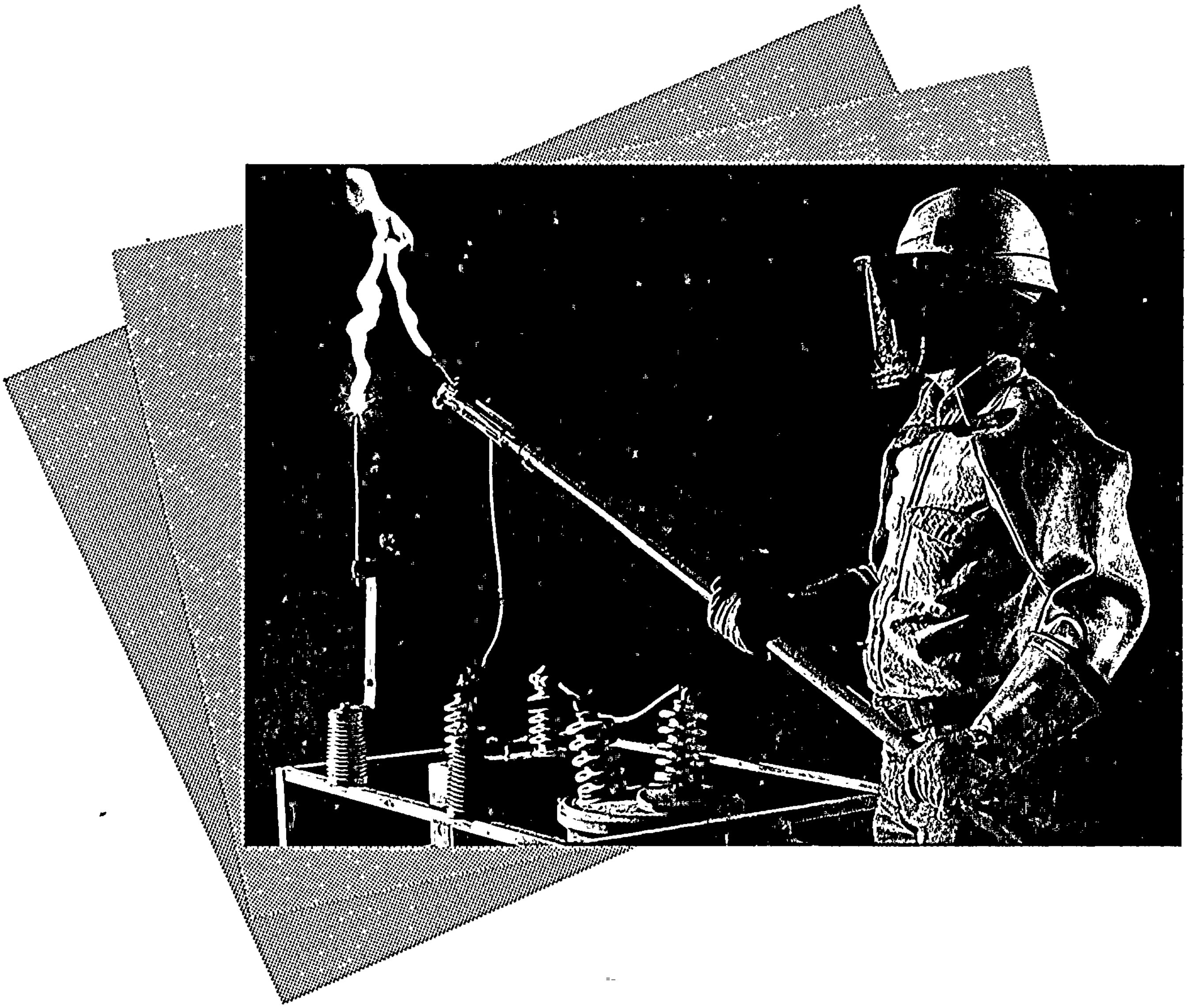
El Paso Electric Company



1989 Annual Report

ANNUAL MEETING OF SHAREHOLDERS

All shareholders are invited to attend the Annual Meeting of Shareholders on Monday, May 21, 1990, at 10 a.m. El Paso time in the Airport Hilton, 2027 Airways Blvd., adjacent to El Paso International Airport.

Proxies for the meeting will be solicited by the Board of Directors in a communication to be mailed in mid-April. This Annual Report is not a part of such proxy solicitation and is not intended to be used as such.

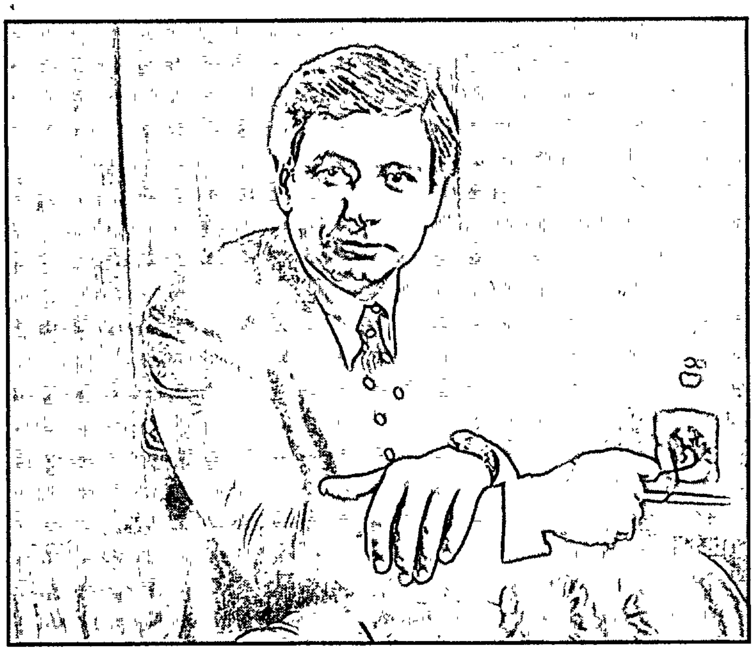
Photography by Valarie & Arturo Enriquez,
Vantage Point 1989

A LETTER TO OUR SHAREHOLDERS

April 3, 1990

Dear Shareholder:

As I expected, 1989 was a tough year for the Company and its shareholders. But we also made substantial progress by returning the Company to its core utility business.



David H. Wiggs, Jr.
Chairman of the Board, President and Chief Executive Officer

For the twelve months ended December 31, 1989, the net loss applicable to common stock (after preferred dividend requirements of $11.8 million) was $117.6 million. This consisted of a loss from discontinued operations of $107.7 million and income from continuing operations of $1.9 million.

When I was elected Chairman of the Board and Chief Executive Officer in 1989, I established, as the first order of business, three short term objectives:

- Obtain proper financing for the Company's utility operations.
- Focus on utility operations by divesting the Company of its non-utility investments.
- Begin the restructuring of the Company's utility operations by reducing costs, consolidating jobs and increasing efficiency.

These goals have been accomplished.

In October 1989, the Company obtained a revolving credit facility from a syndicate of eight money-center banks. The facility, which now provides $150 million of borrowing capacity, is structured to meet the Company's projected cash needs through the scheduled expiration of the facility in May 1991. The Company must periodically issue long-term debt to reduce borrowings under the facility. This was first done in January 1990, when the Company sold $153 million of First Mortgage Bonds (11.1% Series due 2001).

In late December 1989, we sold our investment in Commercial Federal Savings & Loan Association, and in January 1990, we sold our non-utility subsidiaries: Franklin Land & Resources, Inc. and PasoTex Corporation. These transactions were supported by fairness opinions from our investment bankers, and have been viewed favorably by the financial community. Although the Company recorded a significant loss on these transactions, we will now be able to focus on our utility operations.

We restructured the Company in mid-1989, eliminating approximately 200 staff positions and reorganizing senior management. Eight senior officers retired,

management layers were reduced, and responsibilities were consolidated. We are continuing to seek ways to cut costs and to increase operating efficiency.

Three developments in 1989 had an adverse impact on the Company. First, the rate order issued by the Public Utility Commission of Texas in May 1989 on the second scheduled increase in base rates under the Rate Moderation Plan was entirely inadequate.

Secondly, when federal regulators failed to approve a previously agreed upon $32 million sale to Commercial Federal Savings & Loan Association of the Company's preferred stock investment in that Association, the Company was forced to accelerate the sale of its non-utility investments.

Finally, the poor operating performance of the Palo Verde Nuclear Generating Station in 1989 contributed to increased expenses and reduced operating margins.

We made many difficult (and sometimes unpopular) decisions in 1989. But we also made substantial progress, and the Company is now prepared to face the challenges of operating an electric utility in the 1990s. Competition is increasing. Power shortages threaten selected areas of the country, while at the same time regulatory uncertainty and environmental concerns restrict new generating capacity. These issues must be addressed against the backdrop of increasingly difficult and cumbersome rate making procedures.

To help us meet the challenge, I am very pleased to welcome five new directors to the Board. In October 1989, William D. Skov was appointed to a newly created Board position, and Hector Holguin was appointed to fill a vacancy created by the June 1989 resignation of former Chairman Evern R. Wall. John C. Schweitzer and James A. Cardwell were appointed this month to fill positions created by the retirements of directors Tad R. Smith and H. M. Daugherty, Jr. William L. Boyan has been nominated to replace retiring director Ben L. Ivey. Messrs. Boyan, Holguin and Skov will stand for election at the annual meeting.

Later this year, I will ask the Board to appoint one or perhaps two new directors. Neither has been selected, but one will replace Robert H. Cutler, who will retire after the annual meeting. The other appointment, if made, will be to a new Board position. Information on Messrs. Boyan, Cardwell, Holguin, Schweitzer and Skov is contained in the proxy statement for the 1990 Annual Meeting.

I believe we now have a foundation for restoring the Company to profitability. We continue to be optimistic about our service area and the prospects for growth. In 1989, native system sales increased 5.0 percent to 4.5 million megawatt hours. Total system sales increased 6.4 percent, and new customers increased by 3 percent, after a 3 percent increase in 1988. For the second time in as many years, the Company achieved record peak demands. Total system peak in 1989 was 1,076 megawatts, a 7.4 percent increase over 1988. The Company's native system peak of 916 megawatts was a 9 percent increase from the previous record of 840 megawatts set in 1988. This load growth is very encouraging. But in the long term, there are two keys to the ultimate success of our Company. Palo Verde must operate efficiently, and the Company must be able to obtain appropriate Texas rate relief, particularly with regard to including Palo Verde Unit 3 in rates.

While Palo Verde experienced significant unscheduled outages in 1989, Units 2 and 3 have been restarted. Unit 2 is presently undergoing scheduled refueling and should return to service in June. A request to the Nuclear Regulatory Commission to restart Unit 1 is scheduled to be made later this month. We expect that recent changes by the Operating Agent in the management of Palo Verde will improve operating performance.

Nonetheless, operating and maintenance expenses at Palo Verde are substantially higher than originally budgeted, creating additional pressure on operating margins and cash flow. These increased expenses must be recovered in rates.

In that regard, the Company has a Texas rate case in progress for the scheduled third increase in base rates under the Rate Moderation Plan for Palo Verde Units 1 and 2. We expect a decision from the Texas Commission this summer. Later this year, the Company will file for the fourth scheduled increase under the Rate Moderation Plan and will request the inclusion of Palo Verde Unit 3 in Texas rates. The Company is under increasing rate pressure from customers and regulators, but we are entitled to, and will aggressively seek the recovery of, a fair return on our investment in Palo Verde.

The rate-making process is time-consuming and extremely expensive. The Company, of

course, pays all costs related to rate cases and must maintain a sizeable staff to prepare cases and to respond to thousands of rate case inquiries. While the Company is committed to working with its regulators and customers to minimize confrontation, to expedite the rate-making process, and to develop innovative methods to lessen the impact of increased rates, we are equally committed to earning a proper return on your investment. We will pursue this return through the regulatory process, or if necessary, by appeal to the courts.

The Company is prohibited from paying dividends on its common stock by the terms of its revolving credit facility. Payment of dividends in the future will depend upon a number of factors, including earnings and cash flow, which in turn are functions of appropriate rate relief.

I urge you to take a few minutes to supplement this general overview with a careful reading of the accompanying Form 10-K. While the Company has made significant progress over the last year—make no mistake about it—we are still in a very difficult period.

Our Board and all Company employees are working hard to meet the ongoing challenges. We are optimistic, and we are dedicated to returning our Company to profitability.

Thank you for your support.

Sincerely,

David H. Wiggs, Jr.

David H. Wiggs, Jr.
Chairman of the Board, President and Chief Executive Officer

SECURITIES AND RECORDS

The common stock of El Paso Electric Company is traded in the over-the-counter market and quoted on the NASDAQ National Market System. The ticker symbol for the common stock is ELPA.

El Paso Electric and The Bank of New York (BONY) act as co-transfer agents and co-registrars for the Company's common and preferred stock. BONY maintains all shareholder records of the Company.

SHAREHOLDER INFORMATION

Shareholders may obtain information relating to their share position, dividends, transfer requirements, lost certificates, and other related matters by telephoning BONY Shareholder Services at 1-800-524-4458.

This service is available to all shareholders Monday through Friday, 8:00 a.m. to 6:00 p.m., Eastern Time. Shareholders also may obtain this information by writing to:
Shareholder Services, BONY,
90 Washington Street,
New York, New York 10286.

SHAREHOLDER INQUIRIES

Shareholders should direct questions about the activities and operating results of the Company to the Office of the Secretary, El Paso Electric, P.O. Box 982, El Paso, Texas 79960.

For toll-free telephone calls within Texas, the number is 1-800-524-1634. For toll-free telephone calls elsewhere in the United States, dial 1-800-351-1621.

BOARD OF DIRECTORS

David H. Wiggs, Jr. (2)
Chairman of the Board, President and Chief Executive Officer

Wilfred E. Binns (7)
President and Sole Shareholder, Binns Construction & Realty, Las Cruces, New Mexico

James A. Cardwell *
President and Principal Shareholder, Crinco Investments, Inc., El Paso, Texas (multi-business holding and investment company)

Robert H. Cutler (20)
Chairman of the Board, The Cutler Corp., El Paso, Texas (transportation and manufacturing)

Leonard A. Goodman, Jr. (11)
Chartered Life Underwriter/ General Agent Emeritus, John Hancock Financial Services, El Paso, Texas

Hector Holguin *
Chief Executive Officer, Accugraph Corp., El Paso, Texas (computer-aided design software)

Ben L. Ivey (20)
Farming, El Paso, Texas

Josefina A. Salas-Porras (11)
Educator, El Paso, Texas (consultant in second language and multicultural training)

John C. Schweitzer *
Managing Partner, Continental Properties Company, Austin, Texas (real estate and investments)

Tom C. Simpson (7)
President and Principal Shareholder, Simpson Farms, Inc., Las Cruces, New Mexico

William D. Skov *
Partner, Skov Farms, SK-Farms, Paso Pork Producers, Clint, Texas; Chairman of the Board, First National Bank of Fabens, Texas

OFFICERS

David H. Wiggs, Jr. (2)
Chairman of the Board, President and Chief Executive Officer

William J. Johnson (12)
Senior Vice President-Financial Group and Chief Financial Officer

William W. Royer (9)
Senior Vice President-Special Projects

Ignacio R. Troncoso (20)
Senior Vice President-Operations Group

Lawrence M. Downum, Jr. (30)
Vice President-Corporate Services Division

Frederic E. Mattson (20)
Vice President-Power Supply Division

Eduardo A. Rodriguez (8)
Secretary and General Counsel

Julius F. Bates, Jr. (17)
Vice President-Customer Services, Texas Division

Russell G. Gibson
Controller

Gary R. Hedrick (12)
Treasurer

John C. Horne (17)
Vice President-Transmission System Division

James A. Mayhew (10)
Vice President-Rates and Regulatory Affairs

Robert C. McNiel (12)
Vice President-Customer Services, New Mexico Division

Dean Jacobson (25)
Assistant Vice President-Information Services

Pedro Serrano, Jr. (12)
Assistant Vice President-Energy Resource & Planning

Susanne M. Sickles (12)
Assistant Vice President-Employee Support Services

Guillermo Silva, Jr. (10)
Assistant Secretary

Hermann Vogenbeck (16)
Assistant Vice President-Power Generation

John Wacker (1)
Assistant Vice President-Internal Audit

John Whitacre (16)
Assistant Vice President-Systems Operations

( ) Years of Service

* Mr. Skov and Mr. Holguin were appointed to the Board of Directors in October 1989. Mr. Schweitzer and Mr. Cardwell were appointed to the Board of Directors effective April 1990.

A complete copy of the Company's 1989 Form 10-K report, filed with the Securities and Exchange Commission, including Financial Statements and Financial Statement schedules, will be provided to shareholders without charge upon written request to: Eduardo A. Rodriguez, Secretary, El Paso Electric Company, Post Office Box 982, El Paso, Texas 79960.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (FEE REQUIRED)
For the fiscal year ended December 31, 1989

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

For the transition period from __________ to__________

Commission file number 0-296

El Paso Electric Company

(Exact name of registrant as specified in its charter)

Texas (State or other jurisdiction of incorporation or organization)	74-0607870 (I.R.S. Employer Identification No.)
303 North Oregon Street, El Paso, Texas (Address of principal executive offices)	79901 (Zip Code)

Registrant's telephone number, including area code: 915-543-5711

None of the Registrant's Securities is Registered Pursuant to Section 12(b) of the Act

Securities Registered Pursuant to Section 12(g) of the Act:

COMMON STOCK, NO PAR VALUE
(Title of Class)

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 (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO ___.

As of February 28, 1990, the aggregate market value of the voting stock held by non-affiliates of the registrant was $307,132,004.

As of February 28, 1990, there were outstanding 35,285,932 shares of common stock, no par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement for the annual meeting of its shareholders to be held on May 21, 1990 are incorporated by reference into Part III of this report.

DEFINITIONS

The following abbreviations or acronyms used in this report are defined below:

Abbreviations or Acronyms	Terms
AFUDC	Allowance for Funds Used During Construction
AIP	Arizona Interconnection Project
APS	Arizona Public Service Company
Common Plant or Common Facilities	Facilities at or related to the Palo Verde Station that are common to all three Palo Verde Units
Company	El Paso Electric Company
CWIP	Construction Work in Progress
FERC	Federal Energy Regulatory Commission
FL&R or Franklin or Franklin Land	Franklin Land & Resources, Inc., a former subsidiary of the Company
Four Corners	Four Corners Project or Four Corners Plant
IID	Imperial Irrigation District, an irrigation district in Southern California
KV	Kilovolt
KW	Kilowatt(s)
KWH	Kilowatt-hour(s)
MW	Megawatt(s)
MWH	Megawatt-hour(s)
NASDAQ	National Association of Securities Dealers Automated Quotations System
New Mexico Commission	New Mexico Public Service Commission
NRC	Nuclear Regulatory Commission
Palo Verde Station or Palo Verde Project or Palo Verde or PVNGS	Palo Verde Nuclear Generating Station
PasoTex	PasoTex Corporation, a former subsidiary of the Company
PNM	Public Service Company of New Mexico
RCF	Credit Agreement dated as of October 26, 1989, as amended, among El Paso Electric Company, each of the Banks signatory thereto, and Chemical Bank, as Agent Bank
SFAS	Statement of Financial Accounting Standards
Texas Commission	Public Utility Commission of Texas
TNP	Texas-New Mexico Power Company

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PART I

PART II

PART III and PART IV

The information set forth in Part III and Part IV has been omitted from this Annual Report to Shareholders.

PART I

Item 1. Business

General

The Company was incorporated in Texas in 1901. Its principal business is the generation and distribution of electricity through an interconnected system to approximately 239,000 customers in El Paso, Texas and in an area in the Rio Grande Valley in West Texas and Southern New Mexico. The Company's principal executive offices are located at 303 North Oregon Street, El Paso, Texas 79901 (telephone 915-543-5711).

The Company's service area extends approximately 110 miles northwesterly from El Paso to the Caballo Dam in New Mexico and approximately 120 miles southeasterly from El Paso to Van Horn, Texas. The service area has an estimated population of 743,000, including approximately 605,000 people in the metropolitan area of El Paso. Copper smelting and refining, oil refining, garment manufacturing, cattle raising and agriculture are important industries in El Paso, which is also an important transportation and distribution center. At December 31, 1989, the Company's largest retail customers included a copper refinery, a smelter, and a steel fabricator in El Paso, and important military installations, namely the U.S. Army Air Defense Center at Ft. Bliss in El Paso and the White Sands Missile Range and Holloman Air Force Base in New Mexico.

The Company's major franchises are with the cities of El Paso, Texas and Las Cruces, New Mexico, such franchises expiring in 2001 and 1993, respectively. The franchises contain no express renewal provisions. Although the City of Las Cruces is currently reviewing alternative sources, and the City of El Paso has approved the formation of a task force to study the City's options with respect to possible municipal ownership of the Company's properties, the Company believes, but has no assurance, that both franchises will be renewed.

During 1989, approximately 63% of the Company's operating revenues were derived from Texas, 19% from New Mexico and 18% from FERC wholesale customers. Sales to (i) residential customers, (ii) small commercial and industrial customers, (iii) large commercial and industrial customers and (iv) public authorities accounted for approximately 35%, 34%, 12% and 19%, respectively, of the Company's operating revenues from retail sales. In 1989, IID, a wholesale customer, accounted for 11.6% of operating revenues. No retail customer accounted for more than 3% of operating revenues. The effect of seasonal sales by quarter are insignificant to the Company's annual operating revenues, but the third quarter of each calendar year traditionally contributes more than 27% of annual revenues due to the climate in the Company's service area. See Note O of Notes to Consolidated Financial Statements.

The Company attained an all-time total system peak load of 1,076 MW on June 20, 1989. In 1988, the Company's total system peak load was 1,002 MW. In 1989 and 1988, the native system peak load was 916 MW and 840 MW, respectively. The Company periodically makes long-range projections of system peak load and estimates future sources of power that may be used to supply the system requirements. The projected annual peak load growth rate for the Company's service area during the 1990-1999 time period is approximately 3%.

The Company had 1,032 employees as of December 31, 1989. Approximately 28% of the employees are covered by a collective bargaining agreement that expires in February 1991.

Prior to January 17, 1990, the Company had, in addition to its electric utility operations, various subsidiaries which engaged in unregulated, non-utility businesses. During 1989, the Company decided to discontinue and to dispose of its non-utility operations. The final disposition transaction occurred on January 17, 1990. See "Non-Utility Operations" and Note P of Notes to Consolidated Financial Statements.

Regulation

Texas. The rates and services of the Company in Texas municipalities are regulated by those municipalities and in unincorporated areas by the Texas Commission. The Texas Commission has exclusive de novo appellate jurisdiction to review municipal orders and ordinances regarding rates and services, and its decisions are subject to judicial review.

New Mexico. The New Mexico Commission has authority over the Company's rates and services in New Mexico, the issuance of securities by the Company and other matters affecting the operations of the Company.

FERC. The Company is subject to regulation by the FERC in certain matters, including rates for wholesale power sales and the issuance of securities. In addition, Congress has enacted energy legislation which, among other things, establishes national standards for consideration by state regulatory agencies in determining utility rates and imposes other requirements on the operations of utilities, including the Company. Under certain circumstances, the FERC may order interconnection, wheeling and pooling.

NRC. The Palo Verde Station is subject to the jurisdiction of the Nuclear Regulatory Commission ("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 radiation hazards and to conduct environmental reviews pursuant to the National Environmental Policy Act. Before any nuclear power plant can become operational, an operating license from the NRC is required. The NRC has granted facility operating licenses for Unit 1, Unit 2 and Unit 3 for terms of forty years each beginning December 31, 1984, December 9, 1985 and March 25, 1987, respectively. See "Construction Program — Palo Verde Station" and "Facilities — Palo Verde Station."

Texas Rate Matters

Rate Moderation Plan — Palo Verde Units 1 and 2. On March 30, 1988, in Docket 7460, the Texas Commission adopted a rate moderation plan which provides for the inclusion in Texas rates, on a phase-in basis, of the Texas jurisdictional portion of the Company's investment in Palo Verde Unit 1 and the Company's lease payments in its sales and leasebacks of its interest in Palo Verde Unit 2 and one-third of Common Plant to the extent of the book value of the plant sold and leased back (which is approximately 83% of such lease payments). The Texas Commission's order was based upon a stipulated settlement entered in October 1987 among the Company, the staff of the Texas Commission and certain industrial customers. The stipulation and the Texas Commission's final order settled all issues regarding prudence of construction of Palo Verde Units 1 and 2 and Common Facilities and all issues involving the prudence of the Company's decisions to make the investment it made in the Palo Verde Project and which resulted in the continuation of that investment, except, as to Unit 3 only, decisional prudence relating to events occurring after the 1978 issuance by the Texas Commission of a Certificate of Convenience and Necessity for the Palo Verde Project. See discussion below regarding the planned Unit 3 rate case. As part of the stipulated settlement, the Company recorded in the third quarter of 1987 a regulatory disallowance of approximately $38.3 million ($24.4 million after tax). The disallowance amounted to less than 2% of the Company's total investment in Palo Verde. The stipulation also settles all issues of excess capacity relating to Units 1 and 2 for the duration of the 10-year rate moderation plan, and the Texas Commission has indicated that it will not consider excess capacity issues relating to Units 1 and 2 during such time period.

The Texas Commission adopted the rate moderation plan by unanimous vote, over the objections of the City of El Paso and two other intervenors representing public entities. Those parties appealed the Texas Commission's order to state district court in Travis County, Texas, where the district court upheld the order of the Texas Commission. The decision of the District Court was appealed by the City of El Paso and the two other intervenors to the Court of Appeals for the 3rd Judicial District at Austin, Texas. A ruling on such appeal is expected later this year. Management anticipates that the Texas Commission's order will be upheld.

The Texas Commission's order in Docket 7460 limits the Company to specified base rate (cash) increases during the first four years of the plan. The plan requires that the Company file rate cases annually to establish the Company's revenue requirements and resulting right to the base rate increase. To the extent the Company's base revenue requirements recognized by the Texas Commission exceed the base rate increase provided for the period, the unrecovered revenue requirements are deferred for collection in later years of the plan. The rate moderation plan, which is explicitly intended to comply with SFAS No. 92, *Regulated Enterprises — Accounting for Phase-In Plans,* requires all revenue deferrals to be recovered within the 10-year term of the plan. The Company is, under the plan, entitled to additional base rate increases for years subsequent to the scheduled fourth increase, if necessary, to recover all such deferrals during such time period. The Company has indicated in its rate filing for the scheduled third base rate increase that such additional cash increases will be necessary. See discussion below regarding Docket 9165.

The Texas Commission's order in Docket 7460 provided for the first scheduled base rate increase of approximately $21 million. The new rates went into effect in April 1988, and the order provided for the deferral for future recovery of approximately $25 million.

In October 1988, the Company filed with the Texas Commission for the scheduled second base rate increase under the rate moderation plan (Docket 8363). The Company requested an increase of approximately $39 million in base revenues. In May 1989, the Texas Commission entered its final order in the case which granted, effective June 1989, the scheduled second cash increase in base revenues of approximately $7.3 million and the deferral of approximately $7.4 million.

The approximate $24.3 million ordered reduction in the revenue deferrals requested by the Company resulted from, principally (1) adjustments made by the Texas Commission which reduced rate base by $61 million, the major components of such reduction being the disallowance of certain operating costs previously deferred under accounting deferral orders issued by the Texas Commission (which disallowance resulted in the after-tax write-off of $15 million in the first quarter of 1989), disallowance of the Company's requested cash working capital levels, removal from rate base of the unamortized balance of Docket 7460 prudence case expenses (which will be considered for recovery in rates in the separate docket described below under "Rate Case Expenses Incurred in Docket 7460") and the one-time offsetting of rate base by deferred taxes associated with the portion of Palo Verde Unit 3 sold and leased back by the Company in December 1987; (2) the Texas Commission's setting the Company's rate of return on common equity at 12.4% as opposed to the Company's requested 14.0%; (3) various operating expenses being reduced or eliminated, totaling approximately $6.4 million; and (4) tax ramifications of the foregoing resulting in a compounding of the reductions.

The Company, as well as certain parties adverse to the Company in the case, appealed the Texas Commission's order in Docket 8363 to state district court in Travis County, Texas. A decision on the appeal is not expected before the end of 1990. The Company has contested the bulk of the adjustments made by the Texas Commission and believes there are justified grounds for its appeal. However, as is the case in any appeal from a decision of the Texas Commission, judicial review is generally limited to a determination of whether substantial evidence exists to support the Texas Commission's order and whether the Texas Commission acted within its statutory authorization and not arbitrarily in reaching its decision. The outcome of the appeal of the case cannot presently be determined.

