UNITED STATES OF AMERICA

NUCLEAR REGULATORY COMMISSION

In the matter of **ARIZONA PUBLIC SERVICE COMPANY,** *et al.*, (Palo Verde Nuclear Generating Station, Unit 1)		DOCKET NO. STN 50-528

APPLICATION IN RESPECT OF A SALE AND LEASEBACK FINANCING TRANSACTION BY

PUBLIC SERVICE COMPANY OF NEW MEXICO

October 18, 1985

TABLE OF CONTENTS

TABLE OF CONTENTS, Continued

EXHIBITS

UNITED STATES OF AMERICA

NUCLEAR REGULATORY COMMISSION

In the matter of ARIZONA PUBLIC SERVICE COMPANY, et al., (Palo Verde Nuclear Generating Station, Unit 1)	DOCKET NO. STN 50-528

APPLICATION IN RESPECT OF A SALE AND LEASEBACK FINANCING TRANSACTION BY PUBLIC SERVICE COMPANY OF NEW MEXICO

Pursuant to Section 103 of the Atomic Energy Act of 1954, as amended, and 10 CFR 50.22 and 50.54(c), Arizona Public Service Company (APS), as Project Manager and Operating Agent of Palo Verde Nuclear Generating Station (PVNGS) Units 1, 2 and 3, submits this application, under 10 CFR 2.206, on behalf of Public Service Company of New Mexico (PNM), licensee under Facility Operating License No. NPF-41, and The First National Bank of Boston, as Owner Trustee under two or more separate grantor trust agreements (hereinafter Owner Trustee). Accompanying this Application is a Memorandum in Support thereof (the Memorandum).

1. Relief Requested

PNM proposes to refinance its construction financing for PVNGS Unit 1 by entering into two or more sale and leaseback financing transactions relating to all or a portion of PNM's 10.2% undivided ownership interest in Unit 1 and all or a proportionate

share of one-third of PNM's 10.2% undivided ownership interest in PVNGS common facilities (said interest in Unit 1 and in the common facilities being hereinafter collectively referred to as the **Facilities**).1 The relief requested by this Application is the issuance of an order (i) authorizing the transfers of the Facilities through the sale and leaseback financing transactions, pursuant to Sections 50.22 and 50.54(c) of the Commission's regulations (10 CFR 50.22 and 50.54(c)), subject to the conditions that:

> (a) The rights acquired by the Owner Trustee and any equity investor and any successors and assigns (including any mortgagee or secured party of such Owner Trustee) in and to PVNGS Unit 1 may be exercised only in compliance with and subject to the same requirements and restrictions as would apply to PNM pursuant to the provisions of Facility Operating License No. NPF-41 (the **License**), the Atomic Energy Act of 1954, as amended (the **Act**), and the regulations issued by the Commission pursuant to the Act; and
>
> (b) Neither the Owner Trustee nor any equity investor nor any of their respective successors or assigns may take possession of any interest in PVNGS Unit 1 prior to either (1) the issuance of a license from the Commission authorizing such possession or (2) the transfer of the License authorizing PNM to possess an interest in PVNGS Unit 1 upon an application for transfer of such License filed pursuant to 10 CFR 50.80(b);

---

1. PNM will retain, however, ownership of easements, rights-of-way and certain other real property rights associated with the Facilities, including property referred to under the Internal Revenue Code as "Section 1250 property" (such as the Administration Building). PNM will also retain ownership of the nuclear fuel and electric transmission facilities associated with PVNGS.

and (ii) acknowledging that neither the Owner Trustee nor any equity investor nor any of their respective successors and assigns is or shall become a licensee under the License unless and until the Commission shall have issued an amendment of the License authorizing such Owner Trustee, equity investor, successor or assign to take possession of an interest in PVNGS Unit 1 or shall have approved a transfer of PNM's license to such Owner Trustee, equity investor, successor or assign.

2. Purpose of the Financing Transaction

The proposed sale and leaseback financing transactions will provide benefits to PNM's customers through two channels. First, the net present value of capital costs (and the total nominal costs) will be reduced by the transfer of tax benefits and by the recapitalization of the plant financing with greater debt leverage. Second, the revenue requirements associated with PNM's capital costs in PVNG's Unit 1 will be levelized over the life of the Unit.

Because the lessors in the proposed sale and leaseback transactions will recapitalize the Unit with greater debt leverage, the required lease payments represent a lower cost of capital than would PNM's composite cost of capital. Also, PNM's tax situation is such that it cannot take full advantage of tax benefits at the present time. The sale will transfer the benefits of tax depreciation to such lessors.

The leveling of revenue requirements over time yields several benefits. Under conventional utility regulation, carrying charges are determined by the asset's net book value which declines over time as the asset is depreciated. This produces so-called "front-end" loading--the familiar situation in which the stream of revenue requirements falls over time while the actual value of the plant output rises over time. Front-end loading is eliminated with the proposed sale and leaseback transaction because a fixed lease payment replaces the conventional "high front-end" revenue requirements stream, thus benefitting PNM's ratepayers and insulating them from potential "rate shock".

3. Description of the Proposed Sale and Leaseback Financing Transaction

PNM proposes to sell to grantor trusts, the beneficiaries of which will be institutional equity investors, the Facilities, including without limitation PNM's 10.2% Generation Entitlement Share[2] in PVNGS Unit 1. Such investors will enter into one or more trust agreements with the Owner Trustee who will take and hold title to the Facilities sold by PNM. The Owner Trustee will in turn lease the Facilities back to PNM for a term of approximately 28-1/2 years

---

2. "Generation Entitlement Share" is defined in Section 3.28 of the Arizona Nuclear Power Project Participation Agreement as amended (see Appendix D attached to the Memorandum) as: "The percentage entitlement of each Participant to the Net Energy Generation and to the Available Generating Capability..."

for a stipulated basic rent. [See Section 4 of the Memorandum for a more complete description of certain significant terms of the leases.]

Under the ANPP Participation Agreement [see Appendices D and E to the Memorandum] which governs the ownership and operation of Unit 1, PNM will be empowered with respect to the Facilities to be and act as the "Participant" with full power and authority, to the exclusion of the Owner Trustee and/or the equity investors, to exercise all the rights and perform all the duties and responsibilities under such Agreement. The leases will confirm this authorization to PNM. The Owner Trustee, as lessor under the leases, will be subject only to typical financing risks and not to operational risks or responsibilities.

Sale and leaseback financing is a recognized and accepted mechanism that has been used for many years by a number of commercial institutions involving a wide variety of property types. APS and a number of other electric utilities have used this mechanism to finance or refinance their investments in non-nuclear generating facilities. In the past year PNM refinanced its investment in one of its transmission lines, known as the Eastern Interconnection Project (EIP), using sale and leaseback documentation similar to that proposed for refinancing its interest in PVNGS Unit 1. When used by electric utilities, sale and leaseback transactions have been subjected to review and approval of state and/or federal regulatory

agencies. [See, for example, Appendices A and B attached to the Memorandum.]

While this will be the first occasion of the use of a sale and leaseback transaction in financing a nuclear power facility, the secured financing of the nuclear fuel used in such facilities utilizing a lease format is not unique.

4. **Conditions Precedent to the Financing Transaction**

The proposed financing transaction is subject to the following conditions precedent, in addition to others commonly associated with any financial transaction of this nature:

4.1 The approval of the transaction by the New Mexico Public Service Commission as required by the laws of the State of New Mexico, such approval to be in form and substance satisfactory to all parties to such transaction.

4.2 The issuance of a declaratory order by the Federal Energy Regulatory Commission (FERC), satisfactory in form and substance to all parties to the transaction, ruling that the equity investors and the Owner Trustee will not, as a result of their holding title to the Leased Interests, become "public utilities" as defined in section 203(a) of the Federal Power Act.

4.3 The actions of the Commission as applied for in this Application.

4.4 Ownership and operation of PVNGS Unit 1, together with Units 2 and 3, is governed by the Arizona Nuclear Power Project

Participation Agreement, as amended. [See Appendices D and E attached to the Memorandum.] The ANPP Administrative Committee created by such Agreement will be required to make a determination that the conditions to the proposed sale and leaseback transaction specified in proposed Amendment No. 10 to such Participation Agreement have been met.

5. **Schedule of the Financing Transaction**

5.1 The viability of the proposed financing transaction hinges upon its consummation on or before December 31, 1985. To meet this date it is planned that preliminary conditional commitments will be obtained from the equity investors and the Owner Trustee on or about October 22, 1985. Thereafter, it is expected that on or about November 15, 1985, approval of the proposed sale and leaseback from the New Mexico Public Service Commission and the requisite order from FERC will be obtained. Finally, it is very desirable that the closing of the sale and leaseback transactions take place on or about December 18, 1985. This is necessary to provide the equity investors with the 1985 available tax benefits without which the proposed transactions will fail to close. A December 18 closing will ensure that the associated public debt offering can be sold in the public market prior to the Christmas holidays.

5.2 To achieve this schedule it will be necessary that the Commission issue its final order not later than November 20, 1985, authorizing the transfers of the Facilities by PNM to the Owner

Trustee and by the Owner Trustee back to PNM. [See Section 1 hereof.]

6. Supporting Information

6.1 The general information respecting applicant PNM required by 10 CFR 50.33 (a) through (d) is provided by Exhibit A attached to this Application.

6.2 The general information respecting applicant Owner Trustee required by 10 CFR 50.33 (a) through (d) is provided, as appropriate, by Exhibit B attached to this Application.

6.3 The total estimated annual operating costs (operation and maintenance expense, including fuel expense) for each of the first five years of operation of PVNGS Unit 1 and PNM's share of such costs are tabulated below:

Year	Total Estimated Operating Costs (in thousands)	PNM's Share of Operating Costs (in thousands)
1986	$122,851	$12,580
1987	111,729	11,566
1988	104,514	10,888
1989	128,490	13,405
1990	133,652	13,976

6.4 The estimates set forth in Section 6.3 above are based on the following assumptions: (a) with respect to operation and maintenance expense (excluding fuel expense and using ANPP Forecast No. 18), (i) the inclusion in common costs of common facilities and

water reclamation facilities, (ii) inclusion of only Unit 1's share of common costs with even allocation across all units (using APS's date of firm power operation for Unit 2), (iii) loads have been included (payroll, with the exception of taxes, materials and service and outside services), and insurance and administrative and general expense have been excluded, (iv) the projection of all dollars at year's cost (escalation at 6% per year), and (v) the exclusion of PNM legal fees, replacement power insurance costs and other PNM in-house costs; and (b) with respect to fuel expense (using the June 1985 nuclear fuel financial forcast), (i) the subtracting out of Western Nuclear's cash flow for 1985, (ii) the assignment to Unit 1 of one third of each of U308 cash flows and conversion cash flows, (iii) the use of the ratio of the current SWU price projection to the old SWU price projection times Unit 1 enrichment cash flows to calculate enrichment, (iv) no change in either fabrication or spent fuel disposal fees and (v) recalculation of use tax assuming 5% of U308 costs instead of 5% of total fuel assembly costs.

6.5 As **Exhibit C** attached to this Application indicates, the cost of decommissioning PVNGS Unit 1 using the DECON alternative (as described in the notice of proposed rulemaking published in the **Federal** Register on February 11, 1985, at pages 23025 _et seq._) is $79 million (expressed in 1982 dollars). PNM is now and, pursuant to the proposed leases, will continue to be obligated to pay 10.2% of the costs of decommissioning PVNGS Unit 1.

7. Environmental Considerations

The proposed conveyances of the Facilities to the Owner Trustee and the leasebacks of the Facilities to PNM by the Owner Trustee do not involve any design or physical change to PVNGS Unit 1, any change in the transmission or other facilities associated with PVNGS Unit 1, any change in types or amounts of effluents from PVNGS Unit 1, any change in the potential for accidental releases from PVNGS Unit 1 or any change in the authorized power level of PVNGS Unit 1. Accordingly, the grant of the relief requested by this Application does not present an unreviewed environmental impact. Pursuant to 10 CFR 51.5(d)(4), no environmental impact statement, negative declaration, or environmental impact appraisal need be prepared in connection with this Application.

8. No Significant Hazards Consideration

The consummation of the proposed sale and leaseback financing transactions will not involve any increase in the probability or consequences of an accident previously evaluated, or create the possibility of a new or different kind of accident from any accident previously evaluated, or involve any reduction in a margin of safety. Accordingly, the consummation of the transfers of the Facilities as contemplated by the proposed sale and leaseback financing transactions does not involve a "significant hazards consideration" within the meaning of that phrase as defined in 10 CFR 50.92.

9. Responsibility for Management of PVNGS Unit 1

9.1 The consummation of the proposed sale and leaseback financing transactions will not result in any change in the responsibilities, obligations or authorities of APS as licensee under the License authorized to operate and maintain PVNGS Unit 1, nor as Operating Agent under the ANPP Participation Agreement.

9.2 Under the terms of the proposed leases and pursuant to the proposed amendment of the ANPP Participation Agreement, PNM shall continue throughout the term of the leases to be a Participant under the ANPP Participation Agreement, entitled to a 10.2% Generation Entitlement Share of the power and energy generated by PVNGS Unit 1, entitled to a full vote on all Unit 1 business and obligated to pay 10.2% of the costs of operating, maintaining and decomissioning such Unit.

9.3 It is not necessary to issue a license to the Owner Trustee and/or equity investors since only APS, as Operating Agent, and the other Unit 1 licensees, including PNM, are able to insure that Unit 1's operation is consistent with the Commission's licensing responsibilities. APS and the other Unit 1 licensees alone have control of and responsibility for the Operating Agent with respect to the operation and maintenance of Unit 1. The ownership rights of the Owner Trustee and/or the equity investors are far too limited in this regard to require a license, as the Memorandum makes abundantly clear. The Owner Trustee and/or the equity investors will have (i) no ability to restrict or inhibit compliance with the security,

safety or other regulations of the Commission, (ii) no capacity to control the use of Unit 1 nuclear fuel or to dispose of special nuclear material generated by Unit 1, and (iii) no right to use or direct the use of the Facilities. Although legal title to the Facilities will reside with the Owner Trustee, the current regime of control, supervision and responsibility is unaltered by the proposed transaction. APS is and will remain responsible to the Commission for the proper operation and maintenance of Unit 1.

WHEREFORE, APS requests on behalf of PNM and the Owner Trustee that the Commission grant the relief requested in Section 1 hereof or in such other form and/or subject to conditions in addition to those stated in such Section as the Commission may deem appropriate.

Respectfully submitted,

ARIZONA PUBLIC SERVICE COMPANY

By Edwin E Van Brunt /PBK
Edwin E. Van Brunt, Jr.
Executive Vice President-ANPP

Dated: October 18, 1985

STATE OF ARIZONA)
) ss.
COUNTY OF MARICOPA)

I, Donald B. Karner, represent that I am Assistant Vice President, Nuclear Production of Arizona Nuclear Power Project, that the foregoing document has been signed by me on behalf of Arizona Public Service Company with full authority to do so, that I have read such document and know its contents, and that to the best of my knowledge and belief, the statements made therein are true.

Donald B. Karner

Donald B. Karner

Sworn to before me this 17 day of OCT, 1985.

Notary Public

My Commission Expires:

My Commission Expires Jan. 23, 1987

UNITED STATES OF AMERICA

NUCLEAR REGULATORY COMMISSION

In the matter of ARIZONA PUBLIC SERVICE COMPANY, et al, (Palo Verde Nuclear Generating Station, Unit 1)	DOCKET NO. STN 50-528

EXHIBIT A

TO

APPLICATION
IN RESPECT OF A SALES AND LEASEBACK
FINANCING TRANSACTION BY
PUBLIC SERVICE COMPANY OF NEW MEXICO

GENERAL INFORMATION CONCERNING
PUBLIC SERVICE COMPANY OF NEW MEXICO

General Information Concerning Public Service Company of New Mexico

(a) Name of applicant:

Public Service Company of New Mexico ("PNM")

(b) Address of applicant:

Alvarado Square
Albuquerque, New Mexico 87158

(c) Description of business of applicant:

PNM is a public utility engaged principally in the generation, transmission, distribution and sale of electricity and, since January 28, 1985, in the gathering, transmission, distribution and sale of natural gas within the State of New Mexico. PNM also owns facilities for the pumping, storage, transmission, distribution and sale of water. In addition, PNM, through its subsidiaries, is engaged in a program of diversification into non-utility areas.

(d) (1) Not applicable.

(d) (2) Not applicable.

(d) (3) (i) State of incorporation and principal location:

PNM is an investor-owned corporation organized and existing under and by virtue of the laws of the State of New Mexico. Its principal offices are in Albuquerque, New Mexico. PNM provides electric service to (1) a large area of north central New Mexico, including the cities of Albuquerque, Belen, Bernalillo, Santa Fe and Las Vegas, (2) Deming in southwestern New Mexico and (3) Clayton in northeastern New Mexico. PNM also provides wholesale electric service to the the City of Gallup, the City of Farmington, Plains Electric Generation & Transmission Cooperative, Inc., and Texas-New Mexico Power Company.

(d) (3) (ii) Names of directors and principal officers:

Directors of Public Service Company of New Mexico

J.P. Bundrant
President, Electric Operations
Public Service Company of New Mexico

A.B. Collins, Jr.
President
Reddy Communications, Inc.
Albuquerque, NM

J.D. Geist
Chairman and President
Public Service Company of New Mexico

C.E. Leyendecker
Chairman of the Board and
Chief Executive Officer
United New Mexico Bank at Mimbres Valley
Deming, NM

A.G. Ortega
Attorney at Law
Ortega & Snead, P.A.
Alburquerque, NM

R.R. Rehder
Professor of Management
Robert O. Anderson Graduate School of Management
University of New Mexico
Albuquerque, NM

R.B. Rountree
Senior Vice President
Public Service Company of New Mexico

R.H. Stephens
President
Stephens-Irish Agency, Inc.
Las Vegas, NM

E.R. Wood
Vice President and General Manager
Wood & Hill Corporation
Santa Fe, NM

H.L. Galles, Jr.
Director Emeritus
Chairman of the Board
Galles Chevrolet Company
Albuquerque, NM

Principal Officers of Public Service Company of New Mexico

PNM CORPORATE

J.D. Geist
Chairman and President

J. B. Mulcock, Jr.
Senior Vice President,
Corporate Affairs and
Secretary

A.J. Robison
Senior Vice President
and Chief Financial Officer

R.B. Rountree
Senior Vice President

M.A. Clifton
Vice President,
Financial Planning

B.D. Lackey
Vice President and
Corporate Controller

J.K. Murphy
Vice President, Regulatory
and Business Policy

W.C. Wygant
Vice President,
Corporate Services

P.J. Archibeck
Treasurer and Assistant Secretary

H.L. Hitchins, Jr.
Assistant Secretary and
Assistant Treasurer

M.J. Marzec
Assistant Treasurer

M. Mason-Plunkett
Assistant Secretary

PNM ELECTRIC

J.P. Bundrant
President and Chief Operating Officer

C.D. Bedford
Senior Vice President,
Planning, Finance and Administration

W.M. Eglinton
Senior Vice President,
Operations

J.L. Wilkins
Senior Vice President,
Power Supply

J.L. Godwin
Vice President,
Power Production and
Manager, San Juan Station

W.M. Hicks, Jr.
Vice ,President,
Energy Management

R.A. Lake
Vice President,
Operations Services

M.A. McDonald
Vice President,
Human Resources and
Support Service

R.F. Mershon
Vice President,
Regional Division Operations

D.J. Morse
Vice President,
Albuquerque Division Operations

R.M. Wilson
Controller, Electric Operations
and Assistant Secretary

GAS COMPANY OF NEW MEXICO

J.T. Ackerman
President and Chief Operating Officer
Gas Operations

O.L. Slaughter
Senior Vice President and
Executive Assistant

J.J. Ruiz
District Vice President

W.J. Real
District Vice President

T.D. Rister
District Vice President

D.L. Pickel
District Vice President

T.A. Coers
District Vice President, Transmission

G.D. Mische
District Vice President, Transmission

M.H. Lambert
Vice President, Pipeline Operations

J.C. Wyman
Vice President, Gas Supply

D.W. McFearin
Vice President, Controller and
Assistant Secretary

D.J. Davis
Vice President and Chief Engineer,
Distribution

E.R. Corliss
Vice President and Chief Engineer, Transmission

T.H. Morse
Vice President,
Distribution Operations

Each of the directors and principal officers of PNM is a citizen of the United States of America.

(d) (3) (iii) Public Service Company of New Mexico is not owned, controlled, or dominated by an alien, a foreign corporation, or a foreign government.

(d) (4) Public Service Company of New Mexico is not acting as agent or representative of another person in respect of this application.

(e) See the Application to which this document is attached as Exhibit A.

(f) In accordance with 10 CFR 50, Appendix C, a copy of Public Service Company of New Mexico's 1984 Annual Report and its Annual Report on Form 10-K for the fiscal year ended December 31, 1984, are attached hereto as **Attachment A.**

(g) Not applicable.

(h) Not applicable.

(i) The names and addresses of regulatory agencies which have jurisdiction over Public Service Company of New Mexico's rates and services are:

New Mexico Public Service Commission
Marian Hall
224 East Palace Avenue
Santa Fe, New Mexico 87503

Federal Energy Regulatory Commission
Washington, D.C. 20426

News publications which circulate in the area in which the facility is located are:

The Arizona Republic
120 East Van Buren
Phoenix, Arizona 85004

The Phoenix Gazette
120 East Van Buren
Phoenix, Arizona 85004

Buckeye Valley News
P.O. Box 217
Buckeye, Arizona 85326

News publications which circulate in Public Service Company of New Mexico's service area include the following:

Las Vegas Daily Optic
Las Vegas, New Mexico 87701

The New Mexican, Inc.
Post Office Box 2048
Santa Fe, New Mexico 87501

Los Alamos Monitor
Post Office Box 899
Los Alamos, New Mexico 87544

Albuquerque Journal
Albuquerque Publishing Company
Post Office Drawer J-T
Albuquerque, New Mexico 87103

Gallup Daily Independent
Post Office Box 1210
Gallup, New Mexico 87301

(j) Not applicable.

UNITED STATES OF AMERICA

NUCLEAR REGULATORY COMMISSION

---------------------------------------x

In the matter of

ARIZONA PUBLIC SERVICE COMPANY, et al,

(Palo Verde Nuclear Generating Station, Unit 1)

DOCKET NO. STN 50-528

---------------------------------------x

ATTACHMENT A TO EXHIBIT A

TO

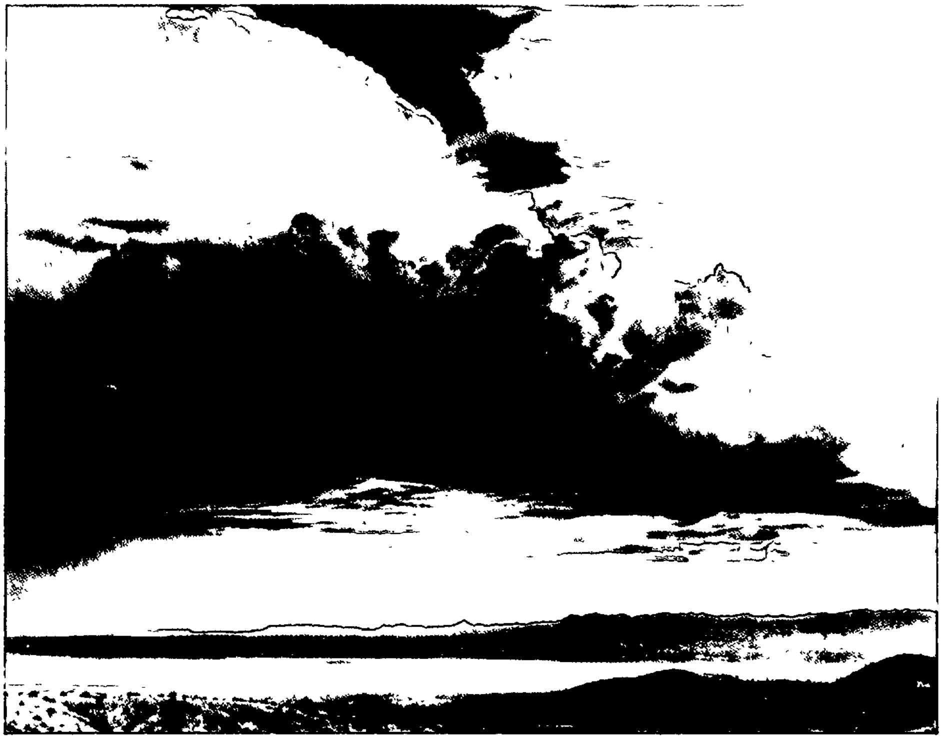
APPLICATION
IN RESPECT OF A SALES AND LEASEBACK
FINANCING TRANSACTION BY
PUBLIC SERVICE COMPANY OF NEW MEXICO

1984 ANNUAL REPORT OF
PUBLIC SERVICE COMPANY OF NEW MEXICO
AND ANNUAL REPORT ON FORM
10-K FOR THE FISCAL YEAR
ENDED DECEMBER 31, 1984

"A fine wind is blowing the new direction of time"

—D H Lawrence

PNM ANNUAL REPORT 1984



Changing, Yet Unchanged

The Southwest is a land of sharp contrasts—modern cities rising from timeless deserts, multistory granite and glass office buildings standing within sight of adobe Indian villages.

Laura Gilpin's "Storm From La Bajada Hill, New Mexico," on the cover of this year's annual report, reveals a dramatic landscape. Since the Gilpin photograph was taken in 1946, a modern interstate has been built across La Bajada's weather-beaten, high mountain desert. Wise travelers have a healthy respect for the storms that often rack the otherwise serene hill.

As you turn the pages of the report you'll see other vintage photographs that convey the ageless quality of New Mexico. They are accompanied by quotes from well-known authors and others whose work has been deeply influenced by experiences in the Southwest.

PNM has also been influenced by the natural beauty and the rich cultural heritage of New Mexico and the Southwest. As we've grown, as we've changed to meet the challenges and take advantage of the opportunities of the 1980s, we've retained our close affinity for the land and for the people we serve.

"STORM FROM LA BAJADA HILL, NEW MEXICO," *Laura Gilpin 1946 © 1985 Amon Carter M*

Table of Contents

Financial Highlights

	1984	1983	% Change
Operating revenues	$ 445,328,000	$ 397,474,000	12.0
Operating expenses	$ 298,834,000	$ 261,227,000	14.4
Operating income	$ 146,494,000	$ 136,247,000	7.5
Net earnings	$ 132,840,000	$ 140,519,000	(5.5)
Net earnings applicable to common stock	$ 108,850,000	$ 116,332,000	(6.4)
Return on average common equity	12.5%	14.3%	(12.6)
Average number of common shares outstanding	35,011,000	32,956,000	6.2
Earnings per common share	$ 3.11	$ 3.53	(11.9)
Dividends paid per common share	$ 2.85	$ 2.81	1.4
Book value per common share at year-end	$ 25.28	$ 25.20	0.3
Utility construction expenditures	$ 278,205,000	$ 261,964,000	6.2
Gross investment in utility property	$2,405,961,000	$2,139,329,000	12.5
Kilowatt-hour sales	6,317,338,000	6,105,201,000	3.5
Number of electric customers served at year-end	243,864	233,256	4.5
Average kWhr usage per residential customer	6,022	5,915	1.8
System peak demand (MW)	976	998	(2.2)
Number of PNM employees	2,822	2,845	(0.8)
Number of common shareholders	66,855	70,210	(4.8)

Chairman's Letter

The midpoint of this decade is pivotal for the Public Service Company of New Mexico.

For years we have been building, endowing New Mexico and the Southwest with the energy resources needed to carry vigorous economic growth well into the next century. That long-term construction strategy is now approaching completion, and we have begun to focus on new services, fresh approaches to marketing and investments that help spur the growth of our state and region.

Such a period of transition demands innovation along with cautious management of the Company's resources. Change is inevitable, a positive response to needs and opportunities. Yet a critical management function is to recognize what should *not* change—the values, policies and traditions that give a corporation its character and durability—the stable business base that makes it possible to innovate without undue risk to shareholders or customers.

With this in mind, I think it appropriate to report this year not only on the changes underway, but also on those qualities of PNM which we recognize as changeless.

A Year of Opportunity

For PNM, this has been an exciting year. We entered 1984 faced with enormous challenges. The events of the past twelve months have proven that those challenges were, in fact, opportunities.

The year brought settlement of a landmark antitrust lawsuit in which PNM was an active plaintiff. The settlement led to PNM's acquisition, early in 1985, of the Gas Company of New Mexico and other New Mexico utility assets of the Dallas-based Southern Union Company. With the acquisition, PNM has added 303,000 gas customers to its service community and should realize approximately $400 million in new revenues during 1985.

Late in the year, the Palo Verde Nuclear Generating Station, in which PNM holds a 10.2 percent interest, received an operating license from the Nuclear Regulatory Commission for Unit 1 of the project. Fuel loading in Unit 1 was completed on January 11, 1985 and low power operation of the unit is underway. The license allows for possible full power operation later in 1985.

In December, the New Mexico Public Service Commission approved a new ratemaking methodology called Inventory of Capacity. This important ratemaking concept successfully deals with the problem of uncommitted capacity while protecting the interests of shareholders and shielding our customers from the impact of sudden rate increases.

Other 1984 highlights: the under budget and ahead of schedule completion of our Eastern Interconnection Project, a 216-mile transmission line which links us to eastern markets and allows immediate bulk power sales to Southwestern Public Service Company; completion—also under budget and ahead of schedule—of Montaña de Fibra, a $67 million medium density fiberboard facility in which our subsidiary, Meadows Resources, Inc., holds a primary interest; and finally, the implementation of a major rate relief package granted by the Commission to our electric utility.

Much of this good news is the outgrowth of years of strategic planning and careful management.

Marshaling of Resources

Our long-term commitment to utility construction began more than a decade ago, triggered in part by two phenomena. The first was the extraordinary growth rate of the 1960s, at times approaching 10 percent annually. The second was the oil crisis of the

1970s, which radically altered the way we and all Americans viewed energy.

We recognized at the time our responsibility to ensure that the economic potential of New Mexico and the Southwest must never be checked by insufficient supplies of energy. We saw clearly that our sources of fuel must be cost efficient, dependable and independent of external manipulation. As a result, PNM launched an intensive construction program to provide a balanced coal and nuclear power base.

Construction activity is now decreasing. The San Juan Generating Station, particularly San Juan Unit 4, which came on-line in 1982, is recognized as one of the most reliable and efficient coal-fired generating units in the nation. At Palo Verde Nuclear Generating Station, Unit 1 should be generating at full power later in 1985. Palo Verde Units 2 and 3 are on schedule and should be in operation by 1987. The ample and dependable energy supplies provided by these facilities represent a major resource for development in New Mexico and throughout the Southwest, a powerful attraction for new industries and businesses.

> ***"Change is inevitable, a positive response to needs and opportunities. Yet a critical management function is to recognize what should not change"***

Marketing: The Future Challenge

Added capacity brings with it a necessity for new emphasis on marketing. With the Eastern Interconnection Project complete, PNM is now linked with power systems to the east. We are also seeking markets to the north and in California. The early results of these efforts are notable. The Company has in-hand contracts to sell nearly three-quarters of our capacity in excess of that demanded by our New Mexico customers from 1985 through 1987.

An important element of our marketing program is the recognition that, by promoting the success of our customers, we ensure our own success. We are listening more closely than ever to what our customers are telling us about their energy needs.

Our marketing program is gaining momentum, but to protect our shareholders and customers against the possible negative impact of uncommitted capacity, we have embraced Inventory of Capacity. Inventorying protects customers from "stairstep" rate increases by holding uncommitted capacity out of the rate base until it is needed. At the same time, this new ratemaking concept recognizes the legitimate interests of shareholders by allowing capital costs to earn a fair return and to be recovered in the future.

Broadening Our Base

PNM is now a diversified business family, organized to accomplish two complementary tasks. Our electric and gas utility divisions serve as New Mexico's primary energy resources. Our investment group, headed by Meadows Resources, Inc., enhances corporate profitability while it spreads our investment risk and creates economic opportunities in New Mexico and the Southwest.

Our investment subsidiary, Meadows, accounted for 14 percent of our net earnings applicable to common stock for the year. Meadows has developed a broad base of interests with investments in forest products, minerals, land and new technologies.

Montaña de Fibra, completed in 1984, is expected to produce as much as 88 million square feet of medium density fiberboard annually. It has also generated 200 new jobs in an economically depressed area of New Mexico.

Meadows is tapping into Southwestern real estate markets through its active partnership with Bellamah Associates, Ltd., a New Mexico-based land development firm. The success of real estate activities has far exceeded our expectations, with total sales during 1984 amounting to $83.0 million.

The Meadows venture capital portfolio includes investments in gas lasers and other exciting technologies. Only about 4 percent of Meadows' assets are dedicated to venture investments, but we expect good returns.

Changing, Yet Unchanged

These key events and accomplishments of 1984 and early 1985 represent major milestones in the Company's strategic plan for the 1980s and beyond. But underlying the developments that I have briefly described, which have accelerated the evolution of PNM, there are solid principles of Company practice that do not change.

Among those principles is our commitment to strong leadership. The recent appointment of John Bundrant as President and Chief Operating Officer of our Electric Operations and John Ackerman as President and Chief Operating Officer of our Gas Operations reaffirms that commitment. These new appointments clearly separate our electric utility from our gas operations and assure a strengthening of active competition between the two utilities.

We seek only the best employees. The early completion of major projects such as Eastern Interconnection Project and Montaña de Fibra—at less than projected cost—is a testament to their skill and dedication.

A tough but fair regulatory atmosphere has yielded rate relief—$38.5 million in relief became available last July with another $7.5 million made available on February 1, 1985—and made possible ratemaking innovations such as Inventory of Capacity.

Finally, we are firmly committed to our customers, our state and our region. Our enduring goals are to help preserve an irreplaceable way of life and to enhance it through new opportunities.

Our shareholders, employees and customers recognize the importance of these goals and commitments. The PNM management and directors thank them all for their confidence and support.

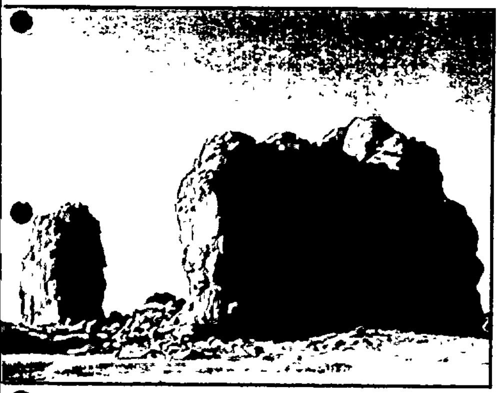
J. D. Geist
Chairman and President

"The wind lay upon me. The monoliths were there in the long light, standing cleanly apart from time."

—N. Scott Momaday

"NAVAJO CHURCH NEAR FORT WINGATE (New Mexico)," *John K. Hillers, Circa 1880, Albumen Print*

Corporate Overview



In the decades ahead, the Public Service Company of New Mexico (PNM) anticipates a continuing population shift to the Southwestern Sunbelt. A land of rich cultural heritage and burgeoning economic development, the Southwest will require a steady and reliable supply of energy to match this expansion. As New Mexico and the Southwest region grow, the Company is committed to meet increasing customer demand—with its electric, gas, and water utilities.

Recognizing its obligation to promote the success of its customers as well as its shareholders, PNM plays a unique role in the development of the region. PNM believes in the importance of beneficial traditions—of development, of goals shared with the citizens it serves, and of a special concern for the land and the resources with which it is entrusted.

1984 Earnings

Careful management of Company resources is reflected in revenues and earnings. Net earnings for 1984 totaled $[illegible] million. This represented a 14 percent increase in earnings over 1983, after eliminating a nonrecurring gain of $24.1 million, in 1983, on the sale of the equity interest in a trust which held certain coal leases.

Earnings per share of common stock were $3.11 in 1984. The average number of shares outstanding was 35.0 million, up 6.2 percent from the 33.0 million shares outstanding in 1983. Return on average common equity was 12.5 percent.

Regulatory Environment

During 1984, PNM was successful in negotiating settlements of several important cases before the New Mexico Public Service Commission (Commission). PNM believes that vigorous negotiation in good faith better serves all interests—the shareholder's, the customer's and the public's—than does prolonged and adversarial litigation.

Rate Filings

In 1984, the Commission approved the stipulated settlement of a rate relief request filed in August 1983, the Company's first electric rate filing since October 1981. The April 1984 settlement allowed PNM's electric utility to collect approximately $300 million in annualized revenues (excluding fuel adjustment clause revenues). The rate relief amounted to $46 million to be implemented in two steps. The first increase, of $38.5 million, was implemented in July 1984. An additional increase of $7.5 million was effective in February 1985.

The bulk of the overall rate adjustment reflects inclusion in the rate base of PNM's portion of construction costs for the fourth and final unit at the Company's coal-fired San Juan Generating Station (San Juan), located in northwest New Mexico.

Inventory of Capacity

The Commission also approved in December 1984 a stipulation between PNM, the Commission staff and other parties that established a ratemaking methodology called "Inventory of Capacity." This methodology places new generating facilities into the rate base gradually. Inventorying protects shareholder investment in new generating plant, while shielding customers from the sudden rate impacts that would otherwise occur if a new plant were put into the rate base all at once.

Faced with the challenge of placing new, capital intensive plant on-line while minimizing the impact on customers, the Company and the Commission began, in 1982, to study this new ratemaking concept, which places certain portions of uncommitted plant capacity into "inventory." In 1983 the Commission established a task force representing the Commission staff, PNM, the Attorney General's staff and three customer groups. This task force was charged with examining the inventorying concept and providing a recommendation on its application as a ratemaking method.

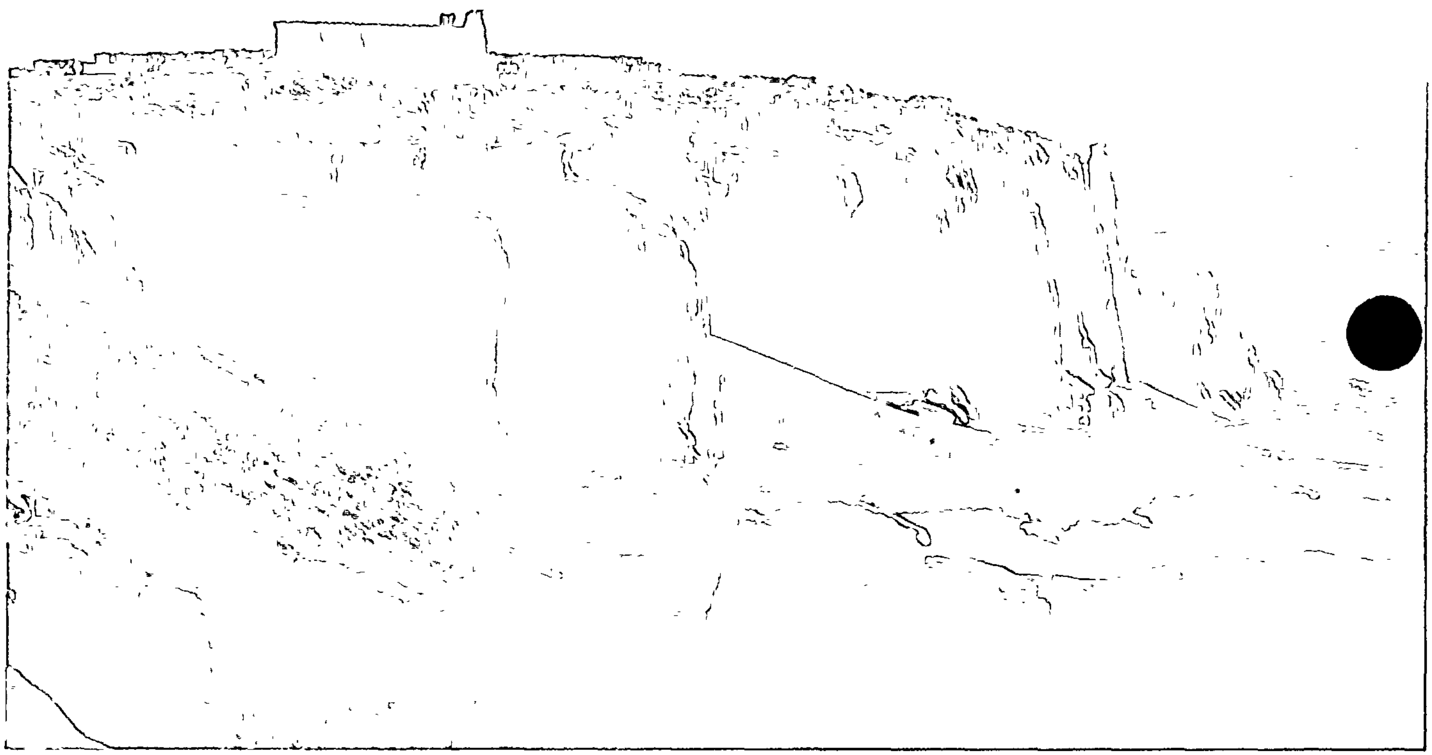
Inventorying defers certain costs associated with uncommitted capacity above a 20 percent reserve margin. It also defers some of the cash return on shareholders' investment and accrues non-cash earnings while the plant is in inventory. Such deferred carrying costs will be recovered from future customers when the inventoried plant is placed into the rate base.

Inventorying includes other cost-recovery methods. Revenues from bulk sales of inventoried capacity will be used first to pay fuel costs and other variable operating costs, then to pay up to half of the depreciation and property tax costs. Any additional revenues will be allocated to these costs and carrying charges, which would otherwise be paid by future customers.

The plan also contains a cap which limits the cost that customers will pay in the future.

"Wherever humanity has made the hardest of all starts and lifted itself out of mere brutality, is a sacred spot."

—Willa Cather



"CLIFF PERCHED ACOMA," *Edward S. Curtis, 1904, Glass Plate Negative*

Securities Transactions

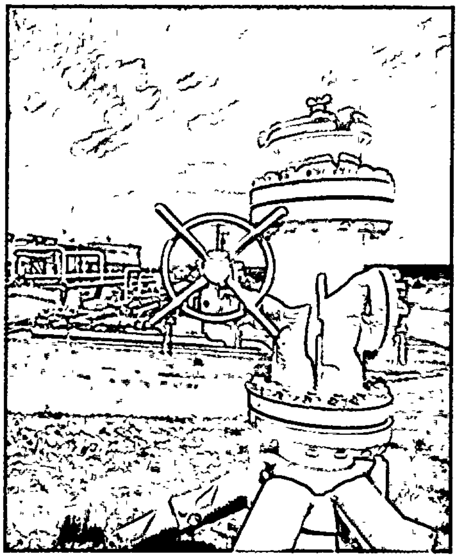
Bonds issued in 1984 were comprised of first mortgage bonds and pollution control revenue bonds. In August, PNM sold $65 million of its First Mortgage Bonds, 13 1/8% Series due 1994. Proceeds were applied to reduce short-term debt. In September, approximately $77 million of first mortgage bonds was issued to secure PNM's guarantee of an equal amount of 5.9% Pollution Control Revenue Refunding Bonds, Series 1977 due 2007, issued by the City of Farmington, New Mexico. The refunding bonds were issued in 1977 to provide funds to pay two prior issues of pollution control revenue bonds which matured October 1, 1984.

In December, a total of $38.5 million of pollution control revenue bonds were sold in two series through the Maricopa County, Arizona Pollution Control Corporation. The bonds were issued to defray a portion of cost to PNM of certain pollution control facilities associated with the Palo Verde Nuclear Generating Station (Palo Verde) Units 1, 2, and 3. Of the $38.5 million, $23 million was Annual Tender Bonds maturing in 2009 which were sold in a public offering and secured by the Company's first mortgage bonds, and $15.5 million was in a separate series sold as a private placement on an unsecured basis.

Approximately $48 million of new equity capital was raised through the Company's special stock plans throughout the year. About 2.2 million shares of PNM common stock were issued through such plans, including the Company's Dividend Reinvestment Plan.

As of December 31, 1984, on a consolidated basis, commercial paper and short-term notes totaling $30.3 million had been borrowed under PNM's $164 million of bank lines of credit and revolving credit arrangements.

During the year, four rating agencies reviewed the Company's securities. Standard & Poor's Corp. and Fitch Investors Service, Inc. reaffirmed their ratings. Duff and Phelps, Inc. removed the Company from its credit-watch list, maintaining its prior rating. Moody's Investors Service lowered its rating on the Company's first mortgage bonds and secured pollution control revenue bonds from A1 to A2. Unsecured pollution control revenue bond ratings have been lowered from A2 to A3, with preferred stock ratings reduced from a2 to a3.



PNM Acquires Gas Company of New Mexico

Among the most significant developments in PNM's history is the recent substantial broadening of its utility commitment. In January 1985, PNM completed the acquisition of Gas Company of New Mexico (GCNM) from the Texas-based Southern Union Company (Southern Union) as partial settlement of an antitrust suit. With the acquisition PNM anticipates that total utility revenues will nearly double in 1985.

PNM purchased Southern Union's New Mexico gas utility assets for net book value (less assumed liabilities) of approximately $224.3 million, with Southern Union to receive $172.8 million. The $51.5 million difference represents Southern Union's settlement of the suit with all parties, including PNM. As part of the settlement, PNM funded $15.6 million, in cash and by issuing a note for $20 million, of the total $51.5 million settlement amount to the other plaintiffs. The remaining $15.9 million of the settlement, less expenses, will be refunded to PNM's electric customers by PNM.

Customers will benefit from direct refunds made as part of the settlement and by PNM negotiations, made possible through the acquisition, for lower gas prices at the wellhead.

Planning for the Future: New Mexico Generating Station

PNM is considering a project with extraordinary potential for serving new markets while contributing to the quality of life in the region. In August, the Company entered into an agreement in principle with the Navajo Nation, General Electric Company and Bechtel Power Corporation to explore the possibility of jointly building and operating a major regional power project in New Mexico. Participants will be evaluating markets, design, fuel sources and financing to determine whether the project would be economically viable in the 1990s.

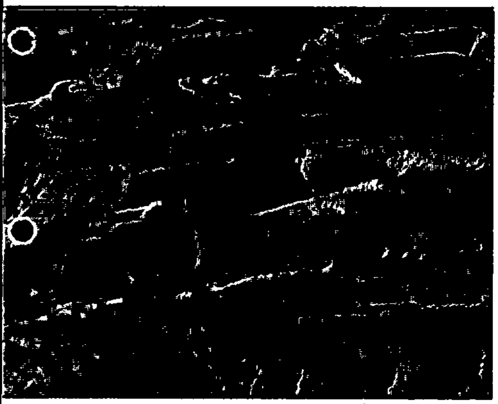
The proposed coal-fired plant, New Mexico Generating Station, would not be designed as generating capacity for PNM's New Mexico electric customers, but would position the Company to respond to growing regional power needs. The project would complement electric operations with associated new transmission lines and facilities that would enhance the Company's ability to market and deliver power.

*"It is the same now, as a thousand years ago once you overlook the cities:
The desert begins just beyond those lights it crouches."*

—Keith Wilson

"CHURCH BUTTRESS, RANCHOS DE TAOS CHURCH," *Paul Strand, 1932, Silver Print*

Gas Company of New Mexico



Attorney Gene Gallegos argued one of the strongest cases of his career at an altitude of 35,000 feet. In 1981, chance placed the Santa Fe lawyer in an airline seat beside Al Robison, PNM's Vice President of Finance. It was a meeting with far-reaching consequences for hundreds of thousands of New Mexico gas and electric customers, for PNM and, ultimately, for PNM shareholders.

Two years earlier, a group of New Mexico school teachers had hired Gallegos to challenge natural gas pricing practices in court. Gallegos believed he could make a credible antitrust price-fixing case against Southern Union Company, the Dallas-based owner of the Gas Company of New Mexico, and several major natural gas producers and suppliers. An antitrust lawsuit was filed on behalf of residential gas consumers purchasing natural gas from GCNM. Certain agencies of the State of New Mexico, all large volume purchasers of natural gas, joined the lawsuit.

The battle dragged on for 23 months through depositions and hearings. Then, on an east-bound airliner, Gallegos found an "attentive ear" in Robison, and laid out the facts of his case.

"As I listened, I realized PNM needed to look at this case very, very carefully," says Robison.

Some of PNM's generating plants were fired by natural gas. If allegations of price fixing were true, PNM was paying too much for its gas and, worse, passing the higher costs along to its own electric customers.

When Robison returned to Albuquerque, he discussed the matter with Jerry Geist, PNM's President, who authorized a further investigation. A few weeks later, PNM joined the suit on the side of the residential gas consumers.

Shortly after PNM entered the case, two defendants, Southland Royalty Company and Supron Energy Corporation, settled out of court. After seven weeks of trial in Las Cruces, New Mexico, the jury ruled against Southern Union and the remaining defendants. However, the liability verdict was overturned on a technicality and a new trial ordered. Conoco and Consolidated Oil and Gas, also defendants, then settled, bringing the settlement total to $70.3 million for PNM and the other plaintiffs.

By the fall of 1983, all defendants except Southern Union had settled. With a second trial scheduled for the spring of 1984, settlement negotiations with Southern Union were conducted over a period of weeks. When these negotiations failed, Sherman G. Finesilver, Chief Judge of the United States District Court for the District of Colorado, ordered top officials of Southern Union and PNM to Denver for a face-to-face talk.

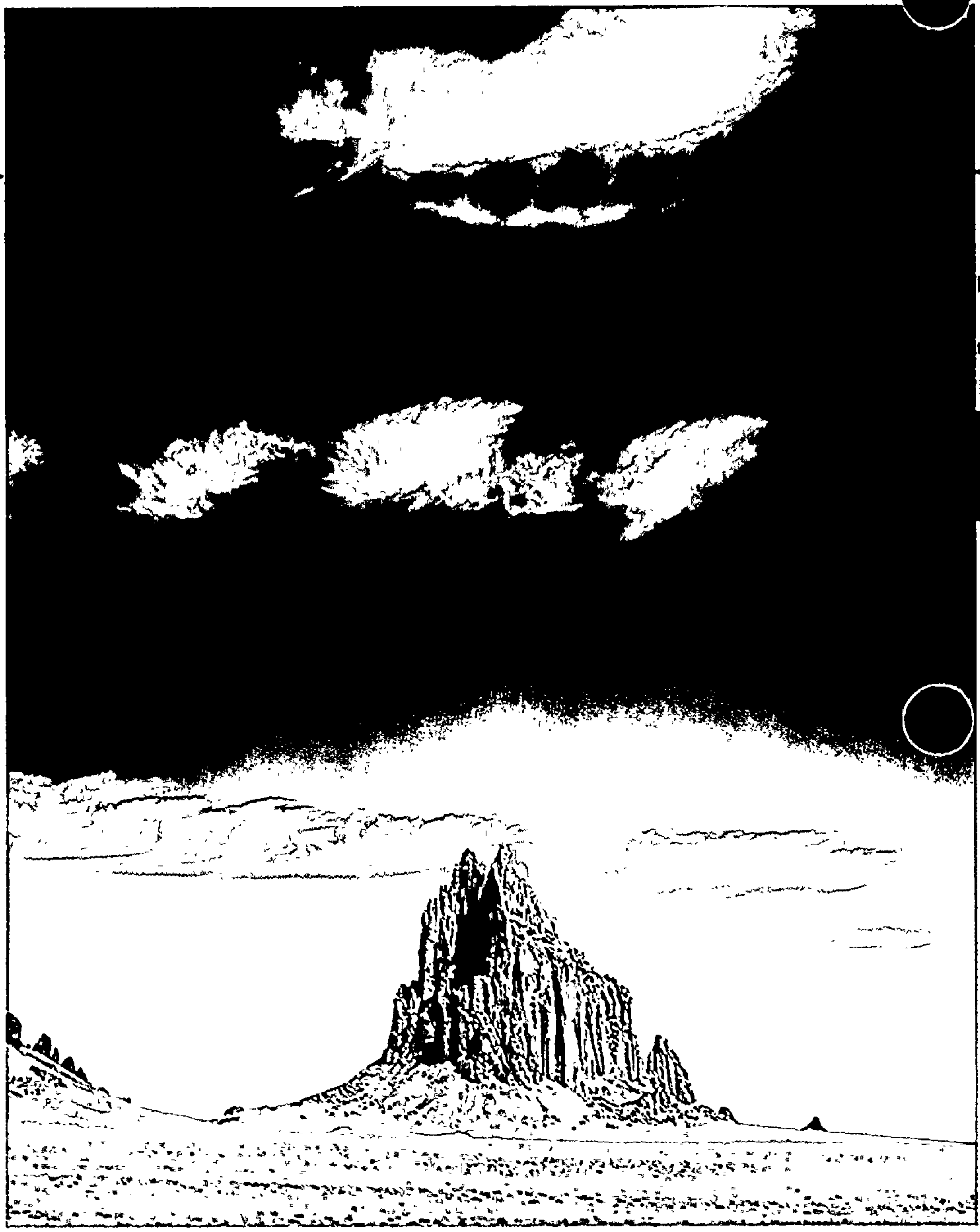
Only a few days before the case was slated for trial, a series of around-the-clock discussions was held. Terms of a settlement were worked out, including an understanding that Southern Union would sell its New Mexico gas utility assets to PNM.

The residential plaintiffs had wanted for several months to bring ownership and control of the gas utility "home to New Mexico." Many months before, Gallegos had suggested to PNM officials that acquisition of GCNM by PNM would be of value to New Mexico and all gas consumers in the state. After careful investigation of the gas utility business, PNM became convinced that the purchase was in the best interest of New Mexico, residential gas customers and the corporation and agreed to the settlement. For PNM, the settlement increases total Company assets, broadens its earnings base and should improve cash flow.

The settlement benefits New Mexicans in a variety of ways. It will provide millions of dollars in refunds to utility customers. And along with bringing control of the state's gas utility back to New Mexico, it may bring lower gas rates as well. According to settlement terms, PNM will renegotiate natural gas supply contracts.

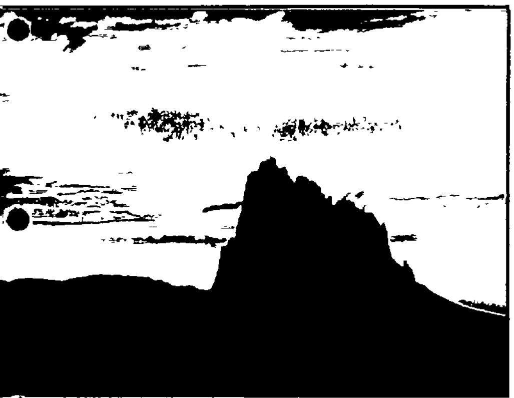
"From any distance it is all by itself . . . Risen alone off the dry plateau, this rock or a mountain of a rock has seemed as alive as it is dead."

—Joseph McElroy



"SHIPROCK, NEW MEXICO," *Jody Forster, 1979, Silver Print*

Electric and Water Utility Activities



The social, political and economic environment has changed over the years, and the utility industry has adapted in a number of ways. Utilities have changed fuel sources to limit dependence on foreign supply. They have broadened resource bases and established nonutility subsidiaries to ensure stability. And they now function in much more competitive markets.

Operating in a changing marketplace, PNM has adapted successfully. Amidst these changes, however, PNM continues to balance its commitments to shareholders, customers and the region with tough productivity goals and innovative marketing.

Electric and Water Utility Report

al operating revenues for 1984 ased 12.0 percent from $397 million in 1983 to $445 million in 1984. This increase in total operating revenues resulted primarily from rate relief granted by the Commission and increased fuel clause revenues.

Due to significant cost containment efforts, utility operation and maintenance expenses, excluding fuel and purchased power expenses, decreased 2.3 percent from $105 million in 1983 to $102 million in 1984. However, total operating expenses in 1984 increased 14.4 percent over 1983, largely because of higher fuel and purchased power costs.

Kilowatt-hour sales increased 3.5 percent in 1984, while retail sales were up 5.3 percent. Sales to wholesale customers increased slightly over 1983 levels. The average number of electric customers rose to 238,000, up from 228,000 in 1983.

Marshaling Resources For The Future

In the 1960s, PNM recognized two factors in the utility industry that would affect the way the Company operates. Sharply rising demand for electricity indicated that it was time to build additional generating capacity, and fluctuating fuel prices cautioned against reliance upon one fuel source.

In response to these signals, PNM launched a construction program to prepare for anticipated rising consumption. It also began to shift its fuel base away from a dependence on oil and gas to a greater reliance on coal and nuclear fuels.

As the Company enters 1985, it has met these objectives. Net operating capacity for 1984 was 1,337 megawatts. Energy is supplied by two coal-fired plants, as well as by reserve oil-fired and natural gas-fired plants. A major nuclear power plant, in which PNM holds an interest, is nearing completion.

Palo Verde Unit 1 Licensed

Beginning in 1985, PNM's system is scheduled to receive its first energy from a 10.2 percent interest in Palo Verde, located 55 miles west of Phoenix, Arizona.

In December, the Nuclear Regulatory Commission issued a 40-year operating license for Palo Verde Unit 1. The license temporarily restricts power production to 5 percent, with successful low-power testing leading to possible full power operation by the end of 1985. Units 2 and 3 are scheduled for operation in 1986 and 1987, respectively.

When all units are complete, Palo Verde will generate 3,810 megawatts. PNM's share will be 390 megawatts. The projected cost for the Company's total interest in the three units is $938 million.

The new inventorying method of ratemaking will allow shareholders to recover the significant capital investment in Palo Verde, while protecting PNM customers from the "rate shock" attributed to sudden rate increases. More important, Palo Verde is securing energy independence for PNM well into the next century.

San Juan Surpasses Expectations

San Juan represents PNM's early commitment to end its reliance on unstable oil and gas markets. Located adjacent to a rich coal supply, San Juan has surpassed Company expectations for cost, reliability and efficiency.

San Juan Unit 4 stands among the most reliable generating units of its type and size in the country. Since April 1982, when Unit 4 was placed in service, it has been available for service 89.5 percent of the time. This compares to an industry average of about 79 percent.

Much of PNM's pride in San Juan stems from its environmental record. The coal-fired plant is equipped with pollution control equipment that meets or exceeds state and federal regulations.

Eastern Interconnection Project Opens New Markets

With capacity additions in place, PNM is looking ahead toward a period of expanded marketing. One important step in reaching new markets is to improve PNM's transmission capability through efforts such as the construction of the Eastern Interconnection Project (EIP). This 216-mile, 345-kilovolt line runs from just north of Albuquerque to an AC/DC converter station located near Clovis, New Mexico and will link the Company with Texas.

In January 1985, PNM began the sale of up to 220 megawatts per hour of surplus energy to Southwestern Public Service Company (SPS). This energy sale will end in 1989, which SPS may extend into 1990. Starting in 1991, the Company will purchase 100 megawatts of interruptible power from SPS, thus improving system reliability and power mix. Between 1995 and 2011, PNM will purchase up to 200 megawatts of interruptible power from SPS.

To speed recovery of investment, the Company sold the facilities associated with the EIP to private investors in February 1985. The facilities have been leased back to PNM, reducing revenue requirements by approximately \$10 million in 1984, or \$35 million in present value over the life of the project.

Sangre de Cristo Water Company

In January 1985, the Commission approved an additional \$3 million rate increase for PNM's Sangre de Cristo Water Company, to be placed into effect in three-steps: one immediate increase, a second scheduled for April 1985 and a third for October 1985.

In November 1984, at the request of the City of Santa Fe, discussions opened regarding a possible sale of this division to the city. If an agreement is reached, the sale could be completed during 1985.

"One important step in reaching new markets is to improve PNM's transmission capability through efforts such as the construction of the Eastern Interconnection Project"

Developing New Markets

PNM recognizes that utilities operate in an increasingly competitive market. Today's customers have the option to choose energy from a sizeable assortment of alternatives, including wood, propane, solar and cogeneration.

To compete effectively in this market, PNM has stepped up its retail marketing efforts. A new marketing program based on the concept of "customer success" will enable PNM to improve its already strong market position by providing more responsive, flexible services to customers.

The business of the electric utility is service. For PNM's electric utility, customer success means finding ways to assist customers with their energy management needs and seeking new ways to help industrial customers increase their profit margins. The net result of this marketing approach for PNM will be increased profitability and enhanced credibility with its customers.

Marketing New Capacity

The Company initiated a marketing program six years ago to increase sales to wholesale customers. During this period, PNM negotiated long-term contracts and annual sales agreements representing approximately 73 percent of what was projected to be available as uncommitted capacity from 1985 through 1987.

Ongoing sales include contracts to sell as much as 236 megawatts of San Juan Unit 4 capacity to San Diego Gas and Electric Company. Also, PNM has contracted with Arizona Public Service Company to sell 60 megawatts during the 1985 summer peak. Plains Electric Generation and Transmission Cooperative, Inc. will receive 15 megawatts of peaking power until 1989.

During 1984, PNM also sold blocks of energy on the wholesale market to such diverse entities as El Paso Electric Company, Texas-New Mexico Power Company, Nevada Power Company and the California cities of Burbank and Pasadena.

The creative challenge that lies ahead for PNM is to design energy products that improve the Company's marketing ability. For example, the Interutility Marketing Department is developing innovative energy packages to attract bulk power purchasers. At the same time, the Company is studying improvements for the transmission system that would open up entirely new markets.

Eastern Interconnection Project

North of Albuquerque, along the Rio Grande, stands PNM's Bernalillo-Algodones transmission switching station. Eastward, beyond the majestic central mountains of New Mexico, stretch rambling plains and many-fingered gulches, reaching for Texas. To motorists traveling the smooth ribbons of eastbound interstate, the power lines darting in and out of view appear almost part of the landscape.

For the people who surveyed and strung the miles of PNM's Eastern Interconnection Project from Algodones to Clovis, New Mexico, those high transmission lines represent two years of hard work in dramatic terrain.

PNM announced the project in November 1982. Plans called for 216 miles of 345-kilovolt transmission line to be strung and operational in less than two years—about half the normal construction time for a project this size.

Southwestern Public Service Company had agreed to purchase up to 220 megawatts per hour of surplus energy from PNM starting in January 1985 and continuing to at least 1989. In 1991, PNM will begin the purchase of 100 megawatts of interruptible power from SPS, and from 1995 through the remaining life of the contract, SPS will provide PNM with up to 200 megawatts of interruptible power.

PNM built both the line and the AC/DC Blackwater Converter Station (Blackwater). Completed late in 1984 the project linked PNM for the first time with power systems to the east.

Not only does the project enable PNM to sell available power not currently demanded by customers in New Mexico, but, says PNM Senior Vice President Jack Wilkins, "The interconnection gives us flexibility in planning future generating projects to meet New Mexico's energy needs. It also provides both PNM and SPS with additional reliability."

One immediate consideration for the EIP team was to solve the problem of interconnecting the systems of PNM and SPS. The generators of the two systems do not rotate identically, so they needed an "interpreter" to complete the connection. The ultimate solution was the Blackwater high voltage direct current (HVDC) converter station which converts the AC of one system to a uniform HVDC and then to a compatible AC system. This rather simple-sounding conversion at Blackwater is accomplished with complex, state-of-the-art equipment.

Looking back on the project, PNM's EIP Project Manager, Larry Sullivan sees some advantages to working under such a tight construction schedule. "We knew going into the project that we would have to be flexible and creative to meet the extremely short deadline," says Sullivan.

