TUCSON ELECTRIC POWER CO
Form 10-K/A
August 06, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K/A
Amendment No. 1

(Mark One)

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

For the fiscal year ended December 31, 2008

OR

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

For the transition period from __________ to __________.

Commission File Number	Registrant; State of Incorporation; Address; and Telephone Number	IRS Employer Identification Number
1-13739	**UNISOURCE ENERGY CORPORATION** (An Arizona Corporation) One South Church Avenue, Suite 100 Tucson, AZ 85701 (520) 571-4000	86-0786732
1-5924	**TUCSON ELECTRIC POWER COMPANY** (An Arizona Corporation) One South Church Avenue, Suite 100 Tucson, AZ 85701 (520) 571-4000	86-0062700

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

Registrant	Title of Each Class	Name of Each Exchange on Which Registered
UniSource Energy Corporation	**Common Stock, no par value, and Preferred Share Purchase Rights**	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Exchange Act: None

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

UniSource Energy Corporation	Yes þ	No o
Tucson Electric Power Company	Yes o	No þ

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

UniSource Energy Corporation	Yes o	No þ
Tucson Electric Power Company	Yes þ	No o

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

UniSource Energy Corporation	Yes þ	No o
Tucson Electric Power Company (1)	Yes o	No þ

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

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

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

UniSource Energy Corporation	Large Accelerated Filer þ Smaller Reporting Company o	Accelerated Filer o	Non-accelerated filer o
Tucson Electric Power Company	Large Accelerated Filer o Smaller Reporting Company o	Accelerated Filer o	Non-accelerated filer þ

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

UniSource Energy Corporation	Yes o	No þ
Tucson Electric Power Company	Yes o	No þ

The aggregate market value of UniSource Energy Corporation voting Common Stock held by non-affiliates of the registrant was $1,094,644,937 based on the last reported sale price thereof on the consolidated tape on June 30, 2008.

At February 25, 2009, 35,602,963 shares of UniSource Energy Corporation Common Stock, no par value (the only class of Common Stock), were outstanding.

At February 25, 2009, 32,139,434 shares of Tucson Electric Power Company s common stock, no par value, were outstanding, all of which were held by UniSource Energy Corporation.

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

Documents incorporated by reference: Specified portions of UniSource Energy Corporation s Proxy Statement relating to the 2009 Annual Meeting of Shareholders are incorporated by reference into Part III.

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A to the Annual Report on Form 10-K for UniSource Energy Corporation (UniSource Energy) and Tucson Electric Power Company (TEP) for the year ended December 31, 2008, originally filed with the Securities and Exchange Commission on February 27, 2009 is being filed for the purpose of amending and revising Part II, Item 8 Consolidated Financial Statements and Supplementary Data in order to correct clerical errors in the UniSource Energy and TEP balance sheets as originally filed.

The following balance sheet line items were corrected:

	UNISOURCE ENERGY December 31, 2008		
	As Originally Filed	**As Corrected**	**Difference**
	- Thousands of Dollars -		
ASSETS			
Current Assets			
Energy Contracts Derivative Instruments	$ 3,682	$ 3,437	$ 245
Regulatory Assets Derivative Instruments	37,596	38,276	(680)
Total Current Assets	**481,651**	**482,086**	**(435)**
Regulatory and Other Assets			
Regulatory Assets Derivative Instruments	17,522	18,324	(802)
Other Assets	26,340	26,339	1
Total Regulatory and Other Assets	**218,219**	**219,020**	**(801)**
Total Assets	**3,508,331**	**3,509,567**	**(1,236)**
CAPITALIZATION AND OTHER LIABILITIES			
Current Liabilities			
Energy Contracts Derivative Instruments	40,642	41,076	(434)
Total Current Liabilities	**351,623**	**352,057**	**(434)**
Deferred Credits and Other Liabilities			
Energy Contracts Derivative Instruments	29,047	29,849	(802)
Total Deferred Credits and Other Liabilities	**650,302**	**651,104**	**(802)**
Total Liabilities	**$ 3,508,331**	**$ 3,509,567**	**$ (1,236)**

	TEP December 31, 2008		
	As Originally Filed	As Corrected	Difference
	- Thousands of Dollars -		
ASSETS			
Current Assets			
Energy Contracts Derivative Instruments	$ 5,172	$ 5,129	$ 43
Other	16,088	16,089	(1)
Total Current Assets	**367,518**	**367,476**	**42**
Regulatory and Other Assets			
Energy Contracts Derivative Instruments	4,385	4,982	(597)
Total Regulatory and Other Assets	**195,116**	**195,713**	**(597)**
Total Assets	**2,841,216**	**2,841,771**	**(555)**
CAPITALIZATION AND OTHER LIABILITIES			
Current Liabilities			
Energy Contracts Derivative Instruments	18,780	18,737	43
Total Current Liabilities	**263,185**	**263,142**	**43**
Deferred Credits and Other Liabilities			
Energy Contracts Derivative Instruments	18,196	18,794	(598)
Total Deferred Credits and Other Liabilities	**577,440**	**578,038**	**(598)**
Total Liabilities	**$ 2,841,216**	**$ 2,841,771**	**$ (555)**

Except as indicated in the preceding tables and for the updated Item 9A, Item 15 and the consent and certifications filed as Exhibits 23, 31 and 32 hereto in accordance with applicable rules of the Securities and Exchange Commission, this Amendment does not modify or update other disclosures in, or exhibits to, the Annual Report on Form 10-K as originally filed.

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ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

UniSource Energy Management s Report on Internal Controls Over Financial Reporting

UniSource Energy Corporation s management is responsible for establishing and maintaining adequate internal control over financial reporting. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the UniSource Energy Corporation s internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework.

Based on management s assessment using those criteria, management has concluded that, as of December 31, 2008, UniSource Energy Corporation s internal control over financial reporting was effective.

Tucson Electric Power Company Management s Report on Internal Controls Over Financial Reporting

Tucson Electric Power Company s management is responsible for establishing and maintaining adequate internal control over financial reporting. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of Tucson Electric Power Company s internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework.

Based on management s assessment using those criteria, management has concluded that, as of December 31, 2008, Tucson Electric Power Company s internal control over financial reporting was effective.

This annual report does not include an attestation report of Tucson Electric Power Company s registered public accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by Tucson Electric Power Company s registered public accounting firm pursuant to temporary rules of the SEC that permit Tucson Electric Power Company to provide only management s report in this annual report.

Report of Independent Registered Public Accounting Firm

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

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of UniSource Energy Corporation and its subsidiaries at December 31, 2008 and December 31, 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the Index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Controls Over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedules, and on the Company s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As described in Note 10 to the consolidated financial statements, the company changed the manner in which it accounts for income taxes as a result of implementing FIN 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 as of January 1, 2007.

As described in Note 11 to the consolidated financial statements, the company changed the manner in which it accounts for pension and post-retirement obligations as a result of implementing Financial Accounting Standards Board Standard No. 158 as of December 31, 2006.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLC
Chicago, Illinois
February 26, 2009

Report of Independent Registered Public Accounting Firm

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

In our opinion, the accompanying consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Tucson Electric Power Company and its subsidiaries at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the Index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 10 to the consolidated financial statements, the company changed the manner in which it accounts for income taxes as a result of implementing FIN 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 as of January 1, 2007.

As described in Note 11 to the consolidated financial statements, the company changed the manner in which it accounts for pension and post-retirement obligations as a result of implementing Financial Accounting Standards Board Standard No. 158 as of December 31, 2006.

PricewaterhouseCoopers LLC
Chicago, Illinois
February 26, 2009

UNISOURCE ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
	2008	**2007**	**2006**
	- Thousands of Dollars - (Except Per Share Amounts)		
Operating Revenues			
Electric Retail Sales	**$ 983,970**	$ 976,795	$ 932,307
CTC Revenue to be Refunded	**(58,092)**		
Net Electric Retail Sales	**925,878**	976,795	932,307
Electric Wholesale Sales	**236,300**	196,233	179,266
Gas Revenue	**163,590**	148,597	159,598
Other Revenues	**71,743**	59,748	36,970
Total Operating Revenues	**1,397,511**	1,381,373	1,308,141
Operating Expenses			
Fuel	**292,557**	291,238	257,515
Purchased Energy	**436,869**	352,898	320,788
Other Operations and Maintenance	**311,907**	258,176	247,069
Depreciation and Amortization	**147,690**	140,638	130,502
Amortization of 1999 Transition Recovery Asset	**23,945**	77,681	65,985
Taxes Other Than Income Taxes	**39,339**	47,837	46,136
Total Operating Expenses	**1,252,307**	1,168,468	1,067,995
Operating Income	**145,204**	212,905	240,146
Other Income (Deductions)			
Interest Income	**11,011**	18,828	19,210
Other Income	**7,838**	7,622	7,453
Other Expense	**(9,286)**	(4,380)	(1,887)
Total Other Income (Deductions)	**9,563**	22,070	24,776
Interest Expense			
Long-Term Debt	**70,227**	73,095	75,039
Capital Leases	**57,272**	64,499	72,586
Loss on Extinguishment of Debt			1,080
Other Interest Expense	**1,837**	5,480	7,922
Interest Capitalized	**(5,566)**	(5,551)	(4,884)
Total Interest Expense	**123,770**	137,523	151,743

Income Before Income Taxes and Discontinued Operations		**30,997**		97,452		113,179
Income Tax Expense		**16,976**		39,079		43,936
Income Before Discontinued Operations		**14,021**		58,373		69,243
Discontinued Operations Net of Tax						(1,796)
Net Income	**$**	**14,021**	$	58,373	$	67,447
Weighted-Average Shares of Common Stock Outstanding (000)		**35,632**		35,486		35,264
Basic Earnings per Share						
Income Before Discontinued Operations	**$**	**0.39**	$	1.64	$	1.96
Discontinued Operations Net of Tax						(0.05)
Net Income	**$**	**0.39**	$	1.64	$	1.91
Diluted Earnings per Share						
Income Before Discontinued Operations	**$**	**0.39**	$	1.57	$	1.85
Discontinued Operations Net of Tax						(0.05)
Net Income	**$**	**0.39**	$	1.57	$	1.80
Dividends Declared per Share	**$**	**0.96**	$	0.90	$	0.84

See Notes to Consolidated Financial Statements.

UNISOURCE ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2008	**2007**	**2006**
	- Thousands of Dollars -		
Cash Flows from Operating Activities			
Cash Receipts from Electric Retail Sales	**$ 1,079,964**	$ 1,061,994	$ 1,008,071
Cash Receipts from Electric Wholesale Sales	**353,618**	301,616	254,322
Cash Receipts from Gas Sales	**182,271**	165,678	173,243
Cash Receipts from Operating Springerville Unit 3	**53,495**	38,887	16,659
Interest Received	**17,246**	19,197	22,231
Performance Deposits Received	**34,404**	12,549	15,307
Income Tax Refunds Received	**22,355**	1,016	553
Refund of Disputed Transmission Costs	**10,665**		
Sale of Excess Emission Allowances	**1,494**	14,861	7,254
MEG Cash Receipts from Trading Activity		2,829	2,704
Other Cash Receipts	**19,299**	11,774	8,823
Purchased Energy Costs Paid	**(577,751)**	(450,197)	(383,943)
Fuel Costs Paid	**(292,646)**	(283,439)	(244,690)
Payment of Other Operations and Maintenance Costs	**(196,697)**	(158,057)	(137,941)
Taxes Other Than Income Taxes Paid, Net of Amounts Capitalized	**(154,548)**	(151,074)	(144,526)
Wages Paid, Net of Amounts Capitalized	**(108,504)**	(106,097)	(100,368)
Interest Paid, Net of Amounts Capitalized	**(58,774)**	(68,446)	(67,006)
Performance Deposits Paid	**(48,520)**	(7,900)	(9,617)
Capital Lease Interest Paid	**(43,828)**	(54,315)	(63,644)
Income Taxes Paid	**(9,900)**	(20,923)	(66,070)
Excess Tax Benefit from Stock Options Exercised	**(633)**	(541)	(1,501)
Other Cash Payments	**(5,999)**	(4,942)	(3,680)
MEG Cash Payments for Trading Activity		(1,704)	(812)
Net Cash Used by Operating Activities of Discontinued Operations			(2,710)
Net Cash Flows Operating Activities	**277,011**	322,766	282,659
Cash Flows from Investing Activities			
Capital Expenditures	**(349,289)**	(245,366)	(238,261)
Deposit to Trustee for Repayment of Collateral Trust Bonds	**(133,111)**		
Proceeds from Investment in Springerville Lease Debt	**24,918**	27,732	22,158
Other Proceeds from Investing Activities	**5,137**	4,475	3,263
Return of Investment from Millennium Energy Businesses	**839**	12	4,835
Investment in and Loans to Equity Investees	**(600)**	(845)	(4,518)
Other Payments for Investing Activities	**(711)**	(3,413)	(1,487)
Sale of Subsidiary			16,000
Payments for Investment in Lease Equity			(48,025)
Net Cash Used by Investing Activities of Discontinued Operations			(46)
Net Cash Flows Investing Activities	**(452,817)**	(217,405)	(246,081)

Cash Flows from Financing Activities			
Proceeds from Issuance of Long-Term Debt	**320,745**		30,000
Proceeds from Borrowings Under Revolving Credit Facilities	**242,000**	205,000	194,000
Repayments of Borrowings Under Revolving Credit Facilities	**(237,000)**	(218,000)	(126,000)
Repayment of Long-Term Debt	**(76,000)**	(6,000)	(93,250)
Payments of Capital Lease Obligations	**(74,316)**	(71,549)	(61,197)
Common Stock Dividends Paid	**(34,043)**	(31,784)	(29,499)
Payment of Debt Issue/Retirement Costs	**(3,739)**	(465)	(2,092)
Proceeds from Stock Options Exercised	**1,969**	1,980	4,861
Excess Tax Benefit from Stock Options Exercised	**633**	541	1,501
Other Cash Receipts	**6,028**	8,210	11,509
Other Cash Payments	**(5,672)**	(7,162)	(6,849)
Net Cash Flows Financing Activities	**140,605**	(119,229)	(77,016)
Net Decrease in Cash and Cash Equivalents	**(35,201)**	(13,868)	(40,438)
Cash and Cash Equivalents, Beginning of Year	**90,373**	104,241	144,679
Cash and Cash Equivalents, End of Year	**$ 55,172**	$ 90,373	$ 104,241
Non-Cash Financing Activity Repayment of Collateral Trust Bonds	**$ (128,300)**	$	$

See Note 17 for supplemental cash flow information.
See Notes to Consolidated Financial Statements.

UNISOURCE ENERGY CORPORATION
CONSOLIDATED BALANCE SHEETS

	December 31, 2008	December 31, 2007
	- Thousands of Dollars -	
ASSETS		
Utility Plant		
Plant in Service	**$ 3,870,493**	$ 3,565,735
Utility Plant Under Capital Leases	**702,337**	702,337
Construction Work in Progress	**171,996**	195,105
Total Utility Plant	**4,744,826**	4,463,177
Less Accumulated Depreciation and Amortization	**(1,580,308)**	(1,534,424)
Less Accumulated Amortization of Capital Lease Assets	**(546,825)**	(521,458)
Total Utility Plant Net	**2,617,693**	2,407,295
Investments and Other Property		
Investments in Lease Debt and Equity	**126,672**	152,544
Other	**64,096**	70,677
Total Investments and Other Property	**190,768**	223,221
Current Assets		
Cash and Cash Equivalents	**55,172**	90,373
Accounts Receivable Retail and Other	**74,288**	67,885
Accounts Receivable Wholesale Sales	**44,725**	46,316
Unbilled Accounts Receivable	**60,146**	62,101
Allowance for Doubtful Accounts	**(19,684)**	(18,446)
Materials and Fuel Inventory	**92,170**	82,433
Energy Contracts Derivative Instruments	**3,437**	5,489
Regulatory Assets Derivative Instruments	**38,276**	708
Regulatory Assets Other	**23,299**	9,554
Deferred Income Taxes Current	**61,398**	60,055
Income Tax Receivable	**12,720**	
Interest Receivable on Capital Lease Debt Investment	**4,491**	6,033
Collateral Posted	**14,120**	
Other	**17,528**	17,739
Total Current Assets	**482,086**	430,240
Regulatory and Other Assets		
Income Taxes Recoverable Through Future Revenues	**19,814**	30,009
Regulatory Assets Pension and Other Postretirement Benefits	**112,035**	16,460
Regulatory Assets Derivative Instruments	**18,324**	298

Regulatory Assets Other	**39,395**	20,556
Regulatory Assets 1999 Transition Recovery Asset		23,944
Energy Contracts Derivative Instruments	**3,113**	8,339
Other Assets	**26,339**	25,354
Total Regulatory and Other Assets	**219,020**	124,960
Total Assets	**$ 3,509,567**	$ 3,185,716

See Notes to Consolidated Financial Statements.

(Consolidated Balance Sheets Continued)

UNISOURCE ENERGY CORPORATION
CONSOLIDATED BALANCE SHEETS

	December 31, 2008	2007
	- Thousands of Dollars -	
CAPITALIZATION AND OTHER LIABILITIES		
Capitalization		
Common Stock Equity	**$ 679,274**	$ 690,075
Capital Lease Obligations	**513,517**	530,973
Long-Term Debt	**1,313,615**	993,870
Total Capitalization	**2,506,406**	2,214,918
Current Liabilities		
Current Obligations Under Capital Leases	**18,334**	58,599
Borrowing under Revolving Credit Facilities	**10,000**	10,000
Current Maturities of Long-Term Debt	**6,000**	204,300
Accounts Payable	**62,514**	72,003
Accounts Payable Purchased Power	**49,146**	50,684
Interest Accrued	**43,440**	48,091
Accrued Taxes Other than Income Taxes	**36,746**	36,775
Accrued Employee Expenses	**26,859**	24,585
Customer Deposits	**22,656**	21,425
Regulatory Liabilities Over-Recovered Purchased Energy Costs	**25,665**	13,084
Regulatory Liabilities Other	**8,161**	3,437
Energy Contracts Derivative Instruments	**41,076**	3,193
Other	**1,460**	1,505
Total Current Liabilities	**352,057**	547,681
Deferred Credits and Other Liabilities		
Deferred Income Taxes Noncurrent	**178,089**	149,730
Regulatory Liabilities Net Cost of Removal for Interim Retirements	**151,796**	106,695
Regulatory Liabilities Derivatives Instruments		6,426
Regulatory Liabilities Over-Recovered Purchased Energy Costs	**44,469**	9,287
Energy Contracts Derivative Instruments	**29,849**	4,930
Pension and Other Postretirement Benefits	**157,769**	76,407
Customer Advances for Construction	**31,062**	28,798
Other	**58,070**	40,844
Total Deferred Credits and Other Liabilities	**651,104**	423,117
Commitments and Contingencies (Note 5)		
Total Capitalization and Other Liabilities	**$ 3,509,567**	$ 3,185,716

See Notes to Consolidated Financial Statements.

(Consolidated Balance Sheets Concluded)

UNISOURCE ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF CAPITALIZATION

					December 31,	
					2008	2007
					- Thousands of Dollars -	
COMMON STOCK EQUITY						
Common Stock-No Par Value					**$ 687,360**	$ 702,368
	2008	**2007**				
Shares Authorized	**75,000,000**	75,000,000				
Shares Outstanding	**35,457,780**	35,314,730				
Accumulated Deficit					**(1,231)**	(628)
Accumulated Other Comprehensive Loss					**(6,855)**	(11,665)
Total Common Stock Equity					**679,274**	690,075
PREFERRED STOCK						
No Par Value, 1,000,000 Shares Authorized, None Outstanding						
CAPITAL LEASE OBLIGATIONS						
Springerville Unit 1					**306,553**	345,800
Springerville Coal Handling Facilities					**90,812**	99,175
Springerville Common Facilities					**108,516**	107,630
Sundt Unit 4					**25,400**	36,034
Other					**570**	933
Total Capital Lease Obligations					**531,851**	589,572
Less Current Maturities					**(18,334)**	(58,599)
Total Long-Term Capital Lease Obligations					**513,517**	530,973
LONG-TERM DEBT						
Issue	**Maturity**		**Interest Rate**			
UniSource Energy:						
Convertible Senior Notes	2035		4.50%		**150,000**	150,000
Credit Agreement	2011		Variable		**58,000**	41,000
Tucson Electric Power Company:						
Variable Rate IDBs	2011		Variable*		**458,600**	328,600
Collateral Trust Bonds	2008		7.50%			138,300
Unsecured IDBs	2020-2033		5.85% to 7.13%		**445,015**	354,270
UNS Gas and UNS Electric:						
Senior Unsecured Notes	2008-2015		6.23% to 7.61%		**200,000**	160,000

Credit Agreement	2011	Variable	**8,000**	26,000
Total Stated Principal Amount			**1,319,615**	1,198,170
Less Current Maturities			**(6,000)**	(204,300)
Total Long-Term Debt			**1,313,615**	993,870
Total Capitalization			**$ 2,506,406**	$ 2,214,918

* TEP s Variable Rate Industrial Development Bonds (IDBs) are backed by letters of credit (LOCs) issued pursuant to TEP s Credit Agreement which expires in August 2011 and the TEP Letter of Credit facility which expires in April 2011. Although the Variable Rate IDBs mature between 2018 and 2029, the above maturity reflects a redemption or repurchase of such bonds in 2011 as though the LOCs terminate without replacement upon expiration of the TEP Credit Agreement. Weighted average interest rates on this variable rate

tax-exempt debt ranged from 0.55% to 8.09% during 2008, 3.11% to 3.95% during 2007, and 2.95% to 3.96% during 2006, and the average interest rate on such debt was 2.11% in 2008, 3.64% in 2007, and 3.47% in 2006.

See Notes to Consolidated Financial Statements.

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

	Common Shares Outstanding*	Common Stock	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders Equity
Balances at December 31, 2005	**34,874**	**$ 689,185**	**$ (65,861)**	**$ (6,583)**	**$ 616,741**
Comprehensive Income:					
2006 Net Income			67,447		67,447
Minimum Pension Liability Adjustment (net of $8,915 income taxes)				13,597	13,597
Unrealized Loss on Cash Flow Hedges (net of $4,897 income taxes)				(7,469)	(7,469)
Reclassification of Unrealized Gains on Cash Flow Hedges to Net Income (net of $77 income taxes)				(117)	(117)
Total Comprehensive Income					73,458
Adjustment to Initially Recognize the Funded Status of Employee Benefit Plans (net of $9,698 income taxes)				(14,792)	(14,792)
Dividends Declared			(29,499)		(29,499)
Shares Issued under Stock Compensation Plans	11				
Shares Issued for Stock Options	305	4,859			4,859
Tax Benefit Realized from Stock Options Exercised		1,501			1,501
Other		1,881			1,881
Balances at December 31, 2006	**35,190**	**697,426**	**(27,913)**	**(15,364)**	**654,149**
Implementation of FIN 48			696		696

Comprehensive Income:					
2007 Net Income			58,373		58,373
Decrease in Pension and Other Post-Retirement Benefit Liabilities (net of $3,929 income taxes)				5,993	5,993
Unrealized Loss on Cash Flow Hedges (net of $2,500 income taxes)				(3,813)	(3,813)
Reclassification of Unrealized Losses on Cash Flow Hedges to Net Income (net of $996 income taxes)				1,519	1,519
Total Comprehensive Income					62,072
Dividends Declared			(31,784)		(31,784)
Shares Issued under Stock Compensation Plans	5				
Shares Issued for Stock Options	120	1,980			1,980
Tax Benefit Realized from Stock Options Exercised		540			540
Other		2,422			2,422
Balances at December 31, 2007	**35,315**	**702,368**	**(628)**	**(11,665)**	**690,075**
Impact of Change in Pension Plan Measurement Date			(603)		(603)
Comprehensive Income (Loss):					
2008 Net Income			14,021		14,021
Unrealized Loss on Interest Rate Swap (net of $2,181 income taxes)				(3,326)	(3,326)
Reclassification of Unrealized Gain on Cash Flow Hedges to Regulatory Asset (net of $1,370 income taxes)				(2,089)	(2,089)

Reclassification of Unrealized Loss on Cash Flow Hedges to Net Income (net of $1,569 income taxes)				2,393	2,393
Employee Benefit Obligations Amortization of net actuarial loss and prior service credit included in net periodic benefit cost (net of $158 income taxes)				(242)	(242)
Increase in SERP Liability (net of $108 income taxes)				(165)	(165)
Reclassification of Pension and Other Postretirement Benefit to Regulatory Asset (net of $5,401 income taxes)				8,239	8,239
Total Comprehensive Income					18,831
Dividends Declared		(20,017)	(14,021)		(34,038)
Shares Issued under Stock Compensation Plans	23				
Shares Issued for Stock Options	120	1,969			1,969
Tax Benefit Realized from Stock Options Exercised		633			633
Other		2,407			2,407
Balances at December 31, 2008	**35,458**	**$ 687,360**	**$ (1,231)**	**$ (6,855)**	**$ 679,274**

* UniSource Energy has 75 million authorized shares of Common Stock.

We discuss the reapplication of FAS 71 in Note 2 and describe limitations on our ability to pay dividends in Note 9.

See Notes to Consolidated Financial Statements.

TUCSON ELECTRIC POWER COMPANY
CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
	2008	**2007**	**2006**
	- Thousands of Dollars -		
Operating Revenues			
Electric Retail Sales	**$ 802,331**	$ 811,649	$ 774,470
CTC Revenue to be Refunded	**(58,092)**		
Net Electric Retail Sales	**744,239**	811,649	774,470
Electric Wholesale Sales	**259,855**	195,999	179,022
Other Revenues	**75,159**	62,855	35,502
Total Operating Revenues	**1,079,253**	1,070,503	988,994
Operating Expenses			
Fuel	**285,224**	291,238	257,515
Purchased Power	**238,024**	140,498	100,090
Other Operations and Maintenance	**267,100**	211,851	198,573
Depreciation and Amortization	**126,040**	119,811	112,346
Amortization of 1999 Transition Recovery Asset	**23,945**	77,681	65,985
Taxes Other Than Income Taxes	**31,649**	40,366	38,834
Total Operating Expenses	**971,982**	881,445	773,343
Operating Income	**107,271**	189,058	215,651
Other Income (Deductions)			
Interest Income	**9,900**	16,072	16,429
Other Income	**5,708**	3,665	7,147
Other Expense	**(6,249)**	(3,296)	(3,029)
Total Other Income (Deductions)	**9,359**	16,441	20,547
Interest Expense			
Long-Term Debt	**47,456**	50,230	51,422
Capital Leases	**57,252**	64,477	72,556
Loss on Extinguishment of Debt			685
Other Interest Expense	**1,367**	4,538	6,436
Interest Capitalized	**(4,675)**	(2,744)	(4,124)
Total Interest Expense	**101,400**	116,501	126,975
Income Before Income Taxes	**15,230**	88,998	109,223

Income Tax Expense		**10,867**		35,542		42,478
Net Income	**$**	**4,363**	$	53,456	$	66,745

See Notes to Consolidated Financial Statements.

TUCSON ELECTRIC POWER COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2008	**2007**	**2006**
	- Thousands of Dollars -		
Cash Flows from Operating Activities			
Cash Receipts from Electric Retail Sales	**$ 883,423**	$ 883,885	$ 840,601
Cash Receipts from Electric Wholesale Sales	**377,579**	301,616	254,322
Cash Receipts from Operating Springerville Unit 3	**53,495**	38,887	16,659
Interest Received	**15,849**	16,284	18,808
Income Tax Refunds Received	**20,902**		
Reimbursement of Affiliate Charges	**16,534**		
Refund of Disputed Transmission Costs	**10,665**		
Performance Deposits Received	**10,150**		
Sale of Excess Emission Allowances	**1,494**	16,975	7,254
Other Cash Receipts	**11,936**	7,931	6,579
Fuel Costs Paid	**(284,830)**	(283,440)	(244,632)
Purchased Power Costs Paid	**(364,356)**	(245,439)	(182,626)
Payment of Other Operations and Maintenance Costs	**(185,206)**	(144,753)	(121,744)
Taxes Other Than Income Taxes Paid, Net of Amounts Capitalized	**(117,611)**	(116,641)	(109,952)
Wages Paid, Net of Amounts Capitalized	**(84,857)**	(82,661)	(77,627)
Capital Lease Interest Paid	**(43,807)**	(54,293)	(63,615)
Interest Paid, Net of Amounts Capitalized	**(38,467)**	(47,050)	(44,100)
Income Taxes Paid		(23,609)	(70,457)
Performance Deposits Paid	**(10,150)**		
Other Cash Payments	**(4,037)**	(3,580)	(2,242)
Net Cash Flows Operating Activities	**268,706**	264,112	227,228
Cash Flows from Investing Activities			
Capital Expenditures	**(286,905)**	(162,539)	(156,180)
Deposit to Trustee for Repayment of Collateral Trust Bonds	**(133,111)**		
Proceeds from Investments in Springerville Lease Debt	**24,918**	27,732	22,158
Payments for Investments in Lease Debt and Equity			(48,025)
Other Cash Receipts	**5,055**	650	1,085
Other Cash Payments	**(711)**	(2,968)	(1,004)
Net Cash Flows Investing Activities	**(390,754)**	(137,125)	(181,966)
Cash Flows from Financing Activities			
Proceeds from Issuance of Long-Term Debt	**220,745**		
Proceeds from Borrowings Under Revolving Credit Facility	**170,000**	160,000	135,000
Repayments of Borrowings Under Revolving Credit Facility	**(170,000)**	(180,000)	(105,000)
Payments of Capital Lease Obligations	**(74,228)**	(71,464)	(61,111)
Repayments of Long-Term Debt	**(10,000)**		
Dividends Paid to UniSource Energy	**(2,500)**	(53,000)	(62,000)

Equity Investment from UniSource Energy		18,000	
Other Cash Receipts	**1,237**	7,795	16,852
Payment of Debt Issue/Retirement Costs	**(3,120)**	(451)	(1,631)
Other Cash Payments	**(3,421)**	(968)	(1,094)
Net Cash Flows Financing Activities	**128,713**	(120,088)	(78,984)
Net Increase (Decrease) in Cash and Cash Equivalents	**6,665**	6,899	(33,722)
Cash and Cash Equivalents, Beginning of Year	**26,610**	19,711	53,433
Cash and Cash Equivalents, End of Year	**$ 33,275**	$ 26,610	$ 19,711
Non-Cash Financing Activity Repayment of Collateral Trust Bonds	**$ (128,300)**	**$**	**$**

See Note 17 for supplemental cash flow information.
See Notes to Consolidated Financial Statements.

TUCSON ELECTRIC POWER COMPANY
CONSOLIDATED BALANCE SHEETS

	December 31, 2008	December 31, 2007
	- Thousands of Dollars -	
ASSETS		
Utility Plant		
Plant in Service	**$ 3,351,474**	$ 3,143,823
Utility Plant Under Capital Leases	**701,631**	701,631
Construction Work in Progress	**145,457**	123,833
Total Utility Plant	**4,198,562**	3,969,287
Less Accumulated Depreciation and Amortization	**(1,531,611)**	(1,490,724)
Less Accumulated Amortization of Capital Lease Assets	**(546,332)**	(521,057)
Total Utility Plant Net	**2,120,619**	1,957,506
Investments and Other Property		
Investments in Lease Debt and Equity	**126,672**	152,544
Other	**31,291**	35,460
Total Investments and Other Property	**157,963**	188,004
Current Assets		
Cash and Cash Equivalents	**33,275**	26,610
Accounts Receivable Retail and Other	**53,091**	44,431
Accounts Receivable Wholesale	**44,610**	46,316
Unbilled Accounts Receivable	**33,554**	35,941
Allowance for Doubtful Accounts	**(17,135)**	(16,538)
Accounts Receivable Due from Affiliates	**16,614**	8,740
Materials and Fuel Inventory	**81,067**	72,732
Energy Contracts Derivative Instruments	**5,129**	2,036
Regulatory Assets Derivative Instruments	**14,242**	
Regulatory Assets Other	**22,834**	9,554
Deferred Income Taxes Current	**59,615**	59,157
Interest Receivable on Capital Lease Debt Investment	**4,491**	6,033
Income Taxes Receivable		8,070
Interest Receivable Current		3,350
Other	**16,089**	13,062
Total Current Assets	**367,476**	319,494
Regulatory and Other Assets		
Regulatory Assets Pension and Other Postretirement Benefits	**106,596**	15,154
Regulatory Assets Derivatives	**5,400**	

Regulatory Assets Other	**38,180**	18,969
Income Taxes Recoverable Through Future Revenues	**19,814**	30,009
Regulatory Assets 1999 Transition Recovery Asset		23,945
Energy Contracts Derivative Instruments	**4,982**	492
Other Assets	**20,741**	19,463
Total Regulatory and Other Assets	**195,713**	108,032
Total Assets	**$ 2,841,771**	$ 2,573,036

See Notes to Consolidated Financial Statements.

(Consolidated Balance Sheets Continued)

TUCSON ELECTRIC POWER COMPANY
CONSOLIDATED BALANCE SHEETS

	December 31, 2008	December 31, 2007
	- Thousands of Dollars -	
CAPITALIZATION AND OTHER LIABILITIES		
Capitalization		
Common Stock Equity	**$ 583,606**	$ 577,349
Capital Lease Obligations	**513,370**	530,714
Long-Term Debt	**903,615**	682,870
Total Capitalization	**2,000,591**	1,790,933
Current Liabilities		
Current Obligations Under Capital Leases	**18,231**	58,502
Current Maturities of Long-Term Debt		138,300
Borrowing Under Revolving Credit Facility	**10,000**	10,000
Accounts Payable	**56,001**	64,664
Accounts Payable Purchased Power	**28,510**	22,935
Accounts Payable Due from Affiliates	**3,610**	4,512
Income Taxes Payable	**2,057**	
Interest Accrued	**35,828**	41,394
Accrued Taxes Other than Income Taxes	**27,679**	28,690
Accrued Employee Expenses	**23,990**	22,557
Energy Contracts Derivative Instruments	**18,737**	2,460
Regulatory Liabilities Over-Recovered Purchased Energy Costs	**14,310**	
Regulatory Liability Other	**7,083**	
Other	**17,106**	15,533
Total Current Liabilities	**263,142**	409,547
Deferred Credits and Other Liabilities		
Deferred Income Taxes Noncurrent	**180,098**	163,834
Regulatory Liabilities Net Cost of Removal for Interim Retirements	**122,037**	87,311
Regulatory Liabilities Over-Recovered Purchased Energy Costs	**44,469**	
Energy Contracts Derivative Instruments	**18,794**	3,278
Pension and Other Postretirement Benefits	**149,955**	72,755
Other	**62,685**	45,378
Total Deferred Credits and Other Liabilities	**578,038**	372,556
Commitments and Contingencies (Note 5)		
Total Capitalization and Other Liabilities	**$ 2,841,771**	$ 2,573,036

See Notes to Consolidated Financial Statements.