In late November 1989, the Company filed with the Texas Commission for the third scheduled base rate increase of 3.5% (Docket 9165). In the filing, the Company seeks an increase in base revenues of approximately $33.9 million, consisting of an approximate $7.1 million cash increase and an approximate $26.8 million in phase-in deferrals. As an alternative calculation of the third scheduled base rate increase, the Company requested a cash base rate increase of approximately $13.1 million, with the balance of its requested increase in base revenues of approximately $20.8 million to be deferred, in order to correct a problem which has arisen in the operation of the rate moderation plan involving the average unit rate paid by customers. The cash increases in base revenues originally projected under the rate moderation plan were projected on the basis of expected average unit rates to

be achieved from forecasted Texas sales. Due to unanticipated shifts in usage among customers and customer groups, the average unit rates for sales has not reached the projected levels. As a consequence, the Company's cash revenues have not reached levels commensurate with the growth in sales that has occurred, which will contribute to the need for additional increases in base rates after the scheduled fourth increase in order to recover all deferred revenues within the 10-year term of the rate moderation plan.

In March 1990, the City of El Paso, in response to the Company's filing, ordered a $6.9 million reduction in the Company's base revenues, which, if ordered by the Texas Commission, would, combined with the scheduled cash increase in base rates, result in an amortization of the deferrals ordered in Dockets 7460 and 8363 by a corresponding amount. The City's order has been appealed to the Texas Commission. The staff of the Texas Commission has recommended an approximate $17.5 million increase in the Company's base revenues, consisting of a $7.1 million cash increase and a $10.4 increase in revenue deferrals. The staff has not yet made its recommendation on approximately $2.2 million of rate case expenses in this Docket, which were requested in the Company's filing. See "Rate Case Expenses Incurred in Docket 7460." Although the staff recommended rejection of the Company's alternative filing with respect to the average unit rate problem, the staff indicated its agreement that additional base rate increases would be required under the rate moderation plan to recover the phase-in deferrals.

Hearings before the Texas Commission commenced in early March 1990. New rates resulting from the Company's filing in Docket 9165 are expected to be effective by August 1990.

The Company's filing in Docket 9165 does not involve the major issues in Docket 8363 relating to the adjustments made by the Texas Commission with respect to deferred operating costs. The issues in Docket 9165 relate principally to return on equity, operations and maintenance expenses (particularly at Palo Verde), deferred taxes and recovery of certain restructuring costs incurred by the Company. The Company believes that it is entitled to the rate relief sought in Docket 9165, including its alternative filing with respect to the average unit rate problem. The Company would, as it has in the past with respect to previous orders of the Texas Commission, appeal to state district court if the Texas Commission were to order insufficient rate relief in this Docket. The outcome of the case cannot presently be determined.

The Company's present plan is to file in the third quarter of 1990 for the fourth scheduled base rate increase under the Docket 7460 rate moderation plan. The scheduled base rate increase under the plan is 3.5%. New rates resulting from the filing should be in effect by summer 1991.

Palo Verde Unit 3 — Inclusion in Texas Rates. Although Palo Verde Unit 3 began commercial operation in January 1988, the Unit cannot satisfy Texas Commission criteria for in-service status, and thereby qualify for eligibility for inclusion in Texas rates, until the AIP transmission facilities, construction of which was completed in December 1989, are energized for operation at a required minimum capacity level. For a description of AIP, see "Facilities — Palo Verde Station."

Utilization of the AIP transmission line can occur only with the consent of the Operating Agent of the Southwest New Mexico Transmission System ("SWNMTS"), who can, in that capacity, unilaterally determine the conditions under which power can be transmitted over the AIP line. Public Service Company of New Mexico ("PNM") is presently acting as operating agent under the SWNMTS. Disputes have arisen between the Company and PNM regarding transmission rights and capabilities in the southern and northern New Mexico transmission systems, and PNM has refused to transfer operating agent status under the SWNMTS to the Company, as required under the SWNMTS agreement upon completion of construction of AIP. As a result of these disputes, the Company in early March 1990 sued PNM in the United States District Court for the Western District of Texas for wrongful refusal to permit the Company its full AIP transmission capability.

On March 30, 1990, the Company reached an agreement in principle with PNM to submit to binding arbitration the entitlement of the parties to the transmission rights and capabilities in dispute. The agreement in principle provides for the energization, pending arbitration, of AIP no later than

April 9, 1990, at the required level of capacity necessary for Unit 3 to meet the Texas Commission's in-service criteria and provides for the Company to become Operating Agent of SWNMTS upon receipt of the decision of the arbitrators. The Company will accrue a payable to PNM, based upon the purchase of a specified amount of wheeling capacity from PNM, which must be paid only if the arbitrators rule in favor of PNM. Each of the Company and PNM will appoint one arbitrator, and the two of them will select a third arbitrator. The agreement in principle calls for the execution of a definitive agreement between the parties by April 6, 1990, at which time the Company's lawsuit will be dismissed. A decision of the arbitrators is scheduled by the end of 1990.

The Company expects a favorable outcome in the arbitration. An unfavorable outcome would not affect the in-service status of Unit 3, and there are alternatives available to the Company, in the event of an unfavorable outcome, to meet its transmission capability requirements not met through the southern New Mexico transmission system, of which AIP is a part.

In September 1989, the Company filed an application with the Texas Commission for an accounting order that would allow the Company to defer and capitalize substantially all Unit 3 operating costs (excluding fuel) and to accrue a carrying charge on its ownership interest in Unit 3 from the date Unit 3 satisfies the Texas in-service criteria until the Texas Commission issues its rate order on Unit 3. The Company's application for the accounting order was consolidated with Docket 9165 described above. The staff of the Texas Commission has recommended that the Texas Commission grant the accounting order. The Company expects the Texas Commission to grant the requested accounting order. If, however, the Texas Commission refused to grant the accounting order, the Company will be required to expense the Unit 3 operating costs beginning with the date that Unit 3 meets the Texas in-service criteria.

Until Unit 3 qualifies for in-service status in Texas, the Texas jurisdictional portion of Unit 3 will be accounted for, as it has been since the Unit went into commercial operation, as plant under construction. The Company, therefore, has been capitalizing, since the Unit went into commercial operation in January 1988, the Texas jurisdictional portion of the costs of owning, operating and maintaining Unit 3. During the year ended December 31, 1989, the Company capitalized a total of $51.1 million to construction work-in-progress related to the Texas jurisdictional portion of Unit 3, consisting of $12.7 million of operation and maintenance costs; $15.9 million of lease expense attributable to the portion of Unit 3 sold and leased back; $2.4 million of property and other taxes; and $20.1 million of AFUDC. Since January 1988 through December 31, 1989, the aggregate of such costs capitalized is $85.9 million. The Company's total investment in the Texas jurisdictional portion of Unit 3 at December 31, 1989, net of the portion sold and leased back, was $216.0 million.

The Company plans to file with the Texas Commission in the third quarter of 1990 for rate treatment of the Texas jurisdictional portion of the Company's investment in Palo Verde Unit 3, including the lease payments in the Company's sales and leasebacks of 40% of its interest in Unit 3. The Company expects the Texas Commission's final order on the Unit 3 case in the late first quarter of 1991, with rates reflecting the outcome of the case to be effective in the summer of 1991.

At present, management believes that inclusion of Unit 3 in Texas rates will probably involve some form of phase-in or rate moderation plan. Either a separate plan for the Unit 3 costs or a revised combined plan, including the Company's investment in Palo Verde Units 1, 2 and 3, are possible. As the Company has only one set of rate tariffs, however, some merger of the plans into a single set of rates will be necessary.

Although issues relating to the prudence of construction costs directly attributable to Unit 3 are not included in the construction prudence issues resolved by the rate moderation plan for Units 1 and 2 and are therefore open for decision in the Unit 3 case, the Company does not expect a material disallowance of Unit 3 costs on the basis of construction imprudence. In March 1989, Ernst & Whinney, a national accounting firm, which oversaw the prudence audit of the Palo Verde Station ordered by the Arizona Corporation Commission in the exercise of its regulatory authority over Arizona Public Service Company, the Operating Agent for Palo Verde, released its audit report. The

report identified approximately $60 million, excluding AFUDC and property taxes, for the entire Palo Verde Project which Ernst & Whinney contends were unreasonable. Of this amount, the Company's share would be approximately $9.5 million (which is less than the write-off recorded by the Company in connection with the adoption of the Docket 7460 rate moderation plan — see discussion above under "Rate Moderation Plan — Palo Verde Units 1 and 2"). Neither the Company nor the Operating Agent accepts the Ernst & Whinney contentions as to the unreasonableness of the Palo Verde construction costs. The audit report also identified certain areas that were found to exceed the standard of reasonableness and to have a positive impact on the Palo Verde Project, including built-in separation of electrical equipment, design replication of the three Palo Verde Units, certain aspects of the regulatory (licensing) management function, and certain labor and contractual arrangements. The report estimated that the potential direct cost savings of the identified areas in which performance exceeded the standard of reasonableness were approximately $300 million for the entire project (excluding AFUDC and property taxes), of which the Company's share would be approximately $47.4 million.

Decisional prudence issues relating to Unit 3 were not resolved in Docket 7460, insofar as such issues relate to events occurring after the Texas Commission's November 1978 issuance of a Certificate of Convenience and Necessity for Palo Verde. In Docket 7460, the Texas Commission acknowledged the prudence of the Company's decision-making through the issuance of the Certificate of Convenience and Necessity for Palo Verde. The Company believes that it will be able to demonstrate in the Unit 3 case the prudence of the Company's decisions regarding the level of its Palo Verde participation after 1978 and does not expect any material disallowance on the grounds of decisional imprudence.

The Company believes that the primary concern with respect to inclusion of the Company's full investment in Unit 3 in Texas rates will relate to issues of excess capacity. Such issues are resolved with respect to Units 1 and 2 under the rate moderation plan for the 10-year term of the plan. The Company believes that proper regulatory treatment recognizes that the construction and addition to utility plant of generating capacity, particularly large investments such as the Company's investment in Palo Verde, cannot exactly be matched to increases in load requirements and that a period of an acceptable level of excess capacity must be anticipated and accepted. Claims of excess in the Company's generating capacity continue to be weakened by the load growth experienced by the Company. If any excess generating capacity were to be found by the Texas Commission relating to Unit 3, the Company believes the amount of any resulting exclusion from rate base would probably be temporary and would be restored to rate base in future rate proceedings to permit full recovery of substantially all of the Texas jurisdictional portion of the Company's investment in Unit 3.

The Company believes that it is entitled to recover in full the Texas jurisdictional portion of the Company's Unit 3 investment and a fair return thereon. If the Company were denied adequate and timely rate relief sufficient to recover the investment and a fair return thereon, the Company would resort to the courts for the rate relief to which it believes it is entitled. The ultimate outcome of the case cannot, however, presently be determined. Failure to receive sufficient inclusion in Texas rates of the Company's Unit 3 investment, on a timely basis, would increase the Company's external financing requirements and could adversely affect access to the capital markets at reasonable cost. An adverse regulatory decision by the Texas Commission with respect to the Company's investment in Unit 3 which, in the judgment of the lending banks under the RCF, causes the Company's revenues to be insufficient to assure its ongoing viability or its access to capital markets or its ability to repay its obligations, constitutes an event of default under the RCF. See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

Fuel Reconciliation Case. In June 1989, the Company filed an application with the Texas Commission to reconcile its fuel expenses and revenues for the period August 1985 through March 1989. The reconciliation is required by Texas Commission rules and final order in Docket 7460. The Company's filing requests an additional $900,000 in fuel revenues for the reconciliation period. The City of El Paso, in response to the Company's filing, recommended that the Company be ordered to refund approximately $14.3 million in previously recovered fuel expenses. The staff of the Texas Commission

has recommended a refund of approximately $10.2 million. Hearings before the Hearing Examiner appointed by the Texas Commission have been completed, and a Hearing Examiner's report and recommendation is expected in the near future. Although the Company is unable to assess the outcome of this matter prior to the issuance of the Hearing Examiner's report, the Company believes that it has, in accordance with the rules of the Texas Commission, made all refunds to customers of overcollected fuel expenses during the four-year reconciliation period and that any material disallowance of the Company's fuel expense recoveries would not be justified. The Company has made no provision for any fuel refunds in the financial statements included in this report.

Rate Case Expenses Incurred in Docket 7460. The approximate $11.4 million of expenses incurred by the Company in connection with the Docket 7460 rate case were severed from the issues ruled upon by the Texas Commission in that Docket and were assigned to a new docket for consideration. The Company has applied for the immediate recovery of approximately $5 million of these expenses through a surcharge to customers and has proposed that the balance of the expenses, attributable to the prudence phase of Docket 7460, be amortized and recovered in rates over the useful life of the Palo Verde Units. The staff of the Texas Commission has recommended that the Company be allowed to recover all of the expenses, without interest, amortized over the useful life of the Units. The City of El Paso has recommended a disallowance of approximately $7.4 million of the prudence expenses. Although hearings in this case were completed in November 1988, no Hearing Examiner's report has been issued. The Company expects a ruling from the Texas Commission by summer 1990. The costs are included as a deferred charge in the accompanying consolidated balance sheet. Although the Company expects to recover the costs, most likely in accordance with the Company's proposed method for recovery, an assessment of the outcome of the case cannot be made prior to the issuance of the Hearing Examiner's report.

Texas Recognition of Palo Verde Sales and Leasebacks. The Company sold and leased back its entire interest in Palo Verde Unit 2 and one-third of Common Plant in transactions completed in August 1986 and December 1986. The Company also sold and leased back approximately 40% of its interest in Palo Verde Unit 3 in December 1987. See Note E of Notes to Consolidated Financial Statements. The Company, under applicable Texas Commission rules, was required to report the Unit 2 and Unit 3 sales and leasebacks to the Texas Commission for a determination by the Commission as to whether the transactions were in the public interest. In its Docket 7460 order and a separate order issued in August 1989, the Texas Commission found the Unit 2 and Unit 3 sales and leasebacks, respectively, to be in the public interest. The rulings have no current ratemaking impact, but do insure that, in the case of the Unit 3 sales and leasebacks, the Commission will consider those transactions in connection with the Company's request for rate treatment of its investment in Unit 3. The City of El Paso appealed the Commission's order with respect to the Unit 3 transactions to state district court in Travis County, Texas. The appeal is not expected to be ruled upon this year. Management believes that the court will uphold the Commission's order. The finding on the Unit 2 sales and leasebacks is a part of the City's appeal of the Docket 7460 order.

Performance Standards for Palo Verde — Texas. In June 1989, the Company filed an application with the Texas Commission to establish performance standards in its Texas jurisdiction for the operation of the Palo Verde Units. The performance standards proposed by the Company correspond to the performance standards for the Palo Verde Units currently in effect with the New Mexico Commission for the Company's New Mexico service area. See "New Mexico Rate Matters" below. The Company's application to establish Texas performance standards has been consolidated with the Company's rate filing in Docket 9165 (see discussion above).

Texas Recovery of Fuel Expenses. In its Texas jurisdiction, the Company recovers its fuel expenses and purchased power costs pursuant to a fuel factor set by the Texas Commission in each general rate request filed by the Company. The Texas Commission has the authority to order proceedings periodically for the purpose of reconciling the Company's fuel revenues against actual fuel expenses. See "Fuel Reconciliation Case" above. As a result of the unscheduled outages of the Palo Verde Units in 1989, the Company incurred and is incurring replacement power costs in excess of the amount of

fuel revenues provided by the Company's fuel factors. Although the Company believes it is entitled to and will recover its actual Texas fuel costs, the Company is unable, at this time, to predict the ultimate financial or regulatory impact of the unscheduled outages. See "Facilities — Palo Verde Station."

New Mexico Rate Matters

In March 1987, the New Mexico Commission adopted a rate moderation plan which provides for the regulatory treatment of the New Mexico jurisdictional portion of the Company's investment in all three Units at Palo Verde. The New Mexico Commission's order was based upon a stipulated settlement among the Company, the staff of the New Mexico Commission and certain intervenors. The New Mexico plan, among other things, provides for the full inclusion in rate base of the Company's investment in Unit 1 and one-third of common plant and recovery as cost of service of the Company's lease payments on the Unit 2 sales and leasebacks to the extent of the book value of plant sold and leased back. The Company agreed, as part of the plan, that it would not request inclusion in New Mexico rates of the New Mexico jurisdictional portion of the Company's investment in Unit 3, one-third of common plant and certain related transmission facilities (aggregating $54.2 million) or any Unit 3 operating expenses. The plan also provided for increases in rates of 3% on a total cents per kilowatt hour basis in 1987, and two additional 3% increases in base rates in 1988 and 1989. The plan settled as far as the New Mexico jurisdiction is concerned all construction and decisional prudence issues relating to the Company's investment in Palo Verde and settled excess capacity issues through 1993.

Similar to the Texas plan for Units 1 and 2 (Docket 7460 described above), the New Mexico plan provides that, to the extent the Company's base revenue requirements determined by the New Mexico Commission exceed the base rate increase provided for the period, the unrecovered revenue requirements are deferred for collection in later years of the plan. However, the New Mexico plan presently provides that all deferred revenues not recovered prior to December 31, 1994 are not to be recovered through New Mexico rates. SFAS No. 92, which governs accounting for rate phase-in plans, was not in existence at the time of the adoption of the New Mexico plan. As a result of the New Mexico plan provision that deferrals not recovered prior to December 31, 1994 will not be recovered in New Mexico rates, the New Mexico plan does not comply with SFAS No. 92. The Company has filed an application with the New Mexico Commission to amend the plan to bring it into compliance with SFAS No. 92 and believes that such amendment will be approved by the New Mexico Commission. A hearing on the application is scheduled in mid-June 1990. If the New Mexico plan is not amended to comply with SFAS No. 92, the Company would be required to write-off approximately $5.5 million of recorded phase-in deferrals and discontinue reporting for financial statement purposes the unrecovered revenue requirements deferred for collection under the plan.

Effective November 1987, the New Mexico Commission ordered the first scheduled rate increase under the New Mexico plan. The order provided for an increase in base revenues of approximately $5.0 million, consisting of approximately $1.8 million cash increase in base rates and approximately $3.2 million deferred revenues.

In November 1987, the Company filed for the second scheduled base rate increase under the New Mexico plan. The Company requested an increase in base revenues of approximately $5.5 million. The New Mexico plan limited the base rate increase to approximately $1.7 million, with the balance of the Company's requested increase in base revenues to be deferred. The New Mexico Commission's final order in the case, which was issued based upon a stipulated settlement on revenue requirements, allowed the Company an increase in base rates of approximately $1.5 million and provided for the capitalization of approximately $1.2 million of fuel expense as a cost of service deferral. No additional deferred revenues were provided under the stipulation or order. Rates based upon the order were effective November 1988.

In July 1989, the Company filed with the New Mexico Commission for the third and final scheduled base rate increase under the plan. The Company requested an increase in base revenues of

approximately $8.5 million, consisting of an increase in base rates of approximately $1.8 million and deferral of approximately $6.7 million. A stipulated settlement of the case was reached in February 1990 which provides for an increase in base revenue of approximately $2.5 million, consisting of an increase in base rates of approximately $1.8 million and deferral of approximately $0.7 million. The Company expects the New Mexico Commission to issue its final order approving the stipulated settlement in April 1990, with new rates to be effective in May 1990.

The Company will be required to recover the New Mexico jurisdictional portion of the Company's investment in Unit 3, which is deregulated under the New Mexico rate moderation plan, through off-system sales in the economy energy market. Market prices for economy energy sales have not been in recent years and are not presently at levels needed by the Company to recover the New Mexico portion of the Company's current operating expenses related to Unit 3, including lease payments. However, the Company believes that over the useful life of Unit 3, based upon its current forecast of plant operating costs and performance, power needs of other utilities and alternative fuel prices, the Company will be able to recover the New Mexico portion of its Unit 3 costs through such sales of power. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

The Company is subject to performance standards in its New Mexico jurisdiction for the operation of the Palo Verde Units. The standards measure performance on the basis of the three Units being viewed as a single generating station and involve the use of designated levels of capacity factors (the ratio of actual generation to maximum possible generation). If the annual capacity factor of the station exceeds the maximum standard (which is 75% capacity), the Company is entitled to a monetary reward based upon the additional fuel costs avoided, calculated with reference to the Company's weighted average fuel and purchased power costs (other than Four Corners, Palo Verde and purchases from Southwestern Public Service Company). If the annual capacity factor falls below the minimum standard (60% capacity), the Company is penalized based upon the additional fuel costs incurred using the same formula. If annual performance falls between the minimum and maximum standards, no consequences result.

Due to the unscheduled outages at Palo Verde during 1989 (see "Facilities — Palo Verde Station" below), the Company recorded at December 31, 1989 an estimated performance penalty of approximately $3.0 million based upon the requirements of the New Mexico performance standards. Under those standards, the New Mexico Commission has the right to re-evaluate whether Palo Verde Units 1 and 2 should continue to be included in New Mexico rates. Although the Company is unable at this time to predict the ultimate financial or regulatory impact of the unscheduled outages at Palo Verde during 1989, the Company believes that, because Units 2 and 3 have been restarted and a request to the NRC to restart Unit 1 is expected in April of 1990, the New Mexico Commission will not exclude any of the Company's investment in Palo Verde Units 1 and 2 from New Mexico rates. See "Facilities — Palo Verde Station" for information on the outages at Palo Verde.

In its New Mexico jurisdiction, the Company recovers its fuel expenses and purchased power costs through a fuel factor set by the New Mexico Commission. The New Mexico rate moderation plan requires that the fuel factor be fixed each year during the term of the plan. On January 31, 1990, the Company filed a request for a new fuel factor in its New Mexico jurisdiction. The requested fuel factor reflected the estimated penalty of $3.0 million recorded by the Company under the New Mexico performance standards as well as a request by the Company to recover during 1990 approximately $2.0 million of under-recovered fuel expenses in New Mexico. Hearings will commence this summer, and the Company expects the New Mexico Commission to issue an order by the fall of 1990.

FERC Rate Matters

The Company's rates for wholesale power sales and transmission services are subject to regulation by the FERC. The Company's sales for wholesale power make up a significant portion of the Company's operating revenues. During both 1989 and 1988, approximately 18% of the Company's electric operating revenues resulted from such sales, respectively. Rate tariffs currently applicable to certain FERC jurisdictional customers contain appropriate fuel and purchased power cost adjustment

provisions designed to recover the Company's fuel and purchased power costs. Two FERC customers have fixed fuel factors approved under FERC tariffs for which no fuel reconciliation is made. Although rates to wholesale customers require FERC approval, the Company and its wholesale customers usually establish such rates through negotiations subject to such FERC approval.

The Company has a rate settlement agreement with IID which is based upon a long-term firm power sales agreement providing for the sale of 100 megawatts of firm capacity to IID beginning in 1987 and continuing through April 2002. In addition, the agreement calls for contingent capacity of 50 megawatts to be made available to IID beginning in 1992 and continuing through April 2002. The terms of the settlement agreement generally provide for sales prices designed to fully recover the scheduled costs over the life of the agreement. The sales prices are generally level throughout the term of the agreement and to the extent that they do not fully recover costs scheduled in the contract, revenues and a return are accrued for subsequent collection. Amounts accrued under the terms of the agreement were $7,340,000, $7,632,000 and $1,510,000 in 1989, 1988 and 1987, respectively. The agreement with IID settles any possible issue of the prudence of the construction costs of Palo Verde and of excess generating capacity.

The Company has a rate settlement agreement with TNP which is based upon a revised firm power sales agreement with TNP. As part of the settlement of the rate increase request, the Company and TNP settled an arbitration with respect to the contractual level of reserve demand under the Company's prior sales agreement with TNP. The revised firm power sales agreement with TNP provides for firm power sales to TNP ranging from 43 megawatts to 79 megawatts, beginning in 1987 and continuing through 2002, with negotiated demand charge rates for such power.

Construction Program

The Company's estimated construction costs for 1990 through 1993 set forth in the table below are approximately $202.6 million in cash and approximately $16.2 million in related AFUDC, net of deferred tax. The estimated costs were prepared as of March 5, 1990. For a number of reasons, actual costs may vary from the construction program estimates set forth below. Such estimates are reviewed and modified from time to time to reflect changed conditions.

	1990	1991	1992	1993
		(In thousands)		
Production:				
Palo Verde Station(1)	$29,000	$21,300	$18,700	$19,500
Palo Verde Deferred Costs(2)	4,500	0	0	0
Other	1,600	3,600	2,100	2,200
Transmission	0	1,300	4,400	2,300
Distribution	21,600	24,000	21,400	16,100
General Plant	1,200	1,200	3,300	3,300
AFUDC:(3)				
Palo Verde Station(2)	8,200	2,300	2,200	2,100
Other	1,800	1,200	1,600	1,100
Deferred Tax on AFUDC(4)	(1,400)	(500)	(1,300)	(1,100)
Total	$66,500	$54,400	$52,400	$45,500

(1) Does not include acquisition costs for nuclear fuel. See "Energy Sources — Nuclear Fuel."

(2) Includes the Texas jurisdictional costs of owning, operating and maintaining Unit 3, which the Company will continue to capitalize until Unit 3 meets present Texas in-service criteria. Subsequent to the Unit 3 in-service date for Texas ratemaking purposes, the Company anticipates deferring the Texas jurisdictional costs of owning, operating and maintaining Unit 3, which are expected to aggregate approximately $14.9 million and $13.0 million for 1990 and 1991, respectively, pursuant to an accounting deferral order that the Company requested from the Texas

Commission. See "Regulation — Texas Rate Matters — Palo Verde Unit 3 — Inclusion in Texas Rates."

(3) AFUDC has been calculated using an estimated accrual of 10.87%.

(4) Deferred tax is provided on the borrowed portion of AFUDC through 1991 and on total AFUDC beginning in 1992 to comply with the Company's adoption of SFAS 96 and will effectively reduce plant to a net amount for ratemaking and depreciation purposes.

Net utility plant at December 31, 1984 was $1,421,591,000. Gross additions to plant, including CWIP, for the five years ended December 31, 1989, totaled $813,035,000 (the largest portion of which was $558,887,000 for PVNGS). Net utility plant at December 31, 1989 (which reflects the sales of plant in the Palo Verde sale and leaseback transactions), was $1,348,975,000 (including capitalized nuclear fuel of approximately $47,114,000 leased from a nuclear fuel trust). See "Energy Sources — Nuclear Fuel."

The Company does not expect to construct additional base load generating facilities during this century.

Palo Verde Station

The Company has a 15.8% interest in the three 1,270 MW nuclear generating units and Common Plant at the Palo Verde Station near Phoenix, Arizona (owned as to Unit 1 and approximately 60% of Unit 3, and leased as to Unit 2 and approximately 40% of Unit 3). The participants in Palo Verde include the Company and six other utilities: Arizona Public Service Company ("APS"), Southern California Edison Company, Public Service Company of New Mexico, Southern California Public Power Authority, Salt River Project Agricultural Improvement and Power District and the Los Angeles Department of Water and Power. Participants share costs and generating entitlements in the same proportion as their percentage interests in the generating units. APS serves as Operating Agent for the Palo Verde Station. In February 1977 and November 1978, respectively, the New Mexico Commission and the Texas Commission issued Certificates of Convenience and Necessity for the Company's participation in Palo Verde Station.

The table below sets forth the actual costs incurred by the Company through December 31, 1989, for the construction of PVNGS (including the cost of start-up and testing and the Company's share of the cost of related switchyard and transmission facilities), and the Company's estimate of the cumulative cost of construction through the completion of PVNGS. The table includes capitalized ownership, operating and maintenance expenses related to the Texas jurisdictional portion of Unit 3, but does not include the Company's share of the estimated cost of nuclear fuel. See "Energy Sources — Nuclear Fuel." The table also does not reflect a regulatory disallowance write-off of approximately $38.3 million. The estimated costs were prepared as of March 5, 1990. See "Regulation."

	Actual Costs Through December 31, 1989	Estimated Cumulative Costs Through December 31,		
		1990	1991	1992
Nuclear Plant	1,044,000	1,077,500	1,098,800	1,117,500
Related AFUDC	532,400	540,600	542,900	545,100
Transmission Lines	18,800	18,800	18,800	18,800
Related AFUDC	8,300	8,300	8,300	8,300
Deferred Tax on AFUDC	(109,200)	(110,300)	(110,600)	(111,300)
Total	$1,494,300	$1,534,900	$1,558,200	$1,578,400

The above table includes approximately $653.4 million in aggregate book value of the undivided interests involved in the Unit 2 and Unit 3 sale and leaseback transactions in which the related leases are accounted for as operating leases. Such book value no longer appears as an asset of the Company.

Sales and Leasebacks. In August and December 1986, the Company sold and leased back all of its 15.8% undivided interest in Unit 2 and one-third of its interest in certain Common Plant at Palo Verde for approximately $684.4 million cash. In December 1987, the Company sold and leased back approximately 40% of its undivided 15.8% interest in Unit 3 for approximately $250 million cash. For a description of the terms and provisions of these transactions, see Note E of Notes to Consolidated Financial Statements.

Facilities

As described below, the Company currently has a net generating capacity of 1,497 MW, consisting of 246 MW at Rio Grande, 478 MW at Newman, 69 MW at Copper, an entitlement of 104 MW from Four Corners Units 4 and 5 and an entitlement of 600 MW from Palo Verde Units 1, 2 and 3.