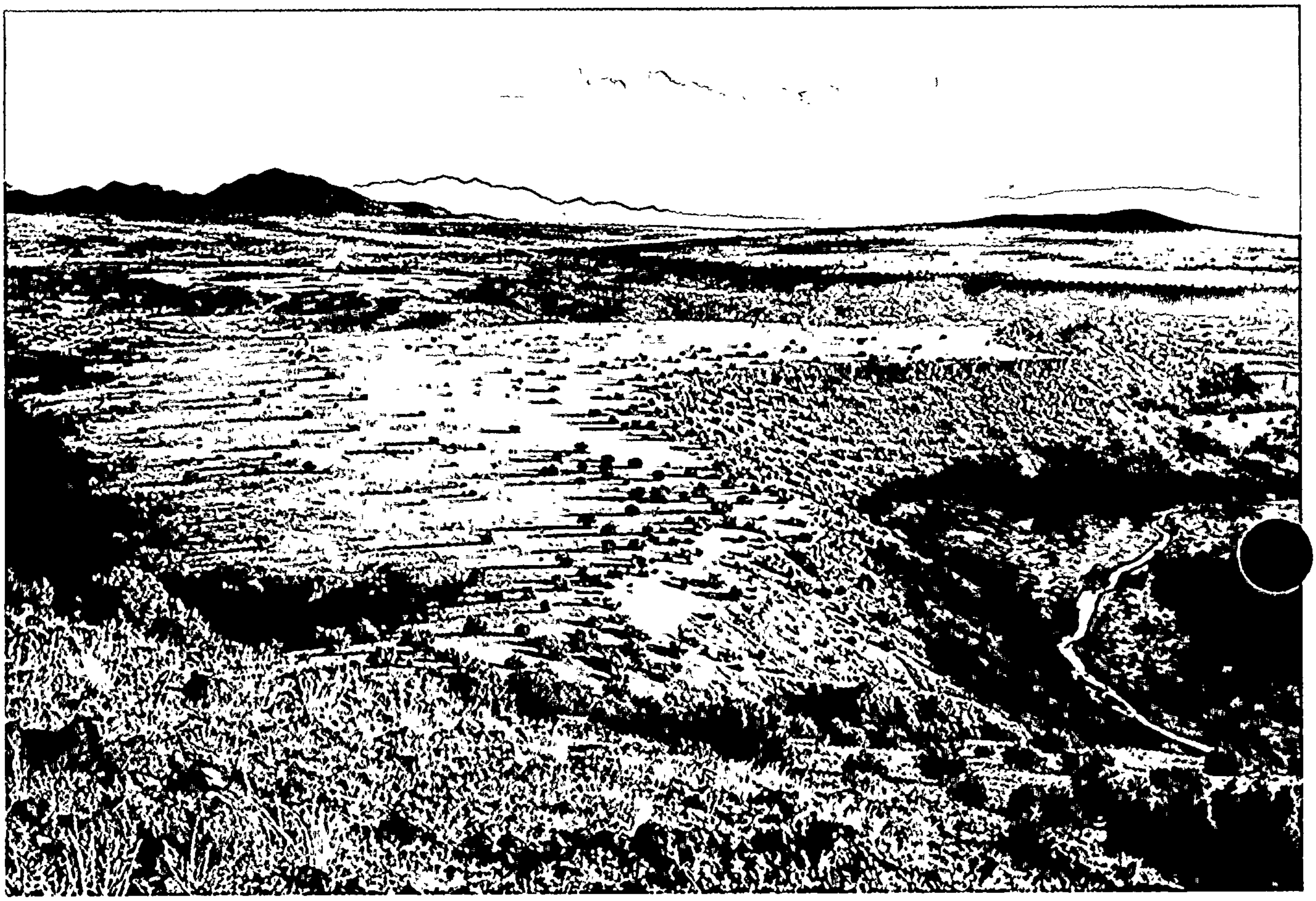
The EIP team devised faster, more efficient ways to perform environmental studies, land surveys, right-of-way negotiations and construction. Even with the tight schedule, the team conducted careful route and environmental studies, consulting with more than a dozen federal, state and, local agencies and community leaders. Along the way, the project turned up such unexpected treasures as historical artifacts, ancient archaeological sites and rare flora—all finds of value to scientists and archaeologists.

Looking for innovative ways to speed up construction, the project team replaced plodding truck caravans with helicopters and increased the pace of tower emplacements from 6 to 30 a day. The 8,000-pound towers were assembled at staging areas about every six miles along the line and lifted by helicopters to their precise concrete foundations where ground crews anchored them with guy wires. The helicopters not only saved time but minimized the amount of needed access land and reduced the project's environmental impact.

With such methods, some of which had never before been used by PNM, the EIP team completed the project ahead of schedule and under budget. "A lot of the innovations just came out of people's enthusiasm," Sullivan says. "We tried to anticipate problems as we went along. Anyone with an idea knew it was going to be heard. It was the enthusiasm of the people involved that made it a success."

". . . I found that I was no longer lost in the enormous landscape of hills and sky. I was a very important part of the teeming life of the llano and the river."

—Rudolfo A. Anaya



"LA MESITA, NEW MEXICO," *William Clift, 1978, Silver Print*

Broadening Our Base

At the core of PNM's long-term business philosophy is a diversification strategy aimed at improving return on equity and stimulating economic growth. The broadening of PNM's revenue base will help stabilize earnings in the years ahead, while enabling the Company to contribute to the economic development of the region. PNM is examining an array of nonutility investments with exciting future earnings potential.

Sunbelt Acquires Gas Gathering Company

PNM's mining subsidiary, Sunbelt Mining Company, Inc., (Sunbelt) acquires, markets and develops coal and other mineral resources and provides contract mining services. Under the GCNM settlement agreement, Sunbelt acquired the stock of Southern Union Gathering Company (Gathering Company), which purchases and trans- [illegible] natural gas for GCNM. Gathering Company plant and equipment assets are in excess of $19 million.

Sunbelt also purchased the stock of Transwestern Mining, Inc. (Transwestern). Transwestern's subsidiary, Calgom Mining Inc. is the operator of Goldstripe joint venture, a surface gold mining project located in California.

Investment Subsidiary Creates Opportunities

The Company's nonutility arm, Meadows Resources, Inc. (Meadows), invests in nonutility ventures with high growth potential. Its real estate activities have contributed to overall earnings for three years, while in July its first major New Mexico project, Montaña de Fibra (MdF), began creating revenues and jobs. Examining a wide variety of potential investment opportunities, from manufacturing plants to high technology products, Meadows seeks to enhance PNM's earnings while contributing to the economic development of New Mexico and the Southwest.

Land Partnership Develops New Potential

Three years ago Meadows entered a land development partnership called Bellamah Community Development (BCD). Meadows owns 50 percent of BCD, and a successor to Bellamah Land Company, a long-time New Mexico-based real estate company, owns the other 50 percent.

BCD's activities range from real estate acquisition, planning and development to the marketing of residential lots or commercial and industrial tracts to builders. While approximately 26 percent of the land owned by BCD is in New Mexico, development activities reach into Arizona, Texas, Oklahoma, and Colorado.

BCD has earned a respected place in the Southwestern real estate development market with two large-scale projects in Dallas, Texas. In 1982, BCD acquired Flower Mound, a 3,018 acre development in northwest Dallas. By the end of 1984 almost all Flower Mound acreage had been sold to developers and builders. This success led the partners to purchase the 4,377 acre Mountain Creek development, 10 miles southwest of downtown Dallas.

Both developments involve multipurpose residential, commercial and industrial land use with sales of parcels to smaller developers who build in accordance with BCD specifications. The projects are also similar in two other important respects: (1) they involve very large, previously undeveloped acreage which allows for comprehensive master planning and zoning; and (2) they are large enough to provide a wide mix of land uses and thus eliminate dependence on a single segment of the real estate market.

Montaña de Fibra, Inc.

Meadows has invested approximately $67 million in the Las Vegas, New Mexico MdF facility which manufactures a wood substitute called medium density fiberboard. Construction of the project was completed in 1984.

Formerly a joint venture between Ponderosa Products Inc. and Meadows, MdF is now a corporation in which Meadows holds a 90 percent ownership. In October, Meadows entered into a sale-leaseback transaction with MdF involving assets of about $55 million.

Meadows Invests Capital

One of Meadows' most exciting activities is its venture capital portfolio. By year-end Meadows held interests in eleven companies, representing a total investment of nearly $7.6 million.

The primary investment focus is in companies with high growth potential. These include a range of medium to high technology enterprises, both in start-up and later stages of development. Most such investments range from $250,000 to $1 million.

Meadows has also joined with other venture capital firms located in Texas, New York and California. This network is providing a new channel for capital, contacts and expertise to support development in New Mexico, while expanding Meadows' investment opportunities outside the state and region.

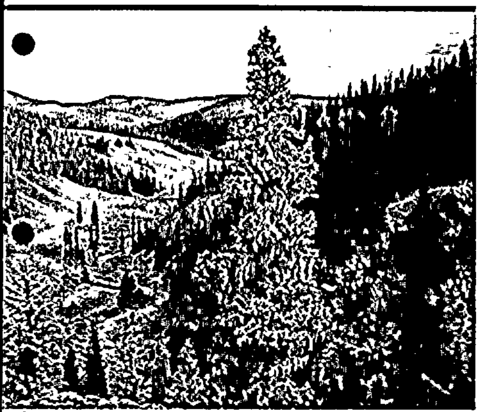
Further development of Meadows' venture capital portfolio should increase return on equity, while contributing to the New Mexico economy. Whenever possible, Meadows invests in companies that either operate in New Mexico or plan expansion into the state. Meadows also lends its expertise and capital support to state economic development efforts, such as the Business Development Corporation, the Technical Innovation Center, New Mexico Entrepreneurs' Club and New Mexico Technet, Inc.

"You should understand the way it was back then, because it is the same even now."

—Leslie Marmon Silko

"CAVE DWELLING, BANDELIER NATIONAL MONUMENT, NEW MEXICO," *David Noble, 1982, Silver Print*

Montaña de Fibra



The eastern slopes of the Sangre de Cristo mountains are covered with pine trees. At the point where the tall, mountain forest meets the broad New Mexico plains stands the once-frontier town of Las Vegas. This historic community has a new and beneficial neighbor.

Montaña de Fibra—that's Spanish for "mountain of fiber"—is also the name of an exciting, new manufacturing facility located a short distance from Las Vegas, New Mexico within view of the mountains and the pine forest it uses as a resource. Completed in 1984—under budget and six months ahead of schedule—the $67 million facility is a source of pride for the town and for Meadows Resources, Inc., PNM's wholly-owned, nonutility investment subsidiary.

MdF takes wood chips, shavings and sawdust— waste from local sawmills, including its own nearby sawmill—and turns them into a highly marketable product called medium density fiberboard. When fully operational, the 250,000-square-foot plant will produce fiberboard at a rate of up to 88 million square feet annually.

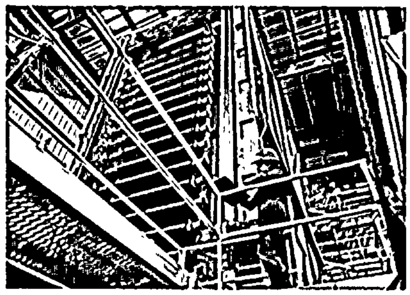
You may be more familiar with medium density fiberboard than you think. It's free of knots, saws cleanly and holds a screw just as snugly as the wood in your favorite rocking chair. Unlike particle board, it does not chip or splinter easily. Fiberboard is a high quality product used to manufacture a host of common items, such as furniture, cabinets, heavy-duty crates and even church pews.

Meadows has the majority interest in the plant. Ponderosa Products, Inc., the operating partner, is a company with many years of experience in the wood products industry. Strategically situated near major transportation routes, emerging markets, and the necessary raw materials, the plant may soon capture as much as 10 percent of the national fiberboard market.

Meadows' contribution to the project includes its financial strength, construction experience and knowledge of New Mexico. Ponderosa brought to the joint venture extensive operating experience in forest products, lumber manufacturing, and marketing. The combination has produced an efficient plant operation.

Ecology and efficiency go hand-in-hand at MdF. Use of sawmill waste to manufacture fiberboard eliminates an environmental nuisance, which otherwise must be burned, buried or dumped. MdF plant waste is used to fuel a boiler in the manufacturing process, and the boiler ash is sold to Las Vegas for fertilizer.

For PNM and its shareholders, MdF is a milestone in a carefully wrought nonutility investment strategy, of which an important element is economic development in New Mexico and the Southwest. The plant already employs over 200 people, and many other new employment possibilities exist because of ancillary businesses attracted to Las

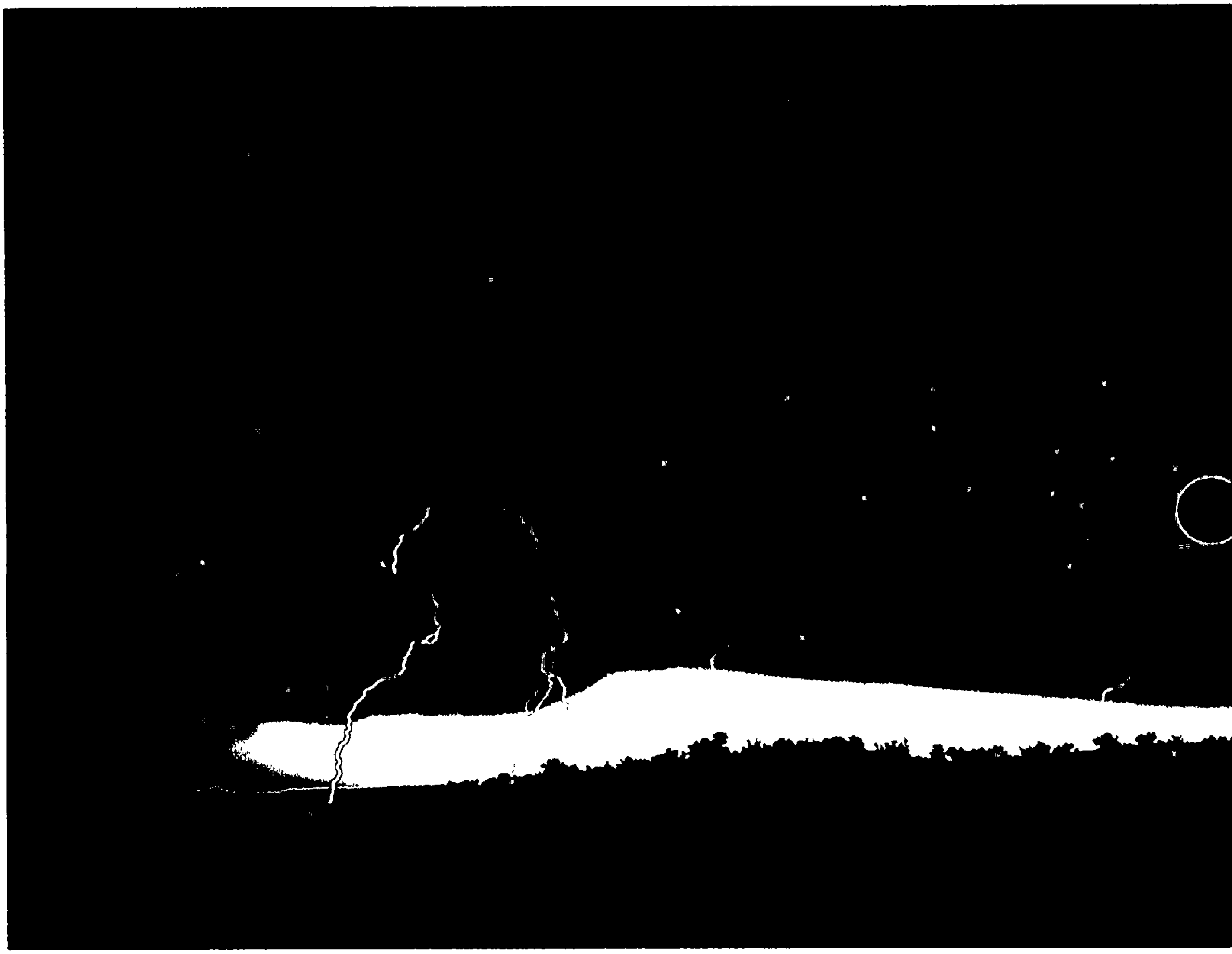


Vegas by MdF. A modest estimate indicates this increased employment will generate $3.5 million in income, $2 million in retail sales and $1.7 million in bank deposits for the area. Demand for electricity from the MdF plant alone is expected to generate revenues for PNM's electric utility of about $300,000 a month.

Las Vegas Mayor Steve Franken says MdF not only has "contributed significantly to the economy of the town, but also has enhanced our image as a good home for industry."

Indeed, the industry has brought a new kind of thinking to the community, says MdF Personnel Manager Abelino Montoya. "More than in buildings and steel, the shareholders of PNM have made a wise investment in the people of New Mexico."

"Black thunder-storms used to roll up from behind it and pounce on us like a panther without warning. The lightning would play round it and jab into it so that we were always expecting it would fire the brush. I've never heard thunder so loud as it was there." —Willa Cather



"LIGHTNING OVER THE RIO GRANDE VALLEY, NEW MEXICO," *Jim Bones, 1983, Dye Transfer*

Financial Data and Consolidated Financial Statements

Comparative Operating Statistics

	1984	1983	1982	1981	1[illegible]
Electric Service					
Energy sales—kWhr (in thousands)					
Residential	**1,279,917**	1,205,046	1,134,827	1,104,827	1,090,003
Commercial	**1,706,044**	1,600,199	1,515,664	1,483,105	1,441,634
Industrial	**762,117**	742,272	784,158	858,454	859,178
Other ultimate customers	**184,725**	185,824	215,853	186,939	167,070
Total sales to ultimate customers	**3,932,803**	3,733,341	3,650,502	3,633,325	3,557,885
Sales for resale	**2,384,535**	2,371,860	2,840,957	2,127,249	1,844,213
Total energy sales	**6,317,338**	6,105,201	6,491,459	5,760,574	5,402,098
Electric revenues (in thousands)					
Residential	**$ 107,395**	$ 90,020	$ 91,065	$ 80,627	$ 72,596
Commercial	**134,532**	107,729	110,745	97,699	85,480
Industrial	**50,439**	44,166	51,714	50,111	44,524
Other ultimate customers	**11,950**	10,913	14,775	12,170	9,750
Total revenues from ultimate customers	**304,316**	252,828	268,299	240,607	212,350
Sales for resale	**131,013**	136,273	149,115	86,781	59,475
Total revenues from energy sales	**435,329**	389,101	417,414	327,388	271,825
Miscellaneous electric revenues	**3,645**	2,846	2,743	2,581	2,598
Total electric revenues	**$ 438,974**	$ 391,947	$ 420,157	$ 329,969	$ 274,423
Customers at year-end					
Residential	**217,614**	208,368	199,679	195,722	191,[illegible]
Commercial	**25,614**	24,259	22,148	21,164	20,932
Industrial	**436**	438	453	458	466
Other ultimate customers	**194**	186	185	180	179
Total ultimate customers	**243,858**	233,251	222,465	217,524	213,072
Sales for resale	**6**	5	6	6	6
Total customers	**243,864**	233,256	222,471	217,530	213,078
Reliable net capability—kW	**1,337,000**	1,343,000	1,473,000	1,047,000	1,080,000
Coincidental peak demand—kW	**976,000**	998,000	957,000	992,000	913,000
Average fuel cost per million BTU	**$ 1.0970**	$ .9957	$ 1.1502	$ 1.1952	$ 1.0961
BTU per kWhr of net generation	**11,023**	11,296	11,296	11,227	10,551
Water Service					
Sales—gallons (in thousands)	**2,392,085**	2,315,980	2,842,381	2,729,457	2,699,816
Revenues (in thousands)	**$ 6,354**	$ 5,527	$ 6,386	$ 6,196	$ 6,093
Customers at year-end	**17,717**	16,721	20,432*	19,899	19,303

*Includes 4,508 customers for the Las Vegas water system which was contributed to the City of Las Vegas on December 30, 1982.

Selected Financial Data

	1984	1983	1982	1981	1980
	(In thousands except per share amounts and ratios)				
Total operating revenues	$ 445,328	$ 397,474	$ 426,543	$ 336,165	$ 280,516
Net earnings	$ 132,840	$ 140,519	$ 115,822	$ 107,958	$ 71,436
Earnings per common share	$ 3.11	$ 3.53	$ 3.22	$ 4.23	$ 3.36
Total assets	$2,598,744	$2,486,429	$2,145,984	$1,831,803	$1,457,900
Preferred stock with mandatory redemption requirements	$ 121,080	$ 123,700	$ 125,000	$ 90,000	$ 90,000
Long-term debt, less current maturities	$1,030,557	$ 974,290	$ 811,653	$ 707,472	$ 567,190
Common stock data:					
Cash dividends declared per common share	$ 2.85	$ 2.81	$ 2.77	$ 2.68	$ 2.04
Dividend pay-out ratio	91.7%	79.6%	86.0%	63.4%	60.7%
Market price per common share at year end	$ 24.375	$ 25.375	$ 26.00	$ 23.75	$ 19.75
Book value per common share at year end	$ 25.28	$ 25.20	$ 24.35	$ 23.87	$ 23.33
Average number of common shares outstanding	35,011	32,956	28,508	20,804	15,933
Return on average common equity	12.5%	14.3%	13.6%	18.6%	14.9%
Ratio of earnings to fixed charges (S.E.C. method)	2.33	2.81	2.70	3.00	2.94
Capitalization:					
Common stock equity	42.1%	41.5%	42.8%	39.5%	33.3%
Preferred stock:					
Without mandatory redemption requirements	4.9	5.2	5.8	7.1	9.3
With mandatory redemption requirements	5.5	6.0	6.9	6.0	7.9
Long-term debt, less current maturities	47.5	47.3	44.5	47.4	49.5
	100.0%	100.0%	100.0%	100.0%	100.0%

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion is management's assessment of the Company's financial condition and the significant factors which have an impact on the results of operations. This discussion should be read in conjunction with the Company's consolidated financial statements.

Liquidity and Capital Resources

The Company is continuing a construction program which will be necessary to meet prospective customer service requirements. The Company's five-year utility construction program for the period 1985-1989 provides for the expenditure of approximately $819 million, including allowance for funds used during construction (AFUDC) of $171 million. Included in such total amount are proposed expenditures during the five-year period of approximately $67 million for the Company's share of nuclear fuel for the Palo Verde Nuclear Generating Station and approximately $112 million for gas utility construction expenditures which will be required as a result of the Company's acquisition of gas utility assets in New Mexico.

The Company currently estimates total utility external funding requirements for the 1985-1989 period to be approximately $427 million including $293 million for long-term debt repayments, mandatory preferred stock redemptions and repayment of notes issued in connection with the acquisition of gas utility assets in New Mexico. Estimates of external funding requirements give effect to the implementation of the "Inventory of Capacity" ratemaking methodology. (See page 5.) The Company's projection of internal cash generation in the 1985-1989 time period assumes timely and adequate rate relief with respect to both retail and wholesale customers. The projection also assumes that the Company's non-utility subsidiaries will provide their capital requirements from internally generated funds and from independent borrowings which would be nonrecourse to the utility.

Utility construction expenditures for the year ended 1984 amounted to $278 million including AFUDC of $73 million. In 1984, internal sources of funds provided from continuing operations equaled $16 million. In 1984, the Company issued $65 million of first mortgage bonds, $48 million of common stock and utilized $15 million of proceeds from pollution control financings to finance the Company's utility construction program. In addition to the issuance of permanent and long-term securities, the Company has financed its capital expenditures on an interim basis through the use of short-term borrowings, commercial paper and reduction of temporary cash investments. Arrangements for bank lines of credit amounted to $21 million and revolving credit arrangements amounted to $143 million at December 31, 1984.

The indenture under which the Company's first mortgage bonds may be issued and the Restated Articles of Incorporation of the Company under which additional shares of its preferred stock may be issued restrict the ability of the Company to issue additional first mortgage bonds and additional preferred stock, respectively, unless certain earnings tests provided therein are met. As of December 31, 1984, after giving effect to the acquisition of gas utility assets in New Mexico, the Company could have issued $238 million of additional first mortgage bonds at an assumed interest rate of 13 1/4 percent. The Company could have issued $307 million of additional preferred stock at an assumed dividend rate of 13 percent without the consent of the holders of outstanding preferred stock.

The Company's capital structure at December 31, 1984 consisted of 47.5 percent long-term debt less current maturities, 5.5 percent preferred stock with mandatory redemption requirements, 4.9 percent preferred stock without mandatory redemption requirements and 42.1 percent common stock equity.

Results of Operations

Operating revenues increased 12.0 percent, or $47.9 million, in 1984 over 1983. The increase reflects increased kWhr sales along with rate relief granted by the New Mexico Public Service Commission which became effective in July 1984.

In addition, increased fuel and purchased power expenses which are passed on to customers resulted in higher recovery of fuel costs through fuel adjustment clauses in 1984. The decrease in kWhr sales to wholesale customers in 1983 was the primary factor contributing to the decreased operating revenues in 1983 from 1982.

Other operation expenses in 1984 decreased approximately $4.5 million from 1983 as a result of the sale of a 28.8 percent ownership interest in San Juan Unit 4 in December 1983. Fuel and purchased power expenses, however, increased substantially in 1984 over 1983 due primarily to a long-term power contract.

The 48.6 percent decrease in fuel and purchased power expense in 1983 from 1982 was due primarily to a greater volume of economy energy sales to other utilities, offsetting fuel and purchased power expense in 1983.

During 1984, the Company earned approximately $14.8 million of interest from temporary cash investments, an increase of $13.7 million over 1983. Such investment funds consisted primarily of proceeds from the sale of a 28.8 percent ownership

interest in San Juan Unit 4. However, net other income and deductions decreased in 1984 from 1983 due primarily to inclusion of an after-tax gain of $24.1 million in 1983 from the sale of the equity interest in a trust which held certain coal leases.

Interest on long-term debt has increased steadily over the three-year period, reflecting issuances of first mortgage bonds and pollution control revenue bonds to finance the Company's construction program.

As a result of items discussed above, net earnings of the Company fluctuated during the three-year period. However, net earnings of the Company, exclusive of the gain on the sale of the equity interest in the trust in 1983, have increased over the comparable period. After eliminating the $24.1 million gain ($.73 per share) on the sale of the equity interest in the trust, net earnings applicable to common stock increased in 1983 and 1984, while earnings per share of common stock decreased in 1983 and increased in 1984.

The effect of inflation on the Company's operation is discussed within the Supplementary Information Concerning the Effects of Changing Prices on pages 34-35.

Management's Responsibility for Financial Statements

The management of Public Service Company of New Mexico is responsible for the preparation and presentation of the accompanying financial statements. The financial statements have been prepared in conformity with generally accepted accounting principles and include amounts that are based on informed estimates and judgments of management.

Management maintains a system of internal accounting controls which it believes is adequate to provide reasonable assurance that assets are safeguarded, transactions are executed in accordance with management authorization and the financial records are reliable for preparing the financial statements. The system of internal accounting controls is supported by written policies and procedures, a staff of internal auditors who conduct comprehensive internal audits and the selection and training of qualified personnel.

The Board of Directors, through its Audit Committee comprised entirely of outside directors, meets periodically with management, internal auditors and the Company's independent auditors to discuss auditing, internal control and financial reporting matters. To ensure their independence, both the internal auditors and independent auditors have full and free access to the Audit Committee.

The independent auditors, Peat, Marwick, Mitchell & Co., are engaged to examine the Company's financial statements in accordance with generally accepted auditing standards.

Auditors' Report

The Board of Directors and Stockholders
Public Service Company of New Mexico:

We have examined the consolidated balance sheet of Public Service Company of New Mexico and subsidiaries as of December 31, 1984 and 1983 and the related consolidated statements of earnings, retained earnings and changes in financial position for each of the years in the three-year period ended December 31, 1984. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of Public Service Company of New Mexico and subsidiaries at December 31, 1984 and 1983 and the results of their operations and changes in their financial position for each of the years in the three-year period ended December 31, 1984, in conformity with generally accepted accounting principles applied on a consistent basis.

PEAT, MARWICK, MITCHELL & CO.

Albuquerque, New Mexico
January 18, 1985

Consolidated Balance Sheet

	December 31 1984	1[illegible]
	(In thousands)	
Assets		
Utility plant, at original cost (notes 3 and 7):		
Electric plant in service	$1,436,929	$1,304,249
Water plant in service	35,729	34,906
Common plant in service	35,909	31,628
	1,508,567	1,370,783
Less accumulated depreciation and amortization	282,602	240,097
	1,225,965	1,130,686
Construction work in progress	832,252	705,191
Electric plant held for future use	65,142	63,355
Net utility plant	2,123,359	1,899,232
Other property and investments:		
Non-utility property, at cost, net of accumulated depreciation, partially pledged	110,602	48,483
Non-utility property under construction, at cost	—	31,050
Investment in unconsolidated affiliates	70,166	51,063
Other, at cost	9,415	8,720
Total other property and investments	190,183	139,316
Current assets:		
Cash	9,434	5,178
Temporary cash investments	140,776	318,977
Receivables, net	53,799	45,774
Fuel, materials and supplies, at average cost	41,629	43,781
Prepaid expenses	4,049	3,029
Total current assets	249,687	416,739
Deferred charges	35,515	31,142
	$2,598,744	$2,486[illegible]
Capitalization and Liabilities		
Capitalization:		
Common stock equity (note 2):		
Common stock—outstanding 36,127,189 shares in 1984 and 33,932,809 shares in 1983	$ 180,636	$ 169,664
Additional paid-in capital	549,633	511,975
Retained earnings	182,964	173,420
Total common stock equity	913,233	855,059
Cumulative preferred stock without mandatory redemption requirements (note 2)	106,000	106,000
Cumulative preferred stock with mandatory redemption requirements (note 2)	121,080	123,700
Long-term debt, less current maturities (note 3)	1,030,557	974,290
Total capitalization	2,170,870	2,059,049
Current liabilities:		
Short-term debt (note 4)	30,313	126,290
Accounts payable	34,650	36,669
Current maturities of long-term debt (note 3)	51,708	5,631
Accrued interest and taxes	33,168	35,823
Provision for refunds	11,151	1,046
Other current liabilities	20,323	24,440
Total current liabilities	181,313	229,899
Deferred credits:		
Accumulated deferred investment tax credits (note 5)	101,805	84,499
Accumulated deferred income taxes (note 5)	114,858	87,683
Other deferred credits	29,898	25,299
Total deferred credits	246,561	197,481
Commitments, contingencies and subsequent events (notes 5, 7, 8, 9 and 12)		
	$2,598,744	$2,486,429

See accompanying notes to consolidated financial statements.

Consolidated Statement of Earnings

	Year ended December 31 1984	1983	1982
	(In thousands except per share amounts)		
Operating revenues:			
Electric (note 8)	$438,974	$391,947	$420,157
Water	6,354	5,527	6,386
Total operating revenues	445,328	397,474	426,543
Operating expenses:			
Fuel and purchased power	95,904	59,365	115,531
Other operation expenses	68,278	72,760	68,842
Maintenance and repairs	34,075	32,028	38,125
Depreciation and amortization	48,975	47,172	34,984
Taxes, other than income taxes	19,246	18,694	16,552
Income taxes (note 5)	32,356	31,208	34,855
Total operating expenses	298,834	261,227	308,889
Operating income	146,494	136,247	117,654
Other income and deductions:			
Allowance for equity funds used during construction	52,754	45,789	45,911
Equity in earnings of unconsolidated affiliates, net of taxes (note 5)	7,975	6,373	2,001
Gain on sale of equity interest in trust, net of taxes (notes 5 and 10)	—	24,129	—
Other, net of taxes (note 5)	8,865	779	1,178
Net other income and deductions	69,594	77,070	49,090
Income before interest charges	216,088	213,317	166,744
Interest charges:			
Interest on long-term debt	98,463	80,922	55,537
Other interest charges	8,421	11,182	14,476
Allowance for borrowed funds used during construction	(23,636)	(19,306)	(19,091)
Net interest charges	83,248	72,798	50,922
Net earnings	132,840	140,519	115,822
Preferred stock dividend requirements	23,990	24,187	24,062
Net earnings applicable to common stock	$108,850	$116,332	$ 91,760
Average number of common shares outstanding	35,011	32,956	28,508
Earnings per share of common stock	$ 3.11	$ 3.53	$ 3.22
Dividends paid per share of common stock	$ 2.85	$ 2.81	$ 2.77

Consolidated Statement of Retained Earnings

	Year ended December 31 1984	1983	1982
	(In thousands)		
Balance at beginning of year (note 1)	$173,420	$149,409	$138,002
Net earnings	132,840	140,519	115,822
Dividends:			
Cumulative preferred stock	(23,990)	(24,187)	(24,062)
Common stock	(99,306)	(92,321)	(80,353)
Balance at end of year	$182,964	$173,420	$149,409

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes In Financial Position

	Year ended December 31		
	1984	1983	1[illegible]
		(In thousands)	
Funds provided:			
Net earnings	$ 132,840	$140,519	$115,822
Charges (credits) to earnings not requiring funds:			
Depreciation and amortization	52,844	51,060	37,940
Provision for non-current deferred income taxes, net	27,175	34,463	4,279
Investment tax credits, net	17,306	9,076	16,463
Allowance for equity funds used during construction	(52,754)	(45,789)	(45,911)
Earnings of unconsolidated affiliates	(14,153)	(9,321)	(3,138)
Funds derived from operations	163,258	180,008	125,455
Sale of common stock	48,254	50,886	184,068
Sale of cumulative preferred stock	—	—	35,000
Sale of first mortgage bonds	65,000	65,000	60,000
Proceeds from pollution control revenue bonds	14,583	101,183	44,143
Increase in short-term debt, net	—	62,428	—
Increase in other long-term debt	31,377	3,711	4,930
Proceeds from sale of utility plant, net	—	156,406	—
Decrease in working capital, other than short-term debt	214,443	—	—
Other	11,910	8,461	15,482
	$ 548,825	$628,083	$469,078
Funds used:			
Cash dividends	$ 123,296	$116,508	$104,415
Utility plant additions	222,580	210,014	267,137
Increase in other property and investments	39,832	27,788	12,470
Decrease in short-term debt, net	95,977	—	44[illegible]
Reduction of long-term debt	54,266	7,370	[illegible]
Increase in working capital other than short-term debt	—	255,125	21[illegible]
Other	12,874	11,278	14,301
	$ 548,825	$628,083	$469,078
Changes in working capital other than short-term debt:			
Cash	$ 4,256	$ 457	$ (5,384)
Temporary cash investments	(178,201)	265,270	25,116
Receivables, net	8,025	(13,434)	4,066
Fuel, materials and supplies	(2,152)	(2,461)	12,240
Prepaid expenses	1,020	(634)	1,052
Accounts payable	2,019	(1,307)	12,809
Current maturities of long-term debt	(46,077)	(1,939)	1,698
Accrued interest and taxes	2,655	(9,177)	4,821
Provision for refunds	(10,105)	18,055	(16,951)
Other current liabilities	4,117	295	(18,315)
Increase (decrease) in working capital other than short-term debt	$(214,443)	$255,125	$ 21,152

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

December 31, 1984, 1983 and 1982

(1) Summary of Significant Accounting Policies

System of Accounts

With respect to utility operations, the Company maintains its accounting records in accordance with the uniform system of accounts prescribed by the Federal Energy Regulatory Commission (FERC) and adopted by the New Mexico Public Service Commission (NMPSC). As a result of the ratemaking process, the application of generally accepted accounting principles by the Company differs in certain respects from the application by non-regulated businesses. Such differences generally regard the time at which certain items enter into the determination of net earnings in order to follow the principle of matching costs and revenues. The balance of retained earnings as of January 1, 1982 has been restated by a charge of $512,000 to reflect a FERC audit adjustment applicable to periods prior to those presented herein. The effect of this restatement on the periods presented herein is insignificant.

Principles of Consolidation

The consolidated financial statements include the accounts of Public Service Company of New Mexico, its wholly-owned subsidiaries and its majority-owned joint ventures. All significant intercompany transactions and balances have been eliminated.

The Company's investments in unconsolidated affiliates are accounted for by the equity method.

Utility Plant

Utility plant is stated at original cost, which includes payroll-related costs such as taxes, pension and other fringe benefits, administrative costs and an allowance for funds used during construction.

It is Company policy to charge repairs and minor replacements of property to maintenance expense and to charge major replacements to utility plant. Gains or losses resulting from retirements or other dispositions of operating property in the normal course of business are credited or charged to the accumulated provision for depreciation.

Depreciation

Provision for depreciation of utility plant is made at annual straight-line rates approved by the NMPSC. The average depreciation rates used were as follows:

	1984	1983	1982
Electric plant	**3.29%**	3.30%	3.16%
Water plant	**2.04**	1.89	1.94
Common plant	**7.28**	7.32	6.87

The provision for depreciation of certain equipment, including amortization applicable to capital leases, is charged to clearing accounts and subsequently allocated to operating expenses or construction projects based on the use of the equipment.

Depreciation of non-utility property is computed on the straight-line method.

Allowance for Funds Used During Construction (AFUDC)

As provided by the uniform system of accounts, AFUDC, a noncash item, is charged to utility plant. AFUDC represents the cost of borrowed funds (allowance for borrowed funds used during construction) and a return on other funds (allowance for equity funds used during construction) and is allocated based on the method required by FERC. The Company capitalizes AFUDC on construction work in progress (CWIP) to the extent allowed by regulatory agencies. The Company also capitalizes AFUDC on its plant held for future use as allowed by the NMPSC.

AFUDC is computed using the maximum rate, net of taxes, permitted by FERC. Effective May 1983, the FERC changed the prescribed formula and required AFUDC to be calculated on pollution control trust fund balances with the interest earned from such funds to be credited against CWIP. The rates used were 9.34 percent, 8.74 percent and 9.38 percent for 1984, 1983 and 1982, respectively, compounded semiannually.

The Company records as AFUDC carrying charges associated with specifically identifiable uncommitted generating capacity as allowed by the NMPSC. Uncommitted capacity was 97 MW for 1984 and 105 MW for 1983 and 1982. The carrying charge is calculated using the maximum rate, net of taxes, permitted by FERC except for the exclusion of short-term debt from such calculation. In December 1984, the NMPSC issued an order allowing the deferral of carrying charges for the period from January 1, 1984 through June 6, 1984 and allowing the deferral of carrying charges to resume beginning in July 1985. Amounts recorded under NMPSC orders have totaled $17.2 million. Of such amounts, $12.3 million have been or are presently being recovered through rates. The remainder is to be recovered over the useful life of property when such capacity is required for customers.

Deferred Fuel and Purchased Power

Economy and other near-term energy transactions are shown as a reduction of fuel and purchased power expenses.

The Company uses the deferral method of accounting for the portion of fuel and purchased power costs which is reflected in subsequent periods under fuel adjustment clauses.

Amortization of Debt Discount, Premium and Expense

Long-term debt discount, premium and expense of issuance are amortized over the lives of the respective issues on the debt outstanding method.

Income Taxes

Certain revenue and expense items in the Consolidated Statement of Earnings are recorded for financial reporting purposes in a year different from the year in which they are recorded for income tax purposes. Deferred income taxes are provided on these timing differences to the extent allowed for ratemaking purposes. This method known as tax normalization is used primarily for differences attributable to deferred fuel costs and the use of liberalized depreciation and accelerated cost recovery methods. Certain other timing differences result in reductions of income tax expense in the current year as required by the NMPSC. This flow-through method is used primarily for minor differences between book and tax depreciation and for certain capitalized construction costs.

Rates subject to FERC control allow recovery of amounts necessary to provide additional tax normalization of the items described above which are accounted for under the flow-through method for other customers. Provision has been made for additional deferred income taxes attributable to amounts collected under these rates.

Non-utility deferred taxes are provided on all non-permanent differences between book and taxable income. These differences consist primarily of interest and other expenses which are capitalized for book purposes and income which is taxable in periods other than when recognized for financial reporting purposes.

The Company defers investment tax credits related to utility assets and amortizes them over the estimated useful lives of the related assets. Investment tax credits generated by non-utility properties are recognized as reductions of consolidated income tax expense.

Revenues

Revenues are recognized based on cycle billings rendered to customers monthly. The Company does not accrue revenues for service provided but not billed at the end of a fiscal period.

(2) Common Stock and Cumulative Preferred Stock

The number of authorized shares of common stock with par value of $5 per share is 80,000,000 shares at December 31, 1984 and 40,000,000 shares at December 31, 1983. The Board of Directors has periodically reserved common stock for the Shareholder's Dividend Reinvestment Plan, the Employee Stock Purchase Plan, the Master Employee Savings Plans and the Consumer Stock Plan (Stock Plans), with 1,674,000 shares remaining unissued at December 31, 1984.

The number of authorized shares of cumulative preferred stock is 10,000,000 shares. Information concerning the cumulative preferred stock at December 31, 1984 is as follows:

	Stated Value	Shares Outstanding	Stated Redemption Price	Aggregate Stated Value (in thousands)
Without mandatory redemption requirements:				
1965 Series, 4.58%	$100	130,000	$102.00	$ 13,000
1974 Series, 9.2%	100	170,000	104.00	17,000
1975 Series, 10.12%	100	100,000	107.00	10,000
9.16% Series	25	800,000	26.70	20,000
8.48% Series	100	200,000	106.00	20,000
8.80% Series	100	260,000	106.20	26,000
		1,660,000		$106,000
With mandatory redemption requirements:				
8.75% Series	100	360,800	105.80	$ 36,080
14.75% Series	100	500,000	114.75	50,000
12.52% Series	50	700,000	52.97	35,000
		1,560,800		$121,080

The Company, upon thirty days notice, may redeem the cumulative preferred stock at stated redemption prices plus accrued and unpaid dividends. Redemption prices are at reduced premiums in future years. Redemption may not be made through certain refunding operations prior to April 1, 1990 for the 14.75% Series and October 15, 1991 for the 12.52% Series.

The Company has agreed to indemnify the holders of the 12.52% Series against the loss of certain income tax benefits. However, the Company has the option to redeem the entire series should payments under such indemnification increase the effective dividend rate on the stock by more than one-half of one percent.

Mandatory redemption requirements for 1985, 1986, 1987, 1988 and 1989 are none, $2,000,000, $5,613,000, [illegible],000 and $5,633,000, respectively.

The changes in common stock, additional paid-in capital and cumulative preferred stock were as follows:

	Common Stock			Cumulative Preferred Stock — Without Mandatory Redemption Requirements		Cumulative Preferred Stock — With Mandatory Redemption Requirements	
	Number of Shares	Aggregate Par Value	Additional Paid-In Capital	Number of Shares	Aggregate Stated Value	Number of Shares	Aggregate Stated Value
			(Dollars in thousands)				
Balance at December 31, 1981	24,675,305	$123,377	$327,625	1,660,000	$106,000	900,000	$ 90,000
Public issue of stock	6,000,000	30,000	116,924	—	—	700,000	35,000
Stock plans	1,365,426	6,827	25,928	—	—	—	—
Balance at December 31, 1982	32,040,731	160,204	470,477	1,660,000	106,000	1,600,000	125,000
Stock plans	1,892,078	9,460	41,298	—	—	—	—
Redemption of stock	—	—	200	—	—	(13,000)	(1,300)
Balance at December 31, 1983	33,932,809	169,664	511,975	1,660,000	106,000	1,587,000	123,700
Stock plans	2,194,380	10,972	37,151	—	—	—	—
Redemption of stock	—	—	507	—	—	(26,200)	(2,620)
Balance at December 31, 1984	36,127,189	$180,636	$549,633	1,660,000	$106,000	1,560,800	$121,080

Charter provisions relating to the cumulative preferred stock and the indenture securing the first mortgage bonds impose certain restrictions upon the payment of cash dividends on common stock of the Company. At December 31, 1984, there were no retained earnings restricted under such provisions.

Long-Term Debt

The details of the Company's outstanding long-term debt are as follows:

Issue and Final Maturity	Interest Rates	1984	1983
		(In thousands)	
First mortgage bonds:			
1984 through 1989	3 5/8% to 12.95%	$ 58,140	$ 60,330
1990 through 1994	4 7/8% to 13 1/8%	74,203	9,403
1995 through 1999	5 7/8% to 7 1/4%	30,397	30,716
2000 through 2004	7 1/2% to 10 1/8%	81,449	81,896
2005 through 2009	8 1/8% to 9 1/8%	115,344	116,538
2010 through 2014	12 7/8% to 17 1/2%	185,000	185,000
1993 through 2013—securing pollution control revenue bonds:			
Pollution control series	5.9% to 10 3/4%	414,045	337,000
Annual tender bonds	7 5/8%	23,000	—
Funds held by trustee		(35,468)	(11,099)
Total first mortgage bonds		946,110	809,784
Pollution control revenue bonds:			
1984 through 2013	5% to 10 3/4%	100,000	208,090
1985	59% to 65% of prime rate	39,000	23,500
Funds held by trustee		(39,708)	(70,118)
Other, including unamortized premium and discount		36,863	8,665
Total long-term debt		1,082,265	979,921
Current maturities		(51,708)	(5,631)
Long-term debt, less current maturities		$1,030,557	$974,290

Substantially all utility plant is pledged to secure the first mortgage bonds. A portion of certain series of long-term debt will be redeemed serially prior to their due dates. The aggregate amounts (in thousands) of maturities on all long-term debt outstanding at December 31, 1984 are as follows:

1985	$51,708
1986	11,023
1987	11,301
1988	18,938
1989	11,608

The annual tender bonds are redeemable at the option of the holders annually on November 1. The interest rate will be adjusted annually, as of each November 1, so that the bonds will have a market value as of the date of such adjustment which approximates their par value. The bonds are subject to a maximum interest rate of 15 percent. The Company considers these obligations, as well as $39 million of unsecured pollution control revenue bonds scheduled to mature in 1985, to be long-term debt since the Company has available unused noncancelable long-term lines of credit (note 4) equal to or exceeding the aggregate outstanding principal amounts and it is management's intent to refinance these obligations on a long-term basis. Accordingly, these obligations have been excluded from the above five-year maturity schedule.

In August 1977, the City of Farmington, New Mexico, issued and sold $77,045,000 principal amount of its 5.9 percent Pollution Control Revenue Refunding Bonds, Series 1977, the proceeds of which were used to retire $77,000,000 of outstanding Pollution Control Revenue Bonds on October 1, 1984.

(4) Short-Term Debt

The Company's interim financing requirements are met through the issuance of commercial paper and notes payable to banks which, respectively, amounted to $22 million and $8 million at December 31, 1984 and $91 million and $35 million at December 31, 1983. At December 31, 1984, the company had unused credit commitments from various banks totaling $164 million. These credit arrangements are used to support the issuance of commercial paper and to provide for short-term borrowings. The Company generally pays commitment fees or maintains cash balances on deposit with banks to assure availability of its credit commitments. These commitments consist of both lines of credit and revolving credit agreements ranging in duration from one to six years.

(5) Income Taxes

Income taxes consist of the following components:

	1984	1983	1982
		(In thousands)	
Current Federal income tax	$ 1,878	$ 3,046	$ 1,262
Current state income tax	2,519	3,989	2,349
Deferred Federal income tax	20,365	25,350	7,332
Deferred state income tax	3,966	4,448	980
Investment tax credit utilized	20,726	18,640	16,785
Amortization of accumulated investment tax credit	(3,060)	(2,958)	(2,639)
Total income taxes	$46,394	$52,515	$26,069
Charged to operating expenses	$32,356	$31,208	$34,855
Charged to other income and deductions	14,038	21,307	(8,786)
Total income taxes	$46,394	$52,515	$26,069

The Company has investment tax credit carryforwards of approximately $47 million as of December 31, 1984 which would, if unused, expire in 1996 through 1999 and a charitable contribution carryforward of $3 million which would, if unused, expire in 1987.

Deferred income taxes result from certain timing differences between the recognition of income and expense for tax and financial reporting purposes, as described in note (1).

The major sources of these differences for which deferred taxes have been provided and the tax effects of each are as follows:

	1984	1983	1982
		(In thousands)	
Deferred fuel costs	$ 1,251	$ (140)	$(6,566)
Depreciation and cost recovery timing differences	24,000	17,587	16,153
Provision for refunds	(7,071)	(232)	—
Charitable contribution carryforward	2,301	3,926	(6,915)
Sale of an equity interest in a trust	—	10,287	741
Other	3,850	(1,630)	4,899
Total deferred taxes	$24,331	$29,798	$ 8,312

The Company's effective income tax rate was less than the Federal income tax statutory rate for each of the years shown. The differences are attributable to the following factors:

	1984	1983	1982
Federal income tax statutory rate	46.0%	46.0%	46.0%
Allowance for funds used during construction	(19.6)	(15.5)	(21.1)
Charitable contribution of appreciated property	—	—	(3.4)
Taxes recorded at capital gains rate net of related minimum tax	(.6)	(3.5)	(.1)
Amortization of utility and flow-through of non-utility investment tax credits	(4.1)	(1.5)	(1.9)
Other	4.2	1.7	(1.1)
Company's effective tax rate	25.9%	27.2%	18.4%

The cumulative net amount of income tax timing differences (which excludes AFUDC) upon which deferred income taxes have not been provided is estimated to be approximately $17 million as of December 31, 1984.

In August 1984, the Internal Revenue Service issued a statutory notice of deficiency related to the examination of Western Coal Co. for the tax years 1975 and 1977-1981. Western Coal Co., liquidated in 1981, was a corporation owned fifty-percent by the Company. The Company has evaluated its exposure on the issues raised and is of the opinion that any amount eventually found to be due will have an immaterial impact on the financial statements. A provision for estimated additional tax expense has been made in the financial statements.

(6) Pension Plan

The Company and its subsidiaries have a pension plan covering substantially all of their employees, including officers. The plan is noncontributory and provides for monthly pension payments to participating employees with 30 years of service or at age 65 with less than 30 years of service. The amounts of such payments are dependent upon length of service and the average salary of the three highest consecutive years of employment. The Company's policy is to fund pension costs which were $5,560,000 in 1984, $8,500,000 in 1983, and $7,798,000 in 1982, which include normal costs and amortization of past service costs over 30 years. In 1984, the funding was reduced by $2,650,000 due to the utilization of a portion of the existing credit balance in the funding standard account.

Changes in plan characteristics were not deemed significant enough to warrant a 1984 actuarial valuation report. As of the two most recent actuarial valuation dates, accumulated plan benefits and plan net assets for the Company's pension plan are as follows:

	January 1 1983	January 1 1982
	(In thousands)	
Actuarial present value of accumulated plan benefits:		
Vested	$29,989	$21,014
Nonvested	4,086	2,163
	$34,075	$23,177
Net assets available for benefits (market value)	$45,308	$29,301

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 8 percent for 1983 and 8 3/4 percent for 1982. The effect of this change and a revision in the mortality assumption was an increase in the actuarial present value of accumulated plan benefits by approximately $3.2 million.

(7) Construction Program and Jointly-Owned Plants

The Company operates and jointly owns the steam turbo-electric San Juan Generating Station. In December 1983, the Company sold 28.8 percent of its undivided interest in San Juan Unit 4. The Company received approximately $170 million from the sale, which approximates the book value of the assets sold plus a recovery of applicable income taxes. The Company owns an undivided 50 percent interest in the first three units of the San Juan Generating Station and 62.725 percent in Unit 4.

The Company also is participating with several other utilities in the construction of the Palo Verde Nuclear Generating Station and anticipates that the first unit will be in commercial operation for the Company's 1986 summer peak.

At December 31, 1984, the Company's ownership interest and investments in the jointly-owned generating facilities were as follows:

Station (Fuel Type)	Plant In Service	Accumulated Depreciation	Construction Work In Progress	Ownership Interest
		(In thousands)		
San Juan Generating Station (Coal)	$820,955	$119,868	$ 17,107	53.8%
Palo Verde Nuclear Generating Station (Nuclear)	—	—	736,172	10.2
Four Corners Generating Station Units 4 and 5 (Coal)	56,148	10,965	35,338	13.0

These amounts represent the Company's share of capital costs, for which the Company has provided its own financing. The Company's share of direct expenses is included in the corresponding operating expenses in the Consolidated Statement of Earnings. The Company also has undivided interests in transmission facilities which are not significant.

It is estimated that the Company's electric utility construction expenditures for 1985 will approximate $243 million, including expenditures of the jointly-owned projects. In connection therewith, substantial commitments have been made.

(8) Long-Term Power Purchase and Sales Contracts

The Company has entered into contracts for the purchase of electric power. Under one of these contracts which expires in 1995, the Company is obligated to pay certain minimum amounts and a variable component representing the expenses associated with the energy purchased and debt service costs associated with capital improvements. Total obligations under this contract during 1984 amounted to $36.4 million. Total minimum payment for each of the next five years is $22.8 million.

The Company has contracts to sell power to two unaffiliated utility companies, which accounted for approximately 12.9 percent and 10.0 percent of total operating revenue during 1983 and 12.5 percent and 10.5 percent during 1982. Sales to these unaffiliated utility companies accounted for less than 10 percent of total operating revenues in 1984.

(9) Lease Commitments

The Company leases data processing, communication, office and other equipment, office space, utility poles (joint use) and real estate. The leases for office buildings provide for purchase options equal to fair market value at the end of the primary terms. Other purchase options, renewal options and contingent rental provisions were not significant.

Leased property under capital leases at December 31, 1984 and 1983 is as follows:

	1984	1983
	(In thousands)	
Data processing equipment	$5,283	$5,137
Other	428	409
	5,711	5,546
Less accumulated amortization	1,864	1,869
	$3,847	$3,677

Future minimum lease payments at December 31, 1984 are:

	Capital Leases	Operating Leases
	(In thousands)	
1985	$1,886	$ 4,233
1986	1,584	3,712
1987	1,475	3,603
1988	1,371	3,620
1989	1,163	3,457
Later years	53	58,585
Total minimum lease payments	7,532	$77,210
Less amount representing executory costs	21	
Net minimum lease payments	7,511	
Less amount representing interest	3,056	
Present value of net minimum lease payments	$4,455	

Operating lease expense was $6,047,000 in 1984, $5,252,000 in 1983 and $5,243,000 in 1982. As of December 31, 1984, the aggregate minimum payments to be received in future periods under noncancelable subleases are approximately $3,026,000.

(10) Gain on Sale of Equity Interest in Trust

The Company held, in a trust, a retained economic interest in a sublease covering various Federal, state and private coal leases at the mine which is the primary source of coal for the San Juan Generating Station. See note (7). On June 30, 1983 the interest in the trust was sold to institutional investors for $38.7 million, resulting in an after-tax gain of approximately $24.1 million, or $.73 per share of common stock.

(11) Charitable Contribution of Appreciated Property

On December 30, 1982, the Company entered into an agreement with the City of Las Vegas, New Mexico whereby the Company contributed its Las Vegas water system to the City of Las Vegas. The physical assets contributed had a net book value of $6,726,000 and a fair market value of $19,600,000. The transaction resulted in a $1,171,000 gain after [illegible]ition of income tax benefits under the rules governing contributions of appreciated property.

([illegible]) Subsequent Events

Gas Company of New Mexico Acquisition

Effective January 28, 1985, the Company acquired the New Mexico natural gas utility assets of Southern Union Company. The acquisition was in connection with the settlement of antitrust litigation brought against Southern Union by the Company and others. The assets were purchased for net book value net of liabilities assumed, which was approximately $224.3 million, less $51.5 million representing the amount of the settlement to all plaintiffs. Of the $51.5 million settlement, $15.9 million less expenses will be refunded to the Company's customers and $35.6 million represents the other plaintiffs' portion. The Company paid $97.5 million in cash at closing and issued $70.7 million of one-year 8% notes and $40.2 million of two-year 8% notes.

The acquisition will be accounted for as a purchase and, accordingly, the Company's financial statements will reflect the assets, liabilities and operating results from the acquisition date forward. The following unaudited pro forma consolidated balance sheet gives effect to the above transaction as if it had been consummated on December 31, 1984. Valuations assigned are preliminary and subject to change.

	December 31, 1984
	(In thousands)
Assets	
Net utility plant	$2,348,611
Other property and investments	190,193
Current assets	238,878
Deferred charges	42,205
	$2,819,887
Capitalization and Liabilities	
Total capitalization	$2,278,915
Current liabilities	261,507
Deferred credits	279,465
	$2,819,887

The following summarizes on a pro forma basis the unaudited combined results of operations as though the acquisition had occurred on January 1, 1984.

	Year ended December 31, 1984
	(In thousands except per share amount)
Operating revenues	$903,037
Net earnings	142,705
Earnings per share of common stock	3.39

Sale and Leaseback

On February 5, 1985, the Company sold a 216-mile, 345kV bulk electrical transmission line and related facilities to a trust comprised of two institutional investors. The Company will lease the system on a long-term net lease basis. The total consideration from the sale was the appraisal value of $73 million which approximates the book value plus recovery of applicable income taxes. The transaction will be accounted for as an operating lease with semiannual lease payments of $3.7 million over a 30 year term.

Supplementary Information Concerning the Effects of Changing Prices

The following supplementary information is presented in accordance with the requirements of the Financial Accounting Standards Board. These requirements deal with certain aspects of inflation in regard to the effects of changes in specific prices of certain assets of the Company (the "current cost" method).

The Company believes it is important for users of the financial statements to develop an understanding of the more significant impacts of inflation upon the Company. However, the Company advises readers that the information presented is determined through the use of experimental techniques and is not intended to replace traditional statements based on historical cost.

The current cost data reflects the change in specific prices of utility plant and equipment from the date the property was acquired to the present, as measured primarily by the Handy-Whitman Index of Public Utility Construction Costs.

Consolidated Statement of Earnings Adjusted for Changing Prices

Year Ended December 31, 1984	As Reported in the Primary Statement	Adjusted for Ch[illegible] in Specific Prices (Current Cost)
	(In thousands)	
Operating revenues	$445,328	$445,328
Operating expenses (excluding depreciation and amortization)	249,859	249,859
Depreciation and amortization (note A)	48,975	75,157
Interest charges	83,248	83,248
Other income and deductions, net	(69,594)	(69,594)
	312,488	338,670
Net earnings (excluding reduction to net recoverable cost)	$132,840	$106,658
Increase in specific prices of net utility plant		$187,581
Reduction to net recoverable cost (note B)		(132,143)
Effects of increase in the general price level		(106,441)
Excess of increase in the general price level over the increase in specific prices of net utility plant after reduction to net recoverable cost		(51,003)
Gain from decline in purchasing power of net amounts owed (note C)		38,801
Net		$(12,202)

Five Year Comparison of Selected Supplementary Financial Data Adjusted for Effects of Changing Prices

	Years ended December 31				
	1984	1983	1982	1981	1980
	(In thousands of average 1984 dollars except per share amounts)				
Current cost information:					
Net earnings excluding reduction to net recoverable cost	$ 106,658	$119,786	$ 90,460	$ 98,253	$ 67,612
Earnings per common share	$ 2.36	$ 2.87	$ 2.26	$ 3.63	$ 2.83
Excess of increase in general price level over increase in specific prices after reduction to net recoverable cost	$ 51,003	$ 46,097	$ 49,461	$133,120	$153,161
Net assets at year-end, at net recoverable cost	$1,005,019	$985,610	$943,345	$768,684	$586,931
General information:					
Purchasing power gain on net amounts owed	$ 38,801	$ 36,981	$ 45,417	$ 94,673	$109,779
Cash dividends declared per common share	$ 2.85	$ 2.93	$ 2.98	$ 3.06	$ 2.57
Market price per common share at year-end	$ 24.04	$ 26.01	$ 27.66	$ 26.25	$ 23.78
Consumer price index for all urban consumers:					
Average	311.1	298.4	289.1	272.4	246.8
Year-end	315.5	303.5	292.4	281.5	258.4

A—Depreciation and amortization adjusted for changing prices

justing historical cost income statement items for general inflation, changes were made only to the provision for depreciation and amortization. All other revenue and expense items were considered to reflect the current average price level for the year.

Estimated utility plant was determined by applying the indices specified to the historical cost of utility plant by vintage year. Depreciation expense was then determined for the adjusted amounts of utility plant by applying the same rates used to compute the historical amount of depreciation.

Note B—Reduction to net recoverable cost

Under the ratemaking prescribed by the regulatory commissions to which the Company is subject, only historical cost of plant is recoverable in revenues as depreciation and amortization. Therefore, the excess of the cost of plant, stated in terms of current cost over the historical cost of plant, is not presently recoverable in rates as depreciation and amortization, and is reflected as a reduction to net recoverable cost. While the ratemaking process gives no recognition to the current cost of replacing property, plant and equipment, the Company believes it will be allowed to earn on the increased cost of its net investment when replacement of facilities actually occurs.

Note C—Gain from decline in purchasing power of net amounts owed

During periods of inflation, the holders of monetary assets suffer a loss of general purchasing power because such items will purchase less at a future date. Alternatively, holders of monetary liabilities such as long-term debt experience a gain because the amount of money required to ultimately settle the liabilities represents dollars of diminished purchasing power.

Since the Company owed net monetary liabilities during a period in which the general purchasing power of the dollar declined, the Company experienced an economic gain in purchasing power. All assets and liabilities other than utility plant and amounts applicable to the cumulative preferred stock not subject to mandatory redemption requirements were treated as monetary items.

Quarterly Operating Results

The unaudited operating results (in thousands except per share amounts) by quarters for 1984 and 1983 are as follows:

Quarter Ended	Operating Revenues	Operating Income	Net Earnings	Earnings per Share
December 31, 1984	$110,838	$32,527	$34,602	$ .80
September 30, 1984	126,922	51,072	44,749	1.10
June 30, 1984	109,574	31,600	25,413	.56
March 31, 1984	97,994	31,295	28,076	.65
December 31, 1983	94,479	30,497	18,761	.38
September 30, 1983	107,227	39,589	40,349	1.03
June 30, 1983	93,217	30,277	49,578	1.33
March 31, 1983	102,551	35,884	31,831	.80

In the opinion of management of the Company, all adjustments (consisting of normal recurring accruals) necessary for a fair statement of the results of operations for such periods have been included.

Stock/Dividend Data

Common Stock:

Range of sales prices of the Company's common stock, reported as composite transactions (Symbol:PNM), and dividends paid on common stock for fiscal year 1984 and 1983, by quarters, are as follows:

	Range of Sales Prices		Dividends
	High	Low	Per Share
Fourth Quarter, 1984	25 1/4	22	$0.72
Third Quarter, 1984	22 3/4	19 1/2	0.71
Second Quarter, 1984	24 1/4	20 3/8	0.71
First Quarter, 1984	26 5/8	23	0.71
Fiscal Year	26 5/8	19 1/2	$2.85
Fourth Quarter, 1983	29 5/8	22 3/4	$0.71
Third Quarter, 1983	28 3/4	25 7/8	0.70
Second Quarter, 1983	28 7/8	26 3/4	0.70
First Quarter, 1983	28	25 1/2	0.70
Fiscal Year	29 5/8	22 3/4	$2.81

Cumulative Preferred Stock:

While isolated sales of the Company's cumulative preferred stock have occurred in the past, the Company is not aware of any active trading market for its cumulative preferred stock.

Quarterly cash dividends were paid on each series of the Company's cumulative preferred stock at their stated rates during 1984 and 1983.

Stockholder Information

Annual Meeting of Stockholders

The annual meeting of stockholders of Public Service Company of New Mexico will be held at the Kimo Theatre, 419 Central Avenue, N.W., Albuquerque, New Mexico, on Tuesday, April 23, 1985, at 9:30 a.m.

Stockholders are urged to attend; however, whether or not they attend, their proxies should be mailed to the Company. A proxy statement and form of proxy will be mailed to stockholders on or about March 18, 1985.

For copies of the Company's Form 10-K filed with the Securities and Exchange Commission, please contact D. E. Peckham, Secretary, Public Service Company of New Mexico Alvarado Square Albuquerque, NM 87158 (505) 848-2842

Stock Exchange Listing

Common stock of the Company is listed on the New York Stock Exchange under the symbol PNM.

Registrar of Stock

First National Bank in Albuquerque
Post Office Box 1305
Albuquerque, New Mexico 87103

Harris Trust Company of New York
Corporate Trust Department, 9th Floor
110 William Street
New York, New York 10038

Stockholder Communications

To notify the Company of change of address, lost certificates, or to request transfer of stock to another name, please write to:

Public Service Company of New Mexico
Stockholder Services
Alvarado Square
Albuquerque, New Mexico 87158

To request transfer of stock please write to:

Common Stock

Public Service Company of New Mexico
Stockholder Services
Alvarado Square
Albuquerque, New Mexico 87158

Harris Trust Company of New York
Corporate Trust Department, 9th Floor
110 William Street
New York, New York 10038

Preferred Stock

Public Service Company of New Mexico
Alvarado Square
Albuquerque, New Mexico 87158

Questions and Comments

Questions and comments about PNM or any information appearing in the annual report and quarterly reports are welcome and may be directed to:

Public Information:

Gayland Bryant
Director, Public Information
Alvarado Square
Albuquerque, New Mexico 87158
(505) 848-2746

Stockholder Information:

Karen Knight
Director, Stockholder Services
Alvarado Square
Albuquerque, New Mexico 87158
(505) 848-4538

Financial Questions:

Valerie C. Cheeseman
Director, Investor Relations
Alvarado Square
Albuquerque, New Mexico 87158
(505) 848-4673

Duplicate Mailings

Sometimes stockholders receive additional mailings of annual and quarterly reports. The Company is required by law to mail to each name on the stockholder list. If a husband, wife, and child each own stock in his/her own name, reports will be sent to each. Since the quarterly and annual reports are sent with either dividend checks or proxies, it is not possible at this time for PNM to eliminate duplicate mailings.

