each of our subsidiaries have complied with our obligations under the acquisition agreement relating to the solicitation of alternative proposals.

For purposes of the acquisition agreement, the term "superior proposal" means an alternative proposal that:

- is more favorable to our shareholders, from a financial point of view taking into account all legal, financial, regulatory and other aspects of the proposal, than the acquisition, including any proposed alterations of the terms of the acquisition agreement made to us by Saguaro Acquisition Corp. in response to the alternative proposal;

- our board of directors concludes is reasonably capable of being completed; and

results in a third party acquiring more than 50% of our common stock or all or substantially all of our and our subsidiaries' assets.

We have agreed to promptly notify Saguaro Acquisition Corp. of the receipt of any inquiries, offers or proposals by 5:00 p.m. New York City time on the next business day after receipt thereof and to keep Saguaro Acquisition Corp. reasonably informed of the status of any discussions or negotiations with respect to any such inquiry, proposal or offer. We also have agreed not to terminate, waive, amend or modify any standstill or confidentiality agreement to which any of our subsidiaries or we are a party.

We have also agreed that our board of directors will not approve or recommend an alternative proposal, or withdraw or modify its approval or recommendation of the acquisition agreement with Saguaro Acquisition Corp. Notwithstanding this provision, our board of directors may approve or recommend an alternative proposal or withdraw or modify its recommendation in favor of the acquisition agreement, upon four business days' notice to Saguaro Acquisition Corp., if, prior to the shareholder's meeting, and in response to the receipt of an unsolicited bona fide written alternative proposal:

- our board of directors has concluded in good faith that the alternative proposal constitutes a superior proposal (after giving effect to any modifications proposed by Saguaro Acquisition Corp.);

- our board of directors, after consultation with outside legal counsel, has concluded in good faith that the failure to take such action could reasonably be expected to constitute a breach of its fiduciary duties to our shareholders under applicable law; and

- we have complied with our obligations under the acquisition agreement not to solicit or encourage alternative proposals.

Under the foregoing circumstances, we would be permitted to terminate the acquisition agreement and cancel the special meeting, subject to the consequences described under " Termination."

Even in the absence of an unsolicited bona fide written alternative proposal, our board of directors, prior to date of the special meeting, may withdraw or modify, or propose to withdraw or modify, its recommendation in favor of the acquisition following four business days' notice to Saguaro Acquisition Corp., but only if our board of directors concludes in good faith, after consultation with outside legal counsel, that it is required to do so in order to comply with its fiduciary duties to our shareholders under applicable law. In this situation, we would not be permitted to terminate the acquisition agreement and would be obligated to conduct the special meeting. Saguaro Acquisition Corp., however, would have the right to terminate the acquisition agreement under such circumstances, as described under " Termination."

Prior to taking any action regarding the recommendation of the board of directors either in response to an unsolicited bona fide written alternative proposal or otherwise, our board of directors will be obligated to negotiate in good faith with Saguaro Acquisition Corp. for a four business day period to adjust the terms and conditions of the acquisition agreement so that either (i) an alternative proposal ceases to be a superior proposal or (ii) the board of directors otherwise ceases to conclude that a recommendation in favor of the acquisition could constitute a breach of its fiduciary duties to our shareholders under applicable law.

We have also agreed not to take any action to exempt any person from the applicability of certain statutory and company-specific anti-takeover provisions, including our shareholder rights agreement.

Conditions to Each Party's Obligation to Effect the Acquisition

Each party's obligation to complete the acquisition is subject to the satisfaction or waiver of the following conditions:

- approval of the acquisition by our shareholders;

the termination or expiration of any waiting period under the Hart-Scott Rodino Antitrust Improvements Act of 1976, as amended; and

the absence of any order of a governmental authority or other legal restraint preventing or making illegal the consummation of the acquisition or any of the transactions contemplated by the acquisition agreement.

