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UNISOURCE ENERGY CORP
Form DEF 14A
April 06, 2005

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
(Amendment No.)

Filed by the Registrant [X]
Filed by a Party other than the Registrant []

Check the appropriate box:

- [] Preliminary Proxy Statement
- [] Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- [X] Definitive Proxy Statement
- [] Definitive Additional Materials
- [] Soliciting Material Pursuant to Sections 240.14a-11(c) or 240.14a-12

UNISOURCE ENERGY CORPORATION

(Name of the Registrant as Specified In Its Charter)

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

Payment of Filing Fee (Check the appropriate box):

- [X] No fee required.
- [] 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:
 - 2) Aggregate number of securities to which transaction applies:
 - 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):
 - 4) Proposed maximum aggregate value of transaction:
 - 5) Total fee paid:
- [] Fee paid previously with preliminary materials.
- [] 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:

UNISOURCE ENERGY CORPORATION
One South Church Avenue
Tucson, Arizona 85701

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April 6, 2005

James S. Pignatelli
Chairman of the Board

(520) 571-4000

Dear Shareholders:

You are cordially invited to attend the UniSource Energy Corporation 2005 Annual Shareholders' Meeting to be held on Friday, May 6, 2005, at the Marriott University Park Hotel, 880 East Second Street, Tucson, Arizona. The meeting will begin promptly at 10:00 a.m., Mountain Standard Time, so please plan to arrive earlier. No admission tickets will be required for attendance at the meeting.

Directors and officers will be available before and after the meeting to speak with you. During the meeting, we will answer your questions regarding our business affairs and we will consider the matters explained in the enclosed Proxy Statement.

We have enclosed a proxy card that lists all matters that require your vote. Please complete, sign, date and mail the proxy card as soon as possible, whether or not you plan to attend the meeting. You may also vote by telephone or the Internet, as explained on the enclosed proxy card. If you attend the meeting and wish to vote your shares personally, you may revoke your proxy at that time.

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

Sincerely,

UNISOURCE ENERGY CORPORATION

/s/ James S. Pignatelli

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

NOTICE OF ANNUAL SHAREHOLDERS' MEETING

To the Holders of Common Stock of
UniSource Energy Corporation

We will hold the 2005 Annual Shareholders' Meeting ("Meeting") of UniSource Energy Corporation at the Marriott University Park Hotel, 880 East Second Street, Tucson, Arizona, on May 6, 2005, at 10:00 a.m., Mountain Standard Time ("MST"). The purpose of the Meeting is to:

1. elect nine directors to our Board of Directors for the ensuing year; and
2. consider any other matters which properly come before the Meeting.

Only shareholders of record at the close of business on March 28, 2005, are entitled to vote at the Meeting.

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We have enclosed our 2004 Annual Report, including audited financial statements, and the Proxy Statement with this notice. Proxy soliciting material is first being sent or given to shareholders on or about April 6, 2005. Your proxy is being solicited by our Board of Directors.

Please complete, sign, date and mail the enclosed proxy card as soon as possible, or vote by telephone or the Internet, as explained on the enclosed proxy card.

/s/ Catherine A. Nichols

Catherine A. Nichols
Corporate Secretary

Dated: April 6, 2005

YOUR VOTE IS IMPORTANT

EACH SHAREHOLDER IS URGED TO COMPLETE, SIGN, DATE AND RETURN PROMPTLY THE ENCLOSED PROXY CARD BY zMAIL, 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 MEETING AND VOTING IN PERSON IF YOU SO DESIRE.

UNISOURCE ENERGY CORPORATION

One South Church Avenue
Tucson, Arizona 85701

ANNUAL SHAREHOLDERS' MEETING
PROXY STATEMENT

| | | |
|----------------|--------------------------------|---|
| Annual Meeting | May 6, 2005 10:00 a.m., MST | Marriott University Park Hotel 880 East Second Street Tucson, Arizona 85719 |
|----------------|--------------------------------|---|

Record Date The record date is March 28, 2005 ("Record Date"). If you were a shareholder of record at the close of business on the Record Date, you may vote at the 2005 Annual Shareholders' Meeting ("Meeting") of UniSource Energy Corporation ("UniSource Energy" as well as references to "we," "our" and "us"). At the close of business on the Record Date, we had 34,547,161 shares of common stock outstanding.

- Agenda
1. Proposal One: Elect nine directors to our Board of Directors ("Board") for the ensuing year.
 2. Consider any other matters which properly come before the Meeting and any adjournments.

Independent Auditors Representatives of PricewaterhouseCoopers, LLP are expected to be present at the Meeting with the opportunity to make a

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statement and respond to appropriate questions from our shareholders.

Proxies A form of proxy for execution by shareholders is enclosed. Unless you tell us on the proxy card to vote differently, we will vote signed returned proxies "for" differently, the Board's nominees. The Board or proxy holders will use their discretion on other matters that properly come before the Meeting. If a nominee cannot or will not serve as a director, the Board or the persons designated as proxies will vote for a person who they believe will carry on our present policies.

We will follow your voting instructions. If none, we will vote signed proxies "for" the nominees.

Proxies Solicited by The Board.

First Mailing Date We anticipate first mailing this Proxy Statement along with the proxy card on or about April 6, 2005.

Revoking Your Proxy You may revoke your proxy before it is voted at the Meeting. To revoke, follow the procedures listed on page 3 under "Voting Procedures/Revoking Your Proxy."

Comments Your comments about any aspects of our business are welcome. You may use the space provided on the proxy card for this purpose, if desired. Although we may not respond on an individual basis, your comments help us to measure your satisfaction, and we may benefit from your suggestions.

We welcome your comments. The proxy card has room for them.

PLEASE VOTE - YOUR VOTE IS IMPORTANT

Prompt return of your proxy will help reduce the costs of re-solicitation.

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VOTING PROCEDURES/REVOKING YOUR PROXY

You can vote by telephone, the Internet, mail or in person. We encourage you to vote by telephone or the Internet to help us save money.

You can vote your shares by telephone, the Internet, mail or in person at the 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 Meeting will constitute a quorum. Business may be conducted once a quorum is represented at the Meeting. Except as otherwise specified by law or in our Articles of Incorporation or Bylaws, if a quorum exists, action on a matter other than the election of directors will be deemed approved if the votes cast in favor of the matter exceed votes cast against it.

Directors are elected by a plurality of the votes cast by the shares entitled to vote if a quorum is present. A plurality means receiving the largest number of votes, regardless of whether that is a majority. Withheld votes will be counted as being represented at the Meeting for quorum purposes but will not have an effect on the vote.

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You may cumulate your votes for directors.

In the election of directors, each shareholder has the right to cumulate his votes by casting a total number of votes equal to the number of his shares of common stock multiplied by the number of directors to be elected. He may cast all of such votes for one nominee or distribute such votes among two or more nominees. For any other matter that may properly come before the Meeting, each share of common stock will be entitled to one vote.

You can revoke your proxy after sending

Any shareholder giving a proxy has a right to revoke that proxy by giving notice to UniSource Energy in writing

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it in by following these procedures.

directed to the Corporate Secretary, UniSource Energy Corporation, One South Church Avenue, Suite 200, Tucson, Arizona 85701, or in person at the Meeting at any time before the proxy is exercised. Those who fail to return a proxy or fail to attend the Meeting will not count towards determining any required plurality, majority or quorum.

The shares represented by an executed proxy will be voted for the election of directors or withheld in accordance with the specifications in the proxy. If no specification is made in an executed proxy, the proxy will be voted in favor of the nominees as set forth herein.

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 \$7,500 plus reasonable out-of-pocket expenses. Solicitations may also be made by telephone, facsimile or personal interview, if necessary, to obtain reasonable representation of shareholders at the 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 brokers and other persons for reasonable expenses they incur in sending these proxy materials to you if you are a beneficial holder of our shares.