Dividend Reinvestment Plan

During 1984, the number of stockholders in the Shareholder Dividend Reinvestment Plan increased by 4,237 to 29,978. Dividends and cash invested through the Dividend Reinvestment Plan during the last eight years by shareholders now total $152.2 million. Under present law, stockholders can defer reinvested dividends of up to $750 annually ($1,500 for a joint return) from income on their federal returns. This law will be in effect until December 31, 1985. A prospectus describing the Dividend Reinvestment Plan and an enrollment form are available by writing to the Company, or telephoning (505) 848-2122 (local calls), 1-800-432-4494 (New Mexico), or 1-800-545-4425 (outside New Mexico).

Directors and Officers

Board of Directors

J. P. Bundrant**
President, Electric Operations
Public Service Company of New Mexico

A. B. Collins, Jr.
President
Reddy Communications, Inc.
Albuquerque, NM

J. D. Geist**
Chairman and President
Public Service Company of New Mexico

C. E. Leyendecker*
Chairman of the Board and
Chief Executive Officer
United New Mexico Bank at Mimbres Valley
Deming, NM

A. G. Ortega
Attorney at Law
Ortega & Snead, P. A.
Albuquerque, NM

R. R. Rehder*
Professor of Management
Robert O. Anderson Graduate
School of Management
University of New Mexico
Albuquerque, NM

R. B. Rountree
Senior Vice President
Public Service Company of New Mexico

R. H. Stephens*
President
Stephens-Irish Agency, Inc.
Las Vegas, NM

E. R. Wood**
Vice President and General Manager
Wood & Hill Corporation
Santa Fe, NM

H. L. Galles, Jr.
Director Emeritus
Chairman of the Board
Galles Chevrolet Company
Albuquerque, NM

*Member of Audit Committee
**Member of Executive Committee

PNM Corporate

J. D. Geist
Chairman and President

J. B. Mulcock, Jr.
Senior Vice President,
Corporate Affairs and
Assistant Secretary

A. J. Robison
Senior Vice President
and Chief Financial Officer

R. B. Rountree
Senior Vice President and
Chairman, Meadows Resources, Inc. and
Sunbelt Mining Company, Inc.

M. A. Clifton
Vice President,
Financial Planning

B. D. Lackey
Vice President and
Corporate Controller

J. K. Murphy
Vice President, Regulatory
and Business Policy

P. J. Archibeck
Treasurer and Assistant
Secretary

D. E. Peckham
Secretary and Assistant
Treasurer

H. L. Hitchins, Jr.
Assistant Secretary and
Assistant Treasurer

M. J. Marzec
Assistant Treasurer

Gas Company of New Mexico

J. T. Ackerman
President and Chief Operating Officer
Gas Operations

O. L. Slaughter
Senior Vice President,
Distribution

J. J. Ruiz
District Vice President

W. J. Real
District Vice President

T. D. Rister
District Vice President

D. A. Pickel
District Vice President

T. A. Coers
District Vice President,
Transmission

G. D. Mische
District Vice President,
Transmission

M. H. Lambert
Vice President,
Pipeline Operations

J. C. Wyman
Vice President,
Gas Supply

D. W. McFearin
Vice President,
Controller and
Assistant Secretary

D. J. Davis
Vice President and Chief Engineer,
Distribution

E. R. Corliss
Vice President and Chief Engineer,
Transmission

PNM Electric

J. P. Bundrant
President and Chief Operating Officer

C. D. Bedford
Senior Vice President, Planning, Finance and Administration

W. M. Eglinton
Senior Vice President, Operations

J. L. Wilkins
Senior Vice President, Power Supply

J. L. Godwin
Vice President, Power Production and Manager, San Juan Station

W. M. Hicks, Jr.
Vice President, Energy Management

R. A. Lake
Vice President, Operations Services

M. A. McDonald
Vice President, Human Resources and Support Service

R. F. Mershon
Vice President, R[illegible]al Division Operations

[illegible] Morse
[illegible]esident, Albuquerque Division Operations

R. M. Wilson
Assistant Controller

Electric Division Managers

L. G. Boyce
Division Manager, Clayton

C. L. Edwards
Division Manager, Belen

E. L. King
Division Manager, Bernalillo

A. R. Lujan
Division Manager, Las Vegas

J. R. Sloan
Division Manager, Sangre de Cristo Water Co.

M. C. Slota
Division Manager, Santa Fe

F. M. Van Gundy
Division Manager, Deming

PNM Subsidiaries

R. B. Rountree
Chairman, Meadows Resources, Inc.
Chairman and President, Sunbelt Mining Company, Inc.

J. F. Jennings, Jr.
President and Chief Operating Officer, Meadows Resources, Inc.

C. E. Hunter
Vice President and General Manager, Sunbelt Mining Company, Inc.

T. D. Bauer
Vice President, Sunbelt Mining Company, Inc.

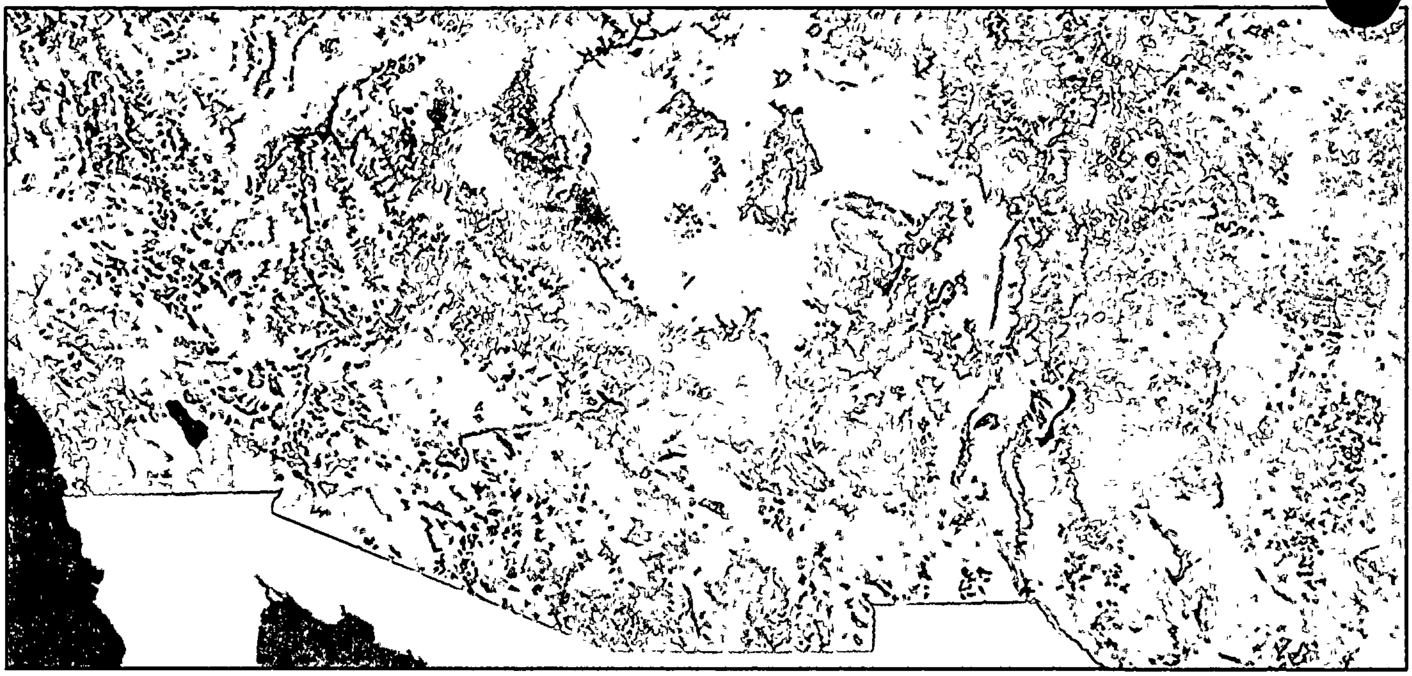
R. C. Rankin
Vice President, Meadows Resources, Inc.

C. A. Underwood
Vice President, Paragon Resources, Inc.

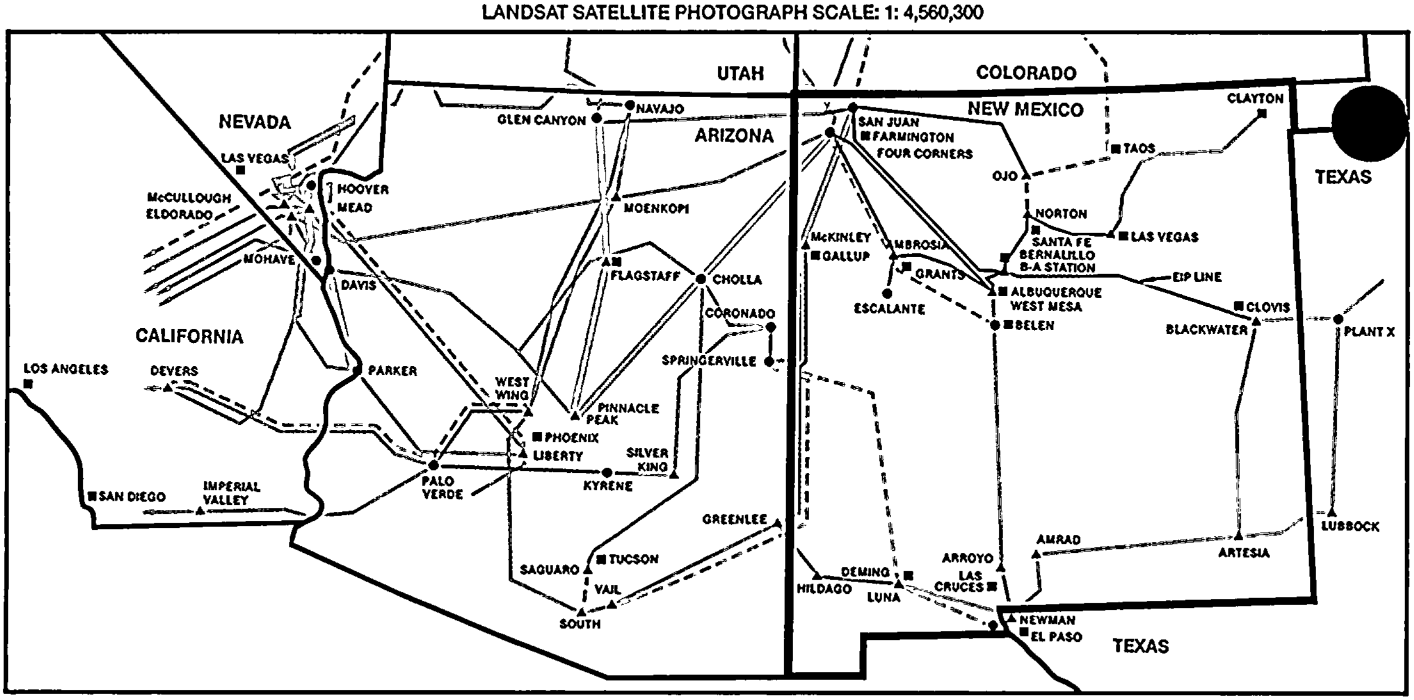
J. H. von Rusten
Controller, Meadows Resources, Inc., and Sunbelt Mining Company, Inc.

M. H. Maerki
Vice President, Meadows Resources, Inc.

Regional Electric System Map



LANDSAT SATELLITE PHOTOGRAPH SCALE: 1: 4,560,300



MAJOR ELECTRIC TRANSMISSION LINES

EXISTING		PROPOSED
	345 kV and Above Owned by PNM	
	230 kV and Below Owned by PNM	
	345 kV and Above Owned by PNM and Others	
	230 kV and Above Owned by Others	
	115 kV Not Shown	

● Generation ▲ Switching Station ■ Cities and Towns

"Our enduring goals are to help preserve an irreplaceable way of life and to enhance it through new opportunities."

—J.D. Geist

CHAIRMAN AND PRESIDENT, PUBLIC SERVICE COMPANY OF NEW MEXICO

Photography Index	Quote Source Index
[illegible]over: Laura Gilpin, 1946 *[illegible]Amon Carter Museum,* *[illegible]n, Texas*	Front cover: D.H. Lawrence, "Song of a Man Who has Come Through," in *Collected Poems D.H. Lawrence* (New York: Viking Press, 1964 London: Lawrence Pollinger Ltd.).
Page 4: John K. Hillers, Circa 1880 *Courtesy Andrew Smith Gallery, Albuquerque, New Mexico*	Page 4: N. Scott Momaday, "The Monoliths," in *The Gourd Dancer* (New York: Harper & Row, 1976).
Page 6: Edward S. Curtis, 1904 *Courtesy Andrew Smith Gallery, Albuquerque, New Mexico*	Page 6: Willa Cather, *The Professor's House* (New York: Random House, Inc., Vintage Books edition, 1973).
Page 8: Paul Strand, 1932 *©1971 The Paul Strand Foundation, as published in Paul Strand: A Retrospective Monograph, The years 1915-1968, Apeture, Millerton, New York*	Page 8: Keith Wilson, "A Winter Poem for New Mexico," in *Retablos* (Los Cerrillos, New Mexico: San Marcos Press, 1980).
Page 10: ©Jody Forster, 1979 *Courtesy Andrew Smith Gallery, Albuquerque, New Mexico*	Page 10: Joseph McElroy, *Women and Men* (New York: Knopf, 1985).
Page 14: ©William Clift, 1978 *Courtesy of the artist, Santa Fe, New Mexico*	Page 14: Rudolfo A. Anaya, *Bless Me Ultima* (Berkeley: Quinto Sol Publications, 1975).
Page 16: ©David Noble, 1982 *Courtesy Scheinbaum & Russek Gallery, Santa Fe, New Mexico*	Page 16: Leslie Marmon Silko, "Storytelling," in *Storyteller* (New York: Seaver Books, 1981).
Page 18: ©Jim Bones, 1983 *Courtesy Andrew Smith Gallery, Albuquerque, New Mexico*	Page 18: Willa Cather, *The Professor's House* (New York: Random House, Inc., Vintage Books edition, 1973).
Page 40: *Landsat map courtesy of National Geographic Society and General Electric Company*	

Additional color photographs by:

Dick Ruddy (Page 2: J.D. Geist, 17: Carson National Forest, NM, 17: MdF plant)

Jim Fisher (Page 12, 13: EIP, near Clovis, NM)

[illegible]rett (Page 7: natural gas gathering system)

[illegible]antagto (Page 5: near Acoma Pueblo, NM)

[illegible]nt (Page 9: near Taos, NM, 11: Shiprock, NM)

PUBLIC SERVICE COMPANY OF NEW MEXICO

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 1984 — Commission File Number 1-6986

Public Service Company of New Mexico

(Exact name of registrant as specified in its charter)

New Mexico (State or other jurisdiction of incorporation or organization)	85-0019030 (I.R.S. Employer Identification No.)
Alvarado Square Albuquerque, New Mexico (Address of principal executive offices)	87158 (Zip Code)

Registrant's telephone number, including area code (505) 848-2700

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

Title of each class	Name of each exchange on which registered
Common Stock, $5.00 Par Value	New York Stock Exchange

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

(Title of Class)

Cumulative Preferred Stock, $100 Stated Value, Comprised of the Following Series:

1965 Series, 4.58%	8.80% Series
1974 Series, 9.2%	8.75% Series
1975 Series, 10.12%	14.75% Series
8.48% Series	

Cumulative Preferred Stock, $25 Stated Value, 9.16% Series

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. YES X NO ___

The aggregate market value of the voting stock held by non-affiliates of the registrant as of March 4, 1985 was $875,906,254.

Shares of Common Stock outstanding as of March 4, 1985 — 36,580,608.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are incorporated by reference into the indicated part or parts of this report:

(a) Annual Report to Stockholders for fiscal year ended December 31, 1984 — Parts II and IV; and

(b) Proxy Statement, dated March 22, 1985, relating to the annual meeting of stockholders to be held on April 23, 1985, filed with the Commission pursuant to Regulation 14A — Part III.

TABLE OF CONTENTS

PART I

ITEM 1. BUSINESS

The Company was incorporated in the State of New Mexico in 1917 and has its principal executive offices at Alvarado Square, Albuquerque, New Mexico 87158 (telephone number 505-848-2700). The Company is a public utility engaged principally in the generation, transmission, distribution and sale of electricity (see "Electric Operations") and, since January 28, 1985, in the gathering, transmission, distribution and sale of natural gas (see "Natural Gas Operations") within the State of New Mexico. The Company also owns facilities for the pumping, storage, transmission, distribution and sale of water. In addition, the Company, through its subsidiaries, is engaged in a program of diversification into non-utility areas.

The total population of the area served by one or more of the Company's utility services is estimated to be approximately 921,300, of which 51.4% live in the greater Albuquerque area.

For the fiscal year ended December 31, 1984, the Company derived approximately 98.6% of its operating revenues from electric operations and 1.4% from water operations.

Electric Operations

Service Area and Power Sales

The Company provides electric service to a large area of north central New Mexico, including the cities of Albuquerque, Santa Fe, Las Vegas, Belen and Bernalillo. The Company also provides electric service to Deming in southwestern New Mexico and to Clayton in northeastern New Mexico. As of December 31, 1984, approximately 244,000 electric customers were served by the Company. The Company has long-term franchises for electric service in the major communities in which it operates. In addition, during 1984, the Company furnished electric service at wholesale in New Mexico to the cities of Farmington ("Farmington") and Gallup, the United States Department of Energy ("DOE") at Los Alamos, Texas-New Mexico Power Company ("TNP") and Plains Electric Generation & Transmission Cooperative, Inc.

For the years 1979 through 1984, total firm energy sales have grown at a compound annual rate of approximately 2.2%. During this same period, the Company's system peak demands in the summer and winter have grown at compound annual rates of approximately 2.7% and 3.5%, respectively, as shown in the following table:

	MW PEAK DEMAND			
	Summer			Winter†
Year	Retail	Wholesale	System	System
1979	668	187	855	774
1980	690	223	913	796
1981	749	243	992	835
1982	702	255	957	860
1983	730	268	998	880
1984	741	235	976	919

† For the winter season beginning in the year noted.

Firm sales to wholesale customers accounted for 28.9% of the Company's kWh sales for the year ended December 31, 1984. In addition, the Company had 6 retail customers with demands generally over 5 MW each, which accounted for 8.3% of total kWh sales during 1984.

The discussion in the two preceding paragraphs does not include contingent sales to other utilities. The most significant contingent sale contracts are those with San Diego Gas & Electric Company ("SDG&E") and Arizona Public Service Company ("APS") discussed below.

In 1979, the Company and SDG&E executed a power sales agreement with sales beginning in 1982. The levels of sales to SDG&E through the expiration of the agreement in April 1988 may be 236 MW, 106 MW or zero at various times, dependent on the dates the three Palo Verde Nuclear Generating Station ("PVNGS") units commence operation. On May 1, 1982, the Company began deliveries of 236 MW to SDG&E and, effective May 1, 1983, sales to SDG&E dropped to 106 MW. Under the agreement, since PVNGS Unit 1 will not be in operation by May 1, 1985, such sales will drop to zero on that date until Unit 1 commences operation, at which time sales would return to 106 MW, subject to later change depending on commencement of operation of PVNGS Units 2 and 3. (See discussion of PVNGS under *"Sources of Power — Nuclear Plant"*.)

The Company entered into a contingent capacity agreement with APS on May 4, 1984, to provide APS with 35 MW of San Juan Unit 4 contingent capacity from May 1, 1985 through October 31, 1985.

In addition to the firm and contingent sales discussed above, in 1984 the Company had non-firm sales of 1,540,630,000 kWh to other regional utilities. The most significant of the Company's current non-firm sales contracts are discussed below.

The Company entered into a block energy agreement with APS on May 4, 1984, to provide APS with up to 110,000,000 kWh of block energy from May 1, 1985 through October 31, 1985. The block energy agreement is being implemented under the Southwest Bulk Power Market Experiment (see *"Sources of Power — Other Sources"*) and thus does not require a filing with the Federal Energy Regulatory Commission ("FERC").

In mid-1983, the Company began deliveries of surplus energy to TNP under an agreement which provided for rates of deliveries of up to 50 MW per hour. This agreement, which was terminated by the Company and TNP effective February 28, 1985, was replaced by a new agreement entered into on January 31, 1985, under which the Company will provide up to 370,000,000 kWh to TNP at rates of delivery of up to 50 MW per hour during the period of March 1, 1985 through December 31, 1985, subject to acceptance for filing by FERC.

The Company and Southwestern Public Service Company ("SPS") entered into an agreement on November 23, 1982, to provide for a transmission interconnection between the two utilities which is expected to provide the Company with greater flexibility in planning to meet customer needs. SPS provides electric service to portions of Texas, New Mexico, Kansas and Oklahoma. A 345 kV transmission line to implement the interconnection was placed into service from the Albuquerque area to the vicinity of Clovis, New Mexico in December 1984 and was the subject of a sale and leaseback transaction in February 1985. (See "Funding Requirements".) Subject to certain conditions, the interconnection agreement provides for the sale by the Company of uncommitted energy to SPS at a rate of up to 220 MW per hour between 1985 and 1990. From 1991 to 1995, the Company would purchase 100 MW of interruptible power from SPS, and from 1995 through 2011, the Company would purchase up to 200 MW of interruptible power.

The Company's load forecasts indicate that the Company will have varying amounts of capacity and associated energy which will not be required to serve firm retail and wholesale loads, satisfy contingent sales contract commitments or meet reserve margins during the next decade. The New Mexico Public Service Commission (the "Commission") has approved an inventoried capacity ratemaking methodology (see "Rates and Regulation") which is designed to move incremental base load plant into rate base in conjunction with increased load. To recover operating expenses and offset, in part, carrying charges to be recorded under such methodology, the Company has contracted sales from its otherwise uncommitted capacity as indicated by the foregoing discussion of non-firm sales activities. Although the Company has been successful in contracting sales from its otherwise uncommitted capacity, significant levels of uncommitted capacity remain to be marketed after 1985. The Company has an average of approximately 456 MW of estimated inventoried capacity available to be sold between 1985 and 1989, beginning with 301 MW in 1985 and amounting to 579 MW in 1989. Taking into account present commitments, the Company has sold approximately 57% of the energy associated with such inventoried capacity for the years 1985-1989. The Company's market assessments

conclude that other southwestern and western utilities will have increasing requirements for capacity and energy through 1989. The Company's ability to sell its remaining uncommitted capacity will be affected by transmission availability and the actual market for bulk power which develops. Additionally, the actual amount of additional capacity or energy available for sale to other utilities will depend in part on the development of actual loads and determinations regarding economic reserve margins of the Company.

Sources of Power

The total net generation capacity of Company-owned generating facilities was 1,340 MW as of December 31, 1984, comprised of generation from two coal-fired plants and three gas/oil-fired plants, all located in New Mexico. This amount includes capacity committed under sales contracts with other utilities. (See *"Service Area and Power Sales"*.) The three gas/oil-fired plants, with an aggregate capacity of 294 MW, are located in the Company's service area, with one in Las Vegas and two in Albuquerque, and are mainly used for mid-range and peaking capacity requirements.

Coal-fired Plants. The San Juan plant is located near Farmington, New Mexico, and consists of four units. Units 1, 2, 3 and 4 at the San Juan plant have rated capacities of 314 MW, 306 MW, 468 MW and 472 MW, respectively. San Juan Units 1 and 2 are owned on a 50% shared basis with Tucson Electric Power Company ("Tucson"), Unit 3 is owned on a 50% shared basis with Alamito Company, formerly a wholly-owned subsidiary of Tucson which is now publicly owned, and Unit 4 is owned 62.725% by the Company, 8.475% by Farmington and 28.8% by M-S-R Public Power Agency ("M-S-R"), a California public power agency. The Company's aggregate ownership in the San Juan plant is 840 MW. In connection with the Company's sale to M-S-R of a 28.8% interest in San Juan Unit 4, the Company agreed to purchase under certain conditions 73.53% (approximately 100 MW) of M-S-R's capacity and associated energy through April 30, 1995, an amount which may be reduced by M-S-R under certain conditions. The Company also agreed to market the remaining energy associated with M-S-R's ownership interest through April 30, 1995 in return for half the profits from such sales, which arrangement may be terminated by M-S-R at any time upon 30 days notice.

The Company also owns 206 MW of capacity derived from its 13% interest in Units 4 and 5 of the Four Corners plant located in northwestern New Mexico on land leased from the Navajo Tribe and adjacent to available coal deposits. Units 4 and 5 at Four Corners are jointly owned with Southern California Edison Company, APS, the Salt River Project, Tucson and El Paso Electric Company ("El Paso") and are operated by APS.

In December 1984, the Company signed an agreement with the County of Los Alamos ("Los Alamos") and DOE under which Los Alamos would purchase a 7.2% undivided ownership interest (approximately 34 MW) in San Juan Unit 4 and also purchase the Company's distribution system serving the community of White Rock. The aggregate purchase price is estimated to be approximately $50 million. The Company has historically served the Los Alamos area with retail service to White Rock and wholesale power to DOE. The proposed arrangement would replace the current method of service and would include the purchase of up to 8 MW of contingent power by the Company from Los Alamos. The transaction is scheduled to occur in the spring of 1985, subject to receiving regulatory approval. There is no assurance that closing will occur.

The Company had previously determined that the best location in New Mexico for a mine-mouth generating station ("New Mexico Generating Station") would be approximately 40 miles southeast of the San Juan plant. On August 7, 1984, the Company, the Navajo Tribe, Bechtel Power Corporation and General Electric Company entered into an agreement in principle, in which the parties undertook a cooperative feasibility study of the New Mexico Generating Station. Negotiations are continuing with respect to extension and revision of the agreement in principle which expired January 31, 1985. Since August 1984, such parties have conducted analyses to determine whether to proceed with the project. If the project proceeds, it is presently contemplated by the parties that the plant would be

located within the Navajo Reservation on land which may be acquired by the Navajo Tribe pursuant to Federal law. It is expected that at the outset sales from the plant would be to customers outside New Mexico.

Nuclear Plant. The Company is participating in the three 1,270 MW units of PVNGS, also known as the Arizona Nuclear Power Project, with APS, the project manager, and three other utilities and a public power agency. The Nuclear Regulatory Commission (the "NRC") issued construction permits for PVNGS in May 1976. APS has reported that, as of December 31, 1984, construction of Units 1 and 2 was 99.7% complete, and construction of Unit 3 was 95.9% complete, based on construction man-hours expended and materials installed. Testing phases follow the completion of construction. As project manager, APS is responsible for maintaining schedules.

The Company's 10.2% interest in the project will amount to approximately 130 MW per unit or a total of 390 MW. Through December 31, 1984, the Company had expended approximately $691 million for construction of its share of the PVNGS units, including allowance for funds used during construction ("AFUDC"), and approximately $45 million for nuclear fuel. Based on the Company's construction budget estimates, the total estimated aggregate cost, excluding costs of related transmission facilities and nuclear fuel prior to commercial operation, but including AFUDC and costs of related pollution control facilities, is expected to be approximately $938 million, resulting in an estimated cost for 390 MW of approximately $2,405 per kW. Such estimate represents the Company's best current forecast. However, APS has advised that actual completion dates, unexpected inflationary pressures and compliance with any additional governmental procedures and regulations could cause final costs to vary substantially from these and any later estimates, as could changes in the plans of the participants.

In January 1985, nuclear fuel loading was completed at PVNGS Unit 1, which is scheduled for firm power operation by the end of 1985. Unit 2 is scheduled for fuel loading in the last quarter of 1985 and for firm power operation in the second quarter of 1986. Unit 3 is scheduled for fuel loading in the first quarter of 1987 and for firm power operation in the second quarter of 1987. Between fuel loading and firm power operation, each unit must undergo extensive testing. APS has indicated that firm power operation represents the time when power from the units can be reliably scheduled for service to customers, although electricity would be produced prior to the firm power operation dates.

Operation of each of the three PVNGS units following its completion will require the obtaining of low and full power operating licenses from the NRC. An application for operating licenses has been docketed by the NRC, and the NRC staff has issued a satisfactory safety evaluation report, subject to certain conditions, and a favorable final environmental statement on such application. Hearings on an intervenor's petition were concluded in 1982, and the Atomic Safety and Licensing Board (the "ASLB") issued a favorable initial decision rejecting the intervenor's contentions. Such initial decision was reviewed and affirmed by the NRC appeal board. After such hearings had been concluded, an entity representing parties who farm in the vicinity of PVNGS petitioned the ASLB to reopen the hearings to consider an environmental issue related to salt emissions associated with the plant's cooling system. By an order issued in December 1982, the ASLB denied the petition as to Unit 1, but granted the petition as to Units 2 and 3. APS has requested that the hearing be delayed indefinitely, but the outcome of the reopened proceedings relating to Units 2 and 3 and their impact on additional construction expenditures cannot currently be predicted.

In December 1984, the NRC granted a facility operating license for Unit 1. Certain pre-operational and start-up tests and other items are required to be completed to the satisfaction of the NRC. The license initially allows operation of Unit 1 at up to 5% of its capability, which may not be exceeded without specific NRC approval. With NRC approval, the power output of Unit 1 may be gradually increased to 100% of its capability.

Other Sources. The Company is also interconnected with various utilities making possible mutual assistance in emergencies and economy energy interchange. The Company participates in the Inland

Power Pool from which the Company anticipates economic benefits resulting from reduced operating reserve requirements, enhanced bulk power electric system reliability and increased efficiency of operations.

In 1983, the Company entered into an experimental arrangement called the Southwest Bulk Power Market Experiment with El Paso, Farmington, SPS, APS and the Salt River Project. The experiment allows certain kinds of energy transactions to occur with only limited regulatory oversight and provides for modified FERC rate treatment. The agreement implementing the experiment was accepted by FERC on December 30, 1983, at which time the rates contained in the agreement were approved by FERC. The agreement became effective on January 1, 1984, for a two-year term, with certain options for the participants to terminate participation earlier. A block energy agreement has been entered into with APS under this arrangement. (See *"Service Area and Power Sales"*.)

Fuel and Water Supply

The percentages of the Company's generation of electricity fueled by coal, gas and oil, and the average costs to the Company of those fuels (in cents per million BTU) during the past five years were as follows:

	Coal		Gas		Oil	
	Percent of Generation	Average Cost	Percent of Generation	Average Cost	Percent of Generation	Average Cost
1980	84.0%	79.1¢	15.9%	243.6¢	0.1%	331.8¢
1981	85.9	89.5	14.1	281.2	*	392.9
1982	95.0	101.3	4.4	350.8	0.6	292.0
1983	99.3	97.1	0.6	407.8	0.1	330.9
1984	99.7	108.7	0.1	451.8	0.2	290.9

* Less than 0.01%

The estimated generation mix in 1985 is 98.9% coal and 1.1% gas and oil. Although not included in the planned generation mix, it is expected that start-up and test energy will be available from PVNGS in 1985. Due to locally available natural gas and oil supplies and the utilization of locally available coal deposits, the Company believes that adequate sources of fuel are available for its generating stations.

Coal. The average cost of fuel for the years 1982, 1983 and 1984 at Four Corners was 71.6¢, 79.6¢ and 84.2¢, respectively, per million BTU ($12.70, $14.18 and $14.77 per ton, respectively) including ash disposal and land reclamation costs. The average cost of fuel, including ash disposal and land reclamation costs, for the San Juan plant for the years 1982, 1983 and 1984 was 107.2¢, 100.2¢ and 113.6¢, respectively, per million BTU ($21.20, $19.57 and $22.16 per ton, respectively).

The Four Corners plant is supplied with coal under a fuel agreement between the owners and Utah International Inc. ("Utah"), under which Utah has agreed to supply all the coal requirements for the life of the plant. The sulfur content of the coal to be supplied cannot exceed an average of 1.5% or a maximum of 2.5%, and to date has averaged .7%. Utah holds a long-term coal mining lease, with options for renewal, from the Navajo Tribe and operates its strip mine adjacent to the Four Corners plant with the coal supply expected to be sufficient to supply the units for their estimated useful lives. In response to indications by the Navajo Tribe that it will contest the mining lease governing the coal reserves from which Utah is currently obtaining coal for the Four Corners plant unless royalties payable to the Navajo Tribe under the lease are substantially increased, Utah and the plant participants (to whom any such increases would be passed through) have negotiated agreements, which, if executed, would provide for royalty increases in return for certain contractual and other concessions from the Navajo Tribe, including an agreement by the Navajo Tribe to sell water for use in the Four Corners plant under certain circumstances if water

rights for the Four Corners plant are adversely affected. (See Item 3 — "Legal Proceedings".) Any collection of the "possessory interest tax" and the "business activity tax" enacted by the Navajo Tribe (see Item 3 — "Legal Proceedings") could also increase Utah's coal costs. The fuel agreement provides for certain adjustments in coal prices due to increases or decreases in the cost of electricity, environmental compliance (including mine reclamation), labor, materials, supplies, taxes and royalties.

The coal requirements for the San Juan plant are being supplied by San Juan Coal Company ("SJCC"), a wholly-owned subsidiary of Utah, from certain Federal, state and private coal leases under a coal sales agreement, pursuant to which SJCC will sell processed coal for operation of the San Juan plant until 2017. Utah has guaranteed the obligations of SJCC under the agreement, which contemplates the delivery of approximately 168 million tons of coal during its remaining term. Such amount would supply the requirements of the San Juan plant through approximately 2017. Such supply is dependent in part upon the successful development of approximately 2,843 acres of coal leases (one Federal and two private) held by SJCC in the La Plata area of northwestern New Mexico located approximately 25 miles northeast of the San Juan plant. An amendment to the coal sales agreement, as well as a transportation agreement among San Juan Transportation Company, a wholly-owned subsidiary of Utah, the Company and Tucson, were executed in April 1984. These agreements provide for the development of a mine to produce coal from the La Plata leases and transportation of such coal to the San Juan plant. Deliveries are expected to begin in 1987.

Natural Gas. The natural gas used as fuel for the Company's Albuquerque electric generating plants has been supplied by Gas Company of New Mexico, which was acquired by the Company on January 28, 1985. (See "Natural Gas Operations".) The Company's cost of gas increases or decreases according to the wellhead prices. The Company has the ability to burn residual fuel oil if the gas supply is curtailed and maintains a supply of fuel oil in storage which it believes is adequate to prevent a reduction of service to its customers.

Nuclear Fuel. The fuel cycle for PVNGS is comprised of the following elements: (1) the mining and milling of uranium ore to produce uranium concentrates; (2) the conversion of uranium concentrates to uranium hexafluoride; (3) the enrichment of uranium hexafluoride; (4) the fabrication of fuel assemblies; (5) the utilization of fuel assemblies in reactors; and (6) the storage of spent fuel and the disposal or (if future circumstances permit) the reprocessing thereof. The participants in PVNGS are parties to a contract with Anaconda Minerals Company for a quantity of uranium concentrate anticipated to be sufficient to supply the initial cores for Units 1, 2 and 3, the first reload for each of Units 1 and 2 and most of the first reload for Unit 3, deliveries of which are complete. In addition, certain participants, including the Company, have entered into contracts with Energy Fuels Exploration Company, Western Nuclear, Inc. and Pathfinder Mines Corporation, which are more than sufficient, if certain options are exercised, to meet operational requirements through 1998. The fuel fabrication contract with Westinghouse Electric Corporation referred to below also gives the participants options to obtain their uranium requirements for the period 1993 through 1997 and 1998 through the expiration of the contract. Spot purchases of uranium in lieu of any which might be obtained pursuant to contract options will be made as appropriate.

The participants have contracted with Allied Corporation for conversion services required through 1987. Contracts have also been entered into with Combustion Engineering, Inc. for the fabrication of fuel assemblies required for the first two years of operation of each of the three PVNGS units and with Westinghouse for the fabrication of fuel assemblies required for approximately the next 15 years of operation of each such unit. Contracts have been entered into with DOE for necessary enrichment services required for the lifetime operation of the three units. The participants presently have no commitments for reprocessing of fuel discharged from reactors. PVNGS is designed to permit on-site storage of spent fuel discharged from normal operation of all three units beyond the year 2000. Federal legislation imposes the responsibility for the disposal of spent nuclear fuel and other high level wastes upon the Federal government and directs the Secretary of DOE to

undertake a program for the development of a waste disposal facility for the receipt and disposal of spent nuclear fuel not later than 1998. The requirements of the legislation are such that the participants were obligated to enter into a contract with DOE prior to the receipt of operating licenses for PVNGS for the disposal of the spent nuclear fuel discharged therefrom. The participants entered into such a contract in July 1984, which provides for the eventual disposal of all spent nuclear fuel expected to be generated by PVNGS Units 1, 2 and 3 during their useful lives.

Water. Water for the Four Corners and San Juan plants is obtained from the San Juan River. (See Item 3 — "Legal Proceedings".) Utah holds rights to San Juan River water and has committed a portion of such rights to the Four Corners plant. The Company and Tucson have a contract with the United States Bureau of Reclamation for consumption of 16,200 acre feet of water per year for the San Juan plant, which contract expires in 2005, and in addition have been granted the authority to consume 8,000 acre feet per year of water under a state permit that is held by Utah. The Company is of the opinion that sufficient water has been secured for the San Juan plant until 2005.

It is anticipated that water necessary for the operation of the PVNGS units will be obtained from sewage effluent under contracts with certain municipalities in the area. The contracted quantity of effluent exceeds the amount required for the three PVNGS units. The validity of the major effluent contract was challenged in a suit filed by the Salt River Pima-Maricopa Indian Community against the Department of the Interior, the Federal agency alleged to have jurisdiction over the use of such effluent. The PVNGS participants, including the Company, were named as additional defendants. The United States District Court for the District of Arizona dismissed the lawsuit as to the Company and certain others for lack of standing, which decision was reversed in September 1984 by the Ninth Circuit Court of Appeals. The Company and such others filed a petition with the United States Supreme Court in December 1984 seeking review of the Ninth Circuit decision, which petition was denied in March 1985. In November 1982, certain operators of farms located in the vicinity of the PVNGS site filed a lawsuit in Maricopa County Superior Court claiming prior rights to effluent to be delivered to PVNGS under the primary and secondary effluent contracts. On December 12, 1983, an owner of land in the river basin from which the effluent to be received under the primary contract is alleged to be derived filed a complaint in the United States District Court for the District of Arizona challenging the primary effluent contract and seeking, among other things, to enjoin its performance. APS has joined with the Salt River Project in bringing an action in an Arizona state court against the plaintiffs in the latter two lawsuits, seeking a declaratory judgment as to rights to effluent under Arizona law. Such declaratory judgment action has been consolidated in the Arizona state court with the lawsuit which was filed in November 1982.

The Company has been informed by APS that, although the foregoing matters remain subject to further evaluation, APS expects that neither the described litigation nor any renegotiation of existing contracts will have a materially adverse impact on the completion, licensing and operation of PVNGS.

Natural Gas Operations

Acquisition of New Mexico Natural Gas Properties

On January 28, 1985, the Company acquired substantially all of the New Mexico natural gas utility assets of Southern Union Company ("Southern Union") (principally a natural gas retail distribution system operated by Southern Union as the Gas Company of New Mexico division and hereinafter referred to as "GCNM"), and Sunbelt Mining Company, Inc. ("Sunbelt"), a wholly-owned subsidiary of the Company, acquired all of the stock of Southern Union Gathering Company ("Gathering Company"), a wholly-owned subsidiary of Southern Union (such assets and stock being hereinafter collectively referred to as the "New Mexico Gas Properties"), in connection with the settlement of antitrust litigation against Southern Union. (See Item 3 — "Legal Proceedings".) The approval of FERC is still pending with respect to the Company's acquisition of one minor transmission line which is not material to the operation of the New Mexico Gas Properties. If authorized, the Company will purchase such transmission line at a later date.

The New Mexico Gas Properties were purchased from Southern Union for their net book value (which gives effect to an assumption of operating liabilities) of $224,326,000 and less $51.5 million representing the amount of the settlement to all plaintiffs in the litigation. Such amount represents the preliminary purchase price which is subject to final adjustments within 75 days from closing to reflect actual values at the closing date. As discussed below, the $51.5 million settlement amount is being funded by the Company by payments to the other plaintiffs and refunds to the Company's electric customers. An initial cash payment of $74,460,000 was made by the Company to Southern Union at closing. Two promissory notes of the Company secured by a first mortgage lien on the properties acquired by the Company were also delivered at the closing, one in the amount of $50,690,000 due January 27, 1986 and one in the amount of $40,203,000 due January 27, 1987. Both notes bear interest at 8% per annum. Sunbelt acquired all of the stock of Gathering Company for a cash payment at closing of $7,473,000.

As part of the settlement, the Company was to fund $35,650,000 of the total $51.5 million settlement amount to the other plaintiffs as payment for their shares of the settlement. Of the $35,650,000, a cash payment of $15,650,000 was made at closing to the other plaintiffs, and the Company issued a promissory note to the other plaintiffs for the $20 million balance bearing 8% interest and due January 2, 1986. The remaining $15,850,000 of the settlement, less expenses, will be refunded to the Company's electric customers by the Company.

Southern Union has agreed to indemnify and hold the Company harmless from any and all occurrences and legal actions (except assumed operational liabilities) arising prior to the closing date, January 28, 1985, in connection with the New Mexico Gas Properties.

Gas Company of New Mexico Division

The Company distributes natural gas through the GCNM division to most of the major communities in New Mexico, including Albuquerque and Santa Fe, serving approximately 307,000 customers as of January 28, 1985. GCNM is organized into four distribution districts along geographic lines (central, eastern, northwest and southwest), and two pipeline districts (related to the major gas-producing areas in the San Juan Basin in northwest New Mexico and the Permian Basin in southeast New Mexico). The central district, comprised primarily of Albuquerque, accounts for approximately 51% of GCNM's total customers. The distribution of GCNM customers by customer class (indicated as a percentage of sales volume) is as follows: residential (35%); industrial (28%); commercial (18%); public authority (15%); irrigation (3%); and resale customers (1%).

The Company holds non-exclusive franchises with varying expiration dates in all incorporated communities where it is necessary to do so in order to carry on its gas utility business as it is now being conducted. The expiration dates for the Company's franchises in Albuquerque and Santa Fe are 1998 and 1995, respectively.

Gathering Company

Gathering Company is engaged in the ownership, leasing and operation of gas gathering facilities in the San Juan Basin, and sale of that gas under long-term contracts to GCNM and to El Paso Natural Gas Company ("EPNG"). Gathering Company also engages in other off-peak sales of gas from sources located in the San Juan Basin and the Permian Basin.

Gathering Company has a contract with EPNG under which EPNG purchased approximately .7 billion cubic feet ("Bcf") of gas in 1984. Under this contract, originally entered into during 1953, EPNG has a preferential first right to purchase all gas gathered by Gathering Company through certain gathering systems in the San Juan Basin in excess of GCNM's needs. The contract continues through June 30, 1985, and from month-to-month thereafter unless terminated by either party on 30 days written notice. In the first two months of 1985, EPNG purchased approximately 5.9 Bcf of gas from Gathering Company.

In addition, Gathering Company has entered into a number of gas sales contracts for the sale of gas in excess of GCNM's and EPNG's current needs. Gathering Company sold approximately 23.9 Bcf of gas under these excess sales contracts in 1984. Such sales of excess gas, during off-peak periods, enable the Company to compete more effectively for gas supplies through higher load factor volume purchases and to better ensure that peak-day requirements of GCNM can be met.

Gas Supply and Prices

Approximately 85% of GCNM's gas requirements in 1984 came from direct purchases at the wellhead under long-term contracts, from field gathering systems (including those of Gathering Company) and from gas processing plants. The remainder was purchased primarily under long-term contracts from interstate pipeline companies. The Company does not anticipate any material change in the makeup of such sources nor any significant problems in meeting the requirements of its high priority customers in its service area during the next few years.

The direct field purchases (which include wellhead purchases and purchases from field gathering systems) of both interstate and intrastate natural gas is made from supply sources located in northwest (the San Juan Basin) and southeast (the Permian Basin) New Mexico and such purchases provide approximately 77% of GCNM's gas requirements.

The prices paid for wellhead purchases of natural gas are generally subject to price regulation under the Natural Gas Policy Act of 1978 (the "NGPA"), which established a series of maximum lawful prices for various categories of both interstate and intrastate natural gas. The base prices under the NGPA are subject to monthly adjustments.

Certain of the Company's purchases of intrastate natural gas in New Mexico are also subject to price regulation under the New Mexico Natural Gas Price Protection Act (the "NMPPA") which provides for ceiling price regulation for intrastate gas in New Mexico. These ceiling prices are generally lower than the price levels which would otherwise be applicable under the NGPA. The NMPPA will terminate June 30, 1985.

Because of current market conditions and because of certain matters alleged by the Company in the antitrust litigation against Southern Union (see Item 3 — "Legal Proceedings"), the Company is presently engaged in renegotiations of wellhead purchase contracts. This renegotiation is also the subject matter of an agreement between the Company and other plaintiffs in such litigation.

Supplemental Gas Supplies

The Company owns and operates an underground storage facility located near Albuquerque for the storage of natural gas and withdrawals therefrom during peak usage periods. At January 28, 1985, approximately 1.2 Bcf of gas was included in the inventory of this facility.

Under a gas injection agreement with a group of unaffiliated producers conducting a gas pressure maintenance program for secondary oil recovery, the Company has the right to inject up to 25,000 Mcf of gas per day into a unitized oil field located near Artesia, New Mexico. Subject to the terms of the gas injection agreement, the Company has the right, during each semi-annual calendar period, to take redelivery of up to one-third of the volume of the gas injected by it during the last semi-annual calendar period in which it injected gas. Further, there are provisions for withdrawal of all recoverable volumes with advance notice to the operator. At January 28, 1985, the Company had an inventory of approximately 3.2 Bcf of gas stored under the agreement.

The Company is a party to various FERC-approved transportation agreements to supplement supplies in service areas where EPNG is the Company's primary wholesale supplier of natural gas. An agreement with EPNG, as amended in 1981 and further amended in 1983, provides that up to 50,000 Mcf per day of system gas may be transported between the companies' various service territories when needed. In addition, agreements with other companies provide for the transportation of up to 8,000 Mcf of gas per day from sources located in southeast New Mexico to augment gas supplies for the Company's service areas in and around Clovis, Portales and Tucumcari, New Mexico.

Utility Construction Program

The Company is continuing a construction program which is intended to meet future customer service requirements. The Company estimates its five-year utility construction program for the period 1985-1989 to be approximately $836 million, including AFUDC of $171 million. Included in such total amount are proposed expenditures during the five-year period of approximately $71 million for the Company's share of nuclear fuel for PVNGS and approximately $113 million of gas utility construction expenditures which will be required as a result of the Company's acquisition of the New Mexico Gas Properties. Utility construction expenditures, including AFUDC, were approximately $278 million in 1984, and are forecasted to be $261 million and $201 million in 1985 and 1986, respectively. The Company's utility construction expenditures are expected to decline to $134 million in 1987, $117 million in 1988 and $123 million in 1989.

A summary of the Company's utility capital expenditures program, including AFUDC, for the period 1985-1989 follows:

	(In millions)
Electric Construction	
PVNGS Units 1, 2 and 3	$259
Other Generation	76
Nuclear Fuel	71
Pollution Control on Existing Facilities	18
Total Generation	424
Transmission	75
Distribution and General	221
Total Electric	720
Gas Construction	
Natural Gas Production	10
Transmission	39
Distribution	53
General	11
Total Gas	113
Water Construction	3
Total Utility	$836

The above-estimated capital expenditures program represents the Company's most current forecast. Such program does not include the acquisition cost required in connection with the Company's acquisition of the New Mexico Gas Properties. (See "Natural Gas Operations".)

The Company conducts a continuing review of its construction program, and such program and the above estimates are subject to periodic revisions based upon changes in assumptions as to system load growth, rates of inflation (including costs of labor), the availability and timing of environmental and other regulatory approvals, the availability and costs of outside sources of capital and changes in project construction schedules. The Company has in the past revised its construction budget in light of such factors and will effect further revisions in the future.

Funding Requirements

The Company estimates its total external funding requirements to be approximately $388 million for the period 1985-1989, including $309 million required for long-term debt repayments, mandatory preferred stock redemptions and repayment of notes issued in connection with the acquisition of the New Mexico Gas Properties. Estimates of external funding requirements give effect to the implementation of the inventoried capacity ratemaking methodology. (See "Rates and Regulation".) The Company

will defer carrying charges associated with specifically identifiable uncommitted generating capacity as allowed by the Commission. On the basis of the current load growth projections and resulting levels of inventoried capacity, the gross amount of such carrying charges for 1985 through 1989 is projected to be approximately $354 million before applying applicable revenues from power and energy sales from inventoried plant. After giving effect to the application of revenues from inventoried plant, the Company projects that the inventoried capacity ratemaking methodology will defer approximately $203 million of net carrying charges during the period 1985-1989. (See "Electric Operations — *Service Area and Power Sales*".) Such amounts will be recovered through charges to customers over the useful life of the property as such capacity is required for such customers.

The Company's projection of internal cash generation in the 1985-1989 time period assumes timely and adequate rate relief with respect to both retail and wholesale customers and assumes that the Company will sell significant amounts of additional uncommitted capacity or energy not currently contracted for, and that revenues from such sales will be sufficient to offset significant amounts of depreciation and property tax expenses for which the Company is at risk according to the inventoried capacity methodology. (See "Electric Operations — *Service Area and Power Sales*" and "Rates and Regulation".) Under such methodology, and based on the Company's current load forecasts, total at-risk costs for the period 1985-1989 are estimated to be approximately $150 million. After giving effect to presently contracted sales from inventoried capacity, the Company projects that at-risk costs not recovered would be approximately $30 million for such period. Taking into account the Company's expected ability to make additional sales, the Company projects that such amount would be further reduced significantly. The projection also assumes that the Company's non-utility subsidiaries will provide their capital requirements from internally generated funds and from independent borrowings which would be non-recourse to the Company.

In 1984, the Company issued $65 million of its First Mortgage Bonds, 13⅛% Series due 1994, and utilized approximately $15 million of proceeds from various pollution control financings. The Company also utilized short-term borrowings and generated approximately $48 million from its Common Stock plans. The Company issued $77,045,000 principal amount of its first mortgage bonds on September 28, 1984 to secure its guarantee in connection with the crossover refunding effected on October 1, 1984 with the proceeds of the outstanding City of Farmington, New Mexico 5.9% Pollution Control Revenue Refunding Bonds, Series 1977 (Public Service Company of New Mexico San Juan Project). In December 1984, the Maricopa County, Arizona Pollution Control Corporation issued $38.5 million principal amount of its pollution control revenue bonds, the proceeds of which were loaned to the Company. Of the $38.5 million, $23 million were 1984 Series A Annual Tender Bonds sold in a public offering and secured by the Company's first mortgage bonds, and $15.5 million were 1984 Series B Bonds sold as a private placement on an unsecured basis.

In February 1985, the Company completed a sale-leaseback financing of the transmission interconnection between the Company and SPS (see "Electric Operations — *Service Area and Power Sales*") through the sale to institutional investors by the Company of such facilities and the concurrent lease to the Company of those facilities.

The Company's interim financing requirements are met through issuance of notes payable to banks and commercial paper. The bank commitments for the Company and its subsidiaries consist of both lines of credit and revolving credit agreements ranging in duration from one to six years. Arrangements for bank lines of credit amounted to $21 million and revolving credit arrangements amounted to $255 million at March 15, 1985.

In order to meet its 1985 external capital requirements of $195 million, the Company proposes to issue common stock and/or preferred stock and to utilize short-term borrowings and approximately $61 million of proceeds from various pollution control financings. The Company also expects to generate approximately $46 million from its Common Stock plans.

The foregoing requirements take into account the proposed sales in 1985 to Los Alamos of the White Rock distribution system and an interest in San Juan Unit 4. (See "Electric Operations — *Sources of Power*".)

Rates and Regulation

The Company is subject to the jurisdiction of the Commission with respect to its retail electric rates, water rates, gas rates, service, accounting, issuance of securities, construction of new generating and transmission facilities and other matters. FERC has jurisdiction over rates and other matters related to wholesale electric sales and over Gathering Company's operations.

A stipulation was agreed upon in November 1984 by a majority of the members, including the Company, of a task force created by the Commission to evaluate the merits of the inventoried capacity ratemaking concept, and was subsequently approved in its entirety by the Commission on December 12, 1984. Inventorying is a ratemaking methodology designed to move incremental base load plant into the New Mexico jurisdictional rate base in conjunction with increased New Mexico jurisdictional load. The actual amount of plant to be inventoried pending inclusion in rate base would be determined annually and is defined as the New Mexico jurisdictional share of that base load plant most recently placed in service which is above a historical 20% reserve margin.

The stipulation permits the capitalization of certain carrying charges associated with inventoried plant. Fixed operation and maintenance expenses associated with inventoried plant will be included in the New Mexico jurisdictional rate base on a current basis. In addition, the stipulation (1) limits the capitalization of carrying charges to an amount equal to 5% per year of the inventoried plant's book value, which limit decreases to 4% over an 11-year period, (2) applies revenues from sales from inventoried plant, to the extent available, first to the payment of fuel expenses and other variable operation and maintenance expenses, second to the payment of up to half of the depreciation and property tax expenses and third to the pro rata payment of remaining depreciation and property tax expenses and capitalized carrying charges and (3) provides that the inventorying methodology can only be altered on a prospective basis. (See "Funding Requirements".)

This inventorying methodology will become effective on July 1, 1985, at which time 99 MW of San Juan Unit 3 and 202 MW of San Juan Unit 4 will be inventoried. The Company anticipates that the PVNGS units will also be inventoried upon achieving commercial operation. The order also allowed the Company in December 1984 to record capitalized carrying charges of approximately $2.9 million, which were reflected in 1984 earnings. A group of consumers, including a dissenting member of the task force, filed an appeal on March 1, 1985 with the New Mexico Supreme Court. The outcome of the appeal and its effect on inventorying cannot currently be predicted.

The second phase of a rate increase granted in April 1984 by the Commission became effective on February 1, 1985 and is designed to increase revenues by $7.5 million annually based upon 1982 data.

On August 28, 1984, the Company filed a request with the Commission to increase its retail electric rates to provide for $76 million of additional annualized revenues. The filing was adjusted on January 31, 1985, to reflect the Commission's approval of the inventorying stipulation. The inventory adjustment lowered the requested revenue increase to $45 million on an annualized basis. Data used in the filing are based on a historical test-year period which ended March 31, 1984, adjusted for known and measurable changes which are expected to occur through May 1985. A decision by the Commission on the proposed increase is expected in August 1985. As a result of the approved inventorying stipulation, 75% of any Commission-granted increase will become effective with bills rendered September 1, 1985, and the remaining 25% will become effective with service rendered January 1, 1986.

On April 18, 1983, the Commission issued an order initiating an investigation regarding the reasonableness of the retained economic interest payments incurred as part of the cost of coal for the San Juan plant. (See Item 2 — "Properties".) In its order, the Commission indicated that the ultimate issues to be determined in the investigation are whether or not the retained economic interest payments constitute a legitimate cost at a reasonable level to be passed on to the Company's New Mexico jurisdictional ratepayers and whether the ratepayers or the shareholders are entitled to the gain resulting from the sale of the interest in the San Juan Coal Trust. Hearings have been scheduled by the Commission to begin in late 1985.

The Commission has joined with the utility regulatory bodies of Texas, Arizona and California in sponsoring an independent audit of PVNGS management and construction costs. The regulatory bodies have selected the accounting firm of Ernst & Whinney to be the [illegible] manager. The Company has agreed to fund up to $510,000 of the costs of the audit. The impact, if any, of the proposed audit on the Company or on the operation of PVNGS cannot currently be predicted.

The Company has fuel adjustment clauses covering all kWh sales. There is an approximate 60 day time lag in implementation of the fuel adjustment clause for billing purposes, except for FERC jurisdictional customers for which there is an approximate 30 day time lag.

GCNM's retail gas rate schedules contain purchased gas adjustment clauses which permit GCNM to adjust its rates as the cost of purchased gas changes. There are no material proceedings currently pending before the Commission with respect to GCNM.

Gathering Company has filed a petition with FERC for a declaratory order to the effect that Gathering Company may sell surplus gas not taken by EPNG without having to obtain a certificate of public convenience and necessity from FERC or an abandonment authorization.

On January 21, 1985, the Commission granted a 61.6% increase allowing $3.3 million of additional annualized revenues for Sangre de Cristo Water Company, the Company's water system division in the Santa Fe area. The increase is being implemented in three phases, the first with bills rendered January 25, 1985, the second with service rendered April 1, 1985, and the third with service rendered October 1, 1985. A notice of appeal has been filed by the City of Santa Fe, and the Company has cross-appealed. (See "Water Operations".)

Environmental Factors

The Company, in common with other electric and gas utilities, is subject to stringent regulations for protection of the environment by both state and Federal authorities, particularly in regard to permissible emissions from its coal-fired generating stations. Capital expenditures for pollution control facilities at the Four Corners and San Juan plants were approximately $9 million in 1984, excluding AFUDC. Based on the Company's most recent construction forecasts for such facilities, capital expenditures for pollution control facilities at the Four Corners and San Juan plants are estimated to approximate $8 million in 1985 and $2 million in 1986, excluding AFUDC. In addition, the Company has made, and will continue to make, expenditures for pollution control facilities at PVNGS. Capital expenditures for pollution control facilities at PVNGS have been approximately $59 million through 1984, excluding AFUDC. For 1985, the Company estimates capital expenditures for pollution control facilities at PVNGS to be approximately $1 million, excluding AFUDC. A portion of the costs for pollution control facilities at PVNGS has been financed through the issuance of pollution control revenue bonds. (See "Funding Requirements".) Except for such additional equipment for Four Corners Units 4 and 5, which are operated by APS, as may be required or permitted by the Clean Air Act Amendments of 1977, or by the sulfur emission permit system of the Navajo Tribe, if ultimately upheld (see Item 3 — "Legal Proceedings"), the Company does not believe that any material additional pollution control equipment, other than as already contemplated and included in its construction program, will be required under the applicable environmental laws for its existing facilities. However, the costs of pollution control equipment may be higher than presently forecast.

PVNGS is subject to the jurisdiction of the NRC, which has authority to issue permits and licenses and to regulate nuclear facilities in order to protect the health and safety of the public from radioactive hazards and to conduct environmental reviews pursuant to the National Environmental Policy Act. The NRC has issued construction permits for PVNGS Units 1, 2 and 3 and an operating license for Unit 1. Before PVNGS Units 2 and 3 can become operational, operating licenses from the NRC will be required. (See "Electric Operations — *Sources of Power*".)

Except as noted below, existing generating units of the Company are in substantial compliance with all presently effective state and Federal air and water pollution control regulations.

Air Quality

The State of New Mexico has adopted emission regulations restricting the emissions from both existing and future coal, oil and gas-fired plants. Regulations adopted by the State of New Mexico are in some instances more stringent than those adopted by the Federal Environmental Protection Agency ("EPA"). The New Mexico Environmental Improvement Board (the "NMEIB") has adopted regulations that prohibit emissions of sulfur dioxide, particulates and nitrogen oxides above certain levels. These apply to "existing sources", including San Juan Unit 2 and Four Corners Units 4 and 5, and "new sources", which include San Juan Units 1, 3 and 4.

APS, operating agent for the Four Corners plant, has for some time been engaged in regulatory and legal proceedings in New Mexico in regard to the necessity for further sulfur dioxide control at the Four Corners plant. Adversaries of APS in such proceedings have included environmental groups and certain state authorities. On August 21, 1980, those adversaries and the Four Corners participants reached a settlement that required achievement of a specified level of control of Four Corners sulfur dioxide emissions from Units 4 and 5 by December 31, 1984. Installation of equipment to achieve this level of control was completed in 1984, with the Company's share of construction expenditures being approximately $31 million. APS has advised the Company that operation of the equipment has resulted in the level of control required by the settlement.

The New Mexico regulation for nitrogen oxides is extremely stringent. Four Corners Units 4 and 5 have operated under variances from this regulation, granted by the NMEIB, since December 1, 1977. The current variance will expire on the earlier of May 13, 1985 or the development of control technology. APS has advised the Company that APS intends to petition the NMEIB for an extension of the current variance.

The Federal Clean Air Act Amendments of 1977 may require installation of "the best available retrofit technology" on existing sources located near certain federally protected areas, in which visibility is an important attribute. The installation is to occur as expeditiously as practicable, and in any event, within approximately five years after revision of the applicable state implementation plan. The full significance of the visibility provisions to the Company's generating stations is difficult to predict pending finalization of state and Federal implementing regulations. The Company believes that the equipment currently installed at the San Juan plant will be in compliance with anticipated regulations.

Water Quality

The Company's National Pollutant Discharge Elimination System ("NPDES") permit from EPA for the San Juan plant, which has a term of five years beginning March 20, 1984, generally prohibits all off-site discharges of pollutants. The San Juan plant water management system, which was phased into operation during 1983 and the first quarter of 1984, is designed to enable compliance with the NPDES permit, as well as with other state and Federal water standards and regulations.

On October 26, 1983, the United States, at the request of the EPA Administrator, filed a civil action in the United States District Court for the District of New Mexico for assessment of civil penalties of up to $10,000 per day of violation for alleged discharges on an unspecified number of days from the San Juan plant in violation of the Clean Water Act. The complaint also seeks to enjoin the Company against future violations. The Company and the United States have signed a consent decree that has been lodged with the District Court. The Federal government has yet to respond formally to the public comments received during the public comment period which ended on December 26, 1983. The Company understands that allegations of personal injury and property damages were made during the public comment period. The consent decree, as presently drafted, requires the Company to pay the sum of $50,000 for all past reported violations of its NPDES permit, prohibits the discharge of pollutants to navigable waters except as authorized by an effective NPDES permit, settles the

issues raised in the complaint and provides for the court to retain jurisdiction to enforce the provisions of the decree for two years from the date of entry. Under the terms of the proposed consent decree, agreement thereto is not to be construed as an admission of a violation by the Company.

A group of residents near the San Juan plant gave notice dated August 30, 1983, of their intention to file a citizens' suit as provided for in the Clean Water Act for alleged past violations at the San Juan plant. On November 10, 1983, the Company received from substantially the same group of residents a copy of a motion to intervene in the above-described suit by the United States. The motion and an accompanying proposed complaint object to the terms of the above-described consent decree. The intervenors' complaint alleges "hundreds of violations" of the Clean Water Act and asks the court to disapprove the consent decree, to have a trial on the merits, to assess the Company penalties of $10,000 for each day of violation, and to permanently enjoin the Company from future violations. The court granted the motion to intervene on July 16, 1984. A tentative settlement has since been reached, under which the intervenors would withdraw their objection to the consent decree.

On April 13, 1984, six of such intervenors filed suit against the Company in the San Juan County District Court claiming damage to property and personal injuries resulting from "discharges of wastewater and pollutants" from the San Juan plant into a nearby arroyo. The plaintiffs seek a total of $6 million in compensation for their alleged damages and injuries, a total of $3 million as punitive damages, and injunctive relief. A tentative settlement agreement has been reached, whereby the plaintiffs would dismiss the lawsuit.