Conditions to the Obligation of Saguaro Acquisition Corp. to Effect the Acquisition

Saguaro Acquisition Corp.'s obligation to complete the acquisition is subject to the satisfaction or waiver of the following conditions:

the representations and warranties that we make are true and correct in all material respects as of the date required to be so true and correct (except failures to be true and correct that, in the aggregate, could not reasonably be expected to have a material adverse effect on us or the acquisition);

we have performed in all material respects all of our obligations required to be performed by us under the acquisition agreement at or prior to the closing;

the absence of any state of facts, change, development, event, effect, condition or occurrence which could reasonably be expected to have a material adverse effect. For purposes of the acquisition agreement a material adverse effect with respect to our business means, subject to certain exceptions, any state of facts, change, development, event, effect, condition or occurrence that is materially adverse to (i) the business, properties, assets, condition, prospects or results of operations of us and our subsidiaries taken together as a whole or (ii) that could reasonably be expected to prevent or materially impair or delay our ability to perform our obligations under the acquisition agreement;

the regulatory approvals necessary to consummate the acquisition must have been obtained and be final and such regulatory approvals must not impose terms or conditions that:

have, or could reasonably be expected to have, a material adverse effect on us;

have, or could reasonably be expected to have, a material adverse effect on the business, properties, assets, condition, prospects or results of operations of the surviving corporation, Saguaro Acquisition Corp. or Saguaro Utility;

have caused or could reasonably be expected to cause the rates of TEP, UNS Electric or UNS Gas to be less favorable than the rates applicable to these companies on the date of the acquisition agreement;

subject Saguaro Utility or any of its limited partners to any regulation under PUHCA, or under any similar federal or Arizona law coming into effect after the date of the acquisition agreement;

require that any of the subsidiaries, assets, operations or business of Saguaro Utility or any of its limited partners be transferred, sold, spun off or distributed to shareholders, or otherwise disposed of, liquidated or wound down; or

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require any of Saguaro Utility's limited partners to restructure its capitalization or amend its organizational documents or require Saguaro Utility to restructure its capitalization or amend any of its organizational documents in any material respect, in each case after the acquisition or in order to ensure that it will not become subject to regulation under PUHCA, or under any similar federal or Arizona law coming into effect after the date of the

acquisition agreement;

Saguaro Utility and its limited partners receiving evidence satisfactory to them in their reasonable judgment that none of their limited partners nor any of their respective affiliates (within the meaning of PUHCA) will become or will otherwise be deemed a "holding company" or a "subsidiary company" or an "affiliate" of a "holding company" within the meaning of that Act or under any similar federal or Arizona law coming into effect after the date of the acquisition agreement that imposes regulation material to Saguaro Utility or any of its affiliates as a result of the acquisition or the transactions contemplated by the acquisition agreement;

except as was in existence on the date of the acquisition agreement, in the reasonable judgment of Saguaro Acquisition Corp., there must be no other law, order, approval or contract that impairs or restricts or could reasonably be expected to impair or restrict the ability of TEP, UNS Electric or UNS Gas to pay dividends or make distributions to their shareholders of all of their net income;

assuming the consummation of certain transactions contemplated to occur in connection with the closing of the acquisition, as described in the acquisition agreement, there must be no law, order, approval or contract that, as applied to TEP and its subsidiaries, impairs or restricts or could reasonably be expected to impair or restrict the ability of these entities to pay dividends or make distributions of all of their net income to their shareholders;

Saguaro Acquisition Corp. must have received the proceeds of the debt financing for the acquisition on terms and conditions that, in the reasonable judgment of Saguaro Acquisition Corp., are comparable to, or more favorable to, Saguaro Acquisition Corp. in the aggregate than the terms and conditions contemplated by the acquisition agreement;

Saguaro Acquisition Corp.'s affiliate must have received evidence that we or our subsidiaries have called for the redemption of certain indebtedness, as required by the acquisition agreement; and

there must be no conditions requested of us, our subsidiaries, Saguaro Acquisition Corp. or the surviving corporation by the Pension Benefit Guaranty Corporation ("PBGC") in connection with any of our pension plans that are or could reasonably be expected to be materially adverse to the surviving corporation and no commencement of any action by the PBGC to terminate any of our pension plans or to appoint a trustee of any such plan.

Conditions to Our Obligation to Effect the Acquisition

Our obligation to effect the acquisition is subject to the satisfaction or waiver of the following conditions:

the representations and warranties of Saguaro Acquisition Corp. are true and correct in all material respects as of the date required to be so true and correct (except failures to be true and correct that, in the aggregate, could not reasonably be expected to have a material adverse effect on Saguaro Acquisition Corp.'s ability to perform its obligations under the acquisition agreement);

Saguaro Acquisition Corp. must have performed in all material respects all of its obligations required to be performed by it under the acquisition agreement at or prior to the closing; and

the regulatory approvals necessary to consummate the acquisition must have been obtained and be final and such regulatory approvals must not impose terms or conditions that could reasonably be expected to prevent the consummation of the transactions contemplated by the acquisition agreement.