(Consolidated Balance Sheets Concluded)

TUCSON ELECTRIC POWER COMPANY
CONSOLIDATED STATEMENTS OF CAPITALIZATION

			December 31, 2008	December 31, 2007
			- Thousands of Dollars -	
COMMON STOCK EQUITY				
Common Stock No Par Value			**$ 813,971**	$ 813,971
	2008	**2007**		
Shares Authorized	**75,000,000**	75,000,000		
Shares Outstanding	**32,139,434**	32,139,434		
Capital Stock Expense			**(6,357)**	(6,357)
Accumulated Deficit			**(217,153)**	(218,488)
Accumulated Other Comprehensive Loss			**(6,855)**	(11,777)
Total Common Stock Equity			**583,606**	577,349
PREFERRED STOCK				
No Par Value, 1,000,000 Shares Authorized, None Outstanding				
CAPITAL LEASE OBLIGATIONS				
Springerville Unit 1			**306,553**	345,800
Springerville Coal Handling Facilities			**90,812**	99,175
Springerville Common Facilities			**108,516**	107,630
Sundt Unit 4			**25,400**	36,034
Other Leases			**320**	577
Total Capital Lease Obligations			**531,601**	589,216
Less Current Maturities			**(18,231)**	(58,502)
Total Long-Term Capital Lease Obligations			**513,370**	530,714
LONG-TERM DEBT				
Issue	**Maturity**	**Interest Rate**		
Variable Rate IDBs	2011	Variable*	**458,600**	328,600
Collateral Trust Bonds	2008	7.50%		138,300
Unsecured IDBs	2020-2033	5.85% to 7.13%	**445,015**	354,270
Total Stated Principal Amount			**903,615**	821,170
Less Current Maturities				(138,300)
Total Long-Term Debt			**903,615**	682,870*

Total Capitalization	**$ 2,000,591**	$ 1,790,933

* TEP s Variable Rate Industrial Development Bonds (IDBs) are backed by letters of credit (LOCs) issued pursuant to TEP s Credit Agreement which expires in August 2011 and the TEP Letter of Credit facility which expires in April 2011. Although the Variable Rate IDBs mature between 2018 and 2029, the above maturity reflects a redemption or repurchase of such bonds in 2011 as though the LOCs terminate without replacement upon expiration of the TEP Credit Agreement. Weighted average interest rates on this variable rate tax-exempt debt ranged from 0.55% to 8.09% during 2008, 3.11% to 3.95% during 2007, and 2.95% to

3.96% during 2006 and the average interest rate on such debt was 2.11% in 2008, 3.64% in 2007, and 3.47% in 2006.

See Notes to Consolidated Financial Statements.

TUCSON ELECTRIC POWER COMPANY
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDER S EQUITY AND COMPREHENSIVE INCOME

	Common Stock	Capital Stock Expense	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholder s Equity
Balances at December 31, 2005	**$ 795,971**	**$ (6,357)**	**$ (224,385)**	**$ (6,583)**	**$ 558,646**
Comprehensive Income:					
2006 Net Income			66,745		66,745
Minimum Pension Liability Adjustment (net of $8,915 income taxes)				13,597	13,597
Unrealized Loss on Cash Flow Hedges (net of $4,897 income taxes)				(7,469)	(7,469)
Reclassification of Unrealized Gains on Cash Flow Hedges to Net Income (net of $77 income taxes)				(117)	(117)
Total Comprehensive Income					72,756
Adjustment to Initially Recognize the Funded Status of Employee Benefit Plans (net of $9,630 income taxes)				(14,688)	(14,688)
Dividends Paid			(62,000)		(62,000)
Balances at December 31, 2006	**795,971**	**(6,357)**	**(219,640)**	**(15,260)**	**554,714**
Implementation of FIN 48			696		696
Comprehensive Income:					
2007 Net Income			53,456		53,456
Decrease in Pension and Other Post-Retirement Benefit Liabilities (net of $3,820 income taxes)				5,826	5,826

Unrealized Loss on Cash Flow Hedges (net of $2,532 income taxes)				(3,862)	(3,862)
Reclassification of Unrealized Losses on Cash Flow Hedges to Net Income to Regulatory Asset (net of $996 income taxes)				1,519	1,519
Total Comprehensive Income					56,939
Capital Contribution from UniSource Energy	18,000				18,000
Dividends Paid			(53,000)		(53,000)
Balances at December 31, 2007	**813,971**	**(6,357)**	**(218,488)**	**(11,777)**	**577,349**
Impact of Change in Pension Plan Measurement Date			(528)		(528)
Comprehensive Income (Loss):					
2008 Net Income			4,363		4,363
Unrealized Loss on Interest Rate Swap (net of $2,181 income taxes)				(3,326)	(3,326)
Reclassification of Unrealized Gain on Cash Flow Hedges to Regulatory Asset (net of $1,337 income taxes)				(2,039)	(2,039)
Reclassification of Unrealized Loss on Cash Flow Hedges to Net Income (net of $1,569 income taxes)				2,393	2,393
Employee Benefit Obligations Amortization of net actuarial loss and prior service credit included in net periodic benefit cost (net of $157 income taxes)				(240)	(240)
Increase in SERP Liability (net of $108 income taxes)				(165)	(165)
Reclassification of Pension and Other Postretirement Benefit to Regulatory Asset (net of $5,441 income taxes)				8,299	8,299

Total Comprehensive Income					9,285
Dividends Paid			(2,500)		(2,500)
Balances at December 31, 2008	**$ 813,971**	**$ (6,357)**	**$ (217,153)**	**$ (6,855)**	**$ 583,606**

We discuss the reapplication of FAS 71 in Note 2 and describe limitations on our ability to pay dividends in Note 9. See Notes to Consolidated Financial Statements.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

UniSource Energy Corporation (UniSource Energy) is a holding company that has no significant operations of its own. Operations are conducted by UniSource Energy s subsidiaries, each of which is a separate legal entity with its own assets and liabilities. UniSource Energy owns 100% of Tucson Electric Power Company (TEP), UniSource Energy Services, Inc. (UES), Millennium Energy Holdings, Inc. (Millennium) and UniSource Energy Development Company (UED).

TEP, a regulated public utility, is UniSource Energy s largest operating subsidiary and represented approximately 81% of UniSource Energy s assets as of December 31, 2008. TEP generates, transmits and distributes electricity to approximately 400,000 retail electric customers in a 1,155 square mile area in Southern Arizona. TEP also sells electricity to other utilities and power marketing entities primarily located in the Western U.S. In addition, TEP operates Springerville Unit 3 on behalf of Tri-State Generation and Transmission Association, Inc. (Tri-State).

UES holds the common stock of UNS Gas, Inc. (UNS Gas) and UNS Electric, Inc. (UNS Electric). UNS Gas is a gas distribution company with 146,000 retail customers in Mohave, Yavapai, Coconino, and Navajo counties in Northern Arizona, as well as Santa Cruz County in South Central Arizona. UNS Electric is an electric transmission and distribution company with approximately 90,000 retail customers in Mohave and Santa Cruz counties.

Millennium invests in unregulated businesses. On March 31, 2006, UniSource Energy completed the sale of all of the capital stock of Global Solar, Inc. (Global Solar), Millennium s largest subsidiary, to a third party. We present Global Solar s operations throughout this report as discontinued operations. See Note 16.

In May 2008, UED completed the development of the Black Mountain Generating Station (BMGS), a 90 MW gas turbine generating facility in Northern Arizona and, through a five-year power sale agreement (PPA), is providing energy to UNS Electric.

We conduct our business in three primary business segments TEP, UNS Gas and UNS Electric.

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

BASIS OF PRESENTATION

We account for our investments in subsidiaries using the consolidation method when we hold a majority of a subsidiary s voting stock and we can exercise control over the subsidiary. The accounts of the subsidiary and parent are combined, and intercompany balances and transactions are eliminated. Intercompany profits on transactions between regulated entities are not eliminated.

We use the equity method to report corporate joint ventures, partnerships, and affiliated company investments when we can demonstrate the ability to exercise significant influence over the operating and financial policies of an investee company. Equity method investments are recorded at cost and appear on a single line item on the balance sheet and net income (loss) from the entity is reflected in Other Income on the income statements. Quarterly, we review the equity investments and where there is an other-than-temporary impairment, we recognize the loss in earnings.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The equity investments at December 31, 2008 were:

Investee	**% Owned**
UniSource Energy	
Carboelectrica Sabinas, S. de R.L. de C.V.	50.0%
Haddington Energy Partners II, LP	31.3%
Valley Ventures III, LP	13.6%

USE OF ACCOUNTING ESTIMATES

We make estimates and assumptions to prepare financial statements under accounting principles generally accepted in the U.S. (GAAP). These estimates and assumptions affect:

- A portion of the reported amounts of assets and liabilities at the dates of the financial statements;
- Our disclosures about contingent assets and liabilities at the dates of the financial statements; and
- A portion of revenues and expenses reported during the periods presented.

Because these estimates involve judgments, the actual amounts may differ from the estimates.

ACCOUNTING FOR RATE REGULATION

The Arizona Corporation Commission (ACC) and the Federal Energy Regulatory Commission (FERC) regulate portions of TEP s, UNS Gas and UNS Electric s utility accounting practices and rates. The ACC authorizes certain rates charged to retail customers, the issuance of securities, and transactions with affiliated parties. The FERC regulates TEP s and UNS Electric s rates for wholesale power sales and transmission services.

We apply the provisions of Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* (FAS 71) to the regulated portion of TEP, UNS Gas and UNS Electric. Beginning in December 2008, as a result of the 2008 TEP Rate Order, TEP reapplied FAS 71 to its generation operations. See Note 2. In accordance with FAS 71, regulatory assets and liabilities are recorded in the consolidated balance sheets. Regulatory assets are the deferral of costs expected to be recovered in future customer rates and regulatory liabilities represent current recovery of expected future costs.

The conditions a regulated company must satisfy to apply the accounting policies and practices of FAS 71 include:

- An independent regulator sets rates;
- The regulator sets the rates to recover the specific enterprise s costs of providing service; and
- The service territory lacks competitive pressures to reduce rates below the rates set by the regulator.

We evaluate our regulatory assets each period and believe recovery is probable. We have received or requested return on certain regulatory assets for which we are currently recovering or seeking recovery through rates. If we were required to terminate application of FAS 71 to all of our regulated operations, we would have to record an extraordinary gain (loss) in the income statement and an after-tax loss in Accumulated Other Comprehensive Income (AOCI) to remove all of the regulatory assets and liabilities in the balance sheet at that time. See Note 2.

CASH AND CASH EQUIVALENTS

We define Cash and Cash Equivalents as cash (unrestricted demand deposits) and all highly liquid investments purchased with an original maturity of three months or less.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

UTILITY PLANT

TEP, UNS Gas and UNS Electric report utility plant at cost. Costs included in utility plant are materials and labor, contractor services, construction overhead (where applicable), and an Allowance for Funds Used During Construction (AFUDC) or capitalized interest during construction.

Costs to replace major units of property are included in utility plant. The cost of planned major maintenance activities, including scheduled overhauls at TEP s generation plants, is recorded as the costs are actually incurred. Replacement of capital equipment included in plant maintenance activities is capitalized to utility plant. TEP, UNS Gas and UNS Electric charge the cost of repairs and minor replacements to Other Operations and Maintenance expense.

When a unit of regulated property is retired the original cost less any salvage value is credited or charged to accumulated depreciation. Prior to December 2008, before TEP reapplied FAS 71 to its generation operations, interim retirements of unregulated generation plant, together with the cost of removal less salvage, were charged to accumulated depreciation. Gains and losses resulting from the final retirement of unregulated properties are credited or charged to the income statement and the corresponding cost and accumulated depreciation is removed from the balance sheet.

AFUDC and Capitalized Interest

AFUDC, which reflects the cost of debt or equity funds used to finance construction, is capitalized as part of the cost of regulated utility plant. AFUDC applies to all regulated operations that follow FAS 71. AFUDC amounts capitalized are included in rate base for establishing utility rates. For operations that do not apply FAS 71, interest related only to debt is capitalized as a cost of construction. The interest capitalized that relates to debt reduces Other Interest Expense on the income statement. The interest capitalized that relates to equity funds is recorded as Other Income. Beginning in December 2008, when TEP reapplied FAS 71 to its generation operations, TEP began capitalizing interest that relates to equity funds. See Note 2.

	TEP		
	2008	**2007**	**2006**
Average AFUDC rate on regulated construction expenditures	7.5%	10.05%	8.59%
AFUDC Debt (in millions)	$ 2	$ 2	$ 1
AFUDC Equity (in millions)	$ 3	$ 1	$ 1
Average capitalized interest rate on generation-related construction expenditures (before December 2008)	5.02%	5.73%	5.72%
Capitalized interest (in millions)	$ 2	$ 1	$ 3

	UNS Gas		
	2008	**2007**	**2006**
Average AFUDC rate on regulated construction expenditures	8.37%	8.12%	8.29%
AFUDC Debt (in millions)	$ 0.1	$ 0.3	$ 0.1
AFUDC Equity (in millions)	$ 0.1	$ 0.3	$ 0.1

	UNS Electric		
	2008	**2007**	**2006**
Average AFUDC rate on regulated construction expenditures	8.84%	13.51%	10.93%
AFUDC Debt (in millions)	$ 0.2	$ 0.7	$ 0.6
AFUDC Equity (in millions)	$ 0.3	$ 0.4	$ 0.5

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Depreciation

TEP, UNS Gas, UNS Electric and UED compute depreciation for owned utility plant on a straight-line basis at rates based on the economic lives of the assets. See Note 6. The ACC approves depreciation rates for all utility plant, except that of UED. Depreciation rates are based on average useful lives and reflect estimated removal costs, net of estimated salvage value for interim retirements. Prior to December 2008, before TEP reapplied FAS 71 to its generation operations, the depreciable lives for TEP s generation assets were based on remaining useful lives. We have summarized the average annual depreciation rates for all utility plants below.

Year	TEP	UNS Gas	UNS Electric	UED
2008	3.33%	2.77%	4.47%	2.57%
2007	3.35%	3.28%	4.60%	n/a
2006	3.21%	3.05%	4.52%	n/a

Computer Software Costs

TEP, UNS Gas and UNS Electric capitalize costs incurred to purchase computer software and amortize those costs over the estimated economic life of the product. If the software is no longer useful, we immediately charge capitalized computer software costs to expense. TEP amortized capitalized computer software costs of $7 million in 2008, $9 million in 2007, and $7 million in 2006.

TEP Utility Plant under Capital Leases

TEP financed the following generation assets with capital leases: Springerville Common Facilities, Springerville Unit 1, Springerville Coal Handling Facilities, and Sundt Unit 4. The following table shows the amount of lease expense incurred for TEP s generation-related capital leases. The lease terms are described in TEP Capital Lease Obligations in Note 7.

	Years Ended December 31, 2008	2007	2006
	-Millions of Dollars-		
Lease Expense:			
Interest Expense on Capital Leases	**$ 57**	$ 64	$ 72
Amortization of Capital Lease Assets Included in:			
Operating Expenses Fuel	**4**	4	4
Operating Expenses Depreciation and Amortization	**21**	21	22
Total Lease Expense	**$ 82**	$ 89	$ 98

INVESTMENTS IN LEASE DEBT AND EQUITY

TEP s investments in lease debt and equity are interests in two of TEP s capital leases: Springerville Unit 1 and Springerville Coal Handling Facilities. See Note 7. These investments do not reduce the capital lease obligations reflected on the balance sheet because there is no legal right of offset. TEP makes lease payments to a trustee who then distributes to debt and equity holders.

TEP s investments in lease debt are considered to be held-to-maturity investments because TEP has the ability and intent to hold until maturity. TEP records these investments at amortized cost and recognizes interest income. TEP presents these investments in Investments in Lease Debt and Equity on the balance sheet and classifies them as investing activities on its cash flow statements. See Note 8.

JOINTLY-OWNED FACILITIES

TEP has investments in several plants and transmission facilities jointly owned with other utilities. These projects are accounted for on a proportionate consolidation basis. See Note 6.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

ASSET RETIREMENT OBLIGATIONS

Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations (*FAS 143) requires entities to record the estimated present value of a liability for a legal obligation to retire an asset in the future. FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47), requires entities to record the estimated present value of a liability for a legal obligation to perform asset retirement activity even if the timing and (or) method of settlement depends on a future event that may or may not be within the control of the entity. TEP records a liability for the estimated present value of a conditional asset retirement obligation related to its generation assets as follows:

- when it is able to reasonably estimate the fair value of any future obligation to retire as a result of an existing or enacted law, statute, ordinance or contract; or
- if it can reasonably estimate the fair value.

When the liability is initially recorded at net present value, TEP capitalizes the cost by increasing the carrying amount of the related long-lived asset. Over time, TEP adjusts the liability to its present value by recognizing accretion expense as an operating expense each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon retirement of the asset, TEP either settles the obligation for its recorded amount or incurs a gain or loss if the actual costs differ from the recorded amount.

Beginning in December 2008, when TEP reapplied FAS 71 to its generation operations, TEP began recording cost of removal for its generation assets that is recoverable through rates charged to customers. See Note 2. TEP, UNS Gas and UNS Electric record cost of removal for their transmission and distribution assets through depreciation rates and recover those amounts in rates charged to their customers. There are no legal obligations associated with these assets. TEP, UNS Gas and UNS Electric have recorded their obligation for estimated costs of removal as regulatory liabilities.

EVALUATION OF ASSETS FOR IMPAIRMENT

TEP, UNS Gas and UNS Electric evaluate their Utility Plant and other long-lived assets for impairment whenever events or circumstances indicate that the value of the assets may be impaired. If the fair value of the asset, determined based on the undiscounted expected future cash flows, is less than the carrying value of the asset, an impairment charge would be recorded.

Millennium evaluates its investments for impairment at the end of each quarter. If the decline in fair value is judged to be other-than-temporary, an impairment loss would be recorded. See Note 3.

DEFERRED FINANCING COSTS

We defer costs related to the issuance of debt and amortize on a straight-line basis over the life of the debt. These costs include underwriters commissions, discounts or premiums, and other costs such as legal, accounting and regulatory fees and printing costs.

TEP, UNS Gas and UNS Electric defer and amortize the gains and losses on reacquired debt associated with their regulated operations to interest expense over the remaining life of the original debt. Prior to December 2008, when TEP reapplied FAS 71 to its generation operations, TEP recognized gains and losses on reacquired debt, including unamortized debt issuance costs, associated with its generation operations, as incurred.

UTILITY OPERATING REVENUES

TEP, UNS Gas and UNS Electric record utility operating revenues when services are provided or commodities are delivered to customers. Operating revenues include unbilled revenues which are earned (service has been provided) but not billed by the end of an accounting period.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Amounts delivered are determined through systematic monthly readings of customer meters. At the end of the month, the usage since the last meter reading is estimated and the corresponding unbilled revenue is calculated. Unbilled revenue is calculated based on daily generation or purchased volumes, estimated customer usage by class, estimated line losses and estimated average customer rates. Accrued unbilled revenues are reversed the following month when actual billings occur. The accuracy of the unbilled revenue estimate is affected by factors that include fluctuations in energy demands, weather, line losses, and changes in the composition of customer classes.

Beginning in January 2009, as a result of the 2008 TEP Rate Order, TEP will have a rate-adjustment mechanism that will provide for the recovery of purchased natural gas and electric fuel and purchased energy cost. UNS Gas and UNS Electric have rate-adjustment mechanisms in place that allow for a revenue surcharge or surcredit (that adjusts the customer s base rate for delivered purchased power) to collect or return under- or over- recovery of costs. These rate-adjustment mechanisms are revised periodically and may increase or decrease the level of costs recovered through base rates for any difference between the total amount collected under the clauses and the recoverable costs incurred. See Note 2.

TEP s wholesale revenue and purchased power costs from settled energy contracts that are not physically delivered are reported on a net basis in Electric Wholesale Sales. The corresponding cash receipts and payments are recorded in the statement of cash flows as Cash Receipts from Electric Wholesale Sales and Purchased Energy Costs Paid, respectively.

We record an Allowance for Doubtful Accounts to reduce accounts receivable for revenue amounts that are estimated to be uncollectible. TEP, UNS Gas and UNS Electric establish an allowance for doubtful accounts based on historical collection experience and any specific customer collection issues that are identified. TEP s Allowance for Doubtful Accounts was $17 million at December 31, 2008 and at December 31, 2007. UNS Gas and UNS Electric s combined Allowance for Doubtful Accounts was $3 million at December 31, 2008 and $2 million at December 31, 2007.

INVENTORY

TEP records fuel inventory, primarily coal, at weighted average cost. TEP uses full absorption costing, under which all handling and procurement costs are included in the cost of the inventory. Examples of these costs include direct material, direct labor, overhead costs and transportation costs. See Note 5 regarding fuel purchase contracts.

Materials and supplies consist of transmission and distribution line construction and repair materials and generating station and transmission and distribution substation repair materials. Materials and supplies inventories are recorded at cost.

FUEL AND PURCHASED ENERGY COSTS

TEP and UNS Electric Purchased Power and Fuel Adjustment Clause (PPFAC)

Beginning in January 2009, as a result of the 2008 TEP Rate Order, TEP will defer differences between purchased energy costs and the recovery of such costs in rates. UNS Electric also defers differences between purchased energy costs and the recovery of such costs in rates. Where applicable, fuel cost over-recoveries (the excess of fuel costs recovered in base rates over fuel costs incurred) are deferred as current regulatory liabilities and under-recoveries (the excess of fuel costs incurred over fuel costs recovered in base rates) are deferred as current regulatory assets. The 2008 TEP Rate Order requires TEP to credit, with interest, $58 million of Fixed CTC true-up revenues, charged from May 2008 to November 30, 2008, to customers through the PPFAC. See Note 2.

UNS Gas Purchased Gas Adjustor (PGA)

UNS Gas defers differences between gas purchase costs and the recovery of such costs in base rates under a Purchased Gas Adjustor (PGA) mechanism. The PGA mechanism addresses the volatility of natural gas prices and allows UNS Gas to recover its commodity costs through a price adjustor. UNS Gas may change the PGA factor monthly based on an ACC approved mechanism that compares the twelve-month rolling weighted average gas cost, subject to limitations on how much the price per therm may change in a twelve-month period. The difference between the actual cost of UNS Gas gas supplies and transportation contracts and that currently allowed by the ACC is deferred and recovered or repaid through the PGA mechanism. When under-or over-recovery trigger points are met, UNS Gas may request a PGA surcharge or surcredit with the goal of collecting or returning the amount deferred from or to customers, with interest, over a twelve-month period. See Note 2.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

INCOME TAXES

GAAP requires us to report some of our assets and liabilities differently for our financial statements than we do for income tax purposes. We reflect the tax effects of these differences as deferred income tax assets or liabilities in our balance sheets. We measure these deferred tax assets and liabilities using current income tax rates. Federal and state income tax credits are accounted for as a reduction of income tax expense in the year in which the credit arises.

GAAP requires that regulated enterprises that apply FAS 71 record a deferred income tax liability for tax benefits that are flowed through to a customer when temporary differences arise. A regulatory asset is established for the future increases in taxes payable and is recovered from customers through future rates as temporary differences reverse. TEP became fully normalized in 1990 and temporary differences, arising after that point in time, do not flow through to ratepayers. The balance in the regulatory asset Income Taxes Recoverable Through Future Revenues relates to flow through years prior to 1990. See Note 2.

We allocate income taxes to the subsidiaries based on their taxable income and deductions as reported in the consolidated tax return filings.

On January 1, 2007, we adopted FIN 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FAS 109* (FIN 48), which requires us to determine whether it is more likely than not that we will sustain a tax position under examination. TEP recorded the cumulative effects of applying this interpretation as an increase of less than $1 million to retained earnings and the recognition of a $13 million uncertain tax liability. The ongoing recognition of changes in measurement of uncertain tax positions are reflected as a component of income tax expense.

UniSource Energy and TEP record interest on unrecognized tax benefits or liabilities as either Interest Income or Interest Expense in the income statements. No penalties were incurred in the periods reported.

TAXES OTHER THAN INCOME TAXES

TEP, UNS Gas and UNS Electric act as conduits or collection agents for excise tax (sales tax) as well as franchise fees and regulatory assessments. We record liabilities payable to governmental agencies when they charge their customers for these amounts. Neither the amounts charged nor payable are reflected in the income statement.

EMISSION ALLOWANCES

The Environmental Protection Agency (EPA) issues emission allowances to qualifying utilities based on past operational history. Each allowance permits emission of one ton of sulfur dioxide (SO_2) in its vintage year or a subsequent year. TEP receives an allotment of these SO_2 emission allowances annually; UNS Electric and UED do not receive SO_2 emission allowances since neither has coal-fired generation. When issued from the EPA, these SO_2 emission allowances have no book value for accounting purposes but may be sold if TEP does not need them for operations. TEP may also purchase additional SO_2 emission allowances if needed. Purchased SO_2 emission allowances are recorded at cost. Beginning in January 2009, as a result of the 2008 TEP Rate Order, TEP will credit 50% of the gains from the sales of SO_2 emission allowances to the PPFAC. The remaining 50% of gains from sales of excess SO_2 emission allowances will be reflected as a reduction of Other Operations and Maintenance expense on TEP s income statement when title passes and in the operating activities section of the statement of cash flows. 100% of gains from sales of excess SO_2 emission allowances were reflected as a reduction of Other Operations and Maintenance expense in the periods presented.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

RENEWABLE ENERGY STANDARDS TARIFF (REST)

In June 2008, the ACC approved a REST surcharge for TEP and UNS Electric. The surcharge is intended to recover the cost of qualified renewable expenditures, such as payments to customers who have renewable energy resources or the incremental cost of renewable power generated or purchased by TEP or UNS Electric. To the extent that the surcharge matches qualified renewable expenditures, TEP and UNS Electric recognize revenue that is reflected in the income statement as Other Revenue. Any surcharge collected in excess of qualified renewable expenditures will be reflected in the financial statements as a current regulatory liability. Conversely, qualified renewable expenditures in excess of the REST surcharge will be reflected as a current regulatory asset. See Note 2.

DERIVATIVE FINANCIAL INSTRUMENTS

TEP, UNS Gas and UNS Electric are exposed to energy price risk associated with their gas and purchased power requirements, volumetric risk associated with their seasonal load and operational risk associated with their power plants, transmission and transportation systems. This risk is mitigated through the PPFAC and PGA mechanisms which provides an adjustment to TEP, UNS Gas and UNS Electric s retail rates to recover the actual costs of purchased power, gas, transmission and transportation. TEP, UNS Gas and UNS Electric further reduce these risks through a variety of derivative and non-derivative instruments. See Note 4.

On the date the company enters into a contract that is considered a derivative instrument, we apply one of the following accounting treatments:

> **Cash Flow Hedges** are used by TEP to hedge the cash flow risk associated with unfavorable changes in the variable interest rate on the Springerville Common Lease. The effective portion of the changes in the market prices of cash flow hedges are recorded as unrealized gains and losses in (AOCI and the ineffective portion, if any, is recognized in earnings.

We formally assess, both at the hedge s inception and on an ongoing basis, whether the derivatives have been and are expected to remain highly effective in offsetting changes in the cash flows of hedged items. We discontinue hedge accounting when: (1) the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item; (2) the derivative expires or is sold, terminated, or exercised; (3) it is no longer probable that the forecasted transaction will occur; or (4) we determine that designating the derivative as a hedging instrument is no longer appropriate.

When TEP determines that a contract is no longer effective in offsetting the changes in cash flows of a hedged item TEP recognizes changes in fair value in earnings. The gains and losses at that time remain in AOCI and are reclassified into earnings as the underlying hedged transaction occurs.

Prior to December 2008, TEP and UNS Gas hedged the changes in cash flows that are to be received or paid in connection with gas swap agreements and forward power sales. These contracts hedged the cash flow risk associated with TEP s summer load requirements and its forecasted excess generation and UNS Gas winter load requirement. Unrealized gains and losses on these contracts were recorded in AOCI.

Beginning in January 2009, as a result of the 2008 TEP Rate Order, TEP is permitted to recover fuel and purchased power costs, including the prudent cost of hedging contracts, through the PPFAC. UNS Gas is also permitted, through its PGA mechanism, to recover the prudent cost of hedging contracts. At December 31, 2008, TEP and UNS Gas reclassified the unrealized gains and losses for commodity contracts that are eligible to be recovered through the PPFAC or PGA as either a regulatory asset or regulatory liability rather than as a component of AOCI.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Mark-to-Market transactions include:

TEP non-trading hedges, such as forward power purchase contracts indexed to gas or short-term forward power sales contracts, that did not qualify for cash flow hedge accounting treatment or did not qualify for the normal scope exception. Prior to December 2008, unrealized gains and losses resulting from changes in the market prices of non-trading hedges or short-term forward power sales contracts were recorded on the same line in the income statement as the hedged transaction. Beginning in December 2008, as a result of the 2008 TEP Rate Order, which permits recovery in the PPFAC of hedging transactions, unrealized gains and losses are recorded as either a regulatory asset or regulatory liability.

TEP trading derivatives which are forward power purchase and sale contracts entered into to reduce our exposure to energy and commodity prices. As unrealized gains and losses resulting from changes in the market prices of trading derivatives are not recoverable in the PPFAC, unrealized gains and losses are recorded in the income statement in Electric Wholesale Sales.

UNS Electric derivatives such as forward power purchases and gas swaps. In December 2006, UNS Electric received authorization from the ACC to defer the unrealized gains and losses on the balance sheet as a regulatory asset or a regulatory liability rather than as a component of AOCI or in the income statement.

UNS Gas derivatives such as forward gas purchases and gas swaps. Beginning in December 2008, unrealized gains and losses are recorded as either a regulatory asset or regulatory liability, as the UNS Gas PGA mechanism permits the recovery of the prudent cost of hedging contracts.

These mark-to-market contracts are subject to specified risk parameters established and monitored by UniSource Energy s Risk Management Committee.

Normal Purchase and Normal Sale transactions are forward energy purchase and sales contracts entered into by TEP, UNS Gas and UNS Electric to support the current load forecast and entered into with a counterparty with load serving requirements or generating capacity. These contracts are not required to be marked-to-market and are accounted for on an accrual basis. On an ongoing basis we evaluate our counterparties for non-performance risk to ensure it does not impact our ability to obtain the normal scope exception.

We consider the effect of counterparty credit risk in determining the fair value of derivative instruments that are in a net asset position, after incorporating collateral posted by counterparties, and allocate the credit risk adjustment to individual contracts. We also incorporate the impact of our own credit risk, after considering collateral posted, on instruments that are in a net liability position and allocate the credit risk adjustment to all individual contracts.

Although TEP s and MEG s gains and losses on trading activities are recorded on a net basis in the income statement, we report the related cash receipts and cash payments separately in the statement of cash flows.

We present cash collateral and derivative assets and liabilities, associated with the same counterparty, separately in our financial statements and we bifurcate all derivatives into their current and long-term portions on the balance sheet.

SHARE-BASED COMPENSATION

UniSource Energy has a stock-based long-term incentive plan. UniSource Energy measures the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award (with some limited exceptions). Such costs are recognized over the period during which an employee is required to provide service in exchange for the award (the requisite service period) which typically will be the vesting period.

Compensation cost is not recognized for anticipated forfeitures of equity instruments prior to vesting. Our share-based compensation plans are described more fully in Note 12.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

RECENTLY ISSUED ACCOUNTING STANDARDS

UniSource and TEP adopted the following recently issued accounting standards:

FAS 157, *Fair Value Measurement*, issued September 2006, defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. FAS 157 clarifies that the exchange price is the price in the principal market in which the reporting entity would transact for the asset or liability. See Note 13.

FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* issued and effective October 2008, provides guidance clarifying how FAS 157 *Fair Value Measures* (FAS 157) should be applied in markets that are not active. The guidance reaffirms the notion of fair value as an exit price as of the measurement date. The FSP emphasizes that approaches other than the market value approach to determine fair value, such as the use of management s internal assumptions about future cash flows and appropriately risk-adjusted discount rates, may be appropriate. See Note 13.

The following recently issued accounting standards are not yet reflected in the UniSource Energy and TEP financial statements:

EITF 08-6, *Equity Method Investment Accounting Considerations*, issued January 2009, requires an entity to apply the cost accumulation model when determining the carrying value of an equity investment. Share issuances by the investee should be accounted for as if the equity investee had sold a proportionate share of its investment with any gain or loss recognized in earnings. In addition, the EITF requires that impairment testing be performed at an overall investment level. The standard is applicable for fiscal years beginning on or after December 15, 2008 and is not expected to have a material impact on our financial statements.

FAS 161, *Disclosures About Derivative Instruments and Hedging Activities* an amendment to FAS 133, *Accounting for Derivative Instruments and Hedging Activities,* issued March 2008, requires enhanced disclosures about an entity s derivative and hedging activity. The standard requires that the objectives for using derivative instruments be disclosed in terms of underlying risk so that the reader understands the purpose of derivative use in terms of the risks that the entity is intending to manage. The standard also requires disclosure of the location in the financial statements of derivative balances as well as the location of gains and losses incurred during the reporting period. The standard will be applicable for fiscal years or interim periods beginning on or after November 15, 2008 with early adoption encouraged. We will adopt the requirements of this pronouncement in our 2009 first quarter Form 10-Q.

FSP FAS 132(R)-1 *Employers Disclosures about Postretirement Benefit Plan Assets* issued in December 2008, amends Statement 132(R)-1 to require more detailed disclosures about employers plan assets, including employers investment strategies, major categories of plan assets, concentrations of risk within plan assets, and valuation techniques used to measure the fair value of plan assets. We will adopt the requirements of this pronouncement in our 2009 Form 10-K.

RECLASSIFICATIONS AND OTHER ADJUSTMENTS

To be comparable with the 2008 presentation, UniSource Energy and TEP reclassified in the prior year Statements of Income less than $0.5 million, from Other Income to Interest Income.

In 2008, UniSource Energy recorded a pre-tax charge of approximately $2 million ($1.2 million after-tax) related to an investment impairment for a Millennium investment, $1 million ($0.6 million after-tax) of which should have been recorded prior to 2008.

In September 2008, TEP recorded an additional tax expense of $1 million related to a determination that certain accrued tax penalty payments will not be deductible for tax purposes under IRS regulations.

NOTE 2. REGULATORY MATTERS

TEP RATES AND REGULATION

In 1999, the ACC approved a Settlement Agreement (1999 Settlement Agreement) between TEP and certain customer groups related to the implementation of retail electric competition in Arizona. The 1999 Settlement Agreement provided for, among other things, recovery of transition assets and capped rates for TEP customers through 2008. Upon approval of the 1999 Settlement Agreement, TEP discontinued regulatory accounting under FAS 71 for its generation operations. Beginning in December 2008, as a result of the 2008 TEP Rate Order, TEP reapplied FAS 71 to its generation related operations. The 1999 Settlement Agreement and the 2008 Rate Order allowed TEP to continue to report its transmission and distribution operations under FAS 71.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

1999 Settlement Agreement

We believe that the 1999 Settlement Agreement contemplated that TEP s retail rates for generation service would have been market-based beginning January 1, 2009. As part of the 2008 TEP Rate Order, TEP and all the parties to the 2008 Proposed Settlement Agreement relinquished all claims related to the 1999 Settlement Agreement and the ACC order adopting the 1999 Settlement Agreement.