Water Operations

The Company's water system in the Santa Fe area accounted for approximately 1.4% of operating revenues in 1984. In 1981, the water operations were reorganized as a division separate from the Company's electric operations. This division, the Sangre de Cristo Water Company, is headquartered in Santa Fe. The Company and the City of Santa Fe have studied the feasibility of the City acquiring the water system. A joint negotiating committee has recommended the adoption of a letter of principles which, if adopted by the City and the Company and subject to required approvals, would provide for such acquisition by the end of 1985.

Non-Utility Subsidiary Operations

Sunbelt Mining Company, Inc. was incorporated in 1979 for the purpose of acquiring, developing and marketing coal and other mineral resources and to provide related contract mining services for both the Company and independent regional customers. Sunbelt operates the De-Na-Zin/Gateway mine in northwestern New Mexico, which provides coal under contract to SJCC and is capable of supplying coal throughout the southwest regional market as opportunities develop. In addition to its coal properties, Sunbelt's interests include leases of chemical-grade limestone in Cibola County, New Mexico. In February 1984, Sunbelt purchased all of the stock of a company engaged in the gold mining business for approximately $2 million. On January 28, 1985, Sunbelt acquired all of the stock of Gathering Company. (See "Natural Gas Operations".)

In 1981, the Company formed Meadows Resources, Inc. ("Meadows") to engage in business ventures that have no connection with the utility business. Meadows' first such venture was a partnership called Bellamah Community Development ("BCD") with Dale Bellamah Land Company, Inc. (such partner now being Bellamah Associates, Ltd., a New Mexico limited partnership). As of December 31, 1984, BCD owned approximately 12,000 acres of land throughout the Southwest for future commercial and residential development. As of December 31, 1984, Meadows' investment for its 50% interest in BCD was approximately $54 million. In addition, Meadows has a note receivable from BCD of approximately $9.1 million.

On December 22, 1983, BCD entered into the Mountain Creek joint venture to acquire and develop approximately 4,200 acres of land in Dallas, Texas, of which more than 3,600 acres have been acquired. BCD's share of Mountain Creek's net profits is approximately 52%.

Another Meadows venture involves the operation of a medium density fiberboard manufacturing plant near Las Vegas, New Mexico. In May 1982, Meadows entered into a joint venture agreement with Frontier Fiber, Inc. (which has since been merged into Ponderosa Products, Inc. ("Ponderosa")) creating a joint venture known as Montana de Fibra. Ponderosa acts as operating manager of the plant. In October 1984, Meadows purchased substantially all of the fixed assets of the joint venture in a sale-leaseback transaction. The lease is for an initial period of 10 years, renewable under varying conditions for four additional 10-year lease periods and includes the right to purchase the plant at the end of each lease period at its then fair market value. The plant went into commercial operation in late 1984. The venturers incorporated the joint venture on January 2, 1985, into Montana de Fibra, Inc., with Ponderosa owning 10% and Meadows owning 90% of the new corporation.

Meadows continues its venture capital investment programs. As of December 1984, a total of approximately $8 million was invested in three venture capital funds and eight start-up companies.

Meadows and the shareholders of Bellamah Holding Company ("BHC"), the corporation which controls Bellamah Associates, Ltd., anticipate entering into an agreement to form MCB Financial Group, Inc., to be owned 50% by Meadows and 50% by the shareholders of BHC. BHC shareholders would contribute all of the shares of BHC, and Meadows would contribute a 31% interest in BCD and the assets leased to Montana de Fibra, Inc. The transaction is expected to have no operational impact on BCD.

The Company's non-utility investment program for the 1985-1989 period is projected to be approximately $136 million. The Company's equity investment in its non-utility subsidiaries, Sunbelt and Meadows, at December 31, 1984 was $20.7 million and $142.7 million, respectively. Although it is projected that the non-utility subsidiaries will provide a substantial portion of their capital requirements from internally generated sources, to the extent that external financing may be required, such borrowings will be made independently by the subsidiaries from third-party sources and will be non-recourse to the Company.

Employees

At December 31, 1984, the Company and its subsidiaries employed 2,979 people. Of these, 1,098 are covered by a collective bargaining agreement with the International Brotherhood of Electrical Workers which expires May 31, 1986, and 36 by a collective bargaining agreement with the International Union of Operating Engineers which expires on December 31, 1986. As of January 28, 1985, the closing date of the acquisition of the New Mexico Gas Properties, GCNM had 1,182 employees and Gathering Company had 44 employees. Of these, 112 employees are covered by collective bargaining agreements with two unions, which agreements expire in May and September 1986.

ITEM 2. PROPERTIES

As of December 31, 1984, the total net generation capacity of the Company's owned generating facilities was 1,340 MW. The Company's thermal electric generating stations as of December 31, 1984 were as follows:

Type	Name	Location	Net MW Generating Capacity
Coal	San Juan(1)	Waterflow, New Mexico	840
Coal	Four Corners(2)	Fruitland, New Mexico	206
Gas/Oil	Reeves	Albuquerque, New Mexico	169
Gas/Oil	Person	Albuquerque, New Mexico	105
Gas/Oil	Las Vegas	Las Vegas, New Mexico	20
			1,340(3)

(1) San Juan Units 1, 2 and 3 are 50% owned by the Company; San Juan Unit 4 is 62.725% owned by the Company.

(2) Four Corners Units 4 and 5 are 13% owned by the Company.

(3) Excludes approximately 6 MW of diesel capacity at Clayton, New Mexico which could be used for supplying the town in an emergency.

The Four Corners plant and a portion of the facilities adjacent to the San Juan plant are located on land held under easements from the United States and also under leases from the Navajo Tribe, the enforcement of which might require Congressional consent. The risk with respect to the enforcement of these easements and leases is not deemed by the Company to be material. However, the Company is dependent in some measure upon the willingness and ability of the Navajo Tribe to protect these properties and to honor its commitments. The San Juan plant is located on private land owned by the Company and Tucson.

On December 31, 1984, the Company's electric transmission system, including jointly-owned lines, consisted of 246 circuit miles of 46,000 volt lines, 5 circuit miles of 69,000 volt lines, 628 circuit miles of 115,000 volt lines, 180 circuit miles of 230,000 volt lines, 1,529 circuit miles of 345,000 volt lines (including a 216 circuit mile transmission line which has since been sold and leased back by the Company) and 45 miles of 500,000 volt lines. The distribution systems consisted of 4,404 miles of overhead lines and approximately 1,786 cable miles of underground lines (excluding street lighting). The Company owns 228 substations having an aggregate transformer capacity of 9,115,970 kVA of which approximately 2,345,100 kVA is step-up transformer capacity at generating stations.

The property of GCNM consists primarily of natural gas gathering, storage, transmission and distribution systems. The gathering systems consist of approximately 1,200 miles (approximately 360 miles of which are leased to Gathering Company) of pipe with compression and treatment facilities. The storage systems are described above. (See "Natural Gas Operations — *Supplemental Gas Supplies*" under Item 1 — "Business".) The transmission systems consist of approximately 1,200 miles of pipe with compression facilities. The distribution system consists of approximately 6,400 miles of pipe. The property of Gathering Company consists primarily of natural gas gathering systems containing approximately 550 miles of pipe with compression facilities.

The Company also owns service and office facilities in Albuquerque and in other operating divisions throughout its service territory. The Company's water property consists of wells, pumping and treatment plants, storage reservoirs and transmission and distribution mains. (See "Water Operations" under Item 1 — "Business".)

Substantially all of the Company's utility plant is pledged to secure its first mortage bonds. The natural gas utility assets acquired by the Company from Southern Union are also subject to a first mortgage lien securing two promissory notes of the Company issued in connection with the acquisition. (See "Natural Gas Operations — *Acquisition of New Mexico Natural Gas Properties*" under Item 1 — "Business".)

The Company leases a major transmission line and associated equipment, data processing, communication, office and other equipment, office space, utility poles (joint use), vehicles and real estate. Certain leases, primarily for data processing equipment, are capital leases. All other leases are operating leases.

Meadows holds nine State of New Mexico coal leases covering 5,101 acres in Catron County, New Mexico. In addition, Sunbelt holds four State of New Mexico coal leases covering 1,600 acres in Catron County and jointly holds, with Salt River Project, eight state coal leases covering 3,499 acres in Catron County, New Mexico. No exploration or resource evaluation has yet been undertaken on any of the Catron County leases.

Paragon Resources, Inc. ("Paragon"), a wholly-owned subsidiary of the Company, holds an undivided one-half interest in three Federal and two state coal leases comprising approximately 5,282 acres, located approximately 40 miles southeast of the San Juan plant and in the vicinity of the proposed site for the New Mexico Generating Station. An exploration program was conducted on the leases held prior to the exchange discussed in the next sentence in an effort to define coal reserves on such leases, and it was estimated that approximately 87 million tons of coal with an average sulfur content of less than 1% were recoverable by surface mining operations on the leases. One of the three Federal leases was obtained in September 1984, through an exchange with the Bureau of Land Management ("BLM") for a similar leasehold, as authorized by an Act of Congress, which is expected to result in an overall increase of three million tons of recoverable coal.

In December 1982, Meadows acquired approximately 43,500 acres of mineral properties in the vicinity of the proposed New Mexico Generating Station site for $9 million, of which $4 million was paid at closing, with the balance payable in five equal annual installments. Of the total, approximately 41,000 acres are coal properties consisting of one Federal coal lease, ten Federal preference right coal lease applications ("PRLAs") and five state coal leases. Approximately 3,000 acres of mineral properties consist of state general mining leases, which overlap to some extent the area covered by coal leases. Such acquisitions are subject to approval by the BLM with respect to Federal properties. It is contemplated that the leases and PRLAs, when converted into leases, may be a source of coal supply for the proposed New Mexico Generating Station as well as for other markets. In addition, Sunbelt holds state coal leases covering 1,560 acres in the area from which it is currently mining coal to fill contractual obligations to SJCC and for sale to regional consumers.

Sunbelt holds additional mineral interests. (See "Non-Utility Subsidiary Operations" under Item 1 — "Business".) The Company currently anticipates that all mineral leases of Meadows and Paragon will be assigned to Sunbelt.

Paragon provides services for the Company's utility operations. It also maintains land and water rights for future power plants by operating or by leasing and managing farms and ranches. Under New Mexico law, water rights must be put to beneficial use or revert to the public. Therefore, Paragon operates or leases those farms and ranches to maintain water rights for the future.

Western Coal Co. ("Western"), a jointly-owned subsidiary of the Company and Tucson which has now been liquidated, formerly held a retained economic interest under the sublease from Western to Utah covering various Federal, state and private leases at the surface coal mine which is the primary source of coal for the San Juan plant. (See "Electric Operations — *Fuel and Water Supply*" under Item 1 — "Business".) On November 30, 1981, in the completion of its liquidation, Western assigned all of its interest under the sublease to the Bank of America National Trust and Savings Association, as Trustee of the San Juan Coal Trust, of which the Company and Tucson were initially the sole beneficiaries. Thereafter, pursuant to a Participation Agreement dated as of December 31, 1981, the Company sold 37.512% of its interest in the San Juan Coal Trust to institutional investors for $30 million, resulting in an after-tax gain of approximately $18.8 million. On May 17, 1982, all of the Company's remaining interest in the San Juan Coal Trust was transferred to a trust with Meadows as the sole beneficiary. This remaining interest was sold to institutional investors on June 30, 1983, for $38.7 million, resulting in an after-tax gain of approximately $24.1 million.

ITEM 3. LEGAL PROCEEDINGS

San Juan River Adjudication. In 1975, the State of New Mexico filed an action entitled *State of New Mexico v. United States, et al.*, in the District Court of San Juan County, New Mexico, to adjudicate all water rights in the "San Juan River Stream System". The Company was made a defendant in the litigation in 1976. The action is expected to adjudicate water rights used at the Four Corners and San Juan plants and at Santa Fe. (See "Electric Operations — *Fuel and Water Supply*" under Item 1 — "Business".) The Company cannot at this time anticipate the effect, if any, of any water rights adjudication on the present arrangements for water at the San Juan and Four Corners plants, nor can it determine what effect the action will have on water for Santa Fe. It is the Company's understanding that no final resolution of the case can be expected for several years.

Four Corners Litigation. The Navajo Tribal Council has enacted three resolutions asserting taxing and regulatory authority on the Navajo Indian Reservation which affect the Four Corners plant. One such resolution purports to impose, as of January 1, 1978, a "possessory interest tax" on the value of natural resources on land leased by the Navajo Tribe; another purports to impose a "business activity tax" effective July 1, 1978. These taxes would also extend to Utah, the contract supplier of fuel for the Four Corners plant, and it is anticipated that any increased cost to Utah resulting from payment of the taxes would be passed on to the participants. The third resolution, to be effective following affirmative action by the Secretary of the Interior (the "Secretary"), purports to establish

a sulfur emission permit system which would require participants in the Four Corners plant to pay a "sulfur emission fee". If validly imposed, the fee would appear to be in an amount that would economically justify an attempt to remove more sulfur dioxide from emissions at the Four Corners plant than required by Federal and state law, in order to minimize the fee. Although none have yet been made, any payments of taxes or fees to the Navajo Tribe prior to the conclusion of legal proceedings will be under protest to the extent possible.

In September 1981, the Navajo Tribal Council's advisory committee adopted a resolution expressing the intent of the Navajo Tribe to honor tax waiver provisions in its lease agreements with the Four Corners participants. If binding upon the Navajo Tribe and not withdrawn by subsequent Navajo Tribal action, this resolution would render the two taxing resolutions inapplicable to the Four Corners plant and its coal supplier. The advisory committee's resolution was apparently adopted with a view toward intensifying negotiations to increase the royalties payable to the Navajo Tribe by the coal supplier, which increase, by agreement, would be passed through to the participants, including the Company. (See "Electric Operations — *Fuel and Water Supply*" under Item 1 — "Business".)

In April 1978, the Four Corners participants filed suit in the United States District Court for the District of New Mexico contesting the action taken by the Navajo Tribe. The District Court dismissed the claims relating to the Navajo Tribe's sulfur emissions resolution on the grounds that such resolution was not yet effective. In 1984, however, the Navajo Tribe informed the District Court that its expressed intent to honor the tax waiver provisions in the Four Corners plant lease agreement did not extend to certain taxes upon the coal supplier to that plant. The District Court has stayed the proceedings relating to the Navajo Tribe's two taxing resolutions pending a decision, expected later this year, by the United States Supreme Court in its review of a Ninth Circuit Court of Appeals case involving other parties which specifically addresses the taxing power of the Navajo Tribe. The District Court has also noted the relevance of a decision by the United States Supreme Court in January 1982 involving other parties which upheld the authority of Indian tribes to impose taxes upon non-Indian businesses under certain circumstances and a decision by the Tenth Circuit Court of Appeals in August 1983 involving other parties which upheld the authority of the Navajo Tribe to impose taxes upon non-Indian businesses pursuant to the two resolutions referred to above. In view of the September 1981 resolution of the Navajo Tribal Council's advisory committee, the Navajo Tribe has requested dismissal of the participants' lawsuit. Although the participants have informed the District Court that this result is acceptable to them, the effect of such resolution on any further assertion with respect to tribal taxing authority has not been determined.

In addition to the Navajo Tribal action, the United States Department of the Interior cited in the late 1970s provisions in the Four Corners plant site lease pursuant to which representatives of the participants and the Department are to meet periodically to review technological advances in air pollution control equipment and mutually decide upon the feasibility of installing additional equipment. The Department has taken no further action in this regard, but if it determined to do so, the participants would contend that, with the intervening enactment of the Clean Air Act, these review functions have lapsed and have been merged into EPA.

Antitrust Litigation against Southern Union and Others. In 1981, the Company filed suit in the United States District Court for the District of New Mexico against Southern Union and other defendants alleging that natural gas supply contracts entered into by the defendants constituted violations of the Federal antitrust laws. Natural gas was purchased by the Company at the time from a division of Southern Union (such division having since been acquired by the Company) for use in the generation of electricity. The suit was consolidated with similar suits filed by a class of residential gas customers of Southern Union and the State of New Mexico. Through 1983, settlement agreements were reached between the plaintiffs and four defendants. In April 1984, a definitive settlement agreement was reached with Southern Union, which provided, among other things, for the purchase by the Company of substantially all of the New Mexico gas utility assets of Southern Union. In an order filed on August 1, 1984, Chief Judge Sherman G. Finesilver, United States District

Judge for the United States District Court for the District of Colorado, approved a Stipulation and Agreement of Settlement providing for the final settlement of the proceedings assuming the consummation of said purchase, which occurred on January 28, 1985. (See "Natural Gas Operations — *Acquisition of New Mexico Natural Gas Properties*" under Item 1 — "Business".)

Western Coal Tax Assessment. By letter dated August 17, 1984, the District Director of the Internal Revenue Service for the Albuquerque District (the "IRS District Director") sent a Notice of Deficiency (the "Notice") to Western alleging additional Federal income taxes due from Western. By a second letter of August 17, 1984, the IRS District Director alleged that the Company has a liability for the tax deficiency as a transferee. (See Item 2 — "Properties".) On November 13 and 14, 1984, petitions were filed with the United States Tax Court (the "Tax Court") on behalf of Western and the Company, respectively, seeking a redetermination of the alleged deficiency.

Prior to December 1, 1980, the coal requirements for the San Juan plant had been supplied by Western from certain Federal, state and private coal leases held by Western, which were mined by Utah, as Western's contract miner. Effective in December 1980, Western subleased its leases to Utah, retaining an economic interest in the coal. Utah further subleased the leases to SJCC, and SJCC entered into a Coal Sales Agreement with the Company and Tucson pursuant to which SJCC will sell processed coal for operation of the San Juan plant until the year 2017. SJCC also purchased from Western, at Western's net book cost of approximately $24.6 million, certain coal processing and reclamation equipment that had been used by Western in connection with its activities on the leases. Western adopted a complete plan of liquidation and was liquidated in 1981, with its assets being distributed to the Company and Tucson.

The Notice alleges additional Federal income taxes due from Western for the 1975 and 1977-1981 tax years, in the aggregate amount of $122,809,131, plus interest. The Internal Revenue Service calculated the portion of the assessment for the tax year ended November 30, 1981, at $117,714,146. Various issues are raised in the Notice, with the largest single issue relating to the proper tax treatment of the sublease of coal leases to Utah, which issue accounts for approximately 95% of the 1981 assessment.

The Company intends to take appropriate steps to see that the deficiency is vigorously contested in the Tax Court. At the time of filing of the tax returns in question, Western believed, on advice of counsel, that the returns were properly filed. The Company has been advised by counsel that Western has a strong defense to the position of the Internal Revenue Service regarding the tax treatment of the sublease of coal leases to Utah. The Company further is of the opinion that the aggregate assessment is far in excess of the amount, if any, that will ultimately be found due by Western for the years in question. The Company, as a former 50% shareholder in Western, has a maximum exposure of 50% of whatever tax deficiency, if any, is ultimately assessed against Western. The Company has evaluated its exposure on the issues raised and is of the opinion that any amount eventually found to be due will have an immaterial impact on its financial statements.

Also see "Electric Operations — *Sources of Power*" and "— *Fuel and Water Supply*", "Rates and Regulation" and "Environmental Factors" under Item 1 — "Business" with regard to other litigation and disputes.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

SUPPLEMENTAL ITEM. EXECUTIVE OFFICERS OF THE COMPANY

Executive officers, their ages, offices held and initial effective dates thereof, are as follows:

Name	Age	Office	Initial Effective Date
J. D. Geist	50	Chairman of the Board and President	November 23, 1982
J. P. Bundrant	53	President — Electric Operations	February 5, 1985
J. T. Ackerman	43	President — Gas Operations	February 5, 1985
C. D. Bedford	44	Senior Vice President	November 1, 1983
W. M. Eglinton	37	Senior Vice President	May 1, 1984
J. F. Jennings, Jr.	51	President and Chief Operating Officer, Meadows Resources, Inc.	June 15, 1983
J. B. Mulcock, Jr.	45	Senior Vice President	November 1, 1983
A. J. Robison	44	Senior Vice President	November 1, 1983
R. B. Rountree	60	Senior Vice President	November 1, 1983
J. L. Wilkins	61	Senior Vice President	November 1, 1983

All executive officers are elected annually by the Board of Directors of the Company, with the exception of Mr. Jennings who is elected by the Meadows Board of Directors.

All of the above executive officers, with the exception of Mr. Jennings, have been employed by the Company and/or its subsidiaries for more than five years in executive or management positions. For at least four years prior to his employment with Meadows in 1983, Mr. Jennings was president of Phelps-Dodge Communications Co.

PART II

ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is traded on the New York Stock Exchange.

The following table indicates the high and low sales prices of the Common Stock of the Company reported as composite transactions:

Year	High	Low
1984		
1st Quarter	26⅝	23
2nd Quarter	24¼	20⅜
3rd Quarter	22¾	19½
4th Quarter	25¼	22
1983		
1st Quarter	28	25½
2nd Quarter	28⅞	26¾
3rd Quarter	28¾	25⅞
4th Quarter	29⅝	22¾

On March 4, 1985, there were 67,172 holders of record of the Common Stock.

The Company has paid quarterly cash dividends on its Common Stock in each year commencing in 1946 when the stock first became publicly held. Dividends per share on the Common Stock since 1980 are as follows:

1980	1981	1982	1983	1984
$2.04	$2.68	$2.77	$2.81	$2.85

On January 22, 1985, the Board of Directors of the Company declared a dividend of $.72 per share of Common Stock payable February 22, 1985, to stockholders of record February 1, 1985. The payment of future dividends will depend upon earnings, the financial condition of the Company, market requirements and other factors.

ITEM 6. SELECTED FINANCIAL DATA

Reference is hereby made to page 21 of the Company's Annual Report to its shareholders for the year ended December 31, 1984.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Reference is hereby made to pages 22 and 23 of the Company's Annual Report to its shareholders for the year ended December 31, 1984.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Reference is hereby made to pages 23 through 36 of the Company's Annual Report to its shareholders for the year ended December 31, 1984.

ITEM 9. DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

Reference is hereby made to pages 2 through 4 of the Company's Proxy Statement dated March 22, 1985 and to the Supplemental Item — Executive Officers of the Company, under Part I.

ITEM 11. EXECUTIVE COMPENSATION

Reference is hereby made to pages 7 through 10 of the Company's Proxy Statement dated March 22, 1985.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Reference is hereby made to pages 1 through 4 of the Company's Proxy Statement dated March 22, 1985.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Reference is hereby made to page 4 of the Company's Proxy Statement dated March 22, 1985.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a)-1 The following consolidated financial statements of Public Service Company of New Mexico and subsidiaries together with the auditors' report thereon, included on pages 23 through 34 of the Annual Report of Public Service Company of New Mexico to its stockholders for the year ended December 31, 1984, are incorporated herein by reference:

Consolidated Balance Sheet — December 31, 1984 and 1983.

Consolidated Statement of Earnings — Years ended December 31, 1984, 1983 and 1982.

Consolidated Statement of Retained Earnings — Years ended December 31, 1984, 1983 and 1982.

Consolidated Statement of Changes in Financial Position — Years ended December 31, 1984, 1983 and 1982.

Notes to Consolidated Financial Statements — December 31, 1984, 1983 and 1982.

(a)-2 The following consolidated financial information for the years 1984, 1983 and 1982 is submitted herewith together with the report thereon of independent auditors:

Supplementary note to 1984, 1983 and 1982 consolidated financial statements.

Schedule I — Marketable securities — Other investments.

Schedule V — Property, plant and equipment.

Schedule VI — Accumulated depreciation and amortization of property, plant and equipment.

Schedule VIII — Valuation and qualifying accounts and reserves.

Schedule IX — Short-term borrowings.

All other schedules are omitted for the reason that they are not applicable, not required, or the information is otherwise supplied.

(a)-3 Exhibits:

The following exhibits are being filed with this report or are incorporated by reference, as permitted by Rule 12b-32 under the Securities Exchange Act of 1934, to the Registration Statement or other document with which they have been previously filed. (Asterisk denotes exhibits filed with this report.)

List of Exhibits

*(3)-A — Restated Articles of Incorporation of the Company, as amended.

*(3)-B — Bylaws of the Company, as amended.

(4)-A — Indenture of Mortgage and Deed of Trust dated as of June 1, 1947, between the Company and Irving Trust Company, as Trustee, creating First Mortgage Bonds 2⅞% Series due 1977, of the Company. (Filed as Exhibit 2-C to Form 8, registration under Section 12(g), Securities Exchange Act of 1934).

(4)-B — Fourteenth Supplemental Indenture dated as of December 1, 1974. (Filed as Exhibit 2-B-2 to Registration Statement No. 2-52832 of the Company).

(4)-C — Agreement of the Company pursuant to Item 601(b)(4)(iii) of Regulation S-K. (Filed as Exhibit 4-C to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1983).

(10)-A — Supplemental Indenture of Lease dated as of July 19, 1966 between the Company and other participants in the Four Corners Project and the Navajo Indian Tribal Council. (Filed as Exhibit 4-D to Registration Statement No. 2-26116 of the Company).

(10)-B — Fuel Agreement, as supplemented, dated as of September 1, 1966 between Utah Construction & Mining Co. and the participants in the Four Corners Project including the Company. (Filed as Exhibit 4-H to Registration Statement No. 2-35042 of the Company).

(10)-C — Contract between the United States and the Company dated April 11, 1968 for furnishing water. (Filed as Exhibit 5-L to Registration Statement No. 2-41010 of the Company).

(10)-D — Co-Tenancy Agreement between the Company and Tucson Gas & Electric Company dated February 15, 1972 pertaining to the San Juan generating plant. (Filed as Exhibit 5-O to Registration Statement No. 2-44425 of the Company).

(10)-E — San Juan Project Construction Agreement between the Company and Tucson Gas & Electric Company, executed December 21, 1973. (Filed as Exhibit to Registration Statement No. 2-50338 of the Company).

(10)-F — San Juan Project Operating Agreement between the Company and Tucson Gas & Electric Company, executed December 21, 1973. (Filed as Exhibit to Registration Statement No. 2-50338 of the Company).

(10)-G — Arizona Nuclear Power Project Participation Agreement among the Company and Arizona Public Service Company, Salt River Project Agricultural Improvement and Power District, Tucson Gas & Electric Company and El Paso Electric Company, dated August 23, 1973. (Filed as Exhibit to Registration Statement No. 2-50338 of the Company).

(10)-H — Amendatory Contract between the United States and the Company dated September 29, 1977 for furnishing water. (Filed as Exhibit to Registration Statement No. 2-60021 of the Company).

(10)-I	—Amendments One through Four to Arizona Nuclear Power Project Participation Agreement. (Filed as Exhibit (c) to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1979).
(10)-J	—Contingent Capacity Agreement between the Company and San Diego Gas & Electric Company dated October 30, 1979. (Filed as Exhibit (a) to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1979).
(10)-K	—Fourth Supplement to Four Corners Fuel Agreement No. 2 effective as of January 1, 1981 between Utah International Inc. and the participants in the Four Corners Project including the Company. (Filed as Exhibit (10)-BB to Annual Report of Registrant on Form 10-K for the fiscal year ending December 31, 1980).
(10)-L	—Accelerated Management Performance Plan of the Company dated January 1981. (Filed as Exhibit (10)-CC to Annual Report of Registrant on Form 10-K for the fiscal year ending December 31, 1980).
(10)-M	—Service Bonus Plan of the Company dated January 1981. (Filed as Exhibit (10)-DD to Annual Report of Registrant on Form 10-K for the fiscal year ending December 31, 1980).
(10)-N	—Coal Sales Agreement executed August 18, 1980 between San Juan Coal Company and the Company and Tucson Electric Power Company. (Filed as Exhibit (10)-EE to Annual Report of Registrant on Form 10-K for the fiscal year ending December 31, 1980).
(10)-O	—San Juan Unit 4 Purchase Agreement between the Company and Tucson Electric Power Company dated as of May 16, 1979 and Modifications No. 1 to San Juan Project Agreements. (Filed as Exhibit 10-T to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1981).
(10)-P	—Amendment Number 1 to Coal Sales Agreement dated September 30, 1981 among San Juan Coal Company, the Company and Tucson Electric Power Company. (Filed as Exhibit 10-V to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1981).
(10)-Q	—Participation Agreement among the Company, Tucson Electric Power Company and certain financial institutions relating to the San Juan Coal Trust dated as of December 31, 1981. (Filed as Exhibit 10-W to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1981).
(10)-R	—Four Corners Units 4 and 5 Capital Improvements Design and Construction Agreement between the Company and the other Four Corners Participants dated as of March 23, 1981. (Filed as Exhibit 10-X to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1981).
(10)-S	—Amendment No. 5 of Arizona Nuclear Power Project Participation Agreement dated as of December 5, 1979. (Filed as Exhibit 10-Z to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1981).
(10)-T	—Amendment No. 6 to the Arizona Nuclear Power Project Participation Agreement effective October 16, 1981. (Filed as Exhibit 10-AA to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1981).
(10)-U	—Executive Incentive Compensation Plan, effective date January 1, 1977. (Filed as Exhibit 10-BB to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1981).

(10)-V — Participation Agreement between the Company, the Owner Trustee and the Equity Participants with respect to the leveraged preferred stock of the Company dated as of December 1, 1981. (Filed as Exhibit 10-CC to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1981).

(10)-W — Amendment No. 7, effective April 1, 1982, to the Arizona Nuclear Power Project Participation Agreement. (Filed as Exhibit 10-BB to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1982).

(10)-X — Amendment No. 1, dated as of April 2, 1982, to the San Juan Contingent Capacity Agreement between the Company and San Diego Gas & Electric Company. (Filed as Exhibit 10-CC to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1982).

(10)-Y — Amendment dated September 8, 1982 to Executive Incentive Compensation Plan of the Company. (Filed as Exhibit 10-DD to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1982).

(10)-Z — Interconnection Agreement dated November 24, 1982, between the Company and Southwestern Public Service Company. (Filed as Exhibit 10-II to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1982).

(10)-AA — San Juan Unit 4 Purchase and Participation Agreement, dated as of November 29, 1982, between the Company and M-S-R Public Power Agency. (Filed as Exhibit 10-JJ to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1982).

(10)-BB — Participation Agreement dated as of June 30, 1983 among Security Trust Company, as Trustee, the Company, Tucson Electric Power Company and certain financial institutions relating to the San Juan Coal Trust. (Filed as Exhibit 10-II to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1983).

(10)-CC — Amendment No. 8, effective September 12, 1983, to the Arizona Nuclear Power Project Participation Agreement. (Filed as Exhibit 10-JJ to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1983).

(10)-DD — San Juan Unit 4 Early Purchase and Participation Agreement dated as of September 26, 1983, between the Company and M-S-R Public Power Agency, and Modifications No. 2 to the San Juan Project Agreements dated December 31, 1983. (Filed as Exhibit 10-KK to Annual Report of Registrant on Form 10-K for fiscal year ending December 31, 1983).

(10)-EE — Purchase and Sale Agreement, dated April 12, 1984, between the Company and Southern Union Company. (Filed as Exhibit 2 to Registration Statement No. 2-95151 of the Company).

(10)-FF — Collateral Trust Indenture dated as of February 1, 1985 among E.I.P. Funding Corporation, the Company and Morgan Guaranty Trust Company of New York, as Trustee. (Filed as Exhibit 4(a) to Registration Statement 2-95151 of the Company).

(10)-GG — Lease dated as of January 2, 1985 between The First National Bank of Boston, Lessor, and the Company, Lessee. (Filed as Exhibit 4(b) to Registration Statement 2-95151 of the Company).

(10)-HH	– Participation Agreements dated as of January 2, 1985 among E.I.P. Funding Corporation, The First National Bank of Boston, Morgan Guaranty Trust Company of New York, the Company and the Owner Participant named therein. (Filed as Exhibit 28(a) to Registration Statement 2-95151 of the Company).
*(10)-II	– Bellamah Community Development Executive Deferred Compensation Plan.
*(10)-JJ	– Amendment No. 9 to Arizona Nuclear Power Project Participation Agreement dated as of June 12, 1984.
*(10)-KK	– Modifications No. 3 to San Juan Project Agreements dated July 17, 1984.
*(10)-LL	– Stipulation and Agreement of Settlement of Claims Against Southern Union Company and Southern Union Gathering Company in MDL Docket No. 403, dated April 12, 1984.
*(10)-MM	– Compensatory Agreement with Mr. James F. Jennings, Jr.
(10)-NN	– Amendment No. Three to Coal Sales Agreement dated April 30, 1984 among San Juan Coal Company, the Company and Tucson Electric Power Company (confidentiality treatment has been requested and exhibit is not filed herewith).
*(10)-OO	– Amended and Restated San Juan Unit 4 Purchase and Participation Agreement dated as of December 28, 1984 between the Company and the Incorporated County of Los Alamos.
*(10)-PP	– New Mexico Public Service Commission Order dated December 12, 1984, and Exhibit A thereto, in NMPSC Case No. 1804, regarding inventoried capacity.
*(13)	– Annual Report to Stockholders for 1984.
*(22)	– Subsidiaries of the Company.
*(24)-A	– Auditors' Consent.
*(24)-B	– Attorneys' Consent.

(b) Reports on Form 8-K:

A Current Report on Form 8-K, dated December 12, 1984, was filed on January 14, 1985, reporting on (i) approval by the Commission of a stipulated agreement concerning the inventoried capacity rate-making methodology; (ii) approval by the Commission of the acquisition of the New Mexico Gas Properties; and (iii) the filing of a lawsuit challenging the acquisition of the New Mexico Gas Properties.

AUDITORS' REPORT

The Board of Directors and Stockholders
Public Service Company of New Mexico:

Under date of February 18, 1985, we reported on the consolidated balance sheet of Public Service Company of New Mexico and subsidiaries as of December 31, 1984 and 1983, and the related consolidated statements of earnings, retained earnings and changes in financial position for each of the years in the three year period ended December 31, 1984, as contained in the 1984 annual report to stockholders. These financial statements and our report thereon are incorporated by reference in the annual report on Form 10-K for the year 1984. In connection with our examinations of the aforementioned consolidated financial statements, we also examined the related supplementary note (13) and financial statement schedules as listed in the accompanying index.

In our opinion, such supplementary note and financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

PEAT, MARWICK, MITCHELL & CO.

Albuquerque, New Mexico
February 18, 1985

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES

SUPPLEMENTARY NOTE TO 1984, 1983 AND 1982 CONSOLIDATED FINANCIAL STATEMENTS

(13) Supplementary Income Statement Information

Taxes, other than income taxes, charged to operating expenses were as follows:

	1984	1983	1982
		(In thousands)	
Ad valorem	$ 8,579	$ 9,053	$ 7,282
City franchise	4,668	3,590	4,221
Payroll	3,862	3,684	3,282
Other	2,137	2,367	1,767
Total taxes, other than income taxes, charged to operating expenses	$19,246	$18,694	$16,552

Amortization of intangibles, royalties and advertising costs were less than 1% of revenues in each of the above periods.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES

SCHEDULE I — MARKETABLE SECURITIES — OTHER INVESTMENTS
Year Ended December 31, 1983

Name of issuer and title of each issue	Number of shares or units — principal amounts of bonds and notes	Cost of each issue	Market value of each issue at balance sheet date	Amount at which each portfolio of equity security issues and each other security issue carried in the balance sheet
		(In thousands)		
Time deposits and certificates of deposit(1)	$ 79,505	$ 79,505	$ 79,505	$ 79,505
E. F. Hutton repurchase agreement	$175,191	175,191	175,287	175,191
U. S. Government and Government agency securities	$ 57,787	55,237	56,154	55,237
Other(2)		9,066	9,044	9,044
Total		$318,999	$319,990	$318,977

(1) No individual issue exceeds two percent of total assets.

(2) Includes 123,400 shares of non-convertible preferred stock, 2,000 shares of common stock and principal amount of $3,839,500 in commercial paper.

NOTE: Marketable Securities — Other Investments did not exceed 10 percent of total assets at December 31, 1984 and 1982.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES

SCHEDULE V — PROPERTY, PLANT AND EQUIPMENT
Years Ended December 31, 1984, 1983 and 1982

Classification	Balance at beginning of year	Additions at cost	Retirements	Other changes Add	Other changes Deduct	Balance at end of year
December 31, 1984			(In thousands)			
Utility plant:						
Electric plant in service:						
Intangible	$ 3,132	$ 1,191	$ 15	$ —	$ —	$ 4,308
Production	886,218	15,244	1,231	498	808	899,921
Transmission	163,277	85,946	172	4	50	249,005
Distribution	212,670	32,102	2,160	1	847	241,766
General	38,952	4,045	708	12	372	41,929
	1,304,249	138,528	4,286	515	2,077	1,436,929
Water plant in service:						
Intangible	225	—	—	—	—	225
Source of supply plant	4,711	—	—	9	41	4,679
Pumping plant	1,902	—	—	24	52	1,874
Water treatment plant	4,058	17	6	—	—	4,069
Transmission and distribution	21,938	1,083	78	50	232	22,761
General	2,072	113	81	17	—	2,121
	34,906	1,213	165	100	325	35,729
Common plant in service:						
Intangible	10,917	1,187	228	—	—	11,876
General	20,711	3,923	612	19	8	24,033
	31,628	5,110	840	19	8	35,909
Construction work in progress	705,191	127,061	—	—	—	832,252
Electric plant held for future use	63,355	6,293	3,980	—	526	65,142
Total utility plant	2,139,329	278,205	9,271	634	2,936	2,405,961
Non-utility property	51,600	9,056	2,270	56,524	10	114,900
Non-utility property under construction	31,050	25,137	—	—	56,187	—
Total property, plant and equipment	$2,221,979	$312,398	$11,541	$57,158	$59,133	$2,520,861

Description of other changes

	Add	Deduct
Transfers between accounts	$56,711	$56,711
Transfer of expired contract deposits to plant in service	—	743
Write-down of electric plant held for future use	—	317
Transfer of contract termination charges	—	462
Miscellaneous corrections and adjustments	447	900
	$57,158	$59,133

(Continued)

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES

SCHEDULE V – PROPERTY, PLANT AND EQUIPMENT – (Continued)
Years Ended December 31, 1984, 1983 and 1982

Classification December 31, 1983	Balance at beginning of year	Additions at cost	Retirements	Other changes Add	Other changes Deduct	Balance at end of year
			(In thousands)			
Utility plant:						
Electric plant in service:						
Intangible	$ 1,843	$ 784	$ 26	$ 531	$ –	$ 3,132
Production	953,887	88,453	156,093	–	29	886,218
Transmission	155,499	9,701	1,898	–	25	163,277
Distribution	184,992	30,962	3,022	107	369	212,670
General	32,942	7,126	1,038	–	78	38,952
	1,329,163	137,026	162,077	638	501	1,304,249
Water plant in service:						
Intangible	214	11	–	–	–	225
Source of supply plant	6,003	77	–	–	1,369	4,711
Pumping plant	1,911	–	–	–	9	1,902
Water treatment plant	4,032	63	37	–	–	4,058
Transmission and distribution	19,996	1,067	88	1,369	406	21,938
General	1,972	143	43	–	–	2,072
	34,128	1,361	168	1,369	1,784	34,906
Common plant in service:						
Intangible	10,042	2,302	896	–	531	10,917
General	19,725	7,375	5,994	77	472	20,711
	29,767	9,677	6,890	77	1,003	31,628
Construction work in progress	599,272	107,936	2,017	–	–	705,191
Electric plant held for future use	61,871	5,973	–	312	4,801	63,355
Total utility plant	2,054,201	261,973	171,152	2,396	8,089	2,139,329
Non-utility property	43,435	13,445	8,253	3,256	283	51,600
Non-utility property under construction	1,913	29,137	–	–	–	31,050
Total property, plant and equipment	$2,099,549	$304,555	$179,405	$5,652	$8,372	$2,221,979

Description of other changes

	Add	Deduct
Transfers between accounts	$4,133	$4,133
Transfer of expired contract deposits to plant in service	–	776
Write-down of electric plant held for future use	–	2,668
Miscellaneous corrections and adjustments	1,519	795
	$5,652	$8,372

(Continued)

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES

SCHEDULE V – PROPERTY, PLANT AND EQUIPMENT – (Continued)
Years Ended December 31, 1984, 1983 and 1982

Classification December 31, 1982	Balance at beginning of year	Additions at cost	Retirements	Other changes Add	Other changes Deduct	Balance at end of year
			(In thousands)			
Utility plant:						
Electric plant in service:						
Intangible	$ 1,764	$ 74	$ 9	$ 14	$ —	$ 1,843
Production	474,254	484,603	318	—	4,652	953,887
Transmission	137,825	17,763	82	—	7	155,499
Distribution	157,091	29,734	1,715	—	118	184,992
General	29,290	3,763	500	389	—	32,942
	800,224	535,937	2,624	403	4,777	1,329,163
Water plant in service:						
Intangible	—	214	—	—	—	214
Source of supply plant	7,735	1,053	—	—	2,785	6,003
Pumping plant	1,389	847	68	—	257	1,911
Water treatment plant	5,032	57	—	—	1,057	4,032
Transmission and distribution	21,413	2,841	11	—	4,247	19,996
General	2,046	197	26	—	245	1,972
	37,615	5,209	105	—	8,591	34,128
Common plant in service:						
Intangible	6,171	3,891	6	—	14	10,042
General	18,359	2,169	69	—	734	19,725
	24,530	6,060	75	—	748	29,767
Construction work in progress	887,100	(269,429)	—	—	18,399	599,272
Electric plant held for future use	7,048	36,915	—	17,908	—	61,871
Total utility plant	1,756,517	314,692	2,804	18,311	32,515	2,054,201
Non-utility property	60,695	22,166	1,791	31	37,666	43,435
Non-utility property under construction	—	1,913	—	—	—	1,913
Total property, plant and equipment	$1,817,212	$338,771	$4,595	$18,342	$70,181	$2,099,549

Description of other changes

	Add	Deduct
Transfers between accounts	$18,311	$18,311
Transfer of expired contract deposits to plant in service	—	1,066
Disposition of utility plant	—	13,014
Conversion of non-utility property to utility operations	—	37,666
Miscellaneous corrections and adjustments	31	124
	$18,342	$70,181

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES

SCHEDULE VI — ACCUMULATED DEPRECIATION AND AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT

Years Ended December 31, 1984, 1983 and 1982

Description	Balance at beginning of year	Additions: Charged to operating expenses	Additions: Charged to other accounts	Retirements	Other changes: Add	Other changes: Deduct	Balance at end of year
			(In thousands)				
December 31, 1984							
Utility plant:							
Accumulated provision for depreciation of utility plant:							
Electric plant in service	$225,733	$41,596	$ 931	$2,919	$ 31	$2,203	$263,169
Water plant in service	5,755	641	36	227	8	6	6,207
Common plant in service	4,105	688	892	394	7	6	5,292
	235,593	42,925	1,859	3,540	46	2,215	274,668
Accumulated provision for amortization of intangible assets — franchises and computer software	4,057	2,231	443	248	—	—	6,483
	239,650	45,156	2,302	3,788	46	2,215	281,151
Retirement work in progress	447	—	—	(1,004)	—	—	1,451
Total utility plant	240,097	45,156	2,302	2,784	46	2,215	282,602
Non-utility property	3,117	—	1,401	288	72	4	4,298
	$243,214	45,156	$3,703	$3,072	$118	$2,219	$286,900
Amortization of deferred carrying charges		3,819					
		$48,975					

Description of other additions and changes

Description	Charged to other accounts	Add	Deduct
Depreciation and amortization of equipment charged to clearing accounts for distribution in accordance with use	$2,302	$—	$ —
Depreciation of non-utility property charged to other income and deductions	1,401	—	—
Disposition of utility plant	—	25	66
Transfers between accounts	—	93	93
Miscellaneous corrections and adjustments	—	—	2,060
	$3,703	$118	$2,219

(Continued)

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES

SCHEDULE VI – ACCUMULATED DEPRECIATION AND AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT – (Continued)

Years Ended December 31, 1984, 1983 and 1982

Description	Balance at beginning of year	Additions: Charged to operating expenses	Additions: Charged to other accounts	Retirements	Other changes: Add	Other changes: Deduct	Balance at end of year
December 31, 1983				(In thousands)			
Utility plant:							
Accumulated provisions for depreciation of utility plant:							
Electric plant in service	$191,836	$43,946	$ 675	$11,421	$ 941	$ 244	$225,733
Water plant in service	5,371	594	31	241	—	—	5,755
Common plant in service	6,743	601	874	4,591	488	10	4,105
	203,950	45,141	1,580	16,253	1,429	254	235,593
Accumulated provisions for amortization of intangible assets – franchises and computer software	2,479	2,031	443	896	—	—	4,057
	206,429	47,172	2,023	17,149	1,429	254	239,650
Retirement work in progress	463	—	—	16	—	—	447
Total utility plant	206,892	47,172	2,023	17,165	1,429	254	240,097
Non-utility property	2,848	—	1,170	154	15	762	3,117
	$209,740	$47,172	$3,193	$17,319	$1,444	$1,016	$243,214

Description of other additions and changes

Description	Charged to other accounts	Add	Deduct
Depreciation and amortization of equipment charged to clearing accounts for distribution in accordance with use	$2,023	$ —	$ —
Depreciation of non-utility property charged to other income and deductions	1,170	—	—
Disposition of utility plant	—	490	249
Transfers between accounts	—	5	5
Accumulated depreciation on an acquisition	—	934	—
Miscellaneous corrections and adjustments	—	15	762
	$3,193	$1,444	$1,016

(Continued)

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES

SCHEDULE VI — ACCUMULATED DEPRECIATION AND AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT — (Continued)

Years Ended December 31, 1984, 1983 and 1982

Description	Balance at beginning of year	Additions: Charged to operating expenses	Additions: Charged to other accounts	Retirements	Other changes: Add	Other changes: Deduct	Balance at end of year
	(In thousands)						
December 31, 1982							
Utility plant:							
Accumulated provision for depreciation of utility plant:							
Electric plant in service	$160,482	$32,318	$ 484	$2,000	$552	$ —	$191,836
Water plant in service	5,985	685	34	134	—	1,199	5,371
Common plant in service	5,631	431	861	48	—	132	6,743
	172,098	33,434	1,379	2,182	552	1,331	203,950
Accumulated provisions for amortization of intangible assets — franchises and computer software	962	1,531	—	14	—	—	2,479
	173,060	34,965	1,379	2,196	552	1,331	206,429
Retirement work in progress	929	—	—	466	—	—	463
Total utility plant	173,989	34,965	1,379	2,662	552	1,331	206,892
Non-utility property	2,538	—	1,591	73	27	1,235	2,848
	$176,527	34,965	$2,970	$2,735	$579	$2,566	$209,740
Amortization of property losses		19					
		$34,984					

Description of other additions and changes

Description	Charged to other accounts	Add	Deduct
Depreciation and amortization of equipment charged to clearing accounts for distribution in accordance with use	$1,379	$—	$ —
Depreciation of non-utility property charged to other income and deductions	1,591	—	—
Disposition of utility plant	—	552	1,331
Conversion of non-utility property to utility operations	—	—	1,235
Miscellaneous corrections and adjustments	—	27	—
	$2,970	$579	$2,566

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES

SCHEDULE VIII—VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

Years Ended December 31, 1984, 1983 and 1982

	Balance at beginning of year	Additions: Charged to operating expenses	Additions: Charged to other accounts	Deductions	Balance at end of year
	(In thousands)				
December 31, 1984					
Allowance for doubtful receivables	$1,099	$1,256	$376(a)	$1,918(b)	$ 813
Reserves for injuries and damages	$ 83	$ 910	$ 3(c)	$ 966(d)	$ 30
December 31, 1983					
Allowance for doubtful receivables	$1,140	$1,415	$360(a)	$1,816(b)	$1,099
Reserves for injuries and damages	$ 140	$ 479	$ 18(c)	$ 554(d)	$ 83
December 31, 1982					
Allowance for doubtful receivables	$ 499	$2,427	$341(a)	$2,127(b)	$1,140
Reserves for injuries and damages	$ 81	$ 492	$ 6(c)	$ 439(d)	$ 140

(a) Recoveries of amounts previously written off.

(b) Uncollectible receivables written off.

(c) Amounts received from insurance companies.

(d) Payments made for injuries and damages.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES

SCHEDULE IX—SHORT-TERM BORROWINGS

Years Ended December 31, 1984, 1983 and 1982

Category of aggregate short-term borrowings	Balance at end of year	Weighted average interest rate at end of year	Maximum amount outstanding during year	Average daily weighted amount outstanding during the year	Average daily weighted interest rate during the year
			(Dollars in thousands)		
December 31, 1984					
Notes payable to banks	$ 8,004	11.62%	$ 47,655	$29,296	11.47%
Commercial paper	$22,309	9.15%	$145,635	$60,908	10.70%
December 31, 1983					
Notes payable to banks	$35,280	10.44%	$ 35,280	$18,294	10.32%
Commercial paper	$91,010	9.66%	$107,525	$86,637	9.16%
December 31, 1982					
Notes payable to banks	$13,887	10.19%	$ 67,003	$29,832	14.39%
Commercial paper	$49,975	9.09%	$105,225	$71,806	12.61%

SIGNATURES

Pursuant to the requirements of Section 13 or 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.

PUBLIC SERVICE COMPANY OF NEW MEXICO
(Registrant)

Date: March 28, 1985

By /s/ J. D. GEIST

J. D. Geist
Chairman of the Board and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Capacity	Date
/s/ J. D. GEIST J. D. Geist *Chairman of the Board and President*	Principal Executive Officer and Director	March 28, 1985
/s/ A. J. ROBISON A. J. Robison *Senior Vice President, Finance*	Principal Financial Officer	March 28, 1985
/s/ B. D. LACKEY B. D. Lackey *Vice President and Corporate Controller*	Principal Accounting Officer	March 28, 1985
/s/ J. P. BUNDRANT J. P. Bundrant	Director	March 28, 1985
/s/ A. B. COLLINS, JR. A. B. Collins, Jr.	Director	March 28, 1985
/s/ C. E. LEYENDECKER C. E. Leyendecker	Director	March 28, 1985
/s/ A. G. ORTEGA A. G. Ortega	Director	March 28, 1985
/s/ R. R. REHDER R. R. Rehder	Director	March 28, 1985
/s/ R. B. ROUNTREE R. B. Rountree	Director	March 28, 1985
/s/ R. H. STEPHENS R. H. Stephens	Director	March 28, 1985
/s/ E. R. WOOD E. R. Wood	Director	March 28, 1985

UNITED STATES OF AMERICA

NUCLEAR REGULATORY COMMISSION

In the matter of ARIZONA PUBLIC SERVICE COMPANY, et al, (Palo Verde Nuclear Generating Station, Unit 1)	:	DOCKET NO. STN 50-528

EXHIBIT B

TO

APPLICATION
IN RESPECT OF A SALES AND LEASEBACK
FINANCING TRANSACTION BY
PUBLIC SERVICE COMPANY OF NEW MEXICO

GENERAL INFORMATION CONCERNING THE
FIRST NATIONAL BANK OF BOSTON

General Information Concerning The First National Bank of Boston

(a) Name:

The First National Bank of Boston (the "Bank")

(b) Address:

100 Federal Street
Boston, Massachusetts 02110
Attention of Corporate Trust Division

(c) Description of business:

The Bank is a national banking association and has been for a number of years the largest commercial bank in New England. Except for directors' qualifying shares, the Bank is a wholly-owned subsidiary of Bank of Boston Corporation ("BBC"), a bank holding company organized under Massachusetts law. Through its subsidiaries, principally the Bank, BBC is engaged in providing a wide variety of services to corporate and institutional customers, governments, individuals and other banks. These services include domestic corporate banking services, international banking services, investment and fund management services, personal banking services, trust services, and banking operations and corporate services. Through its Corporate Trust Division, the Bank provides corporate trust services to a broad range of entities.

(d) (1) Not applicable.

(d) (2) Not applicable.

(d) (3) (i) State of incorporation and principal location:

The Bank is a national banking association chartered under the National Bank Act in 1864. The principal offices of the Bank are located in Boston, Massachusetts.

(d) (3) (ii) Names of directors and principal officers:

The names of the directors of the Bank and BBC are set forth in Attachments A and B hereto, respectively. Information with respect to the officers of the Bank and BBC is set forth on pages 86 and 87 of Attachment C hereto.

(d) (3) (iii) Neither the Bank nor BBC is owned, controlled, or dominated by an alien, a foreign corporation, or a foreign government. Further information relating to the U.S. citizenship of the Bank and BBC and the directors of the Bank

and BBC is contained in Attachments A and B hereto, respectively.

(d) (4) The Bank will serve as trustee under two or more trust agreements to be dated as of December 15, 1985, between the Bank and the respective equity investors described in the Application to which this document is attached as Exhibit B. The trusts created by these trust agreements will (i) receive title to the interests in PVNGS Unit 1 conveyed thereto by PNM and (ii) lease such interests back to PNM, all as more fully described in said Application. Although the Bank is not legally an "agent" for or a "representative" of such equity investors, the Bank does act as trustee of the trusts of which such investors are the respective beneficiaries. Under the terms of the trust agreements the Bank is generally obligated to act upon the instructions of the relevant equity investor/beneficiary so long as such instructions are not inconsistent with the provisions of documents constituting the sale and leaseback transaction.

The Bank is without knowledge, however, concerning possible foreign ownership, control or domination of the proposed equity investors, and is thus unable to provide information with respect thereto.

(e) The Bank is not making application for a license under 10 C.F.R. Part 50, or any other license available from the Nuclear Regulatory Commission.

(f) A copy of BBC's 1984 Annual Report is attached as Attachment C hereto. Provision to the Commission of BBC's 1984 Annual Report is without prejudice to the provisions of the respective trust agreements which provide that, (i) except in certain very limited circumstances (such as the Bank's wilful misconduct or gross negligence), the Bank is not answerable or accountable in its individual capacity and (ii) that all persons (individuals, partnerships, corporations, trusts, unincorporated associations or joint ventures, governments or any departments or agencies thereof, or any other entities) having any claim against the Bank, in its capacity as trustee, by reason of any aspect of the sale and leaseback transaction (including the holding by the Bank of legal title interests in PVNGS Unit 1) shall look only to the assets held by the Bank (including but not limited to the interests in PVNGS Unit 1 and PNM's obligations under the transaction documents) pursuant to the trust agreements for payment or satisfaction of such claim.

(g) Not applicable.

(h) Not applicable.

(i) Not applicable.

(j) Not applicable.

UNITED STATES OF AMERICA

NUCLEAR REGULATORY COMMISSION

In the matter of ARIZONA PUBLIC SERVICE COMPANY, et al, (Palo Verde Nuclear Generating Station, Unit 1)	:	DOCKET NO. STN 50-528

ATTACHMENT A TO EXHIBIT B

TO

APPLICATION
IN RESPECT OF A SALES AND LEASEBACK
FINANCING TRANSACTION BY
PUBLIC SERVICE COMPANY OF NEW MEXICO

AFFIDAVIT OF U.S. CITIZENSHIP
OF THE FIRST NATIONAL BANK OF BOSTON

AFFIDAVIT OF U.S. CITIZENSHIP

The Commonwealth of Massachusetts)
) ss.
County of Suffolk)

I, T. McLean Griffin, 14 Beckford Street, Salem, Massachusetts, being duly sworn, depose and say:

1. That I am Cashier, General Counsel, and Secretary of the Board of Directors of The First National Bank of Boston, a national banking association, organized and existing under the laws of the United States (hereinafter called the "Bank"), with offices at 100 Federal Street, Boston, Massachusetts, in evidence of which organization a certified copy of the Articles of Association is filed herewith together with a certified copy of the By-Laws;

2. That I am authorized by and on behalf of the Bank to execute and deliver this Affidavit of U.S. Citizenship;

3. That the names of the Chairman of the Board of Directors who is the Chief Executive Officer, the President, and the Executive Vice Presidents or other individuals who are authorized to act in the absence or disability of the President or other Chief Executive Officer, and of the Directors of the Bank as of September 30, 1985, are as follows:

Name	Title	Date and Place of Birth
Martin A. Allen	Director	January 27, 1931 Des Moines, IA
William F. Andrews	Director	October 7, 1931 Easton, PA
Benjamin J. Bowden	Executive Vice President	June 13, 1932 Beverly, MA
William L. Brown	Chairman of the Board of Directors and Director	February 1, 1922 Hendersonville, NC
J. Richard Bullock	Director	March 2, 1923 Worcester, MA
William J. Clark	Director	October 1, 1923 Kansas City, MO
Gary L. Countryman	Director	July 30, 1939 South Bend, WA
John F. Cunningham	Director	March 5, 1943 Boston, MA

Name	Title	Date and Place of Birth
Alice F. Emerson	Director	October 26, 1931 Durham, NC
Lawrence K. Fish	Executive Vice President	October 9, 1944 Chicago, IL
Raymond C. Foster	Director	March 30, 1919 Watertown, MA
Gerhard M. Freche	Director	July 13, 1931 Kansas City, MO
Charles K. Gifford	Executive Vice President	November 8, 1942 Providence, RI
Nelson S. Gifford	Director	May 3, 1930 Newton, MA
T. McLean Griffin	Senior Vice President, General Counsel and Cashier	September 12, 1922 Lake Placid, NY
Richard D. Hill	Director	November 6, 1919 Salem, MA
D. Brainerd Holmes	Director	March 24, 1921 New York, NY
Samuel Huntington	Director	April 24, 1939 Bayshore, N.Y.
John G. McElwee	Director	December 19, 1921 Port Bannatyne, Scotland
Donald F. McHenry	Director	October 13, 1936 St. Louis, MO
Alan L. McKinnon	Executive Vice President	February 13, 1928 Boston, MA
Clark W. Miller	Executive Vice President	January 25, 1930 Columbia, PA
Colman J. Mockler, Jr.	Director	December 29, 1929 St. Louis, MO
J. Donald Monan	Director	December 31, 1924 Blaisdell, NY

Name	Title	Date and Place of Birth
Edwin B. Morris, III	Executive Vice President	July 19, 1939 Washington, D.C.
Peter C. Read	Executive Vice President	March 15, 1936 Cambridge, MA
Charles A. Sanders	Director	February 10, 1932 Dallas, TX
Richard A. Smith	Director	November 1, 1924 Boston, MA
Ira Stepanian	President and Director	November 14, 1936 Cambridge, MA
Stephen J. Sweeney	Director	December 15, 1928 Winthrop, MA
Eugene M. Tangney	Executive Vice President	April 8, 1928 Boston, MA
Paul N. Vonckx, Jr.	Executive Vice President	January 22, 1938 Cambridge, MA
George R. West	Director	April 11, 1920 Boston, MA
Richard A. Wiley	Executive Vice President	July 18, 1928 Brooklyn, NY

and that each of said individuals is a citizen of the United States by virtue of birth in the United States, birth abroad of U.S. citizen parents, by naturalization during minority through the naturalization of a parent, by marriage to a U.S. citizen prior to September 22, 1922, or as otherwise authorized by law.

4. That the information as to stock ownership, upon which the Bank relies to establish that the required percentage of stock ownership is vested in citizens of the United States as of September 30, 1985, is as follows:

Name of Stockholder	Number of Shares	Percentage of Shares Owned
Bank of Boston Corporation	6,015,520 common	99+%
Martin A. Allen	0	—
William F. Andrews	0	
J. Richard Bullock	0	—
William L. Brown	0	—
William J. Clark	0	—
Gary L. Countryman	0	—
John F. Cunningham	0	—
Alice F. Emerson	0	—
Raymond C. Foster *	80	—
Gerhard M. Freche	0	—
Nelson S. Gifford *	80	—
Richard D. Hill	0	—
D. Brainerd Holmes *	80	—
Samuel Huntington	0	—
John G. McElwee	0	—
Donald F. McHenry	0	—
Colman M. Mockler, Jr.	0	—
J. Donald Monan *	80	—
Charles A. Sanders *	80	—

Name of Stockholder	Number of Shares	Percentage of Shares Owned
Richard A. Smith	0	—
Ira Stepanian	0	—
Stephen J. Sweeney	0	—
George R. West *	80	—

* In Accordance with the National Bank Act, each National Bank Director must own in his or her own right either shares of the capitol stock of the association of which he or she is a director the aggregate par value of which is not less than $1,000, or an equivalent interest in any company which has control over such association. As of September 30, 1985, these six (6) Directors of The First National Bank of Boston qualified with shares of capitol stock of the Bank. The remaining Directors, qualified with common stock of the Bank of Boston Corporation.

5. That the controlling interest in said Bank, as established by the data hereinbefore set forth, is owned by citizens of the United States; that the title to such proportion of the stock of said Bank is vested in citizens of the United States free from any trust or fiduciary obligation in favor of any person not a citizen of the United States; that such proportion of the voting power of said Bank is vested in citizens of the United States; that through no contract or understanding it is so arranged that the majority of the voting power of said Bank may be exercised, directly or indirectly in behalf of any person who is not a citizen of the United States; and that by no means whatsoever, is control of said Bank conferred upon or permitted to be exercised by any person who is not a citizen of the United States.

6. That affiant has carefully examined this affidavit and asserts that all of the statement and representations contained therein are true to the best of his knowledge, information, and belief.

Dated: 10/15/85

T. McLean Griffin

The Commonwealth of Massachusetts)
) ss.
County of Suffolk)

On the 15th day of October, 1985, before me appeared T. McLean Griffin, to me personally known, who being by me duly sworn, did depose and say that he is the Senior Vice President, General Counsel, Cashier, and Secretary of the Board of Directors of THE FIRST NATIONAL BANK OF BOSTON, a national banking association, that the seal was affixed to the instrument by T. McLean Griffin in his capacity aforesaid by authority conferred upon him by the By-Laws of the Bank and that he acknowledged said instrument to be the free act and deed of THE FIRST NATIONAL BANK OF BOSTON.

Nancy F. O'Neill
Notary Public
My commission expires March 31, 1989

UNITED STATES OF AMERICA

NUCLEAR REGULATORY COMMISSION

In the matter of ARIZONA PUBLIC SERVICE COMPANY, et al, (Palo Verde Nuclear Generating Station, Unit 1)	DOCKET NO. STN 50-528

ATTACHMENT B TO EXHIBIT B

TO

APPLICATION
IN RESPECT OF A SALES AND LEASEBACK
FINANCING TRANSACTION BY
PUBLIC SERVICE COMPANY OF NEW MEXICO

AFFIDAVIT OF U.S. CITIZENSHIP
OF BANK OF BOSTON CORPORATION

AFFIDAVIT OF U.S. CITIZENSHIP

The Commonwealth of Massachusetts)
) ss.
Country of Suffolk)

I, T. McLean Griffin, of 14 Beckford Street, Salem, Massachusetts, being duly sworn, depose and say:

1. That I am Clerk, General Counsel and Secretary of the Board of Bank of Boston Corporation, a Massachusetts corporation, organized and existing under the laws of the Commonwealth of Massachusetts "the Corporation", with offices at 100 Federal Street, Boston, Massachusetts, in evidence of which organization a certified copy of the By-Laws is filed;

2. That I am authorized by and on behalf of the Corporation to execute and deliver this Affidavit of U.S. Citizenship;

3. That the names of the Chairman of the Board of Directors, who is the Chief Executive Officer, the President, and other individuals who are successively authorized to act in the absence or disability of the Chairman of the Board and the names of the Directors of the Corporation as of September 30, 1985 are as follows:

Name	Title	Date and Place of Birth
Martin A. Allen	Director	January 27, 1931 Des Moines, IA
William F. Andrews	Director	October 7, 1931 Easton, PA
William L. Brown	Chairman and Director	February 1, 1922 Hendersonville, NC
J. Richard Bullock	Director	March 2, 1923 Worcester, MA
William J. Clark	Director	October 1, 1923 Kansas City, MO
Gary L. Countryman	Director	July 30, 1939 South Bend Washington
John F. Cunningham	Director	March 5, 1943 Boston, MA
Alice F. Emerson	Director	October 26, 1931 Durham, NC
Raymond C. Foster	Director	March 30, 1919 New York, NY

Name	Title	Date and Place of Birth
Gerhard M. Freche	Director	July 13, 1931 Kansas City, MO
Nelson S. Gifford	Director	May 3, 1930 Newton, MA
T. McLean Griffin	Clerk, General Counsel, and Secretary of the Board of Directors	September 12, 1922 Lake Placid, NY
Richard D. Hill	Director	November 6, 1919 Salem, MA
Samuel Huntington	Director	April 24, 1939 Bayshore, N.Y.
D. Brainerd Holmes	Director	May 24, 1921 New York
John G. McElwee	Director	December 19, 1921 Port Bannatyne, Scotland
Donald F. McHenry	Director	October 13, 1936 St. Louis, MO
Alan L. McKinnon	Executive Vice President, Comptroller and Treasurer	February 13, 1928 Boston, MA
Colman M. Mockler, Jr.	Director	December 29, 1929 St. Louis, MO
J. Donald Monan	Director	December 31, 1924 Blaisdell, NY
Charles A. Sanders	Director	February 10, 1932 Dallas, TX
Richard A. Smith	Director	November 1, 1924 Boston, MA
Ira Stepanian	President and Director	November 14, 1936 Cambridge, MA
Stephen J. Sweeney	Director	December 15, 1928 Winthrop, MA

Name	Title	Date and Place of Birth
George R. West	Director	April 11, 1920 Boston, MA

and that each of said individuals is a citizen of the United States by virtue of birth in the United States, birth abroad of U.S. citizen parents, by naturalization during minority through the naturalization of a parent, by marriage (if a women) to a U.S. citizen prior to September 22, 1922, or as otherwise authorized by law.