Termination

The acquisition agreement may be terminated and the acquisition may be abandoned at any time prior to the effective time of the acquisition, whether before or after shareholder approval has been obtained, as follows:

- by the mutual written consent of the parties;
- by either party if:
  - the closing has not been consummated on or before March 31, 2005, except that this termination right will not be available to any party whose failure to comply with the acquisition agreement has resulted in the failure of the closing to have been consummated on or before such date;
  - there has been a material breach by the other party, which breach has not been cured within 30 days receipt of notice thereof or cannot be cured prior to closing, of any of the covenants or agreements or any of the representations or warranties set forth in the acquisition agreement, which breach, individually or together with all other such breaches, would constitute, if occurring or continuing on the date of the closing, the failure of any of the applicable closing conditions set forth in the acquisition agreement;
  - any governmental authority has issued a final order or taken any action permanently enjoining or otherwise prohibiting the consummation of the acquisition or the transactions contemplated by the acquisition agreement, unless the failure of this condition to have been satisfied is due to the failure of the terminating party to comply with the acquisition agreement; or
  - a required regulatory approval is denied or a required regulatory approval is obtained but contains provisions that would otherwise result in the inability of the applicable regulatory closing conditions to be satisfied or makes another applicable closing condition incapable of being satisfied;
- by Saguaro Acquisition Corp. if:
  - our shareholders do not approve the acquisition upon taking a vote at the special meeting;
  - our board of directors withdraws or modifies its recommendation to our shareholders in favor of the acquisition and/or recommends a superior proposal that caused it to change its recommendation in favor of the acquisition;
  - we breach certain of our obligations regarding the preparation of this proxy statement, the convening of the special meeting or in the solicitation of alternative proposals; or
  - an alternative proposal that is publicly announced is commenced or communicated to us and (i) we do not reject such proposal within ten business days after the date of the receipt thereof or after the date its existence first becomes publicly announced, if sooner, (ii) our board of directors approves or recommends the alternative proposal or (iii) we fail to confirm our recommendation in favor of the acquisition within ten business days after being requested by Saguaro Acquisition Corp. to do so; and

- by us if:

our shareholders do not approve the acquisition upon taking a vote at the special meeting, unless we have breached our obligations relating to the preparation of this proxy statement, the convening of the special meeting or the solicitation of alternative proposals; or

prior to the special meeting, our board of directors withdraws or modifies its recommendation to our shareholders in favor of the acquisition and has resolved to recommend and approve the superior proposal that caused it to change its recommendation regarding the acquisition, unless we breached our obligations relating to the preparation of this proxy statement, the convening of the special meeting or the solicitation of alternative proposals.

Termination Fees and Expenses

If the acquisition agreement is terminated:

by either party due to the closing not being consummated on or before March 31, 2005, and either (i) the ACC approval cannot be obtained or (ii) the ACC approval is obtained but the order issued by the ACC does not satisfy any of the conditions described in the fourth, sixth and seventh bullet points under " Conditions to the Obligation of Saguaro Acquisition Corp. to Effect the Acquisition," then we must pay Saguaro Acquisition Corp. termination expenses not to exceed $7 million;

by either party due to the closing not being consummated on or before March 31, 2005, and (i) at or prior to the termination date, an alternative proposal is publicly announced, commenced or otherwise communicated to us and (ii) within twelve months of the termination date, we or any of our affiliates either becomes a party to any definitive agreement, letter of intent or agreement in principle in connection with any alternative proposal or consummates a transaction that would constitute an alternative proposal, then we must pay Saguaro Acquisition Corp. a termination fee in the amount of $15 million and termination expenses not to exceed $10 million;

by Saguaro Acquisition Corp. due to a material breach by us of any of the covenants or agreements or any of the representations or warranties contained in the acquisition agreement, then we must pay Saguaro Acquisition Corp. termination expenses not to exceed $10 million, and, further, if either (i) at or prior to the termination date, an alternative proposal shall have been publicly announced or otherwise communicated to us or (ii) within twelve months of the termination date, we or any of our affiliates either becomes a party to any definitive agreement, letter of intent or agreement in principle in connection with any alternative proposal or consummates a transaction that would constitute an alternative proposal, then we must also pay Saguaro Acquisition Corp. a termination fee in the amount of $15 million;