UNISOURCE ENERGY SHARE OWNERSHIP

Security Ownership of Management

The following table sets forth the number and percentage of shares beneficially owned as of the Record Date and the nature of such ownership by each of our directors (all of which are nominees), our Chief Executive Officer and our five other most highly compensated executive officers at January 5, 2005 (the "Named Executives") and all directors and officers as a group. Ownership includes direct and indirect (beneficial) ownership, as defined by the SEC rules.

| Title of Class ----- | Name and Title of Beneficial Owner ----- | Amount and Nature of Beneficial Ownership (1) ----- |
|----------------------------|---|--|
| Common | James S. Pignatelli Chairman, President and Chief Executive Officer | 737,547 (2) |
| Common | Lawrence J. Aldrich Director | 11,484 (3) |

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| Title of Class ----- | Name and Title of Beneficial Owner ----- | Amount and Nature of Beneficial Ownership (1) ----- |
|----------------------------|--|--|
| Common | Larry W. Bickle Director | 17,424 (4) |
| Common | Elizabeth T. Bilby Director | 15,077 (5) |
| Common | Harold W. Burlingame Director | 13,677 (4) |
| Common | John L. Carter Director | 24,231 (6) |
| Common | Robert A. Elliott Director | 1,610 (7) |
| Common | Kenneth Handy Director | 8,477 (8) |
| Common | Warren Y. Jobe Director | 6,885 (8) |
| Common | Steven J. Glaser Senior Vice President and Chief Operating Officer, Transmission & Distribution - Tucson Electric Power Company ("TEP") | 211,371 (9) |
| Common | Dennis R. Nelson Senior Vice President and Chief Operating Officer - UniSource Energy Services, Inc. ("UES") | 195,490 (10) |
| Common | Michael J. DeConcini Senior Vice President, Investments and Planning / Senior Vice President and Chief Operating Officer, Energy Resources - TEP | 144,888 (11) |
| Common | Kevin P. Larson Vice President, Chief Financial Officer and Treasurer | 126,255 (12) |
| Common | Vincent Nitido, Jr. Vice President, General Counsel and Chief Administrative Officer | 159,565 (13) |
| Common | All directors and executive officers as a group | 2,016,052 (14) |

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- o 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 707,764 shares subject to options exercisable within 60 days, and 15,708 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of December 31, 2004.
- (3) Includes 7,572 shares subject to options exercisable within 60 days.
- (4) Includes 10,772 shares subject to options exercisable within 60 days.
- (5) Includes 14,372 shares subject to options exercisable within 60 days.
- (6) Includes 13,172 shares subject to options exercisable within 60 days.
- (7) Includes 797 shares subject to options exercisable within 60 days.
- (8) Includes 5,572 shares subject to options exercisable within 60 days.
- (9) Includes 186,201 shares subject to options exercisable within 60 days, and 2,693 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of December 31, 2004.
- (10) Includes 178,988 shares subject to options exercisable within 60 days, and 8,420 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of December 31, 2004.
- (11) Includes 135,008 shares subject to options exercisable within 60 days, and 4,910 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of December 31, 2004.
- (12) Includes 105,154 shares subject to options exercisable within 60 days, and 2,337 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of December 31, 2004.
- (13) Includes 139,654 shares subject to options exercisable within 60 days, and 4,017 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of December 31, 2004.
- (14) Includes 1,818,311 shares subject to options exercisable within 60 days, and 39,386 shares purchased under the 401(k) Plan UniSource Energy Stock Fund as of December 31, 2004.

Security Ownership of Certain Beneficial Owners As of March 28, 2005, 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:

Name and Address

Amount and Nature of

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| Title of Class ----- | of Beneficial Owner ----- | Beneficial Ownersh ----- |
|-------------------------|---|-----------------------------|
| Common | Third Point Management Co., LLC 360 Madison Ave., 24th Floor New York, NY 10017 | 2,900,000 (1) |
| Common | Zimmer Lucas Capital, LLC 45 Broadway, 28th Floor New York, NY 10006 | 2,429,000 (2) |
| Common | White Mountains Insurance Group 80 South Main Street Hanover, NH 03755 | 2,293,100 (3) |
| Common | Shumway Capital Partners, LLC 600 Steamboat Road Greenwich, CT 06830 | 2,205,600 (4) |

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advisory agreement (28,100 shares), (ii) employee benefit plans of WMIG which are controlled by White Mountains Advisors LLC (830,000 shares) and (iii) third parties which are controlled by White Mountains Advisors LLC pursuant to an investment advisory agreement (220,000 shares).

- (4) In a statement (Schedule 13G) filed with the SEC on February 4, 2005, Shumway Capital Partners, LLC indicated that it has shared voting and shared dispositive power over 2,205,600 shares of our common stock.

Section 16(a)
Beneficial
Ownership
Reporting
Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, and regulations of the SEC require our executive officers, directors and persons who beneficially own more than 10% of our common stock, as well as certain affiliates of those persons, to file initial reports of ownership and monthly transaction reports covering any changes in ownership with the SEC and the New York Stock Exchange ("NYSE"). SEC regulations require these persons to furnish us with copies of all reports they file pursuant to Section 16(a).

Based solely upon a review of the copies of the reports received by us and on written representations of our directors and officers, we believe that, during fiscal year 2004, except as described below, all filing requirements applicable to executive officers and directors were complied with in a timely manner. Forms 4 reporting our January 2, 2004 restricted stock grants and restricted stock unit grants to our non-employee directors (Mr. Aldrich, Mr. Bickle, Ms. Bilby, Mr. Burlingame, Mr. Carter, Mr. Elliott, Mr. Handy, and Mr. Jobe) were filed late. Forms 4 reporting stock option exercises by Mr. Delawder on February 12, 2004, Ms. Nichols on March 24, 2004, Ms. Kissinger on May 28, 2004, Mr. Hansen

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on June 4, 2004, and Mr. DeConcini on June 7, 2004 and, in the case of Mr. Delawder, Ms. Nichols, and Mr. DeConcini, related sales of stock on the option exercise dates, were filed late. Forms 4 reporting dividend equivalent stock units credited under our Omnibus Stock and Incentive Plan, our Outside Director Stock Option Plan, and our Management and Director Deferred Compensation Plan, as applicable, on June 10, 2004 and again on October 4, 2004 for each of our non-employee directors identified above and for each of Mr. DeConcini, Mr. Delawder, Mr. Glaser, Mr. Hansen, Ms. Kissinger, Mr. Larson, Mr. Nelson, Mr. Nitido and Mr. Pignatelli were filed late.

PROPOSAL ONE: ELECTION OF DIRECTORS

General
We will elect
nine directors
this year.

At the Meeting, our shareholders of record will elect nine directors to serve on our Board for the ensuing year and until their successors are elected and qualified. The shares represented by executed proxies in the form enclosed, unless withheld, will be voted for the nine nominees listed below, or, in the discretion of the persons acting as proxies, will be voted cumulatively for one or more of such nominees. All of the current nominees are present members of the Board. All of the nominees have consented to serve if elected. If any nominee becomes unavailable for any reason, or a vacancy should occur before the election, it is the intention of the persons designated as proxies to vote, in their discretion, for other nominees.

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BOARD NOMINEES

| | |
|-------------------------------|---|
| James S. Pignatelli | Chairman of the Board, President and Chief Executive Officer of UniSource Energy since July 1998; Senior Vice President and Chief Operating Officer of UniSource Energy from December 1997 to July 1998; Chairman of the Board of Directors, President and Chief Executive Officer of TEP, the principal subsidiary of UniSource Energy, since July 1998; Executive Vice President and Chief Operating Officer of TEP from March 1998 to July 1998; Senior Vice President and Chief Operating Officer of TEP from 1996 to 1998; Chairman of the Board of Directors, President and Chief Executive Officer of Millennium Energy Holdings, Inc. ("Millennium"), a wholly owned subsidiary of UniSource Energy, since 1997; Director of UES, a wholly-owned subsidiary of UniSource Energy, since 2003. Board member since 1998. Age 61. |
| Lawrence J. Aldrich (4) | General Partner, Valley Ventures, LP, since September 2002; Managing Director and Founder, Tucson Ventures, LLC, from February 2000 to |

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September 2002; President and Chief Executive Officer of Tucson Newspapers from January 1992 to February 2000; Director of TEP and Millennium since 2000; Director of UES since 2004. Board member since 2000. Age 52.

Larry W. Bickle
(4) Managing Director of Haddington Ventures, LLC, an investment company, since 1997; Director of St. Mary Land and Exploration since 1995; Director of Millennium since 1998; Director of UES since 2004; Responsible Director of Infinite Power Solutions, Inc. ("IPS") since 2004. Board member since 1998. Age 59.

Elizabeth T. Bilby
(4) Retired President of Gourmet Products, Inc., an agricultural product marketing company; Retired Director of Marketing of Green Valley Pecans. Director of TEP since 1995; Director of Millennium from 1998-2003; Director of UES since 2004. Board member since 1995. Age 65.

Harold W. Burlingame
(1) (2) (3) Senior Executive Advisor for Cingular Wireless Services (formerly AT&T Wireless) since July 2001; Executive Vice President, Communications and Human Resources of AT&T Wireless Services from April 2000 to June 2001; Executive Vice President, Merger and Joint Venture Integration of AT&T from March 1999 to March 2000; Executive Vice President of Human Resources of AT&T from 1987 to March 1999; Member of the AT&T Foundation from November 1986 to December 2002; Chair, Executive Committee, Organization Resources Counselors since June 1999; Director of TEP since 1998. Board member since 1998. Age 64.

John L. Carter
(1) (2) (3) (4) Retired from IBM in 1987; held executive positions at various locations in IBM, including General Manager of IBM, Tucson, Arizona. President and Chief Executive Officer of Qualtronics Manufacturing, Inc. from 1987 to 1993. Retired as Executive Vice President and Chief Financial Officer of Burr-Brown Corporation in 1996. Director of TEP since 1996; Director of Millennium since 1998; Director of UES since 2004; Responsible Director of Global Solar Energy, Inc. ("GSE") since 2004. Board member since 1996. Age 70.