4. That I have access to the stock books and records of the Corporation; that said stock books and records have been examined and disclose (a) that as of September 30, 1985 the Corporation had issued and outstanding 19,525,938 shares of Common Stock of the Corporation issued and outstanding owned of record by 13,936 stockholders;

(b) That the registered address of 13,854 owners as of September 30, 1985 of record of 19,463,294 shares of the issued and outstanding Common Stock of the Corporation are shown on the stock books and records of the Corporation as being within the United States, said 19,463,294 being ninety-nine and sixty-seven one hundredths per centum of the total number of shares of said stock; As of September 30, 1985 the Corporation had 1,045,712 issued and outstanding shares of Adjustable Rate Cumulative Preferred Stock, Series A (liquidation preference $50 per share). Of this amount, 1602 shareholders representing 99.81% of the total number of shares are United States citizens. As of September 30, 1985, the Corporation had 1,576,068 issued and outstanding shares of Adjustable Rate Cumulative Preferred Stock, Series B. Of this amount, 3,089 shareholders representing 99.87% of the total number of shares are United States citizens.

(c) That pursuant to Section 13 of the Securities Exchange Act of 1934, any beneficial owner of more than 5% of the Corporation's class of Common Stock is required to file a report on Schedule 13G or 13D with the Securities and Exchange Commission with a copy sent to the Corporation. The records of the Corporation indicate that only two Schedule 13G and no Schedule 13D was filed in 1985 with respect to the Corporation's Common Stock. A Schedule 13G was filed by Wellington Management Company/Thorndike, Doran, Paine & Lewis ("Wellington") who beneficially owned 1,638,129 shares of the Common Stock of the Corporation, representing 8.53% of the issued and outstanding Common Stock of the Corporation as of December 31, 1984. A Copy of this Schedule 13G is enclosed herewith as Exhibit A an indicates that no one advisory client of Wellington has ownership of more than 5% of the issued and outstanding Common Stock of the Corporation (see Item 6 of the attached Schedule 13G) and that Wellington has shared voting power with respect to only 146,900 of such shares, and shared investment discretion with respect to all such shares. As of September 30, 1985, the beneficial ownership of Wellington was 1,728,349 shares of the Common Stock of the Corporation, representing 8.88%. Wellington has shared voting power with respect to only 266,100 of such shares, and shared investment discretion for all shares.

(d) That the following individuals are all partners of "Wellington" and that each of said individuals is a citizen of the United States of America unless otherwise indicated.

Daniel A. Ahearn
Nancy T. August
Vincent Bajakian
Anthony T. Cope (U.K.)
William D. DiIanni
Robert W. Doran
Charles T. Freeman
James C. French
John H. Gooch
William C. S. Hicks
William D. Jones, Jr.
F. Danby Lackey, III
George Lewis
Earl E. McEvoy
Duncan M. McFarland
Paul M. Mecray, III
Ernst Hans von Metszch(Netherlands)
Jerrold I. Mitchell
John B. Neff
John A. Myheim
Edward P. Owens
Stephen D. Paine
Saul J. Pannell
Stephen M. Pazuk
Eugene E. Record, Jr.
Dena W. Reed
David W. Scudder
Binkley C. Shorts
Stephen A. Soderberg
Ralph E. Stuart, Jr.
Paul G. Sullivan
W. Nicholas Thorndike
Gene R. Tremblay
James L. Walters
Francis V. Wisneski

That "Wellington", holds title as nominee, to none of the shares of Common Stock as of September 30, 1985; all such shares are held in nominee names of individual clients.

That the beneficial interest of such shares is held by 30 discrentionary client accounts of which shares 1,685,176 or 8.74% is shown to be held by stockholders having registered addresses within the United States; and

That none of the owners of the shares so held owns 5 percent or more of the issued and outstanding common stock.

(e) That as of December 31, 1984 Sanford C. Bernstein and Co., Inc. was the holder of record ownership of 1,290,160 shares or 6.7% of the Common Stock of the Corporation, with sole investment discretion for 1,290,160 shares and sole voting power for all 348,500 shares. A copy of this Schedule 13G is enclosed herewith as Exhibit B.

(f) That none of the owners of the shares so held owns 5% or more of the issued and outstanding Common Stock.

(g) That the following individuals are all directors of Sanford C. Bernstein and Co., Inc. and are all U.S. citizens.

Valman C. Bernstein, Chairman
Lewis A. Sanders, President
Roger Hertog
Joseph B. Greeley
Stuart K. Nelson

(h) As of July 31, 1985, Sanford C. Bernstein and Co., Inc. held 250 shares of Common Stock of the Corporation.

(i) As of September 30, 1985, no other stockholder owned of record 5% or more of the outstanding Common Stock of the Corporation other than Cede & Co., a nominee for The Depository Trust Company, who owned of record 13,985,104 shares, or 71.62% of the issued and outstanding Common Stock. Cede & Co., owned 502,996 shares of Adjustable Rate Cumulative Preferred Stock, Series A or 48.1% of the issued and outstanding stock. Cede & Co., owned 692,289 shares of Adjustable Rate Cumulative Preferred Stock, Series B or 43.92% of the issued and outstanding stock. The Depository Trust Company is a limited purpose trust company chartered under the Banking Law of the State of New York, a member of the Federal Reserve System, and a "clearing corporation" within the definition set forth in Section 8-102(3) of the Uniform Commercial Code. Depository Trust is presently a wholly-owned subsidiary of the New York Stock Exchange, Inc. and is engaged in the business of effecting the transfer and pledge of securities deposited with it by its participants through bookkeeping entries as permitted by the Uniform Commercial Code. In order to facilitate subsequent transfers, all securities deposited by participants with Depository Trust are registered in the name of its partnership nominee, Cede & Co. Neither Depository Trust nor its nominee, Cede & Co., beneficially own any securities. Participants in the Depository Trust system are financial organizations, such as member firms of the New York Stock Exchange and the American Stock Exchange, banks, registered management companies and clearing corporations. the organizations which deposit securities with Depository Trust may or may not be the beneficial owners of such securities. Depository Trust has no indication whether or not securities are beneficially owned by the organizations which deposit them in its system. Cede & Co., as nominee, holds the shares of the Corporation Common Stock for the clearing members.

5. That the controlling interest in said Corporation, as established by the data hereinbefore set forth, is owned by citizens of the United States; that the title to such proportion of the stock of said Corporation is vested in citizens of the United States free from any trust or fiduciary obligation in favor of any person not a citizen of the United States; that such proportion of the voting power of said

Corporation is vested in citizens of the United States; that through no contract or understanding it is so arranged that the majority voting power of said Corporation may be exercised, directly or indirectly in behalf of any person who is not a citizen of the United States; and that by no means whatsoever, is control of said Corporation conferred upon or permitted to be exercised by any person who is not a citizen of the United States.

6. That the affiant has carefully examined this affidavit and asserts that all of the statements and representations contained therein are true to the best of his knowledge, information, and belief.

Dated: 10/15/85

T. McLean Griffin

The Commonwealth of Massachusetts)
) ss.
Country of Suffolk)

On the 15th day of October, 1985, before me, the undersigned Notary Public in and for said Commonwealth duly commissioned and sworn, personally came T. McLean Griffin, to me known, who being by me duly sworn, did depose and say that he resides at No. 14 Beckford Street, Salem, Massachusetts; that he is Clerk, General Counsel, and Secretary of the Board of Directors of BANK OF BOSTON CORPORATION, a Massachusetts business corporation organized and existing under the laws of the Commonwealth of Massachusetts that the seal affixed thereto is the seal of said Corporation, and that he was duly authorized by the Board of Directors of said Corporation to execute said certificate and to affix the seal of said Corporation thereto.

Nancy F. O'Neill
Notary Public
My Commission Expires March 31, 1989

UNITED STATES OF AMERICA

NUCLEAR REGULATORY COMMISSION

In the matter of ARIZONA PUBLIC SERVICE COMPANY, et al, (Palo Verde Nuclear Generating Station, Unit 1)	DOCKET NO. STN 50-528

ATTACHMENT C TO EXHIBIT B

TO

APPLICATION
IN RESPECT OF A SALES AND LEASEBACK
FINANCING TRANSACTION BY
PUBLIC SERVICE COMPANY OF NEW MEXICO

1984 ANNUAL REPORT OF
BANK OF BOSTON CORPORATION

1984 Annual Report

BANK OF BOSTON
CORPORATION

200 Years of Service

Corporate Group

"To enhance our leadership position through innovative and responsive financial services for our customers."

Chad Gifford

International Group

"To provide global reach for our domestic businesses and to be a key local bank within selected countries."

Clark Miller

New England Group

"To be the preeminent New England bank in profitability, size and creative management thinking."

Larry Fish

Real Estate Group

"To reaffirm our commitment to the real estate capital and mortgage markets."

Ed Morris

Treasury/Investment Banking Group

"To serve as the financial crossroads for structuring, funding and placing debt and equity transactions."

Peter Read

Financial Highlights

		1984	1983	1982	Percentage Increase (Decrease) 1984 Compared with 1983	Percentage Increase (Decrease) 1983 Compared with 1982
For the Year *(in thousands)*	Net interest revenue	$669,932	$606,451	$554,125	10%	9%
	Provision for credit losses	180,000	54,000	48,000	233	13
	Other operating income	479,802	266,001	227,686	80	17
	Other operating expense	722,280	595,211	549,189	21	8
	Net income	164,054	135,736	124,401	21	9
Per Common Share Data	Net income	$ 8.35	$ 7.40	$ 6.67	13%	11%
	Dividends declared	2.34	2.17	1.97	8	10
	Book value	58.75	53.26	48.70	10	9
	Market value at December 31	39¾	40½	33¾	(2)	20
	Average shares outstanding	19,117,167	18,349,634	18,660,785	4	(2)
Selected Ratios	Return on average assets	.79%	.72%	.71%	10%	1%
	Return on average common stockholders' equity	15.19	14.44	14.70	5	(2)
	Dividends declared per common share to net income per common share	28.02	29.32	29.54	(4)	(1)
	Price/earnings at December 31	4.76X	5.47X	5.06X	(13)	8
	Total assets to stockholders' equity at December 31	18.62X	19.40X	20.66X	(4)	(6)
At Year End *(in millions)*	Loans and lease financing	$ 14,589	$ 11,896	$ 10,714	23%	11%
	Total assets	22,079	19,538	18,267	13	7
	Deposits	15,258	12,381	11,674	23	6
	Total stockholders' equity	1,185	1,007	884	18	14

Contents

1784

BANK OF BOSTON CORPORATION

To Our Stockholders

William L. Brown, ***Chairman*** **Ira Stepanian,** ***President***

"To maximize long-term shareholder value in the conduct of a highly ethical financial enterprise."

Your Corporation generated record earnings of $8.35 per common share in 1984, an increase of 13% over the $7.40 reported a year earlier. Net income for 1984 was $164.1 million, an improvement of 21% over the $135.7 million recorded in 1983.

Continued growth in earnings allowed your Directors to increase the annual dividend rate on the Corporation's common stock from $2.32 a share to $2.40. This is the seventh increase in as many years and the 18th in the last 20 years, representing a 3% increase in the dividend rate.

Increases were also posted in two common measures of your Corporation's profitability. Return on common equity (ROE) was 15.19% for 1984, compared with 14.44% for 1983. Return on assets (ROA) was .79%, up from .72% in 1983.

This year's strong performance reflects the gain related to the sale of our Boston headquarters building, as well as increases in net interest revenue and other operating income. These gains were offset in part by a higher provision for credit losses, including a $100 million special provision, and increases in other operating expenses. The building, which will be leased back to the Corporation, will continue to be known as the Bank of Boston Building and remain your Corporation's world headquarters. The building was sold for $363 million in December, resulting in a pre-tax gain of $295 million. Of that amount, $177 million was recognized in 1984's operating earnings. The remaining $118 million was required to be deferred and amortized over the initial term of the lease agreement.

After adjusting for the effect of the sale of the building and other special fourth quarter events, such as the special provision for credit losses and the writedown of the mortgages previously held in the portfolio, operating income for the year was a disappointing $5.99 per share. However, we expect a better performance in 1985 based on our strategic plan.

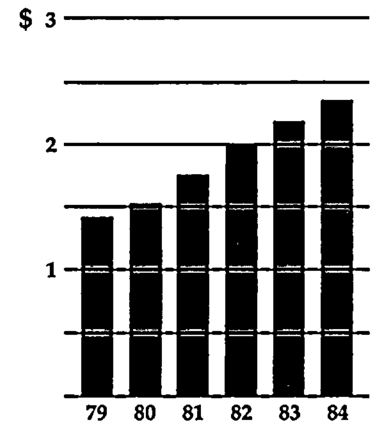
Bank of Boston's Strategic Plan

To enhance our performance in the years ahead, we implemented our strategic plan at the beginning of 1985. Our more formalized planning effort began two years ago in response to developments both inside and outside the Corporation. These included:

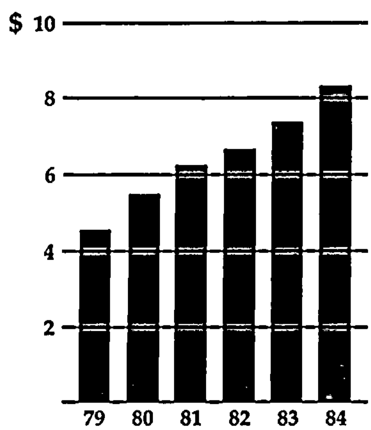
- Our size, after more than a decade of worldwide growth
- The rapidly changing competitive and regulatory environment
- Higher shareholder expectations

Growth: Until recently, the banking industry — including Bank of Boston — emphasized growth through the expansion of services. For many years, this strategy proved successful. Our primary objective was service; our willingness to enter new businesses in response to customer needs was well rewarded. But the fortuitous link between growth and profits began to weaken. By

Dividends Declared
Per Common Share



Net Income
Per Common Share



1982, we had become a giant institution. Clearly the time had come to take a closer look at our structure and management systems.

The changing marketplace: While we were expanding, deregulation and increased competition were altering the shape of the financial services industry. The most profound change was the emergence of money market funds, with their pronounced ability to attract consumer assets. In addition, brokerage firms, insurance companies and other financial service companies began offering competitive alternatives to banking products. Bankers, hobbled by outmoded regulations, watched helplessly as their traditional retail business was eroded by "non-banks." By the time the regulatory burden was lifted, we found ourselves faced with stiffer competition than ever before — from competitors that had been non-existent only a few years ago. Successfully meeting our competition and capitalizing on new opportunities now available to us, required a thorough examination of our strengths and weaknesses and a plan for the redeployment of our resources.

Higher shareholder expectations: Along with increased competition for business, we foresaw increased competition for capital, a vital resource. Investors began demanding a higher return on equity — a return sufficient to increase the price of their shares. To satisfy these expectations, it was

clear that we had to instill new disciplines and kindle a new management consciousness at all levels of the Corporation.

The new plan, the new structure

After two years of analysis and evaluation, the strategic planning processes generated the blueprint for Bank of Boston's new structure: a decentralized, numbers driven, strategically managed Corporation, well positioned to maximize the value of its shareholders' investment.

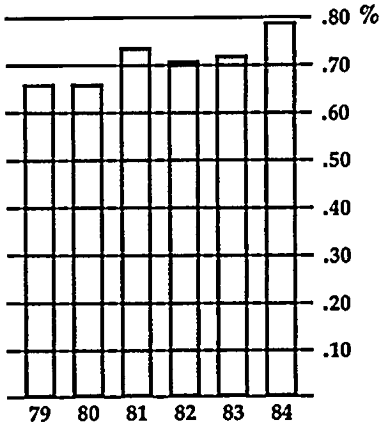
A new organization: Bank of Boston has a new five-Group organizational structure that is examined in detail in this year's special section:

- Corporate Group
- International Group
- New England Group
- Real Estate Group
- Treasury/Investment Banking Group

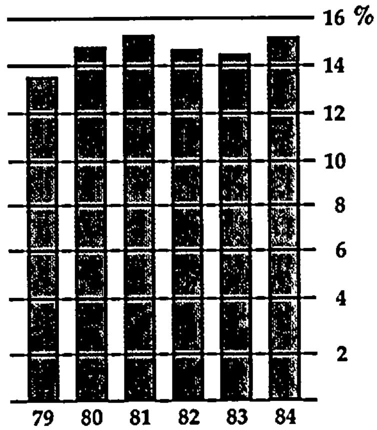
Each of these Groups is now an independent, separately managed business with its own strategic direction and with control over and responsibility for its own costs and profitability.

Establishing the strategic direction of the Corporation and setting its public posture is the role of the Office of the Chairman, which also retains

Return on Average Assets



Return on Average Common Equity



ultimate decision-making responsibility. The Office of the Chairman and the five Group Executives compose the Management Committee, which is responsible for the Corporation's overall performance and policies. In addition, the Management Committee initiates and supervises intergroup cooperation and the sharing of resources.

While many staff services have been decentralized to give line managers control over costs, and thereby increase efficiency, a small staff unit remains: the Corporate Center. This core group of senior staff professionals provides support to the Office of the Chairman, and functional guidance and advisory services to the Groups.

A new financial discipline: In response to competitive and profitability pressures, the Corporation now is analyzing itself in a new way. We are now concentrating our focus on the return on equity, not only of the consolidated Corporation, but also of *each* of our individual businesses.

This yardstick allows us to compare empirically the productivity of resources committed to each of our domestic and international business units. Our goal is to temper and direct our growth to maximize returns. The ROE standard will largely indicate those businesses to expand, those businesses to merely maintain, and those we should divest.

A new approach to employee commitment: Closely related to this discipline are our efforts to develop a new management and employee consciousness: an entrepreneurial dedication to the profitability of the business unit and Group to which the employee is assigned. Our goal is for each employee to participate in and contribute creatively to his or her particular area — whether through new business development, cost control or productivity improvements. In return, employees will receive the rewards and personal satisfaction that accompany the attainment of positive results.

Our strategy in New England

A key element of your Corporation's strategy is to be our region's preeminent bank. Our objective is to have a major presence in each New England state. Regional expansion efforts have been temporarily halted by a suit before the United States Supreme Court challenging provisions in some interstate banking laws that allow reciprocity only with other New England states. We believe that the constitutionality of these statutes will be upheld and that we will soon be able to complete the pending acquisitions of Colonial Bancorp in Connecticut and RIHT Financial Corporation in Rhode Island. A significant step in our New England strategy was accomplished in March with the acquisition of Maine's Casco-Northern Corporation.

Economic outlook

After two years of vigorous growth, it is likely that the pace of business activity will moderate somewhat during 1985. There is little doubt, however, that both the national and regional economies will remain firmly on the path of expansion. With inflation expected to remain in the range of 3 to 4%, continuing gains in real consumer income will

contribute to the forward momentum of the economy. Moreover, the easier credit conditions fostered by the Federal Reserve, and the resultant declines in interest rates seen in recent months, will undoubtedly have a rejuvenating effect on business activity.

A time of change

Obviously, this is a time of significant change at Bank of Boston. But one goal remains: to maximize long-term shareholder value in the conduct of a highly ethical financial enterprise. We also reaffirm our commitment to our employees and the communities and customers we serve. In an important sense, these commitments are buttressed by our quest for improved profitability. For if our return on equity is not sufficient, we will be unable to serve these constituencies.

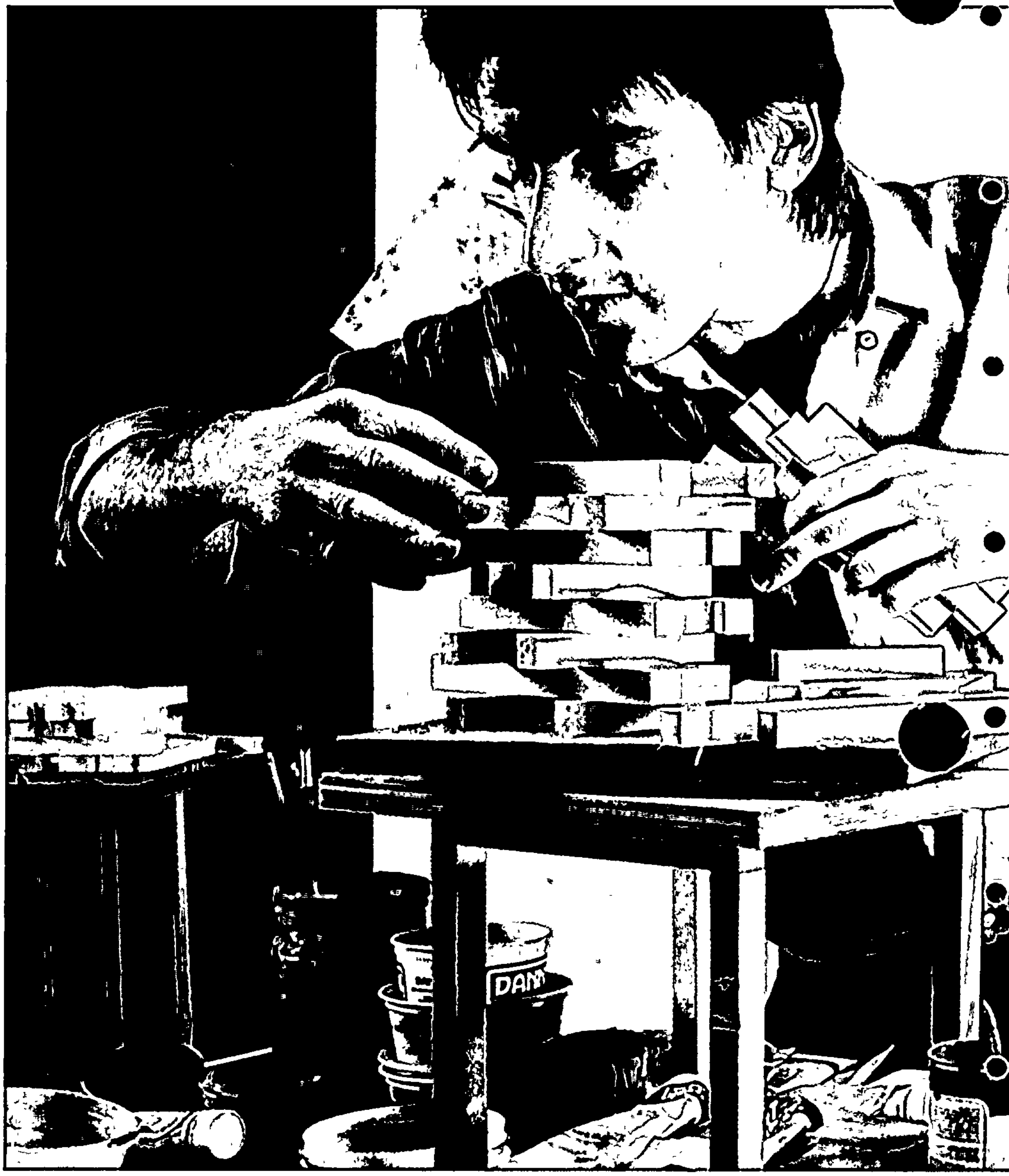
Just as our success over the years has been the product of our employees' pride, dedication and professionalism, so our future success will spring from their continued commitment and tomorrow's accomplishments. Your Corporation values highly its ability to attract and retain the widest range of qualified employees, so we have expanded our affirmative action programs for women, minorities and other groups. The results are gratifying: We have reduced the turnover rate among women and minorities, increased the number of handicapped employees in our workforce, and achieved a higher representation of women and minorities in key managerial and professional positions.

It is also appropriate that we express our gratitude to two individuals whose accomplishments have set high standards for the Corporation for many years: former Chairman Richard D. Hill, who retired as Chairman of the Executive Committee this year, and George E. Phelan, who retired as Vice Chairman of the Corporation. Their valuable counsel will still be available to us, however, as Mr. Hill continues to serve as a Director of the Bank and Corporation and Mr. Phelan remains on the Board of Casco-Northern Corporation.

During 1984, three new members were elected to our Board of Directors. William F. Andrews, President, Chairman and Chief Executive Officer of Scovill Inc. was named in March. In August, John F. Cunningham, President of Wang Laboratories, replaced An Wang, who continues to serve as an honorary director. In December, Samuel Huntington, President and Chief Executive Officer of New England Electric System, replaced Guy W. Nichols, who retired from the Board. We thank Mr. Nichols for his years of service to the Corporation.

William L. Brown
Chairman

Ira Stepanian
President



"A new structure was created to capitalize on the characteristics that have made us unique among American banks."

Sculptor Chuck Holtzman

Bank of Boston's New Strategy

In 1984, Bank of Boston's strategic planning process resulted in a new form and new direction for the Corporation.

A new structure was created to capitalize on the characteristics that have made us unique among American banks. We are:

- a sophisticated national provider of corporate financial services
- a significant international bank
- the largest bank in New England
- one of the country's leading real estate banks
- a major participant in national and international money markets

Each of these characteristics represents an important opportunity for us, which is reflected in our new organization:

- Corporate Group
- International Group
- New England Group
- Real Estate Group
- Treasury/Investment Banking Group

Each Group has its own support units, controls its own costs and is responsible for its own profitability. Each is a distinct yet integral part of the Bank. Each has an important role to play in helping Bank of Boston thrive now — and in the future.

Corporate Group

Boston Garden

Charles K. Gifford, ***Group Executive***

"To enhance our leadership position through innovative and responsive financial services for our customers."

Engineering supervisor Keith Handysi[illegible] at WNEV-TV

A new direction

Corporate lending has long been a mainstay of Bank of Boston's earnings. Much of our growth is attributable to our historical strength in the New England corporate lending market, our participation in national markets and our international lending capabilities, particularly in Latin America.

But traditional lending will no longer be enough to sustain any true competitor in today's rapidly changing financial marketplace. New competition, new techniques and new financing ideas are changing the way corporations assess and meet their capital needs. A major thrust of the Bank, through its Corporate Group and the closely related Treasury/Investment Banking Group, is expansion beyond lending to provide a broad range of high value financial products. These include innovative and sophisticated techniques in the areas of tax advantaged financing, interest rate protection, corporate finance and specially designed leasing products, which will more completely meet the needs of a broader range of customers and prospects.

Where we are going

The Bank has recognized that this strategy requires changes in the way we approach our markets. As a result, we have reorganized along customer lines — Large Corporate, Middle Market and Specialized Industries.

Simultaneously, we are designing two new approaches to cross-selling credit and non-credit products and services — transaction management and relationship planning.

Transaction management will permit us to bring together the special combination of investment banking and corporate lending skills needed to provide solutions to complex financing problems such as mergers, leveraged buy-outs, or capital structure. The other, relationship planning, will bring a new discipline to our marketing activities by encouraging officers to focus on the total range of a customer's needs. To accomplish this, we have brought two important services, Cash Management and Freight Management, within the Corporate Group.

Large Corporate: The primary goal is to enhance our relationships with carefully selected customers and prospects, and to become a more significant supplier of products and services to them on a mutually beneficial basis. Our global approach to the management of designated U.S. multinational companies provides us with numerous opportunities to enhance these important relationships. The ability to create new products quickly will be one important tool in achieving this objective. Another is our ability to pinpoint those customers and prospects that can benefit most from a broad spectrum of our resources, allowing us to more efficiently deliver our services to this segment of our market. Despite the strength of the dollar, foreign investment in this country continues to present attractive financing opportunities to us.

Middle Market: The vitality of mid-sized companies — those with sales ranging from $50 million to $150 million — is a true

[illegible] Manning heads one of the largest bank leasing operations in the U.S.

New ventures team leader Barbara Mastro talks with Kenneth Leavitt of CGX Corporation

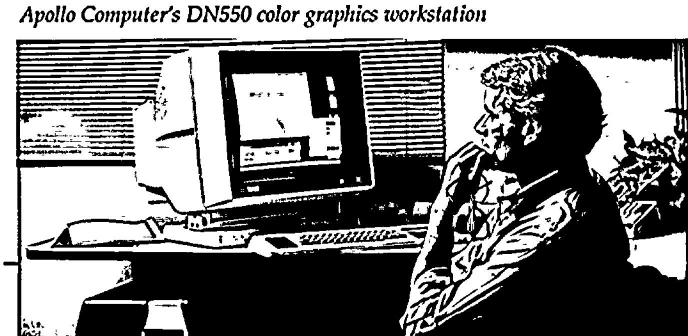
Corporate bankers (from left)
Constantin R. Boden, Phillip M. Sullivan, T. Lincoln Morison Jr., Paul N. Vonckx Jr.

indicator of America's rejuvenated economy. These corporations will play an important role in asset and earnings growth. Today we are the largest lender to middle market corporations in New England.

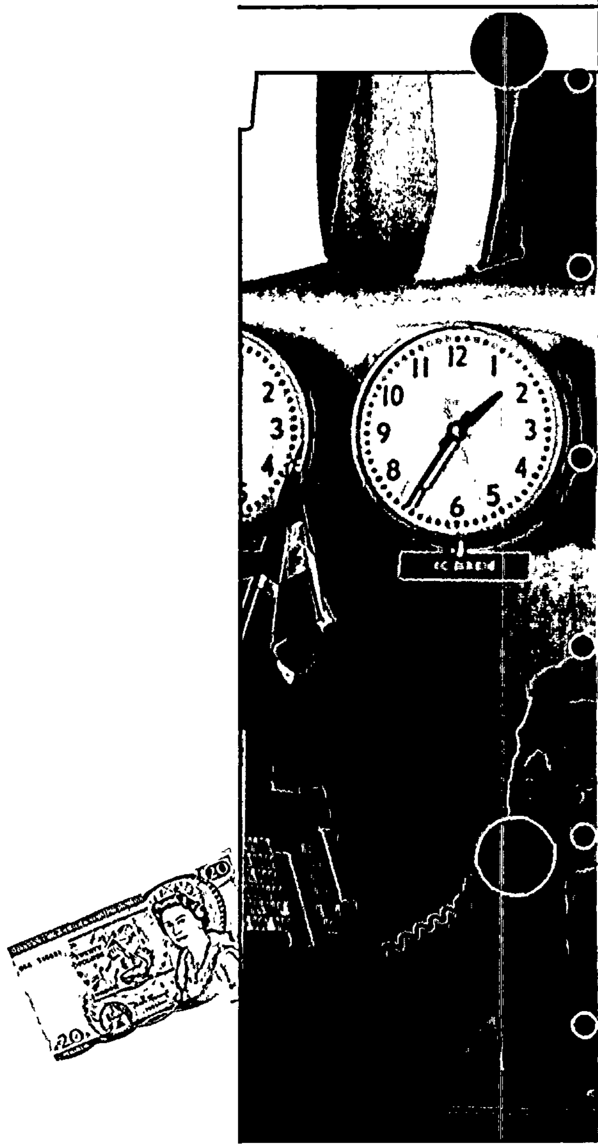
Our middle-market prominence in other areas of the country reflects the success of our asset based financing activities — commercial finance, factoring and leasing. We intend to build on this prominence by committing more resources to our regional centers in Atlanta, Dallas, Chicago and Los Angeles. The flow of new products from the Treasury/Investment Banking Group will permit us to better retain those relationships we established through asset based financing at an early stage of the customer's development.

Specialized Industries: By committing people and resources to particular industries, Bank of Boston has become a national leader in specialized lending. We are one of three recognized high technology banks in the country. In addition, we have a long history of successful involvement with the entertainment, communications, transportation and utilities industries. More recently, we have achieved a significant yet selective penetration of the energy and insurance markets. Our familiarity with industry trends, business cycles and unusual financing requirements gives us an important competitive advantage in these industries and a major opportunity for growth and increased profitability.

Apollo Computer's DN550 color graphics workstation



International Group



Clark W. Miller, *Group Executiv*

"To provide global reach for our domestic businesses and to be a key local bank within selected countries."

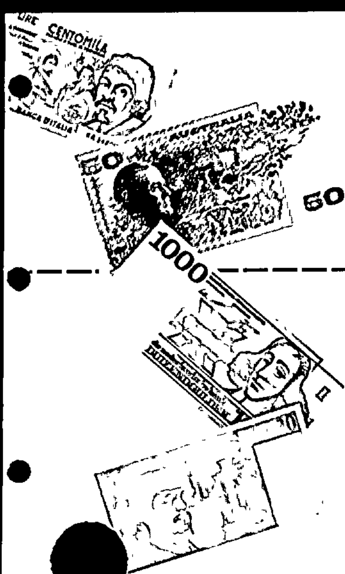
Providing services around the world

In the past two decades, Bank of Boston has expanded its international network into one of the most extensive among American banks. In the future, the Bank will leverage this network — where we have offices in 38 countries — to provide global reach for our other operating Groups and to generate income through international banking activities.

One of the most important goals of the Group is to boost earnings by increasing transaction volume flowing among the various international facilities without materially increasing cross-border exposure. To accomplish this objective, Worldwide Financial Services has been created to augment the geographic thrust of Latin America, Asia/Pacific and Europe/Middle East/Africa.

While these geographic areas retain responsibility for credit and local currency banking in their respective regions, Worldwide Financial Services bears strategic responsibility for integrating all international correspondent banking, trade services and private banking activities. By coordinating product development and administration for each of these businesses, they create economies of scale that can significantly increase the profitability of these services. In addition, by providing a global marketing perspective, Worldwide Financial Services assures that customers will utilize our international network to the fullest.

Latin America: Since 1917, when we opened our first international branch in Buenos Aires, Latin America has been the cornerstone of the Bank's international operations. Despite periods of



Timothy F. Hurley, head of foreign exchange desk

Banco de Boston, Buenos Aires

turbulence, the Bank has maintained its commitment to the region — and has reaped substantial rewards for doing so.

Today, our extensive Latin American presence is one of the Bank's most valuable assets. Although there has been a need to restructure some loans, by limiting our involvement in certain countries and expanding in others, we have preserved a competitive position that will allow aggressive business development during the region's anticipated economic recovery later in this decade.

Our strategy in the region, which has been to emphasize local currency lending and minimize cross-border exposure, remains unchanged. Increased local currency needs have led to the expansion of branch networks in Argentina, Uruguay and Chile.

Other opportunities have emerged as well:

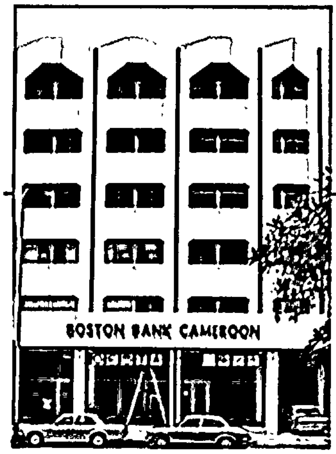
- International cash management is increasing in importance. For example, in Brazil, the introduction of this service resulted in the expansion of our local fee businesses.
- We have opened loan production offices for indigenous lending and non-traditional banking services in various Latin American countries.
- We continue to have significant interest in deposit-gathering capabilities in the Caribbean.

Asia/Pacific: Trade services, correspondent banking and, to a lesser extent, private banking, are our most significant opportunities in the Far East.

A new attitude toward foreign investments by the government of Australia also creates welcome opportunities there. We look forward to offering additional services that will supplement our successful leasing and merchant banking activities.

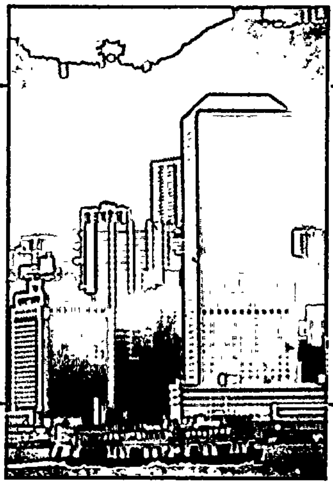
Europe/Middle East/Africa: In Europe, special emphasis is being placed on leasing, high technology lending and on the products and services offered by Worldwide Financial Services. Our new branch in Istanbul, established to capitalize on banking opportunities within Turkish borders, forges a link between our European operations and the Middle East.

International teller Alice Vasquez

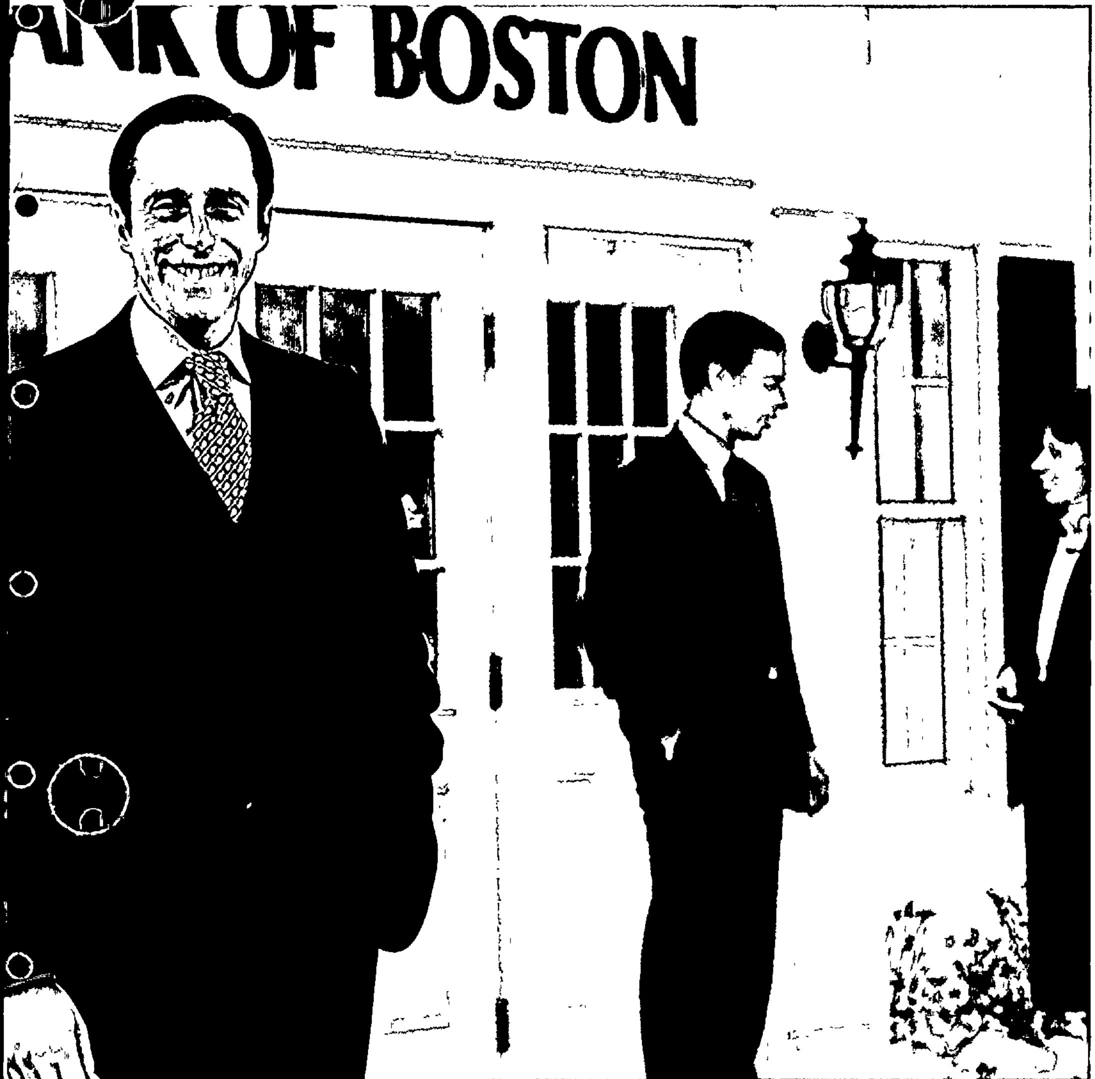


Bank of Boston, Cameroon

Bank of Boston, Hong Kong



New England Group



Lawrence K. Fish, *Group Executive*

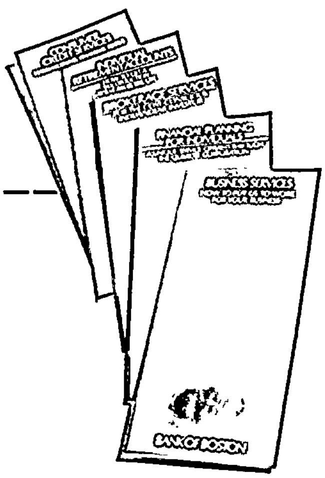
Orleans branch, Cape Cod, Massachusetts

Becoming the region's leader

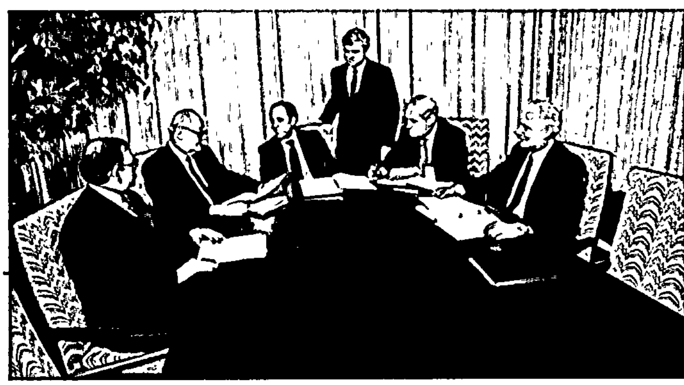
The six-state area presents greater opportunities than ever before to Bank of Boston. With more than 5,000 employees and nearly 200 branches dedicated to serving New Englanders, the Bank enjoys unmatched access to the business and personal banking customers in one of America's most attractive markets.

Our goal is to be the preeminent New England bank in profitability, size and creative management thinking. *Preeminent* means that Bank of Boston will achieve a leadership position that is widely recognized by our customers, our competition and our employees; *New England* reemphasizes our commitment to the region; *profitability* underscores return on equity as the primary

"To be the preeminent New England bank in profitability, size and creative management thinking."



The weekly review meeting of the New England Management Committee includes (from left) John C. Martin, Benjamin J. Bowden, Lawrence K. Fish, D. Bruce Wheeler, Eugene M. Tangney and Ralph B. Fifield



measurement for all our businesses; *size* conveys knowing how and when to use our strengths to better serve our regional markets, and *creative management thinking* addresses our concern that all managers be bold enough to experiment and make difficult decisions.

As a "bank within a bank," the New England Group will measure its performance and profitability against the top regional banks in the country. By achieving returns equal to or exceeding the levels set by these banks, the Group can have a major impact on stockholder investment.

Regional Financial Centers: A significant shift in management philosophy

New England's distinct diversity — both geographic and economic — demands a bold approach to managing, where each business is responsible for its own profitability. Region-wide success will depend on how well we understand and meet the needs of each geographic area and the particular customer segments in which we choose to compete. Rather than have multiple units reporting to a single Boston management headquarters, the Massachusetts network has been decentralized into seven Regional Financial Centers (RFCs): Greater Boston, Metropolitan North, Metropolitan South, Southeastern Massachusetts, Cape Cod, Worcester, and Western Massachusetts.

Each RFC is a self-contained, autonomous bank within the Group, providing comprehensive services to the priority customer segments in its geographic area. Depending upon the region, these segments may include:

- Retail Banking for the mass market and upscale customers
- Personal Trust for high-net-worth individuals who have investment and fiduciary needs
- Private Banking for high income individuals who have credit needs
- Middle market companies
- Small commercial and community businesses
- Commercial real estate

Each RFC has its own President and Regional Board of Directors, all of whom are prominent members of the local community. Each RFC has discretionary credit-granting capability. Each determines how best to serve its market.

This decentralized structure brings important advantages to both our customers and the Bank:

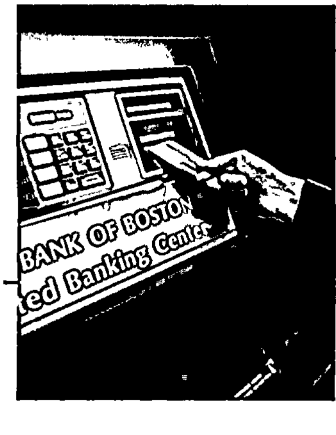
- Localized management leads to greater understanding of local needs and allows us to tailor our staffing and services to meet those needs.
- Each RFC becomes a single source provider of a spectrum of highly personalized banking services. For example, through their relationship officers, business executives can obtain commercial loans, mortgages, personal loans, education loans and estate planning services.
- Local managers have control of the direct costs associated with providing services to local customers.

Product management and cost management: Essential disciplines

The localized management approach is the most visible aspect of the New England Group's strategy. Less evident but equally important are our product management capability and stringent cost control measures.

Product management: While products requiring highly personalized service are being managed at the RFC level, management of certain basic retail products is being central-

Automated Teller Machine



Bay State Lobster's Jim Faro and catch

Benjamin J. Bowden (center, seated), Massachusetts banking head, confers with Regional Financial Center Presidents (from left) Myles Borland, Barrett C. Nichols, Francis J. McCormack, Ronald S. LaStaiti, Karl Walczak and Francis D. McGrath

i[illegible]RAs, NOW accounts, credit cards, consumer loans and similar products will be managed by product management teams, who will coordinate with retail banking managers within each RFC. This interaction will ultimately lead to higher quality products and more cost-effective delivery systems.

Cost management: Every aspect of the New England Group's operations, from its branch network to its operating systems to its management structure, is being scrutinized to assure that all possible economies are achieved. A sophisticated management information system is being developed t[illegible]p evaluate and [illegible] costs.

[illegible]ajor initiatives are being undertaken that will save us millions of dollars over the next few years. Included in this category are the consolidation of our Massachusetts operational activities, relocation of our credit card operations, the decentralization of several staff support units, new systems in our Shareholder Services and Personal Trust businesses and the development of a facilities planning program.

A national leader in operating services

The New England Group manages the Bank's operating products and services. Long a leader in providing a complete range of quality technology-intensive services to our customers, we are narrowing our focus to fewer businesses where economies of scale and competitive advantage allow us to profitably provide quality service.

Two businesses where we are renewing and expanding our commitment are *Shareholder Services* — Bank of Boston is the nation's third largest bank stock-transfer agent — and *Corporate Trust Services,* through which we serve as trustee and paying agent on more than $14.5 billion in corporate and municipal debt issues.

We continue to be a leader in *Correspondent Banking,* ranking as one of the largest correspondent banks in the country and the largest in New England. In *Mutual Funds Services,* we have a growing and respected business that now ranks as the fourth largest among banks in the country. In the area of electronic funds transfer, we operate the *Monec®* network and participate in a joint venture with another New England retail bank, christened *MONEY SUPPLY*™, which provides cash-dispensing services in high-volume retail outlets across Massachusetts.

The Merger with Casco-Northern: Becoming "New England's Bank"

The first stage of our regional expansion was completed in March, 1984, with the acquisition of Maine's Casco-Northern Corporation, a bank holding company with nearly $900 million in assets, close to 1000 employees and 56 branches serving a substantial percentage of Maine's commercial and retail markets. One of Maine's largest bank holding companies, Casco-Northern has long been a leading commercial lender and an innovative retailer. Its trust department consistently ranks among the nation's best in investment performance.

The Casco-Northern acquisition is a prime example of how two banking organizations can complement one another. Well-managed and autonomous, Casco is already a solid contributor to the Bank's earnings. Its in-depth knowledge of local markets and independent management style are consistent with the RFC concept. In turn, as part of the New England Group, Casco will benefit from product improvements and innovations and cost reduction programs that may have been too expensive for Casco to undertake independently.

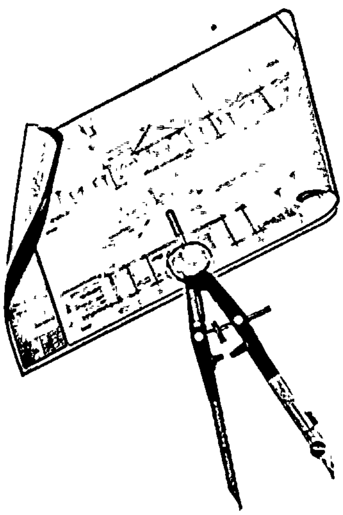
John M. Daigle, Casco-Northern

Beth Levine (foreground) sorts checks at high speed with Caryl Kennedy

Real Estate Group

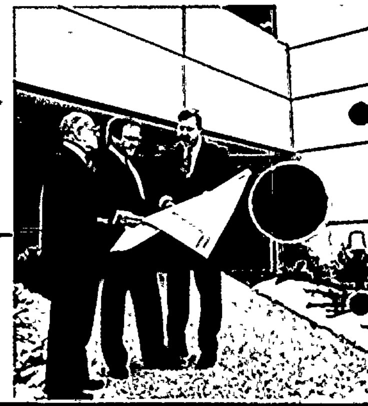
Edwin B. Morris III, *Group Executive*

International Place at Fort Hill, Boston



"To reaffirm our commitment to the real estate capital and mortgage markets."

John F. Ahearn with developers Donald T (center) and his father, Arnold (left)



Lead lender in high-rise office building at 599 Lexington Avenue in New York City

A national leader Real Estate has been a distinctive specialty of Bank of Boston for many years. Rather than signaling a strategic change, the creation of the Real Estate Group reaffirms the Corporation's commitment to serving this major industry. The independence and specialization of our staff and our long-standing dedication of financial resources have earned the Real Estate Group a reputation for responsiveness and industry competence unmatched by banks where real estate is simply an adjunct of corporate banking.

[illegible] result, the Bank [illegible]y ranks among the nation's leaders in the Group's two primary businesses: wholesale real estate lending and retail mortgage banking.

Wholesale lending: By carefully managing our relationships with developers to emphasize officer continuity and personalized service, we have become one of the top providers of real estate financing in the country. Like our customers' projects, our financings are individually designed and reflect the knowledge and innovation available only from professionals with years of experience. Four years ago, this "custom crafted" approach to financing motivated us to become one of the first commercial real estate lenders to match fund many of our construction loans, thereby removing the interest cost variable from the critical project budget. Later, during a period of tightness in the availability of commercial long-term real estate loans, we instituted what has become a highly successful program in which the Bank shares in a project's profit in exchange for providing medium-term funds at predictable, stable interest rates.

This reputation with developers greatly enhances our ability to structure attractive syndications of loans to other lenders desiring loan participations from the Real Estate Group.

Mortgage Banking: The Bank's prominence in the retail mortgage markets of the Southeast, as well as New England, places it among the top ten U.S. mortgage bankers. An excellent counterbalance for wholesale real estate lending, residential mortgage volume typically increases early in an economic recovery when interest rates are traditionally low — and well before wholesale construction loan volume builds. Today the mortgage banking industry faces important challenges, including the role of technology in mortgage generation and a shifting regulatory outlook. We have implemented an operating strategy designed specifically to meet these challenges.

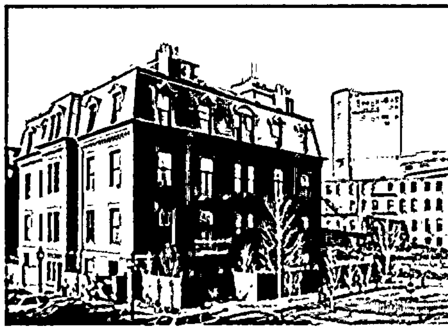
The Pooled Real Estate Investment Fund

The Real Estate Group manages the Pooled Real Estate Investment Fund. Formed in 1975, the Fund provides pension and profit sharing plans with a real estate investment vehicle that generates an attractive total rate of return and contributes to portfolio diversification. Currently, the Fund's portfolio exceeds $230 million and consists of investments in income producing properties across the country.

During the past three years, a time of relatively low inflation, the fund has earned an inflation-adjusted annual real return of 9.4%. During the same period, the Fund's unit value increased by 46%, compared with an increase in the Consumer Price Index of 12.6%.

[illegible]n Seaworld Hotel in Orlando, Florida

Garlan Morse Jr. with David Barrett (left) of Boston Properties at Cambridge (Mass.) Center



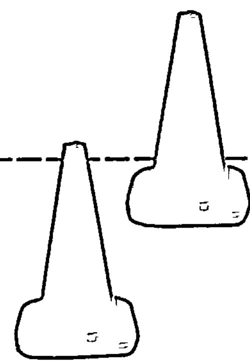
Renaissance Properties, Boston

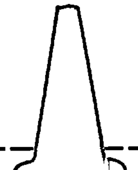
Treasury/Investment Banking Group

Peter C. Read, *Group Executive*

Trading room floor, Boston headquarters

"To serve as the financial crossroads for structuring, funding and placing debt and equity transactions."





Boiler section being erected for Thermal Electron Corporation co-generation plant in Florida that will produce electricity, air conditioning and hot water

A new role

The role of Treasury/Investment Banking is central to the success of Bank of Boston's strategy. The Group's primary customers are the Bank's own relationship officers, particularly those of the Corporate Group. Treasury/Investment Banking is both the source of funds for delivery to commercial borrowers, and the developer of new financial products and services that are aimed at expanding existing relationships and attracting new ones.

The product source: Investment Banking

New financing techniques provide special benefits to customers and Bank of Boston alike. For our customers, they promise new solutions to financing problems and offer ways to tailor financing more closely to a corporation's special requirements. For the Bank, these techniques offer a way to generate increased income without creating assets, thereby removing constraints created by capital ratios, tax position and other factors.

Shaping these techniques into products that are valuable to corporate customers, and then marketing them to a wide range of investors, is the role of Investment Banking. In the process, Investment Banking provides corporate lending officers with the broad range of products they need to be competitive in today's marketplace. For example, Investment Banking created a highly successful program involving the packaging and placing of tax-exempt Adjustable Rate Industrial Revenue Bonds to meet the needs of corporate customers for low-cost financing of capital investment.

Investment Banking operates in five discrete areas:

- *Merchant banking:* Involvement as principal in venture capital and mezzanine financing, and leveraged buyouts
- *Corporate finance:* Structuring of corporate debt instruments, mergers and acquisitions, corporate advisory services, and project finance
- *Public finance:* Underwriting tax-exempt issues such as municipal and Industrial Revenue Bonds
- *Placements:* Selling assets to corporations, other banks and financial institutions, and individuals
- *Product development:* Working closely with Treasury to design, structure and deliver new products to relationship officers

In fulfilling its expanded investment banker role, Bank of Boston has several distinct advantages. First, unlike large investment banks, we have a built-in origination system with our existing staff of relationship officers. These officers regularly address the financing requirements of several thousand companies.

Second, we have a substantial presence in the middle market, where the greatest growth and financing needs exist.

Finally, our potential competitors in the middle market cannot offer a major international presence, which is a gateway to sources of capital that range from foreign multinational corporations to sophisticated individual investors seeking to enhance their financial returns through investment opportunities in the U. S.

The funds source: Treasury

Treasury is the banker for the Corporation: It is the clearing house for all funds. In executing this role, it must balance

Richard L. Timpson, Treasury head, discusses interest rates at bank officers meeting

Peter F. Groff, Government Securities head, monitors price movements

Thomas A. Fransioli, Investment Banking head

requirements of its providers of funds — depositors and investors — for market rates of return with the needs of borrowers — the asset generators of the other groups — for funds at the lowest possible cost.

To meet this challenge, substantial investments are being made in sophisticated management information systems, enabling a worldwide approach to asset/liability management and aggressive development of untapped or underutilized sources of funds.

Treasury also works closely with Investment Banking to create new financial products and services, such as interest rate swaps, where floating rate loans are converted to fixed rate, and loan participation programs, designed to enhance both our relationships with corporate borrowers and our fee income.

In addition, Treasury manages several stand-alone businesses: It is a major U.S. government bond dealer; the premier underwriter of tax-exempt securities in the region; New England's primary foreign exchange trader, and an important participant in national money markets. The "Boston Option," an innovative and highly flexible foreign exchange product that insulates customers from rate fluctuations, was introduced in 1984 and found high customer acceptance. In addition, Treasury provides a broad range of investment management and advisory services to corporations and correspondent banks throughout New England.

Bank of Boston: New opportunities, new flexibility

While Bank of Boston's new organization should facilitate maximum profitability in each of our businesses, it also creates channels of interaction among the five Groups. In fact, one of the primary goals of Bank of Boston is to spark intergroup synergy by making the strengths of one valuable and easily accessible to the others.

But even more important than our intergroup strength is our unprecedented flexibility — a deliberate outgrowth of the strategic planning process. The financial services industry is one of the country's most fluid, and few financial institutions can afford to limit their direction or their vision by setting their sights on a single, narrowly defined goal. On the contrary, we have worked to assure that we are among the small number of leaders who will one day be the backbone of financial services in the United States.

Today, Bank of Boston possesses the organizational, analytical and tactical tools to reach that goal.

Constance Johnson lists municipal bond sales

BANK OF BOSTON CORPORATION

Consolidated Selected Financial Data

(in millions)	*1984*	*1983*	*1982*	*1981*	*1980*	*1979*	*Fiv[illegible] Com[illegible] Growth [illegible]*
	Years Ended December 31						
Income statement data:							
Interest income	$2,922.4	$2,333.2	$2,506.3	$2,748.5	$2,163.7	$1,513.9	14.1%
Interest expense	2,252.5	1,726.8	1,952.2	2,221.6	1,697.8	1,109.3	15.2
Net interest revenue	669.9	606.4	554.1	526.9	465.9	404.6	10.6
Provision for credit losses	180.0	54.0	48.0	48.0	48.0	49.0	29.7 (1)
Net interest revenue after provision for credit losses	489.9	552.4	506.1	478.9	417.9	355.6	6.6
Other operating income	479.8	266.0	227.7	195.4	166.8	120.9	31.7 (2)
Other operating expense	722.2	595.2	549.2	500.2	421.0	328.8	17.0
Income before income taxes	247.5	223.2	184.6	174.1	163.7	147.7	10.9
Provision for income taxes	83.4	87.5	60.2	55.5	61.6	63.5	5.6
Net income	$ 164.1	$ 135.7	$ 124.4	$ 118.6	$ 102.1	$ 84.2	14.3
Balance sheet data:							
Average for the period:							
Cash and due from banks	$ 1,434	$ 1,177	$ 1,166	$ 1,209	$ 1,297	$ 1,288	2.2
Interest bearing deposits in other banks	2,420	2,940	2,984	2,452	2,781	2,324	.8
Federal funds sold and resale agreements	286	189	222	177	159	297	(.8)
Trading account securities	413	427	272	164	111	123	27.[illegible]
Investment securities	1,018	1,167	1,296	1,667	1,926	1,354	(5.5)
Loans and lease financing	13,210	11,076	10,125	9,050	8,046	6,524	15.2
Other assets	2,038	1,845	1,441	1,212	1,064	899	17.8
Total assets	$ 20,819	$ 18,821	$ 17,506	$ 15,931	$ 15,384	$ 12,809	10.2
Deposits	$ 13,804	$ 12,001	$ 11,436	$ 10,427	$ 9,727	$ 8,353	10.6
Federal funds purchased and repurchase agreements	2,345	2,709	2,389	2,218	2,666	1,721	6.4
Notes and other funds borrowed	1,958	1,573	1,530	1,384	1,293	1,187	10.5
Other liabilities	1,621	1,598	1,305	1,127	1,009	929	11.8
Stockholders' equity	1,091	940	846	775	689	619	12.0
Total liabilities and stockholders' equity	$ 20,819	$ 18,821	$ 17,506	$ 15,931	$ 15,384	$ 12,809	10.2
At December 31:							
Loans and lease financing	$ 14,589	$ 11,896	$ 10,714	$ 9,551	$ 8,848	$ 7,369	14.6
Total assets	22,079	19,538	18,267	16,809	15,948	13,760	9.9
Deposits	15,258	12,381	11,674	11,020	10,815	8,965	11.2
Stockholders' equity	1,185	1,007	884	821	730	649	12.8

(1) Growth rate calculated without the $100 million special provision for credit losses in 1984 is 10.3%.

(2) Growth rate calculated without the $177 million gain from sale of headquarters building in 1984 is 20.1%.

Financial Review

BANK OF BOSTON CORPORATION

Consolidated Selected Financial Data, *continued*

	Years Ended December 31 1984	1983	1982	1981	1980	1979	Five Year Compound Growth Rate
Per common share:							
Net income	$ 8.35	$ 7.40	$ 6.67	$ 6.25	$ 5.48	$ 4.56	12.9%
Dividends declared	2.34	2.17	1.97	1.73	1.52	1.40	10.8
Book value at December 31	58.75	53.26	48.70	43.02	38.66	35.14	10.8
Market value at December 31	39¾	40½	33¾	30⅜	23¾	19⅛	15.8
Average common shares outstanding (in thousands)	19,117	18,350	18,661	18,975	18,646	18,469	.7
Common stockholders of record (1)	15,138	15,983	16,630	17,450	18,767	19,320	(4.8)
Selected ratios:							
Return on average assets (Net income to average assets)	.79%	.72%	.71%	.74%	.66%	.66%	3.7
Return on average common equity (Net income applicable to common stock to average common stockholders' equity)	15.19	14.44	14.70	15.30	14.83	13.61	2.2
Common dividend payout ratio (Dividends declared per common share to net income per common share)	28.02	29.32	29.54	27.68	27.74	30.70	(1.8)
Average stockholders' equity to average assets	5.24	5.00	4.83	4.86	4.48	4.83	1.6
Primary capital ratio at December 31 (2)	6.87	5.85	5.52	5.58	5.22	5.32	5.2
Market value/book value at December 31	67.66	76.04	69.30	70.70	61.43	54.54	4.4
Double leverage at December 31 (3)	110.16	103.81	102.88	101.93	104.52	111.22	(.2)
Total assets to stockholders' equity at December 31	18.62×	19.40×	20.66×	20.49×	21.85×	21.20×	(2.6)
Price/earnings ratio at December 31	4.76	5.47	5.06	4.86	4.33	4.19	2.6

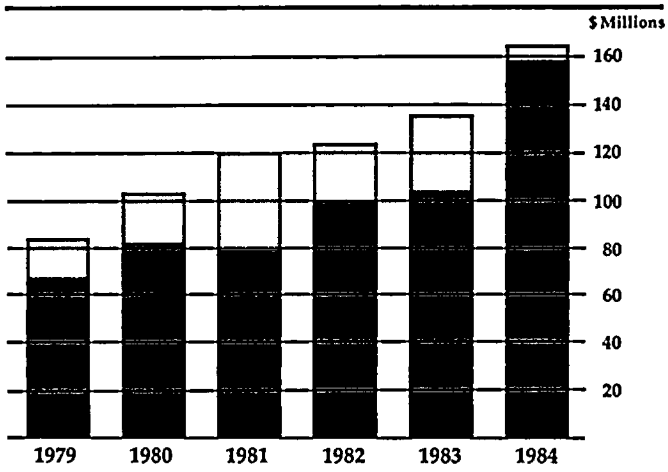
(1) The number of stockholders of record includes banks and brokers who act as nominees, each of whom may represent more than one stockholder.

(2) Computed based on regulatory guidelines in effect at December 31, 1984.

(3) Double leverage describes in percentage terms the extent to which equity investments in subsidiaries are financed with parent company debt. This situation occurs when a parent company borrows funds (leveraged once), then invests the funds in equity of a subsidiary, thus adding to the subsidiary's borrowing power (leveraged twice). The ratio is derived by dividing equity investment in subsidiaries less goodwill by the parent company's net worth less goodwill.