1999 Transition Recovery Asset

TEP s Transition Recovery Asset consisted of generation-related regulatory assets and a portion of TEP s generation plant asset costs. Transition costs that were recovered through the Fixed CTC included: (1) the Transition Recovery Regulatory Asset; (2) a small portion of generation-related plant assets included in Plant in Service on the balance sheet; and (3) excess capacity deferrals related to operating and capital costs associated with Springerville Unit 2 which were amortized as an off-balance sheet regulatory asset through 2003. In May 2008, TEP fully amortized the remaining Transition Recovery Asset balance, as costs were fully recovered through rates.

In May 2007, the ACC ordered that TEP s current Fixed CTC revenue remain at its then-current level until the effective date of a final order in the TEP 2008 proposed settlement agreement proceeding. As of December 1, 2008, when new rates went into effect, TEP had collected $58 million of true-up revenues and recorded a $58 million reserve for Fixed CTC revenue to be refunded against its Electric Retail Sales in 2008. The 2008 TEP Rate Order requires TEP to return the Fixed CTC true-up revenues to customers by reducing the PPFAC balance.

These transition costs were amortized as follows:

	Years Ended December 31,		
	2008	**2007**	**2006**
	-Millions of Dollars-		
Transition Costs Being Recovered through the Fixed CTC:			
Balance, beginning of year	**$ 26**	$ 112	$ 185
Amortization of 1999 Transition Recovery Asset Recorded on the Income Statement	**(24)**	(78)	(66)
Amortization of Generation-Related Plant Assets	**(2)**	(8)	(7)
Balance, end of year	**$**	$ 26	$ 112

TEP amortized the portion of the 1999 Transition Recovery Regulatory Asset that is recorded on the balance sheet as follows:

	Years Ended December 31,		
	2008	**2007**	**2006**
	-Millions of Dollars-		
1999 Transition Recovery Regulatory Asset, beginning of year	$ 24	$ 102	168
Amortization of 1999 Transition Recovery Asset Recorded on the Income Statement	(24)	(78)	(66)
1999 Transition Recovery Regulatory Asset, end of year	$	$ 24	102

TEP 2008 Rate Order

The 2008 TEP Rate Order, issued by the ACC and effective December 1, 2008, provides for a cost of service rate methodology for TEP s generation assets; an average base rate increase of 6% over TEP s previous retail rates; a fuel rate included in base rates of 2.9 cents per kilowatt-hour (kWh); a PPFAC effective January 1, 2009; a base rate increase moratorium through January 1, 2013; and a waiver of any claims under the 1999 Settlement Agreement.
As a result of the 2008 TEP Rate Order, TEP reapplied FAS 71 to its generation operations. In addition, in December 2008, TEP began deferring its mark-to-market adjustments as regulatory assets/liabilities for derivative instruments that are expected to be recovered through the PPFAC. TEP also reflected the Fixed CTC revenues to be refunded as part of the PPFAC. See discussion below and Note 4.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

TEP expects to credit to customers $14 million of Fixed CTC revenue in the next twelve months and classified this amount as Current Regulatory Liabilities Over-Recovered Purchased Energy Costs. The remaining $44 million is classified as Non-Current Regulatory Liabilities Over-Recovered Purchased Energy Costs.

Purchased Power and Fuel Adjustment Clause

The PPFAC became effective January 1, 2009. The PPFAC allows recovery of fuel and purchased power costs, including demand charges and the prudent costs of contracts for hedging fuel and purchased power costs. The PPFAC consists of a forward component and a true-up component.

The forward component will be updated on April 1 of each year, starting in 2009. The forward component will be based on the forecasted fuel and purchased power costs for the 12-month period from April 1 to March 31, less the base cost of fuel and purchased power of 2.9 cents per kWh, which is embedded in base rates. At January 1, 2009, the forward component was zero because of CTC true-up revenues of $58 million that will be credited to customers.

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

In addition to the $58 million of CTC true-up revenues, TEP will credit the following against the PPFAC: 100% of short-term wholesale revenues; 10% of the profit on trading activity; and 50% of the gains from the sales of SO_2 emission allowances.

Ratemaking Methodology for Generation Assets

Rates for generation service are based on a cost-of-service methodology. All generation assets acquired by TEP between the end of the rate case test year (December 31, 2006) and the end of the base rate increase moratorium period (December 31, 2012) shall be included in TEP s rate base at their respective original depreciated cost, subject to subsequent review and approval by the ACC in future rate cases.

Luna is included in TEP s original cost rate base at its net book value of $48 million as of December 31, 2006. Springerville Unit 1 non-fuel costs are being recovered through base rates at $25.67 per kilowatt (kW) per month, which approximates the levelized cost of Springerville Unit 1 through the remainder of the lease term.

Depreciation and Net Negative Salvage

On December 1, 2008, TEP implemented new depreciation rates that include a component for net negative salvage value for all generation assets except Luna and new depreciation rates for distribution and general plant assets that will extend the depreciable lives of these assets. The net impact on the income statement is to increase depreciation expense $11 million per year.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
Impact of Reapplying FAS 71 to TEP s Generation Operations

In December 2008, as a result of the 2008 TEP Rate Order, TEP reapplied FAS 71 to its generation operations and TEP recorded the following adjustments:

	Income Statement (Gain)/Loss	Balance Sheet Regulatory Asset Current	Balance Sheet Regulatory Asset Non Current	AOCI
Recorded in Fuel:				
San Juan Coal Contract Amendment	$ (9)	$ 1	$ 8	$
Retiree Health Care and Final Mine Reclamation Costs	(15)		15	
Unrealized gains (losses) on derivative contracts (PPFAC)	(8)	14	5	(11)
Deregulation Costs Recorded in O&M:	(1)	1		
Property Taxes	(7)	7		
Pension and Other Postretirement Benefits			14	(14)
Pre-Tax Impact of Reapplying FAS 71	$ (40)	$ 23	$ 42	$ (25)

San Juan Coal Contract Amendment costs of $9 million, incurred by TEP in 2000, will be amortized over 9 years beginning in December 2008.

Final Mine Reclamation and Retiree Health Care Costs represent costs associated with TEP s jointly-owned facilities at San Juan, Four Corners and Navajo. TEP is required to recognize the present value of its liability associated with final reclamation and retiree health care obligations. As TEP is permitted to fully recover these costs through the PPFAC when the costs are invoiced by the miners, TEP recorded a regulatory asset.

Unrealized gains (losses) on derivative instruments (PPFAC) are contracts for which the settled amounts will be recovered through the PPFAC. As TEP expects to recover the final settled amounts through the PPFAC, TEP reclassified amounts previously recorded in the income statement and in AOCI to a regulatory asset.

Deregulation Costs represent deferred expenses that TEP incurred to comply with various ACC deregulation orders.

Property taxes related to generation assets which will be recovered in rates as cash is paid rather than as costs are accrued.

Pension and Other Postretirement Benefits represent the underfunded status of TEP s defined benefit and other postretirement benefit plans prior to December 2008. As TEP expects to recover these costs in rates, TEP reclassified amounts previously recorded in AOCI to a regulatory asset.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
Income Statement Impact of Applying FAS 71
In addition to the impact of reapplying FAS 71, TEP recorded the following amounts in its income statement as a result of applying FAS 71:

	Years Ended December 31,		
	2008	2007	2006
	-Millions of Dollars-		
Operating Expenses			
Amortization of 1999 Transition Recovery Asset	**$ 24**	$ 78	$ 66
Depreciation (related to Net Cost of Removal for Interim Retirements)	**10**	7	5
Interest Expense			
Long-Term Debt (amortization of loss on reacquired debt costs)	**1**	1	1
Income Taxes	**4**	5	5
Total Expense Increase	**$ 39**	$ 91	$ 77

If TEP had not applied FAS 71 in these years, the above amounts would have been reflected in the income statements in prior periods.
Renewable Energy Standard Tariff (REST)
The ACC approved a REST surcharge for TEP effective June 1, 2008, to allow TEP to recover the cost of qualified renewable expenditures, such as payments to customers who have renewable energy resources or the incremental cost of renewable power generated or purchased by TEP. Any surcharge collected in excess of qualified renewable expenditures will be reflected in the financial statements as a current regulatory liability. Conversely, qualified renewable expenditures in excess of the REST surcharge will be reflected as a current regulatory asset. Through December 31, 2008, TEP collected $9 million in customer surcharge, of which $3 million was expensed for REST projects and the remaining $6 million was recorded as a current regulatory liability.
The approved REST adjustor mechanism, allows TEP to file an application with the ACC to apply any shortage or surplus in the prior year s program expenses to the subsequent year s REST surcharge.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
The following table summarizes TEP s regulatory assets and liabilities:

	December 31,	
	2008	2007
	-Millions of Dollars-	
Current Regulatory Assets		
Property Tax Deferrals [1]	**$ 16**	$ 9
Derivative Instruments [2]	**14**	
Deregulation Costs [3]	**4**	
San Juan Coal Contract Amendment [5]	**1**	
Self-Insured Medical Deferrals [1]	**1**	1
1999 Transition Recovery Asset		24
Other	**1**	
Total Current Regulatory Assets	**37**	34
Pension and Other Postretirement Benefits [7]	**107**	15
Regulatory Assets Other		
Derivative Instruments[2]	**5**	
Deregulation Costs [3]	**10**	12
San Juan Coal Contract Amendment [5]	**8**	
Final Mine Reclamation Costs [8]	**8**	
Retiree Health Care Costs [8]	**6**	
Rate Case Costs [4]	**1**	1
Unamortized Loss on Reacquired Debt [9]	**5**	6
Total Regulatory Assets Other	**43**	19
Income Taxes Recoverable through Future Revenues [6]	**20**	30
Current Regulatory Liabilities		
Over-Recovered Purchased Energy Costs	**(14)**	
Derivative Instruments[2]	**(1)**	
Renewable Energy Standards Tariff (REST) [10]	**(6)**	
Total Current Regulatory Liabilities	**(21)**	
Other Regulatory Liabilities		
Net Cost of Removal for Interim Retirements [11]	**(123)**	(87)
Over-Recovered Purchased Energy Costs	**(44)**	

Total Other Regulatory Liabilities		**(167)**		(87)
Total Net Regulatory Assets	**$**	**19**	$	11

Regulatory assets are either being collected in rates or are expected to be collected through rates in a future period, as described below:

1. Property Tax and Self-Insured Medical Deferrals are recorded based on historical ratemaking treatment allowing recovery as costs are paid out, rather than as costs are accrued. In December 2008, as a result of TEP reapplying FAS 71 for its generation operations, TEP recorded a regulatory property tax asset related to its generation assets. While these assets do not earn a return, the costs are fully recovered in rates over an approximate six month period.

2. Derivative Instruments represent the unrealized gains or losses on contracts entered into to hedge the variability of purchased energy costs and short-term wholesale sales that are expected to be recovered through the PPFAC. As a result of the rate case and the approval of the PPFAC, TEP deferred the gains and losses on certain contracts that meet the recovery criteria under the PPFAC requirements.

3. Deregulation costs represent deferred expenses that TEP incurred to comply with various ACC deregulation orders, the recovery of which has been authorized by the ACC in the 2008 TEP Rate Order. These assets are included in rate base and consequently earn a return. TEP will recover these costs through rates over a four-year period, beginning in December 2008.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Rate Case Costs. In the 2008 TEP Rate Order, the ACC approved recovery of rate case costs over a four-year period beginning in December 2008. TEP does not earn a return on these assets.

5. San Juan Coal Contract Amendment costs of $15 million were incurred by TEP in 2000. In the 2008 TEP Rate Order, the ACC approved the recovery of $9 million of these costs over a nine-year period beginning in December 2008. These assets do not earn a return.

6. Income Taxes Recoverable Through Future Revenues, while not included in rate base, are amortized over the life of the assets. TEP does not earn a return on these assets.

7. Pension Assets. In December 2008, as a result of TEP reapplying FAS 71 for its generation operations, TEP recorded a regulatory pension and postretirement benefit asset related to its generation employees. Based on past regulatory actions, TEP expects to recover these costs in rates. TEP does not earn a return on these assets.

8. Final Reclamation and Retiree Health Care Costs represent costs associated with TEP s jointly-owned facilities at San Juan, Four Corners and Navajo. TEP is required to recognize the present value of its liability associated with final reclamation and retiree health care obligations. As TEP is permitted to fully recover these costs through the PPFAC when the costs are invoiced by the miners, TEP recorded a regulatory asset. TEP expects to recover these costs over the life of the mines, which is estimated to be between 17 and 34 years. TEP will not earn a return on these assets.

9. Unamortized Loss on Reacquired Debt Costs is amortized for rate recovery over the remaining life of the related debt instruments over a period of 21 years. TEP does not earn a return on these costs.

Regulatory liabilities represent items that TEP expects to pay to customers through billing reductions in future periods or use for the purpose for which they were collected from customers, as described below:

10. Renewable Energy Standards Tariff (REST) represents the REST surcharge collected in excess of qualified renewable expenditures. See below.

11. Net Cost of Removal for Interim Retirements represents an estimate of the cost of future asset retirement obligations net of salvage value. These are amounts collected through revenue for the net cost of removal of interim retirements for transmission, distribution, general and intangible plant which are not yet expended. In December 2008, as a result of the 2008 TEP Rate Order, TEP began collecting through revenue the net cost of removal of interim retirements for generation plant, which it has not yet expended.

Future Implications of Discontinuing Application of FAS 71

TEP continues to apply FAS 71 to its regulated operations. TEP regularly assesses whether it can continue to apply FAS 71 to these operations. If TEP stopped applying FAS 71 to its regulated operations, it would write-off the related balances of its regulatory assets as an expense and its regulatory liabilities as income on its income statement. Based on the regulatory assets balances, net of regulatory liabilities, at December 31, 2008, if TEP had stopped applying FAS 71 to its regulated operations, it would have recorded an extraordinary after-tax gain of $53 million and an after-tax loss in AOCI of $64 million. While future regulatory orders and market conditions may affect cash flows, TEP s cash flows would not be affected if TEP stopped applying FAS 71.

UNS GAS RATES AND REGULATION

2007 UNS Gas Rate Order

In November 2007, the ACC issued a final order in the UNS Gas rate case, approving a $5 million, or 4% base rate increase. New rates went into effect in December 2007. UNS Gas also received modifications to its PGA mechanism to help address problems posed by volatile gas prices, as discussed below.

As a result of the order allowing $0.3 million of rate case costs, UNS Gas expensed $0.6 million of deferred costs in October 2007.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

2008 General Rate Case Filing

In November 2008, UNS Gas filed a general rate case (on a cost of service basis) with the ACC requesting a total rate increase of 6% to cover a revenue deficiency of $10 million. The case uses a June 30, 2008 test year. UNS Gas expects the ACC to rule on its rate case in 2009.

Purchase Gas Adjustor (PGA) Mechanism

UNS Gas retail rates include a PGA mechanism intended to address the volatility of natural gas prices and allow UNS Gas to recover its actual commodity costs, including transportation, through a price adjustor. All purchased gas commodity costs, including transportation, increase the PGA bank, a balancing account. UNS Gas recovers these costs or returns amounts over-collected from/to ratepayers through a PGA rate. The PGA rate includes the following two components:

(1) The **PGA factor**, computed monthly, is a calculation of the twelve-month rolling weighted average gas cost, and automatically adjusts monthly, subject to limitations on how much the price per therm may change in a twelve-month period. Effective December 2007, the ACC increased the annual cap on the maximum increase in the PGA factor from $0.10 per therm to $0.15 per therm in a twelve-month period.

(2) At any time UNS Gas PGA bank balance is under-recovered, UNS Gas may request a **PGA surcharge** with the goal of collecting the amount deferred from customers over a period deemed appropriate by the ACC. When the PGA bank balance reaches an over-collected balance of $10 million on a billed basis, UNS Gas is required to request a **PGA surcredit** with the goal of returning the over-collected balance to customers over a period deemed appropriate by the ACC.

The PGA surcharge in 2006 ranged between $0.05 cents and $0.35 cents per therm. In 2007, the PGA surcharge was $0.05 cents per therm through April 2007. In September 2007, the ACC approved a $0.04 cent per therm PGA surcredit, effective October 2007 through April 2008. Since May 2008, there has been no surcharge or surcredit in effect.

Based on current projections of gas prices, UNS Gas believes that the current PGA rates will allow it to timely recover its gas costs. However, changes in the market price for gas, sales volumes and surcharge amount could significantly change the PGA bank balance in the future.

The following table shows the balance of over-recovered purchased gas costs:

	December 31, 2008	December 31, 2007
	-Millions of Dollars-	
Under (Over) Recovered Purchased Gas Costs Regulatory Basis as Billed to Customers	**$ 5**	$ (3)
Estimated Purchased Gas Costs Recovered through Accrued Unbilled Revenues	**(10)**	(10)
Over-Recovered Purchased Gas Costs (PGA) Included as a Current Regulatory Liability	**$ (5)**	$ (13)

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Other Regulatory Assets and Liabilities

In addition to the Over Recovered Purchased Gas Costs, UNS Gas has the following Regulatory Assets and Liabilities:

	December 31,	
	2008	2007
	-Millions of Dollars-	
Current Assets		
Derivative Instruments	**$ 7**	$
Pension Assets	**3**	1
Other Regulatory Assets		
Derivative Instruments	**6**	
Other Regulatory Assets	**1**	1
Other Regulatory Liabilities		
Net Cost of Removal for Interim Retirements	**(19)**	(17)

Regulatory assets are either being collected in rates or are expected to be collected through rates in a future period, as described below:

Derivative Instruments represent the unrealized gains or losses on contracts entered into to hedge the variability of purchased energy costs that are expected to be recovered through the PGA. UNS Gas does not earn a return on these costs.

Pension Assets represent the unfunded status of UNS Gas share of the UES pension and other postretirement benefit plans that it expects, based on past regulatory actions, to recover through rates. UNS Gas does not earn a return on these costs.

Other Regulatory assets consist of its 2007 rate case costs which are recoverable over 3 years. In addition, UNS Gas deferred its 2008 rate case costs and its low income assistance program costs. UNS Gas requested recovery of these costs in its 2008 rate case filing. UNS Gas does not earn a return on these costs.

Regulatory liabilities represent items that UNS Gas expects to pay to customers through billing reductions in future periods or use for the purpose for which they were collected from customers, as described below:

Net Cost of Removal for Interim Retirements represents an estimate of the cost of future asset retirement obligations. These are amounts collected through revenue for the net cost of removal of interim retirements for which removal costs have not yet been expended. In December 2007, to comply with ACC requirements, UNS Gas reclassified $12 million of Net Cost of Removal for Interim Retirements from Accumulated Depreciation to a regulatory liability.

Income Statement Impact of Applying FAS 71

If UNS Gas had not applied FAS 71, net income would have been $4 million lower in 2008 as UNS Gas would have recognized under-recovered purchased energy costs as an expense to its income statement rather than a reduction to its regulatory liability. Net income would have been $9 million higher in 2007 and $11 million higher in 2006 as UNS Gas would have been able to recognize over-recovered purchased energy costs as a reduction to its expenses in the income statement rather than record a regulatory liability.

Future Implications of Discontinuing Application of FAS 71

UNS Gas regularly assesses whether it can continue to apply FAS 71. If UNS Gas stopped applying FAS 71 to its regulated operations, UNS Gas would write-off the related balance of its regulatory assets as an expense and write-off its regulatory liabilities as income on its income statement. Based on the regulatory asset and liability balances, if UNS Gas had stopped applying FAS 71 to its regulated operations, it would have recorded an extraordinary after-tax gain of $14 million and an after-tax loss in AOCI of $10 million at December 31, 2008. Discontinuing application of

FAS 71 would not affect UNS Gas cash flows.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
UNS ELECTRIC RATES AND REGULATION
2008 UNS Electric Rate Order

In the May 2008 rate order, the ACC approved a rate increase of 2.5% ($4 million) effective in June 2008. As a result of the May 2008 rate order limiting recovery of deferred rate case costs, UNS Electric expensed $0.3 million of the $0.6 million deferred costs in May 2008.

Purchased Power and Fuel Adjustment Clause (PPFAC)

UNS Electric s retail rates include a PPFAC, which allows for a separate surcharge or surcredit to the base rate for delivered purchased power to collect or return under- or over-recovery of costs. Allowable PPFAC costs include fuel, purchased power (less proceeds from most wholesale sales) and transmission costs.

As part of the May 2008 ACC rate order, a new PPFAC rate of approximately $0.087 per kWh took effect on June 1, 2008. The PPFAC mechanism has a forward component and a true-up component. The forward component of the PPFAC rate is based on forecasted fuel and purchased power costs. The true-up component reconciles actual fuel and purchased power costs with the amounts collected in the preceding PPFAC year and any amounts to be refunded/collected from customers in the coming year s PPFAC rate. The true-up component is updated on June 1 of each year, beginning June 1, 2009. The retail rates prior to June 2008 included a charge for fuel and purchased power of approximately $0.07 per kWh (base rate recovery of $0.052 per kWh and a transmission surcharge of $0.018).

At December 31, 2008, UNS Electric had over recovered its purchased power by $7 million on an accrual (GAAP) basis, of which less than $0.5 million was under-recovered on a billed basis. The PPFAC balance is shown in Current Liabilities as Regulatory Liabilities Over-Recovered Purchased Energy Costs. At December 31, 2007, UNS Electric had over recovered its purchased power by $9 million on an accrual (GAAP) basis of which $4 million was on a billed (regulatory) basis and the balance is shown as a noncurrent liability in Deferred Credits and Other Liabilities Over-Recovered Purchased Power Costs.

Purchased Power Agreement

In June 2008, UED and UNS Electric entered into a 5-year Power Purchase Agreement (PPA) under which UED sells all the output of BMGS to UNS Electric. The PPA is a tolling arrangement in which UNS Electric takes operational control of BMGS and assumes all risk of operation and maintenance costs, including fuel. UNS Electric accounts for the PPA as an operating lease. The costs associated with the PPA are recoverable through UNS Electric s PPFAC.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
Regulatory Assets and Liabilities
UNS Electric s regulatory assets and liabilities were as follows:

	December 31, 2008	December 31, 2007
	-Millions of Dollars-	
Current Regulatory Assets		
Derivatives	**$ 17**	$ 1
Other Regulatory Assets		
Derivative Instruments	**7**	
Pension Assets	**3**	1
Rate Case Costs		1
Current Regulatory Liabilities		
Derivative Instruments		(3)
REST	**(1)**	
Over-Recovered Purchased Power Costs	**(6)**	
Other Regulatory Liabilities		
Over-Recovered Purchased Power Costs		(9)
Derivative Instruments		(7)
Net Cost of Removal for Interim Retirements	**(11)**	(2)

Regulatory assets are either being collected in rates or are expected to be collected through rates in a future period, as described below:

Derivative Instruments represent the unrealized gains or losses on contracts entered into to hedge the variability of purchased energy costs that are expected to be recovered through the PPFAC. UNS Electric does not earn a return on these costs.

Pension Assets represent the unfunded status of UNS Electric s share of the UES pension and other postretirement benefit plans that it expects, based on past regulatory actions, to recover through rates. UNS Electric does not earn a return on these costs.

Rate case costs are included in rate base and consequently earn a return. The recovery period is 3 years.

Regulatory liabilities represent items that UNS Electric expects to pay to customers through billing reductions in future periods or use for the purpose for which they were collected from customers, as described below:

Renewable Energy Standards Tariff (REST) represents the REST surcharge collected in excess of qualified renewable expenditures. The ACC approved a REST surcharge for UNS Electric, effective June 1, 2008, to allow UNS Electric to recover the cost of qualified renewable expenditures, such as payments to customers who have renewable energy resources or the incremental cost of renewable power generated or purchased by UNS Electric. Any surcharge collected in excess of qualified renewable expenditures will be reflected in the financial statements as a current regulatory liability. Conversely, qualified renewable expenditures in excess of the REST surcharge will be reflected as a current regulatory asset. The REST plan includes an adjustor mechanism which allows UNS Electric to file an application with the ACC to apply any shortage or surplus in the prior year s program expenses to the subsequent year s REST surcharge.

UNS Electric defers differences between purchased energy costs and the recovery of such costs in revenues. Future billings are adjusted for such deferrals through use of a already deferred PPFAC approved by the ACC. The PPFAC allows for a revenue surcharge or surcredit (that adjusts the customer s rate for delivered purchased power) to collect or return under- or over-recovery of costs.

Net Cost of Removal for Interim Retirements represents an estimate of the cost of future asset retirement obligations. These are amounts collected through revenue for the net cost of removal of interim retirements for which removal costs have not yet been expended. In June 2008, to comply with ACC expectations, UNS Electric reclassified $7 million of Net Cost of Removal for Interim Retirements from Accumulated Depreciation to a regulatory liability.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Income Statement Impact of Applying FAS 71

If UNS Electric had not applied FAS 71, net income would have been $15 million lower in 2008 as UNS Electric would have recognized under-recovered purchased energy and unrealized losses on its commodity derivative instruments as an expense to its income statement, rather than as regulatory assets or a reduction to its regulatory liabilities. If UNS Electric had not applied FAS 71, net income would have been $1 million higher in 2007, and $3 million higher in 2006, as UNS Electric would have been able to recognize over-recovered purchased power costs as a credit to the income statement rather than record an increase to regulatory liabilities.

Future Implications of Discontinuing Application of FAS 71

UNS Electric regularly assesses whether it can continue to apply FAS 71 to its operations. If UNS Electric stopped applying FAS 71 to its regulated operations, it would write-off the related balances of its regulatory assets as an expense and would write-off its regulatory liabilities as income on its income statement. Based on the regulatory asset and liability balances, if UNS Electric had stopped applying FAS 71 to its regulated operations, it would have recorded an extraordinary after-tax loss of $4 million and an after-tax loss in AOCI of $1 million at December 31, 2008. Discontinuing application of FAS 71 would not affect UNS Electric s cash flows.

NOTE 3. SEGMENT AND RELATED INFORMATION

We have three reportable segments that are determined based on the way we organize our operations and evaluate performance:

(1) TEP, a vertically integrated electric utility business, is our largest subsidiary.

(2) UNS Gas is a regulated gas distribution utility business.

(3) UNS Electric is a regulated electric distribution utility business.

The UniSource Energy and UES holding companies, Millennium, and UED are included in All Other. All Other also includes the discontinued operations of Global Solar. See Note 16.

Revenues and expenses included in All Other include the following:

In 2006, Millennium recorded an after-tax loss of approximately $2 million related to the discontinued operations and disposal of Global Solar.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Reconciling adjustments consist of the elimination of intersegment revenue which were due to the following transactions:

	Reportable Segments								UniSource Energy		UniSource Energy
	TEP		UNS Gas		UNS Electric		Other		Eliminations		Consolidated
	-Millions of Dollars-										
Intersegment Revenue											
2008:											
Wholesale Sales TEP to UNSE	$	24	$		$		$		$	(24)	**$**
Wholesale Sales UNSE to TEP						9				(9)	
Wholesale Sales UED to UNSE								7		(7)	
Gas Revenue UNSG to UNSE & UED				8						(8)	
Other Revenue TEP to Affiliates(1)		8								(8)	
Other Revenue Millennium to TEP & UNSE(2)								16		(16)	
Other Revenue TEP to UNSE(3)		2								(2)	
Total Intersegment Revenue	$	34	$	8	$	9	$	23	$	(74)	**$**
2007:											
Other Revenue TEP to Affiliates(1)	$	7	$		$		$		$	(7)	**$**
Other Revenue Millennium to TEP & UNSE(2)								15		(15)	
Total Intersegment Revenue	$	7	$		$		$	15	$	(22)	**$**
2006:											
Other Revenue TEP to Affiliates(1)	$	2	$		$		$		$	(2)	**$**
Other Revenue Millennium to TEP & UNSE(2)								15		(15)	
Total Intersegment Revenue	$	2	$		$		$	15	$	(17)	**$**

(1) TEP provides corporate

services (finance, accounting, tax, information technology services, etc.) to UniSource Energy and its subsidiaries. See Note 15.

(2) A Millennium subsidiary provides a supplemental workforce and meter reading services to TEP and UNS Electric.

(3) TEP provides control area services to UNS Electric. See Note 15.

Other significant reconciling adjustments include intercompany interest between UniSource Energy and UED, the elimination of investments in subsidiaries held by UniSource Energy and reclassifications of deferred tax assets and liabilities.

Our portion of the net income (loss) of the entities in which Millennium owns a voting interest or has the ability to exercise significant influence is shown below in Net Income (Loss) from Equity Method Entities.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

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

	Reportable Segments					
2008	**TEP**	**UNS Gas**	**UNS Electric**	**All Other**	**Reconciling Adjustments**	**UniSource Energy**
				-Millions of Dollars-		
Income Statement						
Operating Revenues External	$ 1,045	$ 166	$ 186	$	$	**$ 1,397**
Operating Revenues Intersegment	34	8	9	23	(74)	
Depreciation and Amortization	126	7	14	1		**148**
Amortization of Transition Recovery Asset	24					**24**
Interest Income	10			1		**11**
Net Loss from Equity Method Entities				(2)		**(2)**
Interest Expense	101	7	7	11	(2)	**124**
Income Tax Expense (Benefit)	11	6	2	(2)		**17**
Net Income (Loss)	4	9	4	15	(18)	**14**
Cash Flow Statement						
Net Cash Flows Operating Activities	269	3	14	(9)		**277**
Net Cash Flows Investing Activities Capital Expenditures	(287)	(16)	(30)	(16)		**(349)**
Net Cash Flows Investing Activities Investments in and Loans to Equity Method Entities				(1)		**(1)**
Net Cash Flows Investing Activities Other	(104)			1		**(103)**
Net Cash Flows Financing Activities	129	1	22	(11)		**141**
Balance Sheet						
Total Assets	2,842	294	285	1,061	(972)	**3,510**
Investments in Equity Method Entities				25		**25**

	Reportable Segments					
2007	**TEP**	**UNS Gas**	**UNS Electric**	**All Other**	**Reconciling Adjustments**	**UniSource Energy**
				-Millions of Dollars-		
Income Statement						
Operating Revenues External	$ 1,064	$ 151	$ 169	$ (3)	$	**$ 1,381**

Operating Revenues						
Intersegment	7			15	(22)	
Depreciation and Amortization	120	8	13			**141**
Amortization of Transition Recovery Asset	78					**78**
Interest Income	16	1		2		**19**
Interest Expense	117	7	6	8		**138**
Income Tax Expense (Benefit)	36	3	3	(3)		**39**
Net Income (Loss)	53	4	5	(4)		**58**
Cash Flow Statement						
Net Cash Flows Operating Activities	264	28	22	9		**323**
Net Cash Flows Investing Activities Capital Expenditures	(162)	(23)	(38)	(22)		**(245)**
Net Cash Flows Investing Activities Investments in and Loans to Equity Method Entities				(1)		**(1)**
Net Cash Flows Investing Activities Other	26	1	1	1		**29**
Net Cash Flows Financing Activities	(120)	(6)	12	(3)	(2)	**(119)**
Balance Sheet						
Total Assets	2,573	276	231	1,077	(971)	**3,186**
Investments in Equity Method Entities	3			28		**31**

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

	Reportable Segments					
2006	**TEP**	**UNS Gas**	**UNS Electric**	**All Other**	**Reconciling Adjustments**	**UniSource Energy**
			-Millions of Dollars-			
Income Statement						
Operating Revenues External	$ 987	$ 162	$ 160	$ (1)	$	**$ 1,308**
Operating Revenues Intersegment	2			15	(17)	
Depreciation and Amortization	112	7	11	1		**131**
Amortization of Transition Recovery Asset	66					**66**
Interest Income	16			3		**19**
Interest Expense	127	7	5	13		**152**
Income Tax Expense (Benefit)	42	3	3	(4)		**44**
Discontinued Operations Net of Tax				(2)		**(2)**
Net Income (Loss)	67	4	5	(9)		**67**
Cash Flow Statement						
Net Cash Flows Operating Activities	227	32	14	10		**283**
Net Cash Flows Investing Activities Capital Expenditures	(156)	(23)	(39)	(20)		**(238)**
Net Cash Flows Investing Activities Investments in and Loans to Equity Method Entities				(5)		**(5)**
Net Cash Flows Investing Activities Other	(26)			23		**(3)**
Net Cash Flows Financing Activities	(79)	(4)	22	(14)	(2)	**(77)**
Balance Sheet						
Total Assets	2,623	253	195	1,038	(922)	**3,187**
Investments in Equity Method Entities	3			27		**30**

NOTE 4. ACCOUNTING FOR DERIVATIVE INSTRUMENTS, TRADING ACTIVITIES AND HEDGING ACTIVITIES

TEP INTEREST RATE SWAP

In June 2006, TEP entered into an interest rate swap to reduce the risk of unfavorable changes in variable interest rates related to changes in LIBOR. The swap has the effect of converting approximately $35 million of variable rate lease payments for the Springerville Common Facilities Lease to a fixed rate through January 1, 2020. The swap is designated as a cash flow hedge for accounting purposes. Because the changes in interest payments, resulting from changes in LIBOR, were completely offset by the interest rate swap in 2008, 2007 and 2006, there was no ineffectiveness recorded in earnings.

FUEL AND POWER TRANSACTIONS

TEP, UNS Gas and UNS Electric enter into forward contracts to purchase or sell a specified amount of capacity or energy at a specified price over a given period of time, within established limits to take advantage of favorable market opportunities and reduce exposure to energy price risk associated with their gas and purchased power requirements, volumetric risk associated with their seasonal load and operational risk associated with their power plants, transmission and transportation systems. TEP, UNS Gas and UNS Electric also have natural gas supply agreements under which each company purchases all of its gas requirements at spot market prices. In an effort to minimize price risk on these purchases and sales, TEP, UNS Gas and UNS Electric enter into gas price swap agreements under which they purchase gas at fixed prices and simultaneously sell gas at spot market prices. All of the contracts and agreements referred to in this paragraph are considered derivative instruments.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Beginning in January 2009, as a result of the 2008 TEP Rate Order, TEP is permitted to recover fuel and purchased power costs, including the prudent cost of hedging contracts, through the PPFAC. UNS Gas is currently permitted, through its PGA mechanism, to recover the prudent cost of hedging contracts. As a result, at December 31, 2008, TEP and UNS Gas reclassified unrealized gains and losses on those commodity contracts that are eligible to be recovered through the PPFAC from AOCI to regulatory assets.

The net unrealized gains and losses on these contracts reported in AOCI were as follows:

	UniSource Energy		
	2008	**2007**	**2006**
	-Millions of Dollars-		
Cash Flow Hedges Unrealized Gains (Losses)			
Forward Power Sales	**$ (7)**	$	$ 8
Gas Price Swaps	**3**	(5)	(18)
Interest Rate Swap	**(5)**	(1)	(2)
Total Pre-Tax Unrealized Gain (Loss)	**$ (9)**	$ (6)	$ (12)
After-Tax Unrealized Gain (Loss) Recorded in AOCI	**$ (5)**	$ (4)	$ (7)
Unrealized (Gain) Loss Reclassified to Net Income	**$ 2**	$ 2	$

	TEP		
	2008	**2007**	**2006**
	-Millions of Dollars-		
Cash Flow Hedges Unrealized Gains (Losses)			
Forward Power Sales	**$ (7)**	$	$ 8
Gas Price Swaps	**3**	(6)	(18)
Interest Rate Swap	**(5)**	(1)	(2)
Total Pre-Tax Unrealized Gain (Loss)	**$ (9)**	$ (7)	$ (12)
After-Tax Unrealized Gain (Loss) Recorded in AOCI	**$ (5)**	$ (4)	$ (7)
Unrealized (Gain) Loss Reclassified to Net Income	**$ 2**	$ 2	$

At December 31, 2008, TEP s interest rate swap was the only remaining cash flow hedge recognized in AOCI.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Prior to December 2008, unrealized gains and losses resulting from changes in the market prices of non-trading hedges or short-term forward power sales contracts were recorded on the same line in the income statement as the hedged transaction. Beginning in December 2008, as a result of the 2008 TEP Rate Order, which permits the recovery of prudent costs associated with hedging contracts through the PPFAC, unrealized gains and losses are recorded as either a regulatory asset or regulatory liability.