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Robert A. Elliott
(1) (2) (3) President and owner of The Elliott Accounting Group since 1983; Director and Minority Shareholder of Southern Arizona Community Bank since 1998; Director of Tucson Urban League from 1998 to 2004; Television Analyst/Pre-game Show Co-host for Fox Sports Arizona since 1999; Corporate Secretary of Southern Arizona Community Bank since 1999; Radio Host of "In the Paint" Sports Talk Show from 2000 to 2004; Chairman of the Board of Tucson Metropolitan Chamber of Commerce since 2002;

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Treasurer of Tucson Urban League from 2002 to 2003; Chairman of the Board of Tucson Urban League from 2003 to 2004; Director of TEP since May 2003. Board member since 2003. Age 49.

Kenneth Handy
(1) (2) (3)

Retired CPA; Vice President and Chief Financial Officer of The Permanente Medical Group, Inc. (the physician services component of the Kaiser Permanente Medical Care Program in Northern California) from 1978 to 1998; Partner at Ernst & Ernst (now Ernst & Young) from 1972 to 1978; Director of TEP since 2001; Director of Millennium from 2001 to 2003; Lead Director of UES since 2004. Board member since 2001. Age 66.

Warren Y. Jobe
(2) (3) (4)

Retired CPA; Senior Vice President of Southern Company from 1998 to 2001; Executive Vice President and Chief Financial Officer and member of the Board of Directors of Georgia Power Company from 1982 to 1998; former President of the Georgia Power Foundation Inc. from 1986 to 2001; Director of Wellpoint, Inc. since 2001; Director of TEP since 2001; Director of Millennium from 2001 to 2003; Director of HomeBanc Corporation since 2004; Director of STI Classic Funds since 2004. Board member since 2001. Age 64.

- (1) Member of the Corporate Governance and Nominating Committee.
- (2) Member of the Audit Committee.
- (3) Member of the Compensation Committee.
- (4) Member of the Finance Committee.

The Board recommends that you vote "FOR" these nominees.

BOARD INFORMATION

Board Meetings In 2004, the Board held a total of 13 regular and special meetings. Each director attended at least 75% of his or her Board and committee meetings. Additionally, the non-management directors met at regularly scheduled executive sessions without management present. Mr. Carter was the Lead Director at these executive sessions.

Board Communication Shareholders or other interested parties wishing to communicate with the Board, the non-management directors or any individual director may contact the Lead Director by mail, addressed to UniSource Energy Lead Director, c/o Corporate Secretary, UniSource Energy Corporation, One South Church Avenue, Suite 200, Tucson, Arizona 85701. The communications will be kept confidential and forwarded to the Lead Director. Communications received by the Lead Director will be forwarded to the appropriate director(s) or to an individual non-management director.

Shareholders or other interested parties wishing to communicate with the Board regarding non-financial matters may contact the Chairperson of the Corporate Governance and Nominating Committee either by mail, addressed to

Chairperson, Corporate Governance and Nominating Committee, UniSource Energy Corporation, P. O. Box 30430, Tucson, Arizona 85751-0430, or by e-mail at unscorpgov@earthlink.net. Shareholders or other interested parties wishing to communicate with the Board regarding financial matters may contact the Chairperson of the Audit Committee either by mail, addressed to Chairperson, Audit Committee, UniSource Energy Corporation, P.O. Box 191191, Atlanta, Georgia 31119, or by e-mail at unscorpaudit@earthlink.net.

Items that are unrelated to a director's duties and responsibilities as a Board member may be excluded from consideration, including, without limitation, solicitations and advertisements, junk mail, product-related communications, job referral materials such as resumes, surveys and material that is determined to be illegal or otherwise inappropriate.

Board Committees

THE AUDIT COMMITTEE reviews current and projected financial results of operations, selects a firm of independent registered public accountants to audit our financial statements annually, reviews and discusses the scope of such audit, receives and reviews the audit reports and recommendations, transmits its recommendations to the Board, reviews our accounting and internal control procedures with our internal audit department from time to time, makes recommendations to the Board for any changes deemed necessary in such procedures and performs such other functions as delegated by the Board. Our Audit Committee held 11 meetings in 2004 and was in full compliance with its written charter, as amended on October 5, 2004 and attached to this Proxy Statement as Appendix A.

Upon the recommendation of the Audit Committee, our Board adopted a code of ethics for our directors, officers and employees.

THE COMPENSATION COMMITTEE reviews the performance of our directors and officers and reviews and approves directors' and officers' compensation. Our Compensation Committee held three meetings in 2004 and was in full compliance with its written charter.

THE FINANCE COMMITTEE reviews and recommends to the Board long-range financial policies, objectives and actions required to achieve those objectives. Specifically, the Finance Committee reviews capital and operating budgets, current and projected financial results of operations, short-term and long-range financing plans, dividend policy, risk management activities and major commercial banking, investment banking, financial consulting and other financial relations of UniSource Energy. Our Finance Committee

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held three meetings in 2004 and was in full compliance with its written charter.

THE CORPORATE GOVERNANCE AND NOMINATING COMMITTEE reviews and recommends corporate governance principles, interviews potential directors and nominates and recommends to the shareholders and directors, as the case may be, qualified persons to serve as directors. The Corporate Governance and Nominating Committee also reviews and recommends membership for all the committees to the Board and reviews applicable rules and regulations relating to

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the duties and responsibilities of the Board. The Corporate Governance and Nominating Committee held two meetings in 2004 and was in full compliance with its written charter.

The Corporate Governance and Nominating Committee identifies and considers nominee candidates supplied by shareholders and Board members. The Corporate Secretary, as directed by the Corporate Governance and Nominating Committee, prepares portfolios for nominee candidates that include confirmation of the candidate's interest, independence, biographical information, review of business background and experience and reference checks. The Corporate Governance and Nominating Committee then evaluates candidates using, in large part, the criteria set forth in the next paragraph and any other criteria the Committee deems appropriate, and conducts a personal interview with each candidate. Upon completion of this process, formal invitations are extended to accept election to the Board.

The Corporate Governance and Nominating Committee has not adopted specific minimum qualifications with respect to a Committee-recommended Board nominee, but desirable qualifications are set forth in the Board manual and include prior community, professional or business experience that demonstrates leadership capabilities, the ability to review and analyze complex business issues, the ability to effectively represent the interests of our shareholders while keeping in perspective the interests of our customers, the ability to devote the time and interest required to attend and fully prepare for all regular and special Board meetings, the ability to communicate and work effectively with the other Board members and personnel and the ability to fully adhere to any applicable laws, rules or regulations relating to the performance of a director's duties and responsibilities.

While no formal policy exists, the Corporate Governance and Nominating Committee does consider recommendations for Board nominees received from our shareholders. The deadline for consideration of recommendations for next year's annual meeting of the shareholders is December 7,

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2005. Recommendations must be in writing and include detailed biographical material indicating the candidate's qualifications and a written statement from the candidate of willingness and availability to serve. Recommendations should be directed to the Corporate Secretary, UniSource Energy Corporation, One South Church Avenue, Suite 200, Tucson, Arizona 85701. The Board will consider nominees on a case-by-case basis and does not believe a formal policy is warranted at this time due to a manageable volume of nominations.

Each member of our Audit Committee, Compensation Committee and Corporate Governance and Nominating Committee is independent based upon independence criteria established by our Board, which criteria are in compliance with applicable NYSE listing standards.

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Copies of
Charters,
Guidelines and
Code of Ethics

A copy of the Audit, Compensation and Corporate Governance and Nominating Committee Charters, as well as our Corporate Governance Guidelines and code of ethics, are available on our Web site at www.unisourceenergy.com or may be obtained by shareholders, without charge, upon written request to Library and Resource Center, UniSource Energy Corporation, 3950 East Irvington Road, Mail Stop RC114, Tucson, Arizona 85714.

BOARD COMPENSATION

Retainer and Fees

In 2004, each non-employee director received a \$20,000 annual cash retainer, \$1,000 for each Board meeting attended, \$1,000 for each committee meeting attended and an additional \$1,000 per committee meeting if acting as a committee chairperson. We reimburse directors for any expenses related to their Board and committee service.

Effective for 2005, a Chairmanship retainer replaces the additional \$1,000 per committee meeting previously paid to the committee chairman. The annual Chairmanship retainer for the Audit Chairman is \$20,000. The annual Chairmanship retainer for all other Chairmanships, including special committee chairmanships, is \$15,000. Chairmanship retainers will be credited to individual Director accounts in the form of stock units and will accrue dividend equivalent stock units. The stock units will be distributed in cash in the year following termination of Board service unless UniSource Energy solicits and receives shareholder approval for a new stock incentive plan, in which case the stock units may be distributed in shares at the Board's or Compensation Committee's discretion.