(4) Share amounts prior to 1982 have been restated to reflect the three-for-two stock split approved by stockholders on March 31, 1982.

Net Income



	1979	1980	1981	1982	1983	1984
☐ International	20%	22%	35%	20%	26%	4%
■ United States	80	78	65	80	74	96

This section presents management's discussion and analysis of the results of operations for the last two years and financial condition at the end of 1984 for Bank of Boston Corporation. The Corporation's net income is derived principally from the operations of The First National Bank of Boston and its subsidiaries. In order to understand this section in context, it should be read in conjunction with the Financial Statements and Statistical Data on pages 44 through 82 of this report.

Summary

Net income in 1984 increased 21% from 1983. In December 1984, the Boston headquarters building at 100 Federal Street was sold and a $177 million pre-tax ($105 million after-tax) gain was reported in 1984. The building will continue to be known as the Bank of Boston Building and house the Corporation's world headquarters. Other significant transactions during 1984 were a $100 million special provision for credit losses, a $16 million write-down of fixed rate mortgages which the Corporation decided to liquidate, a $5 million group of charges related to the restructuring of certain businesses in connection with strategic planning initiatives and a $5 million year-end contribution to the Corporation's charitable foundation. The net effect of these transactions was to increase earnings per common share in 1984 by $2.36.

Net income per common share was $8.35 or 13% higher in 1984. The lower per share percentage increase when compared with net income reflects the effect of preferred dividends in 1984 and greater average common shares outstanding. The dividends on the preferred stock, which was issued in connection with the acquisition of Casco-Northern Corporation (Casco), have been more than covered by Casco's earnings since acquisition.

Exclusive of the transactions described above, increases in net interest revenue and other operating income were more than offset by higher other operating expense and a larger provision for credit losses.

Net income in 1983 increased 9% from 1982 because of increases in net interest revenue and other operating income, which were partially offset by higher other operating expense, a higher provision for income taxes and an increase in the provision for credit losses.

As depicted in the Net Income chart, net income from United States and International Operations have varied significantly in the past three years. United States Operations, including the gain on the sale of

the headquarters building, contributed 96% of total net income in 1984, 74% in 1983, and 80% in 1982. United States Operations in 1984 increased $58 million to $158.2 million while International Operations decreased $30 million to $5.9 million. For additional information relating to the geographic segmentation of operations refer to pages 66 and 67.

In March 1984 Casco, a Maine-based bank holding company, became a subsidiary of Bank of Boston Corporation. The acquisition was accomplished through the issuance by the Corporation of 1,045,712 shares of adjustable rate cumulative preferred stock valued at $52 million at the time of acquisition. Casco added $522 million to loans and leases, $654 million to deposits, $749 million to total assets and $52 million to total stockholders' equity. In July 1983, Stockton, Whatley, Davin & Company (SWD), a Florida-based mortgage banking company, was acquired for $120 million in cash. At the time of acquisition, SWD was servicing approximately $4 billion of mortgage loans for third party investors. Financial Statement Footnote 21 contains additional information on the acquisition of Casco and a discussion of the pending acquisitions of Colonial Group, Inc. and RIHT Financial Corporation.

At December 31, 1984 the Corporation was the 16th largest bank holding company in the United States with total assets of $22.1 billion, a 13% increase compared with 1983. Loans and leases at December 31, 1984 were $14.6 billion, up 23% from a year ago and deposits increased 23% to $15.3 billion. Stockholders' equity was higher by 18%, totalling $1.2 billion at December 31, 1984. Return on average common equity was 15.19% in 1984 as compared with 14.44% in 1983. The return on average assets increased in 1984 to .79% as compared with .72% in 1983.

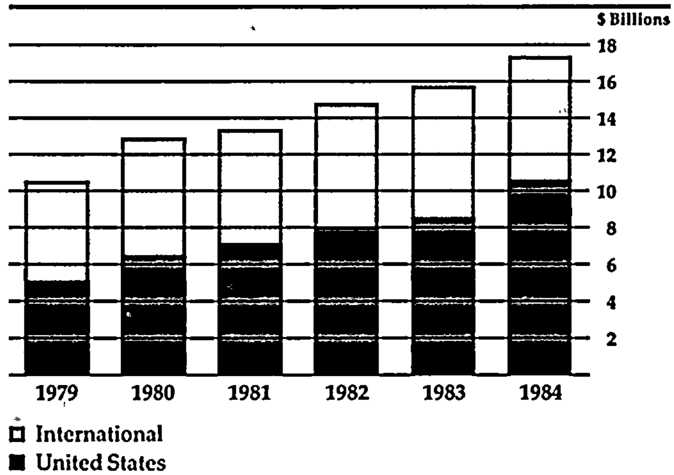
The following is a more detailed discussion of the Corporation's operating results and financial condition.

Results of Operations

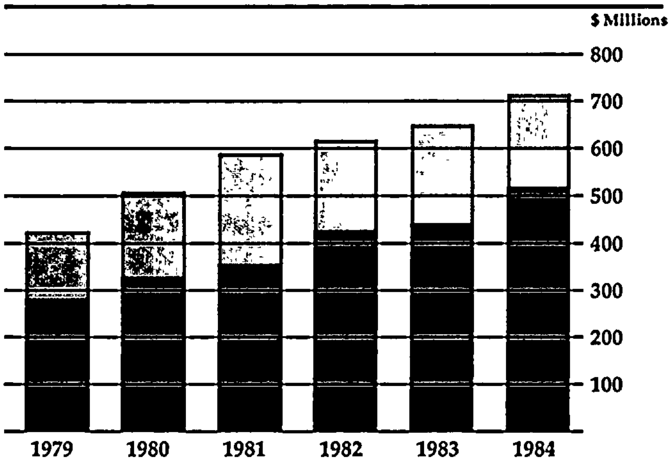
Net Interest Revenue *(fully taxable equivalent basis)*

This discussion of Net Interest Revenue should be read in conjunction with the Average Balances and Interest Rates and Interest Differential Analysis and the Change in Net Interest Revenue-Volume and Rate Analysis on pages 61 through 65. For purposes of this review, income that is either exempt from federal income taxes or taxed at a preferential rate has been adjusted to a fully taxable equivalent basis. The adjustment of income to a fully taxable

Average Earning Assets



Net Interest Revenue *Taxable Equivalent*



equivalent basis has been calculated using a tax ra[illegible] of 52.8%, which is equal to the statutory federal income tax rate adjusted for applicable state and local income taxes net of the related federal tax benefit.

The following table shows an analysis of net interest revenue between United States and International Operations. It also presents the adjustment to reflect net interest revenue on a fully taxable equivalent basis.

	Years Ended December 31		
(in millions)	*1984*	*1983*	*1982*
United States Operations:			
Net interest revenue before provision for uncollectible income	$488.3	$403.0	$384.3
Adjustment of tax-exempt income to a fully taxable equivalent basis	48.7	47.2	67.7
Net interest revenue—fully taxable equivalent basis before provision for uncollectible income	537.0	450.2	452.0
Less: Provision for uncollectible income	24.4	5.4	23.[illegible]
Net interest revenue—fully taxable equivalent basis	512.6	444.8	428.3
International Operations:			
Net interest revenue before provision for uncollectible income	228.5	223.8	207.7
Adjustment of tax-exempt income to a fully taxable equivalent basis	1.7	2.8	
Net interest revenue—fully taxable equivalent basis before provision for uncollectible income	230.2	226.6	207.7
Less: Provision for uncollectible income	22.5	14.9	14.2
Net interest revenue—fully taxable equivalent basis	207.7	211.7	193.5
Consolidated net interest revenue—fully taxable equivalent basis	$720.3	$656.5	$621.8

Compared with 1983

Net Interest Revenue from United States Operations

Net interest revenue from United States Operations improved $67.8 million (15%) compared with 1983. Revenue from Casco as well as a $1.9 billion increase in average loans and lease financing, including Casco, and improved loan fees of $19.9 million (51%), including Casco, were responsible for the rise. These increases were moderated by a higher provision for uncollectible income and narrower spreads.

Casco's net interest revenue for the nine months since acquisition, was $33 million or about one half of the total domestic increase. At year end, Casco's earning assets amounted to $747 million, including outstanding loans and leases of $625 million. Real estate loans and commercial and industrial loans each accounted for approximately one-third, while personal banking amounted to about one-fourth of Casco's total loan portfolio.

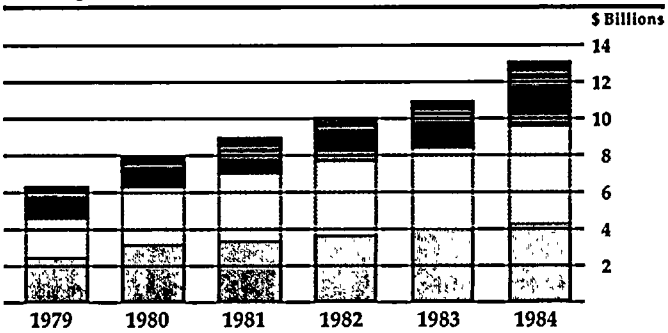
Overall, loan and lease financing volume, which increased 27%, was strongest in the areas of real estate, commercial lending and asset-based financing.

Real estate lending continues to report strong growth as its loan volume increased by over 35%. New construction lending was once again a major reason for this improvement, reflecting strong demand for new loans from existing customers as well as normal advances to complete projects originated in previous years. The increase also reflected the first full year of having SWD as a subsidiary and from the addition of Casco.

Commercial lending benefited from the generally improved economy which brought about increased borrowings by existing customers as well as new business. Some areas, such as the Massachusetts Corporate Lending function which serves the state's small and middle sized businesses, also carried out a more selective and productive marketing effort. This function reached its goal of doubling its volume in 1984.

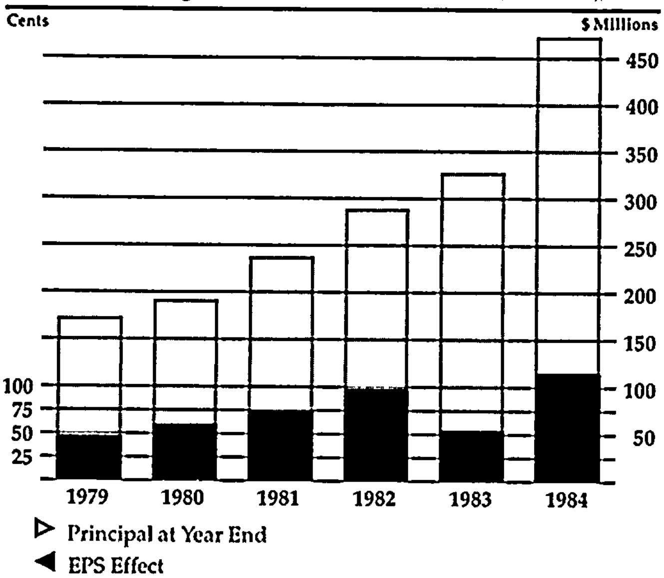
The asset-based financing function specializes in secured financing techniques such as factoring, receivable and inventory financing and chattel mortgage loans. In 1984, because of their knowledge and expertise in these types of financing, this function was able to increase its average loan portfolio by over 50%.

Average Loans and Leases



	1979	1980	1981	1982	1983	1984
United States:						
■ Personal banking	5%	5%	5%	5%	4%	5%
■ Asset-based financing	8	7	6	6	6	7
■ Real estate	9	9	10	12	13	16
□ Commercial lending	39	39	40	40	40	40
□ International	39	40	39	37	37	32

Nonperforming Loans and Leases *And Earnings Per Share Effect*



The increase in loan fees was primarily attributable to higher commercial loan fees of $7 million, commitment fees of $5.2 million and fees from BancBoston Mortgage Corporation of $1.8 million. SWD and Casco added $2.9 million and $1.5 million, respectively.

Moderating the positive effects of loan growth and higher fees was a $19 million increase in the provision for uncollectible income. This rise resulted from a combination of factors including an increase in nonaccrual loans and leases to $244 million at December 31, 1984 from $185 million last year; a higher average base lending rate during the year; and lower recognition of cash previously received and deferred on loans that had been on nonaccrual.

Interest rates, which affect net interest revenue, at the end of 1984 were approximately the same as at the end of 1983, although the average base lending rate rose 126 basis points during 1984. Specifically, the base rate began the year at 11%, where it remained until the end of the first quarter when it increased 50 basis points. In the second quarter, it rose steadily until it reached a high of 13%, a level that was maintained throughout the third quarter. During the fourth quarter, the base rate fell to its year end level of 10.75%.

The effect of movements in the base rate are indicated in changes in average rates on earning assets and interest bearing liabilities. During the first quarter, the yield on earning assets remained constant, but the average cost of funds rose 34 basis points, thus causing narrower spreads that stabilized in the second quarter. Spreads were further constricted in the third quarter as increases in the cost of funds out-paced those for earning assets. In the fourth quarter, spreads increased as the cost of funds dropped faster than yields on earning assets. The average spread for the year decreased to 3.02% from 3.31% for 1983 as the turnabout in the fourth quarter spread was not enough to offset earlier declines. Interest rate margin decreased 30 basis points in 1984, to 4.81% from 5.11%. See page 61 for definitions of interest rate spread and margin.

Interest Revenue from International Operations

Net interest revenue from International Operations decreased $4 million. This decline was the result of a $7.6 million increase in the provision for uncollectible income, reflecting higher interest rates and a $83 million rise in the level of loans and leases on nonaccrual. Net interest revenue before the provision for uncollectible income increased $3.6 million. Average earning assets declined $406 million, primarily because of a $678 million decrease in average interest bearing deposits in other banks reflecting a planned decrease in international placements. This was partially offset by a $235 million increase in average loans and leases.

Net interest revenue from operations in Argentina decreased $16.4 million (37%) from 1983 resulting, in part, from additional governmental regulations which limited local currency loan spreads. Furthermore, the increased level of cross-border nonaccrual loans negatively affected Argentine results by $8.6 million.

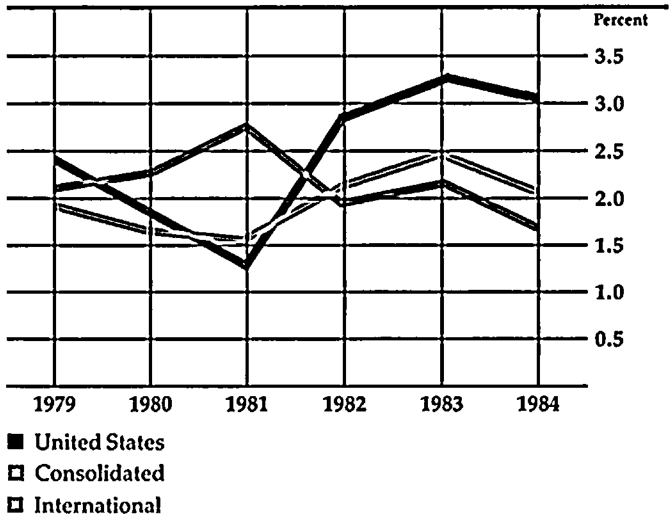
Brazil's net interest revenue was down $2.6 million, or 6%, partly reflecting an increase in the provision for uncollectible income of $1.9 million. As the result of changes in local market conditions, strong momentum and favorable funding actions taken in 1983 did not continue throughout 1984.

Other Latin American operations, on a taxable equivalent basis, recorded an $11.4 million (29%) gain in net interest revenue primarily associated with the favorable effect in 1984 of the Corporation's Nassau-based funding operations with other regions.

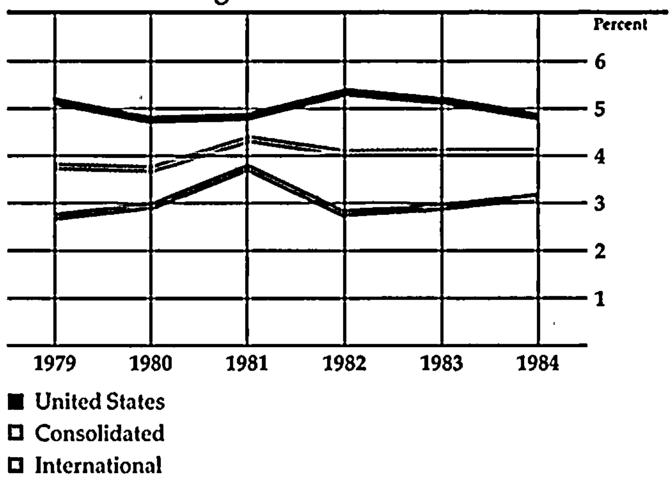
The Corporation's European operations reported a $.6 million increase in net interest revenue over 1983. Improvements were realized in the United Kingdom, primarily due to loan volume, and in the Milan Branch, which concluded its first full year of operations. These were moderated by declines in France as a result of a decrease in inter-bank activity, and in Germany as the favorable spreads of 1983 were unable to be matched in 1984.

Net interest revenue from the Asia/Pacific region was down $1.4 million or 6% in 1984. The Corporation reduced operations in Australia in compliance with governmental restrictions, which caused lower loan volume and reduced net interest revenue. However, these restrictions were lifted in November of 1984, and the Corporation's Australian affiliates are in the process of returning to full operations.

Interest Rate Spread



Interest Rate Margin



Other regions recorded an increase of $4.4 million in net interest revenue. A major contributor to this increase was the growth in volume of Canadian lending operations.

In conjunction with strategic planning goals, the Corporation continues to seek selective expansion in nations where our presence has previously been established. In 1984 a branch office was opened in Turkey and locations were added in Chile, Uruguay and Argentina.

1983 Compared with 1982

Net Interest Revenue from United States Operations

Net interest revenue from United States Operations increased $16.5 million (4%), primarily as a result of a higher volume of loans, a lower provision for uncollectible income and wider spreads. This was moderated by the effects of lower average interest rates in 1983. Average loans and leases increased $690 million. The 11% improvement in loan and lease volume was mainly generated in the areas of real estate and commercial lending.

Real estate lending showed strong growth with a loan volume increase of over 30%. This expansion was primarily the result of major increases in the construction loan portfolio reflecting active development of customers in Massachusetts and the regional offices across the country. The Corporation's mortgage banking subsidiaries also played an important role. Loan volume of Mortgage Corporation of the South increased substantially. The acquisition of SWD in 1983, added an average of more than $60 million to total loans.

Commercial lending volume reflects diversification in both a wide range of industries and in geographic locations. The Corporation's offices throughout the nation offer expertise to customers in such fields as high technology, communications, entertainment and insurance. Also, this expertise extends to the ability to offer customers a variety of financing packages. A 9% improvement in commercial lending was mainly because of expanded marketing efforts and increased borrowings by existing customers.

Net interest revenue also benefited from a decrease of $18.3 million in the provision for uncollectible income. This decline resulted from a lower average base lending rate as well as greater recognition of cash previously received and deferred on loans that had been on nonaccrual. The level of domestic nonaccrual loans rose slightly in 1983.

Finally, net interest revenue was helped by wider spreads. Interest rates remained relatively stable throughout 1983; however, average interest rates were significantly lower than in 1982. Specifically, the base lending rate began the year at 11.5%, dropped to 10.5% at the end of February and remained at that level until early August, when it rose to the year-end level of 11%. The average base rate decreased approximately 400 basis points compared with 1982. Cost of funds were in the 9% to 10% range throughout 1983, a decline of about 275 basis points from the prior year. However, average interest rate spread rose 40 basis points from 2.91% in 1982 to 3.31% in 1983 as the decline in the yield on earning assets was exceeded by a greater reduction in the cost of funds. The lower interest rate environment resulted in a 22 basis point decline in average interest rate margin as the relative value of free funds declined.

Net Interest Revenue from International Operations

International net interest revenue rose more than 9% when comparing 1983 with 1982. This $18.2 million improvement was derived from nearly all regions where the Corporation conducted business and reflected an increase in average earning assets of $232 million (3%) and an increase in the interest rate margin of 17 basis points.

Argentina's net interest revenue declined $5.4 million (11%), stemming from restricted volume growth and narrower spreads that affected the banking industry in that country in general.

Net interest revenue from Brazil improved $9.9 million (28%). This increase was attributable to a higher volume of loan activity and improved spreads resulting from favorable positions taken in Brazil's money markets.

Other Latin American operations, on a taxable equivalent basis, recorded a $5.4 million (16%) gain in net interest revenue. In addition to new aircraft leasing activity in Mexico and the Caribbean, operating conditions in Chile were favorable, resulting in higher earning assets and wider spreads.

In Europe, the increase of $5.4 million (12%) was the result of greater loan volume and lower funding costs in Germany and United Kingdom.

The Asia/Pacific region experienced a 16% increase from $19.6 million in 1982 to $22.7 million in 1983, as the operations in Australia, Taiwan and Korea turned in favorable results.

During 1983, new branches were established in Italy and Curacao (Netherlands Antilles) and additional locations were added to our existing networks in Chile, Panama, Paraguay and Uruguay. Also, a new representative office was opened in Bahrain.

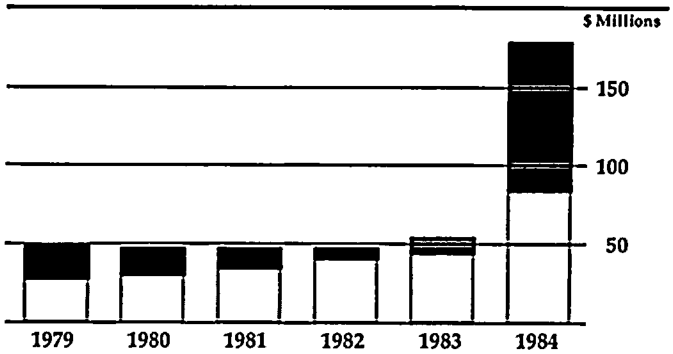
Provision for Credit Losses

The 1984 provision for credit losses was $180 million, including the $100 million special provision, as compared with $54 million in 1983. The increase reflects the higher level of 1984 net charge-offs and the Corporation's concern, shared with growing segments of the banking industry, about general worldwide economic conditions. These charge-offs, together with the additional provision for credit losses, are in line with the Corporation's aggressive charge-off policy and conservative approach to the credit loss reserve.

The consolidated reserve for credit losses as a percentage of loans and lease financing was 1.66% at December 31, 1984, up from 1.14% last year. The special provision for credit losses was allocated to United States and International Operations on the basis of their respective outstanding loan balances. In United States Operations, the reserve was 1.49% at year-end 1984, an increase from last year's 1.03%. The International portion of the reserve was 2.08% for 1984, up from 1.33% a year ago. The changes in the total provision allocated to United States Operations and International Operations also reflect changes in the amounts of net credit losses. Net credit losses in the U.S. were $45.3 million compared with $22.5 million last year. Internationally, these losses increased to $34.7 million this year from $21.7 million in 1983. The increases in net credit losses were caused by the sharp deterioration during the fourth quarter of a limited number of loans in both the domestic and international portfolios.

The Corporation's aggressive charge-off policy is reflected in the relatively high ratios of charge-offs and recoveries. Consolidated net credit losses as a percentage of average loans and lease financing was .61% in 1984, up from .40% in 1983. The Corporation's recoveries as compared with credit losses decreased to 24%, as compared with 28% a year ago, as the rise in credit losses outpaced the increase in recoveries. Over the last five years, however, this ratio has approximated 30%.

Provision for Credit Losses *And Net Credit Losses*



	1979	1980	1981	1982	1983	1984
■ Provision for Credit Losses						
United States	67%	33%	55%	23%	42%	62%
International	33	67	45	77	58	38
□ Net Credit Losses						
United States	73	36	53	26	51	57
International	27	64	47	74	49	43

Other Operating Income and Expense

Other important sources of income for the Corporation, in addition to interest-bearing activities, are its wide range of fee-based services and its global participation in financial markets. To remain competitive, these services require specialized personnel and equipment that generate related expenses.

Other Operating Income:

1984	*1983*	*1982*
$479.8 million	$266.0 million	$227.7 million

Other operating income excluding the building sale gain and the write down of mortgages held for sale, increased 20% to $318.7 million in 1984. On the same basis, other operating income was 31% of the total of net interest income and other operating income as compared with 29% and 27% for the two previous years. The rising percentage is an indication of the importance of fee-generating activities as a source of income for the Corporation.

Gain on Sale of Building:

On December 31, 1984, the Bank sold its headquarters building in Boston for $363 million. This resulted in a gain of $295 million, of which $177 million, or $105 million after tax, was recognized in 1984's income. The additional amount of $118 million was required to be deferred and amortized over the initial terms of the lease agreement. For additional details on this transaction, see Financial Statement Footnote 8.

Financial Service Fees:

1984	*1983*	*1982*
$161.8 million	$125.0 million	$100.7 million

The Corporation provides a number of services such as: letter of credit and acceptance financing; freight payment processing; payroll preparation and other data processing activities; factoring and mortgage servicing; and maintenance of demand deposits along with various other services. The fees and commissions earned from these activities comprise financial service fees. In the past three years, these fees have accounted for approximately one-half of total other operating income (not including the gain on the building sale in 1984 as mentioned previously).

Domestic increases in 1984 were primarily attributable to higher demand deposit fees of $7.3 million, mortgage servicing fees of $3.5 million, factoring fees of $3.2 million and letter of credit commissions of $2.8 million. Internationally, the Argentine branch contributed $6.8 million to the increase, as a result of a greater demand for documentary letters of credit and acceptances, as well as by offering new services, such as cash management.

Mortgage servicing fees contributed $14 million to the increase in 1983, reflecting the acquisition of SWD in July of that year. Additionally, domestic increases in letters of credit, demand deposit and factoring fees added $10.2 million to the 1983 improvement.

Trust and Agency Fees:

1984	*1983*	*1982*
$71.3 million	$59.5 million	$51.9 million

To service a broad range of both private and corporate customers, the Corporation offers its expertise in a variety of activities generating trust and agency fees. These services include managing personal trusts and estates, administering pension and profit-sharing plans, managing endowments, servicing mutual funds, and acting as a securities transfer agent or registrar.

The greater value of assets held in 1984 was responsible for the higher fees earned from the management of personal trusts of $2.9 million and corporate trusts of $2.1 million. Additionally, the 1984 acquisition of Casco contributed $1.7 million. Higher fees in both personal trusts, as well as custody and operational fees, increased the income of 1983.

In 1984, price increases and TEFRA related special work performed by the stock transfer department accounted for $2.3 million of the total $5.1 million improvement in mutual fund and stock transfer services fees. These accounts increased $3.8 million in 1983, which resulted from a higher volume of business.

Trading Account Profits and Commissions:

1984	*1983*	*1982*
$7.2 million	$9.8 million	$14.5 million

The Corporation is very active in worldwide money markets, as both an issuer and a dealer. Income is earned through the net gains and commissions on the sale of securites from our dealer portfolios. Interest rate and related price changes in the securities markets are primarily responsible for fluctuations which occur.

decline in 1984 reflects the upward trend in domestic interest rates in the first half of the year. Also, a $5.6 million decline was reported in the trading account of Brazil, which was caused by both the absence of revaluation gains that were recorded in 1983, as well as the effects of market declines on the trading portfolio during 1984.

Domestic interest rates stabilized in 1983, reducing trading account profits to a level more in line with previous years. The establishment of the Brazilian trading account, which reported profits of more than $3 million, moderated the decrease in the domestic income.

Investment Portfolio Gains (Losses):

1984	*1983*	*1982*
$(.5) million	$3.9 million	$(11.2) million

This category consists of pre-tax gains and losses from the sale of securities held in our investment portfolio.

The net loss in 1984 was mainly the result of losses incurred on the sale of U.S. Treasury securities being greater than the gains recorded on the sale of equity securities. In 1983, gains were recorded from the sale of equity securities and other securities held by overseas offices. These gains were partially offset by a loss on the liquidation of the Bank's state and municipal securities portfolio.

Other Income:

1984	*1983*	*1982*
$62.8 million	$67.8 million	$71.8 million

Other income consists of various fees and commissions earned on foreign exchange activity, credit card services and sales of various securities as well as income from other sources. For further details see Financial Statement Footnote 14.

In 1984 other income was down $5 million as a result of a $16 million loss recorded in connection with the Corporation's decision to sell approximately $150 million of its fixed rate mortgages. Also contributing to the decrease was the absence of 1983's $12.2 million gains from the sale of Commodore Corporation warrants and sales of various securities by venture capital subsidiaries. These factors were partially offset by higher credit card and other fees of $11.1 million and lower net translation/hedge losses of $6.3 million.

In 1983, net translation/hedge losses were $6.9 million greater than in 1982 and losses relating to the sale of mortgages were $4.9 million. Partially offsetting these declines, was the gain on the sale of Commodore Corporation warrants and venture capital securities of $12.2 million.

Other Operating Expense:

1984	*1983*	*1982*
$722.3 million	$595.2 million	$549.2 million

Other operating expense rose 21% in 1984 as compared with 8% in 1983. Substantial increases were reported in all categories with the exception of employee benefits. The acquisitions of Casco and SWD were major contributors to these increases.

The Corporation is a service-oriented business which requires a relatively high number of employees to perform these services. Thus, it is expected that salaries and employee benefit costs would be the largest components of total other operating expense.

Domestic salaries were up 22% and 14% in 1984 and 1983, respectively. These increases reflect additional staff, primarily from the acquisitions of Casco and SWD as well as merit and promotional increases for existing staff. Salaries for overseas employees rose 12% in 1984 and declined 3% in 1983. The Argentine government policy of mandating salary increases to keep pace with that country's inflation was primarily responsible for the rise in 1984. The decrease in 1983 resulted from the effect of devaluation in certain Latin American countries more than offsetting increases in normal annual compensation.

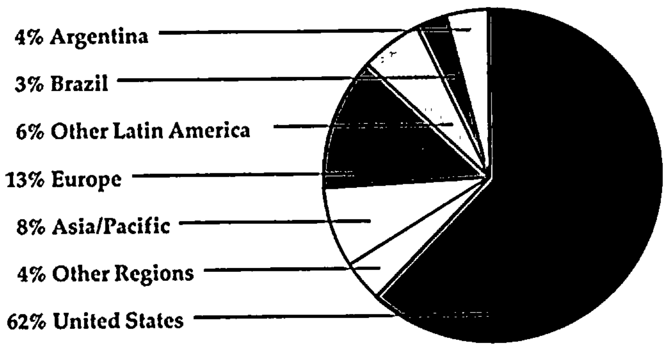
The total number of employees grew 8% in 1984 and 12% in 1983. At year end, total employees were:

1984	*1983*	*1982*
16,000	14,800	13,200

In past years, employee benefit costs have generally risen similarly to salaries, as many of these benefits are directly related to salary levels or the number of employees. However, in 1984, even though salaries and the total number of employees were up, benefit costs remained at about 1983 levels. This resulted principally from reduced thrift-incentive costs, which are a function of the level of earnings from normal operations, and revisions to certain other benefit plans.

Equipment expense was higher in 1984 by $14.8 million. The domestic increase included depreciation expense of $5.1 million and repairs and maintenance

Geographic Distribution of Average Assets



of $1 million, as well as $2.9 million and $1.5 million from the additions of Casco and SWD, respectively.

Other non-interest expenses included a special $5 million contribution to the Corporation's charitable foundation, as well as charges of about $5 million associated with current strategic planning initiatives. Footnote 17 to the Financial Statements further details other non-interest expenses which have risen with the Corporation's need to support expanded operations, and with generally increased prices for goods and services.

Income Taxes

Provision for Income Taxes:

1984	*1983*	*1982*
$83.4 million	$87.5 million	$60.2 million

The effective tax rate in 1984 was 34%, down from 39% in 1983 and up from 33% in 1982. The decreased effective tax rate in 1984 was the result of applying the lower capital gains tax rate to the gain on the sale of the Corporation's headquarters building. The higher effective tax rate in 1983 reflected a reduction in the ratio of tax-exempt to taxable income. The Corporation's decision early 1983 to substantially reduce its holdings of tax-exempt assets was the reason for the reduction in tax-exempt income in that year. Financial Statement Footnote 11 contains additional information with respect to the Corporation's income taxes.

Financial Condition

Liquidity

It is the Corporation's objective to meet at a reasonable cost its cash needs, which arise primarily from new or additional loans and leases, the maturing of liabilities used to fund assets and the withdrawal of deposits. Liquidity management requires the ability to obtain funds for various terms.

As the Geographic Distribution of Average Assets chart indicates, United States Operations accounted for 62% of total assets while International's asset base is diversified to many parts of the world. It is also the Corporation's objective to fund assets to the maximum extent possible with liabilities in the same currency so as to reduce transfer risk exposure.

The Corporation's need for funds has increased, as is depicted in the Average Total Assets Distribution chart, at a five year annual compound growth rate of 10%. This chart also shows that the greatest use of funds was for loans, which grew 19% from 1983 and

[illegible] more than doubled in the past six years. Indicative of the liquidity of the loan portfolio, the percentage of total loans maturing in one year or less was about 60% at December 31, 1984.

Funds obtained to support asset growth are detailed in the Average Total Sources of Funds chart. This chart indicates interest bearing funds, which rose 10% in 1984 from 1983, to be the major source. Interest bearing deposits, with a five year compound growth rate of 12%, have remained a stable source of funds. Money market deposit accounts (First Rate Accounts) have been an important source of funds, totalling $2.2 billion and $1.2 billion at the end of 1984 and 1983, respectively. These funds are used as a substitute for certificates of deposits and are considered more stable. In order to secure funds at the lowest possible cost, the Corporation maintains ready access to both Domestic and International markets.

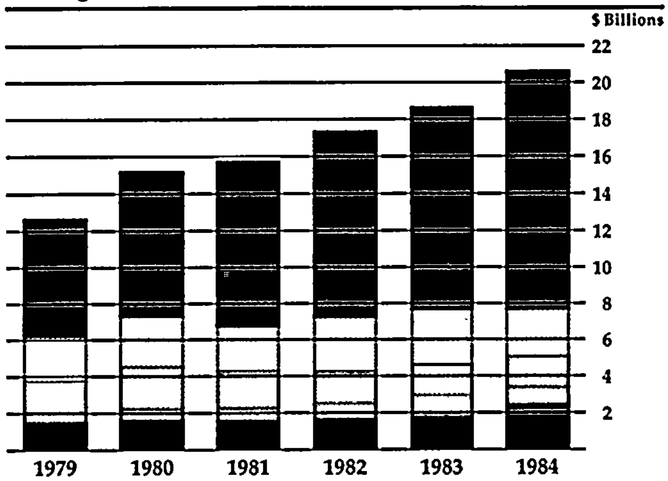
The Corporation possesses an excellent reputation in the worldwide money markets, thus enhancing its ability to obtain funds. The Corporation continues to be an active dealer in bank and government obligations and an issuer of repurchase agreements, Eurodollar notes, commercial paper and other money market instruments. A worldwide branch network gives the Corporation a 24-hour a day trading presence in the various international funding markets such as Boston, New York, London, Singapore and Hong Kong. Should it be necessary to add funds rapidly, sufficient residual capacity remains in these markets to meet funding needs.

Managing Interest Rate Risk

Interest rates fluctuated more in 1984 than in 1983 but not with the volatility that characterized the 1980-1982 period. Thus, as it has been in past years, flexibility in the management of interest rate risk was very important to the profitability of the Corporation.

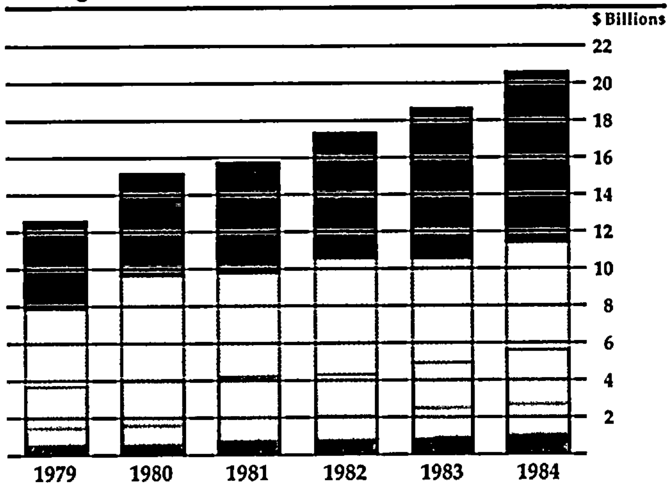
Interest rate risk arises when an asset matures or when its rate of interest changes in a time frame different from that of the supporting liability. For the most part, the Corporation does not match each of its assets with specific liabilities, however, the aggregate of all its assets and liabilities is used to determine overall interest rate risk within several specific time frames. This interest rate risk is referred to as the "interest sensitivity gap", and is essentially the difference between the amount of interest-sensitive assets and interest-sensitive liabilities maturing during a specific time frame. A "positive" gap results when the amount of interest-

Average Total Assets Distribution



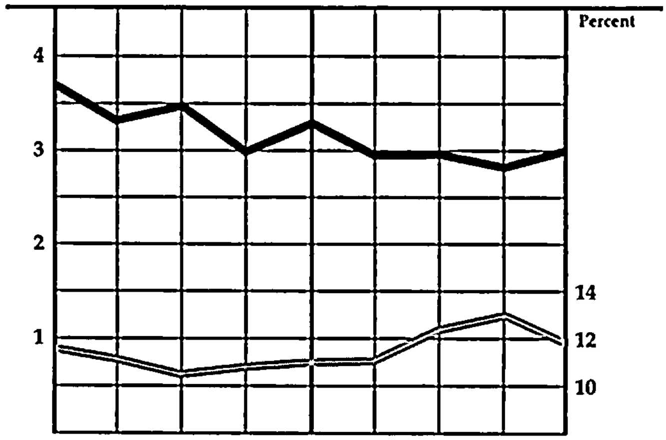
	1979	1980	1981	1982	1983	1984
■ Loans and Lease Financing	51%	52%	57%	58%	59%	63%
□ Interest Bearing Deposits in Other Banks	18	18	15	17	16	12
□ Investment Securities and Other Earning Assets	14	15	13	10	9	8
□ Acceptances	4	4	4	5	6	5
■ Other Assets	13	11	11	10	10	12

Average Total Sources of Funds

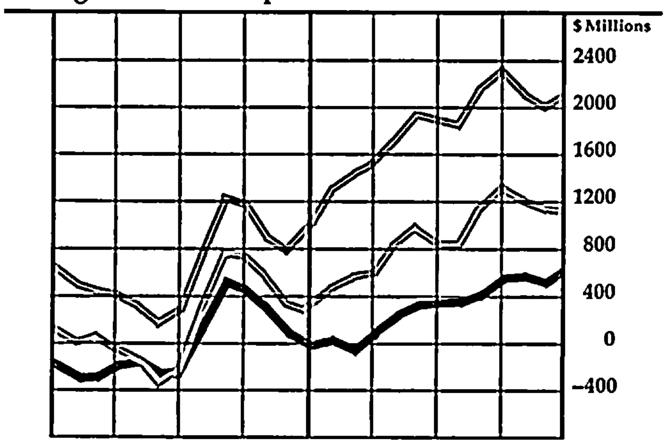


	1979	1980	1981	1982	1983	1984
■ Interest Bearing Deposits	38%	37%	38%	39%	44%	45%
□ Money Market Funds and Other Borrowings	32	36	35	35	29	28
□ Non-Interest Bearing Deposits	18	16	15	13	13	14
□ Acceptances and Other Liabilities	7	7	7	8	9	8
■ Stockholders' Equity	5	4	5	5	5	5

Domestic Spread and Base Rate *Quarterly Averages*



Average Domestic Gap



Note: Interest sensitivity gap analysis has limitations and should therefore be used with great caution. Gap analysis is only one of several factors considered when assessing the effect of interest rate changes on net interest revenue. Specifically, changes in interest rates do not affect all categories of assets and liabilities equally or simultaneously. Furthermore, the gap position at any one specific time can be quickly and significantly changed by management as conditions dictate. Also, the replacement of maturing assets and liabilities can have opposite affects on net interest revenue and gap position; for example, while the present trend of interest rates may be downward, the current level may still be high. If medium-term debt that was originally issued during a period of low rates is renewed at a higher level, net interest revenue will be adversely affected despite the fact that the gap position may be negative.

sensitive assets exceeds that of interest-sensitive liabilities; a "negative" gap results when the amount of interest-sensitive liabilities exceeds that of interest-sensitive assets.

Management uses gap analysis to monitor the potential effect of rate changes on net interest revenue. While the Corporation monitors a number of gap positions in managing interest rate risk, particular attention is paid to the cumulative ninety day gap. Ninety days is believed to be the optimal period to exercise control of interest rate risk. Ninety days is long enough to allow an ordered restructuring of asset and liability positions and short enough to allow those actions to positively affect current performance in a changing rate environment.

The Corporation has sought to maintain flexibility in its gap positions in order to take advantage of both short-term and long-term changes in market rates. This flexibility has also been accomplished, in part, by maintaining short-term maturities in a portion of the Corporation's assets and liabilities, including the relatively short average maturity of its fixed-rate U.S. Treasury securities, currently less than one year.

The accompanying charts, which plot the domestic interest rate spread and the average base lending rate, and the domestic average gap positions, show the relationship between interest rates and the gap positions taken at the Corporation's Boston headquarters in anticipation of changes in rates for the last two years.

At the end of 1983, the cumulative ninety day gap was in a small positive position, thus allowing quick movement in either direction depending on market indications. In the first quarter of 1984, interest rates began to rise and, accordingly, the positive gap position was increased. This move was accomplished by liquidating portions of the fixed-rate U.S. Government securities portfolio. The average interest rate spread narrowed as the cost of funds rose while the average base lending rate was relatively flat.

During the second and third quarters, the average gap was moved into a more positive position as interest rates continued to increase. Spreads declined only slightly as increases in the base rate kept pace with the higher cost of funds.

In the early part of the fourth quarter, interest rates began to decline and movement was made to bring the gap into a smaller positive position. This reversal in the cumulative ninety day gap position will continue during the beginning of 1985, as long as there are no indications that domestic interest rates will begin to rise again.

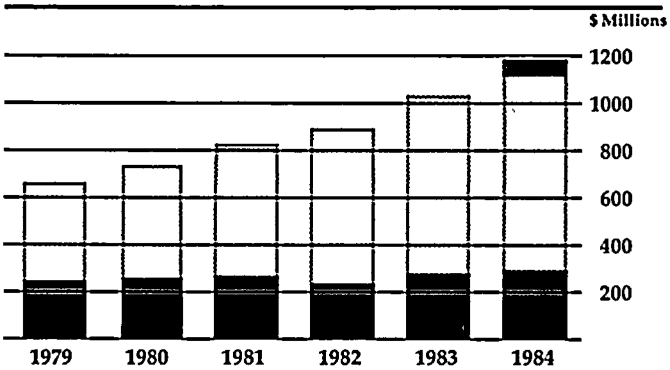
This table presents the interest sensitivity gap analysis at year-end for the Corporation's operations located at its Boston headquarters and for its Massachusetts banking affiliates. The gap positions of the Corporation's overseas operations are monitored for compliance with overall corporate objectives and policies that limit the size of international gap positions. At December 31, 1984, the overseas dollar position had a negative ninety day cumulative gap of about $170 million.

Interest Sensitivity Gap Analysis at December 31, 1984

	Interest Sensitivity Period(1)					
(in millions)	*One Day*	*2-30 Days*	*31-90 Days*	*91-365 Days*	*Over One Year*	*Total*
Earning Assets:						
Loans and lease financing	$5,081	$1,487	$ 658	$ 853	$1,669	$ 9,748
U.S. Treasury securities			6	366	68	440
All other	463	127	38	8	139	775
Total earning assets	5,544	1,614	702	1,227	1,876	10,963
Interest Bearing Liabilities:						
Federal funds and repurchase agreements	1,099	447	138	44		1,728
Certificates of deposit, commercial paper and notes payable	1	1,674	459	162	428	2,724
All other	20	2,603	283	461	814	4,181
Total interest bearing liabilities	1,120	4,724	880	667	1,242	8,633
Non-interest bearing funds	503				1,827	2,330
Interest sensitivity gap	$3,921	(3,110)	(178)	560	(1,193)	$ 0
Cumulative interest sensitivity gap		$ 811	$ 633	$1,193	$ 0	

(1) For the analysis, deposits have been included after deducting applicable reserve requirements. Allocations to specific interest sensitivity periods are based primarily on contractual maturities. The most notable exception is non-interest bearing funds, primarily demand deposits that can be withdrawn without notice. These have been allocated on the following basis: the estimated core level of non-interest bearing funds has been allocated to the over one year period; the difference between the actual non-interest bearing funds at December 31, 1984, and the core level has been allocated to the one day interest sensitivity period.

Stockholders' Equity *At Year End*



Capital Resources

Strong capitalization has always been a primary objective of management and the Corporation has long been a leader among its peers in comparisons of capital ratios. During 1983, the bank regulatory agencies established a 5% minimum capitalization guideline and late in 1984, they proposed new guidelines which when issued will raise the minimum primary capital ratio to 5.5% and clarify the components of this ratio. Under current rules, the Corporation's primary capital ratio was 6.87% at the end of 1984 and 5.85% at the end of 1983; and for the Bank it was 6.13% and 5.03% at the end of 1984 and 1983, respectively.

In February 1984 the Corporation issued $100 million of floating-rate subordinated "equity commitment" notes due in 1996. These notes, because of a commitment to issue an equal amount of equity over the life of the notes, are considered as primary capital for regulatory capital adequacy purposes. The Corporation expects to meet this commitment entirely through its dividend reinvestment and employee benefit plans. At December 31, the amount of notes considered as primary capital was $90 million, the difference bei the common stock issued since February 1984.

Other transactions in 1984 that enhanced the capital adequacy ratio were the issuance of preferred stock, the sale of the Bank's headquarters building and the $100 million special addition to the reserve for possible credit losses. The preferred stock, which accounts for 4% of total stockholders' equity, was issued in March for the acquisition of Casco and added $52 million to stockholders' equity. Also, the building sale together with the increase in the reserve for credit losses raised primary capital by $158 million.

The Corporation's strong capital base, which is depicted in the Stockholders' Equity chart, was primarily increased through the retention of earnings: In 1984 the percentage of retained earnings was 70% as compared with 71% in 1983. Another measure of capital strength is leverage, total assets to stockholders' equity. At December 31, 1984, this ratio was 18.62, an improvement from 19.40 at

year-end 1983. This decrease is consistent with management's goal of growth without relying on ever-increasing leverage. The Corporation's ability to support asset growth through earnings is also reflected in the internal growth rate, or return on common equity times the percentage of earnings retained, which was 10.63% in 1984 and 10.21% in 1983.

Total return to common stockholders grew over the past five years at an annual compound rate of 26.58%. This return is the sum of a 10.82% growth rate in common dividends declared plus a 15.76% appreciation in the market price of common stock.

The Corporation's dividend reinvestment and common stock purchase plan continued to contribute to the growth of its capital base. In 1984, proceeds were approximately 24% of common dividends paid, up from 18% last year. This plan not only provides a source of capital for the Corporation but it is also an economical and convenient method for stockholders to increase their investment in the Corporation.

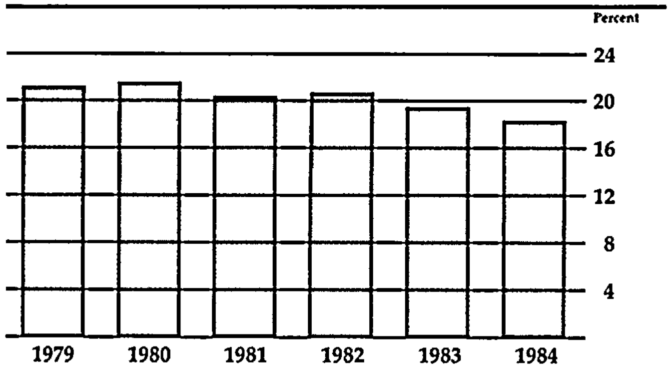
Shares reissued from treasury in 1984 added $4.4 million to the Corporation's capital, while in 1983 they contributed $9 million. These shares were purchased in 1982, at an average price of approximately $23 while the average reissued price approximated $34 in 1984 and $37 in 1983.

Adversely affecting the capital base was the effect of exchange-rate fluctuations on the net assets of certain foreign units. The cumulative effect of translation adjustments reduced capital by $6.3 million at December 31, 1984, of which $2.1 million occurred in 1984. These fluctuations are often temporary, and are excluded from the income statement until realized.

Effects of Inflation and Changing Prices

The discussion of the impact of inflation and changing prices on the Corporation's performance, and the information required by Statement of Financial Accounting Standards No. 33, Financial Reporting and Changing Prices, is presented on pages 80 and 81 of this report.

Leverage *Year-End Assets to Equity*



BANK OF BOSTON CORPORATION
100 FEDERAL STREET · BOSTON · MASSACHUSETTS 02110

Report of Management

The accompanying financial statements of Bank of Boston Corporation have been prepared by management, which is responsible for their integrity. The statements have been prepared in conformity with generally accepted accounting principles appropriate in the circumstances, and necessarily include some amounts that are based on management's judgment.

Bank of Boston Corporation maintains a system of internal accounting control designed to provide reasonable assurance that assets are safeguarded against loss from unauthorized use; that transactions are executed in accordance with management's authorizations; and that the financial records are adequate and reliable for the preparation of financial statements. The concept of reasonable assurance is based on the recognition that the cost of a system of internal control must not exceed the related benefits. The system in use is supported by written policies and procedures that are communicated to the Corporation's operating units worldwide. Adherence to these policies and procedures is monitored by management and evaluated by a coordinated audit effort of the internal audit staff and independent certified public accountants.

The Audit Committee of the Board of Directors, composed solely of outside directors, meets periodically with the Corporation's management, internal auditors and independent certified public accountants to review matters relating to the quality of financial reporting and internal accounting control and the nature, extent and results of the audit effort. The independent certified public accountants and internal auditors have direct access to the Audit Committee, with or without management present.

The accompanying financial statements have been examined by Coopers & Lybrand, independent certified public accountants. Their examinations include a study and evaluation of the Corporation's system of internal accounting control as required by generally accepted auditing standards. Under these standards, the purpose of such evaluations is to establish a basis for reliance on the system of internal accounting control in determining the nature, timing and extent of other auditing procedures required to support their opinion on the financial statements.

WILLIAM L. BROWN
Chairman of the Board

IRA STEPANIAN
President

ALAN L. MCKINNON
Executive Vice President
Comptroller and Treasurer

Coopers
&Lybrand

certified public accountants

The Board of Directors and Stockholders
Bank of Boston Corporation:

We have examined the consolidated and parent company balance sheets of Bank of Boston Corporation as of December 31, 1984 and 1983, and the related consolidated and parent company statements of income, changes in stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 1984. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated and parent company financial position of Bank of Boston Corporation as of December 31, 1984 and 1983, and the consolidated and parent company results of operations and changes in consolidated and parent company financial position for each of the three years in the period ended December 31, 1984, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Boston, Massachusetts
January 21, 1985

BANK OF BOSTON CORPORATION

Consolidated Balance Sheet

(in thousands, except share amounts)		*December 31* 1984	1983
Assets	Cash and due from banks (Note 2)	$ 1,793,257	$ 1,479,367
	Interest bearing deposits in other banks	2,131,243	2,456,064
	Federal funds sold and securities purchased under agreements to resell	495,353	115,425
	Trading account securities (market value of $222,000 in 1984 and $191,800 in 1983)	221,565	190,073
	Investment securities (Note 3):		
	U.S. Treasury	506,983	755,529
	Other	459,835	442,741
	Total investment securities (market value of $1,011,000 in 1984 and $1,240,000 in 1983)	966,818	1,198,270
	Loans and lease financing (net of unearned income of $199,030 in 1984 and $217,960 in 1983) (Notes 4 and 5)	14,588,515	11,895,923
	Reserve for possible credit losses (Note 6)	(242,384)	(135,842)
		14,346,131	11,760,081
	Premises and equipment (Note 8)	318,207	325,155
	Due from customers on acceptances	1,035,612	1,305,884
	Accrued interest receivable (Note 5)	289,039	275,265
	Other assets (Note 9)	481,594	432,798
	Total Assets	$22,078,819	$19,538,382
Liabilities and Stockholders' Equity	Deposits:		
	Domestic offices:		
	Non-interest bearing	$ 3,358,506	$ 2,488,141
	Interest bearing	5,853,753	3,46[illegible]
	Overseas offices:		
	Non-interest bearing	368,567	32[illegible]
	Interest bearing	5,677,440	6,110,357
	Total deposits	15,258,266	12,380,924
	Funds borrowed (Note 10)	3,415,766	3,981,314
	Acceptances outstanding	1,044,937	1,307,032
	Accrued and deferred income taxes (Note 11)	110,383	113,645
	Accrued expenses and other liabilities (Note 8)	639,673	448,115
	Notes payable (Note 12)	424,350	300,000
	Total Liabilities	20,893,375	18,531,030
	Commitments and contingencies (Notes 19, 20 and 21)		
	Stockholders' equity (Notes 7, 13, 16 and 21):		
	Preferred stock without par value:		
	Authorized—10,000,000 shares		
	Issued and outstanding:		
	Series A—1,045,712 shares	52,286	
	Common stock, par value $4.50:		
	Authorized—40,000,000 shares		
	Issued—19,440,807 shares	87,484	87,484
	Surplus	201,323	196,958
	Retained earnings	854,208	739,085
	Treasury stock, at cost—154,124 shares in 1984; 526,938 shares in 1983	(3,510)	(11,965)
	Cumulative translation adjustments	(6,347)	(4,210)
	Total Stockholders' Equity	1,185,444	1,00[illegible]
	Total Liabilities and Stockholders' Equity	$22,078,819	$19,538,382

The accompanying notes are an integral part of these financial statements.

BANK OF BOSTON CORPORATION

Consolidated Statement of Income

(In thousands, except share amounts)		*Years Ended December 31* 1984	1983	1982
Interest income:	Loans and lease financing, including fees (Note 5)	$2,253,128	$1,757,446	$1,857,692
	Investment securities	136,421	145,877	175,733
	Trading account securities	78,985	67,364	32,494
	Federal funds sold and securities purchased under agreements to resell	106,086	73,736	48,145
	Deposits with banks	347,804	288,841	392,267
	Total interest income	2,922,424	2,333,264	2,506,331
Interest expense:	Deposits of domestic offices	450,917	284,949	369,805
	Deposits of overseas offices	1,025,401	747,824	935,756
	Funds borrowed	729,964	660,280	614,351
	Notes payable	46,210	33,760	32,294
	Total interest expense	2,252,492	1,726,813	1,952,206
	Net interest revenue	669,932	606,451	554,125
	Provision for credit losses (Note 6)	180,000	54,000	48,000
	Net interest revenue after provision for credit losses	489,932	552,451	506,125
Other operating income:	Financial service fees	161,802	125,011	100,743
	Trust and agency fees	71,317	59,470	51,898
	Trading account profits and commissions	7,240	9,806	14,478
	Investment portfolio gains (losses) (Note 11)	(497)	3,891	(11,245)
	Gain on sale of headquarters building (Note 8)	177,128		
	Other income (Note 14)	62,812	67,823	71,812
	Total other operating income	479,802	266,001	227,686
Other operating expense:	Salaries	309,878	258,772	236,632
	Employee benefits (Note 15)	74,690	70,215	66,188
	Occupancy expense	54,038	42,930	40,307
	Equipment expense	57,009	42,240	37,544
	Other expense (Note 17)	226,665	181,054	168,518
	Total other operating expense	722,280	595,211	549,189
	Income before income taxes	247,454	223,241	184,622
	Provision for income taxes (Note 11)	83,400	87,505	60,221
	Net Income	$ 164,054	$ 135,736	$ 124,401
	Preferred dividends	$ 4,350		
	Net income applicable to common stock	$ 159,704	$ 135,736	$ 124,401
	Per common share:			
	Net income	$ 8.35	$ 7.40	$ 6.67
	Dividends declared	$ 2.34	$ 2.17	$ 1.97
	Average common shares outstanding	19,117,167	18,349,634	18,660,785

The accompanying notes are an integral part of these financial statements.

BANK OF BOSTON CORPORATION

Consolidated and Parent Company Statement of Changes in Stockholders' Equity

(in thousands, except share amounts)	*Three Years Ended December 31, 1984* Preferred Stock	Common Stock	Surplus	Retained Earnings	Treasury Stock, at cost	Cumulative Translation Adjustments	Total
Balance, December 31, 1981		$79,467	$185,407	$555,658			$ 820,532
Adjustment at January 1, 1982 for foreign currency translation (net of tax benefit of $188)						$ (340)	(340)
Common shares issued in connection with:							
Stock split—6,377,329 shares		6,377	(6,377)				
Dividend reinvestment and stock purchase plan—261,009 shares		1,245	5,846				7,091
Net income—1982				124,401			124,401
Dividends declared				(36,675)			(36,675)
Treasury stock purchased—1,200,000 shares					$(27,715)		(27,715)
Translation adjustments, net of tax						(3,220)	(3,220)
Balance, December 31, 1982		87,089	184,876	643,384	(27,715)	(3,560)	884,074
Common shares issued in connection with:							
Acquisitions—501,288 shares			6,621		11,739		18,360
Dividend reinvestment and stock purchase plan—191,380 shares		395	4,402		2,422		7[illegible]
Employee benefit plans—68,175 shares			1,059		1,589		2,648
Net income—1983				135,736			135,736
Dividends declared				(40,035)			(40,035)
Translation adjustments, net of tax						(650)	(650)
Balance, December 31, 1983		87,484	196,958	739,085	(11,965)	(4,210)	1,007,352
Preferred shares issued in connection with acquisition—1,045,712 shares	$52,286						52,286
Common shares issued in connection with:							
Dividend reinvestment and stock purchase plan—292,829 shares			3,339		6,640		9,979
Employee benefit plans—79,985 shares			1,026		1,815		2,841
Net income—1984				164,054			164,054
Dividends declared:							
Preferred stock				(4,131)			(4,131)
Common stock				(44,800)			(44,800)
Translation adjustments, net of tax						(2,137)	(2,137)
Balance, December 31, 1984	$52,286	$87,484	$201,323	$854,208	$ (3,510)	$(6,347)	$1,185,444

The accompanying notes are an integral part of these financial statements.

BANK OF BOSTON CORPORATION

Consolidated Statement of Changes in Financial Position

(in thousands)		Years Ended December 31 1984	1983	1982
Funds were provided from:	Net income	$ 164,054	$ 135,736	$ 124,401
	Non-cash charges (credits) included in net income:			
	Provision for credit losses	180,000	54,000	48,000
	Depreciation and amortization	40,293	32,290	24,095
	Deferred income taxes	(20,835)	15,808	(8,762)
	Funds provided from operations	363,512	237,834	187,734
	Increase in:			
	Deposits	2,877,342	706,428	654,588
	Funds borrowed		20,187	538,908
	Acceptances outstanding		393,144	205,730
	Accrued income taxes	17,573		7,121
	Accrued expenses and other liabilities	68,700	21,263	
	Notes payable	124,350	500	
	Decrease in:			
	Cash and due from banks			151,444
	Interest bearing deposits in other banks	324,821	637,187	
	Federal funds sold and securities purchased under agreements to resell		69	10,749
	Investment and trading account securities	200,924	176,367	3,830
	Due from customers on acceptances	270,272		
	Accrued interest receivable		27,226	
	Proceeds from sale of headquarters building, net of gain included in pretax income	185,872		
	Issuance of stock:			
	Preferred	52,286		
	Common		3,432	7,091
	Treasury stock reissued	12,820	24,795	
		$4,498,472	$2,248,432	$1,767,195
Funds were used for:	Dividends declared:			
	Preferred stock	$ 4,131		
	Common stock	44,800	$ 40,035	$ 36,675
	Increase in:			
	Cash and due from banks	313,890	350,933	
	Interest bearing deposits in other banks			124,372
	Federal funds sold and securities purchased under agreements to resell	379,928		
	Loans and lease financing	2,766,050	1,224,243	1,204,601
	Premises and equipment, excluding sale of headquarters building	90,452	85,974	57,720
	Due from customers on acceptances		395,424	204,493
	Accrued interest receivable	13,774		17,737
	Other assets	55,667	141,539	87,560
	Decrease in:			
	Funds borrowed	565,548		
	Acceptances outstanding	262,095		
	Accrued income taxes		9,634	
	Accrued expenses and other liabilities			2,262
	Notes payable			500
	Treasury stock purchased			27,715
	Translation adjustments	2,137	650	3,560
		$4,498,472	$2,248,432	$1,767,195

The accompanying notes are an integral part of these financial statements.

BANK OF BOSTON CORPORATION

Parent Company Balance Sheet

(in thousands, except share amounts)		*December 31* 1984	1983
Assets	Cash and due from banks	$ 1,009	$ 190
	U.S. Treasury securities (market value of $187,400 in 1984 and $493,300 in 1983)	185,163	493,025
	Loans (net of reserve for possible credit losses of $2,000 in 1984 and in 1983) (Note 6)	171,700	170,268
	Advances to subsidiaries:		
	Bank subsidiaries		15,680
	Nonbank subsidiaries	966,196	776,672
	Investments in subsidiaries (Note 7):		
	Bank subsidiaries	1,110,566	875,251
	Nonbank subsidiaries	191,076	163,914
	Accrued interest and dividends receivable:		
	Subsidiaries	3,795	3,987
	Other	7,130	13,318
	Prepaid and refundable income taxes	7,821	6,733
	Other assets	9,077	7,493
	Total Assets	$2,653,533	$2,526,531
Liabilities and Stockholders' Equity	Funds borrowed	$1,047,037	$1,198,495
	Dividends payable	11,572	10,970
	Accrued interest payable:		
	Subsidiaries	8,159	8,159
	Other	11,259	10,296
	Other liabilities	62	[illegible]
	Advance from nonbank subsidiary	90,000	[illegible]
	Notes payable	300,000	200,000
	Total Liabilities	1,468,089	1,519,179
	Commitments and contingencies (Notes 19 and 21)		
	Stockholders' equity (Notes 7, 13, 16 and 21):		
	Preferred stock without par value: Authorized—10,000,000 shares Issued and outstanding: Series A—1,045,712 shares	52,286	
	Common stock, par value $4.50: Authorized—40,000,000 shares Issued—19,440,807 shares	87,484	87,484
	Surplus	201,323	196,958
	Retained earnings	854,208	739,085
	Treasury stock, at cost—154,124 shares in 1984; 526,938 shares in 1983	(3,510)	(11,965)
	Cumulative translation adjustments	(6,347)	(4,210)
	Total Stockholders' Equity	1,185,444	1,007,352
	Total Liabilities and Stockholders' Equity	$2,653,533	$2,526,531

The accompanying notes are an integral part of these financial statements.

BANK OF BOSTON CORPORATION

Parent Company Statement of Income

(in thousands)		Years Ended December 31 1984	1983	1982
Operating income:	Dividends:			
	Bank subsidiaries	$ 12,812	$ 38,856	$ 34,584
	Nonbank subsidiaries	4,668	4,650	6,500
	Interest income:			
	U.S. Treasury securities	27,289	5,228	1,501
	Loans	22,846	18,510	40,469
	Advances to subsidiaries	90,079	67,065	93,818
	Investment portfolio losses	(1,141)	(78)	
	Total operating income	156,553	134,231	176,872
Operating expense:	Interest expense:			
	Funds borrowed	104,622	60,005	84,061
	Advance from subsidiary	13,954	13,916	8,311
	Notes payable	29,349	19,184	23,579
	Reversal of reserve for possible credit losses (Note 6)		(1,000)	(3,130)
	Other expense	1,096	378	209
	Total operating expense	149,021	92,483	113,030
	Income before income taxes and equity in undistributed net income of subsidiaries	7,532	41,748	63,842
	Provision (benefit) for income taxes	(4,478)	(624)	11,590
	Income before equity in undistributed net income of subsidiaries	12,010	42,372	52,252
	Equity in undistributed net income of subsidiaries	152,044	93,364	72,149
	Net Income	$164,054	$135,736	$124,401

The accompanying notes are an integral part of these financial statements.