UniSource Energy and TEP record unrealized gains and losses on energy trading contracts in Wholesale Sales. In 2008 and 2007, there were no net unrealized gains and losses. In 2006, UniSource Energy and TEP had a net unrealized gain of $1 million.

The following table discloses unrealized gains and losses on energy contracts that are reported on the balance sheet as a regulatory asset or a regulatory liability rather than as a component of AOCI or in the income statement.

	UniSource Energy		
	2008	**2007**	**2006**
	-Millions of Dollars-		
Mark-to-Market Transactions (Increase) Decrease Recorded in Regulatory Accounts on the Balance Sheet			
Recorded in Current Regulatory Assets Derivatives:			
Gas Swaps	**$ 27**	$ 1	$
Forward Power Purchases	**11**		
Recorded in Current Regulatory Liabilities Derivatives:			
Forward Power Purchases	**3**	(3)	
Recorded in Other Regulatory Assets Derivatives:			
Gas Swaps	**11**		
Forward Power Purchases	**7**		
Recorded in Other Regulatory Liabilities Derivatives:			
Forward Power Purchases	**6**	(3)	(3)
Total Increase (Decrease)	**$ 65**	$ (5)	$ (3)

	TEP		
	2008	**2007**	**2006**
	-Millions of Dollars-		
Mark-to-Market Transactions (Increase) Decrease Recorded in Regulatory Accounts on the Balance Sheet			
Recorded in Current Regulatory Assets Derivatives:			
Gas Swaps	**$ 14**	$	$
Recorded in Current Regulatory Liabilities Derivatives:			
Forward Power Purchases	**(1)**		
Recorded in Other Regulatory Assets Derivatives:			
Gas Swaps	**4**		
Forward Power Purchases	**2**		
Total Increase (Decrease)	**$ 19**	$	$

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The fair value of derivative assets and liabilities were as follows:

	UniSource Energy					
	December 31, 2008			December 31, 2007		
	Mark-to-Market Contracts	Cash Flow Hedge	Total	Mark-to-Market Contracts	Cash Flow Hedges	Total
	-Millions of Dollars-					
Current Assets	**$ 3**	**$**	**$ 3**	$ 4	$ 1	$ 5
Current Liabilities	**(41)**		**(41)**	(1)	(2)	(3)
Net Current Assets (Liabilities)	**$ (38)**	**$**	**$ (38)**	$ 3	$ (1)	$ 2
Noncurrent Assets	**$ 3**	**$**	**$ 3**	$ 8	$	$ 8
Noncurrent Liabilities	**(22)**	**(8)**	**(30)**	(2)	(3)	(5)
Net Noncurrent Assets (Liabilities)	**$ (19)**	**$ (8)**	**$ (27)**	$ 6	$ (3)	$ 3

	TEP					
	December 31, 2008			December 31, 2007		
	Mark-to-Market Contracts	Cash Flow Hedge	Total	Mark-to-Market Contracts	Cash Flow Hedges	Total
	-Millions of Dollars-					
Current Assets	**$ 5**	**$**	**$ 5**	$ 1	$ 1	$ 2
Current Liabilities	**(19)**		**(19)**	(1)	(2)	(3)
Net Current Assets (Liabilities)	**$ (14)**	**$**	**$ (14)**	$	$ (1)	$ (1)
Noncurrent Assets	**$ 5**	**$**	**$ 5**	$	$	$
Noncurrent Liabilities	**(11)**	**(8)**	**(19)**		(3)	(3)
Net Noncurrent Assets (Liabilities)	**$ (6)**	**$ (8)**	**$ (14)**	$	$ (3)	$ (3)

As cash collateral is disclosed separately in the balance sheet, the above balances exclude any cash collateral posted with counterparties.

At December 31, 2008, TEP and UNS Electric had contracts that will settle through the fourth quarter of 2013. UNS Gas had contracts that will settle through the first quarter of 2012. Amounts presented, above, as Net Current Assets (Liabilities), are expected to be reclassified into earnings within the next twelve months.

Credit Risk Adjustment

When the fair value of our derivative contracts are reflected as an asset, the counterparty owes us and this creates credit risk. We minimize our credit risk by (1) entering into transactions with high-quality counterparties, (2) limiting our exposure to each counterparty, (3) monitoring the financial condition of the counterparties and (4) requiring collateral in accordance with the counterparty master agreements. Using a combination of market credit default swap data and historical recovery rates for subordinated bonds, we consider the impact of counterparty credit worthiness in determining the fair value of our derivatives as well as its possible effect on continued qualification for cash flow hedge accounting. At December 31, 2008, the impact of counterparty credit risk on the fair value of derivative asset contracts was less than $0.5 million.

We also consider the impact of our own credit risk on instruments that are in a net liability position, after deducting collateral posted, using market credit default swap data and allocate the credit risk adjustment to all individual contracts in a net liability position. The impact of our own credit risk was less than $0.5 million.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The settlement of forward purchased power and sales trading contracts entered into to reduce exposure to changes in energy and commodity prices were reflected in the financial statements of UniSource Energy and TEP as follows:

	2008	2007	2006
		-Millions of Dollars-	
Recorded in Wholesale Sales:			
Forward Power Sales	**$ 80**	$ 61	$ 73
Forward Purchased Power	**(79)**	(62)	(71)
Net Impact in Wholesale Sales	**$ 1**	$ (1)	$ 2

The settlement of forward purchased power and sales contracts that do not result in physical delivery were reflected in the financial statements of UniSource Energy and TEP as follows:

	2008	2007	2006
		-Millions of Dollars-	
Recorded in Wholesale Sales:			
Forward Power Sales	**$ 30**	$ 28	$ 6
Forward Purchased Power	**(30)**	(28)	(6)

MEG TRADING TRANSACTIONS

MEG, a wholly-owned subsidiary of Millennium, entered into swap agreements, options and forward contracts relating to SO_2 emission allowances. In December 2007, MEG settled its outstanding trading positions. MEG had no derivative assets or liabilities at December 31, 2008 and December 31, 2007. MEG is not expected to have any further activities and is in the process of being dissolved. MEG had no gain or loss from trading activities in 2008 or 2007, and a net loss of less than $1 million in 2006.

CONCENTRATION OF CREDIT RISK

The use of contractual arrangements to manage the risks associated with changes in energy commodity prices creates credit risk exposure resulting from the possibility of nonperformance by counterparties pursuant to the terms of their contractual obligations. TEP, UNS Gas and UNS Electric enter into contracts for the physical delivery of energy and gas which contain remedies in the event of non-performance by the supply counterparties. In addition, volatile energy prices can create significant credit exposure from energy market receivables and mark-to-market valuations.

As of December 31, 2008, TEP had total credit exposure to other counterparties of $27 million related to its wholesale marketing and gas hedging activities, of which two counterparties individually composed greater than 10% of the total credit exposure. UNS Gas and UNS Electric had no credit exposure to other counterparties.

To provide credit enhancements for forward energy purchase contracts and hedging activities TEP, posted credit enhancements of $1 million with counterparties exposed to TEP. UNS Gas and UNS Electric each posted cash collateral of $7 million and letters of credit of $10 million and $7 million, respectively.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
NOTE 5. COMMITMENTS AND CONTINGENCIES
TEP COMMITMENTS

At December 31, 2008, TEP had various firm non-cancelable purchase commitments and operating leases as described in the table below.

	Purchase Commitments						
	2009	2010	2011	2012	2013	Thereafter	Total
	-Millions of Dollars-						
Fuel (including Transportation)	$ 148	$ 101	$ 57	$ 43	$ 39	$ 181	$ 569
Purchased Power	37	3	3	3	2	2	50
Transmission	2	2	2	2	2	5	15
Total Firm Purchase Commitments	187	106	62	48	43	188	634
Operating Lease Payments	1	1					2
Total Unrecognized Firm Commitments	$ 188	$ 107	$ 62	$ 48	$ 43	$ 188	$ 636

Fuel and Purchased Power Contracts

TEP has long-term contracts for the purchase and delivery of coal and natural gas with various expiration dates from 2009 through 2020. Amounts paid under these contracts depend on actual quantities purchased and delivered. Some of these contracts (i) include a price adjustment clause that will affect the future cost and (ii) require TEP to pay a take-or-pay charge or liquidated damages if certain minimum quantities are not purchased and/or transported. TEP expects to spend more to meet its fuel requirements than the minimum purchase obligations outlined above. TEP paid $233 million in 2008, $209 million in 2007, and $186 million in 2006 for the purchase and delivery of coal and natural gas.

TEP has entered into agreements with utilities and other energy suppliers for purchased power to meet system load and energy requirements, replace generation from company-owned units under maintenance and during outages, and meet operating reserve obligations. In general, these contracts provide for capacity payments and energy payments based on actual power taken under the contracts. These contracts expire in various years between 2009 and 2014. Certain of these contracts are at a fixed price per MW and others are indexed to natural gas prices. The commitment amounts included in the table are based on projected market prices as of December 31, 2008. TEP paid $91 million in 2008, $40 million in 2007, and $17 million in 2006 for purchased power under non-cancelable contracts.

TEP paid $2 million for transmission contracts in each of 2008, 2007, and 2006.

Starting January 1, 2009, fuel and purchased power costs are recoverable from customers through a PPFAC.

Operating Leases

TEP s aggregate operating lease expense, which is primarily for office facilities and computer equipment, with varying terms, provisions, and expiration dates, totaled $1 million in 2008 and $2 million in each of the years 2007 and 2006.

Environmental Regulation

Federal Clean Air Act Amendments

TEP generating facilities are subject to EPA limits on the amount of sulfur dioxide (SO_2) and nitrogen oxide (NOx) emissions into the atmosphere. TEP capitalized $73 million in 2008, $7 million in 2007 and $1 million in 2006 in construction costs to comply with environmental requirements and expects to capitalize $20 million in 2009 and $7 million in 2010, including TEP s share of new pollution control equipment being installed at San Juan described below. In addition, TEP recorded operating expenses of $14 million in 2008, $10 million in 2007 and 2006 related to environmental compliance. TEP expects environmental expenses to be $13 million in 2009.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

As a result of a 2005 settlement agreement between PNM, environmental activist groups, and the New Mexico Environment Department (PNM Consent Decree), the co-owners of San Juan are installing new pollution control equipment at the generating station to reduce mercury, particulate matter, NOx, and SO_2 emissions. TEP owns 50% of San Juan Units 1 and 2. The PNM Consent Decree includes stipulated penalties for non-compliance with specified emissions limits at San Juan. TEP s share of stipulated penalties at San Juan was $1 million in 2008, $2 million in 2007, and less than $0.5 million in 2006. TEP can not deduct these penalties for income tax purposes. TEP does not expect to incur any stipulated penalties at San Juan in 2009. The installation of new pollution control equipment designed to remedy all emission violations was completed in 2008 for San Juan Unit 1 and is expected to be completed at San Juan Unit 2 in early 2009.

In 1993, the EPA allocated TEP s generating units SO_2 Emission Allowances based on past operational history. Beginning in 2000, TEP s generating units were required to hold SO_2 Emission Allowances equal to the level of emissions in the compliance year or pay penalties and offset excess emissions in future years. To date, TEP has had sufficient SO_2 Emission Allowances to comply with the SO_2 regulations.

Mercury Emissions

In 2005, the EPA adopted the Clean Air Mercury Rule (CAMR), a cap and trade regulation relating to mercury emissions, requiring states to develop rules for implementing the federal requirements. Arizona adopted its mercury emission rules in 2007. In order to comply with the CAMR or Arizona s current mercury rules, emission control equipment may be required at Springerville by 2013. TEP expects the associated capital costs for this equipment to be approximately $6 million for Springerville Units 1 and 2. If the emission control equipment is installed, TEP expects the annual operating expenses to be approximately $3 million, once all installations are completed.

In February 2008, the D.C. Circuit Court of Appeals vacated the CAMR. Unless and until this decision is overturned, the law in effect prior to the adoption of the CAMR becomes the applicable law, and requires the EPA to develop an emission limit for mercury that represents the maximum achievable control technology. It is expected to take the EPA at least two years to establish such a standard, followed by a period of three years during which existing plants would implement any controls needed to comply with the standard.

As of January 31, 2009, TEP and ADEQ reached an agreement that improves regulatory certainty regarding mercury compliance obligations under existing Arizona rules, while achieving mercury reductions substantially similar to those that would be required by the existing Arizona rules. This agreement relates to the Springerville and Sundt generating stations.

Depending on the rulemaking schedule for developing either the federal or state standards, emission controls may be required at some or all coal fired units by 2013 or later. As stipulated in the PNM Consent Decree described above, the co-owners of San Juan are installing new pollution control equipment at the generating station to reduce mercury emissions. Mercury emissions controls for San Juan Units 1 and 2 must be installed by December 31, 2009. TEP will continue to review and comply with any changes to federal and state regulations. Changes to the regulations could result in the need for different emission control equipment with different capital and operating costs than those currently expected.

Climate Change

Based on the competing proposals to regulate greenhouse gas emissions by federal, state, and local regulatory bodies and uncertainty in the regulatory process, the scope of such regulations and their affect on our operations cannot be determined.

Regional Haze

The EPA s regional haze rules require emission controls known as Best Available Retrofit Technology (BART) for certain industrial facilities emitting air pollutants that reduce visibility. The operators of the Four Corners, Navajo, and San Juan generating stations submitted BART analyses in 2007 and early 2008. PNM, operator of San Juan, believes the controls being installed at San Juan as a result of the 2005 settlement agreement between PNM, environmental activist groups, and the New Mexico Environment Department (PNM Consent Decree) constitute BART and did not recommend installation of any additional pollution control equipment. The operators of the Four Corners and Navajo generating stations recommended installing certain additional pollution control equipment in their respective BART analyses. The level and cost of pollution control required, if any, will not be known until the plans are approved by the regulatory agencies. If required, controls would need to be in place by 2013 or later.

TEP may incur additional costs to comply with future changes in federal and state environmental laws, regulations and permit requirements at existing electric generating facilities. Compliance with these changes may reduce operating efficiency.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
UNS GAS and ELECTRIC COMMITMENTS

At December 31, 2008, UNS Gas had various firm non-cancelable purchase commitments as described in the table below.

	Purchase Commitments						
	2009	2010	2011	2012	2013	Thereafter	Total
	-Millions of Dollars-						
Total Unrecognized Firm Commitments Fuel	$ 64	$ 42	$ 23	$ 4	$ 7	$ 19	$ 159

UNS Gas purchases gas from various suppliers at market prices. However, UNS Gas risk of loss due to increased costs (as a result of changes in the market price of fuel) is mitigated through the use of the PGA, which provides for pass-through of most fuel costs to customers. UNS Gas forward gas purchase agreements expire through 2012. UNS Gas has firm transportation agreements with capacity sufficient to meet its load requirements. These contracts expire in various years between 2011 and 2023. UNS Gas paid $55 million in 2008, $13 million in 2007, and $10 million in 2006 for gas and transportation under committed contracts.

At December 31, 2008, UNS Electric had various firm non-cancelable purchase commitments as described in the table below.

	Purchase Commitments						
	2009	2010	2011	2012	2013	Thereafter	Total
	-Millions of Dollars-						
Fuel (including Transportation)	$ 20	$ 9	$ 2	$	$	$	$ 31
Purchased Power	41	30	13	8	7		99
Transmission	2	2	1				5
Total Unrecognized Firm Commitments	$ 63	$ 41	$ 16	$ 8	$ 7	$	$ 135

Since UNS Electric s all-requirements purchased power contract expired in May 2008, UNS Electric has entered into agreements with various energy suppliers for purchased power at market prices to meet energy requirements. In general, these contracts provide for capacity payments and energy payments based on actual power taken under the contracts. These contracts expire in various years through 2013. Certain of these contracts are at a fixed price per MW and others are indexed to natural gas prices. The commitment amounts included in the table above are based on market prices as of December 31, 2008. UNS Electric paid $53 million in 2008 for purchased power under these contracts.

UNS Electric imports the power it purchases over the Western Area Power Administration s (WAPA) transmission lines. UNS Electric s transmission capacity agreements with WAPA provide for annual rate adjustments and expire in 2011 and 2017. However, the effects of both purchased power and transmission cost adjustments are mitigated through a purchased power rate-adjustment mechanism. UNS Electric paid $7 million in 2008, $7 million in 2007, and $8 million in 2006 for transmission under committed contracts.

In addition, UNS Gas and UNS Electric s combined operating lease expense, which is primarily for office facilities and computer equipment, with varying terms, provisions, and expiration dates was $1 million in each of the years 2008, 2007 and 2006. UNS Gas and UNS Electric s estimated future minimum payments under non-cancelable operating leases are approximately $1 million per year from 2009 to 2011 and $1 million thereafter.

See Note 7 for a description of the UNS Gas and UNS Electric long-term debt.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
MILLENNIUM COMMITMENTS
Millennium has a remaining obligation to fund investments for capital and operations of less than $1 million over the next 4 years.
TEP CONTINGENCIES
El Paso Electric Transmission
In 2006, El Paso filed a complaint at the FERC claiming that TEP must request service under El Paso s Open Access Transmission Tariff (OATT) in order to transmit power from Luna to TEP s system. TEP filed a counter complaint stating that TEP has existing rights under a 1982 Tucson-El Paso Transmission Agreement and, therefore, is not required to pay for transmission service under El Paso s OATT. On November 13, 2008, the FERC issued an order supporting TEP s position. In December 2008, El Paso refunded to TEP $10 million paid for transmission service from Luna during the pendency of this dispute and interest of $1 million. On January 14, 2009, FERC granted El Paso s request for a rehearing of this matter. TEP deferred recognition of a reduction in transmission expense pending resolution of the appeals process and is no longer accruing for transmission service under El Paso s OATT.
On December 30, 2008, TEP filed a complaint in the United States Federal District Court against El Paso seeking a $2 million reimbursement from El Paso for transmission charges paid by TEP to PNM because of the El Paso dispute. On February 23, 2009, El Paso filed a motion to dismiss TEP s complaint, or in the alternative, requested a stay in the proceeding pending further resolution by FERC. TEP intends to a file a response requesting that the court deny El Paso s motion. TEP s response is due on March 12, 2009. TEP cannot predict the timing or outcome of this lawsuit.
Claims Related to Navajo Generating Station

In June 1999, the Navajo Nation filed suit against Salt River Project, several Peabody Coal Company entities (including Peabody Western Coal Company, the coal supplier to Navajo Generating Station), Southern California Edison Company, and other defendants in the U.S. District Court for the District of Columbia (D.C. Lawsuit). The D.C. Lawsuit alleges, among other things, that the defendants obtained a favorable coal royalty rate of the lease agreements under which Peabody mines coal by improperly influencing the outcome of a federal administrative process pursuant to which the royalty rate was to be adjusted. The suit seeks $600 million in damages, treble damages, and punitive damages of not less than $1 billion, and the ejection of defendants from all possessory interests and Navajo Tribal lands arising out of the primary coal lease. In July 2001, the U.S. District Court dismissed all claims against Salt River Project. In March 2008, the U.S. District Court lifted a stay that had been in place since October 2004 and referred pending discovery related motions to a Magistrate judge. The Magistrate filed his Report and Recommendations on June 13, 2008 and the Navajo thereafter sought judicial review of the Magistrate s Report and Recommendations by filing an Objection with the District Court on June 27, 2008. The matter was fully briefed and parties are awaiting the Judge s decision.

In 2004, Peabody Western Coal Company (Peabody) filed a complaint in the Circuit Court for the City of St. Louis, Missouri against the participants at Navajo, including TEP (7.5% owner), for reimbursement of royalties and other costs arising out of the D.C. Lawsuit. In July 2008, the parties entered into a joint stipulation of dismissal of these claims which was approved by the Circuit Court. TEP cannot predict whether the lawsuit will be refiled based upon the final outcome of the D.C. Lawsuit.

Claims Related to San Juan Coal Company
San Juan Coal Company, the coal supplier to San Juan, through leases with the federal government and the State of New Mexico, owns coal interests with respect to an underground mine. Certain gas producers have oil and gas leases with the federal government, the State of New Mexico and private parties in the area of the underground mine. These gas producers allege that San Juan Coal Company s underground coal mining operations have or will interfere with their gas production and will reduce the amount of natural gas that they would otherwise be entitled to recover. San Juan Coal Company has compensated certain gas producers for any remaining gas production from a well when it was

determined that mining activity was close enough to warrant shutting down the well. These settlements, however, do not resolve all potential claims by gas producers in the underground mine area. TEP cannot estimate the impact of any future claims by these gas producers on the cost of coal at San Juan.

Environmental Reclamation at Remote Generating Stations

TEP currently pays on-going reclamation costs related to the coal mines which supply the remote generating stations, and it is probable that TEP will have to pay a portion of final reclamation costs upon mine closure. When a reasonable estimate of final reclamation costs is available, the liability is recognized as a cost of coal over the remaining term of the corresponding coal supply agreement. At December 31, 2008, TEP has recorded a liability of $9 million based on our $17 million obligation at the expiration dates of the coal supply agreements in 2011 through 2017. At December 31, 2007, TEP had recorded a liability of $4 million. See *Resolution of TEP Contingencies Navajo Generating Station* below.

TEP s PPFAC, as approved in the 2008 TEP Rate Order, allows TEP to pass-through most fuel costs, including final reclamation costs, to customers. Therefore, in 2008, when TEP reapplied FAS 71 to its generation operations, TEP reclassified these costs from fuel expense to a regulatory asset. TEP will increase the regulatory asset and the liability over the remaining life of the coal supply agreements on an accrual basis, and will recover the regulatory asset through the PPFAC as final mine reclamation costs are paid to the coal suppliers.

Amounts recorded for final reclamation are subject to various assumptions, such as estimating the costs of reclamation, when final reclamation will occur, and the credit-adjusted risk-free interest rate to be used to discount future liabilities. As these assumptions change, TEP will prospectively adjust the expense amounts for final reclamation over the remaining coal supply agreement term. TEP does not believe that recognition of its final reclamation obligations will be material to TEP in any single year because recognition occurs over the remaining terms of its coal supply agreements.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

TEP Wholesale Accounts Receivable and Allowances

TEP s Accounts Receivable from Electric Wholesale Sales includes $16 million of receivables at December 31, 2008 and December 31, 2007 related to sales to the California Power Exchange (CPX) and the California Independent System Operator (CISO) in 2001 and 2000. To ensure that TEP is adequately reserved for its transactions with the CPX and the CISO, TEP increased its Allowance for Doubtful Accounts by $0.5 million in 2008. The recognized reserve balance at December 31, 2008 and at December 31, 2007 was $14 million and $13 million respectively. There are several outstanding legal issues, complaints and lawsuits concerning the California energy crisis related to the FERC, wholesale power suppliers, Southern California Edison Company, Pacific Gas and Electric Company, the CPX and the CISO. We cannot predict the outcome of these issues or lawsuits.

Tucson to Nogales Transmission Line

TEP and UNS Electric are parties to a project development agreement for the joint construction of an approximately 60-mile transmission line from Tucson to Nogales, Arizona. UNS Electric s participation in this project was initiated in response to an order by the ACC to improve reliability to UNS Electric s retail customers in Nogales, Arizona.

In 2002, the ACC approved the location and construction of the proposed 345-kV line along a route identified as the Western Corridor route subject to a number of conditions, including obtaining all required permits from state and federal agencies. The U.S. Forest Service subsequently identified a preference for a route identified as the Central Corridor route in the final Environmental Impact Statement for the project. TEP is considering options for the project including potential new routes. If a decision is made to pursue an alternative route, approvals will be needed from the ACC, the Department of Energy, U.S. Forest Service, Bureau of Land Management, and the International Boundary and Water Commission. As of December 31, 2008, TEP had capitalized $11 million related to the project, including $2 million of land and land rights. If TEP does not receive the required approvals or abandons the project, TEP believes there is a high likelihood of cost recovery for prudent and reasonably incurred costs related to the project as a consequence of the ACC s requirement for a second transmission line serving the Nogales, Arizona area.

RESOLUTION OF TEP CONTINGENCIES Navajo Generating Station

In 2004, Peabody Western Coal Company (Peabody), the coal supplier to the Navajo Generating Station, filed a complaint in the Circuit Court for the City of St. Louis, Missouri against the participants at Navajo, including TEP (7.5% owner), for reimbursement of royalties and other costs and breach of the coal supply agreement. In July 2008, the parties entered into a joint stipulation of dismissal of these claims which was approved by the court. TEP had not recorded a liability for these claims.

In addition, in 1996, SRP filed a lawsuit in Maricopa County Superior Court on behalf of the participants at Navajo, including TEP, seeking declaratory judgment that the Navajo participants are not responsible for postretirement benefit costs payable to the coal supplier s employees and final reclamation costs after the coal supply agreement expires and the mine closes. The Navajo participants and Peabody entered into a settlement agreement, which was approved by the court in the third quarter of 2008, and thereafter dismissed the lawsuit with prejudice. As a result of this settlement agreement, TEP recorded the present value of its share of the postretirement benefit costs, totaling $6 million, and final reclamation costs, totaling $3 million, as fuel expense in the third quarter. In December 2008, when TEP reapplied FAS 71 to its generation operations (see Note 2), TEP reclassified these expenses from fuel expense to a regulatory asset as the ACC permits recovery of mine reclamation and retiree health care costs in rates. TEP will increase its regulatory asset and increase its liabilities over the remaining life of the coal supply agreement on an accrual basis. TEP will recover the regulatory asset through the PPFAC as the final mine reclamation and retiree health care costs are invoiced by the miner (cash basis). TEP will pay its share of the settlement as coal is purchased in the future with an estimated annual cash impact of approximately $1 million per year from 2008 to 2026.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
GUARANTEES AND INDEMNITIES

In the normal course of business, UniSource Energy and certain subsidiaries enter into various agreements providing financial or performance assurance to third parties on behalf of certain subsidiaries. We enter into these agreements primarily to support or enhance the creditworthiness of a subsidiary on a stand-alone basis. The most significant of these guarantees are:

- UES guarantee of senior unsecured notes issued by UNS Gas ($100 million) and by UNS Electric ($100 million),
- UES guarantee of the $60 million UNS Gas/UNS Electric Revolver, and
- UniSource Energy s guarantee of approximately $2 million in building lease payments for UNS Gas.

To the extent liabilities exist under these contracts, the liabilities are included in our consolidated balance sheets.

In addition, we have indemnified the purchasers of interests in certain investments from additional taxes due for years before the sale of such investments. The terms of the indemnifications do not include a limit on potential future payments; however, we believe that we have abided by all tax laws and paid all tax obligations. We have not made any payments under the terms of these indemnifications to date.

We believe that the likelihood UniSource Energy or UES would be required to perform or otherwise incur any significant losses under any of these guarantees or indemnities is remote.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
NOTE 6. UTILITY PLANT AND JOINTLY-OWNED FACILITIES
UTILITY PLANT

The following table shows Utility Plant in Service by company and major class.

	December 31, 2008 -Millions of Dollars-				
	TEP	UNS Gas	UNS Electric	UED	UniSource Energy
Plant in Service:					
Electric Generation Plant	$ 1,398	$	$ 17	$ 58	$ 1,473
Electric Transmission Plant	660		29	4	693
Electric Distribution Plant	1,044		163		1,207
Gas Distribution Plant		201			201
Gas Transmission Plant		18			18
General Plant	173	14	9		196
Intangible Plant	71	1	4		76
Electric Plant Held for Future Use	5		1		6
Total Plant in Service	$ 3,351	$ 234	$ 223	$ 62	$ 3,870
Utility Plant under Capital Leases	$ 701	$	$ 1	$	$ 702

	December 31, 2007 -Millions of Dollars-			
	TEP	UNS Gas	UNS Electric	UniSource Energy
Plant in Service:				
Electric Generation Plant	$ 1,343	$	$ 17	$ 1,360
Electric Transmission Plant	580		28	608
Electric Distribution Plant	985		143	1,128
Gas Distribution Plant		185		185
Gas Transmission Plant		18		18
General Plant	162	12	10	184
Intangible Plant	69	1	7	77
Electric Plant Held for Future Use	5	1		6
Total Plant in Service	$ 3,144	$ 217	$ 205	$ 3,566
Utility Plant under Capital Leases	$ 701	$	$ 1	$ 702

Intangible Plant primarily represents computer software costs. TEP s unamortized computer software costs were $29 million as of December 31, 2008 and $34 million as of December 31, 2007. UNS Gas and UNS Electric had unamortized computer software costs of $1 million as of December 31, 2008 and as of December 31, 2007.

All TEP Utility Plant under Capital Leases is used in TEP s generation operations and amortized over the primary lease term as described in Note 7. The amortization expense on capital lease assets was $25 million in each of 2008 and 2007 and $26 million in 2006.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The following table reconciles the gross investment in utility plant to net investment in utility plant, segregated between regulated and non-regulated utility plant.

	December 31, 2008						
	TEP			UNS Gas	UNS Electric	UED	UniSource Energy
	T&D	Gen*	Total Plant	Total Plant	Total Plant	Plant	Total Plant
	-Millions of Dollars-						
Gross Plant in Service	$ 1,953	$ 1,398	$ 3,351	$ 234	$ 223	$ 62	$ 3,870
Less Accumulated Depreciation and Amortization	865	667	1,532	9	39	1	1,581
Net Plant in Service	$ 1,088	$ 731	$ 1,819	$ 225	$ 184	$ 61	$ 2,289

	December 31, 2007							
	TEP			UNS Gas	UNS Electric	UniSource Energy		
	T&D	Gen*	Total Plant	Total Plant	Total Plant	All Other	TEP Gen*	Total Plant
	-Millions of Dollars-							
Gross Plant in Service	$ 1,801	$ 1,343	$ 3,144	$ 217	$ 205	$ 2,223	$ 1,343	$ 3,566
Less Accumulated Depreciation and Amortization	836	654	1,490	5	39	880	654	1,534
Net Plant in Service	$ 965	$ 689	$ 1,654	$ 212	$ 166	$ 1,343	$ 689	$ 2,032

* The category Gen includes the generation assets. Beginning December 1, 2008, the ACC sets rates on a cost-of-service basis and as such TEP s generation operations are now accounted for under the

provisions of FAS 71. Prior to December 1, 2008, generation assets were not accounted for under FAS 71. Rates for the remaining utility operations appearing in this table are set by the ACC on a cost-of-service basis, and are accounted for under the provisions of FAS 71 for all periods. The category T&D includes all transmission and distribution Plant in Service.

The depreciable lives currently used are as follows:

Major Class of Utility Plant in Service	**TEP**	**UNS Gas, UNS Electric & UED**
Electric Generation Plant	20-71 years	38-49 years
Electric Transmission Plant	10-50 years	20-50 years
Electric Distribution Plant	27-60 years	23-50 years
Gas Distribution Plant	n/a	30-55 years
General Plant	5-30 years	30-65 years
Intangible Plant	3-15 years	5-40 years

See *TEP Utility Plant* in Note 1 and *TEP Capital Lease Obligations* in Note 7.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
JOINTLY-OWNED FACILITIES

At December 31, 2008, TEP s interests in jointly-owned generating stations and transmission systems were as follows:

	Ownership Percentage	Plant in Service	Construction Work in Progress	Accumulated Depreciation
		-Millions of Dollars-		
San Juan Units 1 and 2	50.0%	$ 353	$ 44	$ 223
Navajo Station Units 1, 2 and 3	7.5	134	3	80
Four Corners Units 4 and 5	7.0	89	1	65
Transmission Facilities	7.5 to 95.0	247		169
Luna Energy Facility	33.3	49	3	3
Total		$ 872	$ 51	$ 540

TEP has financed or provided funds for the above facilities and TEP s share of their operating expenses is reflected in the income statements. See Note 5 for commitments related to TEP s jointly-owned facilities.

NOTE 7. DEBT, CREDIT FACILITIES, AND CAPITAL LEASE OBLIGATIONS

Long-term debt matures more than one year from the date of the financial statements. We summarize UniSource Energy and TEP s long-term debt in the statements of capitalization.

UNISOURCE ENERGY DEBT

Convertible Senior Notes

In March 2005, UniSource Energy issued $150 million of 4.50% Convertible Senior Notes (Convertible Senior Notes) due 2035. The Convertible Senior Notes are unsecured and are not guaranteed by TEP or any other UniSource Energy subsidiary. Each $1,000 of Convertible Senior Notes is convertible into 27.033 shares of UniSource Energy Common Stock at any time, representing a conversion price of approximately $36.99 per share of our Common Stock, subject to adjustment in certain circumstances.

Beginning on March 5, 2010, UniSource Energy will have the option to redeem the Convertible Senior Notes, in whole or in part, for cash at a price equal to 100% of the principal amount plus accrued interest. Holders of the Convertible Senior Notes may require UniSource Energy to repurchase the Convertible Senior Notes, in whole or in part, for cash on March 1, 2015, 2020, 2025 and 2030, or if certain change of control transactions occur, or if our common stock is no longer listed on a national securities exchange. The repurchase price will be 100% of the principal amount of the Convertible Senior Notes plus accrued interest.

TEP DEBT

Collateral Trust Bonds

In 1998, TEP issued a total of $140 million, 7.5% Collateral Trust Bonds, due August, 2008. TEP retired these bonds in 2008. See Pima A and Pima B Bonds below.

Pima A Bonds

In March 2008, The Industrial Development Authority of Pima County (Pima Authority) issued, for the benefit of TEP, approximately $91 million of its 2008 Series A tax-exempt, unsecured, 6.375% bonds (Pima A Bonds) due September 1, 2029. The proceeds were used to redeem a corresponding principal amount of bonds previously issued by the Pima Authority for TEP s benefit, which TEP repurchased in 2005. In 2005, TEP did not cancel the repurchased bonds, which remained outstanding under their respective indentures but were not reflected as debt on the balance sheet. As holder of the repurchased bonds, TEP received the payment of the redemption price.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

TEP used the redemption proceeds to repay $75 million in revolving loans outstanding under its revolving credit facility. The remaining proceeds were used in May 2008 to redeem $10 million of the $138 million 7.5% Collateral Trust Bonds due August 2008. TEP capitalized $1 million of costs related to the issuance of the 2008 Pima A Bonds and will amortize these costs through August 2029, the term of the bonds.

Interest on the 2008 Pima A Bonds is payable semi-annually, commencing on September 1, 2008.

Beginning in March 2013, TEP will have the option to redeem the 2008 Pima A Bonds, in whole or in part, for cash, at a price equal to 100% of the principal amount, plus accrued interest.