Option and
Restricted Share
Grants

Under the terms of the 1994 Outside Director Stock Option Plan, each non-employee director in office on the first business day of each year, and who has been a director for at least three months, is granted a

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stock option covering a number of shares of our common stock equal to \$10,000 divided by the value of an option as of the date of grant. In 2004, non-employee directors received an award of restricted stock units in lieu of stock options due to the impact of the proposed merger on the market value of our common stock. Restricted stock units vest in one-third increments over three years.

Each non-employee director in office on the first business day of each year is also granted a number of restricted shares of our common stock equal to \$10,000 divided by the then fair market value of a share of our common stock. Restricted shares vest on the third anniversary of the grant date.

On January 2, 2004, each of the non-employee directors received 405 restricted stock units and 405 restricted shares of our common stock.

Effective for 2005, the value of the equity compensation component of non-employee director compensation is increased from \$20,000 to \$40,000. Because awards valued at \$20,000 were made under the 1994 Outside Director Stock Option Plan in January 2005, a one-time award of restricted stock units equal to \$20,000 divided by the then fair market value of a share of our common stock, will be made to each non-employee director in office on May 6, 2005, the date of the annual Shareholder Meeting. The awards will vest over a one-year period and,

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once vested, will accrue dividend equivalent stock units. The stock units will be distributed in cash in the year following termination of Board service unless UniSource Energy solicits and receives shareholder approval for a new stock incentive plan, in which case the stock units may be distributed in shares at the Board's or Compensation Committee's discretion. Unvested awards are forfeited at termination other than for disability or retirement.

DIRECTOR COMPENSATION FOR LAST FISCAL YEAR

| Name (1) | Cash Compensation | | Number of Shares Subject to Restricted Stock Award |
|---------------------|-----------------------------|----------------------|--|
| | Annual Retainer Fee (\$)(2) | Meeting Fees (\$)(2) | |
| Lawrence J. Aldrich | 20,000 | 22,000 (3) (5) | 810 |

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| | | | |
|----------------------|--------|--------------------|-----|
| Larry W. Bickle | 20,000 | 20,000 (4) (5) | 810 |
| Elizabeth T. Bilby | 20,000 | 27,000 (5) | 810 |
| Harold W. Burlingame | 20,000 | 31,000 | 810 |
| John L. Carter | 20,000 | 48,000 (3) (4) (5) | 810 |
| Robert A. Elliott | 20,000 | 30,000 | 810 |
| Kenneth Handy | 20,000 | 35,000 (3) (5) | 810 |
| Warren Y. Jobe | 20,000 | 44,000 | 810 |

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EXECUTIVE COMPENSATION AND OTHER INFORMATION

Summary of Compensation The following table summarizes the compensation and stock option grants to, and stock options/stock appreciation rights ("SARs") held by, the Named Executives.

SUMMARY COMPENSATION TABLE

| Name and Principal Position | Year | Annual Compensation | | Compensation Awards | |
|---|------|---------------------|------------|---------------------------------------|------------------|
| | | Salary (\$) | Bonus (\$) | Restricted Stock Awards (\$)(1) | Se Un Opti |
| James S. Pignatelli Chairman, President and Chief Executive Officer | 2004 | 624,231 | 525,000 | -- | |
| | 2003 | 599,327 | 550,000 | -- | |
| | 2002 | 574,654 | 320,000 | -- | 1 |
| Steven J. Glaser Senior Vice President and Chief Operating Officer, Transmission & Distribution - TEP | 2004 | 284,692 | 178,000 | -- | |
| | 2003 | 274,596 | 166,000 | -- | |
| | 2002 | 259,654 | 110,000 | -- | |
| Dennis R. Nelson Senior Vice President and Chief Operating Officer - UES | 2004 | 274,846 | 137,000 | -- | |
| | 2003 | 269,732 | 150,000 | -- | |
| | 2002 | 260,000 | 90,000 | -- | |
| Michael J. DeConcini Senior Vice President, Investments and Planning / Senior Vice President and Chief Operating Officer, Energy Resources - TEP | 2004 | 244,537 | 138,000 | -- | |
| | 2003 | 229,192 | 145,000 | -- | |
| | 2002 | 199,654 | 72,000 | -- | |

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| | | | | |
|--|------|---------|---------|----|
| Kevin P. Larson | 2004 | 229,692 | 130,000 | -- |
| Vice President, Chief Financial Officer and Treasurer | 2003 | 219,462 | 145,000 | -- |
| | 2002 | 199,656 | 76,000 | -- |
| Vincent Nitido, Jr. | 2004 | 229,692 | 130,000 | -- |
| Vice President, General Counsel and Chief Administrative Officer | 2003 | 219,462 | 145,000 | -- |
| | 2002 | 199,654 | 68,000 | -- |

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Stock Option Grants in 2004 During 2004, the Compensation Committee of our Board granted no stock options to officers.

Option and SAR Holdings as of December 31, 2004 The following table includes the number and value of exercisable and non-exercisable options and SARs held by the Named Executives as of December 31, 2004.

AGGREGATED OPTION/SAR EXERCISES IN
LAST FISCAL YEAR AND FISCAL YEAR-END OPTION/SAR VALUES

| Name | Shares Acquired on Exercise (#) | Value Realized(\$) | Number of Securities Underlying Unexercised Options/SARs at Fiscal Year-End (#) Exercisable/Unexercisable | In |
|----------------------|---------------------------------|--------------------|---|----|
| James S. Pignatelli | 7,424 | \$53,022 | 707,764 / 0 | |
| Steven J. Glaser | 3,671 | \$28,256 | 186,201 / 0 | |
| Dennis R. Nelson | 4,543 | \$37,380 | 178,988 / 0 | |
| Michael J. DeConcini | 342 | \$2,849 | 135,008 / 0 | |
| Kevin P. Larson | 2,014 | \$16,716 | 105,154 / 0 | |
| Vincent Nitido, Jr. | 1,939 | \$15,882 | 139,654 / 0 | |

2004 Long-Term Incentive Plan Awards The following table includes the number of shares, units or other rights awarded to the Named Executives in the last fiscal year under any long-term incentive plan.

Payout of the 2004 long-term incentive plan awards was based on the achievement, during the 2004 performance period, of three financial goals. The three equally-weighted financial goals were UNS earnings per share, TEP operating cash flow and UNS consolidated operating cash flow. Threshold

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performance is achieved at 80% of target, and exceptional performance is achieved at 120% of target.

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LONG-TERM INCENTIVE PLANS
AWARDS IN LAST FISCAL YEAR

| Name | Number of Shares, Units or Other Rights (#) | Performance or Other Period Until Maturation or Payout |
|----------------------|--|---|
| James S. Pignatelli | 625,000 (2) | 1/1/04 - 12/31/04 |
| Steven J. Glaser | 285,000 (2) | 1/1/04 - 12/31/04 |
| Dennis R. Nelson | 275,000 (2) | 1/1/04 - 12/31/04 |
| Michael J. DeConcini | 245,000 (2) | 1/1/04 - 12/31/04 |
| Kevin P. Larson | 230,000 (2) | 1/1/04 - 12/31/04 |
| Vincent Nitido, Jr. | 230,000 (2) | 1/1/04 - 12/31/04 |

EQUITY COMPENSATION PLAN INFORMATION

Equity Compensation Plans Our only equity-based compensation plan that has not been approved by shareholders is the Management and Directors Deferred Compensation Plan (the "DCP"). Shareholder approval of the DCP has not been required. Under the DCP, certain eligible officers and other employees selected for participation, and non-employee members of the Board, may elect to defer a percentage of the compensation or fees that would otherwise become payable to the individual for their services to us. We also credit DCP accounts of employees participating in our 401(k) Plan with the additional amount of UniSource Energy matching contributions that the participant would have been entitled to under the 401(k) Plan if certain Code limits did not apply to limit the amount of UniSource Energy matching contributions made under the 401(k) Plan. Each participant in the DCP may elect that his or her deferrals be credited in the form of deferred shares. Deferred shares are bookkeeping entries that, when payable, will be paid in the form of an equivalent number of shares of UniSource Energy common stock. Deferred shares accrue dividend equivalents, credited in the form of additional deferred shares, as dividends are paid by UniSource Energy on its issued and outstanding common stock. Each participant elects the time and manner of payment (lump sum or installments) of his or her deferred shares under the DCP. The shares used to satisfy our stock obligations under the DCP are shares that have been purchased on the open market.