Palo Verde Station

For information regarding the Company's interest in the Palo Verde Station, see "Regulation" and "Construction Program." For a description of nuclear fuel acquisition, see "Energy Sources — Nuclear Fuel."

Operation of each of the three Palo Verde Units requires an operating license from the NRC. Full power operating licenses for Units 1, 2 and 3 were issued by the NRC in June 1985, April 1986 and November 1987, respectively. The full power operating licenses, each valid for a period of approximately 40 years, authorize APS to operate the three Palo Verde Units at full power.

All three Palo Verde Units were out of service for substantial periods during 1989. Unit 3 and Unit 1 experienced unscheduled outages on March 3, 1989 and March 5, 1989, respectively, and Unit 2 was removed from service for testing by APS on March 15, 1989. In March 1989, the NRC issued confirmatory action letters requiring APS to take certain corrective actions and to receive NRC approval before restarting any of the Palo Verde units. APS placed Units 3 and 1 in their scheduled refueling outages on March 8, 1989 and April 8, 1989, respectively.

With NRC approval, APS restarted Unit 2 on June 29, 1989 (although the unit experienced subsequent outages during the year) and Unit 3 on January 21, 1990. On February 24, 1990, APS placed Unit 2 in its second refueling outage, which is scheduled to continue approximately 100 days. APS is undertaking corrective actions relating to Unit 1 and it is currently estimated that APS will request NRC approval to restart the Unit during April of 1990. Because of the present uncertainties regarding the timing of NRC approval, the restart date for Unit 1 cannot currently be predicted.

As a result of the unscheduled outages of the Palo Verde Units, the Company is incurring replacement power costs in excess of the amount of fuel revenues provided by the Company's fuel factors. See "Regulation — Texas Rate Matters — Texas Recovery of Fuel Expenses" and "Regulation — New Mexico Rate Matters." The Company's total undercollection of fuel revenues at December 31, 1989 was approximately $10 million. The Company has deferred, and will continue to defer, any undercollections resulting from the Palo Verde outages in accordance with procedures governing recovery of fuel expenses in its regulatory jurisdictions. Although the Company believes it is entitled to and will recover its actual fuel costs, net of the New Mexico performance standard penalty discussed under "Regulation — New Mexico Rate Matters," the Company is unable, at this time, to predict the ultimate financial or regulatory impact of the unscheduled outages.

On April 19, 1989, the manufacturer of the Control Element Assembly Drive Mechanisms of all three Palo Verde Units notified the NRC of a potential safety concern related to multiple Control Element Assembly ("CEA") "slip or drop events." APS has implemented interim precautionary measures in the event of multiple CEA slips or drops, and APS and the manufacturer are currently developing a plan to quantify risks and consequences associated with a double CEA slip or drop event at Palo Verde, to provide guidance for operator actions following such an event, and to correct the cause of such event. APS and the manufacturer are also evaluating permanent corrective actions.

By letter dated June 29, 1989, the NRC informed APS that it would conduct a Diagnostic Evaluation of Palo Verde in order for NRC senior management to review the results of previous inspection reports and performance indicators. The NRC delivered the evaluation report to APS by letter dated March 16, 1990. The report stated that the evaluation team found that Palo Verde had several substantial management, organizational and technical problems caused by a number of long-standing deficiencies. The report concluded that the root causes for Palo Verde's performance problems were (1) insufficient technical and management depth to support the start-up and operation of a three-unit facility, (2) during start-up, management and technical resources were focused on the next unit to go on line at the expense of the operational units, resulting in a backlog of technical and programmatic issues, and (3) a 1987 Palo Verde management reorganization which compounded, rather than improved, management deficiencies. The report also stated that the evaluation team observed several positive attributes and strengths at Palo Verde. Overall the team concluded that APS had a good understanding of the major performance problems affecting Palo Verde and that recent management changes combined with numerous initiatives under way were beginning to show progress in resolving known management issues. On or before May 15, 1990, APS must provide the NRC with a summary of an integrated action plan addressing the issues raised in the report.

The NRC is also currently evaluating possible enforcement action relating to (i) alleged violations of NRC regulations in connection with the reactor start-up of Palo Verde Unit 1 on May 14, 1988 and (ii) an alleged lack of timeliness of corrective actions with respect to controls over locked high-radiation areas at Palo Verde. The facts upon which the alleged violations are based were reported to the NRC by APS, the Palo Verde Operating Agent.

The Company has completed construction of a new 345 KV, 313-mile transmission line and associated substation equipment, known as the "Arizona Interconnection Project" or "AIP," which will serve a number of purposes, including providing access to the Company's full generation entitlement share to the Palo Verde Units. The transmission line originates at the Springerville Generating Station in Springerville, Arizona, and terminates at the Company's Rio Grande Power Plant in Dona Ana County, New Mexico (northwest of El Paso). In addition to enabling the Company to access its full generation entitlement share in Palo Verde, AIP will enable the Company to import low cost energy from the Arizona and New Mexico power grid, enhance the Company's transmission system reliability, better equip the Company to meet future strategic generating resource mix requirements and further enable the Company to benefit from economy energy purchases. See "Regulation — Texas Rate Matters — Palo Verde Unit 3 — Inclusion in Texas Rates."

Assured supplies of water are important both to the Company (for its generating plants) and to its customers. However, conflicting claims to limited amounts of water in the southwestern United States have resulted in numerous court actions in recent years.

In connection with the construction and operation of Palo Verde, APS, as Operating Agent, has entered into contracts with certain municipalities granting the right to purchase effluent for cooling purposes at Palo Verde. The validity of the primary effluent contract has been challenged in a suit filed by the Salt River Pima-Maricopa Indian Community (the "Community") against the United States Department of the Interior (the Federal agency alleged to have jurisdiction over the use of such effluent) and additional defendants, including APS and the Company. The portion of the action challenging the effluent contract has been stayed while the Community litigates its claims against the Department of the Interior and other defendants for wrongful exclusion from SRP, a Federal reclamation project. On October 21, 1988, federal legislation was enacted conforming to the requirements of a proposed settlement that would terminate this case without affecting the validity of the primary effluent contract. Certain contingencies, however, remain to be performed before the settlement is finalized and the suit is dismissed. Among these contingencies are the appropriation of significant funds by Congress and the Arizona legislature and approval by the court in the Lower Gila Watershed litigation (see below). The Company is unable to predict when, or if, the contingencies will be satisfied so that the settlement will become effective.

A summons served on APS in early 1986 required all water claimants in the Lower Gila River Watershed in Arizona to assert any claims to water on or before January 20, 1987, in an action pending in Maricopa County Superior Court. Palo Verde is located within the geographic area subject to the summons, and the rights of the Palo Verde participants to the use of groundwater and effluent at Palo Verde are potentially at issue in this action. APS, as Operating Agent, filed claims that dispute the Court's jurisdiction over the Palo Verde participants' groundwater rights and their contractual rights to effluent relating to Palo Verde and, alternatively, seek confirmation of such rights. No trial date has been set in this matter.

Although the foregoing matters remain subject to further evaluation, APS, as Operating Agent for Palo Verde, has advised the Company that APS expects that the described litigation will not have a materially adverse impact on the operation of the Palo Verde generating units.

The Palo Verde participants have insurance for public liability payments resulting from nuclear energy hazards to the full limit of liability under Federal law. This potential liability is covered by primary liability insurance provided by commercial insurance carriers in the amount of $200 million and the balance by an industry-wide retrospective assessment program. The maximum assessment per reactor under the retrospective assessment program for each nuclear incident is approximately $66 million, subject to an annual limit of $10 million per incident. Based upon the Company's 15.8% interest in the three Palo Verde units, the Company's maximum potential assessment per incident is approximately $31.3 million, with an annual payment limitation of $4.74 million. The insureds under this liability insurance include the Palo Verde participants and "any other person or organization with respect to his legal responsibility for damage caused by the nuclear energy hazard."

The Palo Verde participants maintain "all risk" (including nuclear hazards) insurance for nuclear property damage to, and decontamination of, property at Palo Verde in the aggregate amount of $2.035 billion, a substantial portion of which must first be applied to decontamination. The Company has also secured insurance against portions of any increased cost of generation or purchase of power resulting from the accidental outage of any of the three Palo Verde Units if such outage exceeds 21 weeks. The Palo Verde outages during 1989 and the current outage of Palo Verde Unit 1 are not covered by this insurance.

For information regarding the obligations of the Company to plan and fund, over the service life of Palo Verde, its share of the estimated costs to decommission Palo Verde, see Note D of Notes to Consolidated Financial Statements. The Company believes that all costs associated with nuclear plant decommissioning will be recoverable through rates.

Four Corners Project

The Company has an undivided 7% interest in Units 4 and 5 at Four Corners located in northwestern New Mexico. Each of the coal-burning generating units has a 739 MW capability. For emergencies each Unit is rated at 784 MW. Both units are located adjacent to a surface-mined supply of coal and are jointly owned by the Company, APS (which is the Operating Agent for Four Corners), Tucson Electric Power Company, PNM, Southern California Edison Company and Salt River Project Agricultural Improvement and Power District. The Company's entitlement of 104 MW is used for the Company's base load to the maximum extent possible.

The Four Corners Plant is located on land held under easements from the Federal Government and also under a lease from the Navajo Indian Tribe (the "Tribe"), the enforcement of which might require Congressional consent. The risk with respect to the enforcement of these easements and of the lease is not deemed by the Company to be material. The Company is dependent, however, in some measure upon the willingness and ability of the Tribe to protect these properties and honor its commitments. Certain of the transmission lines and almost all of the contracted coal sources for the Four Corners Plant are located on the Tribe's reservation.

On October 30, 1989, oral argument was heard by the Navajo Supreme Court regarding the issue of the enforceability of the APS anti-nepotism policy at the Four Corners Plant, for which APS is the Operating Agent. This matter was appealed to the Navajo Supreme Court by APS from a February 10, 1987 decision of the Office of the Navajo Labor Relations Board (the "Board") enjoining APS from enforcing its anti-nepotism policy at the Four Corners Plant. APS believes that a March 1985 letter agreement between it and the Tribe governs employment relations at the plant, rather than the Navajo Preference in Employment Act adopted by the Navajo Tribal Council in August 1985 and used by the Board as the basis for its decision. The letter agreement provides, among other things, that APS shall determine qualifications for employment and promotion at the plant. If necessary, APS will consider an appeal to Federal District Court. The Company cannot currently predict the ultimate outcome of this matter.

The participants in Four Corners are defendants in a suit filed by the State of New Mexico in March 1975 in state district court in New Mexico, against the United States of America, the City of Farmington, New Mexico, the Secretary of the Interior as Trustee for the Navajo and other Indian tribes, and certain other defendants. The suit seeks adjudication of the water rights of the San Juan River Stream System in New Mexico, which, among other things, supplies the water used at Four Corners. No trial date has been set in this matter. An agreement reached with the Tribe in 1985 provides that if the Four Corners Plant loses a portion of its rights in the adjudication, the Tribe will provide sufficient water from its allocation to offset the loss.

The Company owns a 230-mile, 345 KV transmission line from Newman to Albuquerque, New Mexico, at which point the Company's entitlement from Four Corners is delivered from 150 miles of transmission lines owned by PNM. This 345 KV transmission line regularly carries power from Four Corners and provides a major interconnection with the other five participants in Four Corners. The Company also owns an undivided interest in a 200-mile, 345 KV transmission line from Newman across southern New Mexico to Greenlee, Arizona. In addition, the Company has completed construction of the AIP transmission line from Springerville, Arizona to Diablo substation located in Sunland Park, New Mexico near the Rio Grande power station. See discussion above under "Palo Verde Station." These lines provide interconnections with Tucson Electric Power Company to provide transmission for the Company's entitlements from Four Corners and Palo Verde and also provide added stability, flexibility and reliability to the Company's system.

Rio Grande Power Station

Rio Grande, located in New Mexico adjacent to the city of El Paso, consists of three steam-electric generating units which have an aggregate capability of 246 MW when operating entirely on natural gas. When interstate natural gas at the station is curtailed, the units operate primarily on fuel oil, which increases operating and maintenance expenses. See "Energy Sources."

Newman Power Station

Newman, located in El Paso, consists of three steam-electric units with an aggregate capability of 266 MW and one combined-cycle unit with a capability of 212 MW. The units regularly operate on natural gas, but are also capable of operating on fuel oil. If they were to operate entirely on fuel oil, operating and maintenance costs would increase and capacities would be lower. See "Energy Sources."

Copper Power Station

Copper, consisting of a 69 MW combustion turbine capable of operating on fuel oil or natural gas and used for peaking purposes, was placed in service in June 1980 on a leased site in El Paso. The station has been classified under the Fuel Use Act as an existing facility, which allows the station to burn natural gas. Since such classification, the station has operated primarily on intrastate natural gas. See "Energy Sources — Natural Gas."

Environmental Matters

Units 4 and 5 of the Four Corners Plant have operated for several years under variances granted by the New Mexico Environmental Improvement Board relating to the emission of nitrogen oxides. The most recent variances were granted on December 18, 1987, to allow adequate time for the installation of additional equipment intended to achieve compliance with existing emissions limitations without adverse operational impacts. Installation of additional equipment on Unit 4 was completed prior to the expiration of the variance, and monitoring by APS, the Operating Agent for Four Corners, indicates that Unit 4 is now operating in compliance with existing emissions limitations. A variance was granted through September 30, 1991 for Unit 5. The Company estimates that its share of costs relating to the installation of additional equipment will be immaterial.

Revisions to environmental laws and regulations continue to be proposed and adopted at Federal, state and local levels. The EPA may also adopt regulations to deal with visibility impairment resulting from regional haze. Amendments to the Clean Air Act have been introduced which are intended to address problems of "acid rain," toxic air pollutants and the nonattainment of national ambient air quality standards. Along with other members of the electric utility industry, the Company is continuing its involvement before the United States Congress, state legislatures and federal and state regulatory agencies concerning revisions to environmental laws and regulations. The Company cannot accurately predict at this time the financial and operational impacts resulting from such revisions.

Energy Sources

General

Since 1985, the Company's energy mix has generally consisted of natural gas, coal and purchased power. Beginning in 1986, uranium became a part of the Company's energy mix, decreasing the importance of purchased power. This, in combination with lower natural gas costs, resulted in decreases in the Company's average yearly system energy cost. The following table lists the percentage contribution of coal, gas, uranium and purchased power to the total energy mix of the Company and the average cost to the Company in cents per KWH.

	Coal		Gas		Uranium		Purchase Power	
	Percent of Energy Mix	Average Cost	Percent of Energy Mix	Average Cost	Percent of Energy Mix	Average Cost	Percent of Energy Mix	Average Cost
1985	11%	1.02¢	28%	3.81¢	—%	—¢	61%	2.80¢
1986	13	1.01	30	2.36	7	.98	50*	2.30
1987	14	1.04	32	2.10	12	.96	42*	2.04
1988	13	1.00	30	2.21	40	1.06	17	2.47
1989	12	1.05	48	2.09	17	.99	23	2.37

* Prior to rate making treatment of the Company's investment in Palo Verde as described in "Regulation," the Company included under purchased power the major portion of energy generated by Palo Verde.

For a discussion of the recovery by the Company of its fuel costs, either in base rates or through fuel adjustment clauses, see "Regulation — Texas Rate Matters — Texas Recovery of Fuel Expenses," "— New Mexico Rate Matters" and "— FERC Rate Matters."

The Company's local generating units are subject to the requirements of the Fuel Use Act, as amended (the "FUA"). Under such Act, the Company may continue to burn natural gas in its existing generating units for the life of the units, subject to compliance with a United States Department of Energy ("DOE") approved energy conservation plan filed by the Company originally in 1982 with the final update filed in 1988. Currently, under Section 712, the Company is required to file annual statements of its compliance with its conservation plan. The Company will continue its conservation programs in the areas of customer assistance, public information and operating efficiency.

Natural Gas

The Company is supplied with natural gas from both interstate and intrastate pipeline systems. The interstate pipeline owned by El Paso Natural Gas Company ("EPNG") provides the Company's Rio Grande Station with spot natural gas and/or contract commodity gas. Meridian Oil Transportation ("MoTrans") supplies the Company's Newman and Copper Stations with a firm natural gas supply made up of both intrastate and spot natural gas purchases.

In 1989, the Company's interstate natural gas requirements consisted solely of spot natural gas supplied by various suppliers. Negotiations continue on the Company's commodity gas contract with EPNG which terminated in December 1987. Given the numerous regulatory issues EPNG currently has pending before the FERC, the Company and EPNG expect to reach a new agreement in 1990. In the interim, EPNG continues to transport spot natural gas for the Company pursuant to transportation agreements with EPNG, and provides commodity gas (as required) to the Company under the original Certificate of Service filed with the FERC.

The intrastate natural gas requirements at Copper and Newman are supplied and transported pursuant to an intrastate natural gas contract with MoTrans. In addition, interstate natural gas can be supplied to Newman units 1, 2, 3 and 4, which allows for a back-up natural gas supply when operational constraints on the intrastate gas system dictate the need for an alternate fuel supply. In December 1989, the Company's intrastate natural gas contract with MoTrans terminated. The Company and MoTrans are currently finalizing a new five-year contract to supply the Company's intrastate gas requirements. It is expected that the new contract will be finalized early in 1990. The new agreement will provide the Company continuing flexibility in scheduling its natural gas requirements while allowing for the maximization of the use of inexpensive economy purchase power and generation from its remote resources Four Corners and Palo Verde.

During 1989, the Company experienced supply curtailments on its interstate and intrastate natural gas system due to pipeline pressure problems caused by severe winter weather conditions in various parts of the nation. The impacts of the curtailments were minimal because the Company was able to shift load to other generating plants or purchase off-system power. The Company does not expect any significant curtailments during 1990 with respect to either interstate or intrastate gas supplies.

Coal

The Company believes that the Four Corners Plant has sufficient reserves of low sulfur coal (the sulfur content of which is currently running at 0.8%) committed to the plant to continue operating it for its useful life. In 1989, average prices paid for coal supplied from reserves dedicated under the existing contract at Four Corners were relatively steady, although applicable contract clauses permit escalations under certain conditions. In addition, major price changes from time to time result from contract renegotiations. APS purchases all of the coal which fuels the Four Corners Plant from a coal supplier with a long-term lease of coal reserves owned by the Tribe.

Nuclear Fuel

The fuel cycle for Palo Verde is comprised of the following stages: (1) the mining and milling of uranium ore to produce uranium concentrates; (2) the conversion of uranium concentrates to uranium hexaflouride; (3) the enrichment of uranium hexaflouride; (4) the fabrication of fuel assemblies; (5) the utilization of fuel assemblies in reactors; and (6) the storage of spent fuel and the disposal thereof. Arrangements have been made to obtain quantities of uranium concentrate anticipated to be sufficient, if certain contract options are exercised, to meet operational requirements through 1997. Spot purchases on the open market will be made as appropriate in lieu of any uranium which might be obtained pursuant to the contract options. The Palo Verde participants have contracted for all conversion services required through 1992. The Palo Verde participants have also contracted for a significant portion of conversion services required in 1993 and 1994, with options to contract for the remaining requirements in 1993 and 1994 and for all of the requirements in 1995 and 1996. The Palo

Verde participants, including the Company, have an enrichment services contract with DOE that obligates DOE to furnish the enrichment services required for the operation of the three Palo Verde units over a term expiring in November 2014, with the annual option to terminate each year of the contract separately with ten years' notice, which option APS exercised in 1989 for the year 1999, on behalf of the Palo Verde participants. In addition, existing contracts will provide fuel assembly fabrication services for at least ten years from the operation date of each Palo Verde unit and, if options are exercised, for approximately fifteen additional years.

Spent fuel storage facilities at Palo Verde have sufficient capacity to store all fuel expected to be discharged from normal operation of all of the Palo Verde units through at least the year 2003. Pursuant to the Nuclear Waste Policy Act of 1982 (as amended in 1987, the "Act"), DOE is obligated to accept and dispose of all spent nuclear fuel and other high-level radioactive wastes generated by all domestic power reactors. The NRC, pursuant to the Act, also requires operators of nuclear power reactors to enter into spent fuel disposal contracts with DOE. APS, on behalf of itself and the other Palo Verde participants, has executed a spent fuel disposal contract with DOE. The Act also obligates DOE to develop the facilities necessary for the permanent disposal of all spent fuel generated and to be generated by domestic power reactors and to have the first such facility in operation by 1998 under prescribed procedures. In November 1989, DOE reported that such permanent disposal facility will not be in operation until 2010, seven years later than previously reported. As a result, under DOE's current criteria for shipping allocation rights, Palo Verde would begin spent fuel shipments to DOE disposal facility in 2017. The Company believes that alternative interim spent fuel storage methods will be available for use by Palo Verde until DOE's scheduled shipments from Palo Verde begin.

Pursuant to the Participation Agreement among the participants in the Palo Verde Station, the Company has an undivided interest in nuclear fuel purchased and to be purchased in connection with the operation of Units 1, 2 and 3 of the Palo Verde Station. The Company has a nuclear fuel purchase commitment with an independent trust. The trust's financing is based upon a letter of credit with a three-year term which is annually extended by one year if notice to the contrary is not given to the trust by the issuing bank. The issuing bank has given notice of non-extension, and, as a result, the letter of credit is currently scheduled to expire on January 8, 1993. The trust purchases nuclear fuel and incurs all costs in connection with the acquisition of the fuel and related materials for use by the Company at Palo Verde. The Company has the option of either purchasing the fuel from the trust or purchasing the heat generated by the fuel at prices established to reimburse the trust for all the costs incurred in connection with acquisition of the fuel. The Company is required to elect one of these options for each batch of nuclear fuel. The Company has elected the heat purchase option as the basis for payment for the first fuel loads as well as the first fuel reloads for Palo Verde Units 1, 2 and 3 and presently intends to elect the heat purchase option as the basis for payment for future fuel reloadings. Quarterly heat payments at the established prices began in the first quarter of 1986 for Palo Verde Unit 1, the first quarter of 1987 for Unit 2 and the second quarter of 1988 for Unit 3. At December 31, 1989, the aggregate investment of the trust in such nuclear fuel and related materials was approximately $87,700,000, including approximately $48,500,000 for fuel loaded at Palo Verde Units 1, 2 and 3.

Preferred Stock Tax Indemnity

In July 1989, the two corporations which are the beneficial owners of the Company's 11.375% preferred stock, aggregate par value $50 million, notified the Company that the IRS had proposed to disallow those holders the dividends received deduction taken by them on their 1985 income tax returns with respect to the dividends they received on that stock. At the same time the IRS also made the same proposed disallowance to the beneficial owners of a number of preferred stock issues of other utilities. Under an agreement the Company entered into on issuance of the shares in 1984, the Company has agreed to indemnify the beneficial owners for loss of the dividends received deduction by reason of IRS action. The beneficial owners are contesting the proposed disallowance as required by the agreement.

In January 1990, the beneficial owners provided the Company a schedule of indemnity payments that would be due if the IRS were to prevail. By the owners' calculation, an indemnity payment of $28,637,989.29 for additional taxes, penalties and interest to September 30, 1989 ($31,362,852 if interest is extended to December 31, 1990) would be due for all dividends paid from January 1, 1985, through October 1, 1989, and additional indemnity payments with respect to dividends due thereafter, paid as the quarterly dividends are paid, would total $6,848,697. Under the indemnity agreement, the owners can require the Company to escrow, during the pendency of the IRS contest, the indemnity payments that would be owing if the IRS prevails, because the Company's First Mortgage Bonds are not rated at specified levels. To date the owners have not required an escrow. The escrow, if established, would be invested for the account of the Company.

Under the Company's interpretation of the indemnity agreement, it requires the Company to make indemnity payments, assuming the IRS prevails, only for dividends paid after the Company received, in July 1989, notice of the proposed IRS action, and therefore, if any escrow is required, the Company would be obligated to escrow indemnity payments only for the October 1, 1989, dividend and each quarterly dividend thereafter as it is paid. If the Company's interpretation is sustained, then, depending on how a dispute is resolved on the tax rate to be used in determining the indemnity payments, the indemnity payment or earlier escrow deposit would be $795,985, by the Company's calculation, or $1,304,826, by the owners' calculation, for the additional tax, penalty and interest to December 31, 1990, with respect to the October 1989, dividend, and for the dividends paid thereafter, the indemnity payment or escrow deposit for each dividend would decrease as the preferred stock is redeemed according to its terms ($10 million a year from July 1990, to final redemption in July 1994), and would total, over the 42-month period, $6,422,136 by the Company's calculation, or $6,848,698 by the owners' calculation. Counsel to the Company believes that the beneficial owners are more likely to prevail than the IRS on the proposed disallowance of the dividends received deduction, and also believes that, if the IRS does prevail, there is substantial support for the Company's position that it is not obligated to indemnify for past dividends. If the IRS were to prevail, the Company believes its dividend and indemnity payments would be deductible as interest paid for federal income tax purposes.

Since these indemnity payments, even under the Company's interpretation, would increase the Company's pre-tax cost by more than 50 basis points, the indemnity agreement gives the Company the right to redeem all of the shares for par plus any indemnity payments due, at any time through the third dividend payment after conclusion of the IRS contest. The Company's present intention, which may change, is not to seek repurchase of the shares before conclusion of the tax contest.

Even if the IRS does not prevail, the Company still must make indemnity payments to the owners for additional taxes they must pay by reason of the reduction in the dividends received deduction by the Tax Reform Act of 1986 and the Revenue Act of 1987. The owners and the Company, however, do not agree on how these payments are to be calculated. By the owners' calculation, an indemnity payment of $1,695,718 is due for past dividends through October 1, 1989, and the indemnity payments for each dividend thereafter would be from $109,872, decreasing to $21,974 and totalling $1,208,593. By the Company's calculation, an indemnity of $487,048 would be due for past dividends, and the continuing indemnity would be from $52,251 down to $10,450 as each dividend is paid, totalling $574,767. These indemnity payments would reduce any payments due on account of the IRS prevailing on its proposed total disallowance of the dividends received deduction.

Arizona Tax Matters

By Notice of Proposed Correction of Income Tax dated February 9, 1990, the Arizona Department of Revenue (the "ADR"), in connection with an audit examination of the taxable years 1984 through 1987, informed the Company that the ADR has determined that the gains from the sales of the Company's interest in Palo Verde Units 2 and 3 are allocable to Arizona for state income tax purposes on the grounds that the Units constitute non-business assets with a situs in Arizona, resulting, according to the ADR, in a proposed deficiency assessment, including related interest and penalties, of approximately $39.5 million. The Company believes Palo Verde Units 2 and 3 constituted business assets at the time of the respective sales, and, in accordance with Arizona law, it apportioned, rather than allocated, the corresponding gains in paying the Arizona income tax on the transactions.

The proposed deficiency by the ADR is not a final administrative determination, and additional informal discussions on the issue will be conducted prior to a formal hearing. The Company believes that the ADR will not prevail in its proposed determination and does not expect to incur any material liability in respect thereof. The Company will litigate any issues not satisfactorily resolved through the administrative process.

As part of its revenue budgeting process, the Arizona state legislature is considering legislation which would, if adopted, increase the Company's Arizona property taxes. Several proposals have been introduced. Although the Company expects that some form of legislation will result, it cannot be determined at this time what the legislation will provide, when it will be adopted, if it is, or what the magnitude of the increase in the Company's Arizona property taxes would be. The Company expects that any such tax increase could be recovered in rates.

Executive Officers of the Registrant

Name	Age	Current Position and Business Experience
David H. Wiggs, Jr	42	Chairman of the Board since June 1989; Chief Executive Officer since March 1989; President and a Director since January 1988; Chief Operating Officer from January 1988 to March 1989; for more than 5 years prior to January 1988, chief regulatory legal counsel and shareholder in Kemp, Smith, Duncan & Hammond, El Paso, Texas.
William J. Johnson	48	Senior Vice President since January 1988; Chief Financial Officer since December 1986; for more than five years prior to January 1988, served in various executive capacities with the Company.
William W. Royer	45	Senior Vice President since January 1990 and from January 1988 through October 1988; for more than five years prior to January 1988, served in various executive capacities with the Company; President, Franklin Land from March 1989 to January 1990; President, Triangle Electric Supply Company, El Paso, Texas (see Item 3) from October 1988 to March 1989.
Ignacio R. Troncoso	43	Senior Vice President since January 1988; for more than five years prior thereto, Vice President.
Lawrence M. Downum, Jr	51	Vice President since 1983.

Name	Age	Current Position and Business Experience
Gary R. Hedrick	35	Treasurer since February 1988; Assistant Vice President, Finance since February 1990; Vice President, Treasurer and Chief Financial Officer of PasoTex from December 1986 to February 1988; Treasurer of Franklin Land from November 1986 to February 1988; for more than 5 years prior to November 1986, served in various managerial and supervisory capacities with the Company.
Eduardo A. Rodriguez	34	Corporate Secretary since February 1989; General Counsel since February 1988; for more than five years prior to February 1988, served in various managerial and supervisory capacities with the Company.
Russell G. Gibson	37	Controller since September 1989; for more than 5 years prior thereto, partner and member, Coopers & Lybrand (certified public accountants).
Julius F. Bates	40	Vice President since June 1989; for more than five years prior thereto, served in various managerial and supervisory capacities with the Company.
John C. Horne	42	Vice President since August 1989; for more than five years prior thereto, served in various managerial and supervisory capacities with the Company.
Robert C. McNiel	43	Vice President since December 1989; for more than five years prior thereto, served in various managerial and supervisory capacities with the Company.
Frederic E. Mattson	45	Vice President since June 1989; for more than five years prior thereto, served in various managerial and supervisory capacities with the Company.
James A. Mayhew	35	Vice President — Rates since August 1989; for more than five years prior thereto, served in various managerial and supervisory capacities with the Company.