BANK OF BOSTON CORPORATION

Parent Company Statement of Changes in Financial Position

		Years Ended December 31		
(in thousands)		*1984*	*1983*	*[illegible]2*
Funds were provided from:	Net income	$164,054	$135,736	$124,401
	Less equity in undistributed net income of subsidiaries	152,044	93,364	72,149
	Funds provided from operations	12,010	42,372	52,252
	Increase in:			
	Funds borrowed		598,627	
	Dividends payable	602	1,349	467
	Accrued interest payable	963	927	3,325
	Advance from nonbank subsidiary			90,000
	Notes payable	100,000		
	Decrease in:			
	Cash and due from banks		2,163	
	Investment securities	307,862		22,258
	Loans			155,622
	Accrued interest and dividends receivable	6,380		1,727
	Other assets			401
	Issuance of stock:			
	Preferred	52,286		
	Common		3,432	7,091
	Treasury stock reissued	12,820	24,795	
	Reduction of investment in subsidiaries	2,137	650	3,560
		$495,060	$674,315	$33[illegible]
Funds were used for:	Dividends declared:			
	Preferred stock	$ 4,131		
	Common stock	44,800	$ 40,035	$ 36,675
	Increase in:			
	Cash and due from banks	819		1,640
	Investment securities		478,294	
	Loans	1,432	15,238	
	Advances to subsidiaries	173,844	86,575	49,534
	Accrued interest and dividends receivable		1,396	
	Prepaid and refundable income taxes	1,088	6,733	
	Other assets	1,584	3,125	
	Additional investment in subsidiaries	112,570	39,905	4,600
	Decrease in:			
	Funds borrowed	151,458		96,554
	Accrued and deferred income taxes		2,214	12,523
	Other liabilities	1,197	150	3,902
	Notes payable			100,000
	Treasury stock purchased			27,715
	Translation adjustments	2,137	650	3,560
		$495,060	$674,315	$336,703

The accompanying notes are an integral part of these financial statements.

Notes to Financial Statements

1. Accounting Policies

The financial reporting and accounting policies of Bank of Boston Corporation (the "Corporation") conform to generally accepted accounting principles. The following is a summary of the significant accounting policies.

Basis of Presentation. The consolidated financial statements include the accounts of the Corporation and its subsidiaries. All material intercompany transactions have been eliminated. The First National Bank of Boston (the "Bank") is the principal subsidiary and currently represents approximately 80% of consolidated assets and 75% of consolidated net income.

Investments in 20% to 50%-owned companies ("affiliates") are recorded using the equity method of accounting. The Corporation's equity interest in their earnings, which in the aggregate is not significant, is included in other income. In the parent company financial statements, investments in subsidiaries are also recorded using the equity method of accounting.

The excess of cost over the assigned value of net [illegible] acquired is included in other assets [illegible] being amortized on a straight-line basis over periods ranging from eight to forty years.

The Corporation recognizes income and expenses using the accrual method of accounting, except for certain fees and other minor sources of income which are recorded as received. These exceptions do not have a material effect on results of operations.

International Operations. On January 1, 1982, the Corporation began accounting for the translation of financial statements of its foreign operations in accordance with Statement of Financial Accounting Standards No. 52. This statement requires a determination of the functional currency of each foreign unit (generally the currency of the primary economic environment in which the unit operates). For those foreign units in which the functional currency is not the U.S. dollar, the assets and liabilities are translated into U.S. dollars at year-end exchange rates while income and expenses are translated using average rates. The resulting translation adjustment and any related hedge gains and losses are recorded, net of tax, as a separate component of stockholders' equity.

For those foreign units operating in a highly inflationary economy, the functional currency is considered to be the U.S. dollar. Their financial statements are translated into U.S. dollars using year-end exchange rates for monetary assets and liabilities, exchange rates in effect on the date of acquisition for property and equipment and certain investments, and average exchange rates for income and expenses. The resulting translation adjustments and related hedge gains and losses for these units are recorded in the income statement as a component of foreign exchange gains and losses.

The Corporation hedges a significant portion of its exposure to translation gains and losses in overseas branches and foreign subsidiaries through the purchase of forward exchange contracts and through investments in fixed assets and certain securities.

The Corporation values its foreign exchange positions monthly. Such valuation includes pricing all spot and forward positions at market rates on the date of valuation. Net foreign exchange gains or losses are included in other income as presented in Note 14.

Securities. Investment securities are stated at cost adjusted for amortization of premiums and accretion of discounts, with the exception of marketable equity securities which are valued at the lower of aggregate cost or market value. Gains or losses on sales of investment securities are generally computed on a specific identified cost basis.

Trading account securities are valued at the lower of cost or market value. Unrealized appreciation on securities which have been written down is not recognized. Gains or losses on the sale of trading account securities and adjustments to the lower of cost or market value are included in other operating income.

Notes to Financial Statements, *continued*

Loans and Lease Financing. Loan principal outstanding is stated net of unearned income. Mortgage loans held for sale are carried at the lower of aggregate cost or market value.

The Corporation accrues interest income on loans and leases at contractual interest rates. However, the Corporation maintains a reserve for uncollectible accrued interest receivable on certain loans as well as a reserve for uncollectible lease income on certain lease payments receivable. The Corporation provides fully for loan interest and lease income receivable when any portion of the principal or interest is ninety days past due. In some cases, where concern exists as to the ultimate collection of principal or interest, a provision is made with respect to the interest accrued or lease income even though payments are less than ninety days past due. These provisions are deducted from interest income, while the reserve is deducted from the related receivable balance. Except for loans which have been placed on nonaccrual as a result of foreign exchange availability problems, interest payments received on nonaccrual loans and leases are not recognized in income before the credit becomes current as to both principal and interest. Interest on loans which are on nonaccrual as a result of foreign exchange availability problems is recognized in income as cash is received.

Reserve for Possible Credit Losses and Provision for Credit Losses. The reserve for possible credit losses is available for future charge-offs of extensions of credit. The reserve is increased by the provision for credit losses and recoveries on items previously charged off. The reserve is decreased as loans and lease financing receivables are charged off. The charge-off, in whole or in part, occurs once a probability of loss has been established, with consideration given to such factors as the customer's financial condition, underlying collateral and guarantees.

Securities and real estate acquired in connection with troubled debt restructurings are recorded at the lower of the book value of the loan or the fair value of the asset received in the exchange. The excess, if any, of the loan value over the fair value of the asset received is charged to the reserve for possible credit losses. Subsequent declines in the value of such assets are charged directly against income.

The provision for credit losses is based upon management's estimation of the amount necessary to maintain the reserve at an adequate level, considering net losses charged to the reserve, current economic conditions, sovereign and transfer risks, changes in the size and character of the credit risks and other pertinent factors warranting current recognition.

Premises and Equipment. Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the lesser of the estimated life of the improvement or the term of the lease.

Income Taxes. The Corporation accounts for certain items of income and expense in different periods for financial reporting than for income tax reporting purposes, including the accrual for financial reporting purposes of income taxes on undistributed earnings of foreign subsidiaries and equity investments. The tax effects of these timing differences are recognized currently in the provision for deferred income taxes.

For financial reporting purposes, the investment credit on lease financing is recognized as lease income over the investment life of the related asset; for premises and equipment, the credit is applied as a reduction of current tax expense in the year the property is placed in service.

Pension Plan. The Corporation has defined benefit pension plans covering the majority of its domestic employees. Under the predominant pension plan, annual pension expense is determined using the Aggregate Cost Method which spreads the entire unfunded cost of future pension benefits over the projected future service lives of employees. Accrued pension costs are funded on a current basis.

Per Share Calculations. Net income per common share is computed by dividing net income, reduced by preferred stock dividends, by the weighted average number of common shares outstanding for each period presented. The dilutive effect of stock options granted is insignificant.

Notes to Financial Statements, *continued*

2. Reserve Requirements

At December 31, 1984 and 1983, cash and due from banks included $363,721,000 and $367,931,000, respectively, to satisfy the reserve requirements of the Federal Reserve and various foreign central banks.

3. Investment Securities

A summary comparison of book and market values of investment securities is as follows:

	December 31, 1984	
(in thousands)	*Book Value*	*Market Value*
U.S. Treasury	$506,983	$ 522,000
States and political subdivisions	22,792	22,000
Other bonds, notes and debentures	321,092	315,000
Marketable equity securities	16,206	50,000
Other equity securities	99,745	102,000
	$966,818	$1,011,000

	December 31, 1983	
(in thousands)	*Book Value*	*Market Value*
U.S. Treasury	$ 755,529	$ 755,000
States and political subdivisions	12,827	12,000
Other bonds, notes and debentures	338,509	337,000
Marketable equity securities	14,129	53,000
Other equity securities	77,276	83,000
	$1,198,270	$1,240,000

Other equity securities consist of equity securities which are not traded on established exchanges and include investments in non-voting stock of other financial institutions, Federal Reserve Bank stock, certain investments of venture capital subsidiaries and securities acquired in debt restructurings. The market value for these securities is based upon management's estimate with consideration given to the underlying value of the issuer's net assets.

4. Loans and Lease Financing

The following are the details of loan and lease financing balances:

	December 31	
(in thousands)	*1984*	*1983*
United States Operations:		
Commercial, industrial and financial	$ 7,010,521	$ 5,253,197
Real estate—construction	955,782	810,444
Real estate—other	1,329,337	778,114
Loans to individuals	921,377	620,180
Lease financing	264,244	212,962
Unearned income	(98,843)	(98,236)
	10,382,418	7,576,661
International Operations:		
Commercial and industrial	2,374,665	2,446,677
Banks and other financial institutions	558,445	643,288
Governments and official institutions	843,057	776,150
Lease financing	286,895	313,432
Loans to affiliates	11,540	33,882
All other	231,682	225,557
Unearned income	(100,187)	(119,724)
	4,206,097	4,319,262
	$14,588,515	$11,895,923

Lease financing is net of long-term debt of $6,850,000 in 1984 and $8,044,000 in 1983 for United States Operations and $41,552,000 in 1984 and $44,548,000 in 1983 for International Operations, all of which is nonrecourse and is secured by liens on the equipment under lease and assignment of the related lease payments receivable.

The Securities and Exchange Commission requires disclosure of loans which exceed $60,000 to executive officers and directors of the Corporation or to their associates. At December 31, 1984 and 1983, these loans totalled $32,617,000 and $23,744,000, respectively. During 1984, total principal additions were $77,360,000 and total principal payments were $68,487,000. Such loans were made on substantially the same terms as those prevailing for comparable transactions with similar risk.

Notes to Financial Statements, *continued*

5. Reserve for Uncollectible Accrued Interest and Lease Income Receivable

An analysis of the changes in the reserve for uncollectible accrued interest and lease income receivable is as follows:

(in thousands)	*United States Operations*	*International Operations*	*Consolidated*
Balance, January 1, 1982	$ 30,871	$15,720	$ 46,591
Provision charged to interest income	23,776	14,160	37,936
Interest and lease income receivable charged off	(10,064)	(5,736)	(15,800)
Adjustment of foreign currency balances (1)		(4,556)	(4,556)
Balance, December 31, 1982	44,583	19,588	64,171
Provision charged to interest income	5,437	14,890	20,327
Interest and lease income receivable charged off	(4,300)	(6,902)	(11,202)
Adjustment of foreign currency balances (1)		(2,604)	(2,604)
Balance, December 31, 1983	45,720	24,972	70,692
Provision charged to interest income	24,352	22,548	46,900
Interest and lease income receivable charged off	(13,396)	(5,605)	(19,001)
Adjustment of foreign currency balances (1)		(3,135)	(3,135)
Balance, December 31, 1984	$ 56,676	$38,780	$ 95,456

(1) The adjustments of foreign currency balances are related to foreign exchange rate fluctuations and are equal to and offset by the effects of exchange rate fluctuations on the corresponding accrued interest and lease income receivable balance.

The year-end loan principal and lease financing balances for which interest and lease income was fully reserved are as follows:

	December 31		
(in thousands)	*1984*	*1983*	*1982*
United States Operations	$244,048	$185,495	$177,240
International Operations	223,837	140,279	106,230
Total	$467,885	$325,774	$283,470

A discussion of certain international nonaccrual balances is included under the caption International Outstandings on pages 68 through 72.

6. Reserve for Possible Credit Losses

An analysis of changes in the reserve is as follows:

(in thousands)	*United States Operations*	*International Operations*	*Consolidated*
Balance, January 1, 1982	$ 76,170	$ 40,970	$ 117,140
Provision	11,100	36,900	48,000
Credit losses	(31,584)	(36,733)	(68[illegible]
Recoveries	20,814	6,735	2[illegible]
Net credit losses	(10,770)	(29,998)	(40,768)
Balance, December 31, 1982	76,500	47,872	124,372
Reserves of acquired companies	1,641		1,641
Provision	22,700	31,300	54,000
Credit losses	(34,267)	(27,052)	(61,319)
Recoveries	11,790	5,358	17,148
Net credit losses	(22,477)	(21,694)	(44,171)
Balance, December 31, 1983	78,364	57,478	135,842
Reserve of acquired company	6,519		6,519
Provision	115,300	64,700	180,000
Credit losses	(62,034)	(43,075)	(105,109)
Recoveries	16,754	8,378	25,132
Net credit losses	(45,280)	(34,697)	(79,977)
Balance, December 31, 1984	$154,903	$ 87,481	$ 242,384

As a result of the Corporation's concern, shared w[illegible] growing segments of the banking industry about[illegible]

Notes to Financial Statements, *continued*

al worldwide economic conditions, the 1984 provision for credit losses includes a $100,000,000 special provision which was recorded in the fourth quarter. This amount was allocated between United States and International Operations based on the relative size of their respective loan and lease financing portfolios.

The parent company's reserve for possible credit losses was reduced by $3,130,000 in 1982, because recoveries on loans previously charged off caused the reserve balance to be in excess of the amount deemed necessary. In 1983, after consideration of the size and risk characteristics of the loan portfolio, an additional $1,000,000 adjustment was made to reduce the reserve.

7. Dividend and Loan Restrictions

The approval of bank regulatory authorities is required if dividends declared by the bank subsidiaries during the year exceed certain prescribed limits. In this connection, the Corporation's bank subsidiaries can declare dividends in 1985, without approval of the regulatory authorities, of approximately $250,000,000 of the undistributed ings at December 31, 1984 plus an additional unt equal to the net profits, as defined for 1985, up to the date of any such dividend declaration. Furthermore, the bank subsidiaries are prohibited by the bank regulatory authorities from granting loans and advances to the parent company which exceed 10% of their capital and surplus, as defined.

Assuming declaration of the above dividends, any such extensions of credit would be limited to an aggregate of $75,500,000, and would be subject to strict collateral requirements.

Therefore, under the foregoing regulations, an aggregate of $785,066,000 of the parent company's equity in the net assets of the bank subsidiaries, which totalled $1,110,566,000, was restricted.

8. Premises and Equipment

In December, 1984, the Bank sold its headquarters building to an investor for $363,000,000, of which $223,000,000 was in cash and $140,000,000 was in the form of a mortgage note maturing in 1985. The Bank has leased back space which it presently occupies for initial terms ranging from 2½ to 10 years with options to renew at market rental rates for up to an additional 25 years. The sale resulted in a pre-tax gain of $295,500,000 of which $118,400,000 has been deferred and will be recognized in proportion to the lease payments, over the initial terms of the leases, as a reduction of occupancy costs.

Premises and equipment are stated at cost less accumulated depreciation and amortization of $144,385,000 at December 31, 1984 and $115,771,000 at December 31, 1983. Depreciation and amortization expense for premises and equipment was $34,243,000 in 1984, $25,415,000 in 1983 and $20,186,000 in 1982.

9. Other Assets

Other assets consist of:

	December 31	
(in thousands)	*1984*	*1983*
Accounts receivable	$108,360	$121,692
Excess of cost over assigned value of net assets acquired	138,985	108,023
Refundable income taxes	28,910	32,429
Accounts receivable for securities transactions	63,893	26,049
Unrealized foreign exchange revaluation profits	18,739	21,618
Prepaid expenses	24,330	17,574
Equity investment in affiliates	12,368	12,752
Other real estate owned	4,906	10,449
Deferred payment letters of credit	7,268	8,757
All other	73,835	73,455
	$481,594	$432,798

Excess of cost over assigned value of net assets acquired includes mortgage servicing of $96,716,000 and $87,368,000 at December 31, 1984 and December 31, 1983, respectively.

Notes to Financial Statements, ***continued***

10. Funds Borrowed

Funds borrowed consist of:

(in thousands)	*December 31* 1984	1983
Federal funds purchased	$ 731,180	$1,492,836
Term federal funds purchased	606,455	348,250
Securities sold under agreements to repurchase	381,407	646,119
Commercial paper	916,524	724,929
Demand notes issued to the U.S. Treasury	140,757	106,471
All other	639,443	662,709
	$3,415,766	$3,981,314

All other funds borrowed includes long-term borrowings of $143,020,000 at December 31, 1984 and $139,880,000 at December 31, 1983.

11. Income Taxes

The components of the provision for income taxes are as follows:

(in thousands)	*Years Ended December 31* 1984	1983	1982
Current:			
Federal	$ 42,321	$ 1,538	$10,774
Foreign:			
Based on income	23,577	36,503	19,899
Withheld on interest and dividends	11,237	15,884	18,864
State and local	31,810	21,142	20,096
	108,945	75,067	69,633
Deferred:			
Federal	(13,724)	13,865	(6,597)
Foreign	87	1,460	1,462
State and local	(7,198)	483	(3,627)
	(20,835)	15,808	(8,762)
Income taxes applicable to translation adjustments recorded directly into stockholders' equity	(4,710)	(3,370)	(650)
	$ 83,400	$87,505	$60,221

Included in the federal and state and local curr[illegible] tax expense are the tax provisions (benefits) relat[illegible] to investment portfolio gains or losses of $(207,000) in 1984, $1,894,000 in 1983 and $(6,505,000) in 1982.

Deferred taxes arise from differences in the timing of recognition of income and expense for tax and financial reporting purposes. The sources of these differences and the tax effect of each were:

(in thousands)	*Years Ended December 31* 1984	1983	1982
Provision for credit losses	$(36,682)	$(16,059)	$ (5,979)
Interest on nonaccrual loans	(9,972)	(6,168)	(24,900)
Cash basis accounting for tax purposes	4,404	(977)	(1,653)
Foreign operations	21,077	11,448	6,684
Incremental taxes on unremitted earnings of foreign subsidiaries	4,170	9,615	5,128
Depreciation and amortization	(5,850)	1,253	(83)
Amortization of mortgage servicing rights	3,248	1,769	[illegible]
Leasing operations	15,839	12,567	10,[illegible]
Sale of headquarters building	(2,907)		
Mortgages held for sale	(8,443)		
Other, net	(5,719)	2,360	828
	$(20,835)	$ 15,808	$ (8,762)

Deferred income taxes included in consolidated accrued and deferred income taxes amounted to $63,789,000 at December 31, 1984 and $84,624,000 at December 31, 1983.

Notes to Financial Statements, *continued*

The following tabulation reconciles the federal statutory tax rate to the consolidated effective tax rate:

	Years Ended December 31		
	1984	*1983*	*1982*
Federal statutory tax rate	46.0%	46.0%	46.0%
Tax-exempt income	(7.3)	(8.8)	(15.7)
Investment tax credit	(.9)	(1.1)	(1.1)
State and local income taxes, net of federal tax benefit	5.1	5.0	4.7
Income subject to tax at capital gains rate, net of minimum tax	(8.5)	(.8)	(1.5)
Other, net	(.7)	(1.1)	.2
Effective tax rate	33.7%	39.2%	32.6%

The effective tax rate for the parent company is substantially less than the federal statutory rate because dividends from subsidiaries are non-taxable.

Domestic pre-tax income was $218,556,000 in 1984, $129,585,000 in 1983 and $113,459,000 in 1982 and foreign pre-tax income was $28,898,000 in 1984, $[illegible]6,000 in 1983 and $71,163,000 in 1982. For this purpose, foreign income is defined as income generated from operations that are located outside the United States.

12. Notes Payable

Notes payable consist of:

	December 31	
(in thousands)	*1984*	*1983*
8.3% notes due July 15, 1985 (issued March, 1978)	$100,000	$100,000
10.65% notes due August 15, 1987 (issued July, 1980)	100,000	100,000
14.25% notes due June 1, 1989 (issued May, 1982)	100,000	100,000
Floating rate subordinated equity commitment notes, 9.56% at December 31, 1984, due February, 1996 (issued February, 1984)	100,000	
Other notes with an average interest rate of 11.03% due 1986 through 1992	24,350	
	$424,350	$300,000

The notes payable are unsecured obligations of the Corporation or of its subsidiaries. The indentures under which certain of these notes were issued prohibit the Corporation from making any payment or other distribution in the stock of the Bank unless the Bank unconditionally guarantees payment of principal and interest on the notes.

13. Preferred Stock

On March 30, 1984, the Corporation issued 1,045,712 shares of the Corporation's Adjustable Rate Cumulative Preferred Stock, Series A, in connection with the acquisition of Casco-Northern Corporation. The dividend rate is adjusted quarterly according to a formula based upon the highest of three interest rate benchmarks. Such dividend rates shall not be less than 6% per annum nor greater than 13% per annum. At December 31, 1984, the dividend rate was 9.6%. Dividends declared in 1984 amounted to $3.95 per share. The preferred stock, which has no preemptive or general voting rights, has a liquidation preference of $50 per share, plus accrued and unpaid dividends, and may be redeemed at the option of the Corporation at $51.50 per share on or after March 30, 1989 through March 29, 1994, and at $50 per share thereafter.

14. Other Income

The components of other income are:

(in thousands)	Years Ended December 31 1984	1983	1982
Foreign exchange:			
Trading profits	$ 17,427	$15,172	$14,039
Net translation/ hedge results from highly inflationary economies	(3,505)	(9,788)	(2,860)
Credit card fee income	19,381	13,379	12,373
Other fees and commissions	19,545	14,398	11,864
Loss on mortgages sold or held for sale	(16,405)	(4,930)	(429)
Gains on sales of securities acquired in troubled debt restructurings		6,268	3,744
Gains on sales of venture capital securities	123	5,979	6,330
Equity in undistributed earnings of affiliates	2,219	4,389	3,397
All other	24,027	22,956	23,354
	$ 62,812	$67,823	$71,812

15. Employee Benefits

Pension expense amounted to $13,991,000 in 1984, $13,765,000 in 1983 and $16,798,000 in 1982. A comparison of the present value of the accumulated plan benefits and plan net assets, computed as of September 30 of each year for the predominant plan is as follows:

(in thousands)	1984	1983
Present value of accumulated plan benefits:		
Vested	$123,534	$105,920
Nonvested	9,463	8,197
Total	$132,997	$114,117
Net assets available for plan benefits	$225,214	$195,030

The assumed rate of return used in determinin[illegible] actuarial present value of accumulated plan benefits was 7% for 1984 and 1983.

Under the Corporation's thrift incentive plan and other domestic, defined contribution plans, the amounts charged to operating expense were $13,189,000 in 1984, $15,186,000 in 1983 and $13,813,000 in 1982.

In addition, the Corporation provides a limited amount of health and life insurance benefits for retired employees. The cost of these benefits for domestic employees, which are expensed as paid, was $267,000 in 1984.

16. Stock Options

A total of 562,960 shares of common stock is reserved for issuance to key employees under the Corporation's 1982 Stock Option Plan (the "Plan"). Options may not be issued at less than fair market value at date of grant. Generally, 25% of the options granted become exercisable at the date of grant, with an additional 25% becoming exercisable each anniversary thereafter. All options expire not later than ten years from the date of grant. The Plan also provides for the granting of units ent[illegible] the holder to receive a cash payment at the end [illegible] two-year period based on the performance of the Corporation in relation to other leading financial institutions. Cash units granted are not significant. Options outstanding at December 31, 1984 are at prices ranging from $24.75 to $41.25 per share. No options or units may be granted under the Plan after December, 1991.

The following is a summary of the changes in options outstanding:

	Years Ended December 31 1984	1983	1982
Options outstanding, January 1	88,815	98,057	
Granted ($24.75 to $41.25 per share)	174,076		98,057
Exercised ($24.75 per share)		(4,040)	
Cancelled	(7,635)	(5,202)	
Options outstanding, December 31	255,256	88,815	98,057
Options exercisable, December 31	112,463	44,982	24,510
Shares available for future options	307,704	474,145	[illegible]

Notes to Financial Statements, *continued*

17. Other Expense

The components of other expense are:

(in thousands)	*Years Ended December 31* 1984	1983	1982
Professional, other services and regulatory examination fees	$ 46,217	$ 38,009	$ 36,032
Travel, customer contact and advertising	40,740	35,575	29,671
Communications	34,950	28,594	25,558
Forms and supplies	19,101	16,246	14,025
Non-income taxes	13,047	11,253	12,020
Other staff costs	9,512	7,496	7,068
FDIC insurance	4,603	4,364	4,099
Federal Reserve service fees	4,581	3,456	3,112
Property and casualty insurance	1,960	1,557	1,926
All other	51,954	34,504	35,007
	$226,665	$181,054	$168,518

18. Pledged Assets

At December 31, 1984, investment securities and other assets of $922,985,000 were used to collateralize repurchase agreements, public deposits and other items.

19. Commitments and Contingencies

In the normal course of business, there are outstanding a number of commitments to extend credit, letters of credit, guarantees and letters of indemnity, as well as obligations related to bankers acceptances participated to other financial institutions and agreements to purchase or sell securities, foreign exchange or interest. In the opinion of management, these agreements do not represent unusual risks for the Corporation and losses, if any, resulting from them will not be material. At December 31, 1984, commitments under outstanding standby letters of credit and similar arrangements, net of participations to other financial institutions, were $1,410,000,000.

The Corporation and its subsidiaries are defendants in a number of legal proceedings arising in the normal course of business. Management, after reviewing all actions and proceedings pending against or involving the Corporation and its subsidiaries, considers that the aggregate liability or loss, if any, resulting from the final outcome of these proceedings will not be material.

20. Lease Commitments

Rental expense for leases of real estate and equipment is summarized below:

(in thousands)	*Years Ended December 31* 1984	1983	1982
Rental expense	$34,084	$32,597	$27,372
Less sublease rental income	3,160	2,874	2,168
Net rental expense	$30,924	$29,723	$25,204

At December 31, 1984, the Corporation was obligated under noncancelable leases for real estate and equipment, including the leases entered into in 1984 for the Corporation's headquarters building as described in Note 8. The minimum rentals under these leases, exclusive of executory costs and net of amortization of deferred gain on sale of headquarters building and sublease rental income, for the years 1985 through 1989 are $32,250,000, $28,158,000, $23,838,000, $19,678,000 and $18,114,000 respectively, and $71,362,000 for 1990 and later.

Capital leases, the minimum rentals of which are included in the preceding amounts, are not significant.

21. Acquisitions

On March 30, 1984, the Corporation purchased all of the common stock of Casco-Northern Corporation ("Casco") in exchange for 1,045,712 shares of the Corporation's Adjustable Rate Cumulative Preferred Stock, Series A, which had a value of $52,286,000 at the time of the acquisition. Casco, with total assets of $857.3 million at December 31, 1984, is engaged in retail and commercial banking in Maine.

Pro forma results of operations, including Casco, for the entire year have not been shown since the results would not be significantly different in relation to the Corporation's consolidated assets or net income.

Notes to Financial Statements, *continued*

In November, 1983, the Corporation entered into an acquisition agreement with Colonial Bancorp, Inc. ("Colonial"). Colonial, with assets of approximately $1.5 billion, is engaged in retail and commercial banking in Connecticut. This proposed merger has been approved by Colonial's stockholders, the Federal Reserve Board and the regulatory authorities of both Massachusetts and Connecticut. Under the terms of the agreement, the Corporation will issue shares of a second series of preferred stock which will be, at the discretion of the Corporation, either adjustable rate cumulative preferred stock or convertible cumulative preferred stock. The value of such shares, had the transaction been consummated on December 31, 1984, would have been approximately $74 million. Under the terms of the agreement, since the acquisition was not consummated by January 1, 1985, the purchase price will be increased to reflect certain increases in Colonial's net worth. In addition, the agreement will terminate on June 30, 1986 unless extended by mutual consent.

In February, 1984, the Corporation entered into an acquisition agreement with RIHT Financial Corporation ("RIHT"). RIHT, with assets of approximately $2.3 billion, is a provider of retail, commercial banking and trust services and is based in Rhode Island. This proposed transaction, the consideration for which, had it been consummated on December 31, 1984, would have been valued at approximately $120 million, has been approved by RIHT's stockholders, the Federal Reserve Board and both Massachusetts and Rhode Island regulatory authorities. Under the terms of the agreement, the consideration payable to RIHT shareholders will consist of a combination of cash and shares of a third series of preferred stock which will be, at the discretion of the Corporation, either adjustable rate cumulative preferred stock or convertible cumulative preferred stock. It is intended that the mix between cash and stock will be such as may be required for the transaction to be treated as a tax-free reorganization by those RIHT stockholders electing to receive Corporation stock. The Corporation has agreed that the purchase price will be increased to reflect certain increases in RIHT's net worth. The agreement may be terminated by either party if the merger is not consummated by December 31, 1985.

The acquisitions of Colonial and RIHT described above are proposed to be consummated under the interstate banking statutes of Connecticut and Rhode Island, respectively, each of which requires reciprocity with the Massachusetts Interstate Banking Statute. The validity of the Massachusetts, Connecticut and Rhode Island statutes has been challenged on constitutional grounds both before the Federal Reserve Board and in court. On August 1, 1984, the United States Court of Appeals for the Second Circuit issued a decision (the "Northeast Decision") affirming several Federal Reserve Board decisions approving New England interstate bank acquisitions, including the Corporation's proposed acquisition of Colonial, and holding that the Massachusetts and Connecticut interstate banking statutes were constitutional. On January 7, 1985, the United States Supreme Court agreed to review the Northeast Decision, and the Corporation's proposed acquisitions of Colonial and RIHT are stayed pending that review.

In addition, stockholders of RIHT have brought two suits, to which the Corporation is not a party, which seek, among other relief, to enjoin RIHT and its directors from consummating the proposed acquisition by the Corporation at the price provided for by the agreement. One of the suits has been dismissed, and that dismissal has been appealed to the United States Court of Appeals for the First Circuit.

22. Segment Information

The Corporation operates in the financial services industry segment. Services are provided through a network of offices located both in the United States and overseas and, consequently, a substantial part of the Corporation's assets are denominated in currencies other than the U.S. dollar. In order to minimize exposure to movements in various currency exchange rates the major portion of such assets is financed with liabilities of the same currency and the remaining portion is substantially hedged. Geographic segment information for the Corporation for the three years ended December 31, 1984 is presented on pages 66 and 67.

BANK OF BOSTON CORPORATION

Consolidated Statistical Information

The following three tables present average balances and interest rates and interest differential information for the Corporation consolidated and separately for its United States and International Operations. Incorporated in these tables is an adjustment of tax exempt income to a fully taxable equivalent basis. This adjustment is calculated assuming a 46% federal income tax rate adjusted for applicable state and local income taxes, net of the related federal tax benefit. Data for loans includes nonaccrual and renegotiated balances as well as fees earned on loans. Average rates for interest bearing funds of United States Operations have been calculated after deducting applicable reserve requirements from average balances shown in the table.

Average Balances and Interest Rates and Interest Differential — Consolidated

	Years Ended December 31								
			1984			*1983*			*1982*
(dollars in millions)	*Average Balance*	*Interest*	*Average Rate*	*Average Balance*	*Interest*	*Average Rate*	*Average Balance*	*Interest*	*Average Rate*
Assets									
Interest bearing deposits in other banks	$ 2,420	$ 350.9	14.50%	$ 2,940	$ 288.8	9.82%	$ 2,984	$ 392.3	13.15%
Federal funds sold and resale agreements	286	106.1	37.10	189	73.7	38.99	222	48.1	21.67
Trading account securities	413	85.4	20.68	427	75.1	17.59	272	43.4	15.96
Investment securities:									
U.S. Treasury	556	59.6	10.72	762	85.9	11.27	785	93.2	11.87
States and political subdivisions	22	2.7	12.27	40	5.6	14.00	192	21.4	11.15
Other	440	80.7	18.34	365	59.7	16.36	319	73.8	23.13
Loans and lease financing (1)	13,210	2,287.4	17.32	11,076	1,794.5	16.20	10,125	1,901.8	18.78
Total earning assets — Interest income	17,347	2,972.8	17.14	15,799	2,383.3	15.09	14,899	2,574.0	17.28
Cash and due from banks	1,434			1,177			1,166		
Other non-earning assets	2,038			1,845			1,441		
Total assets	$20,819			$18,821			$17,506		
Liabilities and Stockholders' Equity									
Deposits:									
Savings	$ 2,266	188.5	8.46	$ 1,520	114.1	7.62	$ 532	27.8	5.49
Time	2,846	290.6	10.39	1,995	185.8	9.59	2,864	353.6	12.73
International Operations	5,747	997.2	17.35	6,006	732.8	12.20	5,769	924.2	16.02
Federal funds purchased and repurchase agreements	2,345	402.8	17.18	2,709	363.6	13.42	2,389	343.3	14.37
Other funds borrowed	1,553	327.2	21.76	1,273	296.7	23.59	1,217	271.0	22.56
Notes payable	405	46.2	11.41	300	33.8	11.26	313	32.3	10.32
Total interest bearing funds — Interest expense	15,162	2,252.5	14.99	13,803	1,726.8	12.60	13,084	1,952.2	15.07
Demand and other non-interest bearing deposits	2,945			2,480			2,271		
Other liabilities	1,621			1,598			1,305		
Stockholders' equity	1,091			940			846		
Total liabilities and stockholders' equity	$20,819			$18,821			$17,506		
Net Interest Revenue		$ 720.3			$ 656.5			$ 621.8	
Interest Rate Spread (2)			2.15%			2.49%			2.21%
Interest Rate Margin (3)			4.15%			4.16%			4.17%

(1) Interest on loans and lease financing includes fees earned of $72.3 million in 1984, $52.2 million in 1983 and $48.4 million in 1982.

(2) Interest rate spread is calculated by subtracting the average rate paid for interest bearing funds from the average rate earned on total earning assets.

(3) Interest rate margin is calculated by dividing net interest revenue by total earning assets.

BANK OF BOSTON CORPORATION

Consolidated Statistical Information, *continued*

Average Balances and Interest Rates and Interest Differential — United States Operations

	Years Ended December 31								
			1984			1983			1982
(dollars in millions)	*Average Balance*	*Interest*	*Average Rate*	*Average Balance*	*Interest*	*Average Rate*	*Average Balance*	*Interest*	*Average Rate*
Assets									
Interest bearing deposits in other banks	$ 411	$ 44.0	10.71%	$ 253	$ 24.1	9.53%	$ 194	$ 26.2	13.51%
Federal funds sold and resale agreements	217	22.8	10.51	132	12.8	9.70	190	23.9	12.58
Trading account securities	350	36.8	10.51	381	37.8	9.92	258	34.6	13.41
Investment securities:									
U.S. Treasury	556	59.6	10.72	762	85.9	11.27	785	93.2	11.87
States and political subdivisions	22	2.7	12.27	40	5.6	14.00	192	21.4	11.15
Other	180	21.4	11.89	113	11.4	10.09	84	9.0	10.71
Loans and lease financing (1)	8,928	1,196.0	13.40	7,029	889.1	12.65	6,339	968.1	15.27
Total earning assets — interest income	10,664	1,383.3	12.97	8,710	1,066.7	12.25	8,042	1,176.4	14.63
Cash and due from banks	1,299			1,018			1,030		
Other non-earning assets	1,006			744			452		
Total assets	$12,969			$10,472			$9,524		
Liabilities and Stockholders' Equity									
Deposits:									
Savings	$ 2,266	188.5	8.46	$ 1,520	114.1	7.62	$ 532	27.8	5.49
Time	2,846	290.6	10.39	1,995	185.8	9.59	2,864	353.6	12.73
Federal funds purchased and repurchase agreements	2,203	226.4	10.28	2,582	232.1	8.99	2,295	272.3	11.86
Other funds borrowed	1,009	102.5	10.68	845	80.4	9.69	886	109.0	12.53
Notes payable	291	29.6	10.17	200	19.1	9.59	253	23.6	9.33
Intersegment funding, net	272	33.1	12.17	(93)	(9.6)	(10.32)	(315)	(38.2)	(12.13)
Total interest bearing funds — interest expense	8,887	870.7	9.95	7,049	621.9	8.94	6,515	748.1	11.72
Demand and other non-interest bearing deposits	2,705			2,267			2,074		
Other liabilities	612			557			351		
Stockholders' equity	765			599			584		
Total liabilities and stockholders' equity	$12,969			$10,472			$9,524		
Net Interest Revenue		$ 512.6			$ 444.8			$ 428.3	
Interest Rate Spread (2)			3.02%			3.31%			2.91%
Interest Rate Margin (3)			4.81%			5.11%			5.33%

(1) Interest on loans and lease financing includes fees earned of $58.8 million in 1984, $38.9 million in 1983 and $38 million in 1982.

(2) Interest rate spread is calculated by subtracting the average rate paid for interest bearing funds from the average rate earned on total earning assets.

(3) Interest rate margin is calculated by dividing net interest revenue by total earning assets.

BANK OF BOSTON CORPORATION

Consolidated Statistical Information, *continued*

Average Balances and Interest Rates and Interest Differential — International Operations

(dollars in millions)	1984 Average Balance	1984 Interest	1984 Average Rate	1983 Average Balance	1983 Interest	1983 Average Rate	1982 Average Balance	1982 Interest	1982 Average Rate
Assets									
Interest bearing deposits in other banks	$2,009	$ 306.9	15.28%	$2,687	$ 264.7	9.85%	$2,790	$ 366.1	13.12%
Resale agreements	69	83.3	120.72	57	61.0	107.02	32	24.2	75.63
Trading account securities	63	48.6	77.14	46	37.2	80.87	14	8.8	62.86
Investment securities—other	260	59.3	22.81	252	48.3	19.17	235	64.8	27.57
Loans and lease financing (1)	4,282	1,091.4	25.49	4,047	905.4	22.37	3,786	933.7	24.66
Total earning assets—interest income	6,683	1,589.5	23.78	7,089	1,316.6	18.57	6,857	1,397.6	20.38
Cash and due from banks	135			159			136		
Other non-earning assets	1,032			1,101			989		
Total assets	$7,850			$8,349			$7,982		
Liabilities and Stockholders' Equity									
Deposits (2):									
Banks in foreign countries	$2,199	208.4	9.48	$2,288	218.9	9.57			
Other foreign savings and time	3,548	788.8	22.23	3,718	513.9	13.82			
Total International Operations	5,747	997.2	17.35	6,006	732.8	12.20	$5,769	924.2	16.02
Repurchase agreements	142	176.4	124.23	127	131.5	103.54	94	71.0	75.53
Other funds borrowed	544	224.7	41.31	428	216.3	50.54	331	162.0	48.94
Notes payable	114	16.6	14.56	100	14.7	14.62	60	8.7	14.62
Intersegment funding, net	(272)	(33.1)	(12.17)	93	9.6	10.32	315	38.2	12.13
Total interest bearing funds—interest expense	6,275	1,381.8	22.02	6,754	1,104.9	16.36	6,569	1,204.1	18.33
Non-interest bearing deposits	240			213			197		
Other liabilities	1,009			1,041			954		
Stockholders' equity	326			341			262		
Total liabilities and stockholders' equity	$7,850			$8,349			$7,982		
Net Interest Revenue		$ 207.7			$ 211.7			$ 193.5	
Interest Rate Spread (3)			1.76%			2.21%			2.05%
Interest Rate Margin (4)			3.11%			2.99%			2.82%

Years Ended December 31

(1) Interest on loans and lease financing includes fees earned of $13.5 million in 1984, $13.3 million in 1983 and $10.4 million in 1982.

(2) The breakdown by category for deposits of International Operations for 1982 is not readily available.

(3) Interest rate spread is calculated by subtracting the average rate paid for interest bearing funds from the average rate earned on total earning assets.

(4) Interest rate margin is calculated by dividing net interest revenue by total earning assets.

Average Asset and Liability Ratios

	1984	1983	1982
Average assets of International Operations to average consolidated assets	38%	44%	46%
Average liabilities of International Operations to average consolidated liabilities	38%	45%	46%

Years Ended December 31

Consolidated Statistical Information, *continued*

Change in Net Interest Revenue—Volume and Rate Analysis—1984 as compared with 1983

The following table presents, on a fully taxable equivalent basis, an analysis of the effect on net interest revenue of volume and rate changes for 1984 as compared with 1983. The change due to the volume/rate variance has been allocated to volume.

	Consolidated			*United States*			*International*		
	Increase (Decrease) Due to Change in			*Increase (Decrease) Due to Change in*			*Increase (Decrease) Due to Change in*		
(in millions)	*Volume*	*Rate*	*Net Change*	*Volume*	*Rate*	*Net Change*	*Volume*	*Rate*	*Net Change*
Earning Assets:									
Interest bearing deposits in other banks	$(75.4)	$137.5	$ 62.1	$ 16.9	$ 3.0	$ 19.9	$(103.6)	$145.8	$ 42.2
Federal funds sold and resale agreements	36.0	(3.7)	32.3	8.9	1.1	10.0	14.5	7.8	22.3
Trading account securities	(2.9)	13.3	10.4	(3.3)	2.3	(1.0)	13.1	(1.7)	11.4
Investment securities:									
U.S. Treasury	(22.1)	(4.2)	(26.3)	(22.1)	(4.2)	(26.3)			
States and political subdivisions	(2.2)	(.7)	(2.9)	(2.2)	(.7)	(2.9)			
Other	13.8	7.2	21.0	8.0	2.0	10.0	1.8	9.2	11.0
Loans and lease financing	369.5	123.4	492.9	254.4	52.5	306.9	59.9	126.1	186.0
Adjustment (1)	(51.4)	51.4		(7.1)	7.1		(82.3)	82.3	
Interest income	265.3	324.2	589.5	253.5	63.1	316.6	(96.6)	369.5	272.9
Interest Bearing Funds:									
Deposits:									
Savings	61.8	12.6	74.4	61.8	12.6	74.4			
Time	89.2	15.6	104.8	89.2	15.6	104.8			
International Operations	(44.9)	309.3	264.4				(44.9)	309.3	264.4
Federal funds purchased and repurchase agreements	(62.5)	101.7	39.2	(39.0)	33.3	(5.7)	18.6	26.3	44.9
Other funds borrowed	53.5	(23.0)	30.5	13.9	8.2	22.1	47.9	(39.5)	8.4
Notes payable	11.5	.9	12.4	9.3	1.2	10.5	2.0	(.1)	1.9
Intersegment funding, net				21.8	20.9	42.7	(21.8)	(20.9)	(42.7)
Adjustment (1)	92.4	(92.4)		2.6	(2.6)		(85.8)	85.8	
Interest expense	201.0	324.7	525.7	159.6	89.2	248.8	(84.0)	360.9	276.9
Net Interest Revenue	$ 64.3	$ (.5)	$ 63.8	$ 93.9	$(26.1)	$ 67.8	$ (12.6)	$ 8.6	$ (4.0)

(1) Adjustment to reflect the effect on total volume and rate changes of the differences in the component mix of earning assets and interest bearing liabilities from year to year.

Consolidated Statistical Information, *continued*

Change in Net Interest Revenue — Volume and Rate Analysis — 1983 as compared with 1982

The following table presents, on a fully taxable equivalent basis, an analysis of the effect on net interest revenue of volume and rate changes for 1983 as compared with 1982. The change due to the volume/rate variance has been allocated to volume.

	Consolidated			*United States*			*International*		
	Increase (Decrease) Due to Change in			*Increase (Decrease) Due to Change in*			*Increase (Decrease) Due to Change in*		
(in millions)	*Volume*	*Rate*	*Net Change*	*Volume*	*Rate*	*Net Change*	*Volume*	*Rate*	*Net Change*
Earning Assets:									
Interest bearing deposits in other banks	$ (4.3)	$ (99.2)	$(103.5)	$ 5.6	$ (7.7)	$ (2.1)	$(10.1)	$ (91.3)	$(101.4)
Federal funds sold and resale agreements	(12.9)	38.5	25.6	(5.6)	(5.6)	(11.2)	26.8	10.0	36.8
Trading account securities	27.3	4.4	31.7	12.2	(8.9)	3.3	25.9	2.5	28.4
Investment securities:									
U.S. Treasury	(2.6)	(4.7)	(7.3)	(2.6)	(4.7)	(7.3)			
States and political subdivisions	(21.3)	5.5	(15.8)	(21.3)	5.5	(15.8)			
Other	7.5	(21.6)	(14.1)	2.9	(.5)	2.4	3.3	(19.8)	(16.5)
Loans and lease financing	154.1	(261.4)	(107.3)	87.3	(166.3)	(79.0)	58.4	(86.7)	(28.3)
Adjustment (1)	(12.0)	12.0		3.3	(3.3)		(61.2)	61.2	
Interest income	135.8	(326.5)	(190.7)	81.8	(191.5)	(109.7)	43.1	(124.1)	(81.0)
Interest Bearing Funds:									
Deposits:									
Savings	75.6	10.7	86.3	75.6	10.7	86.3			
Time	(80.4)	(87.4)	(167.8)	(80.4)	(87.4)	(167.8)			
International Operations	28.9	(220.3)	(191.4)				28.9	(220.3)	(191.4)
Federal funds purchased and repurchase agreements	43.0	(22.7)	20.3	25.8	(66.0)	(40.2)	34.2	26.3	60.5
Other funds borrowed	13.4	12.3	25.7	(3.9)	(24.7)	(28.6)	49.0	5.3	54.3
Notes payable	(1.5)	3.0	1.5	(5.1)	.6	(4.5)	6.0		6.0
Intersegment funding, net				22.9	5.7	28.6	(22.9)	(5.7)	(28.6)
Adjustment (1)	19.4	(19.4)		12.8	(12.8)		(59.0)	59.0	
Interest expense	98.4	(323.8)	(225.4)	47.7	(173.9)	(126.2)	36.2	(135.4)	(99.2)
Net Interest Revenue	$ 37.4	$ (2.7)	$ 34.7	$ 34.1	$ (17.6)	$ 16.5	$ 6.9	$ 11.3	$ 18.2

(1) Adjustment to reflect the effect on total volume and rate changes of the differences in the component mix of earning assets and interest bearing liabilities from year to year.

Consolidated Statistical Information, *continued*

Geographic Segment Information

The following tables present geographic segment information for the Corporation for each of the three years ended December 31, 1984. This geographic segment information presents assets and income segregated into country or regional locations based upon the domicile of the customer or borrower, but without regard to such factors as method of funding (i.e., local vs. non-local currency), or location of any cash collateral or guarantees.

As a result of the inter-relationships that exist within the Corporation's worldwide network, allocations of certain income and expense items are necessarily based on assumptions and subjective criteria. Interest expense allocations, for example, are based on an assumed average money market rate. Additionally, corporate capital is allocated based on the relative risk characteristics of assets in the various geographic regions. Finally, allocations have been made among units based upon the Corporation's management accounting system whereby non-interest income and expenses are adjusted to reflect the cost of services provided by one unit to another, including corporate overhead.

For the purpose of evaluating the potential for certain transfer risks associated with cross-border outstandings, such factors as method of funding and location of any cash collateral or guarantees should be taken into account. A discussion of cross-border outstandings may be found under the caption International Outstandings on pages 68 through 72.

(in millions)	*Argentina*	*Brazil*	*Other Latin American Countries*	*Europe*	*Asia/ Pacific*	*Other Regions*	*Total Inter-national Operations*	*United States Operations*	*Consol-idated*
For the Year Ended December 31, 1984									
Net interest revenue	$ 28.1	$ 42.3	$ 48.6	$ 50.9	$ 21.3	$ 14.8	$ 206.0	$ 463.9	$ 669.9
Provision for credit losses	4.0	5.4	11.8	16.3	22.0	5.2	64.7	115.3	[illegible]
Net interest revenue after provision for credit losses	24.1	36.9	36.8	34.6	(.7)	9.6	141.3	348.6	489.9
Other operating income	29.5	1.9	8.4	8.9	12.1	6.3	67.1	412.7	479.8
Other operating expense	44.5	20.9	21.4	35.1	18.7	7.4	148.0	574.2	722.2
Non-interest allocations, net-charge/(credit)	4.0	6.1	15.2	12.3	8.5	2.7	48.8	(48.8)	
Income before income taxes	5.1	11.8	8.6	(3.9)	(15.8)	5.8	11.6	235.9	247.5
Net income	$ 2.5	$ 5.1	$ 4.1	$ (2.3)	$ (7.7)	$ 4.2	$ 5.9	$ 158.2	$ 164.1
Average assets:									
Interest bearing deposits in other banks	$ 41.0	$ 16.0	$ 178.0	$1,243.0	$ 369.0	$162.0	$2,009.0	$ 411.0	$ 2,420.0
Loans and lease financing	488.0	448.0	842.0	1,147.0	857.0	500.0	4,282.0	8,928.0	13,210.0
All other assets	232.0	187.0	203.0	431.0	406.0	100.0	1,559.0	3,630.0	5,189.0
Total average assets	$761.0	$651.0	$1,223.0	$2,821.0	$1,632.0	$762.0	$7,850.0	$12,969.0	$20,819.0

BANK OF BOSTON CORPORATION

Consolidated Statistical Information, *continued*

Geographic Segment Information

(in millions)	*Argentina*	*Brazil*	*Other Latin American Countries*	*Europe*	*Asia/ Pacific*	*Other Regions*	*Total Inter-national Operations*	*United States Operations*	*Consol-idated*
For the Year Ended December 31, 1983									
Net interest revenue	$ 44.5	$ 44.9	$ 36.1	$ 50.3	$ 22.7	$ 10.4	$ 208.9	$ 397.5	$ 606.4
Provision for credit losses	2.1	3.0	15.8	3.7	5.6	1.1	31.3	22.7	54.0
Net interest revenue after provision for credit losses	42.4	41.9	20.3	46.6	17.1	9.3	177.6	374.8	552.4
Other operating income	19.8	11.2	.5	12.7	12.5	4.4	61.1	204.9	266.0
Other operating expense	37.0	19.6	15.4	32.6	15.2	6.9	126.7	468.5	595.2
Non-interest allocations, net-charge/(credit)	5.8	5.2	6.6	14.7	5.9	2.8	41.0	(41.0)	
Income before income taxes	19.4	28.3	(1.2)	12.0	8.5	4.0	71.0	152.2	223.2
Net income	$ 9.2	$ 13.4	$ (.5)	$ 7.0	$ 4.1	$ 2.2	$ 35.4	$ 100.3	$ 135.7
Average assets:									
Interest bearing deposits in other banks	$ 1.0	$ 6.0	$ 192.0	$1,781.0	$ 453.0	$254.0	$2,687.0	$ 253.0	$ 2,940.0
Loans and lease financing	503.0	351.0	811.0	1,041.0	893.0	448.0	4,047.0	7,029.0	11,076.0
All other assets	247.0	199.0	172.0	358.0	578.0	61.0	1,615.0	3,190.0	4,805.0
Total average assets	$751.0	$556.0	$1,175.0	$3,180.0	$1,924.0	$763.0	$8,349.0	$10,472.0	$18,821.0

(in millions)	*Argentina*	*Brazil*	*Other Latin American Countries*	*Europe*	*Asia/ Pacific*	*Other Regions*	*Total Inter-national Operations*	*United States Operations*	*Consol-idated*
For the Year Ended December 31, 1982									
Net interest revenue	$ 49.9	$ 35.0	$ 33.5	$ 44.8	$ 19.5	$ 10.8	$ 193.5	$ 360.6	$ 554.1
Provision for credit losses	3.2	1.0	13.8	15.4	2.5	1.0	36.9	11.1	48.0
Net interest revenue after provision for credit losses	46.7	34.0	19.7	29.4	17.0	9.8	156.6	349.5	506.1
Other operating income	21.5	12.1	4.0	9.5	9.5	3.1	59.7	168.0	227.7
Other operating expense	42.2	24.5	15.2	30.9	11.0	4.7	128.5	420.7	549.2
Non-interest allocations, net-charge/(credit)	7.6	6.1	3.4	12.5	3.6	2.0	35.2	(35.2)	
Income before income taxes	18.4	15.5	5.1	(4.5)	11.9	6.2	52.6	132.0	184.6
Net income	$ 9.1	$ 7.4	$ 2.4	$ (2.3)	$ 5.6	$ 3.1	$ 25.3	$ 99.1	$ 124.4
Average assets:									
Interest bearing deposits in other banks	$ 2.0	$ 1.0	$ 314.0	$1,778.0	$ 493.0	$202.0	$2,790.0	$ 194.0	$ 2,984.0
Loans and lease financing	595.0	339.0	769.0	1,020.0	692.0	371.0	3,786.0	6,339.0	10,125.0
All other assets	179.0	149.0	151.0	342.0	544.0	41.0	1,406.0	2,991.0	4,397.0
Total average assets	$776.0	$489.0	$1,234.0	$3,140.0	$1,729.0	$614.0	$7,982.0	$9,524.0	$17,506.0

BANK OF BOSTON CORPORATION

Consolidated Statistical Information, *continued*

International Outstandings

At December 31, 1984, international outstandings represent approximately 35% of the Corporation's consolidated total assets. Included in these outstandings are cash and deposits in other banks, resale agreements, investment and trading account securities, loans and lease financing, amounts due from customers on acceptances and accrued interest receivable. Total cross-border outstandings represent approximately 25% of consolidated total assets at December 31, 1984. Cross-border outstandings are defined as amounts payable to the Corporation in U.S. dollars or other non-local currencies, plus amounts payable in local currency but funded with U.S. dollars or other non-local currencies. Excluded from the computation of cross-border outstandings for a given country are (a) local currency outstandings funded locally and (b) U.S. dollar or other non-local currency outstandings reallocated as a result of external guarantees or cash collateral.

Cross-border outstandings in countries which individually exceed .75% of consolidated total assets at December 31, 1984 and December 31, 1983 are approximately as follows:

	December 31, 1984					
(dollars in millions)	*Public (1)*	*Banks (2)*	*Other*	*Total*	*Percentage of Consolidated Total Assets*	*Commitments (3)*
Country						
Argentina	$110	$ 5	$135	$250	1.1%	$ 80
Brazil	190	5	135	330	1.5	20
Canada		240	30	270	1.2	60
France	15	335	20	370	1.7	25
Italy	15	220	10	245	1.1	5
Japan		220	55	275	1.2	[illegible]
Mexico	95	20	115	230	1.0	10
South Korea	40	115	65	220	1.0	20
United Kingdom	15	240	250	505	2.2	105
West Germany	40	45	100	185	.8	45

	December 31, 1983					
(dollars in millions)	*Public (1)*	*Banks (2)*	*Other*	*Total*	*Percentage of Consolidated Total Assets*	*Commitments (3)*
Country						
Argentina	$ 75		$215	$290	1.5%	$ 35
Australia		$ 70	115	185(4)	.9	15
Brazil	120	10	175	305	1.6	35
Canada		325	55	380(4)	1.9	60
France	20	275	20	315	1.6	20
Italy	40	240	10	290	1.5	5
Japan		475	165	640(4)	3.3	15
Luxembourg		165	10	175(4)	.9	10
Mexico	75	30	120	225	1.2	
South Korea	60	255	55	370(4)	1.9	10
Taiwan	15	30	120	165(4)	.8	40
United Kingdom	10	270	250	530(4)	2.7	105
West Germany	40	85	105	230(4)	1.2	[illegible]

Consolidated Statistical Information, *continued*

(1) Included within public are cross-border outstandings to central governments and their agencies, central or government development banks, state and local foreign governments and non-bank commercial enterprises, majority-owned by central governments. Excluded are banks owned by foreign governments that do not function as central banks or banks of issue.

(2) Included within banks are cross-border outstandings to (a) private banking institutions, and (b) banks owned by a foreign government other than central banks or banks of issue.

(3) Included within commitments are letters of credit, the undisbursed portion of loan commitments and guarantees. Amounts presented are net of reallocations.

(4) December 31, 1983 amounts have been restated to reflect current judgments as to the inclusion of certain funding arrangements as cross-border outstandings.

All of the overseas activities of the Corporation's subsidiaries are subject to the political conditions in, and economic and regulatory policies of, the governments of the countries in which the activities are conducted, including the policies of such governments toward indebtedness to foreign lenders, toward private business, and toward the United States. In addition, high rates of inflation and local, regional and worldwide recessionary conditions of varying degrees of severity affect local economies and governments and accordingly may also affect overseas activities.

Moreover, from time to time, conditions in a country may be such that, due to foreign exchange liquidity problems, currency restrictions or other situations unrelated to normal credit risk, non-local currency debt service payments are not made as originally scheduled. Currently, such conditions exist in a number of countries throughout the world, including three countries whose cross-border outstandings individually exceed .75% of consolidated total assets at December 31, 1984 (Argentina, Brazil and Mexico).

Argentina. A proposal, endorsed by the IMF and Argentina's Bank Advisory Committee, to provide new funds and to reschedule certain public and private credits has been submitted to Argentina's international lenders. In responding to this proposal, the Corporation has agreed to disburse approximately $50 million in financing (primarily 10-year-term; 3 years grace on installments of principal) during the course of 1985 and the first quarter of 1986. The proposal also calls for Argentina to repay the remaining balance of a bridge loan provided by international lenders in prior years. The Corporation would expect to receive $10 million from this repayment in 1985. In addition to the new money commitment discussed above, $7 million in medium-term financing disbursed by the Corporation in prior years, at Argentina's request, will remain outstanding.

The proposal also provides for a rescheduling of approximately $70 million of the Corporation's cross-border loans and calls upon the Corporation to maintain trade lines into Argentina at September 30, 1984 levels (approximately $120 million). The Corporation's Argentine trade financing is primarily associated with acceptances and documentary letters of credit.

Consolidated Statistical Information, *continued*

The following summarizes significant data relative to the approximately $70 million in non-trade related cross-border loans which will be rescheduled u this proposal.

(dollars in millions)	Approximate Principal Amount	Weighted Average Interest Rate		Approximate 1984 Interest Income		
		Current	Proposed	Actual	Pro Forma Assuming all Loans on Full Accrual	Pro Forma Assuming Full Accrual at Proposed Interest Rates
(1) Certain private sector loans	$55	15.5%	Libor + 1.4%	$3.6	$8.4	$7.4
(2) Certain public sector loans	$15	12.9%	Libor + 1.4%	$1.4	$2.1	$2.0

Repayment of private and public sector loans will generally be over a ten-year period with three years grace on installments of principal.

In late December 1984, approximately $1 million in past due interest was received by the Corporation on the approximately $15 million in public sector loans referred to above. This interest was recognized as income; however substantially all of the related principal remained on nonaccrual at December 31, 1984. In addition, $28 million of the approximately $55 million in private sector loans affected by this proposal were on nonaccrual at December 31, 1984.

Approximately $70 million of the Corporation's cross-border outstandings to Argentina, which originated in the private sector and originally matured in 1982 and 1983, have been subject to a rescheduling program initially established under Argentine Communication A-251. Under this program, lenders may either accept dollar-denominated five-year government obligations as payment or extend the original loan for five additional years, using the government obligations as collateral. The rescheduling arrangement in effect provides the guarantee of the Argentine government for loans to such private borrowers, or transfers fully the obligation from private outstandings to public outstandings. At December 31, 1984, the Corporation had received (in payment or as collateral) all of these government obligations associated with such cross-border outstandings. These loans are on full accrual status at December 31, 1984 since the underlying government obligation has been issued in payment or as collateral and the interest owed is being paid in accordance with the terms of the program.

To the extent the government obligation was iss before November 4, 1983, interest due was recei in cash. On November 4, 1983 Communication A-404, affecting approximately $55 million of the $70 million of the Corporation's cross-border outstandings referred to in the preceding paragraph, was announced. This Communication included a provision which amended the manner in which interest would be paid for government obligations issued from that date onward. Interest due on these loans is being paid ten percent in cash and ninety

Consolidated Statistical Information, *continued*

nt in the form of a 120-day, Argentine Central Bank interest bearing deposit. As these deposits mature, they are being paid out to the Corporation in cash. As of December 31, 1984, the Corporation held $2 million of these deposits associated with cross-border outstandings.

During 1984, approximately $25 million of interest income was recorded on cross-border outstandings to Argentina and approximately $25 million was received in cash. Total Argentine loans on nonaccrual at December 31, 1984, including the cross-border outstandings discussed previously were $60 million, representing $46 million of private and $14 million of public outstandings.

Brazil. During 1983 and 1984, the Corporation disbursed $31 million and $33 million respectively to Brazil in medium to long-term financing under agreements negotiated between Brazil and its international lenders.

The Corporation has agreed to reschedule non-trade related cross-border outstandings maturing in 1983 and 1984 amounting to approximately $35 million and $20 million respectively. Under these rescheduling plans, referred to as Project II, borrowers with dollar debt make principal payments in local currency to the Central Bank, which converts the local currency to an interest bearing dollar account which is payable to the Corporation in scheduled payments extending to 1993.

Under both the medium-term financing and Project II programs, referred to above, the interest-bearing dollar account funds are available to the Corporation under certain conditions for relending within Brazil. At December 31, 1984, the Corporation had relent approximately $70 million under this aspect of the programs.

In connection with that portion of Brazil's refinancing package dealing with short-term trade financing, the Corporation agreed to maintain its current level of funding (approximately $80 million) during 1984.

During 1984, approximately $40 million of interest income was recorded on cross-border outstandings to Brazil and approximately $45 million was received in cash. Total Brazilian loans on nonaccrual at December 31, 1984 were $6 million, all of which are attributable to credit-related problems.

Mexico. During 1983 and 1984, the Corporation disbursed $17 million and $10 million respectively to Mexico in medium to long-term financing under agreements negotiated between Mexico and its international lenders. The Corporation's aggregate commitment under these agreements is $31 million.

During 1984, approximately $10 million of interest income was recorded on public cross-border outstandings to Mexico and approximately $10 million was received in cash. Total public cross-border outstandings to Mexico at December 31, 1984 were approximately $95 million.

An agreement in principle to reschedule certain public loans has been reached between Mexico and its international lenders. The rescheduling, which affects approximately $70 million of the Corporation's public cross-border outstandings, calls for (1) a further rescheduling of outstandings which originally matured between August, 1982 and December, 1984 (12 year term; no grace on installments of principal), (2) a rescheduling of the 1983 portion of the medium- to long-term financing previously referred

Consolidated Statistical Information, *continued*

to (10 year term; 4 years grace on installments of principal), and (3) a rescheduling (for the first time) of the Corporation's public cross-border outstandings with original maturities falling between 1985 and 1990 (14 year term; 1 year grace on installments of principal). The Corporation received no principal repayments on any public cross-border outstandings in 1984.

The following summarizes the effects which this proposal will have on the Corporation's public cross-border outstandings.

(dollars in millions)	*Principal Amount*	*Weighted Average Interest Rate*	
		Current	*Proposed*
(1) Further rescheduling of loans originally maturing between August 1982 and December 1984	$45	Prime + 1.7%	Libor + 1.2%
(2) 1983 Medium Term Loan	$17*	Prime + 2.1%	Prime + 1.1%
(3) First rescheduling of Loans maturing between 1985 and 1990	$ 9	Libor + .9%	Libor + 1.2%

* It is expected that Mexico will prepay approximately $3 million to $4 million of this loan as part of the proposed package during 1985. The Corporation received the first installment of this prepayment amounting to approximately $1 million in January, 1985.

Approximately $20 million of the Corporation's cross-border outstandings represent placements with Mexican banks. These outstandings continue to be renewed under short-term arrangements at market rates of interest.

Mexico has established a program, known as FICORCA, whereby principal amounts due from private borrowers will generally be repaid over terms ranging from six to eight years. Substantially all of the Corporation's private cross-border outstandings are covered by this program.

Total Mexican loans on nonaccrual at December 31, 1984 were $20 million, all of which are to private borrowers and are attributable to credit-related problems. The Mexican government is making foreign exchange available for the payment of interest on private and public loans.

