

steel and plastic distribution mains, and 127,015 customer service lines.

Citizens is subject to regulation in Arizona by the ACC with respect to retail electric and gas rates, the issuance of securities, affiliate transactions, the maintenance of books and records, and other matters and by the FERC with respect to wholesale power sales and interstate transmission service.

Citizens and UniSource Energy have entered into separate Asset Purchase Agreements, each dated October 29, 2002, relating to the purchase of Citizens' electric and gas utility businesses in Arizona. Under the terms of the Asset Purchase Agreement relating to Citizens' electric utility business, Citizens has agreed to sell and UniSource Energy has agreed to purchase all of the assets (subject to certain stated exceptions) used by Citizens in connection with or otherwise necessary for the conduct of its electric utility business in Arizona (the "Electric Assets"). Under the terms of the Asset Purchase Agreement relating to Citizens' gas utility business, Citizens has agreed to sell and UniSource Energy has agreed to purchase all of the assets (subject to certain stated exceptions) used by Citizens in connection with or otherwise necessary for the conduct of its gas utility business in Arizona (the "Gas Assets").

UniSource Energy has agreed to pay Citizens \$92 million in cash for the Electric Assets and \$138 million in cash for the Gas Assets, subject in each case to adjustment based on the date on which the Transaction closes and on the amount of certain assets and liabilities associated with the Assets at the time of closing. In addition, the base price for the Electric Assets and the Gas Assets will be reduced by \$10 million in the aggregate if the Transaction closes by July 28, 2003. However, whether or not the Transaction closes by July 28, 2003, UniSource Energy has agreed to reduce rate base for the Gas Assets by \$10 million. UniSource Energy will not assume Citizens' obligations under existing industrial development revenue bonds that were issued to finance portions of the purchased assets. Citizens will remain liable on these obligations.

Under the Asset Purchase Agreements, UniSource Energy and Citizens also agreed to coordinate the overall development of the positions to be taken and the regulatory actions to be requested regarding the two utility rate cases that Citizens has pending before the ACC. As part of the Joint Application of Citizens Communications Company and

UniSource Energy Corporation to the Arizona Corporation Commission ("Joint Application"), UniSource Energy is seeking approval for a reduced level of rate increases. On April 1, 2003, UniSource Energy, Citizens, TEP and the staff of the Utilities Division of the ACC entered into a Settlement Agreement ("Settlement"), which sets forth the agreement and understanding of the parties with respect to the settlement of all issues arising under the Joint Application, the amount of the reduction in Citizens' proposed gas rate increase, UniSource Energy's forfeiture of any right to seek recovery of the under-collected balance under Citizens' purchase power and fuel adjustment clause, and other matters.<sup>1</sup> The proposed Settlement is subject to approval by the ACC. UniSource Energy states that under the proposed Settlement Citizens' electric and gas customers would save a total of about \$29 million per year, as compared to the amount of rate increases proposed in Citizens' pending applications. The proposed Settlement also contains the agreement of the parties with respect to UniSource Energy's plan for financing the Transaction, as described below.

UniSource Energy states that the Transaction is subject to, among other conditions precedent, receipt by the parties of required approvals by the ACC, the FERC and this Commission, and filing of pre-merger notification statements under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and expiration or early termination of the statutory waiting period. The boards of directors of UniSource Energy and Citizens have each approved the proposed Transaction. The Transaction does not require shareholder approval by either company.

UniSource Energy states that it intends to fund the purchase price under the Asset Purchase Agreements using a combination of several sources, including: (1) Available cash at UniSource Energy; (2) possibly the issuance of new equity by UniSource Energy; (3) a loan from TEP; and (4) debt issued by the New Utility Companies or HoldCo (if the HoldCo Structure is utilized), which will be repaid either directly or indirectly from the cash

flows of the New Utility Companies. The issuance of new debt securities by the New Utility Companies and the loan from TEP are subject to approval by the ACC.

More specifically, in the Joint Application, UniSource Energy is requesting the authorization of the ACC for the New Utility Companies to: (1) Issue or guarantee up to \$175 million of debt securities for the purpose of funding a portion of the purchase price and initial working capital requirements of the New Utility Companies; (2) issue or guarantee additional debt securities from time to time under the terms of a new revolving credit agreement that will provide ongoing liquidity support to the New Utility Companies; (3) enter into indentures or security agreements which grant liens on some or all of the properties held by such companies to secure the debt obligations of such companies; and (4) issue common stock to UniSource Energy (or to HoldCo if the HoldCo Structure is used). Additionally, UniSource Energy and TEP are seeking authority from the ACC to allow TEP to fund up to \$50 million of the aggregate purchase price through a loan to UniSource Energy. Authorization of this loan from TEP would provide financing flexibility to UniSource Energy in the event that, at the time of the consummation of the Transaction, UniSource Energy is unable to issue common stock on reasonable terms in order to fund the purchase price.

Under the proposed Settlement filed with the ACC, the New Utility Companies are expected to have an initial capital structure of about 40% common equity and 60% long-term debt. UniSource Energy's objective is to capitalize the New Utility Companies at a level that is consistent with an investment grade rating, in accordance with current ratings criteria published by the principal rating agencies. UniSource Energy has agreed that, until common equity as a percentage of total capitalization (*i.e.*, common and preferred equity and long-term debt, including current portion) of each of the New Utility Companies equals 40%, such company will not pay dividends to UniSource or HoldCo, as the case may be, in an amount exceeding 75% of such company's earnings. The \$50 million loan from TEP would have a maturity not to exceed four years, would be secured by a pledge of 100% of the common stock of the New Utility Companies or HoldCo (if the HoldCo Structure is used), and would bear interest at 383 basis points above the yield-to-maturity of an equivalent four-year U.S. Treasury security as determined on the date of the loan. The

<sup>1</sup> Under the proposed Settlement, UniSource Energy has agreed to seek an increase in rates of the new gas utility of approximately 20.9%, versus the 28.9% increase requested by Citizens. In addition, UniSource Energy has agreed to forfeit its right to seek recovery of the under-collected balance under Citizens' electric purchase power and fuel adjuster clause (estimated to be at least \$135 million as of July 28, 2003). As a result, electric rates of the new electric utility would increase by 22%, rather than the 45% increase proposed by Citizens.