Pima B Bonds

In June 2008, the Pima Authority issued for TEP s benefit, $130 million of its 2008 Series B tax-exempt variable rate IDBs (Pima B Bonds) due September 1, 2029. The 2008 Pima B Bonds are supported by a letter of credit (LOC) issued under the TEP 2008 Letter of Credit Facility. The LOC is secured by $132 million of 1992 Mortgage Bonds and expires April 30, 2011. The proceeds were used to redeem a corresponding principal amount of bonds previously issued by the Pima Authority for TEP s benefit which TEP repurchased in 2005. TEP did not cancel the repurchased bonds, which remained outstanding under their respective indentures but were not reflected as debt on the balance sheet. As holder of the repurchased bonds being redeemed, TEP received the payment of the redemption price.

TEP deposited the redemption proceeds with the trustee for its 7.5% Collateral Trust Bonds. In August 2008, the deposit was applied to the payment of $128 million of principal plus $5 million of accrued interest on such bonds at maturity.

TEP was required to deposit these funds with the trustee pursuant to amendments dated May 30, 2008 to the TEP Credit Agreement and the 2008 TEP Letter of Credit Facility. These amendments allowed TEP to exclude the $128 million of Collateral Trust Bonds to be retired in August 2008 from Total Indebtedness for the calculation of its leverage ratio covenant at June 30, 2008.

TEP capitalized $1 million of costs related to the issuance of the 2008 Pima B Bonds and will amortize these costs through August 2029.

The 2008 Pima B Bonds accrue interest at a rate which resets weekly unless and until the interest rate mode is converted to another permitted interest rate mode, such as a term rate. The average weekly interest rate on TEP s Pima B Bonds ranged from 0.50% to 8.25%, with an average rate of 2.03% for 2008. The peak weekly rate of 8.25% occurred in mid-September 2008, when the short-term debt markets began to experience significant disruptions related to the creditworthiness of several large financial institutions. As of December 31, 2008, the rate on this debt was 0.75%. TEP pays a remarketing fee of 10 basis points (bps) to the remarketing agent of the bonds, an LOC fee of 65 bps to the lenders, and an LOC issuing fee of 12.5 bps to the issuing bank.

1992 Mortgage

TEP s 1992 Mortgage creates liens on and security interests in most of TEP s utility plant assets, with the exception of Springerville Unit 2. San Carlos Resources Inc., a wholly-owned subsidiary of TEP, holds title to Springerville Unit 2. Utility Plant under Capital Leases is not subject to such liens or available to TEP creditors, other than the lessors. The net book value of TEP s utility plant subject to the lien of the indenture was approximately $1 billion at December 31, 2008.

TEP CAPITAL LEASE OBLIGATIONS

The terms of TEP s capital leases are as follows:

- The Sundt Lease has an initial term to January 2011 and provides for renewal periods of two or more years through 2020.

- The Springerville Common Facilities Leases have an initial term to December 2017 for one lease and January 2021 for the other two leases, subject to optional renewal periods of two or more years through 2025.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The Springerville Unit 1 Leases have an initial term to January 2015 and provide for renewal periods of three or more years through 2030.

The Springerville Coal Handling Facilities Leases have an initial term to April 2015 and provide for one renewal period of six years, then additional renewal periods of five or more years through 2035.

TEP has agreed with the owners of Springerville Units 3 and 4 that, upon expiration of the Springerville Coal Handling Facilities and Common Leases, TEP will acquire the leased interest in the facilities at fixed prices of $120 million in 2015, $38 million in 2017, and $68 million in 2021. Upon such acquisitions by TEP, each of the owners of Unit 3 and Unit 4 have the obligation to purchase or continue renting from TEP a 17% and 14% interest, respectively, in such facilities. On or before the Sundt and Springerville Unit 1 Lease expiration dates, TEP will determine if it will purchase the assets at the fair market value or renegotiate the lease terms.

In January 2009, through scheduled lease payments, TEP reduced its capital lease obligation by $14 million.

Investments in Springerville Lease Debt and Equity

TEP held an undivided equity ownership interest in Springerville Unit 1 lease totaling $48 million at December 31, 2008 and at December 31, 2007. TEP held an investment in Springerville Unit 1 lease debt totaling $59 million at December 31, 2008 and $71 million at December 31, 2007. TEP also held an investment in Springerville Coal Handling Facilities lease debt totaling $20 million at December 31, 2008 and $34 million at December 31, 2007.

Springerville Common Lease Debt Refinancing

In 1985, TEP sold and leased back its undivided one-half ownership interest in the common facilities at the Springerville Generating Station. TEP refinanced the lease debt totaling $68 million in June 2006, and the leases were amended to remove the requirement that the notes be periodically refinanced to avoid the occurrence of a special event of loss. The lease debt now matures when the leases expire. Interest is payable at LIBOR plus 1.5% through 2009. Thereafter, the spread over LIBOR increases by 0.125% every three years, to 2% by June 2018. Prior to the refinancing, the interest rate was LIBOR plus 4%. The refinancing had no impact on the Springerville Common Facilities capital lease obligation or asset.

A portion of the rent payable by TEP pursuant to the Springerville Common Facilities Leases is determined by the amount of interest payable on the underlying floating rate lease debt. In June 2006, TEP entered into an interest rate swap to hedge a portion of the interest rate risk associated with the portion of rent determined by the interest rate on this debt. This swap has the effect of fixing the interest portion of rent at a rate of 7.27% on a portion of the principal balance, which was $35 million as of December 31, 2008. The interest rate swap has been recorded by TEP as a cash flow hedge for financial reporting purposes. See Note 4.

UNS ELECTRIC LONG-TERM DEBT

In August, 2008, UNS Electric issued $100 million of senior unsecured debt; $50 million at 6.5%, due 2015 and $50 million at 7.1%, due 2023 (UNS Electric 2008 Long-Term Debt). The UNS Electric Long-Term Debt is guaranteed by UES. The notes may be prepaid with a make-whole call premium reflecting a discount rate equal to an equivalent maturity U.S. Treasury security yield plus 50 basis points.

UNS Electric used $60 million of the proceeds to repay its 7.61% senior unsecured notes that matured on August 11, 2008. The remaining proceeds were used to repay UNS Electric s outstanding borrowings under the UNS Gas/UNS Electric Revolver and for general corporate purposes. UNS Electric capitalized $1 million of costs related to the issuance of the debt and will amortize these costs over the life of the debt.

The UNS Electric Long-Term Debt contains certain restrictive covenants, including restrictions on transactions with affiliates, mergers, liens to secure indebtedness, restricted payments and incurrence of indebtedness. As of December 31, 2008, UNS Electric was in compliance with the covenants.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

UNS Electric must meet a leverage test and an interest coverage test to issue additional debt or to pay dividends. However, UNS Electric may, without meeting these tests, refinance existing debt and incur up to $5 million in short-term debt.

UNS GAS LONG-TERM DEBT

UNS Gas has $100 million of senior unsecured notes outstanding, consisting of $50 million of 6.23%, due August 2011, and $50 million of 6.23%, due August 2015. The notes may be prepaid with a make-whole call premium reflecting a discount rate equal to an equivalent maturity U.S. Treasury security yield plus 50 basis points. UES guarantees the notes.

UNS Gas must meet a leverage test and an interest coverage test to issue additional debt or to pay dividends. UNS Gas may refinance existing debt and incur up to $7 million in short-term debt.

The note purchase agreement contains certain restrictive covenants, including restrictions on transactions with affiliates, mergers, liens to secure indebtedness, restricted payments and incurrence of indebtedness. As of December 31, 2008, UNS Gas was in compliance with the terms of its note purchase agreement.

DEBT MATURITIES

Long-term debt, including term loan payments, revolving credit facilities classified as long-term, and capital lease obligations mature on the following dates:

	TEP Variable Rate IDBs Supported by Letters of Credit	TEP Scheduled Debt Retirements	TEP Capital Lease Obligations	TEP Total	UNS Gas	UNS Electric	UniSource Energy	Total
			- Millions of Dollars -					
2009	$	$	$ 63	$ 63	$	$	$ 6	$ 69
2010			92	92			6	98
2011	459		107	566	50	8	46	670
2012			118	118				118
2013			122	122				122
Total 2009 2013	459		502	961	50	8	58	1,077
Thereafter		445	304	749	50	100	150	1,049
Less: Imputed Interest			(274)	(274)				(274)
Total	$ 459	$ 445	$ 532	$ 1,436	$ 100	$ 108	$ 208	$ 1,852

TEP s Variable Rate IDBs are backed by a $341 million LOC issued pursuant to TEP s Credit Agreement which expires in August 2011 and TEP s $132 million Letter of Credit Facility which expires in April 2011. Although the Variable Rate IDBs mature between 2018 and 2029, the above table reflects a redemption or repurchase of such bonds in 2011 as though the LOCs terminate without replacement upon expiration of the TEP Credit Agreement.

Effective with commercial operation of Springerville Unit 3 in July 2006, Tri-State is reimbursing TEP for various operating costs related to the common facilities on an ongoing basis, including 14% of the Springerville Common Lease payments and 17% of the Springerville Coal Handling Facilities Lease payments. TEP remains the obligor under these capital leases, and Capital Lease Obligations do not reflect any reduction associated with this reimbursement. Lease expenses reimbursed by Tri-State were $7 million in each of 2008 and 2007 and $3 million in 2006.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

UNISOURCE ENERGY CREDIT AGREEMENT

The UniSource Energy Credit Agreement consists of a $30 million amortizing term loan facility and a $70 million revolving credit facility and matures in August 2011. UniSource Energy s obligations under the UniSource Credit Agreement are secured by a pledge of the capital stock of Millennium, UES and UED.

At December 31, 2008 the following balances were outstanding:

	Current Liabilities	Long-Term Debt	Total	Current Liabilities	Long-Term Debt	Total
			-Millions of Dollars-			
	December 31, 2008			December 31, 2007		
Revolver	**$**	**$ 43**	**$ 43**	$	$ 20	$ 20
Term Loan	**$ 6**	**$ 9**	**$ 15**	$ 6	$ 15	$ 21
Weighted Average Interest Rate on the Revolver		**2.48%**	**2.48%**		6.27%	6.27%

We have included the revolver borrowings in Long-Term Debt as UniSource Energy has the ability and the intent to have outstanding borrowings for the next twelve months. In January 2009, UniSource Energy repaid $1 million under its revolving credit facility.

Principal payments of $1.5 million on the outstanding term loan are due quarterly, with the balance due at maturity. We have the option of paying interest on the term loan and on borrowings under the revolving credit facility at adjusted LIBOR plus 1.25% or the sum of the greater of the federal funds rate plus 0.5% or the agent bank s reference rate and 0.25%.

The UniSource Energy Credit Agreement restricts additional indebtedness, liens, mergers, sales of assets, and certain investments and acquisitions. We must also meet: (1) a minimum cash flow to interest coverage ratio for UniSource Energy on a standalone basis and (2) a maximum leverage ratio on a consolidated basis. In September 2008, as a result of higher than expected fuel and purchased power costs, UniSource Energy amended the UniSource Energy Credit Agreement to provide more flexibility to meet the leverage ratio test for the next four calendar quarters, ending June 30, 2009. In February 2009, the leverage test in the UniSource Energy Credit Agreement was further amended through August 2011. The leverage ratio is calculated as the ratio of consolidated total indebtedness to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA). As of December 31, 2008, UniSource Energy was in compliance with the terms of its credit agreement.

UniSource Energy may pay dividends if, after giving effect to the dividend payment, it has more than $15 million of unrestricted cash and unused revolving credit.

TEP CREDIT AGREEMENT

The TEP Credit Agreement consists of a $150 million revolving credit facility, and a $341 million LOC facility which supports $329 million of tax-exempt Variable Rate IDBs. The TEP Credit Agreement matures in August 2011 and is secured by $491 million of Mortgage Bonds issued under the 1992 Mortgage which creates a lien on and security interest in most of TEP s utility plant assets.

Interest rates and fees under the TEP Credit Agreement are based on a pricing grid tied to TEP s credit ratings. Letter of credit fees are 0.45% per annum and amounts drawn under a letter of credit would bear interest at LIBOR plus 0.45% per annum. TEP has the option of paying interest on borrowings under the revolving credit facility at LIBOR plus 0.45% or the greater of the federal funds rate plus 0.5% or the agent bank s reference rate.

The TEP Credit Agreement restricts additional indebtedness, liens, sale of assets and sale-leaseback agreements. The TEP Credit Agreement also requires TEP to meet a minimum cash coverage ratio and a maximum leverage ratio. If TEP complies with the terms of the TEP Credit Agreement, TEP may pay dividends to UniSource Energy.

In September 2008, as a result of higher than expected fuel and purchased power costs, TEP amended the TEP Credit Agreement, to provide more flexibility to meet the leverage ratio test for the next four calendar quarters, ending June 30, 2009. The leverage ratio is calculated as the ratio of consolidated total indebtedness to EBITDA. As of December 31, 2008, TEP was in compliance with all the terms of its credit agreement.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

As of December 31, 2008, TEP had $10 million in loans outstanding under its revolving credit facility at an interest rate of 0.91% and $1 million outstanding in letters of credits. As of December 31, 2007, TEP had $10 million outstanding under this facility. The revolving loan balances are included in Current Liabilities in the UniSource Energy and TEP balance sheets. The outstanding Letters of Credit are off-balance sheet obligations of TEP.

TEP Letter of Credit Facility

In April 2008, TEP entered into a three-year $132 million letter of credit and reimbursement agreement (2008 TEP Letter of Credit Facility). The 2008 TEP Letter of Credit Facility supports $130 million aggregate principal amount of variable rate tax-exempt IDBs that were issued on behalf of TEP in June 2008. (See Pima B Bonds above).

Interest rates and fees under the 2008 TEP Letter of Credit Facility are based on a pricing grid tied to TEP s credit ratings. Based on TEP s current credit ratings, the letter of credit fees are 0.65% per annum during the first two years and 0.775% in the third year.

The TEP Letter of Credit Facility contains substantially the same restrictive covenants as the TEP Credit Agreement described above. As of December 31, 2008, TEP was in compliance with all the terms of the TEP Letter of Credit Facility.

UNS GAS/UNS ELECTRIC CREDIT AGREEMENT

The UNS Gas/UNS Electric Revolver is a $60 million revolving credit facility which matures in August 2011. Either UNS Gas or UNS Electric may borrow up to a maximum of $45 million, so long as the combined amount borrowed does not exceed $60 million. UNS Gas is only liable for UNS Gas borrowings, and similarly, UNS Electric is only liable for UNS Electric s borrowings under the UNS Gas/UNS Electric Revolver. UES guarantees the obligations of both UNS Gas and UNS Electric.

UNS Gas and UNS Electric each have the option of paying interest at LIBOR plus 1.0% or the greater of the federal funds rate plus 0.5% or the agent bank s reference rate.

The UNS Gas/UNS Electric Revolver contains restrictions on additional indebtedness, liens, mergers and sales of assets. The UNS Gas/UNS Electric Revolver also contains a maximum leverage ratio and a minimum cash flow to interest coverage ratio for each borrower. As of December 31, 2008, UNS Gas and UNS Electric were each in compliance with the terms of the UNS Gas/UNS Electric Revolver.

The borrowings under the UNS Gas/UNS Electric Revolver were as follows:

	UNS Gas	**UNS Electric**	UNS Gas	UNS Electric
	-Millions of Dollars-			
	December 31, 2008		December 31, 2007	
Balance on the Revolver	**$**	**$ 8**	$	$ 26
Weighted Average Interest Rate		**1.5%**		5.89%
Outstanding Letters of Credit	**$ 10**	**$ 7**	$ 10	$

At December 31, 2008 and December 31, 2007, UNS Electric s borrowings under the UNS Gas/UNS Electric Revolver were excluded from Current Liabilities and presented as Long-Term Debt, as UNS Electric has the ability and the intent to keep the borrowings outstanding under the UNS Gas/UNS Electric Revolver for the next twelve months. The outstanding letters of credit support power and gas purchases and hedges and are off-balance sheet obligations for UNS Gas and UNS Electric.

In February 2009, UNS Electric repaid $4 million under the UNS Gas/UNS Electric Revolver.

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UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 8. FAIR VALUE OF FINANCIAL INSTRUMENTS NOT CARRIED AT FAIR VALUE

The fair value of a financial instrument is the market price that would be received to sell an asset or transfer a liability at the measurement date. We use the following methods and assumptions for estimating the fair value of our financial instruments:

The carrying amounts of our current assets and liabilities, including Current Maturities of Long-Term Debt and amounts outstanding under our credit agreements, approximate their fair value due to the short-term nature of these instruments. Accordingly, these items have been excluded from the table below.

Investments in Lease Debt and Equity: TEP calculated the present value of remaining cash flows at the balance sheet date using current market rates with similar characteristics with respect to credit rating and time-to-maturity. In 2008, we also incorporated the impact of counterparty credit risk using market credit default swap data.

Fixed Rate Long-Term Debt: UniSource Energy and TEP used quoted market prices, where available, or calculated the present value of remaining cash flows at the balance sheet date using current market rates for bonds with similar characteristics with respect to credit rating and time-to-maturity. In 2008, we also incorporate the impact of our own credit risk using a credit default swap rate when determining the fair value of fixed rate long-term debt.

Variable Rate Long-Term Debt: TEP considers the principal amounts of variable rate debt outstanding to be reasonable estimates of their fair value. In 2008, the fair value of variable rate long-term debt has also been adjusted for credit risk using a credit default swap rate.

The use of different estimation methods and/or market assumptions may yield different estimated fair value amounts. The amount recorded in the balance sheet (carrying value) and the estimated fair values of our financial instruments included the following:

	December 31,			
	2008		**2007**	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	-Millions of Dollars-			
Assets:				
TEP Investment in Lease Debt and Equity	**$ 127**	**$ 144**	$ 153	$ 157
Liabilities:				
Fixed Rate Long-Term Debt				
UniSource Energy	**350**	**339**	310	319
TEP	**445**	**322**	492	498
Variable Rate Long-Term Debt				
UniSource Energy	**66**	**66**	67	67
TEP	**459**	**441**	329	329

See Note 7 for a description of TEP s investment in Springerville Lease Debt and Equity. TEP intends to hold the $79 million investment in Springerville Lease Debt Securities to maturity (Springerville Coal Handling Facilities lease debt totaling $20 million matures through July 1, 2011, and Springerville Unit 1 lease debt totaling $59 million matures through January 1, 2013). This investment is stated at amortized cost, which means the purchase cost has been adjusted for the amortization of the premium and discount to maturity.

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UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 9. STOCKHOLDERS EQUITY

DIVIDEND LIMITATIONS

UniSource Energy

In February 2009, UniSource Energy declared a first quarter dividend to shareholders of $0.29 per share of UniSource Energy Common Stock. The dividend, totaling approximately $10 million, will be paid on March 9, 2009 to common shareholders of record as of February 24, 2009. In 2008, UniSource Energy paid quarterly dividends to the shareholders of $0.24 per share, for a total of $0.96 per share, or $34 million for the year. In 2007, UniSource Energy paid quarterly dividends to the shareholders of $0.225 per share, for a total of $0.90 per share, or $32 million, for the year. During 2006, UniSource Energy paid quarterly dividends to the shareholders of $0.21 per share, for a total of $0.84 per share, or $29 million, for the year.

In 2008, UniSource Energy s dividend to the shareholders of $34 million exceeded its retained earnings. As a result, we recorded dividends of $14 million against retained earnings and dividends of $20 million against common stock. UniSource Energy has no additional paid-in capital. Such dividends do not represent a return of capital dividend for income tax purposes.

Our ability to pay cash dividends on Common Stock outstanding depends, in part, upon cash flows from our subsidiaries: TEP, UES, Millennium and UED, as well as compliance with various debt covenant requirements. As of December 31, 2008, we complied with the terms of all such debt covenant requirements.

TEP

TEP paid dividends of $3 million in 2008, $53 million in 2007, and $62 million in 2006. UniSource Energy is the holder of TEP s common stock. TEP met the requirements discussed below before paying these dividends.

In December 2007, UniSource Energy contributed $18 million of capital to TEP.

Bank Credit Agreement

TEP s Credit Agreement as of August 2006 allows TEP to pay dividends as long as TEP complies with the agreement and certain financial covenants including quarterly limits on the ratio of total indebtedness to total earnings before interest expense/income, income taxes and non-cash items. TEP is in compliance with these covenants.

Federal Power Act

This Act states that dividends shall not be paid out of funds properly included in capital accounts. TEP s 2008, 2007 and 2006 dividends were paid from current year earnings.

UNS Gas and UNS Electric

Restrictions placed on UNS Gas and UNS Electric limit UES ability to pay dividends. The 2003 UES Settlement Agreement limits UNS Gas and UNS Electric s ability to pay dividends of no more than 100% of its earnings to UniSource Energy. Additionally, the terms of the senior unsecured note agreements entered into by both UNS Gas and UNS Electric contain dividend restrictions. See Note 7. UES did not pay any dividends to UniSource Energy in 2008, 2007 or 2006.

UES made capital contributions to UNS Electric of less than $0.5 million in 2008.

UniSource Energy made no capital contributions to UNS Electric in 2008 and $10 million in 2007.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Millennium and UED

Millennium paid dividends of $25 million to UniSource Energy in 2008 and $15 million in 2007. Millennium did not pay dividends to UniSource Energy in 2006. UED paid dividends to UniSource Energy of $0.5 million in 2008. No dividend payments were made in 2007 or 2006. Millennium and UED have no dividend restrictions.

In December 2008, UniSource Energy contributed $59 million in capital to UED by canceling an intercompany promissory note in the amount of $59 million. Borrowings under the promissory note were used to finance the development of BMGS.

UNISOURCE ENERGY SHAREHOLDER RIGHTS PLAN

In March 1999, UniSource Energy adopted a Shareholder Rights Plan. As of April 1, 1999, each Common Stock shareholder receives one Right for each share held. Each Right initially allows shareholders to purchase UniSource Energy s Series X Preferred Stock at a specified purchase price. However, the Rights are exercisable only if a person or group (the acquirer) acquires or commences a tender offer to acquire 15% or more of UniSource Energy Common Stock. Each Right would entitle the holder (except the acquirer) to purchase a number of shares of UniSource Energy Common or Preferred Stock (or, in the case of a merger of UniSource Energy into another person or group, common stock of the acquiring person) having a fair market value equal to twice the specified purchase price. At any time until any person or group has acquired 15% or more of the Common Stock, UniSource Energy may redeem the Rights at a redemption price of $0.001 per Right. The Rights trade automatically with the Common Stock when it is bought and sold. The Rights expire on March 31, 2009.

NOTE 10. INCOME TAXES

A reconciliation of the federal statutory income tax rate to each company s effective income tax rate is as follows:

	UniSource Energy			TEP		
	Years Ended December 31,					
	2008	2007	2006	**2008**	2007	2006
	-Millions of Dollars-					
Federal Income Tax Expense at Statutory Rate	**$ 11**	$ 34	$ 40	**$ 5**	$ 31	$ 38
State Income Tax Expense, Net of Federal Benefit	**1**	5	5	**1**	4	5
Depreciation Differences (Flow Through Basis)	**2**	3	2	**2**	3	2
San Juan Generating Station Environmental Penalties	**3**			**3**		
Federal/State Tax Credits	**(3)**	(2)	(2)	**(3)**	(2)	(2)
Other	**3**	(1)	(1)	**3**		(1)
Total Federal and State Income Tax Expense (before Discontinued Operations)	**$ 17**	$ 39	$ 44	**$ 11**	$ 36	$ 42

In 2008, the effective tax rate is 55% for UniSource Energy and 71% for TEP compared to a combined federal and state statutory effective tax rate of 39.6%. In 2008, it was determined that the environmental penalties at San Juan Generating Station would never be deductible for income tax purposes. As a result, an additional $3 million of tax expense was recognized in 2008 for penalties incurred in the current and prior years. Other items included in GAAP expense which will never be deductible for tax were offset by the recognition of income tax credits.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Income tax expense included in the income statements consists of the following:

	UniSource Energy			TEP		
	Years Ended December 31,					
	2008	2007	2006	**2008**	2007	2006
	-Millions of Dollars-					
Current Tax Expense						
Federal	**$ (17)**	$ 14	$ 37	**$ (12)**	$ 22	$ 32
State	**(2)**	3	12	**(1)**	6	10
Total	**(19)**	17	49	**(13)**	28	42
Deferred Tax Expense (Benefit)						
Federal	**34**	20		**23**	9	5
State	**2**	2	(5)	**1**	(1)	(5)
Total	**36**	22	(5)	**24**	8	
Total Federal and State Income Tax Expense (before Discontinued Operations)	**17**	39	44	**11**	36	42
Tax on Discontinued Operations			(2)			
Total Federal and State Income Tax Expense (including Discontinued Operations)	**$ 17**	$ 39	$ 42	**$ 11**	$ 36	$ 42

We record deferred income tax assets and liabilities for amounts that will increase and decrease, respectively, income taxes on future tax returns. We consider it more likely than not that all the deferred tax assets will be used on a tax return. Consequently, we have not recorded a valuation allowance to reduce our deferred tax assets.

The significant components of deferred income tax expenses and liabilities consist of the following:

	UniSource Energy		TEP	
	December 31,		December 31,	
	2008	2007	**2008**	2007
	-Millions of Dollars-			
Gross Deferred Income Tax Assets				
Capital Lease Obligations	**$ 209**	$ 230	**$ 209**	$ 230
Customer Advances and Contributions in Aid of Construction	**40**	39	**26**	26
Alternative Minimum Tax Credit	**49**	38	**35**	24
Accrued Postretirement Benefits	**24**	25	**24**	25
Emission Allowance Inventory	**13**	14	**12**	12

Other		**39**		40		**27**		27
Gross Deferred Income Tax Assets		**374**		386		**333**		344
Gross Deferred Income Tax Liabilities								
Plant Net		**(390)**		(363)		**(357)**		(340)
Capital Lease Assets Net		**(61)**		(71)		**(61)**		(71)
Regulatory Asset Income Taxes Recoverable Through Future Revenues		**(8)**		(12)		**(8)**		(12)
1999 Transition Recovery Asset				(9)				(9)
Pensions		**(7)**		(4)		**(8)**		(5)
Deferred Lease Payment		**(6)**		(6)		**(6)**		(6)
Other		**(19)**		(11)		**(13)**		(6)
Gross Deferred Income Tax Liabilities		**(491)**		(476)		**(453)**		(449)
Net Deferred Income Tax Liabilities	**$**	**(117)**	$	(90)	**$**	**(120)**	$	(105)

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The balance sheets display the net deferred income tax liability as follows:

	UniSource Energy		TEP	
	December 31,		December 31,	
	2008	**2007**	**2008**	**2007**
	-Millions of Dollars-			
Deferred Income Taxes Current Assets	**$ 61**	$ 60	**$ 60**	$ 59
Deferred Income Taxes Noncurrent Liabilities	**(178)**	(150)	**(180)**	(164)
Net Deferred Income Tax Liability	**$ (117)**	$ (90)	**$ (120)**	$ (105)

Deferred Income Tax Assets Current at December 31, 2008 and 2007 for UniSource Energy includes $3 million of deferred tax assets related to losses of a foreign investment held by a Millennium subsidiary. Management plans to dispose of its investment in the foreign joint venture and recognize the deferred losses on UniSource Energy s federal and state income tax returns. This recognition on filed tax returns will allow for realization of the deferred tax asset. If management is unable to complete its plans to dispose of the joint venture, UniSource Energy may be required to write off the deferred tax asset of $3 million.

UniSource Energy and TEP have net operating loss carryforwards in the states of Arizona and New Mexico. Deferred tax assets at December 31, 2008 reflect $43 million of state net operating losses at UniSource Energy and $28 million at TEP which are expected to be used before the carryforward period expires in 2013. Deferred tax assets also include $2 million of federal and state capital loss carryforward at UniSource Energy expiring in 2010 and 2011. Management expects to use these losses on filed tax returns before they expire.

Management believes that based on its historical pattern of taxable income, UniSource Energy will produce sufficient income in the future to realize its deferred income tax assets. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax asset will not be realized. No valuation allowance has been recorded to reduce the balance in deferred tax assets since management believes it is more likely than not that UniSource Energy will be able to recognize the tax deductions on future returns.

As of December 31, 2008, UniSource Energy s balance sheet reflects income taxes receivable of $13 million. This balance includes $16 million of alternative minimum tax paid with the 2006 federal return which will be refunded through a carryback of 2008 net operating income tax losses of $77 million. This receivable is offset by amounts due to tax authorities for audit adjustments carried over from prior years.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Uncertain Tax Positions

UniSource Energy and TEP adopted *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48)* as of January 1, 2007. FIN 48 requires us to determine whether it is more likely than not that we will sustain a tax position under examination. Each tax position is measured to determine the amount of benefit to recognize in the financial statements. The amount of unrecognized tax benefit reported by UniSource Energy, all of which is recorded at TEP, was $20 million at December 31, 2008 and $12 million at December 31, 2007. The amount recorded by UniSource Energy and TEP on January 1, 2007 when FIN 48 was adopted was $13 million. The following table shows the changes in unrecognized tax benefits of UniSource Energy and TEP:

	December 31, 2008	December 31, 2007
Unrecognized Tax Benefits, beginning of year	**$ 12**	$ 13
Additions based on tax positions taken in the current year	**6**	
Reductions based on tax positions taken in the current year		
Additions based on tax positions taken in the prior year	**3**	
Reductions based on tax positions taken in the prior year	**(1)**	(1)
Unrecognized Tax Benefits, end of year	**$ 20**	$ 12

Unrecognized tax benefits which, if recognized, would reduce the effective tax rate, were $1 million at December 31, 2008 for both UniSource Energy and TEP. There were no significant amounts of such unrecognized tax benefits at December 31, 2007.

The $8 million increase in the balance of unrecognized tax benefits from 2007 to 2008 relates to $6 million of tax benefit attributable to tax positions taken in 2008 which may not be sustainable, plus $3 million of tax positions taken in prior years which are now uncertain based on additional guidance issued by the Internal Revenue Service (IRS) in 2008, offset by the recognition of $1 million of previously uncertain tax benefits from prior years. The balance in unrecognized tax benefits could increase in the next twelve months as a result of the ongoing IRS audits, but the amount of the increase cannot be determined.

TEP recognizes interest accrued related to unrecognized tax benefits in Other Interest Expense in the income statements. In September 2008, the statute of limitations expired for the 2004 tax year. As a result of the closure of the statute, TEP reversed $1 million of previously recorded interest expense associated with uncertain tax positions. No interest expense was recognized for 2008, $1 million was recognized in 2007. The balance of interest payable at December 31, 2008 is $1 million. No penalties have been recognized.

UniSource Energy and TEP have been audited by the IRS through tax year 2004. UniSource Energy and TEP are currently under audit by the IRS for 2005 for a limited issue related to the amount of indirect costs capitalized into the tax basis of assets, and is under audit for 2006. The 2005 audit continues from prior years and the 2006 audit began in late 2008. No material adjustments have been proposed by the IRS for either year, but UniSource Energy and TEP have recorded a current liability of $3 million for taxes and interest for issues agreed to in prior years which have been accepted by the IRS as affecting 2005 and 2006. We are unable to determine when the audits will be completed. UniSource Energy and TEP are not currently under audit by any state tax agencies.

Other Tax Matters

On its 2002 tax return, TEP filed for an automatic change in accounting method relating to the capitalization of indirect costs to the production of electricity and self-constructed assets. We also used the new accounting method on the 2003 and 2004 returns for TEP, UNS Gas and UNS Electric. In 2005, the Internal Revenue Service issued a ruling limiting the ability of electric and gas utilities to use the new accounting method. Based on settlement guidelines issued by the IRS in March 2007, this issue has been settled with the IRS. In December 2007, TEP recorded the effect of the settlement by recognizing $2 million of interest income. In 2008, UniSource Energy received a $16 million refund of taxes and interest, of which $15 million related to TEP. The refunds have no income statement impact to UniSource Energy or TEP.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 11. EMPLOYEE BENEFIT PLANS

PENSION BENEFIT PLANS

TEP, UNS Gas and UNS Electric maintain noncontributory, defined benefit pension plans for substantially all regular employees and certain affiliate employees. Employees receive benefits based on their years of service and average compensation. TEP, UNS Gas and UNS Electric fund the plans by contributing at least the minimum amount required under Internal Revenue Service regulations.

We recognize the underfunded status of our defined benefit pension plans as a liability on our consolidated balance sheets. The underfunded status is measured as the difference between the fair value of the plans assets and the projected benefit obligation for pension plans. We recognize a regulatory asset to the extent these future costs are probable of recovery in rates. In December 2008, as a result of the 2008 TEP Rate Order, TEP reapplied FAS 71 to its generation operations. Accordingly, TEP reclassified pension amounts related to its generation operations, previously recognized in AOCI, to a regulatory asset.

TEP also provides supplemental retirement benefits to certain employees whose benefits are limited by IRS benefit or compensation limitations. Changes in benefit obligations are recognized as a component of AOCI.

Pension Contributions

The Pension Protection Act of 2006 (The Pension Act) establishes minimum funding targets for pension plans beginning in 2008. A plan s funding target is the present value of all benefits accrued or earned as of the beginning of the plan year. While the annual targets are not legally required, if a plan does not meet the annual funding targets, the plan s benefit payment options are limited and a funding deficiency notice must be sent to all plan participants. All TEP, UNS Gas and UNS Electric plans are in compliance with The Act.

In 2009, to meet the funding requirements of The Pension Act, TEP expects to contribute $16 million and UNS Gas and UNS Electric expect to contribute a total of $2 million to the pension plans.

OTHER POSTRETIREMENT BENEFIT PLANS

TEP provides limited health care and life insurance benefits for retirees. All regular employees may become eligible for these benefits if they reach retirement age while working for TEP or an affiliate. UNS Gas and UNS Electric provide postretirement medical benefits for current retirees and a small group of active employees. In the 2008 TEP Rate Order, the ACC authorized accrual basis recovery of other postretirement benefit plan costs based on a commitment to fund the plan. TEP, UNS Gas and UNS Electric now record changes in their other postretirement obligation, not yet reflected in net periodic benefit cost, as a regulatory asset, as such amounts are probable of future recovery in rates. Amounts previously recorded in AOCI have been reclassified to a regulatory asset.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The pension and other postretirement benefit related amounts (excluding tax balances) included in the UniSource Energy balance sheet are:

	Pension Benefits		Other Postretirement Benefits	
	Years Ended December 31,			
	2008	**2007**	**2008**	**2007**
	-Millions of Dollars-			
Regulatory Pension Asset included in Other Regulatory Assets	**$ 105**	$ 16	**$ 7**	$
Accrued Benefit Liability included in Accrued Employee Expenses			**(4)**	(4)
Accrued Benefit Liability included in Pension and Other Postretirement Benefits	**(95)**	(16)	**(63)**	(60)
Accumulated Other Comprehensive Loss	**3**	10		6
Net Amount Recognized	**$ 13**	$ 10	**$ (60)**	$ (58)

The table above includes accrued pension benefit liabilities for UNS Gas and UNS Electric of approximately $7 million and $3 million, at December 31, 2008 and 2007 respectively, and a postretirement benefit liability of $1 million for UNS Gas and UNS Electric, for each period presented.