EQUITY COMPENSATION PLAN TABLE

Equity Compensation The following table sets forth information as of December 31, 2004, with respect to UniSource Energy's equity compensation plans.

| Plan Category | Number of Shares of UniSource Energy Common Stock to be Issued Upon Exercise of Outstanding Options and Rights | Weighted-Average Exercise Price of Outstanding Options | Number of Common Stock Future I Compensat Shar in th |
|--|--|--|--|
| Equity Compensation Plans Approved by Shareholders (1) | 2,328,674 (2) | \$16.19 (3) | |
| Equity Compensation Plans Not Approved by Shareholders | 55,951 (5) | -- | |
| Total | 2,384,625 | -- | |

Pension Plans The following table shows the estimated annual retirement benefit payable to participants, including the Named Executives, for the average annual compensation and years of service indicated. Compensation is comprised of the officers' average annual compensation during the five consecutive years of employment with the highest compensation within the last 15 years preceding retirement. Compensation is comprised of salary and bonus, as shown on the Summary Compensation Table.

PENSION PLAN TABLE

| Remuneration (\$) | Years of Service | | | |
|-------------------|------------------|---------|---------|---------|
| | 10 | 15 | 20 | 25 |
| | -- | -- | -- | -- |
| 125,000 | 54,850 | 54,850 | 54,850 | 54,850 |
| 150,000 | 65,820 | 65,820 | 65,820 | 65,820 |
| 175,000 | 76,790 | 76,790 | 76,790 | 76,790 |
| 200,000 | 87,760 | 87,760 | 87,760 | 87,760 |
| 225,000 | 98,730 | 98,730 | 98,730 | 98,730 |
| 250,000 | 109,700 | 109,700 | 109,700 | 109,700 |
| 300,000 | 131,640 | 131,640 | 131,640 | 131,640 |

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| | | | | | |
|-----------|---------|---------|---------|---------|---------|
| 400,000 | 175,520 | 175,520 | 175,520 | 175,520 | 175,520 |
| 450,000 | 197,460 | 197,460 | 197,460 | 197,460 | 197,460 |
| 500,000 | 219,400 | 219,400 | 219,400 | 219,400 | 219,400 |
| 550,000 | 241,340 | 241,340 | 241,340 | 241,340 | 241,340 |
| 600,000 | 263,280 | 263,280 | 263,280 | 263,280 | 263,280 |
| 650,000 | 285,220 | 285,220 | 285,220 | 285,220 | 285,220 |
| 700,000 | 307,160 | 307,160 | 307,160 | 307,160 | 307,160 |
| 750,000 | 329,100 | 329,100 | 329,100 | 329,100 | 329,100 |
| 800,000 | 351,040 | 351,040 | 351,040 | 351,040 | 351,040 |
| 850,000 | 372,980 | 372,980 | 372,980 | 372,980 | 372,980 |
| 900,000 | 394,920 | 394,920 | 394,920 | 394,920 | 394,920 |
| 950,000 | 416,860 | 416,860 | 416,860 | 416,860 | 416,860 |
| 1,000,000 | 438,800 | 438,800 | 438,800 | 438,800 | 438,800 |
| 1,100,000 | 482,680 | 482,680 | 482,680 | 482,680 | 482,680 |
| 1,200,000 | 526,560 | 526,560 | 526,560 | 526,560 | 526,560 |
| 1,300,000 | 570,440 | 570,440 | 570,440 | 570,440 | 570,440 |
| 1,400,000 | 614,320 | 614,320 | 614,320 | 614,320 | 614,320 |

The amount of the pension benefit is equal to a base of 40% of the compensation for ten years of service, plus 9.7% (life annuity factor) of such calculated amount. The estimated benefits shown in the Pension Plan Table are straight life annuities not subject to a reduction for any Social Security benefits. The table also reflects amounts payable under the Excess Benefits Plan which will pay from the general funds of UniSource Energy the difference, if any, between the benefits under TEP's pension plan and any benefit payments, which may be limited by federal regulations.

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The credited years of service for UniSource Energy's Named Executives are as follows:

| Name | Credited Years of Service |
|----------------------|------------------------------|
| ----- | ----- |
| James S. Pignatelli | 10 |
| Steven J. Glaser | 15 |
| Dennis R. Nelson | 27 |
| Michael J. DeConcini | 16 |
| Kevin P. Larson | 19 |
| Vincent Nitido, Jr. | 14 |

OFFICER CHANGE IN CONTROL AGREEMENTS

Change in Control Agreements were adopted to attract and retain quality management.

TEP has Change in Control Agreements ("Agreements") with all of its officers. The Agreements are in effect until the later of: (i) five years after the date either TEP or the officer gives written notice of termination of the Agreement, or (ii) if a change in control occurs during the term of the Agreement, five years after the change in control. On March 29, 2004, a change in control occurred for purposes of the Agreements when our shareholders, at a special meeting, approved the acquisition agreement that provided for an affiliate of Saquaro Utility Group L.P. to acquire all of our outstanding shares of

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common stock. This was not affected by the fact that the acquisition was ultimately not consummated.

For the purpose of the Agreements, a change in control includes the acquisition of beneficial ownership of 30% of the common stock of UniSource Energy, certain changes in the UniSource Energy Board of Directors, approval by the shareholders of certain mergers or consolidations or certain transfers of the assets of UniSource Energy. The 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 an employment 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 for cause).

In the event that the officer's employment is terminated by TEP (with the exception of termination due to the officer's acceptance of another position 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: (i) a lump sum payment equal to the present value of three times annual salary and bonus compensation, (ii) the present value of the additional amount the officer would have received under the TEP Retirement Plan if the officer had continued to be employed for the five-year period after a change in control occurs, plus (iii) 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 is also entitled to continue to participate in TEP's health, death and disability benefit plans for five years after the termination. The Agreements further provide that TEP will 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 Mr. Pignatelli's and the other Named

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Executives' employment was terminated, the total payments made by UniSource Energy pursuant to the Agreements would not be expected to exceed \$20 million.

On March 3, 2005, TEP provided the officers with respect to which the Agreements were in effect at that time, written notice of termination of the

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Agreements. Pursuant to the terms of the Agreements, the termination will become effective on March 3, 2010, the fifth anniversary of the date of the written notice of termination.

DIRECTOR INDEPENDENCE CRITERIA

Board independence is determined by consideration of established criteria.

The Board has established the following criteria for determining independence, among other things, in order to determine eligibility to serve on the Audit Committee, the Compensation Committee and the Corporate Governance and Nominating Committee.

Directors that meet each of the following criteria are deemed independent:

1. A director who is an employee of the Company or whose immediate family member is an executive officer of the Company cannot be "independent" until three years after the employment has ended. Employment as an interim Chairman or CEO shall not disqualify a director from being considered independent following that employment.
2. A director who is, or in the past three years has been, affiliated with or employed in a professional capacity by a present or former internal or external auditor of the Company or whose immediate family member is, or in the past three years has been, affiliated with or employed in a professional capacity by a present or former internal or external auditor of the Company cannot be "independent" until three years after the end of the affiliation, employment or auditing relationship.
3. A director who is employed, or whose immediate family member is employed, as an executive officer of another company where any of the Company's present executives serve on that company's compensation committee is not "independent" until three years after the end of such service or the employment relationship.
4. A director who receives, or whose immediate family member receives, more than \$100,000 per year in direct compensation from the Company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service), is not independent until three years after he or she ceases to receive more than \$100,000 per year in such compensation.

Compensation received by a director for former service as an interim Chairman or CEO need not be considered in determining independence.

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Compensation received by an immediate family member for service as a non-executive employee of the Company need not be considered in determining independence under this test.

5. A director who is an executive officer or an employee, or whose immediate family member is an executive officer, of a company that makes payments to, or receives payments from, the Company for property or services in an amount which, in any single fiscal year, exceeds the greater of \$1 million or 2% of such other company's consolidated gross revenue, is not "independent" until three years after falling below such threshold.
6. Directors who possess an interest in any transaction for which disclosure would be required pursuant to Item 404(a) of SEC Regulation S-K (generally, this item requires proxy statement disclosure of transactions exceeding \$60,000 between a director and the Company or any of our subsidiaries) are not independent.
7. Directors that do not meet item 6 of the aforementioned criteria may nonetheless be deemed independent by a majority of independent directors, provided the basis for such determination shall be disclosed in the Company's Proxy Statement.

Based upon the foregoing criteria, the Board has deemed each director to be independent, with the exceptions of Mr. Aldrich, Mr. Bickle, Ms. Bilby and Mr. Pignatelli. See "Transactions with Management and Others" below.

TRANSACTIONS WITH MANAGEMENT AND OTHERS

Haddington Energy Partners II LP 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. Bickle, a member of our Board, is the managing director of Haddington Ventures LLC, the general partner of Haddington Energy Partners II LP. As of December 31, 2004, Millennium had funded approximately \$10.9 million under this commitment, \$2.4 million of which was funded in 2004.