Venezuela. Although not included in the .75% and higher outstandings, cross-border outstandings to Venezuela at December 31, 1984 were approximately $125 million, of which approximately $10 million was to public borrowers, $45 million was to banks (of which approximately $20 million was to government owned banks) and $70 million was to private borrowers. In addition, cross-border letters of credit into Venezuela amounted to $10 million at December 31, 1984.

The Venezuelan government has reached an agreement with its Bank Advisory Committee on the rescheduling of public debt. It is not expected that Venezuela's international creditors will sign the agreement until the private rescheduling program, referred to below, is finalized. Currently, payments of principal on public debt have been deferred until April 30, 1985. The Corporation's public borrowers were substantially current with respect to the payment of interest at December 31, 1984.

Although not yet finalized, Venezuela has announced a rescheduling program for private sector debt. Presently, borrowers continue to experience difficulties in obtaining foreign exchange and a portion of private sector loan principal and interest has fallen past due.

Total Venezuelan loans on nonaccrual at December 31, 1984 were $46 million, most of which is attributable to delays in obtaining foreign exchange.

In management's opinion, the conditions described above will not ultimately have a material adverse effect on the Corporation. However, in light of continuing uncertainties within countries experiencing difficulties in meeting non-local debt service, it is likely that from time to time additional loans will be placed on nonaccrual.

Consolidated Statistical Information, *continued*

Loans and Lease Financing

The Corporation's lending activities are conducted principally by the Bank. The loan and lease financing portfolio is broadly diversified both in terms of geographical and industrial categories. There are no concentrations of loans exceeding 10% of total loans which are not otherwise disclosed below. The following table presents details of consolidated loan and lease financing balances outstanding on the dates indicated.

	December 31									
	1984		1983		1982		1981		1980	
(dollars in millions)	*Balance*	*Percent*	*Balance*	*Percent*	*Balance*	*Percent*	*Balance*	*Percent*	*Balance*	*Percent*
United States Operations:										
Commercial, industrial and financial	$ 7,010.5	48.1%	$ 5,253.2	44.2%	$ 4,945.9	46.1%	$4,339.8	45.4%	$3,900.1	44.1%
Real estate—construction	955.8	6.6	810.4	6.8	585.3	5.5	435.9	4.6	373.6	4.2
Real estate—other	1,329.3	9.1	778.1	6.5	588.1	5.5	554.5	5.8	379.9	4.3
Loans to individuals	921.4	6.3	620.2	5.2	602.2	5.6	618.5	6.5	570.2	6.4
Lease financing	264.2	1.8	213.0	1.8	214.0	2.0	171.3	1.8	131.7	1.5
Unearned income	(98.8)	(.7)	(98.2)	(.8)	(115.4)	(1.0)	(111.2)	(1.2)	(116.6)	(1.3)
	10,382.4	71.2	7,576.7	63.7	6,820.1	63.7	6,008.8	62.9	5,238.9	59.2
International Operations:										
Commercial and industrial	2,374.7	16.3	2,446.7	20.6	2,534.8	23.7	2,418.5	25.3	2,599.2	29.4
Banks and other financial institutions	558.4	3.8	643.3	5.4	558.3	5.2	404.6	4.2	409.8	4.6
Governments and official institutions	843.1	5.8	776.1	6.5	355.2	3.3	310.7	3.3	290.5	3.3
Lease financing	286.9	1.9	313.4	2.6	307.2	2.9	295.8	3.1	223.9	2.5
All other	243.2	1.7	259.4	2.2	262.5	2.4	228.6	2.4	156.4	1.8
Unearned income	(100.2)	(.7)	(119.7)	(1.0)	(123.9)	(1.2)	(116.0)	(1.2)	(71.2)	(.8)
	4,206.1	28.8	4,319.2	36.3	3,894.1	36.3	3,542.2	37.1	3,608.6	40.8
	$14,588.5	100.0%	$11,895.9	100.0%	$10,714.2	100.0%	$9,551.0	100.0%	$8,847.5	100.0%

The Corporation does not have an automatic rollover (renewal) policy for maturing loans. Rather, loans are renewed at the maturity date only at the request of those customers who are deemed to be creditworthy by the Corporation. Additionally, the Corporation reviews such requests in substantially the same manner as applications by new customers for extensions of credit (see also International Outstandings beginning on page 68). The maturity date and interest terms of renewed loans are based, in part, upon the needs of the individual customer and the Corporation's credit review and evaluation of current and future economic conditions. Since these factors have varied considerably and will most likely continue to do so, the Corporation believes it is impracticable to estimate the amount of loans in the portfolio which may be rolled over in the future.

Consolidated Statistical Information, *continued*

The following table presents the maturities and interest sensitivity, based on original contractual terms, of the Corporation's loans at December 31, 1984, exclusive of domestic office loans secured [illegible] one to four-family residential properties, domestic loans to individuals and lease financing.

(in millions)	*Within One Year*	*After One but within Five Years*	*After Five Years*	*Total*
Commercial, industrial and financial	$3,932.0	$2,333.9	$ 523.5	$ 6,789.4
Real estate—construction	746.4	199.3	10.1	955.8
Real estate—other	355.6	215.1	135.1	705.8
Overseas offices	2,861.4	891.4	492.4	4,245.2
	$7,895.4	$3,639.7	$1,161.1	$12,696.2
Loans with predetermined interest rate	$3,184.6	$ 620.3	$ 234.4	$ 4,039.3
Loans with floating interest rate	4,710.8	3,019.4	926.7	8,656.9
	$7,895.4	$3,639.7	$1,161.1	$12,696.2

Nonperforming Loans and Leases

Provision for Uncollectible Accrued Interest Receivable and Lease Income Receivable:

The Corporation's policy with respect to nonaccrual loans and leases is discussed in Note 1 of Notes to Financial Statements under the caption Loans and Lease Financing. At December 31, 1984, approximately 15% of nonaccrual loans and leases were less than ninety days past due. The aggregate provision for uncollectible interest and lease income was $46.9 million in 1984, $20.3 million in 1983, $37.9 million in 1982, $27 million in 1981 and $18.5 million in 1980.

The following is a summary of outstanding loans and leases by type and as a percentage of the related consolidated loan category for which the related accrued interest and lease income receivable was partially or fully reserved.

	December 31									
	1984		*1983*		*1982*		*1981*		*1980*	
(dollars in millions)	*Balance*	*Percent of Loan Category*	*Balance*	*Percent of Loan Category*	*Balance*	*Percent of Loan Category*	*Balance*	*Percent of Loan Category*	*Balance*	*Percent of Loan Category*
United States Operations:										
Commercial, industrial and financial	$198.3	2.8%	$125.1	2.4%	$152.3	3.1%	$ 99.2	2.3%	$ 58.5	1.5%
Real estate—construction	24.3	2.5	37.2	4.6	8.8	1.5	17.2	4.0	2.8	.7
Real estate—other	9.3	.7	11.7	1.5	4.8	.8	10.2	1.8	9.6	2.5
Loans to individuals	9.0	1.0	7.8	1.3	6.6	1.1	5.4	.9	19.5	3.4
Lease financing	3.2	1.2	3.7	1.7	4.8	2.3	1.7	1.0		
	244.1	2.4	185.5	2.4	177.3	2.6	133.7	2.3	90.4	1.8
International Operations:										
Commercial and industrial	150.0	6.3	111.6	3.9	70.9	2.8				
Banks and other financial institutions	12.4	2.5	14.4	2.8	10.4	1.9				
Governments and official institutions	51.8	5.8	9.6	2.0	17.2	4.9				
Lease financing	.8	.3	.3	.1	1.1	.3				
All other	8.8	3.6	4.4	1.7	6.6	2.9				
	223.8	5.3	140.3	3.2	106.2	2.7	101.2	3.0	64.6	1.9
	$467.9	3.2%	$325.8	2.7%	$283.5	2.6%	$234.9	2.5%	$155.0	[illegible]

The breakdown by category of International nonaccrual loans and leases for years prior to 1982 is not available.

BANK OF BOSTON CORPORATION

Consolidated Statistical Information, *continued*

The following is an analysis of interest income related to loans and leases on nonaccrual at December 31, 1984:

(in millions)	*United States Operations*	*International Operations*	*Total*
Interest income that would have been recognized during the period if the loans had been current at original contractual rates	$24.4	$36.2	$60.6
Amount recognized as interest income	7.9	10.8	18.7
Difference	$16.5	$25.4	$41.9

Renegotiated Loans:

A renegotiated loan is one for which the Corporation has compromised the contractual terms to provide a reduction in the rate of interest and, in most instances, an extension of payments of principal or interest or both because of a deterioration in the financial position of the borrower. Renegotiated loans, which are performing in accordance with their new terms, are not included in outstanding loans for which the related accrued interest receivable was partially or fully reserved unless concern exists as to the ultimate collection of principal or interest. Loans for which contractual interest rates had been reduced and which are performing in accordance with their new terms were less than .1% of total related consolidated loan categories in 1981 through 1984. In 1980, the total balance was $33.7 million or .4%.

Reserve for Possible Credit Losses

The Corporation's reserve for possible credit losses (the "Reserve") is available for future charge-offs of extensions of credit. The provision for credit losses (the "Provision"), added to the Reserve by charges to income, is based upon management's estimation of the amount necessary to maintain the Reserve at an adequate level, considering net losses charged to the Reserve, current economic conditions, sovereign and transfer risks, changes in the size and character of the credit risks, and other pertinent factors warranting current recognition.

The Corporation charges all or a portion of a loan or lease receivable against the Reserve when a probability of loss has been established, with consideration given to such factors as the customer's financial condition, underlying collateral and guarantees. The Corporation utilizes a loan rating system in its United States and International Operations to assist management in its evaluation of the loan portfolio. At least annually, individual loans are reviewed and assigned ratings based principally upon potential risk. If indicated by the assigned rating, particular loans are reviewed more frequently.

In addition, the Corporation's independent certified public accountants review the loan and lease financing portfolio on an annual basis. The loans of the Corporation's bank subsidiaries are also subject to periodic examination by bank regulatory authorities.

Consolidated Statistical Information, *continued*

Allocation of Reserve for Possible Credit Losses

The Corporation does not allocate its reserve for possible credit losses to specific loan and lease categories because management views the reserve as being available for all categories of prospective loss. However, to be responsive to the Securities and Exchange Commission's Guides for Statistical Disclosures by Bank Holding Companies, the Corporation has allocated its year end reserves for possible credit losses to the major loan and lease categories. The allocations result from giving consideration to management's evaluation of risk in the portfolios, current economic conditions, recent years' loss experience, and the review of the loan portfolio of the Bank by the Comptroller of the Currency. The unallocated reserve in 1984 was increased to reflect the effect of the $100 million special provision recorded during the year. See Note 6 of Notes to Financial Statements. Based upon the foregoing, the allocations of the Reserve were as follows:

Loans and Lease Financing

	December 31									
	1984		*1983*		*1982*		*1981*		*1980*	
(dollars in millions)	*Amount*	*Percent of Total*	*Amount*	*Percent of Total*	*Amount*	*Percent of Total*	*Amount*	*Percent of Total*	*Amount*	*Percent of Total*
United States Operations:										
Commercial, industrial and financial	$ 7,010.5	48.1%	$ 5,253.2	44.2%	$ 4,945.9	46.1%	$4,339.8	45.4%	$3,900.0	44.1%
Real estate	2,285.1	15.7	1,588.5	13.3	1,173.4	11.0	990.4	10.4	753.5	8.5
Loans to individuals	921.4	6.3	620.2	5.2	602.2	5.6	618.5	6.5	570.2	6.4
Lease financing	264.2	1.8	213.0	1.8	214.0	2.0	171.3	1.8	131.7	1.5
	10,481.2	71.9	7,674.9	64.5	6,935.5	64.7	6,120.0	64.1	5,355.4	[illegible]
International Operations	4,306.3	29.5	4,439.0	37.3	4,018.0	37.5	3,658.2	38.3	3,679.9	[illegible]
	14,787.5	101.4	12,113.9	101.8	10,953.5	102.2	9,778.2	102.4	9,035.3	102.1
Unearned income	(199.0)	(1.4)	(218.0)	(1.8)	(239.3)	(2.2)	(227.2)	(2.4)	(187.8)	(2.1)
	$14,588.5	100.0%	$11,895.9	100.0%	$10,714.2	100.0%	$9,551.0	100.0%	$8,847.5	100.0%

Allocation of Reserve for Possible Credit Losses

	December 31									
	1984		*1983*		*1982*		*1981*		*1980*	
(dollars in millions)	*Amount*	*Percent of Total*	*Amount*	*Percent of Total*	*Amount*	*Percent of Total*	*Amount*	*Percent of Total*	*Amount*	*Percent of Total*
United States Operations:										
Commercial, industrial and financial	$ 54.0	22.3%	$ 39.0	28.7%	$ 36.0	29.0%	$ 36.0	30.7%	$ 31.0	30.3%
Real estate	7.0	2.9	8.0	5.9	6.0	4.8	7.0	6.0	5.0	4.9
Loans to individuals	8.0	3.3	6.0	4.4	7.0	5.6	8.0	6.8	8.5	8.3
Lease financing	2.0	.8	2.0	1.5	4.0	3.2	2.0	1.7	2.0	2.0
	71.0	29.3	55.0	40.5	53.0	42.6	53.0	45.2	46.5	45.5
International Operations	50.0	20.6	40.0	29.5	34.0	27.4	29.0	24.8	25.1	24.5
	121.0	49.9	95.0	70.0	87.0	70.0	82.0	70.0	71.6	70.0
Unallocated	121.4	50.1	40.8	30.0	37.4	30.0	35.1	30.0	30.7	30.0
	$242.4	100.0%	$135.8	100.0%	$124.4	100.0%	$117.1	100.0%	$102.3	100.0%

BANK OF BOSTON CORPORATION

Consolidated Statistical Information, *continued*

is of Reserve for Possible Credit Losses

The following table presents a five year analysis of the Corporation's reserve for possible credit losses.

(in millions)	*1984*	*1983*	*1982*	*1981*	*1980*
United States Operations:					
Balance, January 1	$ 78.4	$ 76.5	$ 76.2	$ 67.4	$ 61.3
Reserves of acquired companies	6.5	1.6		.6	.6
Provision	115.3	22.7	11.1	26.2	15.8
Credit losses, net of recoveries:					
Commercial, industrial and financial:					
Losses	(55.5)	(27.7)	(20.4)	(23.5)	(13.8)
Recoveries	12.9	9.4	15.8	10.9	8.8
	(42.6)	(18.3)	(4.6)	(12.6)	(5.0)
Real estate—construction:					
Losses	(.3)		(2.0)		
Recoveries	1.0			.1	
	.7		(2.0)	.1	
Real estate—other:					
Losses	(.3)	(.1)	(.3)		(.3)
Recoveries	.2				.1
	(.1)	(.1)	(.3)		(.2)
Loans to individuals:					
Losses	(5.2)	(5.1)	(5.5)	(6.9)	(6.1)
Recoveries	2.4	2.0	4.7	1.6	1.1
	(2.8)	(3.1)	(.8)	(5.3)	(5.0)
Lease financing:					
Losses	(.7)	(1.3)	(3.3)	(.3)	(.2)
Recoveries	.2	.4	.2	.1	.1
	(.5)	(.9)	(3.1)	(.2)	(.1)
Net credit losses	(45.3)	(22.4)	(10.8)	(18.0)	(10.3)
Balance, December 31	$ 154.9	$ 78.4	$ 76.5	$ 76.2	$ 67.4
International Operations:					
Balance, January 1	$ 57.4	$ 47.9	$ 40.9	$ 34.9	$ 21.5
Provision	64.7	31.3	36.9	21.8	32.2
Credit losses	(43.1)	(27.1)	(36.7)	(17.0)	(21.5)
Recoveries	8.5	5.3	6.8	1.2	2.7
Net credit losses	(34.6)	(21.8)	(29.9)	(15.8)	(18.8)
Balance, December 31	$ 87.5	$ 57.4	$ 47.9	$ 40.9	$ 34.9
Consolidated:					
Balance, January 1	$ 135.8	$ 124.4	$ 117.1	$102.3	$ 82.8
Reserves of acquired companies	6.5	1.6		.6	.6
Provision	180.0	54.0	48.0	48.0	48.0
Credit losses	(105.1)	(61.3)	(68.2)	(47.7)	(41.9)
Recoveries	25.2	17.1	27.5	13.9	12.8
Net credit losses	(79.9)	(44.2)	(40.7)	(33.8)	(29.1)
Balance, December 31	$ 242.4	$ 135.8	$ 124.4	$117.1	$102.3
Loans and lease financing at December 31	$14,589	$11,896	$10,714	$9,551	$8,848
Average loans and lease financing	$13,210	$11,076	$10,125	$9,050	$8,046
Ratios:					
Reserve for possible credit losses to loans and lease financing at ecember 31	1.66%	1.14%	1.16%	1.23%	1.16%
credit losses to average loans and ease financing	.61	.40	.40	.37	.36
Net credit losses to provision for credit losses	44.43	81.80	84.93	70.30	60.87
Total recoveries to total credit losses	23.91	27.97	40.33	29.27	30.49

Consolidated Statistical Information, *continued*

Investment Securities

The following table sets forth the book values of investment securities of the Corporation on the dates indicated.

(in millions)	*December 31* 1984	1983	1982
U.S. Treasury	$507.0	$ 755.5	$ 874.5
States and political subdivisions	22.8	12.8	171.1
Other bonds, notes and debentures	321.1	338.5	265.1
Marketable equity securities	16.2	14.1	17.6
Other equity securities	99.7	77.3	61.2
	$966.8	$1,198.2	$1,389.5

The following table illustrates the relative maturities and weighted average interest rates of investment securities held at December 31, 1984, excluding equity securities. Rates for states and political subdivisions are stated on a fully taxable equivalent basis assuming a 46% federal income tax rate, adjusted for applicable state and local income taxes net of the related federal tax benefit.

	Within One Year		*After One but within Five Years*		*After Five but within Ten Years*		*After Ten Years*		*Total*	
(dollars in millions)	*Amount*	*Rate*	*Amount*	*Rate*	*Amount*	*Rate*	*Amount*	*Rate*	*Amount*	*Rate*
U.S. Treasury	$401.5	10.6%	$ 97.2	11.5%	$ 2.5	10.8%	$ 5.8	11.6%	$507.0	10.[illegible]
States and political subdivisions	8.6	12.2	8.2	16.6	5.5	12.3	.5	12.7	22.8	13.8
Other bonds, notes and debentures:										
United States Operations	11.5	13.5	20.4	11.7	13.3	9.9	18.1	8.7	63.3	10.8
International Operations	173.6	31.8	71.3	42.9	12.8	14.0	.1	68.0	257.8	34.0
	$595.2	16.9%	$197.1	23.1%	$34.1	11.9%	$24.5	9.9%	$850.9	17.9%

Deposits

The aggregate amount of deposits by foreign depositors in domestic offices averaged $235,103,000 in 1984, $173,686,000 in 1983 and $157,058,000 in 1982.

The following table presents the maturities of time certificates of deposit and other time deposits issued by domestic offices in denominations of $100,000 or more, at December 31, 1984.

(in millions)	*Time Certificates of Deposit*	*Other Time Deposits*	*Total*
Maturing within three months	$1,262.9	$ 77.8	$1,340.7
Over three through six months	29.8	31.8	61.6
Over six through 12 months	32.1	16.5	48.6
Over 12 months	230.2	21.0	251.2
	$1,555.0	$147.1	$1,7[illegible]

The majority of foreign office deposits are in denominations of $100,000 or more.

Consolidated Statistical Information, *continued*

Short-Term Borrowings

(dollars in millions)	*Balance at End of Period*	*Weighted Average Interest Rate*	*Maximum Amount Outstanding During the Period*	*Daily Average Amount Outstanding During the Period*	*Weighted Average Interest Rate During the Period*
Category of Aggregate Short-Term Borrowings:					
For the Year Ended December 31, 1984					
Federal funds purchased (1)	$ 731.2	8.72%	$1,500.1	$1,119.0	10.24%
Term federal funds purchased (1)	606.5	9.67	996.0	664.3	11.03
Securities sold under agreements to repurchase (2)	381.4	84.15	735.3	562.0	38.24
Commercial paper (3)	916.5	9.40	916.5	804.5	10.65
Demand notes issued to the U.S. Treasury (4)	140.8	8.50	216.6	115.1	10.12
All other (5)	496.4	36.32	689.1	494.0	36.51
For the Year Ended December 31, 1983					
Federal funds purchased (1)	$1,492.8	10.29%	$2,130.2	$1,549.4	8.08%
Term federal funds purchased (1)	348.3	10.17	779.1	516.6	9.55
Securities sold under agreements to repurchase (2)	646.1	29.83	1,199.8	643.2	29.40
Commercial paper (3)	724.9	9.76	724.9	593.8	9.25
Demand notes issued to the U.S. Treasury (4)	106.5	9.94	222.6	135.8	9.00
All other (5)	522.8	35.74	594.1	441.0	42.38
For the Year Ended December 31, 1982					
Federal funds purchased (1)	$1,227.0	10.44%	$1,412.1	$1,149.3	11.73%
Term federal funds purchased (1)	646.1	9.60	646.1	467.1	13.06
Securities sold under agreements to repurchase (2)	767.7	22.68	986.5	772.3	19.08
Commercial paper (3)	577.3	8.92	665.6	639.1	12.68
Demand notes issued to the U.S. Treasury (4)	201.4	10.87	209.9	120.3	12.66
All other (5)	430.6	42.56	430.6	351.7	38.23

(1) Federal funds purchased are overnight transactions while term federal funds purchased have maturities in excess of one day. A large portion of federal funds purchased arise because of the Bank's money market activity in federal funds for its regional correspondent banks.

(2) Securities sold under agreements to repurchase by domestic offices are collateralized by United States Government securities and mature within one year. Securities sold under agreements to repurchase by overseas offices related primarily to the Brazilian operations of the Bank for which various Brazilian Government securities serve as collateral.

(3) Commercial paper represents unsecured obligations with maximum maturities of nine months.

(4) Demand notes issued to the U.S. Treasury represent depository liabilities that are not subject to reserve requirements and bear interest at ¼ of one percent below the weekly average federal funds interest rate.

(5) All other short-term borrowings represent secured and unsecured obligations, primarily of the Corporation's overseas branches and subsidiaries, to financial institutions at various rates and terms.

Consolidated Statistical Information, ***continued***

Summary of Selected Financial Data Adjusted for the Effects of Changing Prices

Inflation has had a pervasive influence on the worldwide economic system. This has resulted in an effort being made to measure inflation's impact on the performance of business enterprises. Although a consensus has not been reached as to the best means to achieve this goal, the Financial Accounting Standards Board (the "Board") has issued Statement of Financial Accounting Standards No. 33 (the "Statement"), entitled "Financial Reporting and Changing Prices." This Statement, as amended, requires that certain large entities measure and report the effects of changing prices by presenting certain historical cost information adjusted for the effects of general inflation. The Corporation uses the historical cost/constant dollar method of accounting, which adjusts assets and liabilities based on changes in the consumer price index for all urban consumers (the "CPI-U"), to measure the effects of inflation. This method is used since less than 2% of the Corporation's assets are comprised of premises and equipment and the majority of its assets and liabilities are monetary. Therefore, the results of using the more specific current cost method of measurement would not be materially different than the constant dollar method.

As with any analytical tool, financial statements adjusted for the effects of changing prices present only a partial picture and, consequently, should not be viewed without reference to other financial and economic indicators. This caveat is especially appropriate in the case of the banking industry. A bank's asset and liability structure differs significantly from that of manufacturing and other concerns in that virtually all assets and liabilities are of a monetary nature. Accordingly, other factors such as its ability to manage interest rate risk may have a much more important impact on a bank's performance. Also, interest rates do not necessarily move in the same direction or magnitude as the prices of goods and services as reflected by the CPI-U. It is not surprising, therefore, that there is little agreement as to the overall usefulness of this type of information.

The impact of inflation on banks is primarily in the lending area. Since customers' goods and services cost more in inflationary times, the level of their financing needs may increase to keep pace. If loan demand increases, the rates charged for the funds may also rise as the financial institutions compete for funds to support the demand. Furthermore, because the borrowers' exposure to financial risk is greatly enhanced as a result of increased leverage at higher rates, banks are faced with increased credit risk. Therefore, additional emphasis must be placed on evaluating the adequacy of the reserve for possible credit losses.

The following table compares selected financial data on a historical basis with the same amounts adjusted to average 1984 dollars using the CPI-U.

	1984	*1983*	*1982*	*1981*	*1980*
Net interest revenue after provision for credit losses (in millions):					
Historical dollars	$489.9	$552.5	$506.1	$478.9	$417.9
Average 1984 dollars	489.9	580.0	544.6	547.0	526.7
Per share data:					
Net income					
Historical dollars	$ 8.35	$ 7.40	$ 6.67	$ 6.25	$ 5.48
Average 1984 dollars	8.35	7.71	7.17	7.14	6.91
Dividends declared					
Historical dollars	$ 2.34	$ 2.17	$ 1.97	$ 1.73	$ 1.52
Average 1984 dollars	2.34	2.26	2.12	1.98	1.92
Market price at year end					
Historical dollars	$39.75	$40.50	$33.75	$30.42	$23.75
Average 1984 dollars	39.20	41.51	35.91	33.62	2[illegible]
Average Consumer Price Index (base year 1967 = 100)	311.1	298.4	289.1	272.4	246.8

Consolidated Statistical Information, *continued*

Purchasing power loss on net monetary assets is a constant dollar concept, designed to measure how general inflation affects monetary assets and liabilities, and is a function of the level of inflation. In periods of inflation, monetary assets such as cash and fixed claims to cash lose in terms of general purchasing power because the cash will buy less at the end of the period than at the beginning. Conversely, monetary liabilities, such as deposits and other funds borrowed, will gain under the same circumstances. This has significant reporting implications for a bank, whose assets and liabilities are almost all monetary in nature. In inflationary periods, a bank will generally report a purchasing power loss, the magnitude of which is inversely related to the degree to which it is leveraged. The lower the proportion of liabilities to equity, the greater the loss to be reported; the more highly capitalized financial institutions will, because of adjustments required by the Statement, show the larger purchasing power loss. Basically, a bank does not hold a significant amount of non-monetary assets and such assets are not material relative to the revenue producing process. Instead, it funds monetary asset growth by simultaneously incurring equal monetary liabilities; interest rates being adjusted to maintain interest margins sufficient to compensate for risk, to mitigate inflationary pressures and to increase capital consistent with the expansion of the bank. Management believes, therefore, that the purchasing power loss amount is not relevant in that it is not indicative of how well a financial institution manages its asset/liability structure.

In the following table, amounts adjusted for general inflation and purchasing power losses are stated in average 1984 dollars.

	1984		*1983*		*1982*		*1981*		*1980*	
(in millions, except share amounts)	*Amount*	*Per Share*	*Amount*	*Per Share*	*Amount*	*Per Share*	*Amount*	*Per Share*	*Amount*	*Per Share*
Net income (1)	$ 164.1	$ 8.35	$ 141.5	$ 7.71	$ 133.9	$ 7.17	$ 135.5	$ 7.14	$ 128.8	$ 6.91
Additional depreciation resulting from adjusting premises and equipment for the effects of general inflation (2)	(11.2)	(.58)	(9.0)	(.49)	(9.0)	(.48)	(7.5)	(.40)	(7.2)	(.39)
Net income as adjusted for general inflation	$ 152.9	$ 7.77	$ 132.5	$ 7.22	$ 124.9	$ 6.69	$ 128.0	$ 6.74	$ 121.6	$ 6.52
Net assets at year end (1)	$1,168.9		$1,032.6		$ 940.6		$ 906.8		$ 878.8	
Increase resulting from adjusting premises and equipment for the effects of general inflation (2)	88.3		165.0		159.1		144.8		126.1	
Net assets at year end as adjusted for general inflation	$1,257.2		$1,197.6		$1,099.7		$1,051.6		$1,004.9	
Purchasing power loss on net monetary assets held during the year (2)	$ 16.4		$ 11.2		$ 14.1		$ 29.1		$ 41.3	

(1) Represents amounts reported in the historical cost financial statements stated in average 1984 dollars.

(2) In accordance with the Statement, additional depreciation and other adjustments have been computed without regard to any related tax benefits.

BANK OF BOSTON CORPORATION

Consolidated Statistical Information, *continued*

Trust Data

The assets shown below represent holdings in accounts for which the Corporation's subsidiaries have investment responsibility at December 31, 1984.

(dollars in millions)	*Market Value*	*Percentage of Total*
Assets by type of investment:		
Common stocks	$3,790.7	55.1%
Corporate bonds and notes	1,216.5	17.7
U.S. Government and agency obligations	932.9	13.5
State, county and municipal obligations	388.9	5.6
Miscellaneous assets	278.9	4.1
Real estate and real estate mortgages	151.1	2.2
Cash	67.6	1.0
Preferred stocks	56.5	.8
Total assets under investment supervision	$6,883.1	100.0%

(dollars in millions)	*Number of Accounts*	*Market Value*	*Percentage of Total*
Assets by type of account:			
Employee benefit trusts	1,974	$3,434.6	49.9%
Personal trusts	6,957	2,607.1	37.9
Agencies	1,368	802.1	11.[illegible]
Estates, conservatorships and guardianships	441	39.3	[illegible]
	10,740	$6,883.1	100.0%

BANK OF BOSTON CORPORATION

Summary of Quarterly Consolidated Financial Information and Common Stock Data

In the opinion of management, all adjustments, which include only normal recurring adjustments, necessary to present fairly the results of operations for each of the following quarterly periods have been made. Notes 6 and 8 of Notes to Financial Statements on pages 54 and 55 include additional information with respect to certain transactions recorded in the fourth quarter 1984.

				1984				1983
(in millions, except share amounts)	*Fourth Quarter*	*Third Quarter*	*Second Quarter*	*First Quarter*	*Fourth Quarter*	*Third Quarter*	*Second Quarter*	*First Quarter*
Income statement data:								
Interest income	$ 812.6	$ 785.4	$ 724.4	$ 600.0	$ 612.0	$ 596.7	$ 563.0	$ 561.5
Interest expense	625.6	613.9	553.0	460.0	458.8	438.3	413.6	416.1
Net interest revenue	187.0	171.5	171.4	140.0	153.2	158.4	149.4	145.4
Provision for credit losses	134.5	16.0	16.0	13.5	13.5	13.5	13.5	13.5
Net interest revenue after provision for credit losses	52.5	155.5	155.4	126.5	139.7	144.9	135.9	131.9
Other operating income	252.7	79.3	74.4	73.4	75.0	65.0	56.3	69.7
Other operating expense	204.0	178.2	179.4	160.6	156.3	154.9	142.6	141.4
Income before income taxes	101.2	56.6	50.4	39.3	58.4	55.0	49.6	60.2
Provision for income taxes	26.6	22.9	19.5	14.4	23.8	22.2	18.4	23.1
Net income	$ 74.6	$ 33.7	$ 30.9	$ 24.9	$ 34.6	$ 32.8	$ 31.2	$ 37.1
Average balance sheet data:								
Cash and due from banks	$ 1,512	$ 1,439	$ 1,395	$ 1,384	$ 1,311	$ 1,160	$ 1,173	$ 1,063
Interest bearing deposits in other banks	2,311	2,469	2,527	2,375	2,709	3,110	2,953	2,993
Federal funds sold and resale agreements	323	282	344	195	150	301	147	156
Trading account securities	474	330	401	448	434	325	474	476
Investment securities	964	963	1,009	1,139	1,132	842	1,397	1,303
Loans and lease financing	14,118	13,728	13,078	11,889	11,500	11,116	10,905	10,772
Other assets	2,093	2,014	2,102	1,940	2,102	1,831	1,751	1,692
Total assets	$21,795	$21,225	$20,856	$19,370	$19,338	$18,685	$18,800	$18,455
Deposits	$14,681	$14,318	$13,710	$12,477	$12,252	$12,272	$11,749	$11,720
Federal funds purchased and repurchase agreements	2,374	2,221	2,357	2,432	2,631	2,341	3,017	2,854
Notes and other funds borrowed	1,971	1,997	1,991	1,873	1,666	1,608	1,524	1,490
Other liabilities	1,617	1,580	1,712	1,573	1,806	1,515	1,583	1,491
Stockholders' equity	1,152	1,109	1,086	1,015	983	949	927	900
Total liabilities and stockholders' equity	$21,795	$21,225	$20,856	$19,370	$19,338	$18,685	$18,800	$18,455
Per common share:								
Net income	$ 3.80	$ 1.68	$ 1.55	$ 1.31	$ 1.86	$ 1.79	$ 1.71	$ 2.04
Dividends declared	.60	.58	.58	.58	.58	.53	.53	.53
Market value:								
High	41⅜	39	37⅜	43⅞	42	44	47⅝	41⅜
Low	34⅛	29	30	35½	34½	37½	39⅞	32⅝
Average common shares outstanding (in thousands)	19,267	19,172	19,061	18,967	18,614	18,322	18,262	18,197

The common stock of the Corporation (BkBos), which is the only class of its securities entitled to vote at the Annual Meeting, is listed and traded on the New York and Boston Stock Exchanges. The ticker symbol is "BKB". The registrar is State Street Bank and Trust Company and the transfer agent is The First National Bank of Boston.

Board of Directors

Martin A. Allen
Chairman
Computervision Corporation

William F. Andrews
Chairman, President and
Chief Executive Officer
Scovill Inc.

William L. Brown
Chairman and
Chief Executive Officer

William J. Clark
President and
Chief Executive Officer
Massachusetts Mutual
Life Insurance Company

Gerhard M. Freche
President and
Chief Executive Officer
New England Telephone
and Telegraph Company

Thomas J. Galligan, Jr.
Chairman, President and
Chief Executive Officer
Boston Edison Company

Nelson S. Gifford
President
Dennison Manufacturing Company

Richard D. Hill
Former Chairman

Colman M. Mockler, Jr.
Chairman and
Chief Executive Officer
The Gillette Company

J. Donald Monan, S.J.
President
Boston College

Charles A. Sanders, M.D.
Executive Vice President
Squibb Corporation

Richard A. Smith
Chairman and
Chief Executive Officer
General Cinema Corporation

Honorary Directors

Frank L. Farwell

James R. Martin

Austin B. Mason

William C. Mercer

Gary L. Countryman
President
Liberty Mutual Insurance Company

John F. Cunningham
President and
Chief Operating Officer
Wang Laboratories, Inc.

Alice F. Emerson
President
Wheaton College

Raymond C. Foster
Chairman and President
Stone & Webster, Incorporated

D. Brainerd Holmes
President
Raytheon Company

Samuel Huntington
President and
Chief Executive Officer
New England Electric System

John G. McElwee
Chairman and
Chief Executive Officer
John Hancock Mutual
Life Insurance Company

Donald F. McHenry
Research Professor of Diplomacy
Georgetown University

Ira Stepanian
President and
Chief Operating Officer

George R. West
Chairman and
Chief Executive Officer
Allendale Mutual Insurance
Company

An Wang

1784

BANK OF BOSTON
CORPORATION
AND
THE FIRST NATIONAL BANK
OF BOSTON

BANK OF BOSTON CORPORATION

William L. Brown
Chairman of the Board

Ira Stepanian
President

Alan L. McKinnon
Executive Vice President, Comptroller & Treasurer

Joseph L. Duran
Assistant Treasurer

Richard A. Wiley
Executive Vice President

T. McLean Griffin
Clerk & General Counsel

Gary A. Spiess
Deputy General Counsel & Assistant Clerk

Eric R. Fischer
Assistant General Counsel & Assistant Clerk

THE FIRST NATIONAL BANK OF BOSTON

William L. Brown
Chairman of the Board

Ira Stepanian
President

Corporate Group

Charles K. Gifford
Group Executive

Large Corporate
Paul N. Vonckx
Eastern
Peter L. Griswold
New York City
Mario Rossi
Midwest
John C. Mechem
Far West
Geoffrey W. Smith
Foreign Multinationals
Jeffrey L. Eberle

Middle Market
Paul N. Vonckx
Commercial Finance
Robert E. Flaherty
East
Gabe E. Romeo
West
Ronald L. Watterworth
Northeast
W. Latimer Gray
Midwest
Edward P. Collins
Southeast
James A. Mahoney
Southwest
Thomas M. Mercer
Far West
Mark A. MacLennan

Specialized Lending
Constantin R. Boden
Communications
C. Douglas Mercer
Energy
David K. McKown
High Technology
L. Thomas Bryan
Insurance
Christopher VanCuran
Transportation
Laurence A. Pierce
Utilities
Jonathan D. Horne

Operating Services and Systems
Phillip M. Sullivan
Cash Management
Stephen J. MacQuarrie
Freight Payment
Anthony J. Rubico

Line Management Processes and Staff Support
T. Lincoln Morison, Jr.

Leasing
Peter J. Manning

International Group

Clark W. Miller
Group Executive

John A. Devine
Deputy

Administration
John R. Kennedy

Asia/Pacific
David W. Kruger

Europe/Middle East/Africa
Robert Woods
Africa
Robert M. Schroder
Middle East
Christopher Y. Crockett

Latin America
Frank N. Aldrich
Caribbean
Alfredo V. Restrepo
Central South America
Henrique de C. Meirelles
Panama and Central America
Benton L. Moyer, III
Southern South America
Manuel R. Sacerdote

Lending
Kevin J. Mulvaney

Worldwide Financial Services
George B. Yurchyshyn
International Correspondent Banking
Gerard M. Marlio
International Private Banking
Patrick R. Wilmerding
International Trade Services
William R. Driver, III
U.S. Trade Services
Bruce J. Haddow
World Trade Group, Inc.
R. Ronald Guerriero

Edge Act Subsidiaries
Bank of Boston International-Los Angeles
Mark J. Udem
Bank of Boston International-New York
Mario S. Rossi
Bank of Boston International South-Houston
Roberto L. Garcia
Bank of Boston International South-Miami
Kenneth B. Ingram

Overseas Locations
Argentina - M.R. Sacerdote
Australia - A.A. Lockhart
Bahamas - R.F. Ploss
Bahrain - W.A. Flemer
Bolivia - M.L. Ruiz
Brazil - H. de C. Meirelles
Cameroon - K. Tenny
Canada - R.S. Perry
Chile - L.G. de Campos Salles
Costa Rica - R. Balma
France - P.G. Bates
Germany - U. Colsman Freybe
Guatemala - M. Astur
Haiti - W.C. Chase
Honduras - A. Calix
Hong Kong - M. Ohayon
Italy - M. Nishibori
Japan - P.J. Robb
Korea - B.W. Lamont
Luxembourg - P.W. Gerrard
Mexico - J.F. Martin
Netherlands Antilles - R.D. Freeland
Nigeria - R.D. Ward
Panama - B.L. Moyer, III
Paraguay - F.S. Alcazar
Philippines - B.C. Sevilla
Puerto Rico - M.J. Blake
Singapore - P.D. O'Brien
Switzerland - M.C. Hubble

Taiwan - P.T. Fei
Turkey - I. Levack
United Kingdom - G.A.E. Fritze
Uruguay - C. Medina
Venezuela - B.F. Johnson

Merchant Banks
First National Boston Limited
Richard J. Fates
First National Boston Asia Limited

New England Group

Lawrence K. Fish
Group Executive

Casco Northern
John M. Daigle
Commercial Financial Group and Human Resources
Bruce U. Munger
Internal Services and Chief Financial Officer
Denison Gallaudet
Northern Division
A.William Cannan
Personal Financial Group
Frank H. Parker

Credit Policy and Loan Review
Ralph B. Fifield

Dewey Square Investors
William B. Moody

Massachusetts Banking
Benjamin J. Bowden
Cape Cod Region
Barrett C. Nichols
Greater Boston Region
Robert M. Mahoney
Metropolitan North Region
Myles Borland
Metropolitan South Region
Francis J. McCormack
Southeastern Region
Ronald S. LaStaiti
Western Massachusetts Region
Karl Walczak
Worcester Region
Francis D. McGrath
Eagle Investment Associates
Roger D. Scoville
Personal Trust/Wealth
David H. Denby

Retail Banking Products and Staff Support
D. Bruce Wheeler
Retail Banking Products
Linda Kanner

Operating Products and Services
Eugene M. Tangney
Correspondent Banking
William I. MacDonald
Deposit Operations
Donald B. Snow
Mutual Funds and Custody Services
Thomas S. Marchiel
Shareholder Services and Corporate Trust
Charles J. Ducie

Systems Development and Data Processing
John C. Martin

Real Estate Group

Edwin B. Morris, III
Group Executive

Real Estate Lending/Investments
Garlan Morse, Jr.
Construction Lending
Raymond H. Weaving
Real Estate Investments
John F. Ahearn

Mortgage Banking
Thomas M. French, Jr.
BancBoston Mortgage Corp.
Edward M. Barrett
Mortgage Corporation of the South
Joe K. Pickett
Stockton, Whatley, Davin & Co.
William F. Boling

Facilities
Theodore M. Edson

Treasury/Investment Banking Group

Peter C. Read
Group Executive

Investment Banking
Thomas A. Fransioli
Corporate Finance
Jamie B. Stewart
Placements
Patrick F. Connelly
Product Development and Management
Eric Hayden
Public Finance
Bradford H. Warner
Equity Investments
Charles R. Klotz
Venture Capital
Paul F. Hogan

Treasury
Richard L. Timpson
Domestic Funding
Dennis J. Kelleher
Government Securities
Peter F. Groff
International Treasury
Steven M. Bavaria
Tax Exempt Securities
James B. Hearty

Corporate Center Staff

Audit
Peter Fischoeder
Community Investment
Robert L. Stearns
Development
Kenneth R. Rossano
Corporate Communications
Barry M. Allen
Economics
James M. Howell
Public Affairs
John W. Delaney
Finance
Alan L. McKinnon
General Services
Howard A. Bouve
Human Resources
John F. Stucke
Information Systems and Services
William R. Synott
Law Office
T. McLean Griffin
Loan Review
Slater Smith
Management Information Systems Development
John A. Ross
Risk Management
Joseph F. Magennis
Strategic Planning
Wendy P. Abt

Executive Office
100 Federal Street, Boston, Massachusetts 02110
(617) 434-2200

Transfer Agent
The First National Bank of Boston

Registrar
State Street Bank and Trust Company

Common Stock Exchange Listings (BkBos)
New York Stock Exchange
Boston Stock Exchange

Annual Meeting Notice
The Annual Meeting of the stockholders will be held at the Federal Reserve Bank of Boston, 600 Atlantic Avenue, on Thursday, March 28, 1985 at 10:30 a.m.

10-K Report
A copy of the Corporation's annual report on Form 10-K for 1984, to be filed with the Securities and Exchange Commission, may be obtained without charge upon written request to the Business Extension Department, P.O. Box 2016, Boston, MA 02106.

Investor Information
Requests for information should be directed to the Corporate Communications Department, P.O. Box 1987, Boston, MA 02105.

An Automatic Dividend Reinvestment and Common Stock Purchase Plan is available for stockholders who wish to increase their equity in the Corporation.

Business of the Corporation
Bank of Boston Corporation is an international multibank holding company, whose principal subsidiary is The First National Bank of Boston. The Corporation and its subsidiaries provide a broad range of financial services to individual, corporate, institutional and government customers, as well as to other banks.

Design:	Hill and Knowlton Corporate Design — New
Photography:	C. Richard Norton Kip Brundage (portraits) Cymie Payne (page 19)
Printing:	W.E. Andrews Co., Inc.

UNITED STATES OF AMERICA

NUCLEAR REGULATORY COMMISSION

In the matter of ARIZONA PUBLIC SERVICE COMPANY, et al, (Palo Verde Nuclear Generating Station, Unit 1)	DOCKET NO. STN 50-528

EXHIBIT C

TO

APPLICATION
IN RESPECT OF A SALES AND LEASEBACK
FINANCING TRANSACTION BY
PUBLIC SERVICE COMPANY OF NEW MEXICO

FINAL REPORT OF THE S.M. STOLLER
CORPORATION DATED AUGUST 3, 1982,
ENTITLED "ESTIMATED COST FOR DECOMISSIONING PALO VERDE
NUCLEAR GENERATING STATION (PVNGS)"

THE S. M. STOLLER CORPORATION

ESTIMATED COST FOR DECOMMISSIONING

PALO VERDE NUCLEAR GENERATING STATION

(PVNGS)

Final Report

August 3, 1982

R. W. Kupp
A. A. Weinstein

ESTIMATED COST FOR DECOMMISSIONING PALO VERDE NUCLEAR GENERATING STATION (PVNGS)

INTRODUCTION AND BACKGROUND

The S. M. Stoller Corporation prepared two previous decommissioning studies for ANPP one in 1975[1] and an update in 1979[2]. Both of these previous studies were based on the actual PVNGS Units with specific material take-offs appropriate to the designs developed for those units. The purpose of this study is to revise those estimates to 1982 dollars and at the same time generally review the approaches taken in those previous studies and modify them as necessary in light of current data or changes in decommissioning views. Utilizing a more explicit budget, decommissioning project payment schedules are defined that are appropriate for the several decommissioning alternatives to assist in evaluating and defining the associated financing policies.

---

(1) Estimated Costs for Decommissioning One of the Palo Verde Nuclear Generating Plant, Prepared by the S.M. Stoller Corporation for the Arizona Nuclear Power Project, 1975.

(2) Update of Estimated Costs for Decommissioning One of the Palo Verde Nuclear Generating Station (PVNGS) Units, Prepared by the S.M. Stoller Corporation for the Arizona Nuclear Power Project, October 3, 1975.

(3) Regulatory Guide 1.86, Termination of Operating Licenses for Nuclear Reactors, U.S. NRC, June 1974.

(4) Plan for Reevaluation of NRC Policy on Decommissioning of Nuclear Facilities, NUREG-0436, Revision 1, U.S. Nuclear Regulatory Commission, December 1978 and Supplement 1, August 1980.

Decommissioning Alternatives

The three approaches to the decommissioning of a nuclear facility identified by the NRC [3] [4] have been evaluated in the previous SMSC analyses of the PVNGS Units. These approaches are:

A. Complete removal

This decommissioning approach is sometimes broken down into two steps, an immediate "dismantlement", the removal of all radioactively contaminated materials from the plant, including radioactively contaminated concrete, steel, etc. such that the facility could then be considered to be a "conventional" non-radioactive plant; and "demolition", the removal of all equipment and buildings to below grade followed by the restoration of the site to its "original" condition. The previous decommissioning studies by SMSC (1975 and 1979) incorporated both of these steps in the dismantling decommissioning alternative. The scenario is sometimes called "DECON".

B. Mothballing

Decontamination followed by "securing" a plant in place for some "long" period of time e.g. 30 years. Eventual dismantlement is necessary if unrestricted release and license termination is desired. This scenario is sometimes called "SAFSTOR".

C. Isolation

Decontamination followed by sealing the remaining radioactivity in a "monolithic" structure ("entombed" for additional safety) for very long term storage. Even with such long term storage dismantlement is probably required. This scenario is sometimes called "ENTOMB".

Costing Background

In the 1975 cost analysis it was assumed in alternatives "B" and "C", Mothballing and Isolation (entombment), that there would be yearly ongoing operating and surveillance costs after the initial decommissioning activities. An entombment structure cannot be designed for a "lifetime" consistent with the long lived isotopes contained therein; therefore, it is not expected that a permanent entombment, the equivalent of an above ground burial facility, would be acceptable as a permanent alternative. Interim isolation of the plant, under scenarios "B" or "C" with plans for complete removal at some future date, is a probable scenario and a reasonable approach for cost estimating. In such a procedure it is clear, even though the complete removal steps are somewhat less expensive in the future because of the reduced radioactivity levels resulting in more efficient use of manpower and lower disposal charges, that the total cost, in constant 1982 dollars, which includes initial decontamination, interim surveillance and eventual removal, will be higher.

Among the "A", "B" and "C" alternatives there are major displacements in time for the expenditure of the funds; hence, the evaluated cost can vary substantially, depending upon how "Present Worth" techniques are utilized. This analysis utilizes constant 1982 dollars for all expenditures and assumes a present worth factor of 3% a year, a value compatible with the constant dollar assumption of the study.

Federal Requirements

There are a number of Federal regulations which establish the basis for decommissioning of a nuclear facility. Those requirements and guidelines, which have been the basis for the development of this decommissioning analysis, are defined in the following documents:

Title 10, Code of Federal Regulations (10CFR), the Rules and Regulations of the Nuclear Regulatory Commission (NRC).

- Part 50, Sections 50.33, 50.51, 50.59, 50.82, 50.90.
- Part 51, Sec. 51.5
- Parts 20, 30, 40, 70

NRC Regulatory Guide 1.86

NRC Regulatory Guide 4.2, Rev. 2, Sec. 5.8

NUREG - 0436 Revision 1 (Plan for Reevaluation of NRC Policy on Decommissioning of Nuclear Facilities)

In 1981 the Nuclear Regulatory Commission proposed additional guidelines[5] regarding the funding requirements for decommissioning at the end of plant lifetime, and in addition proposed new funding requirements for early decommissioning which would not normally be anticipated. The cost for such early decommissioning would be similar, but slightly lower than that developed for "end of life", because the total induced radioactivity would be somewhat less as a result of shorter radiation exposure. It has been proposed by NRC that utilities maintain property damage insurance available to the nuclear industry which could be applicable to such early and unanticipated Decommissioning[6].

---

(5) "Decommissioning Criteria for Nuclear Facilities; Notice of Availability of Draft Generic Environmental Impact Statement", Federal Register, 46:11666, February 10, 1981.

(6) "Interim Final Rule Requiring Utility Licensees to Purchase On-Site Property Insurance to be Used for Decontamination Expenses Arising from an Accident", Federal Register, 47:13750, March 31, 1982.

SUMMARY AND CONCLUSIONS

Basis of Study

This decommissioning study updates the costs developed in previous studies in several ways as summarized below:

1. A review has been completed of the major components of the plant to assure that the weights and volumes are appropriate for the PVNGS as designed and built;

2. Labor cost and construction equipment charges have been updated to January 1, 1982 dollars;

3. Radioactive waste shipment and disposal charges have been updated to conform to current charges for such service;

4. A credit has been taken for those items and materials which have a positive salvage value;

5. A task and work schedule was prepared and analyzed so as to form a basis for the cash flow required for the manpower, contract services, equipment and fees;

6. Expensed nuclear fuel has been eliminated from the cost of disposal as these charges are recovered from utility customers as a part of fuel cycle cost.

A major reference used in developing the manpower and cost analysis is the detailed report prepared for the Nuclear Regulatory Commission on the decommissioning of a pressurized water reactor station[7]. In addition, several other historic and current decomissioning reports [8] [9] [10] [11] were utilized to develop the plan and cost summarized in this document. These costing data as developed and presented in these references, and specifically the prior PVNGS S. M. Stoller Studies[12], have been reviewed and compared to the updated costs presented herein as a check for consistency.

---

(7) R. I. Smith, G. J. Konzek and W. E. Kennedy, Jr., Technology, Safety and Costs of Decommissioning a Reference Pressurized Water Reactor Power Station, NUREG/CR-130, Prepared by Pacific Northwest Laboratory for U.S. Nuclear Regulatory Commission, June 1978, Addendum, August 1979.

(8) H. D. Oak et al., Technology, Safety and Costs of Decommissioning a Reference Boiling Water Reactor Power Station, NUREG/CR-0672, Prepared by Pacific Northwest Laboratory for U.S. Nuclear Regulatory Commission, June 1980.

(9) W. J. Manion, T.S. La Guardia and P. Garrett, An Engineering Evaluation of Nuclear Power Reactor Decommissioning Alternatives, AIF/NESP-009-009SR, a National Environmental Studies Project of the Atomic Industrial Forum, Inc., November 1976.

(10) B. J. Davis, "Elk River Reactor Dismantling", Proceedings of the First Conference on Decontamination and Decommissioning (D & D) of ERDA Facilities, COMF-75-827 p. 83, August 1975.

(11) Nuclear Power Plant Decommissioning Study for Millstone Units No. 1 and 2, Prepared by Northeast Utilities Service Company, Berlin, Connecticut, May, 1981.

(12) Op. Cit. (1), (2).

REFERENCE DECOMMISSIONING SCENARIO

The ANPP reference for decommissioning OF PVNGS is that of scenario "A" - "Complete Removal" (immediate dismantlement) after plant shutdown which includes the decontamination and removal of all radioactive components and materials followed by the demolition of all structures to below grade and the regrading of the site.

This scenario A reference was decided upon, rather than scenario "B" -"Safe Storage" followed by dismantlement or "C", long term "Entombment" also followed by dismantlement, as scenario A represents the most straight-forward approach to recovery of the site to its original condition and its early subsequent unlimited use. Immediate dismantlement also is conservative in that it results in the highest "Present Worth" dollar cost which must be provided at the time of plant shutdown. The other two decommissioning alternatives although they result in higher total dollars, are lower in "Present Worth" charges. Table 1 summarizes the cash flow for the three alternatives in 1982 dollars as a function of years after shutdown and it also summarizes the "Present Worth" cost of these different patterns of expenditure using a 3 percent discount rate.

Another factor in the decision to use the immediate dismantlement, scenario A, as the decommissioning reference is the view expressed in the NRC draft statement on decommissioning of nuclear facilities [13]. In

(13) Draft Generic Environmental Impact Statement, NUREG-0586, U.S. Nuclear Regulatory Commission, January 1981.

TABLE 1

PALO VERDE NUCLEAR GENERATING STATION DECOMMISSIONING COSTS FOR ONE UNIT

TOTAL COST AND CASH FLOW FOR ALTERNATIVE DECOMMISSIONING SCENARIOS

(Millions of 1982 Dollars)

YEAR (0 is the Time of Shutdown	SCENARIO A Immediate Dismantlement & Removal DECON(13)		SCENARIO B Mothballing Followed by Removal SAFSTOR (13)		SCENARIO C Isolation Followed by Removal ENTOMB(13)	
-2	1.1		1.1		1.1	
-1	3.0		2.7		2.8	
1	15.1	79.1	10.3	22.6	11.3	26.6
2	28.0		6.6		9.1	
3	23.8		1.9		2.3	
4	8.1		0.14	3.4	0.05	1.2
5-27*-$/Year			0.14		0.05	
28			0.5		0.6	
29			1.7		1.9	
30			12.6	65.8	12.8	67.1
31			22.8		23.1	
32			20.3		20.6	
33			7.9		8.1	
TOTAL 1982 $	79.1		91.8		94.9	
PRESENT WORTH $**	74.3		50.2		53.1	

* Could be for a shorter or longer isolation period which would result in higher or lower present worth costs.

** Based on 3%/year discount rate to zero time (shutdown of reactor).

(13) Nomenclature used by NRC - NUREG 0586

that document, although it was stated that 30 year SAFSTOR (Scenario B) was a reasonable option, longer term, e.g. "100 Year SAFSTOR (or presumably a similar ENTOMB period) is not considered a reasonable option since it results in the continued presence of a site dedicated to radioactivity containment for an extended time period. It was also stated [13] NUREG-0585 that the economics op cit. [12] were not as good.

The cost data in Table 1 assumes that each unit on the PVNGS site would be decommissioned separately. If multiple units were to be decommissioned at about the same time there would be some savings per unit as a result of sharing common costs (e.g. planning, engineering, licensing), from more efficient use of personnel and equipment and also from "learning" from the first unit to the next. These savings have been estimated and the cash flows and totals for a three-unit decommissioning, with a time displacement of two years between units, is summarized in Table 2 for the scenario A alternative. This two-year displacement is reasonably optimum which is illustrated by the relatively level total cash flow.

The costs and cash flows in Table 1 have been used as a basis for a funding requirement and a recommended funding plan.

A summary by major components of costs for the reference decommissioning is given in Table 2. It should be noted that fuel shipment and disposal are not included as these charges are incorporated into the fuel cycle costing and are collected from customers and accrued during the operating period.

TABLE 2

PVNGS Decommissioning Cost for Multiple Units

SCENARIO A - Immediate Dismantlement and Removal (DECON)

Cash Flow - (Millions of 1982 Dollars)

Year (0 is time of Shutdown Unit 1)	Unit 1	Unit 2	Unit 3	TOTAL
-2	1.1.			1.1
-1	3.0			3.0
1	15.1	0.2		15.3
2	28.0	0.5		28.5
3	23.8	14.7	0.2	38.7
4	8.1	27.1	0.5	35.7
5		23.5	14.7	38.2
6		8.1	27.1	35.2
7			23.5	23.5
8			8.1	8.1
TOTAL	79.1	74.1	74.1	227.3
PRESENT WORTH (to Zero Time @ 3% per year)	74.3	65.3	61.5	201.1

The cost savings for the second and third units are also summarized in Table 3. These savings result from a nominal expenditure for additional planning, engineering and licensing requirements and modest savings, on the order of five percent from more efficient use of labor, radioactive waste packaging and improved scheduling as a result of learning on the first unit. There is a reasonable possibility that even more savings may develop. To maintain a conservative approach a twenty five percent contingency has been used for all three units.

The cash flow requirement has been developed from the costing of the "Major Activities" which are shown on a project schedule, Figure 1, and the total expenditures as summarized in Table 3. Inherent in this cash flow development is a a credit for the sale of scrap equipment or materials. In the past most contaminated materials, those with "surface" radioactivity, have not been sufficiently decontaminated to be useful as standard items of commerce, although sufficient decontamination could theoretically be accomplished and in some cases has actually been achieved. Whether the additional expenditure of funds for this extra treatment is justified, would have to be determined from a balance between those costs, radioactive transportation and disposal charges, and the market for such commercial scrap material. As this balance has not been well established from historical data to date, we have stayed with the known technology, the more conservative approach, which results in a higher cost and assumed disposal.

TABLE 3

SUMMARY OF PALO VERDE DECOMMISSIONING COST ESTIMATE

SINGLE AND MULTIPLE UNIT DECOMMISSIONING

Scenario "A" - Immediate Dismantlement and Demolition (DECON)

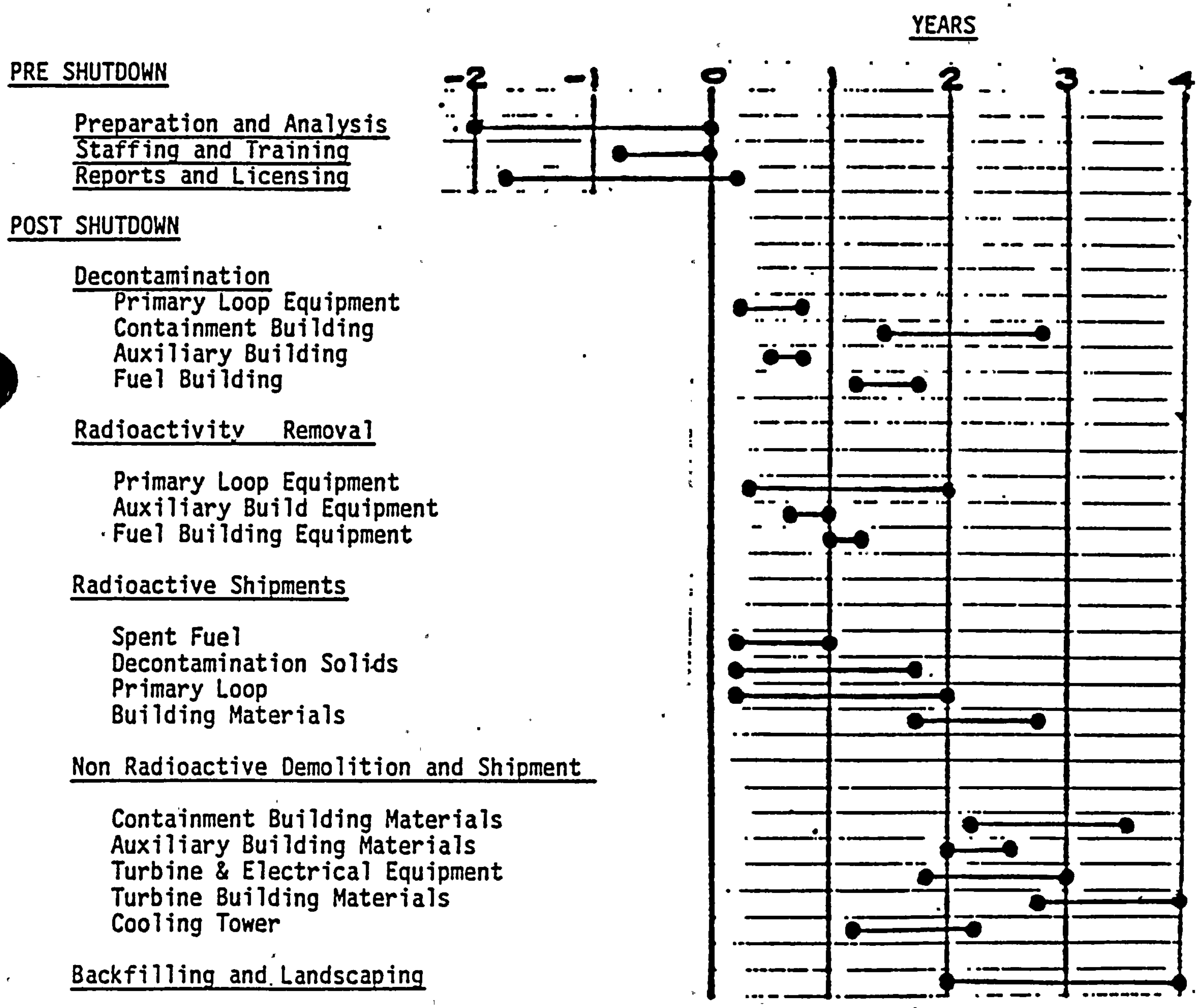
Cost Category	Millions of 1982 $ Unit 1	Unit 2 & 3
Disposal of Radioactive Material	18.8	17.9
Labor	16.7	15.9
Energy	12.6	12.6
Contract Demolition*	7.4	7.1
Insurance	1.2	1.2
Licensing	1.5	.2
Special Tools and Equipment	1.7	1.0
Miscellaneous Supplies	3.4	3.4
TOTAL	63.3	59.3
Contingency @ 25%	15.8	14.8
GRAND TOTAL	$79.1	74.1

* Net including credit for salvage value.

FIGURE 1

PVNGS DECOMMISSIONING SCHEDULE

(Single Unit)



For the non-radioactive portions of the plant the demolition costs are a net charge as the demolition contractor would sell, for his own account, that equipment having a positive salvage value. This was the basis on which the estimate was developed [14].

Costing Procedures

The principle costing reference is that of NUREG-130, the very complete PWR decommissioning study developed by the NRC. As this study was completed in May 1978 and published shortly thereafter, it is necessary to update the costing to account for economic changes between that date and today. In addition diferences in plant design, site location, a project management approach and energy costs all require additional corrections for the final costs to be appropriate for the PVNGS units.

Those charges previously developed for PVNGS were to a large extent based on the decommisioning of the Elk River reactor - the only major nuclear facility fully dismantled and demolished. A check of this historic data against the updated NUREG-130 provides an independent correlation and confidence in the costs developed.

---

(14) J. M. Mc Farland, Report on Representative Cost Estimates for Demolition of Structures at a Pressurized Water Reactor Site, PNL-2450, Prepared for Battelle, Pacific Northwest Laboratory, by McFarland Wrecking Corporation, Seattle WA 98108, September 30, 1976.

Several major corrections were made to the data developed in the NRC report to make the costs applicable to the PVNGS site. These are summarized as follows:

1. Labor cost - The labor unit rates have been adjusted to account for escalation between 1978 and 1982.

2. Tools, equipment and supplies - Adjusted from 1978 to 1982 with a composite index of steel products, chemical, electrical, and commodities.

3. Electrical energy - Use of a current incremental electrical cost for Arizona as compared to the lower "average" cost used in NUREG-130.

4. Contract demolition - Adjusted for increases in construction labor and equipment.

5. Waste Disposal - Use of current rates which have increased by more than 400% for disposal charges. In addition, shipping charges are based on a 500 mile shipment (reflecting state/regionalization of disposal sites) and actual current tarriff rates.

6. Licensing - A significant increase in this charge reflecting a view that more preplanning and technical work is necessary for such major demolition both for licensing and project management.

7. Size - Related to most of the above items. Corrections were made for the somewhat larger size of the unit and for specific quantities take-off.