The executive officers of the Company are elected no less often than annually and serve at the discretion of the Board of Directors.

Non-Utility Operations

During 1989, the Company decided to discontinue all of the non-utility operations conducted through the Company's principal subsidiaries, FL&R and PasoTex. FL&R had primarily been engaged in real estate operations in downtown El Paso and other investment activities. PasoTex had engaged through subsidiaries in a variety of non-utility activities, including specialty steel manufacturing, oil country tubular goods end-finishing and marketing, and furniture and accessory manufacturing.

The decision to discontinue these operations reflects the Company's plan to return its operations exclusively to its core utility business. That plan and the timing and nature of the dispositions of the non-utility operations and investments were impacted by a number of factors, including the cash requirements of such operations, regulatory, contractual and financing restrictions applicable to the Company, the value and future prospects for the discontinued operations, the timing and amount of federal income tax benefits associated with the disposition of the operations and the impact of the discontinued operations on the consolidated financial results of the Company.

In late December 1989, PasoTex sold its $60 million preferred stock investment in Commercial Federal Savings and Loan Association, Omaha, Nebraska. The Commercial Federal investment, which was written off by the Company in its entirety under provisions recorded in the 1989 third and fourth quarters due to Commercial Federal's failure to meet regulatory capital requirements and continue paying dividends, was sold by PasoTex to an independent third party corporation, whose principals are experienced in the thrift industry, for a nominal amount of cash plus a $2 million non-recourse purchase money note. All principal and interest on the purchase money note is due on November 30, 1994, but mandatory prepayments are required based upon a percentage of the purchaser's net cash flow. The preferred stock was pledged to secure the payment of the purchase money note and is held by an independent escrow agent. As additional consideration in the transaction, PasoTex received a warrant to purchase 49.5% of the then outstanding shares of common stock of the third party purchaser (although shares purchased would be non-voting) for an aggregate consideration of approximately $500,000. The warrant may be exercised from time to time, in whole or in part, until December 30, 1996. The warrant may be assigned, subject to applicable securities laws. The transaction was supported by a fairness opinion from an investment banking firm retained by PasoTex. The note and warrant received by PasoTex in the sale were transferred to the Company prior to the sale of PasoTex and Franklin in January 1990.

Also in late December 1989, PasoTex surrendered its 50% common equity interest in Westwood Lighting Group, Inc., a lamp manufacturer, back to Westwood without consideration.

The disposition of the Commercial Federal preferred stock and the surrender of the Westwood common stock resulted in current federal income tax benefits of approximately $18.6 million and $2.3 million, respectively.

On January 17, 1990, the Company sold all of the capital stock of FL&R and its 35% stock ownership of PasoTex (which was owned 65% by FL&R) to an unrelated third party special purpose corporation, whose managers have substantial experience in the ownership and operations of diverse business enterprises. The Company received as consideration in the transaction the note and warrant received by PasoTex in the disposition of the Commercial Federal investment. The Company transferred at closing of the transaction approximately $3 million to PasoTex for working capital purposes and agreed to transfer approximately $5 million to FL&R no later than July 15, 1990, to be applied against the obligations of FL&R under its mortgage debt relating to a hotel owned in El Paso. As a result of the sale of FL&R, the Company's indirect liability for FL&R's $9,756,000 borrowings under the Rio Grande Resources Trust will become a direct liability of the Company. The stock purchase agreement relating to the transaction provides for an indemnity payment, estimated at approximately $1,800,000, from the Company to the purchaser to compensate for certain Federal income tax investment tax credit recapture liability which may be incurred upon FL&R's eventual sale of the hotel. The indemnity payment is contingent upon certain tax elections which the purchaser is entitled to make with respect to the sale of FL&R and PasoTex. The consideration for the transaction was based upon the combined values of FL&R and PasoTex. The transaction was supported by a fairness opinion from the Company's financial advisor, a nationally recognized investment banking firm.

The loss on the sale of Franklin and PasoTex will generate federal income tax benefits of approximately $18 million.

The Company's final divestiture of its non-utility operations and investments in 1990 has been reflected in discontinued operations in its 1989 financial statements.

See Part II, Item 7 — "Management's Discussion and Analysis of Financial Condition and Results of Operations — Results of Operations — Non-Utility Operations."

Utility Operating Statistics

	December 31, 1989	1988	1987
Operating Revenues (In thousands):			
Retail:			
Residential	$ 122,598	$ 112,957	$ 103,232
Commercial and industrial, small	117,272	105,166	95,766
Commercial and industrial, large	42,250	35,575	32,976
Sales to public authorities	63,886	57,240	51,493
Provision for refund	62	(1,641)	(3,019)
Other	2,438	4,891	1,573
	348,506	314,188	282,021
Wholesale:			
Sales for resale	77,742	67,919	55,242
Total operating revenues	$ 426,248	$ 382,107	$ 337,263
Number of customers (End of year):			
Residential	214,664	209,550	204,102
Commercial and industrial, small	21,762	21,069	20,582
Commercial and industrial, large	52	39	41
Other	2,659	2,543	2,505
Total	239,137	233,201	227,230
Average annual use and revenue per residential customer:			
KWH	6,124	6,025	5,846
Revenue	$ 577.60	$ 546.13	$ 511.48
Average revenue per KWH:			
Residential	9.43¢	9.07¢	8.75¢
Commercial and industrial, small	8.08	7.52	7.28
Commercial and industrial, large	5.53	5.10	5.19
Energy supplied, net, KWH (In thousands):			
Generated	4,753,236	4,904,854	3,186,967
Purchased and interchanged	1,446,063	969,793	2,264,955
Total	6,199,299	5,874,647	5,451,922
Energy sales, KWH (In thousands):			
Retail:			
Residential	1,299,768	1,246,081	1,179,812
Commercial and industrial, small	1,450,817	1,397,913	1,316,198
Commercial and industrial, large	763,650	697,758	635,448
Sales to public authorities	947,948	908,238	860,852
	4,462,183	4,249,990	3,992,310
Wholesale:			
Sales for resale	1,411,162	1,271,366	1,087,444
Total sales	5,873,345	5,521,356	5,079,754
Losses and company use	325,954	353,291	372,168
Total	6,199,299	5,874,647	5,451,922
Native system:			
Peak load, KW	916,000	840,000	820,000
Net generating capacity for peak, KW	1,497,000	1,497,000	1,297,000
Load factor	61.0%	63.0%	61.5%
Total system:			
Peak load, KW	1,076,000	1,002,000	975,000
Net generating capacity for peak, KW	1,497,000	1,497,000	1,297,000
Load factor	67.0%	67.3%	64.4%

Item 2. Properties

The principal properties of the Company are described in Item 1 of this report, and such descriptions are incorporated herein by reference thereto. Transmission lines are located either on private rights-of-way, easements or on streets or highways by public consent. Reference is made to Note J of Notes to Consolidated Financial Statements for information regarding encumbrances against the principal properties of the Company and its subsidiaries.

Item 3. Legal Proceedings

First Service Life Litigation

Pending Actions Involving the Company's Collateral. On September 26, 1988, the Company filed a declaratory judgment action in the 345th Judicial District Court, Travis County, Texas, against First Service Life Insurance Company, a life insurance company organized under the laws of the Cayman Islands ("First Service"), and R. B. Ashworth, as Conservator for the affairs of First Service under the Texas Insurance Code (the "Conservator"), for a determination that (i) the Company has legal, valid, duly perfected and enforceable security interests in certain collateral granted to the Company by First Service to secure annuities purchased by the Company from First Service, the present balance of which is approximately $20 million (the Company's original annuity investment purchased from First Service being $70 million); and (ii) that events of default have occurred under the collateral security documents pertaining to such annuities which entitle the Company to enforce such security interests. In late May 1988, the Company notified First Service that First Service was in default under the annuities and the collateral agreements and that the Company intended to enforce its security interests. The Conservator, who was appointed by the Texas Commissioner of Insurance in early June 1988, notified the Company that First Service might not be in default, expressed doubt as to the validity and enforceability of the security interests held by the Company and demanded that the Company return to the Conservator all of the collateral and desist and refrain from proceeding with enforcement of the security interests and other interference with the conservatorship and the conservatorship proceedings.

On September 29, 1988, the Conservator, in conjunction with his answer and denial of the Company's declaratory judgment action, countersued the Company on behalf of First Service and two affiliated corporations, First Service Life, a Turks and Caicos corporation ("FSL"), and Knickerbocker Life Insurance Company ("Knickerbocker"), for actual damages of at least $50 million, plus punitive damages of at least $300 million. The Conservator's counterclaim seeks (i) a temporary and permanent injunction against the Company's enforcement of its security interests in the collateral, (ii) an accounting from the Company as to all payments and transfers of property to the Company from First Service with respect to the Company's annuities, (iii) a declaratory judgment that the Company's security interests are illegal and unenforceable under the Texas Insurance Code and that the sale and purchase of the annuities was an illegal transaction under the Texas Insurance Code by a company doing insurance business in Texas without authorization, and (iv) disgorgement by the Company of all payments received on its annuities and all collateral therefor. The counterclaim alleges several causes of action against the Company including principally fraud, conversion and breach of duty of good faith and fair dealing (based upon an alleged affiliate or "insider" relationship between the Company and First Service).

On December 1, 1988, a receiver (the "Receiver") was appointed for First Service by the 53rd Judicial District Court of Travis County, Texas, and on December 13, 1988, the Receiver in his capacity for First Service was substituted as a party for the Conservator in the above-described litigation. On January 18, 1989, the Receiver was appointed as receiver for FSL as well. The Conservator remains a party to the above-described litigation in its capacity as conservator for Knickerbocker.

Although only preliminary discovery has been conducted, the Company's legal counsel, Small, Craig & Werkenthin, P.C., Austin, Texas, has reviewed the basic facts of the case with management and other parties familiar with various aspects of the transactions involved in the litigation, examined

documents and records of the Company and other parties which relate to such transactions, and evaluated the allegations against the Company made in the counterclaim. Based upon its preliminary evaluation and investigation of the case to date, and subject to the results of discovery, counsel believes that it is more likely than not that the outcome of the litigation will be favorable to the Company.

The Company believes that the Company's security interests in the collateral are valid and enforceable, and the Company intends to recover amounts owed to it on the annuities through enforcement of its rights to the collateral. The Company strongly denies the allegations of the counterclaim, believes the counterclaim is without merit and intends to vigorously defend against it. Upon reevaluation of the collateral, the Company recorded at June 30, 1989 a provision for loss on the investment of $7 million. The Company has made no provision for loss for the effects, if any, of the ultimate outcome of the litigation. Effective April, 1988 the Company discontinued the accrual of interest income on the annuities.

Claims by Annuitants. On October 16, 1989, the case of *Pedro Meneses, et al. v. Maury Page Kemp, et al.*, Civil Action No. EP-89-CA-37H, was filed in the Western District of Texas, El Paso Division (the "Lawsuit"). The plaintiffs in the Lawsuit include most of the holders of annuities from First Service (the "Annuitants"). The defendants include the beneficial principal shareholders and officers and directors of First Service and Knickerbocker; certain affiliated companies of the principal beneficial shareholders of First Service and Knickerbocker, the Company and its former subsidiaries, PasoTex and Franklin Land; the accounting firm of Coopers & Lybrand; the law firm of Kemp, Smith, Duncan & Hammond, which serves as general counsel to the Company; and two individual attorneys who are shareholders in such firm, one of whom is a former director of the Company. The Lawsuit, as amended, alleges that the defendants violated the Racketeer Influenced and Corrupt Organization Act ("RICO"), conspired to violate RICO, violated the Federal and Texas securities laws, committed common law fraud, civil conspiracy to defraud, violations of the Texas Deceptive Trade Practices Act and violations of the Texas Insurance Code and violated certain provisions of the Texas Penal Code relating to theft, false statements to obtain property or credit, fraud in insolvency, receiving deposit, premium or investment in a failing financial institution, commercial bribery and misapplication of fiduciary property or property of a financial institution. The claims made against the Company and its former subsidiaries are based upon allegations that the Company controlled and/or conspired with First Service.

The plaintiffs are seeking damages in the amount of their lost annuities, plus interest, multiplication of actual damages, punitive and exemplary damages, and attorneys fees and costs. The complaint in the Lawsuit alleges sales of annuities to the plaintiffs in excess of $9 million, and the total claim for damages exceeds $59 million.

The Company vigorously denies any liability in respect of the Lawsuit and believes that all related claims are without merit. Based upon the limited evaluations and investigation of Small, Craig & Werkenthin, P.C., Austin, Texas, the Company's legal counsel in connection with the pending litigation, such counsel believes that it is more likely than not that the ultimate outcome of the Lawsuit will be favorable to the Company.

The Lawsuit names as a defendant Billye E. Bostic, formerly an executive officer of the Company, who is entitled to indemnity under the Company's charter, bylaws and other applicable agreements to the same extent as indemnification is afforded by the Company to all of its officers and directors with respect to service on boards of directors of other companies. Mr. Bostic has advised the Company that he denies any liability in respect of the Lawsuit and believes that the claims asserted against him therein are without merit. Mr. Bostic is represented by counsel separate from the Company's counsel.

There are numerous parties who purchased annuities from Knickerbocker, not included within the group of the Annuitants, who may assert additional claims similar in nature to the claims asserted by the Annuitants, against the Company. These claims, if asserted, could result in additional suits against the Company.

Suit Against Directors of First Service. On February 3, 1989, the Receiver filed suit in the 345th Judicial District Court, Travis County, Texas, against certain individuals who were alleged to be directors of First Service and/or FSL, including Mr. Bostic.

The Receiver alleges that First Service engaged in the sale of annuities in Texas without authorization to do so and that such actions constituted illegal insurance transactions under the Texas Insurance Code. The Receiver further alleges that the alleged illegal sale of annuities by First Service constitutes a breach by the directors of First Service of their fiduciary duty to exercise due care in the management of the affairs of First Service and/or FSL and resulted in unspecified losses to First Service. The suit seeks actual damages of at least $33 million and, in addition, exemplary damages of at least double the actual damages. No significant discovery has been conducted at this time.

Mr. Bostic has advised the Company that he denies that he served as a director of First Service or FSL during the period of the alleged activities complained of, denies any liability in respect of the Receiver's suit and intends to vigorously defend against it. Mr. Bostic is represented by counsel separate from the Company's counsel in the First Service litigation. Mr. Bostic is entitled to indemnity with respect to the Receiver's suit to the extent indemnification is afforded by the Company to all of its officers and directors with respect to service on certain outside boards.

Because no significant discovery has been conducted, counsel for Mr. Bostic is unable to express an opinion as to the ultimate outcome of the suit. No provision for an indemnity payment, if any, is included in the 1989 consolidated financial statements.

Other Legal Proceedings

Information regarding legal proceedings relating to Palo Verde, Four Corners, rates and regulation, environmental matters, preferred stock tax indemnities and certain Arizona tax matters is described under the subcaptions "Regulation," "Facilities," "Environmental Matters," "Preferred Stock Tax Indemnities" and "Arizona Tax Matters" under "Business" in Item 1 of this report and is incorporated herein by reference thereto.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

The Company's Common Stock is traded in the over-the-counter market and quoted on the NASDAQ National Market System. The high and low sale prices for the Company's Common Stock, as reported by NASDAQ, and the quarterly dividends per share paid by the Company, for the periods during 1988 and 1989 indicated below, were as follows:

	Sale Price		
	High	Low	Dividends
1988			
First Quarter	$16⅝	$13⅞	$0.38
Second Quarter	16⅜	14¼	0.38
Third Quarter	16⅜	15⅛	0.38
Fourth Quarter	16⅜	13¼	0.38
1989			
First Quarter	15⅜	11	0.38
Second Quarter	11⅞	6½	—
Third Quarter	9⅞	7⅞	—
Fourth Quarter	10	7⅞	—

At February 28, 1990, there were 33,305 holders of record of the Company's Common Stock.

The terms of the RCF entered into by the Company in October 1989 (see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources") prohibit the Company from declaring or paying any dividends with respect to its Common Stock.

In addition, the Company's Restated Articles of Incorporation and the First Mortgage Indenture and certain of the supplemental indentures relating to various series of First Mortgage Bonds contain restrictions as to the payment of dividends on the Common Stock of the Company. At December 31, 1989, the retained earnings available for dividends on the Common Stock under the most restrictive of those provisions was approximately $54,940,000.

Item 6. Selected Financial Data

As of and for the years ended December 31:

	1989	1988	1987	1986	1985
	(In thousands except per share data)				
Operating revenues	$ 426,248	$ 382,107	$ 337,263	$ 318,262	$ 346,278
Operating income	56,551	81,533	92,592	89,126	90,294
Income from continuing operations before cumulative effect of change in accounting method	$ 1,956	$ 63,877	$ 47,431	$ 98,715	$ 113,071
Income (loss) from continuing operations before cumulative effect of change in accounting method per weighted average shares of common stock	(0.28)	1.48	0.98	2.41	2.88
Dividends declared per share of common stock	0.38	1.52	1.52	1.52	1.49
Total assets	1,769,518	1,799,949	2,275,573	2,194,418	1,919,060
Additions to utility plant, net of allowance for equity funds used for construction	125,644	79,845	61,246	136,598	169,437
Long-term, financing and capital lease obligations and preferred stock — redemption required	$ 810,788	$ 687,589	$ 888,328	$ 947,631	$ 971,228

See "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 for a discussion of certain of the information in the foregoing table.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

For the year ended December 31, 1989 and 1988, continuing operations generated income of $1,956,000 and $63,877,000, respectively, and discontinued operations generated losses of $107,789,000 and $39,508,000, respectively. As more fully discussed in "Results of Operations" in this section, the principal factors contributing to the significant decrease in income from continuing operations in 1989 were: (1) an increase in operating expenses, primarily related to Palo Verde, in excess of an increase in operating revenues, of $24,982,000; (2) regulatory disallowances of $16,178,000, net of tax benefits; and (3) reduced investment income of $19,462,000. The regulatory disallowance resulted from, and the increase in operating revenues was negatively affected by, the Texas Commission's 1989 rate order in Docket 8363.

The Company has disposed of its non-utility investments and operations (see "Non-Utility Operations" below). Future results of the Company's operations, accordingly, will be significantly affected by the actions of the Company's principal regulatory bodies.

The Company has rate moderation plans in place in both its Texas and New Mexico jurisdictions. In late November 1989, the Company filed with the Texas Commission for the third scheduled base rate increase under the Texas plan, seeking an increase in base revenues of $33.9 million. Hearings before the Texas Commission are underway, and new rates resulting from the filing are expected to be effective by August 1990. In addition, the Company plans to file for the fourth scheduled base rate

increase under the plan in the third quarter of 1990. New rates resulting from the filing should be in effect by summer 1991.

The Company filed in July 1989 with the New Mexico Commission for the third and final scheduled base rate increase pursuant to the New Mexico rate moderation plan. The Company requested an increase in base revenues of approximately $8.5 million. A stipulated settlement of the case provides for an increase in base revenues of $2.5 million. New rates are expected to be effective in May 1990.

Higher operation and maintenance expenses during 1989 at Palo Verde adversely affected results from continuing operations in 1989 and, such increased expenses, together with higher fuel and purchased power costs, increased the Company's external financing requirements. During 1989, the Palo Verde units performed at an average 23% of capacity compared to 71% in 1988. If Palo Verde does not operate at satisfactory levels, future operations would be adversely impacted to the extent that any resulting increased costs are not recovered in rates. The Company believes that 1989 was a year of adjustment and correction for Palo Verde, and that the units will perform at satisfactory levels. However, continued satisfactory operation will require operation and maintenance expenditure levels at or above those incurred during 1989. The Company expects to be able to recover such costs in rates.

The Company plans to file with the Texas Commission in the third quarter of 1990 for rate treatment of the Texas jurisdictional portion of the Company's investment in Palo Verde Unit 3, including the lease payments in the Company's sales and leasebacks of 40% of its interest in Unit 3. The Company expects the Texas Commission's final order on the Unit 3 case in the late first quarter of 1991, with rates reflecting the outcome of the case to be effective in the summer of 1991. The timing and method of inclusion of the Company's Unit 3 investment in Texas rates will significantly affect results of operations, beginning in 1991. Failure to receive sufficient inclusion in Texas rates of the investment, on a timely basis, would increase the Company's external financing requirements and could adversely affect access to the capital markets at reasonable cost. The Company believes that it is entitled to recover its Unit 3 investment and a fair return thereon, but the ultimate outcome of the case cannot be predicted.

The New Mexico portion of the Company's Unit 3 investment, including the Unit 3 lease payments, is deregulated under the New Mexico rate moderation plan. The Company, therefore, is required to recover the investment through off-system sales in the economy energy market. Although the Company believes that over the useful life of Unit 3 the Company will be able to recover the investment, market prices for economy energy sales have not been in recent years and are not presently at levels needed by the Company to recover the New Mexico portion of the Company's current operating expenses related to Unit 3, including lease payments. Such market conditions will continue to affect the Company's results of operations.

The less than full inclusion in Texas and New Mexico rates of the Company's annual lease expense on its Unit 2 sales and leasebacks, and the exclusion of the New Mexico portion of the Unit 3 lease expense from New Mexico rates (an aggregate of approximately $12.1 million before tax), will continue to adversely affect results of operations.

For more detail regarding the above information, see Part I, Item 1, "Business — Regulation".

Liquidity and Capital Resources

The Company expects to externally finance its cash requirements not met through cash generated from operations. Those requirements include construction expenditures and, until the Company's base rates provide for current recovery of the Company's cost of service and return on investment, operating and capital costs deferred pursuant to rate moderation plans, operating and capital costs related to the Texas jurisdictional portion of Palo Verde Unit 3, payments of long-term debt and preferred stock maturities and redemptions. See Part I, Item 1, "Business — Regulation."

The Company's estimated external financing requirements for 1990 are $242 million, of which $153 million was completed on January 26, 1990. Proceeds were used to reduce borrowings then outstanding under the RCF (see discussion below). Proceeds from the balance of the required financings, $89 million, combined with cash on hand and internal cash generation (together estimated at $46.5 million), will be used to meet the Company's 1990 estimated construction expenditures of $53.4 million, payments of long-term debt and preferred stock maturities and redemptions of $48.5 million and estimated regulatory deferrals and Palo Verde Unit 3 capitalized costs of $33.6 million.

During 1991 and 1992, the Company expects to incur construction expenditures of $51.4 million and $49.9 million, respectively. Payments of long-term debt and preferred stock maturities and redemptions aggregate approximately $95.6 million and $59.1 million, respectively. Cash requirements in 1991 and 1992 for regulatory deferrals will be dependent upon future levels of rate relief obtained.

In October 1989, the Company obtained a revolving credit facility (herein, the "RCF") from a syndicate of money center banks which provides for borrowings by the Company from time to time through May 31, 1991, the initial termination date of the RCF, of up to $150 million outstanding at any one time. The May 31, 1991 termination date of the RCF, which is set with reference to the expected timing of the Texas Commission's order on the Company's Unit 3 rate case, may be extended, subject to the consent of the lending banks, for successive one-year periods.

The RCF requires the Company to issue, for purposes of repaying borrowings thereunder, $270 million of long-term debt through the period expiring March 31, 1991, including at least $100 million of long-term debt by January 31, 1990. On January 26, 1990, the Company issued and sold, in a private placement to institutional investors, $153 million of First Mortgage Bonds, 11.10% Series Due 2001, the proceeds of which were applied, as required, to reduction of borrowings outstanding under the RCF. $47 million of the balance of the $270 million of long-term debt issuances required under the RCF is required to be issued no later than December 31, 1990, leaving $70 million of required long-term debt issuance by March 31, 1991.

The RCF is secured by first and second mortgage bonds of the Company in an aggregate principal amount equal to the committed amount of the RCF. The RCF requires that the Company meet certain fixed charge and maintenance of equity ratios, maintain specified long-term debt issuance capacity and meet certain maintenance of collateral value tests. The terms of the RCF prohibit the Company from declaring or paying any dividend with respect to its common stock.

$104 million was available for borrowing under the RCF at March 30, 1990.

The Company intends to use borrowings under the RCF and the required long-term debt issuances to meet its external financing requirements through May 31, 1991. The Company believes that it will be able to issue and sell the long-term debt required to be issued and sold under the terms of the RCF. The Company will require an extension of the RCF or its replacement with a similar facility to meet financing requirements beyond May 31, 1991. The RCF includes as an event of default an adverse regulatory decision by the Texas Commission with regard to the Company's investment in Unit 3 which, in the judgment of the lending banks, causes the Company's revenues to be insufficient to assure (1) the Company's ongoing viability, (2) its access to capital markets or (3) its ability to refinance or repay its obligations when due. Although the Company believes that it is entitled to recover its Unit 3 investment and a fair return thereon, the ultimate outcome of the case cannot be predicted. Failure to receive sufficient inclusion in Texas rates of the Unit 3 investment, on a timely basis, would increase the Company's external financing requirements and could adversely affect access to the capital markets at reasonable cost. See Part I, Item 1, "Business — Regulation — Texas Rate Matters — Palo Verde Unit 3 — Inclusion in Texas Rates."

In addition to the borrowings available under the RCF, the Company has limited short-term borrowing availability under the credit facility supporting the independent trust established to meet the Company's nuclear fuel requirements at Palo Verde. At March 30, 1990, the Company had $22.1 million of borrowings available to it under such credit facility.

Financing Restrictions

Short-term borrowings by the Company are limited to levels approved by the FERC. The FERC has approved short-term borrowings by the Company, including borrowings under the RCF and the nuclear fuel trust credit facility, of up to $200 million through December 31, 1991.

The RCF restricts the Company's incurrence of indebtedness, other than under the RCF, to (1) borrowings up to a specified level under the nuclear fuel trust credit facility and commercial paper backed by the RCF (in which case the amount available to the Company under the RCF is reduced by the amount of commercial paper outstanding) (2) indebtedness which is unsecured, or junior in right of security to the RCF, and which does not require principal amortization prior to the then termination date of the RCF, (3) scheduled long-term financing by the Company, including the long-term financings required under the RCF, and (4) refundings, renewals, extensions and replacements of maturing indebtedness.

The letter of credit agreements providing for the letters of credit which the Company caused to be issued to the equity participants in the Company's sale and leaseback transactions involving Palo Verde Units 2 and 3, and one other bank credit agreement, were renegotiated contemporaneously with the closing of the RCF. These letter of credit agreements and the bank credit agreement, as amended, require the Company to meet the same maintenance of equity and fixed charge ratios required to be met under the RCF. The transaction documents for the Palo Verde Unit 2 sales and leasebacks were also renegotiated and amended contemporaneously with the closing of the RCF. The incurrence of debt restrictions in those transaction documents have been suspended for so long as complying letters of credit remain in effect. With respect to all but one of the eight equity participants in the Unit 2 sales and leasebacks, complying letters of credit must be maintained through at least December 31, 1999. One equity participant in the Unit 2 sales and leasebacks is entitled to letter of credit support for its equity investment throughout the lease term. The Company expects to be able to maintain complying letters of credit in effect as required under the amended documents, and, therefore, does not expect the Unit 2 incurrence of debt restrictions to impact its external financing capability.

Other Restrictions — Restated Articles of Incorporation; Mortgage Indentures. The Company's Restated Articles of Incorporation provide that, unless consented to by the holders of preferred stock, additional shares of preferred stock may not be issued unless certain tests are met with respect to (i) net earnings of the Company available for preferred dividends, (ii) after-tax earnings available for interest, amortization and preferred dividends and (iii) the sum of junior stock capital and, if the Company so elects, surplus. The most restrictive of said tests, (i) above, would not have permitted the issuance of any new shares of preferred stock at December 31, 1989. It is not expected that the Company will be able to satisfy the preferred stock issuance tests in 1990.

In addition, the Company's Restated Articles of Incorporation provides that, unless consented to by the holders of preferred stock, the aggregate of unsecured long-term debt shall not exceed 10% of the total of the Company's outstanding secured debt, capital and surplus. At December 31, 1989, the Company would have been permitted to issue approximately $62.3 million in additional unsecured long-term debt.