The balance remaining in AOCI of $3 million relates to the TEP supplemental executive retirement plan.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

OBLIGATIONS AND FUNDED STATUS

In accordance with FAS 158, we measured the actuarial present values of all pension benefit obligations and other postretirement benefit plans at December 31, 2008. In 2007, the measurement date was December 1. As a result of the change in the measurement date, we recorded a loss of less than $1 million to retained earnings. The tables below include TEP, UNS Gas and UNS Electric plans. The change in projected benefit obligation and plan assets and reconciliation of the funded status are as follows:

	Pension Benefits		Other Postretirement Benefits	
	Years Ended December 31,			
	2008	**2007**	**2008**	**2007**
	-Millions of Dollars-			
Change in Projected Benefit Obligation				
Benefit Obligation at Beginning of Year	**$ 209**	$ 218	**$ 65**	$ 66
Actuarial (Gain) Loss	**13**	(17)		(1)
Interest Cost	**14**	13	**4**	4
Service Cost	**7**	8	**2**	2
Measurement Date Change	**1**			
Amendments	**(2)**			(3)
Benefits Paid	**(12)**	(13)	**(4)**	(3)
Projected Benefit Obligation at End of Year	**230**	209	**67**	65
Change in Plan Assets				
Fair Value of Plan Assets at Beginning of Year	**193**	176		
Actual (Loss) Return on Plan Assets	**(57)**	20		
Benefits Paid	**(12)**	(13)	**(4)**	(4)
Employer Contributions	**10**	10	**4**	4
Measurement Date Change	**1**			
Fair Value of Plan Assets at End of Year	**135**	193		
Funded Status at End of Year	**$ (95)**	$ (16)	**$ (67)**	$ (65)

The table above includes pension benefit obligations for UNS Gas and UNS Electric of approximately $7 million and $3 million, at December 31, 2008 and 2007 respectively, plan assets of $5 million and a postretirement benefit liability of $1 million, for UNS Gas and UNS Electric, for each period presented.

The following table provides the components of UniSource Energy s regulatory assets and accumulated other comprehensive loss that have not been recognized as components of net periodic benefit cost as of December 31, 2008:

Other

	Pension Benefits	Postretirement Benefits
	-Millions of Dollars-	
Net Loss	**$ 105**	**$ 13**
Prior Service Cost (Benefit)	**3**	**(6)**

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The accumulated benefit obligation for all defined benefit pension plans was $198 million at December 31, 2008 and $180 million at December 31, 2007. Changes in actuarial assumptions including a decrease in the discount rate impacted the accumulated benefit obligation.

	December 31, 2008	December 31, 2007
	-Millions of Dollars-	
Information for Pension Plans with an Accumulated Benefit Obligation in Excess of Plan Assets:		
Projected Benefit Obligation at End of Year	**$ 230**	$ 10
Accumulated Benefit Obligation at End of Year	**198**	7
Fair Value of Plan Assets at End of Year	**135**	

At December 31, 2008, all UniSource Energy defined benefit pension plans had accumulated benefit obligations in excess of plan assets. At December 31, 2007, only TEP s supplemental executive retirement plan, which is unfunded, had an accumulated benefit obligation in excess of plan assets.

The components of net periodic benefit costs are as follows:

	Pension Benefits			Other Postretirement Benefits		
	Years Ended December 31,					
	2008	**2007**	**2006**	**2008**	**2007**	**2006**
	-Millions of Dollars-					
Service Cost	**$ 7**	$ 8	$ 7	**$ 2**	$ 2	$ 2
Interest Cost	**14**	13	12	**4**	4	4
Expected Return on Plan Assets	**(16)**	(14)	(13)			
Prior Service Cost Amortization	**2**	1	2	**(2)**	(2)	(1)
Recognized Actuarial Loss		2	3	**1**	1	1
Net Periodic Benefit Cost	**$ 7**	$ 10	$ 11	**$ 5**	$ 5	$ 6

A portion of the net periodic benefit cost was capitalized as a cost of construction and the remainder was included in Other Operating and Maintenance costs.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The changes in plan assets and benefit obligations recognized as regulatory assets or in AOCI are as follows:

	Pension Benefits					
	2008		2007		2006	
	Regulatory Asset	AOCI	Regulatory Asset	AOCI	Regulatory Asset	AOCI
	-Millions of Dollars-					
Current Year Actuarial (Gain) Loss	**$ 85**	**$ 1**	$ (16)	$ (6)	$	$
Amortization of Actuarial Gain (Loss)			(1)	(1)		
Prior Service (Cost) Amortization	**(2)**		(1)	(1)		
Plan Amendments	**(2)**					
Reclassification from AOCI to Regulatory Asset	**8**	**(8)**				
Change in Additional Minimum Liability					4	(23)
Total Recognized	**$ 89**	**$ (7)**	$ (18)	$ (8)	$ 4	$ (23)

	Other Postretirement Benefits			
	2008		2007	2006
	Regulatory Asset	AOCI	AOCI	AOCI
	-Millions of Dollars-			
Current Year Actuarial (Gain) Loss	**$**	**$**	$ (1)	$
Amortization of Actuarial Gain (Loss)	**(1)**		(1)	
Prior Service (Cost) Amortization	**2**		2	
Change in Additional Minimum Liability			(2)	
Reclassification from AOCI to Regulatory Asset	**6**	**(6)**		
Total Recognized	**$ 7**	**$ (6)**	$ (2)	$

For all pension plans, we amortize prior service costs on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan. We will amortize $7 million estimated net loss and less than $1 million prior service cost from other regulatory assets or AOCI into net periodic benefit cost in 2009. The estimated net loss and prior service benefit for the defined benefit postretirement plans that will be amortized from other regulatory assets into net periodic benefit cost in 2009 are $1 million and $2 million, respectively.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

	Pension Benefits		Other Postretirement Benefits	
	2008	**2007**	**2008**	**2007**
Weighted-Average Assumptions Used to Determine Benefit Obligations as of the Measurement Date				
Discount Rate	**6.3%**	6.6 - 6.8%	**6.5%**	6.5%
Rate of Compensation Increase	**3.0 5.0%**	3.0 5.0%	**N/A**	N/A

	Pension Benefits		Other Postretirement Benefits	
	2008	**2007**	**2008**	**2007**
Weighted-Average Assumptions Used to Determine Net Periodic Benefit Cost for Years Ended December 31				
Discount Rate	**6.6 6.8%**	5.9%	**6.5%**	5.6 5.8%
Rate of Compensation Increase	**3.0 5.0%**	3.0 5.0%	**N/A**	N/A
Expected Return on Plan Assets	**7.75- 8.3%**	8.3%	**N/A**	N/A

Net periodic benefit cost for the other postretirement benefit plan was remeasured as of January 1, 2007 to reflect the plan amendment communicated to plan participants on January 2, 2007. A discount rate of 5.6% was used for the January 2007 portion of the expense, while a discount rate of 5.8% was used for the remaining eleven months.

Net periodic benefit cost is subject to various assumptions and determinations, such as the discount rate, the rate of compensation increase, and the expected return on plan assets. We estimated the expected return on plan assets based on a review of the plans asset allocations. We also consulted with a third-party investment consultant and the plans actuary who consider factors such as:

- market and economic indicators
- historical market returns
- correlations and volatility
- central banks and government treasury departments forecasts and objectives, and
- recent professional or academic research.

Changes that may arise over time with regard to these assumptions and determinations will change amounts recorded in the future as net periodic benefit cost.

	December 31,	
	2008	**2007**
Assumed Health Care Cost Trend Rates		
Health Care Cost Trend Rate Assumed for Next Year	**7.5%**	8%
Ultimate Health Care Cost Trend Rate Assumed	**5%**	5%
Year that the Rate Reaches the Ultimate Trend Rate	**2017**	2013

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Assumed health care cost trend rates significantly affect the amounts reported for health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects on the December 31, 2008 amounts:

	One-Percentage-Point Increase	One-Percentage-Point Decrease
	-Millions of Dollars-	
Effect on Total of Service and Interest Cost Components	$ 1	$ (1)
Effect on Postretirement Benefit Obligation	4	(4)

PENSION PLAN ASSETS

TEP, UNS Gas and UNS Electric calculate the fair value of plan assets on December 31, the measurement date. The 2007 measurement date was December 1. Pension plan asset allocations, by asset category, were as follow:

	TEP Plan Assets		UNS Gas and UNS Electric Plan Assets	
	December 31, 2008	December 1, 2007	December 31, 2008	December 1, 2007
Asset Category				
Equity Securities	**51%**	54%	**67%**	66%
Debt Securities	**33%**	27%	**31%**	
Fixed Income Securities				33%
Real Estate	**13%**	10%		1%
Other	**3%**	9%	**2%**	
Total	**100%**	100%	**100%**	100%

TEP s investment policy for the pension plans targets exposure to the various asset classes in the following allocations: equity securities 50%, debt securities 30%, real estate 10%, and other 3%. TEP rebalances the portfolio when the portfolio allocation is not within the desired range of exposure. The plan seeks to provide returns in excess of a portfolio benchmark. TEP tracks the plan s portfolio relative to the benchmark and provides quarterly investment reviews which consist of a performance and risk assessment on all investment managers and on the portfolio. Investment managers for the plan may use derivative financial instruments for risk management purposes or as a part of their investment strategy. Currency hedges have also been used for defensive purposes. Real estate managers use leverage but it is limited by investment policy.

ESTIMATED FUTURE BENEFIT PAYMENTS

TEP expects to pay the following benefit payments, which reflect future service, as appropriate.

	Pension Benefits	Other Postretirement Benefits
	-Millions of Dollars-	
2009	$ 8	$ 5
2010	9	5
2011	10	6
2012	11	6

2013	12	6
Years 2014-2018	77	29

UNS Gas and UNS Electric expect to pay pension and postretirement benefits of approximately $4 million in 2009 through 2013 and $7 million in 2014 through 2018.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

DEFINED CONTRIBUTION PLANS

TEP, UNS Gas and UNS Electric offer defined contribution savings plans to all eligible employees. The Internal Revenue Code identifies the plans as qualified 401(k) plans. Participants direct the investment of contributions to certain funds in their account which may include a UNS stock fund. TEP, UNS Gas, and UNS Electric match part of a participant s contributions to the plans. TEP made matching contributions to these plans of approximately $4 million in each of 2008, 2007 and 2006. UNS Gas and UNS Electric made matching contributions of less than $0.5 million in each of 2008, 2007, and 2006.

NOTE 12. SHARE-BASED COMPENSATION PLANS

Under the 2006 Omnibus Stock and Incentive Plan, the Compensation Committee of the UniSource Energy Board of Directors may issue various types of share-based compensation, including stock options, restricted shares/units, and performance shares. The total number of shares which may be awarded under the Plan cannot exceed 2.25 million shares. At December 31, 2008, the total number of shares awarded under the 2006 Omnibus Stock and Incentive Plan was 0.7 million shares.

STOCK OPTIONS

In 2008, the Compensation Committee of the UniSource Energy Board of Directors granted 303,550 stock options to officers with an exercise price of $26.18. In 2007, the board granted 184,260 stock options to officers with an exercise price of $37.88. In 2006, the board granted 187,640 stock options to officers with an exercise price of $30.55.

Stock options are granted with an exercise price equal to the fair market value of the stock on the date of grant, vest over three years, become exercisable in one-third increments on each anniversary date of the grant and expire on the tenth anniversary of the grant. Compensation expense is recorded on a straight-line basis over the service period for the total award based on the grant date fair value of the options less estimated forfeitures. For awards granted to retirement eligible officers, compensation expense is recorded immediately. Certain stock option awards accrue dividend equivalents that are paid in cash on the earlier of the date of exercise of the underlying option or the date the option expires. Compensation expense is recognized as dividends are paid.

The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton option pricing model with the assumptions noted in the following table. The expected term of the stock option granted in 2008 was estimated using historical exercise data. The expected term of all other options granted in prior years was estimated using a simplified method which considers the 3 year vesting period and the contractual term. The risk-free rate is based on the rate available on a U.S. Treasury Strip with a maturity equal to the expected term of the option at the time of the grant. Expected volatility was based on historical volatility for UniSource Energy s stock for the past 6 years, the expected term. The expected dividend yield on a share of stock was calculated using the historical dividend yield with the implicit assumption that current dividend yields will continue in the future.

	2008	2007	2006
Expected Term (years)	**6**	6	6
Risk-free Rate	**3.1%**	4.4%	4.97%
Expected Volatility	**18.8%**	20.2%	22.57%
Expected Dividend Yield	**2.8%**	2.4%	2.45%
Weighted-Average Grant-Date Fair Value of Options Granted During the Period	**$ 4.23**	$ 8.13	$ 7.38

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

A summary of the stock option activity follows:

(Shares in Thousands)	2008		2007		2006	
Stock Options	**Shares**	**Weighted Average Exercise Price**	**Shares**	**Weighted Average Exercise Price**	**Shares**	**Weighted Average Exercise Price**
Outstanding, Beginning of Year	**1,451**	**$ 21.21**	1,388	$ 18.59	1,537	$ 16.75
Granted	**304**	**$ 26.18**	184	$ 37.88	187	$ 30.55
Exercised	**(120)**	**$ 16.34**	(120)	$ 16.56	(304)	$ 15.97
Forfeited	**(33)**	**$ 29.24**	(1)	$ 12.28	(32)	$ 25.14
Outstanding, End of Year	**1,602**	**$ 22.36**	1,451	$ 21.21	1,388	$ 18.59
Exercisable, End of Year	**1,153**	**$ 19.50**	1,139	$ 17.43	1,188	$ 16.49
Aggregate Intrinsic Value of Options Exercised ($000s)	**$ 1,680**		$ 2,226		$ 4,687	

		At December 31, 2008 ($000s)
Aggregate Intrinsic Value for Options Outstanding	$	12,225
Aggregate Intrinsic Value for Options Exercisable	$	12,225
Weighted Average Remaining Contractual Life of Outstanding Options		4.6 years
Weighted Average Remaining Contractual Life of Exercisable Options		3.1 years

A summary of stock options follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number of Shares (000s)**	**Weighted-Average Remaining Contractual Life**	**Weighted-Average Exercise Price**	**Number of Shares (000s)**	**Weighted-Average Exercise Price**
$11.00 $15.28	413	1.2 years	$ 14.13	413	$ 14.13
$17.44 $18.84	524	3.0 years	$ 18.02	524	$ 18.02
$26.18. $37.88	665	7.9 years	$ 30.88	216	$ 33.33

We summarize the status of nonvested stock options as of December 31, 2008, and changes during 2008 below:

Nonvested Shares	**Number of Shares (000s)**	**Weighted-Average Grant-Date Fair Value**
Nonvested at January 1, 2008	312	$ 7.83
Granted	304	4.23
Vested	(134)	7.73
Forfeited	(33)	5.47

Nonvested at December 31, 2008	449	$	5.60

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
RESTRICTED STOCK UNITS/AWARDS AND PERFORMANCE SHARES
Restricted Stock Units

Restricted stock and stock units are generally granted under the Plan to non-employee directors. Restricted stock is an award of Common Stock that is subject to forfeiture if the restrictions specified in the award are not satisfied. Stock units are a non-voting unit of measure that is equivalent to one share of Common Stock. The directors may elect to receive stock units in lieu of restricted stock. Restricted stock generally vests over periods ranging from one to three years and are payable in Common Stock. Stock units vest either immediately or over periods ranging from one to three years. The restricted stock units vest immediately upon death, disability, or retirement. In the January following the year the person is no longer a director, Common Stock shares will be issued for the vested stock units. Compensation expense equal to the fair market value on the grant date is recognized over the vesting period. Fully vested but undistributed stock unit awards accrue dividend equivalent stock units based on the fair market value of common shares on the date the dividend is paid. Compensation expense is recognized when dividends are paid.

In 2008, the Compensation Committee of the UniSource Energy Board of Directors granted the following stock units to non-employee directors:

February 2008 3,130 stock units at a weighted average fair value of $28.75 per share,
May 2008 18,448 stock units at a weighted average fair value of $31.71 per share, and
August 2008 1,400 stock units at a weighted average fair value of $32.15 per share.

In 2007, the Compensation Committee of the UniSource Energy Board of Directors granted 17,857 stock units at a weighted average fair value of $37.30 per share to non-employee directors. In 2006, we granted 17,151 stock units to non-employee directors at a weighted-average fair value of $30.76 per share on the grant date.

Performance Share Awards

In February 2008, the Compensation Committee of the UniSource Energy Board of Directors granted 49,120 performance share awards (targeted shares) to Officers at a grant date fair value, based on a Monte Carlo simulation, of $17.10 per share. The performance share awards will be paid out in shares of UniSource Energy Common Stock based on UniSource Energy s performance over the performance period of January 1, 2008 through December 31, 2010. The performance criteria specified in the awards is determined based on targeted UniSource Energy Total Shareholder Return during the performance period compared to the Total Shareholder Return over the same period of an industry or peer group. The performance shares vest ratably over the performance period and any unearned awards are forfeited. Compensation expense equal to the fair value on the grant date is recognized over the vesting period if the requisite service period is fulfilled whether or not the threshold is received.

In March 2007, the Compensation Committee of the UniSource Energy Board of Directors granted 37,270 performance share awards (targeted shares) to certain officers at a grant date fair value of $35.56 per share (market price of $37.88 less the present value of expected dividends of $2.32). The performance share awards will be paid out in shares of UniSource Energy Common Stock based on UniSource Energy s achievement of targeted Cumulative Cash Flow from Operations and Cumulative Diluted Earnings per Share over the performance period of January 1, 2007 through December 31, 2009.

In May 2006, 45,520 performance share awards (targeted shares) were granted to certain officers at a grant date fair value of $28.39 per share (market price of $30.55 less the present value of expected dividends of $2.16). The performance share awards will be paid out in shares of UniSource Energy Common Stock based on UniSource Energy s achievement of targeted Cumulative Cash Flow from Operations and Cumulative Earnings per Share over the period of January 1, 2006 through December 31, 2008. The total number of shares that vested as of the end of the performance period was 12,325.

The performance criteria specified for the 2007 and 2006 awards is determined based on targeted UniSource Energy cumulative Cash Flow from Operations during the performance period, cumulative Earning per Share in 2006, and Diluted Earnings per Share in 2007. The performance shares vest ratably over the performance period and any unearned awards are forfeited. Compensation expense equal to the fair market value on the grant date less the present value of expected dividends is recognized over the vesting period if it is probable that the performance criteria will be met. Compensation expense is adjusted if the goals are not achieved.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

	Performance Shares		Restricted Stock Units	
	Shares (000s)	Weighted-Average Grant-Date Fair Value	Shares (000s)	Weighted-Average Grant-Date Fair Value
Non-vested at January 1, 2008	72	$ 31.77	20	$ 35.91
Granted	49	17.10	23	31.33
Vested	(12)	28.39	(20)	35.91
Forfeited	(42)	25.98		
Non-vested at December 31, 2008	67	$ 25.23	23	$ 31.33

SHARE-BASED COMPENSATION EXPENSE (Stock Options, Performance Shares and Restricted Stock Units)

Annually during 2006 through 2008, TEP recorded share-based compensation expense of $2 million. UniSource Energy recorded share-based compensation expense of $3 million in 2008 and 2007 and $2 million in 2006. The actual tax deduction realized from the exercise of share-based payment arrangements totaled $1 million for 2008, $0.5 million in 2007, $2 million in 2006. We capitalize a portion share-based compensation costs as a cost of construction.

At December 31, 2008, the total unrecognized compensation cost related to non-vested share-based compensation was $2 million, which will be recorded as compensation expense over the remaining vesting periods through February 2011. The total number of shares awarded but not yet issued, including target performance based shares, under the share-based compensation plans at December 31, 2008 was 2 million.

2009 SHARE-BASED COMPENSATION AWARDS

In February 2009, the Compensation Committee of the UniSource Energy Board of Directors granted 248,760 stock options to officers with an exercise price of $26.11 and 62,190 performance share awards (targeted shares) at a grant date fair value, based on a Monte Carlo Simulation of $21.62 per share. The performance share awards will be paid out in shares of UniSource Energy Common Stock based on targeted, cumulative UniSource Energy Total Shareholder Return during the performance period of January 1, 2009 through December 31, 2011, compared to the Total Shareholder Return over the same period of an industry or peer group.

NOTE 13. FAIR VALUE MEASUREMENTS

Effective January 1, 2008, we adopted FAS 157, *Fair Value Measurements* (FAS 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. As defined in FAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability between market participants at the measurement date (exit price). FAS 157 clarifies that the exchange price is the price in the principal market in which the reporting entity would transact for the asset or liability. With limited exceptions, the provisions of FAS 157 are applied prospectively. There was no transition adjustment as a result of adopting FAS 157.

As permitted by FSP FAS 157-2, we have elected to defer the adoption of the nonrecurring fair value measurement disclosures of nonfinancial assets and liabilities, such as asset retirement obligations, until January 1, 2009.

FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active,* issued October 2008, provides guidance clarifying how FAS 157 should be applied in markets that are not active. The guidance reaffirms the notion of fair value as an exit price as of the measurement date. The FSP emphasizes that approaches other than the market value approach to determine fair value, such as the use of management s internal assumptions about future cash flows and risk-adjusted discount rates, may be appropriate. The FSP, which is effective upon issuance and applicable to prior periods for which financial statements have not yet been issued, did not have a material impact on our financial statements.

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UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

In accordance with FAS 157, we have categorized our financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy defined by FAS 157 are as follows:

Level 1. Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market (examples include active exchange-traded equity securities and listed derivatives).

Level 2. Financial assets and liabilities whose values are based on quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in non-active markets (examples include corporate bonds, which trade infrequently), pricing models whose inputs are observable for substantially the full term of the asset or liabilities (examples include most non-exchange-traded derivatives, including interest rate swaps), and pricing models whose inputs are derived principally from or corroborated by observable market data through correlation or other means for substantially the full term of the asset or liability.

Level 3. Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management s own assumptions about the assumptions a market participant would use in pricing the asset or liability (examples include longdated or complex derivatives including certain long-dated options on gas and power).

The following tables set forth, by level within the fair value hierarchy, UniSource Energy and TEP s financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2008. As required by FAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	UniSource Energy			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
	December 31, 2008 -Millions of Dollars-			
Assets				
Cash Equivalents (1)	$ 14	$	$	$ 14
Rabbi Trust Investments to support the Deferred Compensation and SERP Plans (2)		9		9
Equity Investments (3)			11	11
Collateral Posted (4)		14		14
Energy Contracts (5)		1	6	7
Total Assets	14	24	17	55

Liabilities				
Energy Contracts [5]		(40)	(23)	(63)
Interest Rate Swap [6]		(8)		(8)
Total Liabilities		(48)	(23)	(71)
Net Total Assets and (Liabilities)	$ 14	$ (24)	$ (6)	$ (16)

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

	TEP			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
	December 31, 2008 -Millions of Dollars-			
Assets				
Cash Equivalents [1]	$ 8	$	$	$ 8
Rabbi Trust Investments to support the Deferred Compensation and SERP Plans [2]		9		9
Energy Contracts [5]			10	10
Total Assets	8	9	10	27
Liabilities				
Energy Contracts [5]		(18)	(11)	(29)
Interest Rate Swap [6]		(8)		(8)
Total Liabilities		(26)	(11)	(37)
Net Total Assets and (Liabilities)	$ 8	$ (17)	$ (1)	$ (10)

(1) Cash Equivalents are based on observable market prices and are comprised of the fair value of Money Market Funds.

(2) Level 2 investments comprise amounts held in mutual and money market funds related to

deferred compensation and Supplemental Executive Retirement Plan (SERP) benefits. The valuation is based on quoted prices, traded in active markets. These investments are included in Investments and Other Property Other in the UniSource Energy and TEP balance sheets.

(3) Equity Investments (UniSource Energy table only) are, in the absence of readily ascertainable market values, based on the investment partners valuations and comprise Millennium s equity investment in unregulated businesses. These investments are included in Investments and Other Property Other in the UniSource Energy balance sheet.

(4)

Collateral provided (UniSource Energy table only) for energy contracts with counterparties to reduce credit risk exposure.

(5) Energy contracts include gas swap agreements (Level 2), forward power purchase and sales contracts (Level 3), and forward power purchase contracts indexed to gas (Level 3), entered into to take advantage of favorable market conditions and reduce exposure to energy price risk. The valuation techniques are described below.

(6) Interest Rate Swap is valued based on the six month LIBOR index.

Energy Contracts

TEP, UNS Gas, UNS Electric and Millennium primarily apply the market approach for recurring fair value measurements and endeavor to utilize the best available information. Where observable inputs are available for substantially the full terms of the asset or liability, such as gas swap derivatives valued using New York Mercantile Exchange (NYMEX) pricing, adjusted for basin differences, the instrument is categorized in Level 2. Derivatives valued using an aggregate pricing service or published prices that represent a consensus reporting of multiple brokers are categorized in Level 3. For both power and gas prices, TEP obtains quotes from brokers, major market participants, exchanges or industry publications as well as its own price experience from active transactions in the market. TEP primarily uses one set of quotations each for power and for gas, and then uses the other sources as validation of those prices. The broker providing quotes for power prices states that the market information provided is indicative only, but believes it to be reflective of market conditions as of the time and date indicated. In addition, energy derivatives include contracts where published prices are not readily available. These include contracts for delivery periods during non-standard time blocks, contracts for delivery during only a few months of a given year when prices are quoted only for the annual average, or contracts for delivery at illiquid delivery points. In these cases, TEP applies certain management assumptions to value such contracts. These assumptions include applying historical price curve relationships to calendar year quotes, applying percentage multipliers to value non-standard time blocks, including the impact of counterparty credit risk, using current and historical default and recovery rates, our own credit risk, using credit default swap data, and including adjustments for transmission and line losses to value contracts at illiquid delivery points. TEP reviews these assumptions on a quarterly basis.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

TEP, UNS Gas, UNS Electric and Millennium s assessment of the significance of a particular input to the fair value measurements requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

The following tables set forth a reconciliation of changes in the fair value of investments and forward power purchase and sales contracts classified as Level 3 in the fair value hierarchy:

	Year Ended December 31, 2008 -Millions of Dollars-			
	UniSource Energy			TEP
	Mark-to-Market Contracts	Investments	Total	Mark-to-Market Contracts
Balance, beginning of year	$ 10	$ 14	$ 24	$
Gains and (Losses) (Realized/Unrealized)				
Recorded to:				
Other Expense		(3)	(3)	
Net Regulatory Assets	(27)		(27)	(1)
Balance, end of year	$ (17)	$ 11	$ (6)	$ (1)

Losses on mark-to-market contracts include the reclassification of realized gains and losses on the settlement of derivative contracts. All of the Level 3 unrealized gains and losses are attributable to the change in fair value of Level 3 assets and liabilities held at the reporting date.

There were no transfers in or out of Level 3 derivatives.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NOTE 14. UNISOURCE ENERGY EARNINGS PER SHARE (EPS)

We compute basic EPS by dividing Net Income by the weighted average number of common shares outstanding during the period. Except when the effect would be anti-dilutive, the diluted EPS calculation includes the impact of shares that could be issued upon exercise of outstanding stock options, contingently issuable shares under equity-based awards or common shares that would result from the conversion of convertible notes. The numerator in calculating diluted earnings per share is Net Income adjusted for the interest on convertible notes (net of tax) that would not be paid if the notes were converted to common shares.

The following table shows the effects of potential dilutive common stock on the weighted average number of shares:

	Years Ended December 31,		
	2008	**2007**	**2006**
		-In Thousands-	
Numerator:			
Net Income	**$ 14,021**	$ 58,373	$ 67,447
Income from Assumed Conversion of Convertible Senior Notes		4,390	4,390
Adjusted Numerator	**$ 14,021**	$ 62,763	$ 71,837
Denominator:			
Weighted-average Shares of Common Stock Outstanding	**35,632**	35,486	35,264
Effect of Diluted Securities			
Convertible Senior Notes		4,000	4,000
Options and Stock Issuable under Employee Benefit Plans and the Directors Plan	**537**	583	601
Total Shares	**36,169**	40,069	39,865

For the year ended December 31, 2008, 4 million potentially dilutive shares from the conversion of convertible senior notes, and after-tax interest expense of $4 million was not included in the computation of diluted EPS because to do so would be anti-dilutive.

Stock options to purchase an average of 312,000, 169,000 and 67,000 shares of Common Stock were outstanding during 2008, 2007 and 2006, respectively, but were not included in the computation of EPS because the stock option s exercise price was greater than the average market price of the Common Stock at year end.

NOTE 15. RELATED PARTIES

UniSource Energy incurs corporate costs that are allocated to its subsidiaries, including TEP. Corporate costs are allocated based on a weighted-average of three factors: assets, payroll and revenues. Management believes this method of allocation is reasonable and approximates the cost that TEP and its other affiliates would have incurred as stand-alone entities. Charges allocated to TEP were $7 million in each of 2008, 2007 and 2006. Charges allocated to UNS Gas and UNS Electric were $1 million in each of 2008, 2007 and 2006.

TEP provides all corporate services (finance, accounting, tax, information technology services, etc.) to UniSource Energy, UNS Gas and UNS Electric as well as to UniSource Energy s non-utility businesses. Costs are directly assigned to the benefiting entity where possible. Common costs are allocated on a cost-causative basis. Management believes this method of allocation is reasonable. The charges by TEP to the other companies were $15 million in 2008, $14 million in 2007, and $9 million in 2006.

In 2008, TEP and UNS Electric began selling power to each other at prices based on the Dow Jones Four Corners Daily Index. TEP had wholesale power sales to UNS Electric of $25 million. UNS Electric had wholesale power sales of $9 million to TEP.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

In 2008, TEP charged UNS Electric $2 million for control area services. No such services were provided in 2007 and 2006.

In May 2008, UED began providing energy from its Black Mountain Generating Station (BMGS) to UNS Electric, through a power sale agreement. UED charged UNS Electric $7 million for this energy. UNS Gas charged UNS Electric $7 million and UED $1 million for gas used by the BMGS facility.

Southwest Energy Solutions, Inc. (SES), a subsidiary of Millennium, provides a supplemental workforce for TEP and UNS Electric. Types of services provided for TEP include dusk to dawn lighting, facilities maintenance, meter reading, transmission and distribution, line locating, and general supplemental support. SES bills TEP for these services. Management believes that the charges for services are reasonable and approximate the cost that TEP would have incurred if it performed these services directly. SES charged TEP $15 million in 2008, $14 million in 2007 and 2006 for these services. SES provides meter reading services for UNS Electric. SES charged UNS Electric $1 million for these services in 2008, 2007 and 2006.

Carboelectrica Sabinas, S. de R.L. de C.V. (Sabinas) is a Mexican limited liability company created to develop up to 800 megawatts (MW) of coal-fired generation in the Sabinas region of Coahuila, Mexico. Millennium owns 50% of Sabinas. Sabinas also owns 19.2% of Minerales de Monclova, S.A. de C.V. (Mimosa). Mimosa is an owner of coal and associated gas reserves and a supplier of metallurgical coal to the Mexican steel industry and thermal coal to the major electric utility in Mexico. Altos Hornos de Mexico, S.A. de C.V. (AHMSA) and affiliates own the other 50%. UniSource Energy s former Chairman, President and Chief Executive Officer, who retired on December 31, 2008, is on the board of directors of AHMSA. As of December 31, 2008, Millennium s remaining investment in Sabinas is $14 million.

Millennium is in the process of finalizing a sale of its interest in Sabinas to Mimosa. In December 2008, Mimosa and Millennium signed a letter delineating the general terms of the sale and purchase. The terms called for an upfront $5 million payment to Millennium which was received in January 2009. Other key terms of the transaction include a three year, interest-bearing, collateralized $15 million note from Mimosa and an interest in carbon credits created from flaring coal mine methane at Mimosa mines. The sale is expected to close before the end of the first quarter of 2009.

NOTE 16. DISCONTINUED OPERATIONS

In January 2006, UniSource Energy s Board of Directors approved a plan to dispose of its investment in Global Solar to a third party. Global Solar appears in these financial statements as discontinued operations.

On March 31, 2006, UniSource Energy sold all of the capital stock of Global Solar to a third party. UniSource Energy received $16 million in cash as part of the transaction; a portion of the proceeds was used to satisfy $10 million of secured promissory notes held by a UniSource Energy subsidiary. In addition to the cash purchase price, UniSource Energy received a ten-year option to purchase between 5 and 10 percent of the common stock of Global Solar. The option is only exercisable after the seventh anniversary of the closing or upon the occurrence of certain events including a sale of all or substantially all of the assets of Global Solar, a merger, a change of control transaction, an initial public offering of Global Solar common stock or the payment by Global Solar of dividends in excess of specified amounts. For accounting purposes, no value was assigned to this repurchase option.