Valley Ventures III, LP In 2000, Millennium made a commitment of \$5 million in capital plus a share of expenses to Tucson Ventures, LLC, a venture capital fund. In 2002, Tucson Ventures, LLC merged with Valley Ventures III, LP, also a venture capital fund. In connection with the merger of the funds, Millennium's commitment was revised to a total of \$6 million, including expenses. Mr. Aldrich, a member of our Board, is a general partner of the company that manages Valley Ventures III, LP. As of December 31, 2004, Millennium had funded approximately \$3.3 million under this commitment.

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Millennium Energy Investments Mr. Stephen Alexander, an immediate family member of Ms. Bilby, a member of our Board, is employed by Millennium. As Director of Energy Investments, Mr. Alexander assists in overseeing Millennium's investment portfolio. For his services in 2004, Mr. Alexander received compensation of approximately \$150,000 from Millennium.

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COMPENSATION COMMITTEE REPORT ON EXECUTIVE COMPENSATION

The Committee The Compensation Committee is responsible for developing and administering executive compensation policies and programs for UniSource Energy and TEP and making recommendations to the Board with respect thereto. The Compensation Committee makes recommendations to the Board with respect to the compensation of UniSource Energy's executive officers, including Mr. Pignatelli and the other Named Executives, and sets policies for and reviews the compensation awarded to other key members of management. UniSource Energy applies a consistent philosophy to compensation for all executive employees, including the Named Executives.

Overall Objectives UniSource Energy's executive compensation policies and programs generally are intended to (i) relate the compensation of employees to the success of UniSource Energy and the corresponding creation of shareholder value and deliver rewards for superior performance and consequences for underperformance and (ii) attract, retain and motivate executives and key employees with competitive compensation opportunities.

Executive Compensation Generally The Compensation Committee reviews our executives' compensation each year. Compensation depends on many factors, including individual performance, responsibilities, future challenges and objectives and the executive's potential contribution to our future success. The Compensation Committee also looks at our financial performance and the compensation levels at comparable companies.

UniSource Energy's 2004 compensation program consisted of three components:

- o base salary;
- o short-term incentive compensation; and
- o long-term incentive compensation.

Base Salary The base salary component of compensation is intended to be competitive with that paid by comparable companies in the energy industry. In developing the compensation program, the Compensation Committee retained an external consultant to conduct a competitive analysis of pay for UniSource Energy's officer group. In conducting its analysis for 2004, the consultant selected a peer group of energy companies with a revenue range of \$585 million to

\$1.6 billion. UniSource Energy ranks at the 33rd percentile of the peer group. The peer group companies were selected based on (i) similarity to UniSource Energy in terms of business sector (i.e., electric services and natural gas distribution companies) and (ii) comparable size to UniSource Energy in terms of sales and market capitalization. The Compensation Committee believes that the companies in the peer group are a more appropriate comparison for UniSource Energy than the Edison Electric 100 companies used in the Performance Graph on page 27 of this Proxy Statement because the type of business, annual revenues and market capitalization of the companies included in the survey are more closely related to those of UniSource Energy and the companies in the peer group are primary competitors of UniSource Energy for top-level management personnel. The external data from companies in the peer group was used to develop market compensation for each executive position. "Market compensation" refers to the median salary for executives in the peer group. Base salaries for UniSource Energy's executive officers, including Mr. Pignatelli and the other

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Named Executives, were set at market compensation levels in January 2004, in recognition of the increasingly competitive environment in the electric industry, the need to continue to attract and retain highly qualified executives and the fact that a substantial portion of each executive's total compensation package is "at-risk," based on the achievement of certain corporate goals. See "Short-Term Incentive Compensation and Long-Term Incentive Compensation" below.

| | |
|---|--|
| Short-Term Incentive Compensation | The Board adopted a Short-Term Incentive Plan to provide compensation for meeting or exceeding specified objectives, designed to contribute to the attainment of UniSource Energy's performance targets and long-term strategic plan. Under the Short-Term Incentive Plan, target award levels are set as a percentage of each participant's base salary. In 2004, the target award levels for our executive officers ranged from 30% to 70% of base salary. Awards for Mr. Pignatelli and the remaining executive officers are determined by the Board based on the achievement of corporate financial goals, including earnings per share and consolidated cash flow, and the accomplishment of previously established individual goals and contribution to business results. Based on the foregoing factors, the Compensation Committee made awards to the Named Executives ranging from 56% to 84% of base salary. In determining Mr. Pignatelli's award, the Compensation Committee focused on the achievement of previously established strategic, financial, operating and community goals. Incentive compensation awarded to |
|---|--|

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Mr. Pignatelli and the other Named Executives is set forth in the preceding Summary Compensation Table.

Long-Term Incentive Compensation UniSource Energy's long-term incentive compensation is intended to attract and retain quality employees over the long-term in a manner that directly aligns their interests with those of UniSource Energy's shareholders and promote UniSource Energy's long-term performance goals.

On February 5, 2004, the Compensation Committee awarded performance units (denominated in cash) to all executive officers of UniSource Energy, including Mr. Pignatelli and the other Named Executives. In calculating the level of awards to the executive officers, the Compensation Committee considered the above analysis of executive compensation at comparative companies. Based on such analysis, the Compensation Committee awarded Mr. Pignatelli and the other Named Executives performance units with a total value equal to 100% of base salary for target performance. The number of performance units awarded to Mr. Pignatelli was 625,000. See "2004 Long-Term Incentives Plan Awards" on page 14 of this Proxy Statement for a discussion of the performance criteria upon which the payout of performance units is dependent. In determining the 2004 long-term incentive awards, the Compensation Committee did not consider awards, including stock options, previously granted or outstanding.

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The Compensation Committee believes that senior management should have a significant equity interest in UniSource Energy. In order to promote equity ownership and further align the interests of management with those of UniSource Energy's shareholders, the Compensation Committee adopted share retention and ownership guidelines for senior management at its February 3, 2005 meeting. Under these guidelines certain executives are expected to maintain a significant ownership position in UniSource Energy common stock, expressed as a multiple of their salary as follows:

- o Chairman, President and Chief Executive Officer 5 times salary
- o Senior Vice President 3 times salary
- o Other Vice President 1 times salary

The Compensation Committee periodically reviews share ownership levels of the persons subject to these guidelines. The following types of shares count towards meeting the specified ownership levels: (i) shares owned outright, jointly with spouse, or in trust for the executive's benefit, (ii) shares held in

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qualified retirement and savings plans and (iii) stock units payable in shares held in nonqualified deferred compensation accounts. Nine of the ten executives subject to these guidelines have achieved shareholdings in excess of the applicable multiple set forth above.

Tax Code Concerns The Compensation Committee does not presently have a policy regarding qualifying compensation paid to executive officers for deductibility under Section 162(m) of the Code.

Respectfully submitted,

THE COMPENSATION COMMITTEE
Harold W. Burlingame, Chair
John L. Carter
Robert A. Elliott
Kenneth Handy
Warren Y. Jobe

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AUDIT COMMITTEE REPORT

The Committee The Audit Committee is made up of five financially literate directors who are independent based upon independence criteria established by our Board, which criteria are in compliance with applicable NYSE listing standards. Our Board has determined that while each member of the Audit Committee has accounting and/or related financial management expertise, Mr. Jobe is the Audit Committee financial expert for the purposes of Item 401(h) of SEC Regulation S-K. In addition to Mr. Jobe, there are two other financial experts on the Committee. Each financial expert is independent as that term is used in Item 7(d)(3)(iv) of Schedule 14A under the Securities and Exchange Act of 1934. The Board previously adopted a written charter for the Audit Committee. On October 5, 2004, the Board approved amendments to the Charter. The Audit Committee Charter is included as Appendix A to this Proxy Statement. The Committee has complied with its charter, including the requirement to meet periodically with our independent auditors, internal audit department and management to discuss the auditors' findings and other financial and accounting matters.

In connection with our December 31, 2004 financial statements, the Audit Committee has (i) reviewed and discussed the audited financial statements with management, (ii) discussed with PricewaterhouseCoopers, LLP, our independent auditor, the matters required to be discussed by SAS 61 (Codification of Statements on Auditing Standards, AU Sec. 380), (iii) received from PricewaterhouseCoopers, LLP the written disclosures and the letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and (iv) discussed with PricewaterhouseCoopers, LLP its independence.

Based on all of its activities during the year, the Audit

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Committee recommended to the Board that the audited financial statements for 2004 be included in the Annual Report on Form 10-K for filing with the SEC.

Pre-Approved Policies and Procedures Rules adopted by the SEC in order to implement requirements of the Sarbanes-Oxley Act of 2002 require public company audit committees to pre-approve audit and non-audit services. Our Audit Committee has adopted a policy pursuant to which audit, audit-related, tax and other services are pre-approved by category of service. Recognizing that situations may arise where it is in our best interest for the auditor to perform services in addition to the annual audit of our financial statements, the policy sets forth guidelines and procedures with respect to approval of the four categories of service designed to achieve the continued independence of the auditor when it is retained to perform such services for us. The policy requires the Audit Committee to be informed of each service and does not include any delegation of the Audit Committee's responsibilities to management. The Audit Committee may delegate to the Chairman of the Audit Committee the authority to grant pre-approvals of audit and non-audit services requiring Audit Committee

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approval where the Audit Committee Chairman believes it is desirable to pre-approve such services prior to the next regularly scheduled Audit Committee meeting. The decisions of the Audit Committee Chairman to pre-approve any such services from one regularly scheduled Audit Committee meeting to the next shall be reported to the Audit Committee.