The Company's First Mortgage Indenture permits the issuance of additional first mortgage bonds to the extent of 60% of the value of unfunded net additions to the Company's utility property, provided net earnings available for interest during a recent twelve-month period were at least twice the annual interest requirements on all bonds to be outstanding and on all prior lien debt. At December 31, 1989, unfunded net additions totaled $453.5 million, which was sufficient, with the inclusion of $0.5 million in bond credits (after giving effect to the $153 million 11.10% Series due 2001), to permit the issuance of approximately $272.6 million principal amount of new bonds. Presently, the Company cannot issue first mortgage bonds on the basis of property additions because earnings are insufficient to meet the net earnings test of the Indenture. However, the Indenture also permits the issuance of first mortgage bonds based upon currently unfunded first mortgage bonds, without, under certain circumstances, being required to meet the net earnings test. The RCF is presently secured by $50 million of first

mortgage bonds and $100 million of second mortgage bonds. The RCF provides that, as the Company issues and sells first mortgage bonds to meet the long-term financing requirements of the RCF, the RCF banks are to release first mortgage bonds then held as collateral in the amount needed by the Company for the proposed long-term financing, which bonds, under the Indenture, constitute additional unfunded first mortgage bonds. The Company would use such additional unfunded first mortgage bonds as the basis for the issuance of any first mortgage bonds issued to meet the long-term financing requirements of the RCF. As the RCF banks release first mortgage bonds from their collateral, the amount of second mortgage bonds held by the banks as collateral increases correspondingly, so that at all times the RCF is secured by a combination of first and second mortgage bonds or second mortgage bonds only.

The Company's Second Mortgage Indenture permits the issuance of additional second mortgage bonds on the basis of 40% of the value of unfunded net additions to the Company's utility property. The indenture also permits the issuance of second mortgage bonds based on currently unfunded second mortgage bonds. At December 31, 1989, unfunded net additions totaled $161.4 million, which was sufficient, with the inclusion of $20 million in bond credits, to permit the issuance of approximately $84.5 million principal amount of new bonds.

Results of Operations

The following comparisons of results for 1989 to 1988 and 1988 to 1987 should be read in conjunction with the above information concerning factors expected to affect future results of operations.

The primary reasons for increases (decreases) in results of operations for the year ended December 31, 1989 compared to the year ended December 31, 1988 and the year ended December 31, 1988 compared to the year ended December 31, 1987 are as follows:

Operating Revenues:

The Company continued to experience increases in electric sales and customer growth in its service area during 1989. Native system sales increased from 4,249,990 megawatt-hours of electricity in 1988 to 4,462,183 megawatt-hours in 1989, an increase of 5.0%. Total system sales increased 6.4% in 1989 compared with 1988. Customers were added to the Company's service area at an annual rate of approximately 3% in both 1988 and 1989. The Company achieved record peak demands in 1989, recording an all-time total system peak load of 1,076 megawatts on June 20, 1989, which was a 7.4% increase over 1988's record peak of 1,002 megawatts. The Company's 1989 native system peak demand of 916 megawatts, which was also a new record, was a 9.0% increase from the previous record of 840 megawatts set in 1988. The projected annual peak load growth rate for the Company's service area during the 1990-1999 time period is approximately 3%.

Base revenues increased for 1989 over 1988 approximately $26,100,000, due primarily to an increase in KWH sales (volume) to all three jurisdictions and an increase in base revenues resulting from rate increases for Texas, effective April 1988 and May 1989, and for New Mexico, effective in November 1988. Base revenues increased for 1988 over 1987 approximately $42,500,000, due primarily to an increase in KWH sales (volume) to all three jurisdictions and an increase in base revenues resulting from rate increases for Texas and New Mexico which were effective in April 1988 and November 1987, respectively. Base revenues from wholesale customers were $44,932,000, $41,327,000 and $38,242,000 in 1989, 1988 and 1987, respectively.

Fuel revenues increased in 1989 compared to 1988 and 1988 compared to 1987 by approximately $18,000,000 and $2,300,000, respectively, due to an increase in fuel and purchased and interchanged power costs and an increase in KWH sales (volume) to all jurisdictions.

Operating Expenses:

Decreased operating performance at the Palo Verde Nuclear Generating Station during 1989 resulted in increases in operating and maintenance costs. Significant improvements and a number of changes have been made at the plant which are expected to improve its operating performance. However, continued satisfactory operation will require operation and maintenance expenditure levels at or above those incurred during 1989. The Company expects to be able to recover such costs in rates. See discussion above in this Item 7 and Part I, Item 1, "Facilities — Palo Verde Station."

Fuel expense and purchased and interchanged power increased in 1989 over 1988 approximately $18,800,000 due to a change in energy mix and an increase in KWH sales (volume). The prolonged Palo Verde outages resulted in a decrease in volume of lower cost nuclear fuel consumed and a decrease in economy sales of electricity to others and forced increases in the volume of natural gas consumed and purchases of electricity. Purchases of electricity from other utilities were approximately $38,900,000 and $19,600,000 in 1989 and 1988, respectively. The increase in costs was partially offset by a decrease in the amount of Palo Verde power accounted for as purchased power due to the extended outage in 1989 at Palo Verde Unit 3, which is currently accounted for as purchased power, and due to placing Units 1 and 2 in service in May 1988 for rate recognition purposes in the Company's Texas jurisdiction. The increase was also offset by a decrease in the average cost of natural gas and purchased power. See Part I, Item 1, "Energy Sources — General."

The decrease in fuel expense and purchased power of $1,400,000 in 1988 over 1987 was a result of a change in energy mix and an increase in KWH sales (volume). The 1988 level of Palo Verde Operations resulted in increased usage of nuclear fuel and a decrease in the amount of electricity purchases and also increased the amount of economy sales of electricity. The Company also increased usage of natural gas. The decrease was partially offset by the increased average cost of nuclear fuel and natural gas and the amount of Palo Verde power accounted for as purchased power due to placing Units 1 and 2 in service in May 1988.

Other operating expense and maintenance expense increased in 1989 over 1988 and 1988 over 1987 due to the timing of inclusion of the Palo Verde Units in rates and increased costs at Palo Verde. Palo Verde Unit 1 was included in rates in May 1988 in the Company's Texas jurisdiction. The lease payments associated with Palo Verde Unit 2 were included in rates in May 1988 in the Company's Texas jurisdiction and November 1987 in the New Mexico jurisdiction, and Unit 3 and related lease payments were excluded from rates in the New Mexico jurisdiction and included in the FERC jurisdiction in January 1988. Prior to inclusion in rates in the respective jurisdictions and subsequent to in-service dates, the operating and maintenance expenses associated with each Unit were deferred and capitalized. The effects of the timing of inclusion in rates of these Units is reflected in the table below.

	1989	1988	1987
		(In thousands)	
Palo Verde costs	$137,406	$121,169	$70,594
Palo Verde costs deferred and capitalized	(28,408)	(42,085)	(50,297)
	108,998	79,084	20,297
Phase-in plan deferrals	(9,030)	(16,366)	(529)
Other non Palo Verde costs	76,255	73,644	68,199
Total operating costs expensed	$176,223	$136,362	$87,967

Increased Palo Verde costs for the year ended December 31, 1989 are net of approximately $4.6 million of Texas jurisdictional costs incurred as a result of the Palo Verde outages which have been deferred. Phase-in plan deferrals decreased in 1989 from 1988 as a result of the impact of the Texas rate case implemented in May 1988 (See Part I, Item 1, "Regulation — Texas Rate Matters — Rate Moderation Plan — Palo Verde Units 1 and 2").

Depreciation and Amortization Expenses:

Depreciation expense increased in 1989 over 1988 due to depreciating the Texas jurisdictional portion of Palo Verde Units 1 and 2 and Common Plant beginning with their inclusion in rates in May 1988. Depreciation increased in 1988 over 1987 due to depreciating the Texas jurisdictional portion of Palo Verde Unit 1 and Common Plant beginning in May 1988 and the New Mexico and FERC jurisdictional portion of Palo Verde Unit 3 beginning in February 1988.

Amortization expense increased in 1989 over 1988 due to amortization of Palo Verde deferred costs beginning in May 1988 and November 1988 for Texas and New Mexico, respectively, along with an increased deferred cost balance subject to amortization as of June 1989 for Texas in conjunction with the inclusion of the amortization of such deferred assets as a part of cost of service under the respective rate moderation plans. Amortization expense increased in 1988 over 1987 due to amortization of a New Mexico deferred debit effective January 1988 and Palo Verde deferred costs beginning in May 1988 and November 1988 for Texas and New Mexico, respectively.

AFUDC:

AFUDC increased in 1989 compared to 1988 due to an increase in the cumulative construction balance accruing AFUDC generally associated with Unit 3 in Texas. AFUDC decreased in 1988 compared to 1987 because of the sale of approximately 40% of Palo Verde Unit 3 in December 1987, which resulted in decreased cumulative construction and Palo Verde deferred cost balances accruing AFUDC. Additionally, AFUDC decreased due to discontinuing accounting recognition of allowance for equity funds on Palo Verde deferred costs related to Units 1 and 2 pursuant to SFAS No. 92.

Phase-in Plan Deferred Return:

Phase-in plan deferred return decreased in 1989 compared to 1988 due to the discontinuance of deferred return on the Texas jurisdictional portion of Palo Verde deferred costs beginning in May 1989 due to the Texas Commission's rate order (see Part I, Item 1, "Regulation — Texas Rate Matters — Rate Moderation Plan — Palo Verde Units 1 and 2") when the deferred balances were included in Texas rate base and a decrease in the return rate, partially offset by an increase in rate moderation plan deferred revenues accruing return as a result of the Company's rate moderation plans in Texas and New Mexico. Phase-in plan deferred return increased in 1988 compared to 1987 due to phase-in plan deferrals accruing return in 1988 with no comparable amount in 1987.

Investment Income:

Investment income decreased in 1989 compared to 1988 due to unrealized losses on the Company's investment in annuities (see Part I, Item 3, "First Service Life Litigation") and decreased average investment balances. Investment income increased in 1988 compared to 1987 due to a higher average investment return and increased income related to an investment in a partnership partially offset by decreased average investment balances.

Other Income, Net:

Other income, net, decreased in 1989 compared to 1988 as a result of a provision for an expected performance penalty incurred by the Company under the Palo Verde performance standards in its New Mexico jurisdiction. Other income, net, increased in 1988 compared to 1987 due to decreased depreciation on plant held for future use which was fully depreciated in May 1988. See Note B for a discussion of Palo Verde performance standards.

Interest on Long-Term and Financing and Capital Lease Obligations:

Interest on long-term and financing and capital lease obligations decreased in 1989 over 1988 due principally to the redemption in May 1989 of the 12¾% Series First Mortgage Bonds, the redemption in July 1989 of the 14½% Series First Mortgage Bonds, the redemption in November 1989 of the 14% Series First Mortgage Bonds and decreased interest on the nuclear fuel lease obligation. Interest on long-term and financing and capital lease obligations decreased in 1988 over 1987 due principally to

the early redemption of the 16.20% Series First Mortgage Bonds in February 1988 and the redemption of a floating rate note in the first quarter of 1988.

Other Interest Expense:

Other interest expense increased in 1989 over 1988 due to an increase in the average short-term debt outstanding and the average short-term debt rate. The increase was partially offset by a lack of interest expense on accumulated provision for rate refund related to the Company's Texas rate case which concluded in 1988, with no comparable expense in 1989 and a decrease in the interest on fuel overrecovery. Other interest expense decreased in 1988 over 1987 due to margin interest incurred in 1987 with no comparable expense in 1988 and a decrease in the interest on fuel overrecovery and the average short-term debt outstanding.

Interest Capitalized and Deferred:

Interest capitalized decreased in 1989 over 1988 due to the interest capitalized on the Texas portion of Unit 1 in 1988 with no comparable interest capitalized in 1989 and decreased interest capitalized related to nuclear fuel lease obligation due to a decreased average nuclear fuel balance. Interest capitalized increased in 1988 over 1987 due to the capitalized interest on Palo Verde deferred costs and increased interest related to nuclear fuel lease obligation and an increase in interest deferred on a portion of a financing obligation relating to one sale and leaseback transaction involving Palo Verde Unit 2.

See Note A of Notes to Consolidated Financial Statements regarding the effect of SFAS No. 96, "Accounting for Income Taxes."

Effects of Inflation:

In contrast to the analysis of increases in base revenues included at the beginning of "Results of Operations," it is sometimes difficult, in the case of operation and maintenance expenses, to distinguish between effects of volume increases and rises in unit costs (which, for purposes of this discussion, are all attributed to inflationary pressures).

Price changes in fuel costs are passed through to certain FERC customers pursuant to fuel cost adjustment provisions. Fuel price changes in the Company's Texas and New Mexico jurisdictions and two FERC customers require fuel reconciliation hearings for the over or under recovery of fuel costs. There are a number of other major expense items such as maintenance costs, payroll costs and other operating costs that are beyond the scope of the fuel reconciliation hearings and the fuel cost adjustment provisions. Inflationary pressures on these items have given rise to earnings attrition between general rate increases. See "Regulation" in Part I, Item 1.

Non-Utility Operations:

On January 17, 1990 the Company sold all of the capital stock of its subsidiary, Franklin Land & Resources, Inc., and the Company's 35% stock ownership of PasoTex Corporation (which is owned 65% by FL&R). The results for the twelve months ended December 31, 1989 and 1988 include provisions for loss of approximately $58,165,000 and $35,954,000, respectively, which includes income tax credits of approximately $9,650,000 and $18,522,000, respectively. The provision for loss includes a provision of approximately $7,669,000 and $11,520,000, respectively, for expected operating losses during the phase-out period of the discontinued operations. In addition, the Company recorded a loss of approximately $41,440,000, net of tax benefits of approximately $18,560,000, for the year ended December 31, 1989 in connection with the sale of its preferred stock investment in Commercial Federal Savings and Loan Association in December 1989. The disposition of its non-utility operations reflects the Company's plan to return its operations exclusively to its core utility business. The Company's final divestiture of its non-utility operations and investments in 1990 has been reflected as discontinued operations. See "Non-Utility Operations" in Part 1, Item 1 and Note P of Notes to Consolidated Financial Statements.

Item 8. Financial Statements and Supplementary Data

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

The Shareholders and Board of Directors
El Paso Electric Company:

We have audited the accompanying consolidated balance sheets of El Paso Electric Company and Subsidiaries as of December 31, 1989 and 1988, and the related consolidated statements of income (loss), retained earnings and cash flows for each of the years in the three-year period ended December 31, 1989. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of El Paso Electric Company and Subsidiaries as of December 31, 1989 and 1988, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1989 in conformity with generally accepted accounting principles.

As more fully discussed in Note B to the Consolidated Financial Statements, uncertainties exist with respect to the outcome of various regulatory matters including the recoverability through Texas regulation of the Company's investment in Unit 3 of Palo Verde Nuclear Generating Station. The ultimate outcome of these matters cannot presently be determined. Accordingly, no provision for any loss that may ultimately be required upon resolution of these matters has been made in the accompanying consolidated financial statements.

As discussed in Note L of Notes to Consolidated Financial Statements, the Company is a defendant in two related lawsuits and, pursuant to indemnity provisions, is contingently liable with respect to another related lawsuit in which a former executive officer of the Company is one of the defendants. The ultimate outcome of such litigation cannot presently be determined. Accordingly, no provision for any liability that may result upon adjudication of any of the lawsuits has been made in the accompanying consolidated financial statements.

As discussed in Note A of Notes to Consolidated Financial Statements, the Company changed its method of accounting for unbilled revenues in 1987.

KPMG PEAT MARWICK

El Paso, Texas
March 30, 1990

EL PASO ELECTRIC COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS

	December 31, 1989	December 31, 1988
	(In thousands)	
Utility plant (Notes B, D and E):		
Electric plant in service	$1,190,333	$1,150,233
Less accumulated depreciation and amortization	233,240	201,547
Net plant in service	957,093	948,686
Construction work in progress	344,768	258,076
Nuclear fuel under capital leases net of amortization of $73,920,000 and $78,599,000, respectively	47,114	54,081
Net utility plant	1,348,975	1,260,843
Non-utility property, at cost net of accumulated depreciation	5,371	4,552
Current assets:		
Cash and temporary investments	28,370	124
Other short-term investments (Note F)	—	100,903
Accounts receivable, principally trade, net	44,251	45,196
Inventories	33,678	31,854
Federal income taxes refundable (Note K)	29,328	—
Net undercollection of fuel revenues	10,127	—
Prepayments and other	18,638	28,683
Total current assets	164,392	206,760
Long-term contract receivable (Note B)	16,482	9,142
Net assets of discontinued operations (Note P)	—	97,062
Deferred charges and other assets:		
Palo Verde deferred costs (Note B)	95,533	122,384
Phase-in plan deferrals (Note B)	52,759	34,642
Other (Note G)	86,006	64,564
Total deferred charges and other assets	234,298	221,590
Total assets	$1,769,518	$1,799,949

See accompanying notes to consolidated financial statements.

EL PASO ELECTRIC COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

CAPITALIZATION AND LIABILITIES

	December 31, 1989	December 31, 1988
	(In thousands)	
Capitalization (Notes E, H, I and J):		
Common stock, no par value, 40,000,000 shares authorized. Issued and outstanding 35,201,267 and 35,075,309 shares, respectively	$ 337,176	$ 335,767
Retained earnings	67,133	198,131
Common stock equity	404,309	533,898
Preferred stock, cumulative, no par value, 2,000,000 shares authorized:		
Redemption required	100,710	108,460
Redemption not required	14,198	14,198
Long-term obligations	590,686	454,908
Financing and capital lease obligations	119,392	124,221
Total capitalization	1,229,295	1,235,685
Current liabilities:		
Current maturities of long-term and financing and capital lease obligations (Note J)	49,100	134,126
Notes payable, commercial paper and revolving credit facility (Note C)	46,756	15,000
Accounts payable, principally trade	21,583	15,364
Taxes accrued (Note K)	21,186	8,260
Interest accrued	15,758	15,781
Other	43,761	30,842
Total current liabilities	198,144	219,373
Deferred credits and other liabilities:		
Accumulated deferred income taxes (Note K)	59,983	32,457
Accumulated deferred investment tax credit (Note K)	96,352	127,129
Deferred gain on sales and leasebacks (Note E)	175,633	182,806
Other	10,111	2,499
Total deferred credits and other liabilities	342,079	344,891
Commitments and contingencies (Notes B, D, E, L and M)		
Total capitalization and liabilities	$1,769,518	$1,799,949

See accompanying notes to consolidated financial statements.

EL PASO ELECTRIC COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (LOSS)

For the years ended December 31, 1989, 1988 and 1987
(In thousands except per share data)

	1989	1988	1987
Operating revenues	$ 426,248	$382,107	$337,263
Operating expenses:			
Operations:			
Fuel	80,607	72,187	51,297
Purchased and interchanged power	34,261	23,917	46,199
	114,868	96,104	97,496
Other	159,635	132,533	74,250
Maintenance	25,618	20,195	14,246
Depreciation and amortization	41,949	34,254	21,162
Phase-in plan deferrals (Note B)	(9,030)	(16,366)	(529)
Taxes:			
Federal income taxes (Note K)	1,531	8,317	15,775
Other	35,126	25,537	22,271
	369,697	300,574	244,671
Operating income	56,551	81,533	92,592
Other income (deductions):			
Allowance for equity funds used during construction	12,578	13,065	31,941
Phase-in plan deferred return (Note B)	10,513	12,603	—
Regulatory disallowance (Note B)	(22,229)	—	(38,323)
Investment income (Note F)	1,093	20,555	13,489
Other, net	(8,034)	(2,630)	(2,963)
Federal income taxes applicable to other income (Note K):			
Regulatory disallowance	6,051	—	13,937
Other	(4,054)	(9,313)	(1,933)
	(4,082)	34,280	16,148
Income before interest charges	52,469	115,813	108,740
Interest charges (credits):			
Interest on long-term and financing and capital lease obligations	63,025	69,199	77,884
Other interest	11,010	4,454	12,732
Interest capitalized and deferred	(6,203)	(13,304)	(6,849)
Allowance for borrowed funds used during construction	(17,319)	(8,413)	(22,458)
	50,513	51,936	61,309
Income from continuing operations before cumulative effect of change in accounting method	1,956	63,877	47,431
Discontinued operations (Note P):			
Loss from discontinued operations, net of income tax credits of $1,731, $6,490 and $8,263, respectively	(8,184)	(3,554)	(6,663)
Provision for loss on disposal of operations, including provision of $7,669 and $11,520 for operating losses during phase-out period, net of income tax credits of $28,210 and $18,522, respectively	(99,605)	(35,954)	—
	(107,789)	(39,508)	(6,663)
Income (loss) before cumulative effect of change in accounting method	(105,833)	24,369	40,768
Cumulative effect of change in accounting method (Note A)	—	—	4,240
Net income (loss)	(105,833)	24,369	45,008
Preferred stock dividend requirements	11,812	12,259	12,892
Net income (loss) applicable to common stock	$(117,645)	$ 12,110	$ 32,116
Net income (loss) per weighted average shares of common stock:			
Income (loss) from continuing operations before cumulative effect of change in accounting method	$ (0.28)	$ 1.48	$ 0.98
Discontinued operations	(3.07)	(1.13)	(0.19)
Cumulative effect of change in accounting method	—	—	0.12
Total	$ (3.35)	$ 0.35	$ 0.91

See accompanying notes to consolidated financial statements.

EL PASO ELECTRIC COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

For the years ended December 31, 1989, 1988 and 1987
(In thousands except per share data)

	1989	1988	1987
Retained earnings at beginning of year	$198,131	$239,320	$264,016
Add:			
Net income (loss)	(105,833)	24,369	45,008
	92,298	263,689	309,024
Deduct:			
Cash dividends:			
Preferred stock	11,812	12,259	12,892
Common stock	13,353	53,254	53,795
Capital stock expense	—	45	165
Purchase of Company common stock	—	—	2,852
	25,165	65,558	69,704
Retained earnings at end of year	$ 67,133	$198,131	$239,320
Dividends declared per share of common stock	$ 0.38	$ 1.52	$ 1.52
Weighted average number of common shares outstanding	35,165,514	35,029,975	35,422,043

See accompanying notes to consolidated financial statements.

EL PASO ELECTRIC COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, 1989, 1988 and 1987

	1989	1988	1987
		(In thousands)	
Cash Flows From Operating Activities:			
Income from continuing operations after cumulative effect of change in accounting method	$ 1,956	$ 63,877	$ 51,671
Adjustments for non-cash items from operating activities:			
Depreciation and amortization	28,381	24,191	18,997
Amortization of nuclear fuel	12,156	22,527	4,368
Deferred income taxes and investment tax credit, net	16,341	14,610	25,280
Allowance for equity funds used during construction	(12,578)	(13,065)	(31,941)
Regulatory disallowance	22,229	—	38,323
Other operating activities	8,653	(5,648)	(5,821)
Loss from discontinued operations	(107,789)	(39,508)	(6,663)
Adjustments for non-cash items from discontinued operations:			
Write down of discontinued segment	120,146	42,956	—
Provision for deferred income taxes and investment tax credit, net	(20,945)	(18,522)	—
Provision for losses during phase-out period	7,669	11,520	—
Accounts receivable	945	(7,895)	(1,115)
Inventories	(1,745)	(610)	229
Federal income taxes refundable	(29,328)	—	—
Net undercollection of fuel revenues	(10,127)	—	—
Prepayments and other current assets	8,002	(3,590)	(8,018)
Long-term contract receivable	(7,340)	(7,632)	(1,510)
Net assets of discontinued operations	(5,860)	6,074	(8,487)
Accounts payable	7,720	(2,465)	8,806
Taxes accrued	11,401	(16,812)	(73,391)
Interest accrued	(23)	(4,388)	(841)
Other current liabilities	(4,000)	(728)	(11,133)
Other deferrals	(12,726)	(12,719)	(16,241)
Palo Verde deferred costs	1,902	(24,626)	(50,534)
Phase-in plan deferrals	(19,145)	(29,348)	(5,294)
Net cash provided by (used for) operating activities	15,895	(1,801)	(73,315)
Cash Flows From Investing Activities:			
Additions to utility plant	(138,222)	(92,910)	(93,187)
Allowance for equity funds used during construction	12,578	13,065	31,941
Additions to non-utility property	(966)	(14,738)	(8,306)
Non-utility acquisitions, net of cash received	—	—	(43,609)
Proceeds from sale of investments	—	5,551	39,776
Purchase of long-term investments	—	(5,000)	(57,606)
Proceeds from sales and leasebacks	—	—	250,000
Sale of nuclear fuel in process to trust	—	—	28,460
Other investing activities	1,213	2,470	(3,173)
Net cash provided by (used for) investing activities	(125,397)	(91,562)	144,296
Cash Flows From Financing Activities:			
Proceeds from long-term obligations	168,358	16,567	32,567
Redemption and repurchase of securities	(7,750)	(2,150)	(19,085)
Dividends paid	(25,165)	(65,513)	(66,687)
Redemption of long-term obligations	(122,007)	(153,527)	(137,293)
Net increase (decrease) in short-term obligations	22,000	(104,229)	140,006
Other financing activities	1,409	(859)	1,317
Net cash provided by (used for) financing activities	36,845	(309,711)	(49,175)
Net increase (decrease) in cash and temporary investments	(72,657)	(403,074)	21,806
Cash and temporary investments at beginning of year	101,027	504,101	482,295
Cash and temporary investments at end of year	$ 28,370	$101,027	$504,101
Supplemental Disclosures of Cash Flow Information:			
Cash paid during the year for:			
Income taxes	$ 387	$ 19,427	$ 50,088
Interest on borrowed money from continuing operations	62,273	63,678	72,777
Non-cash transactions:			
Capitalization of nuclear fuel and related obligation	—	20,084	43,872

For the purposes of this statement, all temporary cash investments with a maturity of three months or less are considered cash equivalents.

See accompanying notes to consolidated financial statements.

EL PASO ELECTRIC COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A. Summary of Significant Accounting Policies

General

El Paso Electric Company (the Company) maintains its accounts in accordance with the Uniform System of Accounts prescribed for electric utilities by the FERC. The subsidiaries are not regulated companies. The Company reports its regulated utility operations pursuant to SFAS No. 71 — Accounting for the Effects of Certain Types of Regulations, as amended.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. See Note P. All significant intercompany balances and transactions have been eliminated in consolidation.

Utility Plant and Non-utility Property

Utility plant and non-utility property are stated at original cost and depreciation is provided on a straight-line basis at annual rates which will amortize the undepreciated cost of depreciable property over the estimated remaining service lives. The average annual depreciation rate used by the Company for utility plant other than the Palo Verde Station was 3.17% in 1989, and 3.43% in 1988 and 1987. The average annual depreciation rate for the portions of the Palo Verde Station for which the Company is providing depreciation was 2.50% for New Mexico and FERC jurisdictions in 1989, 1988 and 1987 and 2.62% for the Texas jurisdictional portion which began in April 1988.

The Company charges the cost of repairs and minor replacements to the appropriate operating expense accounts and capitalizes the cost of renewals and betterments. The cost of depreciable utility plant retired or sold and the cost of removal, less salvage, are charged to accumulated depreciation.

The Company is amortizing nuclear fuel under the units of heat production method.

Decommissioning cost for the Company's interest in the PVNGS are charged to depreciation expense and are being deposited in external trust funds until the decommissioning of the facility takes place.

AFUDC

The Company's applicable regulatory bodies, FERC, the New Mexico Commission and the Texas Commission, generally provide for the capitalizing of AFUDC, which is defined as an amount which includes the net cost during a period of construction of borrowed funds used for construction purposes plus a reasonable rate on other funds when so used. While AFUDC results in an increase in the cost of utility plant under construction, with a corresponding increase in income, it is not current cash income. AFUDC, net of certain tax effects, is normally recovered in cash over the service life of utility plant in the form of increased revenue collected as a result of higher depreciation expense. The Company records AFUDC during the construction period of utility plant.

The amount of AFUDC is determined by applying an accrual rate to the balance of certain CWIP and deferred costs. In this connection, the FERC has promulgated procedures for the computation (a prescribed formula) of the accrual rate. The weighted average accrual rate was 10.5%, 11.1% and 11.4% for 1989, 1988 and 1987, respectively. The Company compounds AFUDC on major construction projects semiannually. Prior to May 1988, certain amounts of CWIP had been allowed in the Company's rate base or had been made the basis of extraordinary cash rate relief, and the appropriate amounts had been excluded from the CWIP balance used as a base for calculating AFUDC.

Change in Accounting Method

Prior to January 1, 1987, the Company recognized utility revenues when billed. To provide a better matching of the Company's revenues from kilowatt-hour sales with the related costs, effective January 1, 1987, the Company changed its method of accounting to record estimated revenues from sales of electricity for services provided subsequent to monthly billing cycle dates but prior to the end of the accounting period. The cumulative effect of this accounting change as of January 1, 1987, net of income taxes of $2,827,000, increased net income and net income per share for the year ended December 31, 1987 by $4,240,000 and $.12, respectively. The pro forma effect on net income for the year ended December 31, 1987 of applying the new method of accounting retroactively is not material.

Fuel Cost Adjustment Provisions

The Company's Texas and New Mexico retail customers are presently being billed under fixed fuel factors approved by the Texas Commission and the New Mexico Commission. The Company's Texas and New Mexico fuel factors are set in the Company's general rate case or Commission ordered fuel reconciliation. In the Texas jurisdiction and New Mexico jurisdiction, the Company's fixed fuel factor is subject to reduction if the utility materially over-recovers its allowable fuel costs under its existing fuel factor. (See Note B).