by either party due to (i)(a) the failure to obtain ACC approval or (b) the ACC approval is obtained but the order issued by the ACC does not satisfy any of the conditions described in the fourth, sixth and seventh bullet points under " Conditions to the Obligation of Saguaro Acquisition Corp. to Effect the Acquisition" or (ii) the failure to obtain the approval of our shareholders, then we must pay Saguaro Acquisition Corp. termination expenses not to exceed $7 million in the case of clauses (i)(a) and (i)(b) or $10 million in the case of clause (ii) and, further, if (1) at or prior to the termination date, an alternative proposal shall have been publicly announced or otherwise communicated to us and (2) within twelve months of the termination date, we or any of our affiliates either becomes a party to any definitive agreement, letter of intent or agreement in principle in connection with any alternative proposal or consummates a transaction that would constitute an alternative proposal, then we must also pay

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Saguaro Acquisition Corp. a termination fee in the amount of $18 million in the case of clauses (i)(a) and (i)(b) or $15 million in the case of clause (ii);

by Saguaro Acquisition Corp. due to the denial of a required regulatory approval other than with respect to the ACC approval, and, further, if (i) at or prior to the termination date, an alternative proposal shall have been publicly announced or

otherwise communicated to us and (ii) within twelve months of the termination date, we or any of our affiliates either becomes a party to any definitive agreement, letter of intent or agreement in principle in connection with any alternative proposal or consummates a transaction that would constitute an alternative proposal, then we must also pay Saguaro Acquisition Corp. a termination fee in the amount of $15 million and termination expenses not to exceed $10 million; or

(i) by Saguaro Acquisition Corp. due to a change in our board of directors' recommendation in favor of the acquisition or a breach by us of certain of our obligations relating to the convening of the shareholders' meeting or the solicitation of alternative proposals, (ii) by us because our board of directors has approved a superior proposal or (iii) by Saguaro Acquisition Corp. because (a) we have not rejected an alternative proposal that was publicly announced or otherwise communicated to us within ten business days after the date of the receipt thereof or after the date of its existence first becomes publicly announced, if sooner, (b) our board of directors approves or recommends the alternative proposal or (c) we fail to confirm our recommendation in favor of the acquisition within ten business days after being requested by Saguaro Acquisition Corp. to do so, then, in each case, we must pay Saguaro Acquisition Corp. a termination fee in the amount of $15 million and termination expenses not to exceed $10 million.

Effect of Termination

If the acquisition agreement is terminated, it will become void and have no effect, other than the provisions relating to confidentiality and termination fees and expenses. Termination, however, will not relieve any party from liability for its breach of the representations, warranties, covenants or agreements set forth in the acquisition agreement. Following the termination of the acquisition agreement no party shall be liable for damages in excess of $25 million, except in the case where a party willfully breached the acquisition agreement.

Amendment

Prior to the effective time of the acquisition, the agreement may be amended by mutual agreement, in writing, of the parties. After the approval of the acquisition agreement by our shareholders, no amendment may be made that would reduce the amount or change the type of consideration into which each share of our common stock will be converted upon consummation of the acquisition.

Waiver

Prior to the effective time of the acquisition, any party may, in writing, (i) extend the time for the performance of any obligation or other act of any other party, (ii) waive any inaccuracy in the representations and warranties contained in the acquisition agreement or any document delivered pursuant thereto and (iii) waive compliance with any agreement or condition contained in the acquisition agreement.

SHARE OWNERSHIP OF MANAGEMENT

The following table sets forth information concerning the beneficial ownership of our shares as of February 18, 2004 by the following directors and executive officers. The total number of our shares beneficially owned as of February 18, 2004 by all directors and executive officers as a group is also listed. Shares listed as beneficially owned include shares as to which the directors and executive officers have or share the power to vote or the power to dispose. In addition, shares listed as beneficially owned include shares subject to options exercisable within 60 days (see "THE ACQUISITION Interests of Certain Persons in the Acquisition Treatment of Stock Options," beginning on page 36, for a description of the amounts payable in respect of unexercised options at the effective time of the acquisition).