Fees The following table details fees paid to PricewaterhouseCoopers, LLP for professional services during 2003 and 2004. The Audit Committee has considered whether the provision of services to us by PricewaterhouseCoopers, LLP, beyond those rendered in connection with their audit and review of our financial statements, is compatible with maintaining their independence as auditors.

| | 2003 | 2004 |
|--------------------|-----------|-------------|
| | ----- | ----- |
| Audit Fees | \$903,566 | \$2,190,556 |
| Audit-Related Fees | \$644,744 | \$76,583 |
| Tax Fees | \$98,645 | \$2,002 |
| All Other Fees | \$2,598 | \$3,228 |

Audit fees include fees for the audit of our consolidated financial statements included in our Annual Report on Form 10-K and review of financial statements included in our Quarterly Reports on Form 10-Q. Audit fees also include services provided by PricewaterhouseCoopers, LLP in connection with the audit of the effectiveness of internal control over financial reporting and on management's assessment of the effectiveness of internal control over financial reporting, comfort letters, consents and other services related to SEC matters and financing transactions, statutory and regulatory audits, and accounting consultations to the extent necessary for PricewaterhouseCoopers, LLP to fulfill their responsibilities under generally accepted auditing standards. Audit fees in connection with the audit of the effectiveness of internal control over financial reporting and on management's assessment of the effectiveness of internal control over financial reporting in compliance with Sarbanes-Oxley totaled \$1,395,841 (already included in Audit Fees in the table above) in 2004.

Audit-related fees during 2004 principally include fees for employee benefit plan audits and due diligence-type services related to proposed acquisitions. During 2003, audit-related fees related primarily to the audits of the gas and electric system assets acquired from Citizens Communications Company on August 11, 2003 (for periods prior to the acquisition date) and audits of employee benefit plans.

Tax fees include tax compliance, tax advice and tax planning.

All other fees consist of fees for all other services other than those reported above and, in 2003 and 2004, principally include subscription fees for research tools.

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All services performed by PricewaterhouseCoopers, LLP are approved in advance by the Audit Committee in accordance with the Audit Committee's pre-approval policy for services provided by the independent auditor.

Respectfully submitted,

THE AUDIT COMMITTEE

Warren Y. Jobe, Chair
Harold W. Burlingame
John L. Carter
Robert A. Elliott
Kenneth Handy

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PERFORMANCE GRAPH

Comparison of Cumulative Five-Year Total Return Among
UniSource Energy, Standard & Poor's 500 Index
and EEI Index of 64 Investor-Owned Utilities (1)

The graph showing on the hard copy represents the comparison of four year cumulative total return between UniSource Energy Corporation, the S&P 500 Index, and EEI Index of 100 investor-owned utilities. The graph's X-axis shows the years 1999 to 2004, and the Y-axis shows dollar values from zero to 250. The data points are connected by lines with the following markers: UniSource Energy Corporation - triangles; S&P 500 - diamonds; EEI Index - 100 Electrics - squares. The data points are as follows:

| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|------------------------------|-------|-------|-------|-------|-------|-------|
| | ---- | ---- | ---- | ---- | ---- | ---- |
| UniSource Energy Corporation | \$100 | \$172 | \$170 | \$166 | \$243 | \$244 |
| S&P 500 Index | \$100 | \$148 | \$135 | \$115 | \$142 | \$175 |
| EEI Index - 100 Electrics | \$100 | \$91 | \$80 | \$62 | \$80 | \$88 |

| | 2000 | 2001 | 2002 | 2003 |
|---------------------------------|--------|---------|---------|--------|
| Data and Calculations | ----- | ----- | ----- | ----- |
| S&P 500 Total Return Change | -9.10% | -11.89% | -22.10% | 28.69% |
| EEI Index - 64 Electrics Change | 47.97% | -8.79% | -14.73% | 23.48% |
| UniSource Energy Change | 71.80% | -1.30% | -2.20% | 46.72% |

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SUBMISSION OF SHAREHOLDER PROPOSALS

General 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 our 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 2006 annual meeting of shareholders, any such notice must be submitted to the Corporate Secretary of UniSource Energy on or before February 20, 2006.

We must receive This requirement is separate and apart from the SEC's

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your shareholder
proposals by
December 7, 2005.

requirements that a shareholder must meet in order to have a shareholder proposal included in our Proxy Statement. Shareholder proposals intended to be presented at our 2006 annual meeting of the shareholders must be received by us no later than December 7, 2005, in order to be eligible for inclusion in our Proxy Statement and the form of proxy relating to that meeting. Direct any proposals, as well as related questions, to the undersigned.

OTHER BUSINESS

The Board knows of no other matters for consideration at the Meeting. If any other business should properly arise, the persons appointed in the enclosed proxy have discretionary authority to vote in accordance with their best judgment.

Copies of our 2004 Annual Report on Form 10-K may be obtained by shareholders, without charge, upon written request to Library and Resource Center, UniSource Energy Corporation, 3950 East Irvington Road, Mail Stop RC114, Tucson, Arizona 85714. You may also obtain our SEC filings through the Internet at www.sec.gov or www.UniSourceEnergy.com.

By order of the Board of Directors,
/s/ Catherine A. Nichols

Catherine A. Nichols
Corporate Secretary

PLEASE VOTE - YOUR VOTE IS IMPORTANT

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APPENDIX A

Amended
October 5, 2004

UNISOURCE ENERGY CORPORATION

AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

CHARTER

1. COMPOSITION

The Audit Committee of the Board of Directors (the "Committee") consists of no fewer than three independent Directors appointed annually by the Board. Directors eligible to serve on the Committee shall be determined in accordance with the NYSE Listed Company Manual, Corporate Governance

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Standards for Audit Committees and the Sarbanes-Oxley Act of 2002. The Board shall designate one of the Committee members as Chairman of the Committee. Each member of the Committee shall be financially literate, and at least one member shall have accounting or financial management expertise.

2. MEETINGS

The Committee will hold at least four regular meetings each year, and such additional meetings as it may deem necessary. Additional meetings will be called by the Chairman of the Committee. The agendas for the regular meetings shall include all items necessary to complete the duties of the Committee as set forth herein. In addition to the Committee members and the Secretary, the Chairman of the Board, Chief Executive Officer and other members of management, internal audit and representatives of the independent auditors may attend as appropriate.

3. RULES OF PROCEDURE

The Committee will determine its own rules of procedure with respect to how its meetings are to be called, as well as the place and time.

4. COMPENSATION

Each member will be paid such fees as may be established from time to time by the Board for service on the Committee, and will be reimbursed for travel expenses incurred by attendance at meetings. Directors' fees are the only compensation an Audit Committee member may receive from the Company.

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5. COMMITTEE SECRETARY

The Secretary of the Committee will be the Corporate Secretary of the Company (or such other representative of management as the Committee may designate) and not be a member of the Committee. The Secretary will attend all meetings and maintain minutes, advise members of all meetings called, arrange with the Chairman or other convening authority for preparation and distribution of the agenda for each meeting, and carry out other functions as may be assigned from time to time by the Committee. At such meetings where attendance by a Company representative is not appropriate, the Chairman shall act as secretary of the meeting or appoint another member of the Committee to act as secretary of such meetings.

6. QUORUM

A majority of the total membership of the Committee will constitute a quorum.

7. COMMITTEE PURPOSE

The Audit Committee is appointed by the Board to assist with Board oversight of (1) the integrity of the Company's financial statements (2) the Company's compliance with legal and regulatory requirements (3) the independent auditor's qualifications and independence, and, (4) the performance of the Company's internal audit function and independent auditors.

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The Audit Committee must also prepare the report that SEC rules require be included in the Company's annual proxy statement.