Rate tariffs currently applicable to certain FERC jurisdictional customers contain appropriate fuel and purchased power cost adjustment provisions designed to recover the Company's fuel and purchased power costs. Two FERC customers have fixed fuel factors approved under FERC tariffs for which no fuel reconciliation is made.

Federal Income Taxes and Investment Tax Credits

Deferred income taxes are provided as a result of timing differences in reporting income and expense items for financial statement and income tax purposes.

With respect to investment tax credit generated by the Company, such investment tax credit utilized is deferred and amortized to income, once such related properties are considered "operational" by the Company's regulatory authorities, over the estimated average remaining useful lives of the Company's fixed assets directly or indirectly involved in the generation and transmission of electricity.

Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes", was issued by the Financial Accounting Standards Board in December 1987. Statement 96 requires a change from the deferred method to the asset and liability method of accounting for income taxes.

Under the asset and liability method, deferred income taxes are recognized for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. Statement 96, as amended, is effective for fiscal years beginning after December 15, 1991.

The Company estimates that adoption of Statement 96 will result in a reduction in the balance of accumulated deferred income tax liability and the creation of a liability to the Company's ratepayers for the effect on regulated assets and liabilities of the reduction of the Federal statutory income tax rate from 46% to 34% as provided for by the Tax Reform Act of 1986. This reduction in accumulated deferred income taxes will be partially offset by the effect of new temporary differences resulting from Statement 96, such as allowance for equity funds used during construction and accumulated deferred investment tax credits. The portion of the regulated liability created by Statement 96 relating to certain temporary differences (i.e. accelerated depreciation) will be recorded as long-term and be amortized

over the remaining life of the assets giving rise to the temporary difference. With respect to its non regulated assets and liabilities, the Company estimates the adoption of SFAS 96 will require an increase in the balance of accumulated deferred income tax liability. Such adjustment is presently estimated to be approximately $16 million.

The Company may recognize the cumulative effect of a change in accounting principle upon adoption of SFAS 96 or restate prior period financial statements to conform to the provisions of the statement. The Company has not decided when it will implement SFAS 96 and has not decided upon the method of adoption.

Reclassification

Certain amounts in the consolidated financial statements for 1988 and 1987 have been reclassified to conform with the 1989 presentation.

B. Rate Matters

Texas. The rates and services of the Company in Texas municipalities are regulated by those municipalities and in unincorporated areas by the Texas Commission. The Texas Commission has exclusive de novo appellate jurisdiction to review municipal orders and ordinances regarding rates and services, and its decisions are subject to judicial review.

New Mexico. The New Mexico Commission has authority over the Company's rates and services in New Mexico, the issuance of securities by the Company and other matters affecting the operations of the Company.

FERC. The Company is subject to regulation by the FERC in certain matters, including rates for wholesale power sales and the issuance of securities. In addition, Congress has enacted energy legislation which, among other things, establishes national standards for consideration by state regulatory agencies in determining utility rates and imposes other requirements on the operations of utilities, including the Company. Under certain circumstances, the FERC may order interconnection, wheeling and pooling.

NRC. The Palo Verde Station is subject to the jurisdiction of the Nuclear Regulatory Commission ("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 radiation hazards and to conduct environmental reviews pursuant to the National Environmental Policy Act. Before any nuclear power plant can become operational, an operating license from the NRC is required. The NRC has granted facility operating licenses for Unit 1, Unit 2 and Unit 3 for terms of forty years each beginning December 31, 1984, December 9, 1985 and March 25, 1987, respectively. See Note D.

Texas

Rate Moderation Plan — Palo Verde Units 1 and 2. On March 30, 1988, in Docket 7460, the Texas Commission adopted a rate moderation plan which provides for the inclusion in Texas rates, on a phase-in basis, of the Texas jurisdictional portion of the Company's investment in Palo Verde Unit 1 and the Company's lease payments in its sales and leasebacks of its interest in Palo Verde Unit 2 and one-third of Common Plant to the extent of the book value of the plant sold and leased back (which is approximately 83% of such lease payments). The Texas Commission's order was based upon a stipulated settlement entered in October 1987 among the Company, the staff of the Texas Commission and certain industrial customers. The stipulation and the Texas Commission's final order settled all issues regarding prudence of construction of Palo Verde Units 1 and 2 and Common Facilities and all

issues involving the prudence of the Company's decisions to make the investment it made in the Palo Verde Project and which resulted in the continuation of that investment, except, as to Unit 3 only, decisional prudence relating to events occurring after the 1978 issuance by the Texas Commission of a Certificate of Convenience and Necessity for the Palo Verde Project. See discussion below regarding the planned Unit 3 rate case. As part of the stipulated settlement, the Company recorded in the third quarter of 1987 a regulatory disallowance of approximately $38.3 million ($24.4 million after tax). The disallowance amounted to less than 2% of the Company's total investment in Palo Verde. The stipulation also settles all issues of excess capacity relating to Units 1 and 2 for the duration of the 10-year rate moderation plan, and the Texas Commission has indicated that it will not consider excess capacity issues relating to Units 1 and 2 during such time period.

The Texas Commission adopted the rate moderation plan by unanimous vote, over the objections of the City of El Paso and two other intervenors representing public entities. Those parties appealed the Texas Commission's order to state district court in Travis County, Texas, where the district court upheld the order of the Texas Commission. The decision of the District Court was appealed by the City of El Paso and the two other intervenors to the Court of Appeals for the 3rd Judicial District at Austin, Texas. A ruling on such appeal is expected later this year. Management anticipates that the Texas Commission's order will be upheld.

The Texas Commission's order in Docket 7460 limits the Company to specified base rate (cash) increases during the first four years of the plan. The plan requires that the Company file rate cases annually to establish the Company's revenue requirements and resulting right to the base rate increase. To the extent the Company's base revenue requirements recognized by the Texas Commission exceed the base rate increase provided for the period, the unrecovered revenue requirements are deferred for collection in later years of the plan. The rate moderation plan, which is explicitly intended to comply with SFAS No. 92, *Regulated Enterprises — Accounting for Phase-In Plans,* requires all revenue deferrals to be recovered within the 10-year term of the plan. The Company is, under the plan, entitled to additional base rate increases for years subsequent to the scheduled fourth increase, if necessary, to recover all such deferrals during such time period. The Company has indicated in its rate filing for the scheduled third base rate increase that such additional cash increases will be necessary. See discussion below regarding Docket 9165.

The Texas Commission's order in Docket 7460 provided for the first scheduled base rate increase of approximately $21 million. The new rates went into effect in April 1988, and the order provided for the deferral for future recovery of approximately $25 million.

In October 1988, the Company filed with the Texas Commission for the scheduled second base rate increase under the rate moderation plan (Docket 8363). The Company requested an increase of approximately $39 million in base revenues. In May 1989, the Texas Commission entered its final order in the case which granted, effective June 1989, the scheduled second cash increase in base revenues of approximately $7.3 million and the deferral of approximately $7.4 million.

The approximate $24.3 million ordered reduction in the revenue deferrals requested by the Company resulted from, principally (1) adjustments made by the Texas Commission which reduced rate base by $61 million, the major components of such reduction being the disallowance of certain operating costs previously deferred under accounting deferral orders issued by the Texas Commission (which disallowance resulted in the after-tax write-off of $15 million in the first quarter of 1989), disallowance of the Company's requested cash working capital levels, removal from rate base of the unamortized balance of Docket 7460 prudence case expenses (which will be considered for recovery in rates in the separate docket described below under "Rate Case Expenses Incurred in Docket 7460") and the one-time offsetting of rate base by deferred taxes associated with the portion of Palo Verde Unit 3 sold and leased back by the Company in December 1987; (2) the Texas Commission's setting the

Company's rate of return on common equity at 12.4% as opposed to the Company's requested 14.0%; (3) various operating expenses being reduced or eliminated, totaling approximately $6.4 million; and (4) tax ramifications of the foregoing resulting in a compounding of the reductions.

The Company, as well as certain parties adverse to the Company in the case, appealed the Texas Commission's order in Docket 8363 to state district court in Travis County, Texas. A decision on the appeal is not expected before the end of 1990. The Company has contested the bulk of the adjustments made by the Texas Commission and believes there are justified grounds for its appeal. However, as is the case in any appeal from a decision of the Texas Commission, judicial review is generally limited to a determination of whether substantial evidence exists to support the Texas Commission's order and whether the Texas Commission acted within its statutory authorization and not arbitrarily in reaching its decision. The outcome of the appeal of the case cannot presently be determined.

In late November 1989, the Company filed with the Texas Commission for the third scheduled base rate increase of 3.5% (Docket 9165). In the filing, the Company seeks an increase in base revenues of approximately $33.9 million, consisting of an approximate $7.1 million cash increase and an approximate $26.8 million in phase-in deferrals. As an alternative calculation of the third scheduled base rate increase, the Company requested a cash base rate increase of approximately $13.1 million, with the balance of its requested increase in base revenues of approximately $20.8 million to be deferred, in order to correct a problem which has arisen in the operation of the rate moderation plan involving the average unit rate paid by customers. The cash increases in base revenues originally projected under the rate moderation plan were projected on the basis of expected average unit rates to be achieved from forecasted Texas sales. Due to unanticipated shifts in usage among customers and customer groups, the average unit rates for sales has not reached the projected levels. As a consequence, the Company's cash revenues have not reached levels commensurate with the growth in sales that has occurred, which will contribute to the need for additional increases in base rates after the scheduled fourth increase in order to recover all deferred revenues within the 10-year term of the rate moderation plan.

In March 1990, the City of El Paso, in response to the Company's filing, ordered a $6.9 million reduction in the Company's base revenues, which, if ordered by the Texas Commission, would, combined with the scheduled cash increase in base rates, result in an amortization of the deferrals ordered in Dockets 7460 and 8363 by a corresponding amount. The City's order has been appealed to the Texas Commission. The staff of the Texas Commission has recommended an approximate $17.5 million increase in the Company's base revenues, consisting of a $7.1 million cash increase and a $10.4 increase in revenue deferrals. The staff has not yet made its recommendation on approximately $2.2 million of rate case expenses in this Docket, which were requested in the Company's filing. See "Rate Case Expenses Incurred in Docket 7460." Although the staff recommended rejection of the Company's alternative filing with respect to the average unit rate problem, the staff indicated its agreement that additional base rate increases would be required under the rate moderation plan to recover the phase-in deferrals.

Hearings before the Texas Commission commenced in early March 1990. New rates resulting from the Company's filing in Docket 9165 are expected to be effective by August 1990.

The Company's filing in Docket 9165 does not involve the major issues in Docket 8363 relating to the adjustments made by the Texas Commission with respect to deferred operating costs. The issues in Docket 9165 relate principally to return on equity, operations and maintenance expenses (particularly at Palo Verde), deferred taxes and recovery of certain restructuring costs incurred by the Company. The Company believes that it is entitled to the rate relief sought in Docket 9165, including its alternative filing with respect to the average unit rate problem. The Company would, as it has in the past with respect to previous orders of the Texas Commission, appeal to state district court if the Texas

Commission were to order insufficient rate relief in this Docket. The outcome of the case cannot presently be determined.

The Company's present plan is to file in the third quarter of 1990 for the fourth scheduled base rate increase under the Docket 7460 rate moderation plan. The scheduled base rate increase under the plan is 3.5%. New rates resulting from the filing should be in effect by summer 1991.

Palo Verde Unit 3 — Inclusion in Texas Rates. Although Palo Verde Unit 3 began commercial operation in January 1988, the Unit cannot satisfy Texas Commission criteria for in-service status, and thereby qualify for eligibility for inclusion in Texas rates, until the AIP transmission facilities, construction of which was completed in December 1989, are energized for operation at a required minimum capacity level.

Utilization of the AIP transmission line can occur only with the consent of the Operating Agent of the Southwest New Mexico Transmission System ("SWNMTS"), who can, in that capacity, unilaterally determine the conditions under which power can be transmitted over the AIP line. Public Service Company of New Mexico ("PNM") is presently acting as operating agent under the SWNMTS. Disputes have arisen between the Company and PNM regarding transmission rights and capabilities in the southern and northern New Mexico transmission systems, and PNM has refused to transfer operating agent status under the SWNMTS to the Company, as required under the SWNMTS agreement upon completion of construction of AIP. As a result of these disputes, the Company in early March 1990 sued PNM in the United States District Court for the Western District of Texas for wrongful refusal to permit the Company its full AIP transmission capability.

On March 30, 1990, the Company reached an agreement in principle with PNM to submit to binding arbitration the entitlement of the parties to the transmission rights and capabilities in dispute. The agreement in principle provides for the energization, pending arbitration, of AIP no later than April 9, 1990, at the required level of capacity necessary for Unit 3 to meet the Texas Commission's in-service criteria and provides for the Company to become Operating Agent of SWNMTS upon receipt of the decision of the arbitrators. The Company will accrue a payable to PNM, based upon the purchase of a specified amount of wheeling capacity from PNM, which must be paid only if the arbitrators rule in favor of PNM. Each of the Company and PNM will appoint one arbitrator, and the two of them will select a third arbitrator. The agreement in principle calls for the execution of a definitive agreement between the parties by April 6, 1990, at which time the Company's lawsuit will be dismissed. A decision of the arbitrators is scheduled by the end of 1990.

The Company expects a favorable outcome in the arbitration. An unfavorable outcome would not affect the in-service status of Unit 3, and there are alternatives available to the Company, in the event of an unfavorable outcome, to meet its transmission capability requirements not met through the southern New Mexico transmission system, of which AIP is a part.

In September 1989, the Company filed an application with the Texas Commission for an accounting order that would allow the Company to defer and capitalize substantially all Unit 3 operating costs (excluding fuel) and to accrue a carrying charge on its ownership interest in Unit 3 from the date Unit 3 satisfies the Texas in-service criteria until the Texas Commission issues its rate order on Unit 3. The Company's application for the accounting order was consolidated with Docket 9165 described above. The staff of the Texas Commission has recommended that the Texas Commission grant the accounting order. The Company expects the Texas Commission to grant the requested accounting order. If, however, the Texas Commission refused to grant the accounting order, the Company will be required to expense the Unit 3 operating costs beginning with the date that Unit 3 meets the Texas in-service criteria.

Until Unit 3 qualifies for in-service status in Texas, the Texas jurisdictional portion of Unit 3 will be accounted for, as it has been since the Unit went into commercial operation, as plant under construction. The Company, therefore, has been capitalizing, since the Unit went into commercial operation in January 1988, the Texas jurisdictional portion of the costs of owning, operating and maintaining Unit 3. During the year ended December 31, 1989, the Company capitalized a total of $51.1 million to construction work-in-progress related to the Texas jurisdictional portion of Unit 3, consisting of $12.7 million of operation and maintenance costs; $15.9 million of lease expense attributable to the portion of Unit 3 sold and leased back; $2.4 million of property and other taxes; and $20.1 million of AFUDC. Since January 1988 through December 31, 1989, the aggregate of such costs capitalized is $85.9 million. The Company's total investment in the Texas jurisdictional portion of Unit 3 at December 31, 1989, net of the portion sold and leased back, was $216.0 million.

The Company plans to file with the Texas Commission in the third quarter of 1990 for rate treatment of the Texas jurisdictional portion of the Company's investment in Palo Verde Unit 3, including the lease payments in the Company's sales and leasebacks of 40% of its interest in Unit 3. The Company expects the Texas Commission's final order on the Unit 3 case in the late first quarter of 1991, with rates reflecting the outcome of the case to be effective in the summer of 1991.

At present, management believes that inclusion of Unit 3 in Texas rates will probably involve some form of phase-in or rate moderation plan. Either a separate plan for the Unit 3 costs or a revised combined plan, including the Company's investment in Palo Verde Units 1, 2 and 3, are possible. As the Company has only one set of rate tariffs, however, some merger of the plans into a single set of rates will be necessary.

Although issues relating to the prudence of construction costs directly attributable to Unit 3 are not included in the construction prudence issues resolved by the rate moderation plan for Units 1 and 2 and are therefore open for decision in the Unit 3 case, the Company does not expect a material disallowance of Unit 3 costs on the basis of construction imprudence. In March 1989, Ernst & Whinney, a national accounting firm, which oversaw the prudence audit of the Palo Verde Station ordered by the Arizona Corporation Commission in the exercise of its regulatory authority over Arizona Public Service Company, the Operating Agent for Palo Verde, released its audit report. The report identified approximately $60 million, excluding AFUDC and property taxes, for the entire Palo Verde Project which Ernst & Whinney contends were unreasonable. Of this amount, the Company's share would be approximately $9.5 million (which is less than the write-off recorded by the Company in connection with the adoption of the Docket 7460 rate moderation plan — see discussion above under "Rate Moderation Plan — Palo Verde Units 1 and 2"). Neither the Company nor the Operating Agent accepts the Ernst & Whinney contentions as to the unreasonableness of the Palo Verde construction costs. The audit report also identified certain areas that were found to exceed the standard of reasonableness and to have a positive impact on the Palo Verde Project, including built-in separation of electrical equipment, design replication of the three Palo Verde Units, certain aspects of the regulatory (licensing) management function, and certain labor and contractual arrangements. The report estimated that the potential direct cost savings of the identified areas in which performance exceeded the standard of reasonableness were approximately $300 million for the entire project (excluding AFUDC and property taxes), of which the Company's share would be approximately $47.4 million.

Decisional prudence issues relating to Unit 3 were not resolved in Docket 7460, insofar as such issues relate to events occurring after the Texas Commission's November 1978 issuance of a Certificate of Convenience and Necessity for Palo Verde. In Docket 7460, the Texas Commission acknowledged the prudence of the Company's decision-making through the issuance of the Certificate of Convenience and Necessity for Palo Verde. The Company believes that it will be able to demonstrate in the

Unit 3 case the prudence of the Company's decisions regarding the level of its Palo Verde participation after 1978 and does not expect any material disallowance on the grounds of decisional imprudence.

The Company believes that the primary concern with respect to inclusion of the Company's full investment in Unit 3 in Texas rates will relate to issues of excess capacity. Such issues are resolved with respect to Units 1 and 2 under the rate moderation plan for the 10-year term of the plan. The Company believes that proper regulatory treatment recognizes that the construction and addition to utility plant of generating capacity, particularly large investments such as the Company's investment in Palo Verde, cannot exactly be matched to increases in load requirements and that a period of an acceptable level of excess capacity must be anticipated and accepted. Claims of excess in the Company's generating capacity continue to be weakened by the load growth experienced by the Company. If any excess generating capacity were to be found by the Texas Commission relating to Unit 3, the Company believes the amount of any resulting exclusion from rate base would probably be temporary and would be restored to rate base in future rate proceedings to permit full recovery of substantially all of the Texas jurisdictional portion of the Company's investment in Unit 3.

The Company believes that it is entitled to recover in full the Texas jurisdictional portion of the Company's Unit 3 investment and a fair return thereon. If the Company were denied adequate and timely rate relief sufficient to recover the investment and a fair return thereon, the Company would resort to the courts for the rate relief to which it believes it is entitled. The ultimate outcome of the case cannot, however, presently be determined. Failure to receive sufficient inclusion in Texas rates of the Company's Unit 3 investment, on a timely basis, would increase the Company's external financing requirements and could adversely affect access to the capital markets at reasonable cost. An adverse regulatory decision by the Texas Commission with respect to the Company's investment in Unit 3 which, in the judgment of the lending banks under the RCF, causes the Company's revenues to be insufficient to assure its ongoing viability or its access to capital markets or its ability to repay its obligations, constitutes an event of default under the RCF. See Note C.

Fuel Reconciliation Case. In June 1989, the Company filed an application with the Texas Commission to reconcile its fuel expenses and revenues for the period August 1985 through March 1989. The reconciliation is required by Texas Commission rules and final order in Docket 7460. The Company's filing requests an additional $900,000 in fuel revenues for the reconciliation period. The City of El Paso, in response to the Company's filing, recommended that the Company be ordered to refund approximately $14.3 million in previously recovered fuel expenses. The staff of the Texas Commission has recommended a refund of approximately $10.2 million. Hearings before the Hearing Examiner appointed by the Texas Commission have been completed, and a Hearing Examiner's report and recommendation is expected in the near future. Although the Company is unable to assess the outcome of this matter prior to the issuance of the Hearing Examiner's report, the Company believes that it has, in accordance with the rules of the Texas Commission, made all refunds to customers of overcollected fuel expenses during the four-year reconciliation period and that any material disallowance of the Company's fuel expense recoveries would not be justified. The Company has made no provision for any fuel refunds in the accompanying financial statements.

Rate Case Expenses Incurred in Docket 7460. The approximate $11.4 million of expenses incurred by the Company in connection with the Docket 7460 rate case were severed from the issues ruled upon by the Texas Commission in that Docket and were assigned to a new docket for consideration. The Company has applied for the immediate recovery of approximately $5 million of these expenses through a surcharge to customers and has proposed that the balance of the expenses, attributable to the prudence phase of Docket 7460, be amortized and recovered in rates over the useful life of the Palo Verde Units. The staff of the Texas Commission has recommended that the Company be allowed to recover all of the expenses, without interest, amortized over the useful life of the Units. The City of

El Paso has recommended a disallowance of approximately $7.4 million of the prudence expenses. Although hearings in this case were completed in November 1988, no Hearing Examiner's report has been issued. The Company expects a ruling from the Texas Commission by summer 1990. The costs are included as a deferred charge in the accompanying consolidated balance sheet. Although the Company expects to recover the costs, most likely in accordance with the Company's proposed method for recovery, an assessment of the outcome of the case cannot be made prior to the issuance of the Hearing Examiner's report.

Texas Recognition of Palo Verde Sales and Leasebacks. The Company sold and leased back its entire interest in Palo Verde Unit 2 and one-third of Common Plant in transactions completed in August 1986 and December 1986. The Company also sold and leased back approximately 40% of its interest in Palo Verde Unit 3 in December 1987. See Note E. The Company, under applicable Texas Commission rules, was required to report the Unit 2 and Unit 3 sales and leasebacks to the Texas Commission for a determination by the Commission as to whether the transactions were in the public interest. In its Docket 7460 order and a separate order issued in August 1989, the Texas Commission found the Unit 2 and Unit 3 sales and leasebacks, respectively, to be in the public interest. The rulings have no current ratemaking impact, but do insure that, in the case of the Unit 3 sales and leasebacks, the Commission will consider those transactions in connection with the Company's request for rate treatment of its investment in Unit 3. The City of El Paso appealed the Commission's order with respect to the Unit 3 transactions to state district court in Travis County, Texas. The appeal is not expected to be ruled upon this year. Management believes that the court will uphold the Commission's order. The finding on the Unit 2 sales and leasebacks is a part of the City's appeal of the Docket 7460 order.

Performance Standards for Palo Verde — Texas. In June 1989, the Company filed an application with the Texas Commission to establish performance standards in its Texas jurisdiction for the operation of the Palo Verde Units. The performance standards proposed by the Company correspond to the performance standards for the Palo Verde Units currently in effect with the New Mexico Commission for the Company's New Mexico service area. See "New Mexico Rate Matters" below. The Company's application to establish Texas performance standards has been consolidated with the Company's rate filing in Docket 9165 (see discussion above).

Texas Recovery of Fuel Expenses. In its Texas jurisdiction, the Company recovers its fuel expenses and purchased power costs pursuant to a fuel factor set by the Texas Commission in each general rate request filed by the Company. The Texas Commission has the authority to order proceedings periodically for the purpose of reconciling the Company's fuel revenues against actual fuel expenses. See "Fuel Reconciliation Case" above. As a result of the unscheduled outages of the Palo Verde Units in 1989, the Company incurred and is incurring replacement power costs in excess of the amount of fuel revenues provided by the Company's fuel factors. Although the Company believes it is entitled to and will recover its actual Texas fuel costs, the Company is unable, at this time, to predict the ultimate financial or regulatory impact of the unscheduled outages. See Note D.

New Mexico

In March 1987, the New Mexico Commission adopted a rate moderation plan which provides for the regulatory treatment of the New Mexico jurisdictional portion of the Company's investment in all three Units at Palo Verde. The New Mexico Commission's order was based upon a stipulated settlement among the Company, the staff of the New Mexico Commission and certain intervenors. The New Mexico plan, among other things, provides for the full inclusion in rate base of the Company's investment in Unit 1 and one-third of common plant and recovery as cost of service of the Company's lease payments on the Unit 2 sales and leasebacks to the extent of the book value of plant sold and leased back. The Company agreed, as part of the plan, that it would not request inclusion in New

Mexico rates of the New Mexico jurisdictional portion of the Company's investment in Unit 3, one-third of common plant and certain related transmission facilities (aggregating $54.2 million) or any Unit 3 operating expenses. The plan also provided for increases in rates of 3% on a total cents per kilowatt hour basis in 1987, and two additional 3% increases in base rates in 1988 and 1989. The plan settled as far as the New Mexico jurisdiction is concerned all construction and decisional prudence issues relating to the Company's investment in Palo Verde and settled excess capacity issues through 1993.

Similar to the Texas plan for Units 1 and 2 (Docket 7460 described above), the New Mexico plan provides that, to the extent the Company's base revenue requirements determined by the New Mexico Commission exceed the base rate increase provided for the period, the unrecovered revenue requirements are deferred for collection in later years of the plan. However, the New Mexico plan presently provides that all deferred revenues not recovered prior to December 31, 1994 are not to be recovered through New Mexico rates. SFAS No. 92, which governs accounting for rate phase-in plans, was not in existence at the time of the adoption of the New Mexico plan. As a result of the New Mexico plan provision that deferrals not recovered prior to December 31, 1994 will not be recovered in New Mexico rates, the New Mexico plan does not comply with SFAS No. 92. The Company has filed an application with the New Mexico Commission to amend the plan to bring it into compliance with SFAS No. 92 and believes that such amendment will be approved by the New Mexico Commission. A hearing on the application is scheduled in mid-June 1990. If the New Mexico plan is not amended to comply with SFAS No. 92, the Company would be required to write-off approximately $5.5 million of recorded phase-in deferrals and discontinue reporting for financial statement purposes the unrecovered revenue requirements deferred for collection under the plan.

Effective November 1987, the New Mexico Commission ordered the first scheduled rate increase under the New Mexico plan. The order provided for an increase in base revenues of approximately $5.0 million, consisting of approximately $1.8 million cash increase in base rates and approximately $3.2 million deferred revenues.

In November 1987, the Company filed for the second scheduled base rate increase under the New Mexico plan. The Company requested an increase in base revenues of approximately $5.5 million. The New Mexico plan limited the base rate increase to approximately $1.7 million, with the balance of the Company's requested increase in base revenues to be deferred. The New Mexico Commission's final order in the case, which was issued based upon a stipulated settlement on revenue requirements, allowed the Company an increase in base rates of approximately $1.5 million and provided for the capitalization of approximately $1.2 million of fuel expense as a cost of service deferral. No additional deferred revenues were provided under the stipulation or order. Rates based upon the order were effective November 1988.

In July 1989, the Company filed with the New Mexico Commission for the third and final scheduled base rate increase under the plan. The Company requested an increase in base revenues of approximately $8.5 million, consisting of an increase in base rates of approximately $1.8 million and deferral of approximately $6.7 million. A stipulated settlement of the case was reached in February 1990 which provides for an increase in base revenue of approximately $2.5 million, consisting of an increase in base rates of approximately $1.8 million and deferral of approximately $0.7 million. The Company expects the New Mexico Commission to issue its final order approving the stipulated settlement in April 1990, with new rates to be effective in May 1990.

The Company will be required to recover the New Mexico jurisdictional portion of the Company's investment in Unit 3, which is deregulated under the New Mexico rate moderation plan, through off-system sales in the economy energy market. Market prices for economy energy sales have not been in recent years and are not presently at levels needed by the Company to recover the New Mexico

portion of the Company's current operating expenses related to Unit 3, including lease payments. However, the Company believes that over the useful life of Unit 3, based upon its current forecast of plant operating costs and performance, power needs of other utilities and alternative fuel prices, the Company will be able to recover the New Mexico portion of its Unit 3 costs through such sales of power.

The Company is subject to performance standards in its New Mexico jurisdiction for the operation of the Palo Verde Units. The standards measure performance on the basis of the three Units being viewed as a single generating station and involve the use of designated levels of capacity factors (the ratio of actual generation to maximum possible generation). If the annual capacity factor of the station exceeds the maximum standard (which is 75% capacity), the Company is entitled to a monetary reward based upon the additional fuel costs avoided, calculated with reference to the Company's weighted average fuel and purchased power costs (other than Four Corners, Palo Verde and purchases from Southwestern Public Service Company). If the annual capacity factor falls below the minimum standard (60% capacity), the Company is penalized based upon the additional fuel costs incurred using the same formula. If annual performance falls between the minimum and maximum standards, no consequences result.