Title of Class	Name and Title of Beneficial Owner	Amount and Nature of Beneficial Ownership(1)	Percent of Class
Common	James S. Pignatelli (Chairman, President & Chief Executive Officer)	508,765(2)	1.5%
Common	Lawrence J. Aldrich (Director)	9,624(3)	*

Title of Class	Name and Title of Beneficial Owner	Amount and Nature of Beneficial Ownership(1)	Percent of Class
Common	Larry W. Bickle (Director)	15,564(4)	*
Common	Elizabeth T. Bilby (Director)	13,625(5)	*
Common	Harold W. Burlingame (Director)	12,225(4)	*
Common	John L. Carter (Director)	22,371(6)	*
Common	Robert A. Elliott (Director)	405	*
Common	Kenneth Handy (Director)	6,359(7)	*
Common	Warren Y. Jobe (Director)	4,359(7)	*
Common	Steven J. Glaser (Senior Vice President and Chief Operating Officer, Transmission & Distribution TEP)	154,343(8)	*
Common	Dennis R. Nelson (Senior Vice president and Chief Operating Officer UES)	159,841(9)	*
Common	Michael J. DeConcini (Senior Vice President, Investments and Planning)	84,711(10)	*

Title of Class	Name and Title of Beneficial Owner	Amount and Nature of Beneficial Ownership(1)	Percent of Class
Common	Kevin P. Larson (Vice President, Chief Financial Officer & Treasurer)	98,905(11)	*
Common	Vincent Nitido, Jr. (Vice President, General Counsel & Chief Administrative Officer)	88,653(12)	*
Common	All directors and executive officers as a group	1,525,703(13)	4.5%

* Represents less than 1% of our common stock.

(1) Amounts include the following:

Any shares held in the name of the spouse, minor children or other relatives sharing the home of the director or officer. Except as otherwise indicated below, the directors and officers have sole voting and investment power over the shares shown. Voting power includes the power to direct the voting of the shares held, and investment power includes the power to direct the disposition of the shares held.

Shares subject to options exercisable within 60 days, based on information from E*Trade, our stock option plan administrator.

Equivalent share amounts allocated to the individuals' 401(k) Plan which, since June 1, 1998, has included a UniSource Energy Stock Fund investment option.

(2) Includes 492,705 shares subject to options exercisable within 60 days, and 14,660 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of February 18, 2004.

(3) Includes 6,120 shares subject to options exercisable within 60 days.

(4) Includes 9,320 shares subject to options exercisable within 60 days.

(5) Includes 12,920 shares subject to options exercisable within 60 days.

(6) Includes 11,720 shares subject to options exercisable within 60 days.

(7) Includes 3,454 shares subject to options exercisable within 60 days.

(8) Includes 150,386 shares subject to options exercisable within 60 days, and 2,470 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of February 18, 2004.

(9) Includes 150,830 shares subject to options exercisable within 60 days, and 8,203 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of February 18, 2004.

(10) Includes 79,927 shares subject to options exercisable within 60 days, and 4,784 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of February 18, 2004.

(11) Includes 83,648 shares subject to options exercisable within 60 days, and 2,277 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of February 18, 2004.

(12) Includes 84,739 shares subject to options exercisable within 60 days, and 3,914 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of February 18, 2004.

(13) Includes 1,415,150 shares subject to options exercisable within 60 days, and 42,903 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of February 18, 2004.

SHARE OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

As of February 23, 2004, based on information reported in filings made by the following persons with the SEC or information otherwise known to us, the following persons were known or reasonably believed to be, as more fully described below, the beneficial owners of more than 5% of our common stock:

Title of Class	Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership		Percent of Class
Common	T. Rowe Price Associates, Inc. 100 E. Pratt Street Baltimore, MD 21202	3,237,005	(1)	9.6%
Common	Gabelli Asset Management Inc. One Corporate Center Rye, NY 10580-1435	2,442,299	(2)	7.25%
Common	White Mountains Insurance Group 80 South Main Street Hanover, NH 03755	1,798,100	(3)	5.3%
Common	Barclays Private Bank Limited 59/60 Grosvenor Street London, WIX 9DA England	1,718,794	(4)	5.1%

(1) In a statement (Schedule 13G/A) filed with the SEC on February 11, 2004, T. Rowe Price Associates, Inc. ("Price Associates") indicated it has sole voting power over 475,705 shares and sole dispositive power over 3,237,005 shares of our common stock. Price Associates stated that these securities are owned by various individual and institutional investors for which Price Associates serves as investment advisor with power to direct investments and/or sole power to vote the securities. For purposes of the reporting requirements of the Securities and Exchange Act of 1934, as amended, Price Associates is deemed to be the beneficial owner of such securities; however, Price Associates expressly disclaimed that it is, in fact, the beneficial owner of such securities.