8. SPECIFIC DUTIES OF THE COMMITTEE

Independent Audit:

- (1) Sole authority to appoint, retain and terminate the Company's independent auditor.
 - (2) Sole authority to approve all audit engagement fees and terms, as well as all significant, non-audit engagements (in accordance with SEC) with the independent auditors.
 - (3) Annually obtain and review a report from the independent auditors delineating all relationships between the auditor and the Company (to assess the auditors' independence).
 - (4) Review the experience and qualifications of the lead partner of the independent auditor.
 - (5) Ensure the rotation of the audit partner(s) as required by law.
 - (6) At least annually, obtain and review a report from the independent auditors describing the firm's internal quality control process, including any material issues raised by the most recent internal quality control review or peer review of the firm, or by any inquiry or investigation by governmental, regulatory or professional authorities within the past five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues.
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- (7) Review the results of each independent audit, including any qualifications in the independent auditor's opinion, any related management letter, and management's response to recommendations made by the independent auditor in connection with the audit.
 - (8) Review the annual audited financial statements with management and the independent auditor, including management's discussion and analysis, major issues regarding accounting and auditing principles and practices, as well as the adequacy of internal controls. Recommend to the Board, based on such review and discussion, whether the audited financial statements should be included in the Company's annual report on Form 10-K.
 - (9) Annually review an analysis prepared by management and the independent auditor of significant financial reporting issues, quality of financial reporting, and judgments made in connection with the preparation of the Company's financial statements, including an analysis of the effect of alternative GAAP methods on the Company's financial statements. Review the procedures employed by the Company in preparing published financial statements and related management commentaries.
 - (10) Review with management and the independent auditor the Company's quarterly financial statements prior to the filing of its Form 10-Q, including management's discussion and analysis and the results of the independent auditors' review of the quarterly financial statements (SAS 90). Note: This can be performed by a

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member of the Audit Committee.

- (11) Discuss annually with the independent auditor the required communications contained within Statement on Auditing Standards No. 61 relating to the conduct of the audit.
- (12) Discuss with the independent auditor material issues on which the national office of the independent auditor was consulted by the Company's audit team.
- (13) Meet with the independent auditor prior to the audit to discuss the planning and staffing of the audit.

Internal Audit:

- (14) Review the appointment, replacement, reassignment or dismissal of the Company's General Auditor.
- (15) Review and approve the internal audit department charter, annual audit plan and the audit methodology.
- (16) Review management and General Auditor reports submitted to the Committee that are material to the Company as a whole, and management's response to those reports.
- (17) Annually review the General Auditor's Summary of Officer's Annual Travel and Entertainment expense schedule. Include in this review a discussion of perquisites.

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Miscellaneous:

- (18) Review earnings press release as well as financial information and earnings guidance provided to analysts and ratings agencies.
- (19) Review quarterly updates from management on material litigation.
- (20) Periodically review with management, the Company's policies on major financial risk exposure, and the measures taken to reduce such risk.
- (21) Annually review the Company's Corporate Code of Conduct and compliance therewith.
- (22) Establish and maintain procedures for the confidential, anonymous submission by employees of the Company of concerns regarding accounting or auditing matters.
- (23) Establish guidelines for the Company's hiring of employees or former employees of the independent auditor.
- (24) Annually review this Audit Committee Charter and make any necessary changes.
- (25) Annually perform an evaluation of the Committee, its members, functions and performance.
- (26) Review disclosures made by the Company's CEO and CFO during their certification process for the Form 10-K and Form 10-Q about any

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significant deficiencies in the design or operation of internal controls or material weaknesses therein and any fraud involving management or other employees who have a significant role in the Company's internal controls.

9. EXECUTIVE SESSION

Meet quarterly with management, the General Auditor and the independent auditor in separate executive sessions.

10. RESPONSIBILITIES OF THE CHAIRMAN

The Chairman of the Committee will present the Committee's recommendations to the Board for its approval and periodically provide the Board, for its information, with a summary of the Committee's determinations and approvals. Additionally, set the annual compensation for the General Auditor in conjunction with the Company's Chief Executive Officer.

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11. RESPONSIBILITIES OF THE CHIEF EXECUTIVE OFFICER

The Chief Executive Officer of the Company will advise and make recommendations to the Committee and, in the normal course, attend all meetings of the Committee.

12. OTHER AUTHORITY

The Audit Committee shall have the authority to retain special legal, accounting or other consultants to advise the Committee. The Audit Committee has full discretion to meet with individuals within or outside the Company.

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APPENDIX B
FORM OF PROXY CARD

UNISOURCE ENERGY

YOUR VOTE IS IMPORTANT
VOTE BY TELEPHONE OR INTERNET
24 HOURS A DAY - 7 DAYS A WEEK

INTERNET

<https://www.proxyvotenow.com/uns>

- Go to the website address listed above.
- Have your proxy card ready.

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- Follow the simple instructions that appear on your computer screen.

OR

TELEPHONE

1-866-358-4695

- Use any touch-tone telephone.
- Have your proxy card ready.
- Follow the simple recorded instructions.

OR

MAIL

- Mark, sign and date your proxy card.
- Detach your proxy card.
- Return your proxy card in the postage-paid envelope provided.

You can vote your shares by telephone, the Internet, mail or in person at the Annual Shareholders' Meeting. Your telephone or Internet vote authorizes the named proxies to vote your shares in the same manner as if you marked, signed and returned your proxy card. If you have submitted your proxy by the Internet or telephone there is no need to mail your proxy card.

For Shareholders who have elected to receive UniSource Energy's Proxy Statement and Annual Report electronically you can now view the 2005 Annual Meeting materials on the Internet by pointing your browser to <http://www.UnisourceEnergy.com>.

1-866-358-4695

CALL TOLL-FREE TO VOTE

THE INTERNET AND TELEPHONE VOTING FACILITIES WILL BE AVAILABLE UNTIL 5:00 P.M. E.S.T. ON THURSDAY, MAY 5, 2005.

DETACH PROXY CARD HERE IF YOU ARE NOT VOTING BY THE INTERNET OR TELEPHONE.

(FORM OF PROXY CARD - FRONT)

Please Sign, Date and Return
the Proxy Promptly Using the
Enclosed Envelope.

[X]
Votes MUST be indicated (x)
in Black or Blue Ink.

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The Board of Directors Recommends a vote "FOR" the following proposal:

1. Election of Directors

FOR all nominees WITHHOLD AUTHORITY to vote *EXCEPTIONS []
listed below for all nominees listed
[] below []

Nominees: 01-James S. Pignatelli, 02-Lawrence J. Aldrich, 03-Larry W. Bickle,
04-Elizabeth T.Bilby, 05-Harold W. Burlingame, 06-John L. Carter,
07-Robert A. Elliott, 08-Kenneth Handy, 09-Warren Y. Jobe

(INSTRUCTIONS: To withhold authority to vote for any individual nominee, mark
the "Exceptions" box and write that nominee's name in the space provided
below).

*Exceptions

If you agree to access our
Annual Report and Proxy
Statement electronically in
the future, please mark this
box. []

To change your address,
please mark this box. []

To include any comments,
please mark this box. []

SCAN LINE

PLEASE SIGN EXACTLY AS YOUR NAME APPEARS
HEREON. When shares are held by joint
tenants in common or as community
property, both should sign. When
signing as attorney, executor,
administrator, trustee, guardian or
custodian, please give full title as
such. If a corporation, please sign in
corporate name by President or other
authorized officer. If a partnership,
please sign in partnership name by
authorized person. Receipt is hereby
acknowledged of Notice of Annual
Meeting, Proxy Statement and the 2004
Annual Report.

Date Shareholder sign here

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Date Co-Owner sign here

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[A street map showing the location of the Annual Shareholders' Meeting is set forth in this area.]

Marriott University Park Hotel
880 East Second Street
Tucson, AZ 85719

520.792.4100 Hotel Direct
800.228.9290 Reservations

TRANSPORTATION
From Tucson International Airport

Shuttle Service
Arizona Stagecoach
Call 520-889-1000

Automobile - Interstate 10 to
Speedway exit

DEAR SHAREHOLDERS:

If you previously elected to view the UniSource Energy Corporation Proxy Statements and Annual Reports over the Internet instead of receiving copies in the mail, you can now access the Proxy Statement for the 2005 Annual Shareholders' Meeting and the 2004 Annual Report on the Internet through the following address: <http://www.UniSourceEnergy.com>. You can vote your shares by telephone, the Internet, Mail or in Person at the Annual Shareholders' Meeting. See the Proxy Statement and the enclosed proxy card for further information about voting procedures.

If you would like a paper copy of the Proxy Statement and Annual Report, UniSource Energy will provide a copy to you upon request. To obtain a copy of these documents, please call 866-275-4867.

(FORM OF PROXY CARD - BACK)

UNISOURCE ENERGY

This Proxy is Solicited on Behalf of the Board of Directors of the Company for the Annual Shareholders' Meeting to be held Friday, May 6, 2005.

P R O X Y

The undersigned hereby appoints James S. Pignatelli and Kevin P. Larson, and each of them, with the power of substitution, to represent and to vote on

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behalf of the undersigned all shares of Common Stock which the undersigned is entitled to vote at the Annual Shareholders' Meeting scheduled to be held at the Marriott University Park Hotel, 880 East Second Street, Tucson, Arizona, on Friday, May 6, 2005, and at any adjournments or postponements thereof, with all powers the undersigned would possess if personally present and in their discretion, upon such other business as may properly come before the meeting. This proxy, when properly executed, will be voted in the manner directed herein by the undersigned shareholder. IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED "FOR" Proposal 1.

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