The following summarizes the amounts included in Discontinued Operations Net of Tax for all periods presented

	Years Ended December 31,		
	2008	**2007**	**2006**
	-Millions of Dollars-		
Revenues from Discontinued Operations	**$**	$	$ 1
Loss from Discontinued Operations Before Income Taxes			(4)
Income Tax Benefit			(2)
Discontinued Operations Net of Tax	**$**	$	$ (2)

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
NOTE 17. SUPPLEMENTAL CASH FLOW INFORMATION

A reconciliation of net income to net cash flows from operating activities follows:

	UniSource Energy		
	Years Ended December 31,		
	2008	2007	2006
	-Thousands of Dollars-		
Net Income	**$ 14,021**	$ 58,373	$ 67,447
Adjustments to Reconcile Net Income To Net Cash Flows from Operating Activities			
Depreciation and Amortization Expense	**147,690**	140,638	130,502
Depreciation and Amortization Recorded to Fuel and Other O&M Expense	**6,467**	6,897	7,604
CTC Revenue to be Refunded	**58,092**		
Impact of Reapplication of FAS 71	**(40,144)**		
Provision for Navajo Retiree Health Care and Mine Reclamation	**10,198**		
Amortization of Transition Recovery Asset	**23,945**	77,681	65,985
Mark-to-Market Transactions	**9,281**	2,459	(929)
Amortization of Deferred Debt-Related Costs included in Interest Expense	**3,891**	3,831	4,622
Impairment of Millennium Investments	**2,469**		
Provision for Bad Debts	**5,007**	3,592	3,439
Deferred Income Taxes	**35,739**	22,021	(5,530)
Pension and Postretirement Expense	**11,991**	14,442	17,753
Pension and Postretirement Funding	**(13,928)**	(13,809)	(12,557)
Share Based Compensation Expense	**2,901**	2,693	2,276
Excess Tax Benefit from Stock Option Exercises	**(633)**	(541)	(1,501)
Net Unrealized Loss (Gain) on MEG Trading Activities		2,562	9,955
Loss on Extinguishment of Debt			1,080
Changes in Assets and Liabilities which Provided (Used) Cash Exclusive of Changes Shown Separately			
Accounts Receivable	**432**	4,981	(33,335)
Materials and Fuel Inventory	**(10,176)**	(8,805)	(7,912)
Over/Under Recovered Purchased Energy Cost	**(10,337)**	2,377	4,808
Accounts Payable	**8,164**	(5,057)	9,163
Income Taxes Receivable (Payable)	**(12,720)**	(2,895)	(11,896)
Interest Accrued	**16,772**	10,031	7,814
Taxes Other Than Income Taxes	**(29)**	1,344	453
Other	**7,918**	(49)	24,332
Discontinued Operations Net of Tax			1,796
Net Cash Used by Operating Activities of Discontinued Operations			(2,710)
Net Cash Flows Operating Activities	**$ 277,011**	$ 322,766	$ 282,659

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

	TEP		
	Years Ended December 31,		
	2008	2007	2006
	-Thousands of Dollars-		
Net Income	**$ 4,363**	$ 53,456	$ 66,745
Adjustments to Reconcile Net Income			
To Net Cash Flows from Operating Activities			
Depreciation and Amortization Expense	**126,040**	119,811	112,346
Depreciation and Amortization Recorded to Fuel and Other O&M Expense	**5,039**	5,339	6,320
CTC Revenue to be Refunded	**58,092**		
Impact of Reapplication of FAS 71	**(40,144)**		
Provision for Navajo Retiree Health Care and Mine Reclamation	**10,198**		
Amortization of Transition Recovery Asset	**23,945**	77,681	65,985
Mark-to-Market Transactions	**9,283**	2,459	(929)
Amortization of Deferred Debt-Related Costs included in Interest Expense	**2,826**	2,677	3,356
Loss on Extinguishment of Debt			685
Provision for Bad Debts	**2,957**	2,161	1,869
Deferred Income Taxes	**24,410**	8,310	(233)
Pension and Postretirement Expense	**10,402**	12,683	16,050
Pension and Postretirement Funding	**(12,439)**	(12,479)	(11,133)
Share Based Compensation Expense	**2,239**	2,097	1,799
Changes in Assets and Liabilities which Provided (Used) Cash Exclusive of Changes Shown Separately			
Accounts Receivable	**131**	4,013	(45,185)
Materials and Fuel Inventory	**(8,774)**	(9,103)	(5,814)
Accounts Payable	**14,812**	(6,230)	22
Interest Accrued	**15,857**	10,113	8,191
Income Taxes Receivable/Payable	**10,127**	(3,378)	(8,702)
Taxes Other Than Income Taxes	**(1,011)**	1,463	(33)
Other	**10,353**	(6,961)	15,889
Net Cash Flows Operating Activities	**$ 268,706**	$ 264,112	$ 227,228

TEP deposited the Pima B redemption proceeds for its 7.5% Collateral Trust Bonds with a trustee. On August 1, 2008, the deposit was applied to the payment of $128 million of principal plus $5 million of accrued interest upon maturity of the bonds. As a result, for the year ended December 31, 2008, UniSource Energy and TEP had a $128 million non-cash financing activity that affected recognized assets and liabilities but did not result in cash receipts or payments.

Other non-cash investing and financing activities of UniSource Energy and TEP that affected recognized assets and liabilities but did not result in cash receipts or payments were as follows:

	Years Ended December 31,		
	2008	**2007**	**2006**

	-Thousands of Dollars-		
(Decrease)/Increase to Utility Plant Accruals	**$ (25,450)**	$ 24,915	$ (3,434)
Net Cost of Removal of Interim Retirements	**45,100**	21,301	6,859
Capital Lease Obligations	**16,612**	13,259	12,808

The non-cash additions to Utility Plant represent accruals for capital expenditures.

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

The non-cash net cost of removal of interim retirements represents an accrual for future asset retirement obligations that does not impact earnings.

The non-cash change in capital lease obligations represents interest accrued for accounting purposes in excess of interest payments in 2008, 2007 and 2006.

NOTE 18. QUARTERLY FINANCIAL DATA (UNAUDITED)

Our quarterly financial information is unaudited but, in management s opinion, includes all adjustments necessary for a fair presentation. Our utility businesses are seasonal in nature. Peak sales periods for TEP and UNS Electric generally occur during the summer months and peak sales periods for UNS Gas generally occur during the winter months. Accordingly, comparisons among quarters of a year may not represent overall trends and changes in operations.

	UniSource Energy			
	First	Second	Third	Fourth
	-Thousands of Dollars- (except per share data)			
2008				
Operating Revenue	$ 330,134	$ 360,322	$ 387,852	$ 319,204
Operating Income	23,276	35,883	15,023	71,022
Net Income (Loss)	(2,614)	4,747	(11,039)	22,927
Basic EPS	(0.07)	0.13	(0.31)	0.64
Diluted EPS	(0.07)	0.13	(0.31)	0.60
2007				
Operating Revenue	$ 317,841	$ 329,772	$ 398,204	$ 335,556
Operating Income	38,199	47,131	71,608	55,967
Net Income	4,943	11,806	25,417	16,207
Basic EPS	0.14	0.33	0.72	0.46
Diluted EPS	0.14	0.32	0.66	0.43

EPS is computed independently for each of the quarters presented. Therefore, the sum of the quarterly EPS amounts may not equal the total for the year.

	TEP			
	First	Second	Third	Fourth
	-Thousands of Dollars-			
2008				
Operating Revenue	$ 228,602	$ 294,141	$ 323,312	$ 233,198
Operating Income	8,719	31,009	7,451	60,092
Net Income (Loss)	(8,862)	5,765	(12,237)	19,697
2007				
Operating Revenue	$ 219,629	$ 268,371	$ 328,841	$ 253,662
Operating Income	27,099	45,420	68,020	48,519

Net Income	821	12,271	25,959	14,405

UNISOURCE ENERGY, TEP AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (concluded)

The principal unusual items for TEP and UniSource Energy include:

UniSource Energy and TEP

Fourth Quarter 2008. In the fourth quarter of 2008, as a result of the 2008 TEP Rate Order, TEP reapplied FAS 71 to its generation operations, and consequently, recorded a reduction to fuel expense, O&M and Taxes Other Than Income Taxes of $32 million, $1 million and $7 million, respectively.

Third Quarter 2008. In the third quarter of 2008, as a result of a settlement between Peabody and the Navajo Generating Station participants, TEP recorded, as fuel expense, the present value of its share of the Navajo Generating Station mine reclamation and postretirement benefit costs, totaling $9 million.

Third Quarter 2008. In the third quarter of 2008, TEP recorded an additional tax expense of $1 million related to a determination that certain accrued tax penalty payments will not be deductible for tax purposes under IRS regulations.

Fourth Quarter 2007. In the fourth quarter of 2007, TEP recorded adjustments relating to periods prior to the fourth quarter of 2007 which decreased net income by less than $0.5 million.

UniSource Energy

Second Quarter 2008. In the second quarter of 2008, UniSource Energy recorded a pre-tax charge of approximately $2 million ($1.2 million after-tax) related to an investment impairment of a Millennium investment, $1 million ($0.6 million after-tax) of which should have been recorded prior to 2008.

First Quarter 2006. On March 31, 2006, Millennium sold Global Solar for $16 million in cash and an option to purchase, under certain conditions, 5% to 10% of Global Solar at a future date. The option is exercisable, upon the occurrence of certain events, beginning in April 2013 and expires in April 2016. In the first quarter of 2006, UniSource Energy recorded an after-tax loss of approximately $3 million related to the discontinued operations and disposal of Global Solar.

Schedule I UniSource Energy Corporation (Parent Company Only)
UniSource Energy Corporation (Parent Company) Condensed Statement of Income

	Years Ended December 31,		
	2008	2007	2006
	-Millions of Dollars-		
Other Income/(Deductions)			
Equity in Earnings of Subsidiaries	**$ 19**	$ 63	$ 74
Interest from Affiliates	**2**	2	
Other			1
Total Other Income/(Deductions)	**21**	65	75
Interest on Long-Term Debt	**10**	10	13
Income Before Income Taxes	**11**	55	62
Income Tax Benefit	**3**	3	5
Net Income	**$ 14**	$ 58	$ 67

See Notes to Financial Statements.

UniSource Energy Corporation (Parent Company) Condensed Statement of Cash Flows

	Years Ended December 31,		
	2008	2007	2006
	-Millions of Dollars-		
Cash Flows from Operating Activities			
Reimbursement of Affiliate Interest	**$ 2**	$ 2	$
Reimbursement of Affiliate Income Tax	**3**	30	81
Reimbursement of Other Affiliate Charges	**5**		
Income Taxes Paid	**(10)**	(21)	(66)
Interest Paid	**(9)**	(10)	(12)
Other Cash Receipts			2
Other Cash Payments		(1)	
Net Cash Flows Operating Activities	**(9)**		5
Cash Flows from Financing Activities			
Proceeds from Borrowing Under Revolving Credit Facilities	**46**	31	
Dividends Received from Affiliates	**28**	68	62
Proceeds from Stock Options Exercised	**2**	2	5
Common Stock Dividends Paid	**(34)**	(32)	(29)
Repayments of Borrowings Under Revolving Credit Facilities	**(23)**		
Repayment of Long-Term Debt	**(6)**	(37)	(39)
Loans to Subsidiaries	**(13)**	(24)	(21)
Equity Investment in Subsidiaries		(28)	(10)

Other Cash Receipts				9		
Other Cash Payments						(7)
Net Cash Flows Financing Activities				(11)		(39)
Net Decrease in Cash and Cash Equivalents		**(9)**		(11)		(34)
Cash and Cash Equivalents, Beginning of Year		**11**		22		56
Cash and Cash Equivalents, End of Year	**$**	**2**	$	11	$	22

See Notes to Financial Statements.

UniSource Energy Corporation (Parent Company) Condensed Balance Sheet

	December 31, 2008	December 31, 2007
	-Millions of Dollars-	
ASSETS		
Investment in Affiliates	**$ 889**	$ 835
Current Assets		
Cash and Cash Equivalents	**2**	11
Accounts Receivable Due from Affiliates	**21**	78
Income Taxes Receivable	**15**	
Total Current Assets	**38**	89
Other Deferred Debits	**4**	5
Total Assets	**$ 931**	$ 929
CAPITALIZATION AND OTHER LIABILITIES		
Capitalization		
Common Stock No Par Value	**$ 687**	$ 703

	2008	2007
Shares Authorized	75,000,000	75,000,000
Shares Outstanding	35,457,780	35,314,730

	2008	2007
Accumulated Deficit	**(1)**	(1)
Accumulated Other Comprehensive Loss	**(7)**	(12)
Total Common Stock Equity	**(679)**	690
Long-Term Debt	**202**	185
Total Capitalization	**881**	875
Current Liabilities		
Current Maturities of Long-Term Debt	**6**	6
Accounts Payable Due to Affiliates	**39**	35
Interest Accrued	**2**	2
Income Taxes Payable		9
Total Current Liabilities	**47**	52
Other Liabilities	**3**	2

Total Capitalization and Other Liabilities	**$ 931**	$ 929

See Notes to Financial Statements.

NOTE 1. BASIS OF PRESENTATION

UniSource Energy Corporation (UniSource Energy) is a holding company that has no significant operations of its own. Operations are conducted by UniSource Energy s subsidiaries, each of which is a separate legal entity with its own assets and liabilities. UniSource Energy owns 100% of Tucson Electric Power Company (TEP), UniSource Energy Services, Inc. (UES), Millennium Energy Holdings, Inc. (Millennium) and UniSource Energy Development Company (UED). These condensed financial statements and related footnotes have been prepared in accordance with Rule 12-04 Schedule I of Regulation S-X. These statements should be read in conjunction with the consolidated financial statements and notes of UniSource Energy.

NOTE 2. DEBT AND CREDIT FACILITIES

See Note 7 of the Notes to the Consolidated Financial Statements for UniSource Energy s Long-Term Debt, Debt Maturities and the UniSource Energy Credit Agreement.

NOTE 3. STOCKHOLDERS EQUITY

See Note 9 of the Notes to the Consolidated Financial Statements for UniSource Energy s Dividend Limitations, Shareholder Rights Plan and details of dividends paid to UniSource Energy.

NOTE 4. INCOME TAXES

See Note 10 of the Notes to the Consolidated Financial Statements.

NOTE 5. SHARE-BASED COMPENSATION PLANS

See Note 12 of the Notes to the Consolidated Financial Statements.

NOTE 6. RELATED PARTY TRANSACTIONS

See Note 15 of the Notes to the Consolidated Financial Statements.

Schedule II Valuation and Qualifying Accounts UniSource Energy

Description	Beginning Balance	Additions- Charged to Income	Deductions	Ending Balance
	-Millions of Dollars-			
Year Ended December 31,				
Allowance for Doubtful Accounts [1]				
2008	$ 18	$ 5	$ 3	$ 20
2007	17	4	3	18
2006	15	4	2	17
Deferred Tax Assets Valuation Allowance [2]				
2008	$	$	$	$
2007				
2006	7		7	

(1) TEP, UNS Gas and UNS Electric record additions to the Allowance for Doubtful Accounts based on historical experience and any specific customer collection issues identified. Deductions principally reflect amounts charged off as uncollectible, less amounts recovered. Balances related primarily to TEP reserves for sales to the CPX and CISO in 2000 and 2001. See Note 5.

(2) The deferred tax assets valuation allowance reduced the deferred tax asset balance. It related to NOL and ITC carryforward amounts. The $7 million valuation allowance at January 1, 2006, relates to losses generated by Global Solar. Global Solar was sold in March 2006 and is no longer included in our consolidated tax returns.

Schedule II Valuation and Qualifying Accounts TEP

Description	Beginning Balance	Additions- Charged to Income	Deductions	Ending Balance
	-Millions of Dollars-			
Year Ended December 31,				
Allowance for Doubtful Accounts [1]				
2008	$ 17	$ 3	$ 3	$ 17
2007	16	2	1	17
2006	15	2	1	16

(1) TEP records additions to the Allowance for Doubtful Accounts based on historical experience and any specific customer collection issues identified. Deductions principally reflect amounts charged off as uncollectible, less amounts recovered. Balances related primarily to TEP reserves for sales to the CPX and CISO in 2000 and 2001. See Note 5.

TEP had no deferred tax assets valuation allowance in the periods presented.

ITEM 9A. CONTROLS AND PROCEDURES

UniSource Energy and TEP s Chief Executive Officer and Chief Financial Officer supervised and participated in UniSource Energy and TEP s evaluation of their disclosure controls and procedures as such term is defined under Rule 13a 15(e) or Rule 15d 15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of December 31, 2008. Disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in UniSource Energy and TEP s periodic reports filed or submitted under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. These disclosure controls and procedures are also designed to ensure that information required to be disclosed by UniSource Energy and TEP in the reports that they file or submit under the Act is accumulated and communicated to management, including the principal executive and principal financial officers, or person performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based upon the evaluation performed, UniSource Energy and TEP s Chief Executive Officer and Chief Financial Officer concluded that UniSource Energy and TEP s disclosure controls and procedures are effective.

While UniSource Energy and TEP continually strive to improve their disclosure controls and procedures to enhance the quality of their financial reporting, there has been no change in UniSource Energy or TEP s internal control over financial reporting during the fourth quarter of 2008, that has materially affected, or is reasonably likely to materially affect, UniSource Energy or TEP s internal control over financial reporting.

UniSource Energy s and TEP s Management s Reports on Internal Control Over Financial Reporting Under 404 of Sarbanes-Oxley appear as the first two reports under Item 8 in UniSource Energy s and TEP s 2008 Annual Report on Form 10-K, as amended by Amendment No. 1 on Form 10-K/A, the Report of Independent Registered Public Accounting Firm for UniSource Energy appears as the third report under Item 8, and the Report of Independent Registered Public Accounting Firm for TEP appears as the fourth report under Item 8.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

SIGNATURES

Pursuant to the requirements of Section 13 and 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

UNISOURCE ENERGY CORPORATION

Date: August 5, 2009

By: /s/ Kevin P. Larson
Kevin P. Larson
Senior Vice President and Principal
Financial Officer

SIGNATURES

Pursuant to the requirements of Section 13 and 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TUCSON ELECTRIC POWER COMPANY

Date: August 5, 2009

By: /s/ Kevin P. Larson
Kevin P. Larson
Senior Vice President and Principal
Financial Officer

EXHIBIT INDEX

*2(a)	Agreement and Plan of Exchange, dated as of March 20, 1995, between TEP, UniSource Energy and NCR Holding, Inc.
*3(a)	Restated Articles of Incorporation of TEP, filed with the ACC on August 11, 1994, as amended by Amendment to Article Fourth of our Restated Articles of Incorporation, filed with the ACC on May 17, 1996. (Form 10-K for year ended December 31, 1996, File No. 1-5924 Exhibit 3(a).)
*3(b)	Bylaws of TEP, as amended April 7, 1995 (Form 10-K for the year ended December 31, 2007, File No. 13739 Exhibit 3(b)).
*3(c)	Amended and Restated Articles of Incorporation of UniSource Energy. (Form 8-A/A, dated January 30, 1998, File No. 1-13739 Exhibit 2(a).)
*3(d)	Bylaws of UniSource Energy, as amended February 27, 2008 (Form 10-K for the year ended December 31, 2007, File No. 13739 Exhibit 3(b)).
*4(a)(1)	Installment Sale Agreement, dated as of December 1, 1973, among the City of Farmington, New Mexico, Public Service Company of New Mexico and TEP. (Form 8-K for the month of January 1974, File No. 0-269 Exhibit 3.)
*4(a)(2)	Ordinance No. 486, adopted December 17, 1973, of the City of Farmington, New Mexico. (Form 8-K for the month of January 1974, File No. 0-269 Exhibit 4.)
*4(a)(3)	Amended and Restated Installment Sale Agreement dated as of April 1, 1997, between the City of Farmington, New Mexico and TEP relating to Pollution Control Revenue bonds, 1997 Series A (Tucson Electric Power Company San Juan Project). (Form 10-Q for the quarter ended March 31,1997, File No. 1-5924 Exhibit 4(a).)
*4(a)(4)	City of Farmington, New Mexico Ordinance No. 97-1055, adopted April 17, 1997, authorizing Pollution Control Revenue bonds, 1997 Series A (Tucson Electric Power Company San Juan Project). (Form 10-Q for the quarter ended March 31, 1997, File No. 1-5924 Exhibit 4(b).)
*4(b)(1)	Loan Agreement, dated as of October 1, 1982, between the Pima County Authority and TEP relating to Floating Rate Monthly Demand Industrial Development Revenue Bonds, 1982 Series A (Tucson Electric Power Company Sundt Project). (Form 10-Q for the quarter ended September 30, 1982, File No. 1-5924 Exhibit 4(a).)
*4(b)(2)	Indenture of Trust, dated as of October 1, 1982, between the Pima County Authority and Morgan Guaranty authorizing Floating Rate Monthly Demand Industrial Development Revenue Bonds, 1982 Series A (Tucson Electric Power Company Sundt Project). (Form 10-Q for the quarter ended September 30, 1982, File No. 1-5924 Exhibit 4(b).)
*4(b)(3)	First Supplemental Loan Agreement, dated as of March 31, 1992, between the Pima County Authority and TEP relating to Industrial Development Revenue Bonds, 1982 Series A (Tucson Electric Power Company Sundt Project). (Form S-4, Registration No. 33-52860 Exhibit 4(h)(3).)
*4(b)(4)	

	First Supplemental Indenture of Trust, dated as of March 31, 1992, between the Pima County Authority and Morgan Guaranty relating to Industrial Development Revenue Bonds, 1982 Series A (Tucson Electric Power Company Sundt Project). (Form S-4, Registration No. 33-52860 Exhibit 4(h)(4).)
*4(c)(1)	Loan Agreement, dated as of December 1, 1982, between the Pima County Authority and TEP relating to Floating Rate Monthly Demand Industrial Development Revenue Bonds, 1982 Series A (Tucson Electric Power Company Projects). (Form 10-K for the year ended December 31, 1982, File No. 1-5924 Exhibit 4(k)(1).)

*4(c)(2)	Indenture of Trust dated as of December 1, 1982, between the Pima County Authority and Morgan Guaranty authorizing Floating Rate Monthly Demand Industrial Development Revenue Bonds, 1982 Series A (Tucson Electric Power Company Projects). (Form 10-K for the year ended December 31, 1982, File No. 1-5924 Exhibit 4(k)(2).)
*4(c)(3)	First Supplemental Loan Agreement, dated as of March 31, 1992, between the Pima County Authority and TEP relating to Industrial Development Revenue Bonds, 1982 Series A (Tucson Electric Power Company Projects). (Form S-4, Registration No. 33-52860 Exhibit 4(i)(3).)
*4(c)(4)	First Supplemental Indenture of Trust, dated as of March 31, 1992, between the Pima County Authority and Morgan Guaranty relating to Industrial Development Revenue Bonds, 1982 Series A (Tucson Electric Power Company Projects). (Form S-4, Registration No. 33-52860 Exhibit 4(i)(4).)
*4(d)(1)	Loan Agreement, dated as of December 1, 1983, between the Apache County Authority and TEP relating to Floating Rate Monthly Demand Industrial Development Revenue Bonds, 1983 Series A (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1983, File No. 1-5924 Exhibit 4(I)(1).)
*4(d)(2)	Indenture of Trust, dated as of December 1, 1983, between the Apache County Authority and Morgan Guaranty authorizing Floating Rate Monthly Demand Industrial Development Revenue Bonds, 1983 Series A (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1983, File no. 1-5924 Exhibit 4(I)(2).)
*4(d)(3)	First Supplemental Loan Agreement, dated as of December 1, 1985, between the Apache County Authority and TEP relating to Floating Rate Monthly Demand Industrial Development Revenue Bonds, 1983 Series A (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1987, File No. 1-5924 Exhibit 4(k)(3).)
*4(d)(4)	First Supplemental Indenture, dated as of December 1, 1985, between the Apache County Authority and Morgan Guaranty relating to Floating Rate Monthly Demand Industrial Development Revenue Bonds, 1983 Series A (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1987, File No. 1-5924 Exhibit 4(k)(4).)
*4(d)(5)	Second Supplemental Loan Agreement, dated as of March 31, 1992, between the Apache County Authority and TEP relating to Industrial Development Revenue Bonds, 1983 Series A (Tucson Electric Power Company Springerville Project). (Form S-4, Registration No. 33-52860 Exhibit 4(k)(5).)
*4(d)(6)	Second Supplemental Indenture of Trust, dated as of March 31, 1992, between the Apache County Authority and Morgan Guaranty relating to Industrial Development Revenue Bonds, 1983 Series A (Tucson Electric Power Company Springerville Project). (Form S-4, Registration No. 33-52860 Exhibit 4(k)(6).)
*4(e)(1)	Loan Agreement, dated as of December 1, 1983, between the Apache County Authority and TEP relating to Variable Rate Demand Industrial Development Revenue Bonds, 1983 Series B (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1983, File No. 1-5924 Exhibit 4(m)(1).)

*4(e)(2)	Indenture of Trust dated as of December 1, 1983, between the Apache County Authority and Morgan Guaranty authorizing Variable Rate Demand Industrial Development Revenue Bonds. 1983 Series B (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1983, File No. 1-5924 Exhibit 4(m)(2).)
*4(e)(3)	First Supplemental Loan Agreement, dated as of December 1, 1985, between the Apache County Authority and TEP relating to Floating Rate Monthly Demand Industrial Developmental Revenue Bonds, 1983 Series B (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1987, File No. 1-5924 Exhibit 4(I)(3).)

*4(e)(4)	First Supplemental Indenture, dated as of December 1, 1985, between the Apache County Authority and Morgan Guaranty relating to Floating Rate Monthly Demand Industrial Development Revenue Bonds, 1983 Series B (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1987, File No. 1-5924 Exhibit 4(I)(4).)
*4(e)(5)	Second Supplemental Loan Agreement, dated as of March 31, 1992, between the Apache County Authority and TEP relating to Industrial Development Revenue Bonds, 1983 Series B (Tucson Electric Power Company Springerville Project). (Form S-4, Registration No. 33-52860 Exhibit 4(I)(5).)
*4(e)(6)	Second Supplemental Indenture of Trust, dated as of March 31, 1992, between the Apache County Authority and Morgan Guaranty relating to Industrial Development Revenue Bonds, 1983 Series B (Tucson Electric Power Company Springerville Project). (Form S-4, Registration No. 33-52860 Exhibit 4(I)(6).)
*4(f)(1)	Loan Agreement, dated as of December 1, 1983, between the Apache County Authority and TEP relating to Variable Rate Demand Industrial Development Revenue Bonds, 1983 Series C (Tucson Electric Power Company Springerville Project). (Form 10-K for year ended December 31, 1983, File No. 1-5924 Exhibit 4(n)(1).)
*4(f)(2)	Indenture of Trust dated as of December 1, 1983, between the Apache County Authority and Morgan Guaranty authorizing Variable Rate Demand Industrial Development Revenue Bonds, 1983 Series C (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1983, File No. 1-5924 Exhibit 4(n)(2).)
*4(f)(3)	First Supplemental Loan Agreement, dated as of December 1, 1985, between the Apache County Authority and TEP relating to Floating Rate Monthly Demand Industrial Development Revenue Bonds, 1983 Series C (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1987, File No. 1-5924 Exhibit 4(m)(3).)
*4(f)(4)	First Supplemental Indenture, dated as of December 1, 1985, between the Apache County Authority and Morgan Guaranty relating to Floating Rate Monthly Demand Industrial Development Revenue Bonds, 1983 Series C (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1987, File No. 1-5924 Exhibit 4(m)(4).)
*4(f)(5)	Second Supplemental Loan Agreement, dated as of March 31, 1992, between the Apache County Authority and TEP relating to Industrial Development Revenue Bonds, 1983 Series C (Tucson Electric Power Company Springerville Project). (Form S-4, Registration No. 33-52860 Exhibit 4(m)(5).)
*4(f)(6)	Second Supplemental Indenture of Trust, dated as of March 31, 1992, between the Apache County Authority and Morgan Guaranty relating to Industrial Development Revenue Bonds, 1983 Series C (Tucson Electric Power Company Springerville Project). (Form S-4, Registration No. 33-52860 Exhibit 4(m)(6).)
*4(g)	Reimbursement Agreement, dated as of September 15, 1981, as amended, between TEP and Manufacturers Hanover Trust Company. (Form 10-K for the year ended December 31, 1984, File No. 1-5924 Exhibit 4(o)(4).)

*4(h)(1)	Loan Agreement, dated as of December 1, 1985, between the Apache County Authority and TEP relating to Variable Rate Demand Industrial Development Revenue Bonds, 1985 Series A (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1985, File No. 1-5924 Exhibit 4(r)(1).)
*4(h)(2)	Indenture of Trust dated as of December 1, 1985, between the Apache County Authority and Morgan Guaranty authorizing Variable Rate Demand Industrial Development Revenue Bonds, 1985 Series A (Tucson Electric Power Company Springerville Project). (Form 10-K for the year ended December 31, 1985, File No. 1-5924 Exhibit 4(r)(2).)

*4(h)(3)	First Supplemental Loan Agreement, dated as of March 31, 1992, between the Apache County Authority and TEP relating to Industrial Development Revenue Bonds, 1985 Series A (Tucson Electric Power Company Springerville Project). (Form S-4, Registration No. 33-52860 Exhibit 4(o)(3).)
*4(h)(4)	First Supplemental Indenture of Trust, dated as of March 31, 1992, between the Apache County Authority and Morgan Guaranty relating to Industrial Development Revenue Bonds, 1985 Series A (Tucson Electric Power Company Springerville Project). (Form S-4, Registration No. 33-52860 Exhibit 4(o)(4).)
*4(i)(1)	Indenture of Mortgage and Deed of Trust dated as of December 1, 1992, to Bank of Montreal Trust Company, Trustee. (Form S-1, Registration No. 33-55732 Exhibit 4(r)(1).)
*4(i)(2)	Supplemental Indenture No. 1 creating a series of bonds designated Second Mortgage Bonds, Collateral Series A, dated as of December 1, 1992. (Form S-1, Registration No. 33-55732 Exhibit 4(r)(2).)
*4(i)(3)	Supplemental Indenture No. 2 creating a series of bonds designated Second Mortgage Bonds, Collateral Series B, dated as of December 1, 1997. (Form 10-K for year ended December 31, 1997, File No. 1-5924 Exhibit 4(m)(3).)
*4(i)(4)	Supplemental Indenture No. 3 creating a series of bonds designated Second Mortgage Bonds, Collateral Series, dated as of August 1, 1998. (Form 10-Q for the quarter ended June 30, 1998, File No. 1-5924 Exhibit 4(c).)
*4(i)(5)	Supplemental Indenture No. 4 creating a series of bonds designated Second Mortgage Bonds, Collateral Series C, dated as of November 1, 2002. (Form 8-K dated November 27, 2002, File Nos. 1-05924 and 1-13739 Exhibit 99.2.)
*4(i)(6)	Supplemental Indenture No. 5 creating a series of bonds designated Second Mortgage Bonds, Collateral Series D, dated as of March 1, 2004. (Form 8-K dated March 31, 2004, File Nos. 1-05924 and 1-13739 Exhibit 10 (b).)
*4(i)(7)	Supplemental Indenture No. 6 creating a series of bonds designated Second Mortgage Bonds, Collateral Series E, dated as of May 1, 2005. (Form 10-Q for the quarter ended March 31, 2005, File Nos. 1-5924 and 1-13739 Exhibit 4(b).)
*4(i)(8)	Supplemental Indenture No. 7 creating a series of bonds designated First Mortgage Bonds, Collateral Series F, dated as of December 1, 2006. (Form 8-K dated December 22, 2006, File Nos. 1-5924 and 1-13739 Exhibit 4.1.)
*4(i)(9)	Supplemental Indenture No. 8 creating a series of bonds designated First Mortgage Bonds, Collateral Series G, dated as of June 1, 2008. (Form 8-K dated June 25, 2008, File Nos. 1-5924 and 1-13739 Exhibit 4(b).).
*4(i)(10)	Supplemental Indenture No. 9 dated as of July 3, 2008. (Form 10-K dated December 31, 2008, File 1-13739)

*4(j)(1)	Loan Agreement, dated as of April 1, 1997 between Coconino County, Arizona Pollution Control Corporation and TEP relating to Pollution Control Revenue Bonds, 1997 Series A (Tucson Electric Power Company Navajo Project). (Form 10-Q for the quarter ended March 31, 1997, File No. 1-5924 Exhibit 4(c).)
*4(j)(2)	Indenture of Trust, dated as of April 1, 1997, between Coconino County, Arizona Pollution Control Corporation and First Trust of New York, National Association, authorizing Pollution Control Revenue Bonds, 1997 Series A (Tucson Electric Power Company Navajo Project). (Form 10-Q for the quarter ended March 31, 1997, File No. 1-5924 Exhibit 4(d).)
*4(k)(1)	Loan Agreement, dated as of April 1, 1997, between Coconino County, Arizona Pollution Control Corporation and TEP relating to Pollution Control Revenue Bonds, 1997 Series B (Tucson Electric Power Company Navajo Project). (Form 10-Q for the quarter ended March 31, 1997, File No. 1-5924 Exhibit 4(e).)

*4(k)(2)	Indenture of Trust, dated as of April 1, 1997, between Coconino County, Arizona Pollution Control Corporation and First Trust of New York, National Association, authorizing Pollution Control Revenue Bonds, 1997 Series B (Tucson Electric Power Company Navajo Project). (Form 10-Q for the quarter ended March 31, 1997, File No. 1-5924 Exhibit 4(f).)
*4(l)(1)	Loan Agreement, dated as of September 15, 1997, between The Industrial Development Authority of the County of Pima and TEP relating to Industrial Development Revenue Bonds, 1997 Series A (Tucson Electric Power Company Project). (Form 10-Q for the quarter ended September 30, 1997, File No. 1-5924 Exhibit 4(a).)
*4(l)(2)	Indenture of Trust, dated as of September 15, 1997, between The Industrial Development Authority of the County of Pima and First Trust of New York, National Association, authorizing Industrial Development Revenue Bonds, 1997 Series A (Tucson Electric Power Company Project). (Form 10-Q for the quarter ended September 30, 1997, File No. 1-5924 Exhibit 4(b).)
*4(m)(1)	Loan Agreement, dated as of March 1, 1998, between The Industrial Development Authority of the County of Apache and TEP relating to Pollution Control Revenue Bonds, 1998 Series A (Tucson Electric Power Company Project). (Form 10-Q for the quarter ended March 31, 1998, File No. 1-5924 Exhibit 4(a).)
*4(m)(2)	Indenture of Trust, dated as of March 1, 1998, between The Industrial Development Authority of the County of Apache and First Trust of New York, National Association, authorizing Pollution Control Revenue Bonds, 1998 Series A (Tucson Electric Power Company Project). (Form 10-Q for the quarter ended March 31, 1998, File No. 1-5924 Exhibit 4(b).)
*4(n)(1)	Loan Agreement, dated as of March 1, 1998, between The Industrial Development Authority of the County of Apache and TEP relating to Pollution Control Revenue Bonds, 1998 Series B (Tucson Electric Power Company Project). (Form 10-Q for the quarter ended March 31, 1998, File No. 1-5924 Exhibit 4(c).)
*4(n)(2)	Indenture of Trust, dated as of March 1, 1998, between The Industrial Development Authority of the County of Apache and First Trust of New York, National Association, authorizing Pollution Control Revenue Bonds, 1998 Series B (Tucson Electric Power Company Project). (Form 10-Q for the quarter ended March 31, 1998, File No. 1-5924 Exhibit 4(d).)
*4(o)(1)	Loan Agreement, dated as of March 1, 1998, between The Industrial Development Authority of the County of Apache and TEP relating to Industrial Development Revenue Bonds, 1998 Series C (Tucson Electric Power Company Project). (Form 10-Q for the quarter ended March 31, 1998, File No. 1-5924 Exhibit 4(e).)
*4(o)(2)	Indenture of Trust, dated as of March 1, 1998, between The Industrial Development Authority of the County of Apache and First Trust of New York, National Association, authorizing Industrial Development Revenue Bonds, 1998 Series C (Tucson Electric Power Company Project). (Form 10-Q for the quarter ended March 31, 1998, File No. 1-5924 Exhibit 4(f).)
*4(p)(1)	Rights Agreement dated as of March 5, 1999, between UniSource Energy Corporation and The Bank of New York, as Rights Agent. (Form 8-K dated March 5, 1999, File No. 1-13739 Exhibit 4.)

*4(q)(1)	Amended and Restated TEP Credit Agreement dated as of August 11, 2006, among TEP, the Lenders Party Thereto, the Issuing Banks Party Thereto, Union Bank of California, N.A., as Lead Arranger and Administrative Agent, The Bank of New York and JPMorgan Chase, N.A., as Co-Syndication Agents, and Wells Fargo Bank, National Association, and ABN Amro Bank N.V. as Co-Documentation Agents. (Form 8-K dated August 15, 2006, File Nos. 1-5924 and 1-13739 Exhibit 4.3.)
*4(r)(2)	Amendment No. 1 to Amended and Restated TEP Credit Agreement, dated September 1, 2006. (Form 10-Q for the quarter ended September 30, 2006, File No. 1-5924 Exhibit 4.)