(2) In a statement (Schedule 13D/A) filed with the SEC on February 6, 2004, Gabelli Asset Management Inc. and its affiliates ("Gabelli") indicated that they have sole voting power over 2,377,299 shares and sole dispositive power over 2,442,299 shares of our common stock. Gabelli stated that the shares are beneficially owned by Gabelli Funds, LLC (1,084,300 shares), GAMCO Investors, Inc. (1,041,599 shares), Gabelli Securities, Inc. (304,400 shares), Gabelli Foundation, Inc. (10,000 shares) and MJG Associates, Inc. (2,000 shares).

(3) In a statement (Schedule 13G/A) filed with the SEC on February 13, 2004, White Mountains Insurance Group ("WMIG") indicated that it has shared voting and shared dispositive power over 1,798,100 shares of our common stock. WMIG indicated that it indirectly controls, through various wholly-owned subsidiaries and certain of its employee benefit plans, 1,798,100 shares. WMIG stated that the shares are beneficially owned by OneBeacon Insurance Company (190,000 shares), The Camden Fire Insurance Association (800,000 shares), Folksamerica Reinsurance Company (143,100 shares) and certain employee benefit plans sponsored by OneBeacon Insurance Company (665,000 shares). WMIG further stated that, through an investment advisory agreement, White Mountains Advisors, LLC has sole voting and sole dispositive power over such shares.

(4) In a statement (Schedule 13G) filed with the SEC on February 17, 2004, Barclays Private Bank Limited ("Barclays") indicated that it has sole voting and sole dispositive power over 1,551,851 shares of our common stock. The filing indicated that the 1,718,794 shares are beneficially owned by Barclays Global Investors (974,374 shares), Barclays Global Fund Advisors (594,020 shares) and Barclays Capital Securities Limited (150,400 shares).

SUBMISSION OF SHAREHOLDER PROPOSALS

The deadline for submitting shareholder proposals for our 2004 annual meeting of shareholders was December 11, 2003. Thus, the deadline has passed. Our proxy statement for our 2004 annual meeting of shareholders will set forth the date by which shareholder proposals must be submitted for inclusion in our 2005 proxy statement, assuming that the acquisition is not completed prior to the 2005 annual meeting of shareholders.

Rule 14a-4 of the SEC's proxy rules allows us to use discretionary voting authority to vote on a matter coming before an annual meeting of the shareholders, which was not included in our proxy statement (if we do not have notice of the matter at least 45 days before the date on which we first mailed our proxy materials for the prior year's annual meeting of the shareholders). In addition, we may also use discretionary voting authority if we receive timely notice of such matter (as described in the preceding sentence) and if, in the proxy statement, we describe the nature of such matter and how we intend to exercise our discretion to vote on it. Accordingly, for our 2004 annual meeting of shareholders, any such notice should have been submitted to our Corporate Secretary on or before February 24, 2004. Thus, the deadline has passed.

SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS

This proxy statement may contain forward-looking statements, particularly regarding the proposed acquisition, as defined by the Private Securities Litigation Reform Act of 1995. We are including the following cautionary statements to make applicable and take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 for any forward-looking statements made by or for us in this proxy statement. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements that are not statements of historical facts. We caution that actual future results may vary materially from those expected or implied. Some of the key factors that could cause actual results to vary materially from those expressed or implied include the receipt of required regulatory approvals, which are significant, and the satisfaction of other conditions precedent to the consummation of the acquisition, including the approval of the transaction by our shareholders, and the availability of financing for the acquisition. There can be no assurance that such conditions will be satisfied or that the acquisition will be consummated. More information about the risks and uncertainties relating to these forward-looking statements are found in our SEC filings, which are available free of charge on the SEC's web site at http://www.sec.gov.

You should rely only on the information contained in this proxy statement to vote on the acquisition agreement. We have not authorized anyone to provide you with information that is different from the information contained in this proxy statement. This proxy statement is dated February 23, 2004. You should not assume that the information contained in this proxy statement is accurate as of any date other than such date. Neither the mailing of this proxy statement to shareholders nor the completion of the acquisition will create any implication to the contrary.

APPENDIX A

AGREEMENT AND PLAN OF MERGER BETWEEN UNISOURCE ENERGY CORPORATION AND SAGUARO ACQUISITION CORP. dated as of November 21, 2003

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