Due to the unscheduled outages at Palo Verde during 1989, the Company recorded at December 31, 1989 an estimated performance penalty of approximately $3.0 million based upon the requirements of the New Mexico performance standards. Under those standards, the New Mexico Commission has the right to re-evaluate whether Palo Verde Units 1 and 2 should continue to be included in New Mexico rates. Although the Company is unable at this time to predict the ultimate financial or regulatory impact of the unscheduled outages at Palo Verde during 1989, the Company believes that, because Units 2 and 3 have been restarted and a request to the NRC to restart Unit 1 is expected in April of 1990, the New Mexico Commission will not exclude any of the Company's investment in Palo Verde Units 1 and 2 from New Mexico rates.

In its New Mexico jurisdiction, the Company recovers its fuel expenses and purchased power costs through a fuel factor set by the New Mexico Commission. The New Mexico rate moderation plan requires that the fuel factor be fixed each year during the term of the plan. On January 31, 1990, the Company filed a request for a new fuel factor in its New Mexico jurisdiction. The requested fuel factor reflected the estimated penalty of $3.0 million recorded by the Company under the New Mexico performance standards as well as a request by the Company to recover during 1990 approximately $2.0 million of under-recovered fuel expenses in New Mexico. Hearings will commence this summer, and the Company expects the New Mexico Commission to issue an order by the fall of 1990.

FERC

The Company's rates for wholesale power sales and transmission services are subject to regulation by the FERC. The Company's sales for wholesale power make up a significant portion of the Company's operating revenues. During both 1989 and 1988, approximately 18% of the Company's electric operating revenues resulted from such sales, respectively. Rate tariffs currently applicable to certain FERC jurisdictional customers contain appropriate fuel and purchased power cost adjustment provisions designed to recover the Company's fuel and purchased power costs. Two FERC customers have fixed fuel factors approved under FERC tariffs for which no fuel reconciliation is made. Although rates to wholesale customers require FERC approval, the Company and its wholesale customers usually establish such rates through negotiations subject to such FERC approval.

The Company has a rate settlement agreement with IID which is based upon a long-term firm power sales agreement providing for the sale of 100 megawatts of firm capacity to IID beginning in

1987 and continuing through April 2002. In addition, the agreement calls for contingent capacity of 50 megawatts to be made available to IID beginning in 1992 and continuing through April 2002. The terms of the settlement agreement generally provide for sales prices designed to fully recover the scheduled costs over the life of the agreement. The sales prices are generally level throughout the term of the agreement and to the extent that they do not fully recover scheduled costs in the contract, revenues and a return are accrued for subsequent collection. Amounts accrued under the terms of the agreement were $7,340,000, $7,632,000 and $1,510,000 in 1989, 1988 and 1987, respectively. The agreement with IID settles any possible issue of the prudence of the construction costs of Palo Verde and of excess generating capacity.

The Company has a rate settlement agreement with TNP which is based upon a revised firm power sales agreement with TNP. As part of the settlement of the rate increase request, the Company and TNP settled an arbitration with respect to the contractual level of reserve demand under the Company's prior sales agreement with TNP. The revised firm power sales agreement with TNP provides for firm power sales to TNP ranging from 43 megawatts to 79 megawatts, beginning in 1987 and continuing through 2002, with negotiated demand charge rates for such power.

C. Liquidity

The Company expects to externally finance its cash requirements not met through cash generated from operations. Those requirements include construction expenditures and, until the Company's base rates provide for current recovery of the Company's cost of service and return on investment, operating and capital costs deferred pursuant to rate moderation plans, operating and capital costs related to the Texas jurisdictional portion of Palo Verde Unit 3, payments of long-term debt and preferred stock maturities and redemptions. See Note B.

The Company's estimated external financing requirements for 1990 are $242 million, of which $153 million was completed on January 26, 1990. Proceeds were used to reduce borrowings then outstanding under the RCF (see discussion below). Proceeds from the balance of the required financings, $89 million, combined with cash on hand and internal cash generation (together estimated at $46.5 million), will be used to meet the Company's 1990 estimated construction expenditures of $53.4 million, payments of long-term debt and preferred stock maturities and redemptions of $48.5 million and estimated regulatory deferrals and Palo Verde Unit 3 capitalized costs of $33.6 million.

During 1991 and 1992, the Company expects to incur construction expenditures of $51.4 million and $49.9 million, respectively. Payments of long-term debt and preferred stock maturities and redemptions aggregate approximately $95.6 million and $59.1 million, respectively. Cash requirements in 1991 and 1992 for regulatory deferrals will be dependent upon future levels of rate relief obtained.

In October 1989, the Company obtained a revolving credit facility (herein, the "RCF") from a syndicate of money center banks which provides for borrowings by the Company from time to time through May 31, 1991, the initial termination date of the RCF, of up to $150 million outstanding at any one time. The May 31, 1991 termination date of the RCF, which is set with reference to the expected timing of the Texas Commission's order on the Company's Unit 3 rate case, may be extended, subject to the consent of the lending banks, for successive one-year periods.

The RCF requires the Company to issue, for purposes of repaying borrowings thereunder, $270 million of long-term debt through the period expiring March 31, 1991, including at least $100 million of long-term debt by January 31, 1990. On January 26, 1990, the Company issued and sold, in a private placement to institutional investors, $153 million of First Mortgage Bonds, 11.10% Series Due 2001, the proceeds of which were applied, as required, to reduction of borrowings outstanding under the RCF. $47 million of the balance of the $270 million of long-term debt issuances required

under the RCF is required to be issued no later than December 31, 1990, leaving $70 million of required long-term debt issuance by March 31, 1991.

The RCF is secured by first and second mortgage bonds of the Company in an aggregate principal amount equal to the committed amount of the RCF. The RCF requires that the Company meet certain fixed charge and maintenance of equity ratios, maintain specified long-term debt issuance capacity and meet certain maintenance of collateral value tests. The terms of the RCF prohibit the Company from declaring or paying any dividend with respect to its common stock.

$104 million was available for borrowing under the RCF at March 30, 1990.

The Company intends to use borrowings under the RCF and the required long-term debt issuances to meet its external financing requirements through May 31, 1991. The Company believes that it will be able to issue and sell the long-term debt required to be issued and sold under the terms of the RCF. The Company will require an extension of the RCF or its replacement with a similar facility to meet financing requirements beyond May 31, 1991. The RCF includes as an event of default an adverse regulatory decision by the Texas Commission with regard to the Company's investment in Unit 3 which, in the judgment of the lending banks, causes the Company's revenues to be insufficient to assure (1) the Company's ongoing viability, (2) its access to capital markets or (3) its ability to refinance or repay its obligations when due. Although the Company believes that it is entitled to recover its Unit 3 investment and a fair return thereon, the ultimate outcome of the case cannot be predicted. Failure to receive sufficient inclusion in Texas rates of the Unit 3 investment, on a timely basis, would increase the Company's external financing requirements and could adversely affect access to the capital markets at reasonable cost. See Note B.

In addition to the borrowings available under the RCF, the Company has limited short-term borrowing availability under the credit facility supporting the independent trust established to meet the Company's nuclear fuel requirements at Palo Verde. At March 30, 1990, the Company had $22.1 million of borrowings available to it under such credit facility.

Financing Restrictions

Short-term borrowings by the Company are limited to levels approved by the FERC. The FERC has approved short-term borrowings by the Company, including borrowings under the RCF and the nuclear fuel trust credit facility, of up to $200 million through December 31, 1991.

The RCF restricts the Company's incurrence of indebtedness, other than under the RCF, to (1) borrowings up to a specified level under the nuclear fuel trust credit facility and commercial paper backed by the RCF (in which case the amount available to the Company under the RCF is reduced by the amount of commercial paper outstanding) (2) indebtedness which is unsecured, or junior in right of security to the RCF, and which does not require principal amortization prior to the then termination date of the RCF, (3) scheduled long-term financing by the Company, including the long-term financings required under the RCF, and (4) refundings, renewals, extensions and replacements of maturing indebtedness.

The letter of credit agreements providing for the letters of credit which the Company caused to be issued to the equity participants in the Company's sale and leaseback transactions involving Palo Verde Units 2 and 3, and one other bank credit agreement, were renegotiated contemporaneously with the closing of the RCF. These letter of credit agreements and the bank credit agreement, as amended, require the Company to meet the same maintenance of equity and fixed charge ratios required to be met under the RCF. The transaction documents for the Palo Verde Unit 2 sales and leasebacks were also renegotiated and amended contemporaneously with the closing of the RCF. The incurrence of debt restrictions in those transaction documents have been suspended for so long as complying letters

of credit remain in effect. With respect to all but one of the eight equity participants in the Unit 2 sales and leasebacks, complying letters of credit must be maintained through at least December 31, 1999. One equity participant in the Unit 2 sales and leasebacks is entitled to letter of credit support for its equity investment throughout the lease term. The Company expects to be able to maintain complying letters of credit in effect as required under the amended documents, and, therefore, does not expect the Unit 2 incurrence of debt restrictions to impact its external financing capability.

Other Restrictions — Restated Articles of Incorporation; Mortgage Indentures. The Company's Restated Articles of Incorporation provide that, unless consented to by the holders of preferred stock, additional shares of preferred stock may not be issued unless certain tests are met with respect to (i) net earnings of the Company available for preferred dividends, (ii) after-tax earnings available for interest, amortization and preferred dividends and (iii) the sum of junior stock capital and, if the Company so elects, surplus. The most restrictive of said tests, (i) above, would not have permitted the issuance of any new shares of preferred stock at December 31, 1989. It is not expected that the Company will be able to satisfy the preferred stock issuance tests in 1990.

In addition, the Company's Restated Articles of Incorporation provides that, unless consented to by the holders of preferred stock, the aggregate of unsecured long-term debt shall not exceed 10% of the total of the Company's outstanding secured debt, capital and surplus. At December 31, 1989, the Company would have been permitted to issue approximately $62.3 million in additional unsecured long-term debt.

The Company's First Mortgage Indenture permits the issuance of additional first mortgage bonds to the extent of 60% of the value of unfunded net additions to the Company's utility property, provided net earnings available for interest during a recent twelve-month period were at least twice the annual interest requirements on all bonds to be outstanding and on all prior lien debt. At December 31, 1989, unfunded net additions totaled $453.5 million, which was sufficient, with the inclusion of $0.5 million in bond credits (after giving effect to the $153 million 11.10% Series due 2001), to permit the issuance of approximately $272.6 million principal amount of new bonds. Presently, the Company cannot issue first mortgage bonds on the basis of property additions because earnings are insufficient to meet the net earnings test of the Indenture. However, the Indenture also permits the issuance of first mortgage bonds based upon currently unfunded first mortgage bonds, without, under certain circumstances, being required to meet the net earnings test. The RCF is presently secured by $50 million of first mortgage bonds and $100 million of second mortgage bonds. The RCF provides that, as the Company issues and sells first mortgage bonds to meet the long-term financing requirements of the RCF, the RCF banks are to release an amount of first mortgage bonds then held as collateral in the amount needed by the Company for the proposed long-term financing, which bonds, under the Indenture, constitute additional unfunded first mortgage bonds. The Company would use such additional unfunded first mortgage bonds as the basis for the issuance of any first mortgage bonds issued to meet the long-term financing requirements of the RCF. As the RCF banks release first mortgage bonds from their collateral, the amount of second mortgage bonds held by the banks as collateral increases correspondingly, so that at all times the RCF is secured by a combination of first and second mortgage bonds or second mortgage bonds only.

The Company's Second Mortgage Indenture permits the issuance of additional second mortgage bonds on the basis of 40% of the value of unfunded net additions to the Company's utility property. The indenture also permits the issuance of second mortgage bonds based on currently unfunded second mortgage bonds. At December 31, 1989, unfunded net additions totaled $161.4 million, which was sufficient, with the inclusion of $20 million in bond credits, to permit the issuance of approximately $84.5 million principal amount of new bonds.

D. Palo Verde Nuclear Generating Station

The Company has expended $1.49 billion (including $431 million of AFUDC net of deferred taxes) through December 31, 1989 for its 15.8% interest in the three 1,270 MW nuclear generating units which comprise the Palo Verde Station, which is located near Phoenix, Arizona. At December 31, 1989, Units 1, 2 and 3 were complete and in commercial operation. See Note B for information on the Company's treatment of the Texas jurisdictional portion of Palo Verde Unit 3.

A summary of the Company's investment in Palo Verde Station and of other jointly owned utility plant, excluding fuel, is as follows:

	Electric Plant in Service	Accumulated Depreciation	Construction Work in Progress
December 31, 1989:			
Palo Verde Station	$656,416,000	$(40,290,000)	$228,228,000
Other	125,090,000	(29,750,000)	5,660,000
December 31, 1988:			
Palo Verde Station	$632,808,000	$(25,371,000)	$185,865,000
Other	125,423,000	(24,805,000)	2,510,000

The Company's investment, at cost, in the Palo Verde Station in the amount of $884,644,000 at December 31, 1989 excludes amounts which represent the book value of the Company's investment in Palo Verde Station which was sold and leased back during 1986 and 1987 and for which the related leases are accounted for as operating leases. See Note E for information regarding such transactions and the Company's lease obligations relating thereto. Additionally, the Company's investment, at cost, in the Palo Verde Station is net of a regulatory disallowance in the amount of $38,323,000. (See Note B).

All three Palo Verde Units were out of service for substantial periods during 1989. Unit 3 and Unit 1 experienced unscheduled outages on March 3, 1989 and March 5, 1989, respectively, and Unit 2 was removed from service for testing by APS on March 15, 1989. In March 1989, the NRC issued confirmatory action letters requiring APS to take certain corrective actions and to receive NRC approval before restarting any of the Palo Verde units. APS placed Units 3 and 1 in their scheduled refueling outages on March 8, 1989 and April 8, 1989, respectively.

With NRC approval, APS restarted Unit 2 on June 29, 1989 (although the unit experienced subsequent outages during the year) and Unit 3 on January 21, 1990. On February 24, 1990, APS placed Unit 2 in its second refueling outage, which is scheduled to continue approximately 100 days. APS is undertaking corrective actions relating to Unit 1 and it is currently estimated that APS will request NRC approval to restart the Unit during April of 1990. Because of the present uncertainties regarding the timing of NRC approval, the restart date for Unit 1 cannot currently be predicted.

As a result of the unscheduled outages of the Palo Verde Units, the Company is incurring replacement power costs in excess of the amount of fuel revenues provided by the Company's fuel factors. (See Note B). The Company's total undercollection of fuel revenues at December 31, 1989 was approximately $10 million. The Company has deferred, and will continue to defer, any undercollections resulting from the Palo Verde outages in accordance with procedures governing recovery of fuel expenses in its regulatory jurisdictions. Although the Company believes it is entitled to and will recover its actual fuel costs, net of the New Mexico performance standard penalty discussed in Note B, the Company is unable, at this time, to predict the ultimate financial or regulatory impact of the unscheduled outages.

Decommissioning and Spent Nuclear Fuel

The Company is required to plan and fund its share of the estimated costs to decommission Palo Verde, including the portion sold and leased back. The Company has assessed the requirements for the funding of such decommissioning and has determined, based upon an independent study, that the Company will have to fund approximately $120 million (stated in 1989 dollars) for decommissioning of Palo Verde. The Company will fund decommissioning over the estimated service life (approximately 40 years) for the portion of its owned interest in Palo Verde and over the term of the related leases (27 to 29 years) for the sold and leased back portions of Palo Verde. The Company has established funds which, as approved, provide for current deductibility up to 40 years for Federal income tax purposes of some or all of the amounts funded. The Company believes that all costs associated with nuclear plant decommissioning will be recoverable through rates.

The Company is currently funding its share of the obligation for spent nuclear fuel costs associated with Palo Verde through payments to the operating agent of Palo Verde of one dollar per gross MWH generated as prescribed by the Department of Energy.

E. Sale and Leaseback Transactions

In August and December 1986 and December 1987, the Company consummated ten separate sale and leaseback transactions involving all of its 15.8% undivided interest in Palo Verde Unit 2, one-third of its undivided interest in certain Common Plant at Palo Verde and approximately 40% of its undivided interest in Unit 3. The Company remains responsible, under the terms of the leases, for all operating and maintenance costs, decommissioning costs, nuclear fuel costs, and other related operating costs of the leased-back facilities.

The aggregate consideration received by the Company in the sale and leaseback transactions was $934.4 million ($684.4 million in 1986 and $250.0 million in 1987). The proceeds from the transactions, which were based upon appraised fair market value, exceeded the cost of the assets sold by $194.0 million, which amount has been deferred and is being amortized into income over the primary terms of the leases. Nine of the ten transactions are accounted for as operating leases; one transaction (sales price of $87.4 million), with an affiliate of a federal savings and loan association is accounted for as a financing transaction. During 1987, the Company acquired $60 million of newly issued, floating rate exchangeable preferred stock of the savings and loan association, which was subsequently disposed of at a total loss during December 1989. (See Note P.) Additionally, an affiliate of the savings and loan association received placement fees aggregating approximately $3.7 million in connection with the ten sale and leaseback transactions and the preferred stock transaction.

Leases related to Unit 2 and Common Plant expire in October 2013, while leases related to Unit 3 expire in January 2017. All of the leases contain certain renewal options and provide for repurchase options, at fair market value, at the termination of the lease. Additionally, all of the leases provide that upon the occurrence of specified events of loss or deemed loss events, as defined, the Company is obligated to pay the related equity investor an amount in cash which, primarily because of certain tax consequences, may exceed the equity investor's unrecovered equity investment. Upon payment of such amount and assumption of the debt portion of the purchase price of the undivided interest, the undivided interest will be transferred to the Company. Approximately 20% of the aggregate purchase price of the undivided interests sold in the sale and leaseback transactions was provided by the equity investors, with the balance being provided through the issuance of non-recourse debt by the lessor/purchasers. Additionally, the Company has agreed to indemnify the lessors in certain circumstances against certain losses, including the loss of certain tax benefits, resulting from specified events.

The lease payments attributable to Unit 2, to the extent of the book value of the plant sold and leased back, plus all related taxes ("book breakeven") are being recovered through rates. On August 2, 1989, the Texas Commission found the Unit 3 sale and leaseback transactions to be in the public interest. The action has no current ratemaking ramifications, but does ensure that the transaction will be considered when the Texas Commission addresses the inclusion of Palo Verde Unit 3 in rates. (See Note B). Lease payments attributable to the portion of Unit 3 sold and leased back which has been deregulated by the New Mexico jurisdiction will have to be recovered through economy off-systems sales of electricity. (See Note B). The balance of the lease payments (approximately $19.3 million per year) are not subject to recovery from ratepayers. During 1989, 1988 and 1987, lease expense under the leases accounted for as operating leases amounted to $85,670,000, $83,891,000 and $40,919,000, respectively, of which $16,041,000, $26,315,000 and $26,164,000, respectively, was deferred and capitalized. Future minimum annual rental payments required under such leases are as follows (in thousands):

Year ending December 31,	
1990	$ 82,627
1991	82,627
1992	82,627
1993	82,627
1994	82.627
Thereafter	1,616,775

F. Other Short-Term Investments

As of December 31, 1989 the Company had sold all of its short-term investments. Other short-term investments for 1988 are generally stated at their lower of cost or market and consisted primarily of dividend capture funds and mortgage-backed securities and are reported net of current market valuation allowance of $2,061,000. Included in other short-term investments was an investment in a partnership, which was carried at market value of $53,848,000 in 1988.

Gross unrealized gains were $6,082,000 and gross unrealized losses were $1,257,000 in 1988.

Net realized losses on investments included in the determination of net income were $1,389,000, $4,014,000 and $12,039,000 for 1989, 1988 and 1987, respectively. The cost of the securities sold was based on the actual cost of each such security at the time of sale.

G. Deferred Charges and Other Assets

Other deferred charges and other assets consisted of the following at December 31:

	1989	1988
Rate case costs	$16,716	$15,723
Corporate restructuring costs	21,294	415
Financing and transaction costs	16,122	15,156
Annuities	12,342	19,342
Palo Verde outage costs	4,574	—
Other	14,958	13,928
	$86,006	$64,564

H. Common Stock

Changes in common stock are as follows:

	Common Stock	
	Shares	Amount (In thousands)
Balance December 31, 1986	35,510,138	$338,800
Issuances of Common Stock:		
1987	88,042	1,482
1988	103,129	1,468
1989	125,958	1,409
Purchase of Common Stock:		
1987	(626,000)	(5,983)
Balance December 31, 1989	35,201,267	$337,176

The Company has various employee stock benefit plans. Shares of common stock reserved for issuance under these stock plans were 1,676,951 at December 31, 1989.

I. Preferred Stock

Preferred Stock, Redemption Required

Following is a summary of issued and outstanding preferred stock, redemption required:

	December 31,				Optional Redemption Price Per Share at December 31, 1989
	1989		1988		
	Shares	Amount (In thousands)	Shares	Amount (In thousands)	
$10.75 Dividend	60,000	$ 6,000	64,000	$ 6,400	$105.250
$ 8.44 Dividend	103,600	10,360	109,600	10,960	104.220
$ 8.95 Dividend	97,500	9,750	105,000	10,500	104.480
$ 9.50 Dividend	46,000	4,600	56,000	5,600	100.000
$10.125 Dividend	200,000	20,000	250,000	25,000	103.375
$11.375 Dividend	500,000	50,000	500,000	50,000	105.220
	1,007,100	$100,710	1,084,600	$108,460	

Each series of preferred stock, redemption required, is entitled to the benefits of its respective annual sinking fund which requires redemptions of a specified number of shares or a percentage of outstanding shares. The sinking fund redemption price on all series is $100 per share plus accrued dividends.

Each series, other than the $10.75 series, is redeemable at the option of the Company at various stated redemption prices. Optional redemptions are also generally restricted as to the timing of redemption when such redemptions are part of or in anticipation of any refunding involving the issue of indebtedness or preferred stock having an effective interest cost or effective dividend cost of less than the stated dividend rate of each preferred stock series.

Sinking fund requirements for each of the above series are cumulative and, in the event they are not satisfied at any redemption date, the Company is restricted from paying any dividends on its

common stock (other than dividends on common stock or other class of stock ranking junior to the preferred stock as to dividends or assets).

The aggregate amounts of the above preferred stock required to be retired for each of the next five years are as follows (in thousands):

1990	$21,350
1991	16,750
1992	16,750
1993	16,750
1994	11,750

Redemptions of preferred stock, redemption required were as follows:

	Shares	Amount (In thousands)
Balance at December 31, 1986	1,157,100	$115,710
Redemption of Preferred Stock, $10.75 Dividend	(4,000)	(400)
Redemption of Preferred Stock, $8.44 Dividend	(12,000)	(1,200)
Redemption of Preferred Stock, $8.95 Dividend	(15,000)	(1,500)
Redemption of Preferred Stock, $9.50 Dividend	(20,000)	(2,000)
Balance at December 31, 1987	1,106,100	110,610
Redemption of Preferred Stock, $10.75 Dividend	(4,000)	(400)
Redemption of Preferred Stock, $8.44 Dividend	(6,000)	(600)
Redemption of Preferred Stock, $8.95 Dividend	(7,500)	(750)
Redemption of Preferred Stock, $9.50 Dividend	(4,000)	(400)
Balance at December 31, 1988	1,084,600	108,460
Redemption of Preferred Stock, $10.75 Dividend	(4,000)	(400)
Redemption of Preferred Stock, $8.44 Dividend	(6,000)	(600)
Redemption of Preferred Stock, $8.95 Dividend	(7,500)	(750)
Redemption of Preferred Stock, $9.50 Dividend	(10,000)	(1,000)
Redemption of Preferred Stock, $10.125 Dividend	(50,000)	(5,000)
Balance at December 31, 1989	1,007,100	$100,710

Preferred Stock, Redemption not Required

Following is a summary of preferred stock issued and outstanding at December 31, 1989 which is not redeemable except at the option of the Company:

	Shares	Amount (In thousands)	Optional Redemption Price Per Share
$4.50 Dividend	15,000	$ 1,534	$109.00
$4.12 Dividend	15,000	1,506	103.98
$4.72 Dividend	20,000	2,001	104.00
$4.56 Dividend	40,000	4,000	100.00
$8.24 Dividend	52,450	5,157	103.40
	142,450	$14,198	

All preferred stock issues (redemption required and redemption not required) are entitled in preference to common stock, to $100 per share plus accrued dividends, upon involuntary liquidation.

All issues are entitled to an amount per share equal to the applicable optional redemption price plus accrued dividends, upon voluntary liquidation.

J. Long-Term and Financing and Capital Lease Obligations

Outstanding long-term and financing and capital lease obligations are as follows:

	Redemption Price at December 31, 1989(1)	December 31, 1989	December 31, 1988
		(In thousands)	
Long-Term Obligations:			
First Mortgage Bonds(2):			
4⅝% Series, issued 1962, due 1992	100.41%	$ 10,385	$ 10,385
6¾% Series, issued 1968, due 1998	101.87	24,800	24,800
7¾% Series, issued 1971, due 2001	103.39	15,838	15,838
9% Series, issued 1974, due 2004	104.11	20,000	20,000
10½% Series, issued 1975, due 2005	105.91	15,000	15,000
8½% Series, issued 1977, due 2007	105.13	25,000	25,000
9.95% Series, issued 1979, due 2004	105.81	19,685	20,748
14½% Series, issued 1984, due 1989(10)	—	—	25,000
14% Series, issued 1984, due 1989(10)	—	—	50,000
13¼% Series, issued 1984, due 1994	—	29,500	29,500
12¾% Series, issued 1984, due 1989(10)	—	—	22,000
Borrowings outstanding pursuant to RCF (see Note C) refinanced on January 26, 1990 with 11.10% Series, due 2001	—	153,000	—
Pollution Control Bonds(3)(4):			
Secured by Second Mortgage Bonds(2):			
Variable rate bonds, due 2014, net of $1,499,000 and $7,936,000, respectively, on deposit with trustee		62,001	55,564
Variable rate refunding bonds, due 2014, net of $25,000 and $2,109,000, respectively, on deposit with trustee		37,075	34,991
Variable rate refunding bonds, due 2015		59,235	59,235
Unsecured:			
Variable rate, refunding bonds, due 2013, net of $3,482,000 and $4,574,000, respectively, on deposit with trustee		32,323	31,231
Floating rate notes secured by Second Mortgage Bonds(2)(5):			
Due 1991		70,000	70,000
Balance forward		$573,842	$509,292

	December 31, 1989	December 31, 1988
	(In thousands)	
Balance forward	$573,842	$509,292
Promissory notes:		
Unsecured (6):		
Due 1990 to 1992 ($20,000,000 due in 1990)	45,000	45,000
Total long-term obligations	618,842	554,292
Financing and Capital Lease Obligations:		
Financing obligation, Palo Verde Unit 2 ($1,055,000 due in 1990) (7)	81,394	81,888
Turbine lease ($1,438,000 due in 1990) (8)	11,675	11,306
Nuclear fuel ($19,644,000 due in 1990) (9)	48,460	67,090
Total financing and capital lease obligations	141,529	160,284
Total long-term and financing and capital lease obligations	760,371	714,576
Amounts due within one year:		
Current maturities	(49,100)	(134,126)
Unamortized discount and premium	(1,193)	(1,321)
	$710,078	$579,129

(1) The premiums reflected in the redemption prices continue at reduced amounts in future years, finally resulting in each case in redemption at par in the final year prior to maturity.

(2) Substantially all of the Company's utility plant is subject to a lien under the Indenture of Mortgage securing the Company's First Mortgage Bonds and a lien under the Indenture of Mortgage securing the Company's Second Mortgage Bonds.

The First Mortgage Indenture securing its First Mortgage Bonds provides for sinking and improvement funds. Except as otherwise noted, the Company is required to make annual payments to the trustee equivalent to 1%, $1,115,000 at December 31, 1989, of the greatest aggregate principal amount of such series outstanding prior to a specified date. The Company has generally satisfied the 1% requirements for such series by relinquishing the right to use a net amount of additional property for the issuance of bonds or by purchasing bonds in the open market and expects to continue these practices. With respect to the 9.95% series, commencing in April 1985 the Company is required to make annual cash payments to the trustee equivalent to 4.25%, of the greatest aggregate principal amount of such series outstanding at any one time prior to a specified date, $1,063,000 in 1989 and 1988; the cash payments must be applied to redeem bonds of the 9.95% series at 100% of the principal amount thereof. With respect to the 13.25% series, commencing in April 1990, the Company is required to make annual cash payments to the trustee equivalent to 20%, of the greatest aggregate principal amount of such series outstanding at any one time prior to a specified date; the cash payments must be applied to redeem bonds of the 13.25% series at 100% of the principal amount thereof.

In accordance with certain provisions of the First Mortgage Indenture, payments of cash dividends on common stock are restricted to an amount equal to retained earnings accumulated after December 31, 1966, plus $4,100,000. Retained earnings in the amount of approximately $54,940,000 are unrestricted as to the payment of cash dividends at December 31, 1989. However, under the RCF, the Company is restricted from declaring or paying any common stock dividends.

The Second Mortgage Bonds have been issued to secure the three variable rate pollution control bond issues due 2014 and 2015, as well as the floating rate note issue due in 1991.