*4(r)(3)	Amendment No. 2 to Amended and Restated TEP Credit Agreement, dated May 30, 2008. (Form 10-K dated December 31, 2008, File 1-13739)
*4(r)(4)	Amendment No. 3 to Amended and Restated TEP Credit Agreement, dated September 16, 2008. (Form 10-K dated December 31, 2008, File 1-13739)
*4(s)(1)	Note Purchase and Guaranty Agreement dated August 11, 2003 among UNS Gas, Inc., and UniSource Energy Services, Inc., and certain institutional investors. (Form 8-K dated August 21, 2003, File Nos. 1-5924 and 1-13739 Exhibit 99.2.)
*4(t)(1)	Note Purchase and Guaranty Agreement date August 5, 2008 among UNS Electric, Inc., and UniSource Energy Services, Inc., and certain institutional investors. (Form 10-Q for the quarter ended June 30, 2008, File Nos. 1-5924 and 1-13739 Exhibit 4.).
*4(u)(1)	Indenture dated as of March 1, 2005, to The Bank of New York, as Trustee. (Form 8-K dated March 3, 2005, File Nos. 1-5924 and 1-13739 Exhibit 4.1).
*4(v)(1)	Registration Rights Agreement dated as of March 1, 2005, between UniSource Energy Corporation and Credit Suisse First Boston LLC, as representative of the several initial purchasers. (Form 8-K dated March 3, 2005, File Nos. 1-5924 and 1-13739 Exhibit 4.2).
*4(w)(1)	Amended and Restated Credit Agreement dated as of August 11, 2006, among UniSource Energy, the Lenders Party Hereto, Union Bank of California, N.A., as Lead Arranger and Administrative Agent, The Bank of New York and JPMorgan Chase, N.A., as Co-Syndication Agents, and Wells Fargo Bank, National Association, and ABN Amro Bank N.V. as Co-Documentation Agents. (Form 8-K dated August 15, 2006, File Nos. 1-5924 and 1-13739 Exhibit 4.1.)
*4(w)(2)	Amendment No. 1 to the Amended and Restated UniSource Energy Credit Agreement, dated September 16, 2008. (Form 10-K dated December 31, 2008, File 1-13739)
*4(w)(3)	Amendment No. 2 to the Amended and Restated UniSource Energy Credit Agreement, dated February 26, 2009. (Form 10-K dated December 31, 2008, File 1-13739)
*4(x)(1)	Amended and Restated Credit Agreement dated as of August 11, 2006, among UNS Electric and UNS Gas, UniSource Energy Services as Guarantor, and the Banks Named Herein and the Other Lenders from Time to Time party Hereto, Union Bank of California, N.A., as Lead Arranger and Administrative Agent, The Bank of New York and JPMorgan Chase, N.A., as Co-Syndication Agents, and Wells Fargo Bank, National Association, and ABN Amro Bank N.V. as Co-Documentation Agents. (Form 8-K dated August 15, 2006, File Nos. 1-5924 and 1-13739 Exhibit 4.4.)
*4(x)(2)	Amendment No. 1 to the Amended and Restated UNS Gas/UNS Electric Credit Agreement, dated as of April 30, 2007. (Form 10-K dated December 31, 2008, File 1-13739)
*4(x)(3)	Amendment No. 2 to the Amended and Restated UNS Gas/UNS Electric Credit Agreement, dated as of July 31, 2008. (Form 10-K dated December 31, 2008, File 1-13739)
*4(y)(1)	

	Letter of Credit and Reimbursement Agreement, dated as of April 30, 2008, among TEP, as Borrower, JPMorgan Chase Bank, N.A., as Issuing Bank, Union Bank of California, N.A., as Syndication Agent, ABN Amro Bank N.V., SunTrust Bank and Wells Fargo Bank, National Association, as Co-Documentation Agents, JPMorgan Chase Bank, N.A., as Administrative Agent, and the Lenders party thereto. (Form 8-K dated June 25, 2008, File Nos. 1-5924 and 1-13739 Exhibit 4(d).)
*4(y)(2)	Amendment No. 1 to the TEP Letter of Credit and Reimbursement Agreement, dated as of May 30, 2008. (Form 10-K dated December 31, 2008, File 1-13739)
*4(y)(3)	Amendment No. 2 to the TEP Letter of Credit and Reimbursement Agreement, dated as of September 16, 2008. (Form 10-K dated December 31, 2008, File 1-13739)

*4(z)(1)	Indenture of Trust, dated as of March 1, 2008, between The Industrial Development Authority of the County of Pima and U.S. Trust National Association authorizing Industrial Development Revenue Bonds, 2008 Series A (Tucson Electric Power Company Project). (Form 8-K dated March 19, 2008, File Nos. 1-5924 and 1-13739 Exhibit 4(a).)
*4(z)(2)	Loan Agreement, dated as of March 1, 2008, between the Industrial Development Authority of the County of Pima and TEP relating to Industrial Development Revenue Bonds, 2008 Series A (Tucson Electric Power Company Project). (Form 8-K dated March 19, 2008, File Nos. 1-5924 and 1-13739 Exhibit 4(b).)
*4(aa)(1)	Indenture of Trust, dated as of June 1, 2008, between The Industrial Development Authority of the County of Pima and U.S. Trust National Association authorizing Industrial Development Revenue Bonds, 2008 Series B (Tucson Electric Power Company Project). (Form 8-K dated June 25, 2008, File Nos. 1-5924 and 1-13739 Exhibit 4(a).)
*4(aa)(2)	Loan Agreement, dated as of June 1, 2008, between the Industrial Development Authority of the County of Pima and TEP relating to Industrial Development Revenue Bonds, 2008 Series B (Tucson Electric Power Company Project). (Form 8-K dated June 25, 2008, File Nos. 1-5924 and 1-13739 Exhibit 4(b).)
*10(a)(1)	Lease Agreements, dated as of December 1, 1984, between Valencia and United States Trust Company of New York, as Trustee, and Thomas B. Zakrzewski, as Co-Trustee, as amended and supplemented. (Form 10-K for the year ended December 31, 1984, File No. 1-5924 Exhibit 10(d)(1).)
*10(a)(2)	Guaranty and Agreements, dated as of December 1, 1984, between TEP and United States Trust Company of New York, as Trustee, and Thomas B. Zakrzewski, as Co-Trustee. (Form 10-K for the year ended December 31, 1984, File No. 1-5924 Exhibit 10(d)(2).)
*10(a)(3)	General Indemnity Agreements, dated as of December 1, 1984, between Valencia and TEP, as Indemnitors; General Foods Credit Corporation, Harvey Hubbell Financial, Inc. and J.C. Penney Company, Inc. as Owner Participants; United States Trust Company of New York, as Owner Trustee; Teachers Insurance and Annuity Association of America as Loan Participant; and Marine Midland Bank, N.A., as Indenture Trustee. (Form 10-K for the year ended December 31, 1984, File No. 1-5924 Exhibit 10(d)(3).)
*10(a)(4)	Tax Indemnity Agreements, dated as of December 1, 1984, between General Foods Credit Corporation, Harvey Hubbell Financial, Inc. and J.C. Penney Company, Inc., each as Beneficiary under a separate Trust Agreement dated December 1, 1984, with United States Trust of New York as Owner Trustee, and Thomas B. Zakrzewski as Co-Trustee, Lessor, and Valencia, Lessee, and TEP, Indemnitors. (Form 10-K for the year ended December 31, 1984, File No. 1-5924 Exhibit 10(d)(4).)
*10(a)(5)	Amendment No. 1, dated December 31, 1984, to the Lease Agreements, dated December 1, 1984, between Valencia and United States Trust Company of New York, as Owner Trustee, and Thomas B. Zakrzewski as Co-Trustee. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(5).)

*10(a)(6)	Amendment No. 2, dated April 1, 1985, to the Lease Agreements, dated December 1, 1984, between Valencia and United States Trust Company of New York, as Owner Trustee, and Thomas B. Zakrzewski as Co-Trustee. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(6).)
*10(a)(7)	Amendment No. 3 dated August 1, 1985, to the Lease Agreements, dated December 1, 1984, between Valencia and United States Trust Company of New York, as Owner Trustee, and Thomas Zakrzewski as Co-Trustee. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(7).)
*10(a)(8)	Amendment No. 4, dated June 1, 1986, to the Lease Agreement, dated December 1, 1984, between Valencia and United States Trust Company of New York as Owner Trustee, and Thomas Zakrzewski as Co-Trustee, under a Trust Agreement dated as of December 1, 1984, with General Foods Credit Corporation as Owner Participant. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(8).)

*10(a)(9)	Amendment No. 4, dated June 1, 1986, to the Lease Agreement, dated December 1, 1984, between Valencia and United States Trust Company of New York as Owner Trustee, and Thomas Zakrzewski as Co-Trustee, under a Trust Agreement dated as of December 1, 1984, with J.C. Penney Company, Inc. as Owner Participant. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(9).)
*10(a)(10)	Amendment No. 4, dated June 1, 1986, to the Lease Agreement, dated December 1, 1984, between Valencia and United States Trust Company of New York as Owner Trustee, and Thomas Zakrzewski as Co-Trustee, under a Trust Agreement dated as of December 1, 1984, with Harvey Hubbell Financial Inc. as Owner Participant. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(10).)
*10(a)(11)	Lease Amendment No. 5 and Supplement No. 2, to the Lease Agreement, dated July 1, 1986, between Valencia, United States Trust Company of New York as Owner Trustee, and Thomas Zakrzewski as Co-Trustee and J.C. Penney as Owner Participant. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(11).)
*10(a)(12)	Lease Amendment No. 5, to the Lease Agreement, dated June 1, 1987, between Valencia, United States Trust Company of New York as Owner Trustee, and Thomas Zakrzewski as Co-Trustee and General Foods Credit Corporation as Owner Participant. (Form 10-K for the year ended December 31, 1988, File No. 1-5924 Exhibit 10(f)(12).)
*10(a)(13)	Lease Amendment No. 5, to the Lease Agreement, dated June 1, 1987, between Valencia, United States Trust Company of New York as Owner Trustee, and Thomas Zakrzewski as Co-Trustee and Harvey Hubbell Financial Inc. as Owner Participant. (Form 10-K for the year ended December 31, 1988, File No. 1-5924 Exhibit 10(f)(13).)
*10(a)(14)	Lease Amendment No. 6, to the Lease Agreement, dated June 1, 1987, between Valencia, United States Trust Company of New York as Owner Trustee, and Thomas Zakrzewski as Co-Trustee and J.C. Penney Company, Inc. as Owner Participant. (Form 10-K for the year ended December 31, 1988, File No. 1-5924 Exhibit 10(f)(14).)
*10(a)(15)	Lease Supplement No. 1, dated December 31, 1984, to Lease Agreements, dated December 1, 1984, between Valencia, as Lessee and United States Trust Company of New York and Thomas B. Zakrzewski, as Owner Trustee and Co-Trustee, respectively (document filed relates to General Foods Credit Corporation; documents relating to Harvey Hubbell Financial, Inc. and JC Penney Company, Inc. are not filed but are substantially similar). (Form S-4 Registration No. 33-52860 Exhibit 10(f)(15).)
*10(a)(16)	Amendment No. 1, dated June 1, 1986, to the General Indemnity Agreement, dated as of December 1, 1984, between Valencia and TEP, as Indemnitors, General Foods Credit Corporation, as Owner Participant, United States Trust Company of New York, as Owner Trustee, Teachers Insurance and Annuity Association of America, as Loan Participant, and Marine Midland Bank, N.A., as Indenture Trustee. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(12).)
*10(a)(17)	Amendment No. 1, dated June 1, 1986, to the General Indemnity Agreement, dated as of December 1, 1984, between Valencia and TEP, as Indemnitors, J.C. Penney Company, Inc., as

	Owner Participant, United States Trust Company of New York, as Owner Trustee, Teachers Insurance and Annuity Association of America, as Loan Participant, and Marine Midland Bank, N.A., as Indenture Trustee. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(13).)
*10(a)(18)	Amendment No. 1, dated June 1, 1986, to the General Indemnity Agreement, dated as of December 1, 1984, between Valencia and TEP, as Indemnitors, Harvey Hubbell Financial, Inc., as Owner Participant, United States Trust Company of New York, as Owner Trustee, Teachers Insurance and Annuity Association of America, as Loan Participant, and Marine Midland Bank, N.A., as Indenture Trustee. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(14).)

*10(a)(19)	Amendment No. 2, dated as of July 1, 1986, to the General Indemnity Agreement, dated as of December 1, 1984, between Valencia and TEP, as Indemnitors, J.C. Penney Company, Inc., as Owner Participant, United States Trust Company of New York, as Owner Trustee, Teachers Insurance and Annuity Association of America, as Loan Participant, and Marine Midland Bank, N.A., as Indenture Trustee. (Form S-4, Registration No. 33-52860 Exhibit 10(f)(19).)
*10(a)(20)	Amendment No. 2, dated as of June 1, 1987, to the General Indemnity Agreement, dated as of December 1, 1984, between Valencia and TEP, as Indemnitors, General Foods Credit Corporation, as Owner Participant, United States Trust Company of New York, as Owner Trustee, Teachers Insurance and Annuity Association of America, as Loan Participant, and Marine Midland Bank, N.A., as Indenture Trustee. (Form S-4, Registration No. 33-52860 Exhibit 10(f)(20).)
*10(a)(21)	Amendment No. 2, dated as of June 1, 1987, to the General Indemnity Agreement, dated as of December 1, 1984, between Valencia and TEP, as Indemnitors, Harvey Hubbell Financial, Inc., as Owner Participant, United States Trust Company of New York, as Owner Trustee, Teachers Insurance and Annuity Association of America, as Loan Participant, and Marine Midland Bank, N.A., as Indenture Trustee. (Form S-4, Registration No. 33-52860 Exhibit 10(f)(21).)
*10(a)(22)	Amendment No. 3, dated as of June 1, 1987, to the General Indemnity Agreement, dated as of December 1, 1984, between Valencia and TEP, as Indemnitors, J.C. Penney Company, Inc., as Owner Participant, United States Trust Company of New York, as Owner Trustee, Teachers Insurance and Annuity Association of America, as Loan Participant, and Marine Midland Bank, N.A., as Indenture Trustee. (Form S-4, Registration No. 33-52860 Exhibit 10(f)(22).)
*10(a)(23)	Supplemental Tax Indemnity Agreement, dated July 1, 1986, between J.C. Penney Company, Inc., as Owner Participant, and Valencia and TEP, as Indemnitors. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(15).)
*10(a)(24)	Supplemental General Indemnity Agreement, dated as of July 1, 1986, among Valencia and TEP, as Indemnitors, J.C. Penney Company, Inc., as Owner Participant, United States Trust Company of New York, as Owner Trustee, Teachers Insurance and Annuity Association of America, as Loan Participant, and Marine Midland Bank, N.A., as Indenture Trustee. (Form 10-K for the year ended December 31, 1986, File No. 1-5924 Exhibit 10(e)(16).)
*10(a)(25)	Amendment No. 1, dated as of June 1, 1987, to the Supplemental General Indemnity Agreement, dated as of July 1, 1986, among Valencia and TEP, as Indemnitors, J.C. Penney Company, Inc., as Owner Participant, United States Trust Company of New York, as Owner Trustee, Teachers Insurance and Annuity Association of America, as Loan Participant, and Marine Midland Bank, N.A., as Indenture Trustee. (Form S-4, Registration No. 33-52860 Exhibit 10(f)(25).)
*10(a)(26)	Valencia Agreement, dated as of June 30, 1992, among TEP, as Guarantor, Valencia, as Lessee, Teachers Insurance and Annuity Association of America, as Loan Participant, Marine Midland Bank, N.A., as Indenture Trustee, United States Trust Company of New York, as Owner Trustee, and Thomas B. Zakrzewski, as Co-Trustee, and the Owner Participants named therein relating to the Restructuring of Valencia s lease of the coal-handling facilities at the Springerville Generating Station. (Form S-4, Registration No. 33-52860 Exhibit 10(f)(26).)
*10(a)(27)	

Amendment, dated as of December 15, 1992, to the Lease Agreements, dated December 1, 1984, between Valencia, as Lessee, and United States Trust Company of New York, as Owner Trustee, and Thomas B. Zakrzewski, as Co-Trustee. (Form S-1, Registration No. 33-55732
Exhibit 10(f)(27).)

*10(b)(1)	Lease Agreements, dated as of December 1, 1985, between TEP and San Carlos Resources Inc. (San Carlos) (a wholly-owned subsidiary of the Registrant) jointly and severally, as Lessee, and Wilmington Trust Company, as Trustee, as amended and supplemented. (Form 10-K for the year ended December 31, 1985, File No. 1-5924 Exhibit 10(f)(1).)
*10(b)(2)	Tax Indemnity Agreements, dated as of December 1, 1985, between Philip Morris Credit Corporation, IBM Credit Financing Corporation and Emerson Finance Co., each as beneficiary under a separate trust agreement, dated as of December 1, 1985, with Wilmington Trust Company, as Owner Trustee, and William J. Wade, as Co-Trustee, and TEP and San Carlos, as Lessee. (Form 10-K for the year ended December 31, 1985, File No. 1-5924 Exhibit 10(f)(2).)
*10(b)(3)	Participation Agreement, dated as of December 1, 1985, among TEP and San Carlos as Lessee, Philip Morris Credit Corporation, IBM Credit Financing Corporation, and Emerson Finance Co. as Owner Participants, Wilmington Trust Company as Owner Trustee, The Sumitomo Bank, Limited, New York Branch, as Loan Participant, and Bankers Trust Company, as Indenture Trustee. (Form 10-K for the year ended December 31, 1985, File No. 1-5924 Exhibit 10(f)(3).)
*10(b)(4)	Restructuring Commitment Agreement, dated as of June 30, 1992, among TEP and San Carlos, jointly and severally, as Lessee, Philip Morris Credit Corporation, IBM Credit Financing Corporation and Emerson Capital Funding, William J. Wade, as Owner Trustee and Co-Trustee, respectively, The Sumitomo Bank, Limited, New York Branch, as Loan Participant and United States Trust Company of New York, as Indenture Trustee. (Form S-4, Registration No. 33-52860 Exhibit 10(g)(4).)
*10(b)(5)	Lease Supplement No.1, dated December 31, 1985, to Lease Agreements, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee Trustee and Co-Trustee, respectively (document filed relates to Philip Morris Credit Corporation; documents relating to IBM Credit Financing Corporation and Emerson Financing Co. are not filed but are substantially similar). (Form S-4, Registration No. 33-52860 Exhibit 10(g)(5).)
*10(b)(6)	Amendment No. 1, dated as of December 15, 1992, to Lease Agreements, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, as Lessor. (Form S-1, Registration No. 33-55732 Exhibit 10(g)(6).)
*10(b)(7)	Amendment No. 1, dated as of December 15, 1992, to Tax Indemnity Agreements, dated as of December 1, 1985, between Philip Morris Credit Corporation, IBM Credit Financing Corporation and Emerson Capital Funding Corp., as Owner Participants and TEP and San Carlos, jointly and severally, as Lessee. (Form S-1, Registration No. 33-55732 Exhibit 10(g)(7).)
*10(b)(8)	Amendment No. 2, dated as of December 1, 1999, to Lease Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, under a Trust Agreement with Philip Morris Capital Corporation as Owner Participant. (Form 10-K for the year ended December 31, 1999, File No. 1-5924 Exhibit 10(b)(8).)
*10(b)(9)	Amendment No. 2, dated as of December 1, 1999, to Lease Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Wilmington Trust

	Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, under a Trust Agreement with IBM Credit Financing Corporation as Owner Participant. (Form 10-K for the year ended December 31, 1999, File No. 1-5924 Exhibit 10(b)(9).)
*10(b)(10)	Amendment No. 2, dated as of December 1, 1999, to Lease Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, under a Trust Agreement with Emerson Finance Co. as Owner Participant. (Form 10-K for the year ended December 31, 1999, File No. 1-5924 Exhibit 10(b)(10).)

*10(b)(11)	Amendment No. 2, dated as of December 1, 1999, to Tax Indemnity Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Philip Morris Capital Corporation as Owner Participant, beneficiary under a Trust Agreement dated as of December 1, 1985, with Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, together as Lessor. (Form 10-K for the year ended December 31, 1999, File No. 1-5924 Exhibit 10(b)(11).)
*10(b)(12)	Amendment No. 2, dated as of December 1, 1999, to Tax Indemnity Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and IBM Credit Financing Corporation as Owner Participant, beneficiary under a Trust Agreement dated as of December 1, 1985, with Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, together as Lessor. (Form 10-K for the year ended December 31, 1999, File No. 1-5924 Exhibit 10(b)(12).)
*10(b)(13)	Amendment No. 2, dated as of December 1, 1999, to Tax Indemnity Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Emerson Finance Co. as Owner Participant, beneficiary under a Trust Agreement dated as of December 1, 1985, with Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, together as Lessor. (Form 10-K for the year ended December 31, 1999, File No. 1-5924 Exhibit 10(b)(13).)
*10(b)(14)	Amendment No. 3 dated as of June 1, 2003, to Lease Agreements, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, under a Trust Agreement with Philip Morris Capital Corporation as Owner Participant. (Form 10-Q for the quarter ended June 30, 2003, File No. 1-5924 Exhibit 10(a).)
*10(b)(15)	Amendment No. 3 dated as of June 1, 2003, to Lease Agreements, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, under a Trust Agreement with IBM Credit, LLC as Owner Participant. (Form 10-Q for the quarter ended June 30, 2003, File No. 1-5924 Exhibit 10(b).)
*10(b)(16)	Amendment No. 3 dated as of June 1, 2003, to Lease Agreements, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, under a Trust Agreement with Emerson Finance Co. as Owner Participant. (Form 10-Q for the quarter ended June 30, 2003, File No. 1-5924 Exhibit 10(c).)
*10(b)(17)	Amendment No. 3 dated as of June 1, 2003, to Tax Indemnity Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Philip Morris Capital Corporation as Owner Participant, beneficiary under a Trust Agreement dated as of December 1, 1985, with Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, together as Lessor. (Form 10-Q for the quarter ended June 30, 2003, File No. 1-5924 Exhibit 10(d).)
*10(b)(18)	Amendment No. 3 dated as of June 1, 2003, to Tax Indemnity Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and IBM Credit, LLC as

	Owner Participant, beneficiary under a Trust Agreement dated as of December 1, 1985, with Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, together as Lessor. (Form 10-Q for the quarter ended June 30, 2003, File No. 1-5924 Exhibit 10(e).)
*10(b)(19)	Amendment No. 3 dated as of June 1, 2003, to Tax Indemnity Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Emerson Finance Co. as Owner Participant, beneficiary under a Trust Agreement dated as of December 1, 1985, with Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, together as Lessor. (Form 10-Q for the quarter ended June 30, 2003, File No. 1-5924 Exhibit 10(f).)

*10(b)(20)	Amendment No. 4, dated as of June 1, 2006, to Lease Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Wilmington Trust Company and William J. Wade, as Owner Trustee and Cotrustee, respectively, under a Trust Agreement with Philip Morris Capital Corporation as Owner Participant. (Form 8-K dated June 12, 2006, File No. 1-5924 Exhibit 10.1.)
*10(b)(21)	Amendment No. 4, dated as of June 1, 2006, to Lease Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Wilmington Trust Company and William J. Wade, as Owner Trustee and Cotrustee, respectively, under a Trust Agreement with Selco Service Corporation as Owner Participant. (Form 8-K dated June 12, 2006, File No. 1-5924 Exhibit 10.2.)
*10(b)(22)	Amendment No. 4, dated as of June 1, 2006, to Lease Agreement, dated as of December 1, 1985, between TEP and San Carlos, jointly and severally, as Lessee, and Wilmington Trust Company and William J. Wade, as Owner Trustee and Cotrustee, respectively, under a Trust Agreement with Emerson Finance LLC as Owner Participant. (Form 8-K dated June 12, 2006, File No. 1-5924 Exhibit 10.3.)
*10(b)(23)	Amendment No. 4, dated as of June 1, 2006 to Tax Indemnity Agreement, dated as of December 1, 1985, between TEP and San Carlos, as Lessee, and Philip Morris Capital Corporation as Owner Participant, beneficiary under a Trust Agreement, dated as of December 1, 1985, with Wilmington Trust Company and William J. Wade, as Owner Trustee and Cotrustee, respectively, together as Lessor. (Form 8-K dated June 12, 2006, File No. 1-5924 Exhibit 10.4.)
*10(b)(24)	Amendment No. 4, dated as of June 1, 2006 to Tax Indemnity Agreement , dated as of December 1, 1985, between TEP and San Carlos, as Lessee, and Selco Service Corporation as Owner Participant, beneficiary under a Trust Agreement, dated as of December 1, 1985, with Wilmington Trust Company and William J. Wade, as Owner Trustee and Cotrustee, respectively, together as Lessor. (Form 8-K dated June 12, 2006, File No. 1-5924 Exhibit 10.5.)
*10(b)(25)	Amendment No. 4, dated as of June 1, 2006 to Tax Indemnity Agreement , dated as of December 1, 1985, between TEP and San Carlos, as Lessee, and Emerson Finance LLC as Owner Participant, beneficiary under a Trust Agreement, dated as of December 1, 1985, with Wilmington Trust Company and William J. Wade, as Owner Trustee and Cotrustee, respectively, together as Lessor. (Form 8-K dated June 12, 2006, File No. 1-5924 Exhibit 10.6.)
*10(c)(1)	Amended and Restated Participation Agreement, dated as of November 15, 1987, among TEP, as Lessee, Ford Motor Credit Company, as Owner Participant, Financial Security Assurance Inc., as Surety, Wilmington Trust Company and William J. Wade in their respective individual capacities as provided therein, but otherwise solely as Owner Trustee and Co-Trustee under the Trust Agreement, and Morgan Guaranty, in its individual capacity as provided therein, but Secured Party. (Form 10-K for the year ended December 31, 1987, File No. 1-5924 Exhibit 10(j)(1).)
*10(c)(2)	Lease Agreement, dated as of January 14, 1988, between Wilmington Trust Company and William J. Wade, as Owner Trust Agreement described therein, dated as of November 15, 1987,between such parties and Ford Motor Credit Company, as Lessor, and TEP, as Lessee. (Form 10-K for the year ended December 31, 1987, File No.1-5924 Exhibit 10(j)(2).)

*10(c)(3)	Tax Indemnity Agreement, dated as of January 14, 1988, between TEP, as Lessee, and Ford Motor Credit Company, as Owner Participant, beneficiary under a Trust Agreement, dated as of November 15, 1987, with Wilmington Trust Company and William J. Wade, Owner Trustee and Co-Trustee, respectively, together as Lessor. (Form 10-K for the year ended December 31, 1987, File No. 1-5924 Exhibit 10(j)(3).)

*10(c)(4)	Loan Agreement, dated as of January 14, 1988, between the Pima County Authority and Wilmington Trust Company and William J. Wade in their respective individual capacities as expressly stated, but otherwise solely as Owner Trustee and Co-Trustee, respectively, under and pursuant to a Trust Agreement, dated as of November 15, 1987, with Ford Motor Credit Company as Trustor and Debtor relating to Industrial Development Lease Obligation Refunding Revenue Bonds, 1988 Series A (TEP s Sundt Project). (Form 10-K for the year ended December 31, 1987, File No. 1-5924 Exhibit 10(j)(4).)
*10(c)(5)	Indenture of Trust, dated as of January 14, 1988, between the Pima County Authority and Morgan Guaranty authorizing Industrial Development Lease Obligation Refunding Revenue Bonds, 1988 Series A (Tucson Electric Power Company Sundt Project). (Form 10-K for the year ended December 31, 1987, File No. 1-5924 Exhibit 10(j)(5).)
*10(c)(6)	Lease Amendment No. 1, dated as of May 1, 1989, between TEP, Wilmington Trust Company and William J. Wade as Owner Trustee and Co-Trustee, respectively under a Trust Agreement dated as of November 15, 1987 with Ford Motor Credit Company. (Form 10-K for the year ended December 31, 1990, File No. 1-5924 Exhibit 10(i)(6).)
*10(c)(7)	Lease Supplement, dated as of January 1, 1991, between TEP, Wilmington Trust Company and William J. Wade as Owner Trustee and Co-Trustee, respectively, under a Trust Agreement dated as of November 15, 1987, with Ford. (Form 10-K for the year ended December 31, 1991, File No. 1-5924 Exhibit 10(i)(8).)
*10(c)(8)	Lease Supplement, dated as of March 1, 1991, between TEP, Wilmington Trust Company and William J. Wade as Owner Trustee and Co-Trustee, respectively, under a Trust Agreement dated as of November 15, 1987, with Ford. (Form 10-K for the year ended December 31, 1991, File No. 1-5924 Exhibit 10(i)(9).)
*10(c)(9)	Lease Supplement No. 4, dated as of December 1, 1991, between TEP, Wilmington Trust Company and William J. Wade as Owner Trustee and Co-Trustee, respectively, under a Trust Agreement dated as of November 15, 1987, with Ford. (Form 10-K for the year ended December 31, 1991, File No. 1-5924 Exhibit 10(i)(10).)
*10(c)(10)	Supplemental Indenture No. 1, dated as of December 1, 1991, between the Pima County Authority and Morgan Guaranty relating to Industrial Lease Development Obligation Revenue Project. (Form 10-K for the year ended December 31, 1991, File No. 1-5924 Exhibit 10(l)(11).)
*10(c)(11)	Restructuring Commitment Agreement, dated as of June 30, 1992, among TEP, as Lessee, Ford Motor Credit Company, as Owner Participant, Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, and Morgan Guaranty, as Indenture Trustee and Refunding Trustee, relating to the restructuring of the Registrant s lease of Unit 4 at the Sundt Generating Station. (Form S-4, Registration No. 33-52860 Exhibit 10(i)(12).)
*10(c)(12)	Amendment No. 1, dated as of December 15, 1992, to Amended and Restated Participation Agreement, dated as of November 15, 1987, among TEP, as Lessee, Ford Motor Credit Company, as Owner Participant, Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, Financial Security Assurance Inc., as Surety, and Morgan Guaranty, as Indenture Trustee. (Form S-1, Registration No. 33-55732 Exhibit 10(h)(12).)

*10(c)(13)	Amended and Restated Lease, dated as of December 15, 1992, between TEP as Lessee and Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, as Lessor. (Form S-1, Registration No. 33-55732 Exhibit 10(h)(13).)
*10(c)(14)	Amended and Restated Tax Indemnity Agreement, dated as of December 15, 1992, between TEP as Lessee and Ford Motor Credit Company, as Owner Participant. (Form S-1, Registration No. 33-55732 Exhibit 10(h)(14).)
*10(d)	Participation Agreement, dated as of June 30, 1992, among TEP, as Lessee, various parties thereto, as Owner, Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, and LaSalle National Bank, as Indenture Trustee relating to TEP s lease of Springerville Unit 1. (Form S-1, Registration No. 33-55732 Exhibit 10(u).)

*10(e)	Lease Agreement, dated as of December 15, 1992, between TEP, as Lessee and Wilmington Trust Company and William J. Wade, as Owner Trustee and Co-Trustee, respectively, as Lessor. (Form S-1, Registration No. 33-55732 Exhibit 10(v).)
*10(f)	Tax Indemnity Agreements, dated as of December 15, 1992, between the various Owner Participants parties thereto and TEP, as Lessee. (Form S-1, Registration No. 33-55732 Exhibit 10(w).)
*10(g)	Restructuring Agreement, dated as of December 1, 1992, between TEP and Century Power Corporation. (Form S-1, Registration No. 33-55732 Exhibit 10(x).)
+*10(h)	1994 Omnibus Stock and Incentive Plan of UniSource Energy. (Form S-8 dated January 6, 1998, File No. 333-43767.)
+*10(i)	Management and Directors Deferred Compensation Plan of UniSource Energy. (Form S-8 dated January 6, 1998, File No. 333-43769.)
+*10(j)	TEP Supplemental Retirement Account for Classified Employees. (Form S-8 dated May 21, 1998, File No. 333-53309.)
+*10(k)	TEP Triple Investment Plan for Salaried Employees. (Form S-8 dated May 21, 1998, File No. 333-53333.)
+*10(l)	Officer Change in Control Agreement between TEP and Karen G. Kissinger, dated as of December 4, 1998 (including a schedule of other officers who are covered by substantially identical agreements.) (Form 10-K for the year ended December 31, 2004, File No. 1-5924 Exhibit 10(p))
+*10(m)	Notice of Termination of Change in Control Agreement from TEP to Karen G. Kissinger, dated as of March 3, 2005 (including a schedule of other officers who received substantially identical notices.) (Form 10-K for the year ended December 31, 2004, File No. 1-5924 Exhibit 10(q))
+*10(n)	Amended and Restated UniSource Energy 1994 Outside Director Stock Option Plan of UniSource Energy. (Form S-8 dated September 9, 2002, File No. 333-99317.)
*10(o)(1)	Asset Purchase Agreement dated as of October 29, 2002, by and between UniSource Energy and Citizens Communications Company relating to the Purchase of Citizens Electric Utility Business in the State of Arizona. (Form 8-K dated October 31, 2002. File No. 1-13739 Exhibit 99-1.)
*10(o)(2)	Asset Purchase Agreement dated as of October 29, 2002, by and between UniSource Energy and Citizens Communications Company relating to the Purchase of Citizens Gas Utility Business in the State of Arizona. (Form 8-K dated October 31, 2002. File No. 1-13739 Exhibit 99-2.)
+*10(p)	UniSource Energy 2006 Omnibus Stock and Incentive Plan (Form S-8 dated January 31, 2007. File No. 333-140353.)
+*10(q)	Stock Option Agreement between UniSource Energy and Raymond S. Heyman dated as of September 15, 2005 (Form 10-K for the year ended December 31, 2007, File No. 1-13739,

	Exhibit 10(r).)
+*10(r)	Management and Directors Deferred Compensation Plan II of UniSource Energy. (Form S-8 dated December 30, 2008, File No. 333-156491.)
+*10(s)	Employment agreement dated as of December 9, 2008, between UniSource Energy and Paul J. Bonavia. (Form 8-K dated December 15, 2008, File No. 1-13739.)

*12(a)	Computation of Ratio of Earnings to Fixed Charges TEP. (Form 10-K dated December 31, 2008, File 1-13739)
*12(b)	Computation of Ratio of Earnings to Fixed Charges UniSource Energy. (Form 10-K dated December 31, 2008, File 1-13739)
*21	Subsidiaries of the Registrants. (Form 10-K dated December 31, 2008, File 1-13739)
23	Consent of Independent Registered Public Accounting Firm.
*24(a)	Power of Attorney UniSource Energy. (Form 10-K dated December 31, 2008, File 1-13739)
*24(b)	Power of Attorney TEP. (Form 10-K dated December 31, 2008, File 1-13739)
31(a)	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act UniSource Energy, by Paul J. Bonavia.
31(b)	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act UniSource Energy by Kevin P. Larson.
31(c)	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act TEP, by Paul J. Bonavia.
31(d)	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act TEP, by Kevin P. Larson.
**32	Statements of Corporate Officers (pursuant to Section 906 of the Sarbanes-Oxley Act of 2002).

(*) Previously filed as indicated and incorporated herein by reference.

(+) Management contracts or compensatory plans or arrangements required to be filed as exhibits to this Form 10-K by item 601(b)(10)(iii) of Regulation S-K.

** Pursuant to Item 601(b)(32)(ii) of Regulation S-K, this certificate is not being filed for purposes of Section 18 of the

Securities
Exchange Act of
1934, as amended.