(3) The funds on deposit with a trustee at December 31, 1989 represent a portion of the proceeds from pollution control revenue bonds and accumulated related interest income, which are to be disbursed as needed to pay the cost of acquiring, constructing, reconstructing, improving, maintaining or furnishing the pollution control facilities financed.

(4) These bonds are supported by long-term irrevocable letters of credit issued by banks. (See Note L). The bonds bear interest at various rates (5.5% to 6.4% during 1989) which will cause the bonds to have a market value which approximates, as nearly as possible, their par value. The bonds may be required to be repurchased at the holder's option and are subject to mandatory redemption upon the occurrence of certain events and are redeemable at the option of the Company under certain circumstances.

(5) The interest rate on the note due 1991 is to be determined using the bank's prime rate, a CD or Eurodollar rate. Pursuant to an interest swap agreement, the interest rate is 10.08%.

(6) One unsecured note due 1990 is fixed (approximately 10.49%) pursuant to the terms of an interest-rate exchange agreement with the lending bank. One unsecured note due 1992 is floating rate, 9.25% at December 31, 1989.

(7) In December 1986, the Company entered into a financing obligation related to one sale and leaseback transaction involving Palo Verde Unit 2. (See Note E). Semiannual payments, including interest (using an assumed interest rate of 9.01%), which began in July 1987, are $4,181,000, with the last payment of $2,091,000 due in July 2013.

(8) In 1980 the Company leased a turbine and certain other related equipment from the trust-lessor for a twenty-year period, with renewal options for up to seven more years. Semiannual lease payments, including interest, which began in January 1982, are $719,000 through January 1991, and $861,000 thereafter to July 2000. The effective annual interest rate implicit in this lease is calculated to be 9.6%. A gain to the Company related to the sale of the turbine to the trust in the amount of $2,343,000 is being amortized to income over the term of the lease.

(9) The Company enters into lease arrangements with an independent trust with respect to nuclear fuel loadings into Units 1, 2 and 3 at Palo Verde Station. The Company accounts for the leases as capital leases and, accordingly, has recorded obligations which have balances of $12,594,000 for Unit 1, $15,658,000 for Unit 2 and $20,208,000 for Unit 3 at December 31, 1989 (interest rate of 9.4% at December 31, 1989). Quarterly lease payments made are based on units of heat production.

(10) During 1989, the 12.75% series bonds, in the amount of $22,000,000, the 14.5% series bonds, in the amount of $25,000,000 and the 14% series bonds, in the amount of $50,000,000 were redeemed in May, August and November, respectively.

Scheduled maturities of long-term and financing and capital lease obligations and sinking fund requirements at December 31, 1989 are as follows (in thousands):

1990	$ 50,215
1991	102,805
1992	51,160
1993	12,519
1994	35,345

Nuclear fuel is reloaded in the units approximately every three years at which time the related capital lease obligation is recorded. The table above includes scheduled maturities, within that three-

year cycle, of obligations existing at December 31, 1989 and does not reflect future fuel loadings and related obligations and maturities.

K. Federal Income Taxes

The provisions (credits) for deferred Federal income taxes, which arise from the timing differences between financial and tax reporting are as follows:

	Years Ended December 31, 1989	1988	1987
		(In thousands)	
Tax effect of:			
Operating income:			
Depreciation differences	$17,554	$ 11,834	$ 8,507
Deferred fuel revenues	3,819	1,318	3,901
Provisions for rate refunds	1,306	4,733	(777)
Allowance for borrowed funds	5,537	2,624	8,983
Taxes capitalized	480	1,126	3,953
Nuclear fuel expense differences	(4)	(5,324)	(6,477)
Deferred and capitalized Palo Verde operation and maintenance expenses	8,763	14,532	25,528
Sale and leaseback transactions	2,760	2,310	(54,027)
Deferred revenues	3,058	6,322	212
Alternative minimum tax deferred	1,066	(3,168)	—
Prudency audit costs	2,845	—	—
Offset of deferred tax credits due to tax net operating losses	(9,911)	(27,681)	—
Other	3,120	(1,622)	(7,772)
Other income:			
Regulatory disallowance	(6,051)	—	(13,937)
Return on deferred costs	1,772	3,955	—
Other	2,938	3,262	2,231
Investment income	(3,978)	959	(7)
Change in accounting method	—	—	2,827
Total deferred taxes	$35,074	$ 15,180	$(26,855)

The detail of Federal income taxes by component are as follows:

	Years Ended December 31,		
	1989	1988	1987
	(In thousands)		
Current income taxes:			
Operating	$(20,206)	$ 2,736	$28,882
Other income	1,350	1,137	(5,125)
Total	(18,856)	3,873	23,757
Deferred income taxes:			
Operating	40,393	7,004	(17,969)
Other income:			
Regulatory disallowance:			
Plant costs	(584)	—	(13,937)
Deferred costs	(5,467)	—	—
Other	732	8,176	2,224
Change in accounting method	—	—	2,827
Total	35,074	15,180	(26,855)
Charge (benefit) equivalent to investment tax credit:			
Operating	(15,389)	1,351	8,336
Other income	1,972	—	4,834
Total	(13,417)	1,351	13,170
Amortization of investment tax credit:			
Operating	(3,267)	(2,774)	(3,474)
Other income	—	—	—
Total	(3,267)	(2,774)	(3,474)
Total Federal income tax expense (benefit)	$ (466)	$17,630	$ 6,598

Federal income tax provisions differ from amounts computed by applying the statutory rate of 34% in 1989 and 1988, and 40% in 1987 to book income from continuing operations before Federal income taxes. Detail is as follows:

	Years Ended December 31,		
	1989	1988	1987
	(In thousands)		
Tax computed at statutory rate	$ 506	$27,712	$20,481
(Decreases) increases due to:			
Allowance for equity funds used during construction	(4,276)	(4,442)	(12,776)
Amortization of equity funds used during construction	3,126	1,258	552
Dividends received not subject to Federal income tax	(716)	(2,333)	(3,187)
ITC Amortization	(3,267)	(2,859)	(1,877)
Amortization of excess deferred taxes	(1,297)	(722)	(698)
Investment valuation adjustment	2,380	—	—
Provision for other taxes	3,881	—	—
Other	(803)	(984)	4,103
Total Federal income tax expense (benefit)	$ (466)	$17,630	$ 6,598
Effective Federal income tax rate	(31.33)%	21.63%	12.89%

The Company has a tax net operating loss carryforward of $57,409,000 from 1988. This loss carryforward expires in the year 2003. For financial statement purposes, net deferred tax credits aggregating approximately $18,827,000 have been eliminated as of December 31, 1989 based upon their expected amortization during the carryforward period. Upon realization of the tax benefits of the net operating loss carryforward in subsequent periods, the amounts eliminated from deferred tax credits will be reinstated. Additionally, as a result of the carryback of tax operating and capital losses generated in 1989, the Company has investment tax credit carryforwards of $16,055,000 which expire in 2001.

At December 31, 1989, the cumulative net amount of income tax timing differences on which deferred income taxes have not been provided approximated $12,200,000.

The consolidated Federal income tax returns of the Company for the years 1983 through 1987 are currently under examination by the IRS. The Company believes that adequate provisions have been made through December 31, 1989 for additional tax that may be due, if any.

L. Commitments and Contingencies

Construction commitments for the Company subsequent to December 31, 1989, total approximately $103,400,000, which includes AFUDC (net of related deferred tax) in the amount of $11,000,000.

The Company has a nuclear fuel purchase commitment with an independent trust (Rio Grande Resources Trust) which is not reflected in the Company's balance sheets. The amount of such commitment at December 31, 1989 was $39,300,000. The Company has elected and intends to continue to elect to purchase the heat produced from the fuel in the trust as the basis for payment for fuel loadings. The trust has a line of credit of $125,000,000, of which $124,500,000 was drawn at December 31, 1989. The trust's financing is based upon a letter of credit with a three-year term which is annually extended by one year if notice to the contrary is not given to the trust by the issuing bank. The issuing bank has given notice of non-extension and, as a result, the letter of credit is currently scheduled to expire on January 8, 1993.

The Company had letters of credit outstanding of approximately $513 million at December 31, 1989 in support of certain debt agreements and lease arrangements.

First Service Life Litigation

Pending Actions Involving the Company's Collateral. On September 26, 1988, the Company filed a declaratory judgment action in the 345th Judicial District Court, Travis County, Texas, against First Service Life Insurance Company, a life insurance company organized under the laws of the Cayman Islands ("First Service"), and R. B. Ashworth, as Conservator for the affairs of First Service under the Texas Insurance Code (the "Conservator"), for a determination that (i) the Company has legal, valid, duly perfected and enforceable security interests in certain collateral granted to the Company by First Service to secure annuities purchased by the Company from First Service, the present balance of which is approximately $20 million (the Company's original annuity investment purchased from First Service being $70 million); and (ii) that events of default have occurred under the collateral security documents pertaining to such annuities which entitle the Company to enforce such security interests. In late May 1988, the Company notified First Service that First Service was in default under the annuities and the collateral agreements and that the Company intended to enforce its security interests. The Conservator, who was appointed by the Texas Commissioner of Insurance in early June 1988, notified the Company that First Service might not be in default, expressed doubt as to the validity and enforceability of the security interests held by the Company and demanded that the Company return to the Conservator all of the collateral and desist and refrain from proceeding with

enforcement of the security interests and other interference with the conservatorship and the conservatorship proceedings.

On September 29, 1988, the Conservator, in conjunction with his answer and denial of the Company's declaratory judgment action, countersued the Company on behalf of First Service and two affiliated corporations, First Service Life, a Turks and Caicos corporation ("FSL"), and Knickerbocker Life Insurance Company ("Knickerbocker"), for actual damages of at least $50 million, plus punitive damages of at least $300 million. The Conservator's counterclaim seeks (i) a temporary and permanent injunction against the Company's enforcement of its security interests in the collateral, (ii) an accounting from the Company as to all payments and transfers of property to the Company from First Service with respect to the Company's annuities, (iii) a declaratory judgment that the Company's security interests are illegal and unenforceable under the Texas Insurance Code and that the sale and purchase of the annuities was an illegal transaction under the Texas Insurance Code by a company doing insurance business in Texas without authorization, and (iv) disgorgement by the Company of all payments received on its annuities and all collateral therefor. The counterclaim alleges several causes of action against the Company including principally fraud, conversion and breach of duty of good faith and fair dealing (based upon an alleged affiliate or "insider" relationship between the Company and First Service).

On December 1, 1988, a receiver (the "Receiver") was appointed for First Service by the 53rd Judicial District Court of Travis County, Texas, and on December 13, 1988, the Receiver in his capacity for First Service was substituted as a party for the Conservator in the above-described litigation. On January 18, 1989, the Receiver was appointed as receiver for FSL as well. The Conservator remains a party to the above-described litigation in its capacity as conservator for Knickerbocker.

Although only preliminary discovery has been conducted, the Company's legal counsel, Small, Craig & Werkenthin, P.C., Austin, Texas, has reviewed the basic facts of the case with management and other parties familiar with various aspects of the transactions involved in the litigation, examined documents and records of the Company and other parties which relate to such transactions, and evaluated the allegations against the Company made in the counterclaim. Based upon its preliminary evaluation and investigation of the case to date, and subject to the results of discovery, counsel believes that it is more likely than not that the outcome of the litigation will be favorable to the Company.

The Company believes that the Company's security interests in the collateral are valid and enforceable, and the Company intends to recover amounts owed to it on the annuities through enforcement of its rights to the collateral. The Company strongly denies the allegations of the counterclaim, believes the counterclaim is without merit and intends to vigorously defend against it. Upon reevaluation of the collateral, the Company recorded at June 30, 1989 a provision for loss on the investment of $7 million. The Company has made no provision for loss for the effects, if any, of the ultimate outcome of the litigation. Effective April, 1988 the Company discontinued the accrual of interest income on the annuities.

Claims by Annuitants. On October 16, 1989, the case of *Pedro Meneses, et al. v. Maury Page Kemp, et al.*, Civil Action No. EP-89-CA-37H, was filed in the Western District of Texas, El Paso Division (the "Lawsuit"). The plaintiffs in the Lawsuit include most of the holders of annuities from First Service (the "Annuitants"). The defendants include the beneficial principal shareholders and officers and directors of First Service and Knickerbocker; certain affiliated companies of the principal beneficial shareholders of First Service and Knickerbocker, the Company and its former subsidiaries, PasoTex and Franklin Land; the accounting firm of Coopers & Lybrand; the law firm of Kemp, Smith, Duncan & Hammond, which serves as general counsel to the Company; and two individual attorneys who are shareholders in such firm, one of whom is a former director of the Company. The Lawsuit, as amended,

alleges that the defendants violated the Racketeer Influenced and Corrupt Organization Act ("RICO"), conspired to violate RICO, violated the Federal and Texas securities laws, committed common law fraud, civil conspiracy to defraud, violations of the Texas Deceptive Trade Practices Act and violations of the Texas Insurance Code and violated certain provisions of the Texas Penal Code relating to theft, false statements to obtain property or credit, fraud in insolvency, receiving deposit, premium or investment in a failing financial institution, commercial bribery and misapplication of fiduciary property or property of a financial institution. The claims made against the Company and its former subsidiaries are based upon allegations that the Company controlled and/or conspired with First Service.

The plaintiffs are seeking damages in the amount of their lost annuities, plus interest, multiplication of actual damages, punitive and exemplary damages, and attorneys fees and costs. The complaint in the Lawsuit alleges sales of annuities to the plaintiffs in excess of $9 million, and the total claim for damages exceeds $59 million.

The Company vigorously denies any liability in respect of the Lawsuit and believes that all related claims are without merit. Based upon the limited evaluations and investigation of Small, Craig & Werkenthin, P.C., Austin, Texas, the Company's legal counsel in connection with the pending litigation, such counsel believes that it is more likely than not that the ultimate outcome of the Lawsuit will be favorable to the Company.

The Lawsuit names as a defendant Billye E. Bostic, formerly an executive officer of the Company, who is entitled to indemnity under the Company's charter, bylaws and other applicable agreements to the same extent as indemnification is afforded by the Company to all of its officers and directors with respect to service on boards of directors of other companies. Mr. Bostic has advised the Company that he denies any liability in respect of the Lawsuit and believes that the claims asserted against him therein are without merit. Mr. Bostic is represented by counsel separate from the Company's counsel.

There are numerous parties who purchased annuities from Knickerbocker, not included within the group of the Annuitants, who may assert additional claims similar in nature to the claims asserted by the Annuitants, against the Company. These claims, if asserted, could result in additional suits against the Company.

Suit Against Directors of First Service. On February 3, 1989, the Receiver filed suit in the 345th Judicial District Court, Travis County, Texas, against certain individuals who were alleged to be directors of First Service and/or FSL, including Mr. Bostic.

The Receiver alleges that First Service engaged in the sale of annuities in Texas without authorization to do so and that such actions constituted illegal insurance transactions under the Texas Insurance Code. The Receiver further alleges that the alleged illegal sale of annuities by First Service constitutes a breach by the directors of First Service of their fiduciary duty to exercise due care in the management of the affairs of First Service and/or FSL and resulted in unspecified losses to First Service. The suit seeks actual damages of at least $33 million and, in addition, exemplary damages of at least double the actual damages. No significant discovery has been conducted at this time.

Mr. Bostic has advised the Company that he denies that he served as a director of First Service or FSL during the period of the alleged activities complained of, denies any liability in respect of the Receiver's suit and intends to vigorously defend against it. Mr. Bostic is represented by counsel separate from the Company's counsel in the First Service litigation. Mr. Bostic is entitled to indemnity with respect to the Receiver's suit to the extent indemnification is afforded by the Company to all of its officers and directors with respect to service on certain outside boards.

Because no significant discovery has been conducted, counsel for Mr. Bostic is unable to express an opinion as to the ultimate outcome of the suit. No provision for an indemnity payment, if any, is included in the 1989 consolidated financial statements.

Palo Verde Liability and Insurance Matters

The Palo Verde participants have insurance for public liability payments resulting from nuclear energy hazards to the full limit of liability under Federal law. This potential liability is covered by primary liability insurance provided by commercial insurance carriers in the amount of $200 million and the balance by an industry-wide retrospective assessment program. The maximum assessment per reactor under the retrospective assessment program for each nuclear incident is approximately $66 million, subject to an annual limit of $10 million per incident. Based upon the Company's 15.8% interest in the three Palo Verde units, the Company's maximum potential assessment per incident is approximately $31.3 million, with an annual payment limitation of $4.74 million. The insureds under this liability insurance include the Palo Verde participants and "any other person or organization with respect to his legal responsibility for damage caused by the nuclear energy hazard."

The Palo Verde participants maintain "all risk" (including nuclear hazards) insurance for nuclear property damage to, and decontamination of, property at Palo Verde in the aggregate amount of $2.035 billion, a substantial portion of which must first be applied to decontamination. The Company has also secured insurance against portions of any increased cost of generation or purchase of power resulting from the accidental outage of any of the three Palo Verde Units if such outage exceeds 21 weeks. The Palo Verde outages during 1989 and the current outage of Palo Verde Unit 1 are not covered by this insurance.

Arizona Tax Matters

By Notice of Proposed Correction of Income Tax dated February 9, 1990, the Arizona Department of Revenue (the "ADR"), in connection with an audit examination of the taxable years 1984 through 1987, informed the Company that the ADR has determined that the gains from the sales of the Company's interest in Palo Verde Units 2 and 3 are allocable to Arizona for state income tax purposes on the grounds that the Units constitute non-business assets with a situs in Arizona, resulting, according to the ADR, in a proposed deficiency assessment, including related interest and penalties, of approximately $39.5 million. The Company believes Palo Verde Units 2 and 3 constituted business assets at the time of the respective sales, and, in accordance with Arizona law, it apportioned, rather than allocated, the corresponding gains in paying the Arizona income tax on the transactions.

The proposed deficiency by the ADR is not a final administrative determination, and additional informal discussions on the issue will be conducted prior to a formal hearing. The Company believes that the ADR will not prevail in its proposed determination and does not expect to incur any material liability in respect thereof. The Company will litigate any issues not satisfactorily resolved through the administrative process.

Preferred Stock Tax Indemnity

In July 1989, the two corporations which are the beneficial owners of the Company's 11.375% preferred stock, aggregate par value $50 million, notified the Company that the IRS had proposed to disallow those holders the dividends received deduction taken by them on their 1985 income tax returns with respect to the dividends they received on that stock. At the same time the IRS also made the same proposed disallowance to the beneficial owners of a number of preferred stock issues of other utilities. Under an agreement the Company entered into on issuance of the shares in 1984, the Company has agreed to indemnify the beneficial owners for loss of the dividends received deduction

by reason of IRS action. The beneficial owners are contesting the proposed disallowance as required by the agreement.

In January 1990, the beneficial owners provided the Company a schedule of indemnity payments that would be due if the IRS were to prevail. By the owners' calculation, an indemnity payment of $28,637,989.29 for additional taxes, penalties and interest to September 30, 1989 ($31,362,852 if interest is extended to December 31, 1990) would be due for all dividends paid from January 1, 1985, through October 1, 1989, and additional indemnity payments with respect to dividends due thereafter, paid as the quarterly dividends are paid, would total $6,848,697. Under the indemnity agreement, the owners can require the Company to escrow, during the pendency of the IRS contest, the indemnity payments that would be owing if the IRS prevails, because the Company's First Mortgage Bonds are not rated at specified levels. To date the owners have not required an escrow. The escrow, if established, would be invested for the account of the Company.

Under the Company's interpretation of the indemnity agreement, it requires the Company to make indemnity payments, assuming the IRS prevails, only for dividends paid after the Company received, in July 1989, notice of the proposed IRS action, and therefore, if any escrow is required, the Company would be obligated to escrow indemnity payments only for the October 1, 1989, dividend and each quarterly dividend thereafter as it is paid. If the Company's interpretation is sustained, then, depending on how a dispute is resolved on the tax rate to be used in determining the indemnity payments, the indemnity payment or earlier escrow deposit would be $795,985, by the Company's calculation, or $1,304,826, by the owners' calculation, for the additional tax, penalty and interest to December 31, 1990, with respect to the October 1989, dividend, and for the dividends paid thereafter, the indemnity payment or escrow deposit for each dividend would decrease as the preferred stock is redeemed according to its terms ($10 million a year from July 1990, to final redemption in July 1994), and would total, over the 42-month period, $6,422,136 by the Company's calculation, or $6,848,698 by the owners' calculation. Counsel to the Company believes that the beneficial owners are more likely to prevail than the IRS on the proposed disallowance of the dividends received deduction, and also believes that, if the IRS does prevail, there is substantial support for the Company's position that it is not obligated to indemnify for past dividends. If the IRS were to prevail, the Company believes its dividend and indemnity payments would be deductible as interest paid for federal income tax purposes.

Since these indemnity payments, even under the Company's interpretation, would increase the Company's pre-tax cost by more than 50 basis points, the indemnity agreement gives the Company the right to redeem all of the shares for par plus any indemnity payments due, at any time through the third dividend payment after conclusion of the IRS contest. The Company's present intention, which may change, is not to seek repurchase of the shares before conclusion of the tax contest.

Even if the IRS does not prevail, the Company still must make indemnity payments to the owners for additional taxes they must pay by reason of the reduction in the dividends received deduction by the Tax Reform Act of 1986 and the Revenue Act of 1987. The owners and the Company, however, do not agree on how these payments are to be calculated. By the owners' calculation, an indemnity payment of $1,695,718 is due for past dividends through October 1, 1989, and the indemnity payments for each dividend thereafter would be from $109,872, decreasing to $21,974 and totalling $1,208,593. By the Company's calculation, an indemnity of $487,048 would be due for past dividends, and the continuing indemnity would be from $52,251 down to $10,450 as each dividend is paid, totalling $574,767. These indemnity payments would reduce any payments due on account of the IRS prevailing on its proposed total disallowance of the dividends received deduction.

M. Pension Plans

The Company's Retirement Income Plan for Employees of El Paso Electric Company (the plan) covers employees who have completed one year of service with the Company. The plan is a noncontributory defined benefit plan. Upon retirement or death of a vested plan participant, assets of the plan are used to purchase an annuity contract with an insurance company. Contributions from the Company are based on the amounts required to be funded under provisions of the plan as actuarially calculated. The assets of the plan consist primarily of fixed income instruments.

The Company's Supplemental Retirement and Survivor Income Plan for Key Employees (SERP) is a non-qualified, non-funded pension plan which covers certain key employees of the Company. The pension cost for the SERP is based on substantially the same actuarial methods and economic assumptions as those used for the defined benefit plan.

Net periodic pension cost under SFAS No. 87 — Employers Accounting for Pensions is made up of the components listed below as determined using the projected unit credit actuarial cost method. For prior years, the Company's net periodic cost was determined using the aggregate actuarial cost method.

Net periodic pension cost for these plans for 1989, 1988 and 1987 (in thousands):

	December 31,		
	1989	1988	1987
Service cost for benefits earned during the period	$ 1,361	$ 1,249	$ 1,386
Interest cost on projected benefit obligation	3,811	3,138	2,898
Actual return on plan assets	(3,422)	(1,597)	(208)
Net amortization and deferral	1,550	(205)	(1,635)
Net periodic pension cost	$ 3,300	$ 2,585	$ 2,441

The assumed annual discount rates used in determining the net periodic pension cost were 8.25%, 8.75% and 8% for 1989, 1988 and 1987, respectively.

The pension cost includes amortization of unrecognized transition obligations over a fifteen-year period beginning in 1987.

The funded status of the plans and amount recognized in the Company's balance sheets at December 31, 1989 and 1988 are presented below (in thousands):

	December 31,			
	1989		1988	
	Retirement Income Plan	SERP	Retirement Income Plan	SERP
Actuarial present value of benefit obligations:				
Vested benefit obligation	$(32,079)	$(5,938)	$(25,437)	$(2,528)
Accumulated benefit obligation	$(33,305)	$(6,041)	$(27,184)	$(3,075)
Projected benefit obligation	$(44,523)	$(7,354)	$(37,653)	$(4,547)
Plan assets at fair value	32,129	—	32,145	—
Projected benefit obligation in excess of plan assets	(12,394)	(7,354)	(5,508)	(4,547)
Unrecognized net loss from past experience	1,947	3,356	51	3,023
Unrecognized prior service cost	—	(258)	—	(310)
Unrecognized transition obligation	4,899	603	5,415	724
Adjustment required to recognize minimum liability	—	(2,388)	—	—
Accrued pension liability	$ (5,548)	$(6,041)	$ (42)	$(1,110)

During 1989, in connection with the Company's general workforce reduction a retirement window plan was established for participants in the Retirement Income Plan and SERP. The window plan resulted in net losses of approximately $5,512,000 and $1,992,000 for the Retirement Income Plan and SERP, respectively. The net losses have been deferred for recovery in rates.

Actuarial assumptions used in determining the actuarial present value of projected benefit obligation are as follows:

	1989	1988
Discount rate	7.75%	8.25%
Rate of increase in compensation levels	7.00%	7.00%
Expected long-term rate of return on plan assets	8.00%	8.00%

N. Franchises and Significant Customer

Franchises

The Company's major franchises are with the cities of El Paso, Texas and Las Cruces, New Mexico, such franchises expiring in 2001 and 1993, respectively. The franchises contain no express renewal provisions. Although the City of Las Cruces is currently reviewing alternative sources, and the City of El Paso has approved the formation of a task force to study the City's options with respect to possible municipal ownership of the Company's properties, the Company believes, but has no assurance, that both franchises will be renewed.

Significant Customer

In 1989 and 1988, Imperial Irrigation District, a wholesale customer, accounted for approximately $49,584,000 and $43,395,000, or 11.6% and 11.4%, respectively, of utility operating revenue.

O. Selected Quarterly Financial Data (Unaudited)

	1989 Quarters				1988 Quarters			
	1st	2nd	3rd	4th	1st	2nd	3rd	4th
	(In thousands of dollars except for per share data)							
Operating revenues(1) ...	$95,286	$109,331	$118,711	$102,920	$89,539	$92,862	$107,913	$ 91,793
Operating income	13,593	13,257	22,191	7,510	21,221	19,697	24,276	16,339
Net income (loss)	(5,720)	(30,038) (3)	(21,875) (3)	(48,200) (3)	16,997	18,473	21,191	(32,292) (2)
Net income (loss) applicable to common stock	(8,759)	(33,063)	(24,776)	(51,047)	13,923	15,398	18,117	(35,328)
Net income (loss) per share of common stock	(0.25)	(0.94)	(0.70)	(1.46)	0.40	0.44	0.52	(1.01)

(1) The selected quarterly financial data for operating revenues differs from that presented in the Company's quarterly reports on Form 10-Q due to the exclusion of non-utility revenues as a result of the discontinuance of the non-utility operations.

(2) The decline in net income during the fourth quarter of 1988 as compared to the third quarter of 1988 was primarily due to the Company's decision to discontinue all of its real estate investment operations. The Company made provisions for the expected losses on the sale of the real estate investments, including provisions for expected operating losses during the phase-out period of those investments.

(3) The decline in net income during the last three quarters of 1989 was primarily due to the Company's decision to discontinue its remaining non-utility operations. The Company made provisions for the expected losses on the sale, including provisions for expected operating losses during the phase-out period. In December 1989 and January 1990, the Company sold all of its non-utility operations. (See Note P).

P. Discontinued Operations

During 1989, the Company decided to discontinue all of the non-utility operations conducted through the Company's principal subsidiaries, FL&R and PasoTex. FL&R had primarily been engaged in real estate operations in downtown El Paso and other investment activities. PasoTex had engaged through subsidiaries in a variety of non-utility activities, including specialty steel manufacturing, oil country tubular goods end-finishing and marketing, and furniture and accessory manufacturing.

The decision to discontinue these operations reflects the Company's plan to return its operations exclusively to its core utility business. That plan and the timing and nature of the dispositions of the non-utility operations and investments were impacted by a number of factors, including the cash requirements of such operations, regulatory, contractual and financing restrictions applicable to the Company, the value and future prospects for the discontinued operations, the timing and amount of federal income tax benefits associated with the disposition of the operations and the impact of the discontinued operations on the consolidated financial results of the Company.

In late December 1989, PasoTex sold its $60 million preferred stock investment in Commercial Federal Savings and Loan Association, Omaha, Nebraska. The Commercial Federal investment, which was written off by the Company in its entirety under provisions recorded in the 1989 third and fourth quarters due to Commercial Federal's failure to meet regulatory capital requirements and continue paying dividends, was sold by PasoTex to an independent third party corporation, whose principals are experienced in the thrift industry, for a nominal amount of cash plus a $2 million non-recourse

purchase money note. All principal and interest on the purchase money note is due on November 30, 1994, but mandatory prepayments are required based upon a percentage of the purchaser's net cash flow. The preferred stock was pledged to secure the payment of the purchase money note and is held by an independent escrow agent. As additional consideration in the transaction, PasoTex received a warrant to purchase 49.5% of the then outstanding shares of common stock of the third party purchaser (although shares purchased would be non-voting) for an aggregate consideration of approximately $500,000. The warrant may be exercised from time to time, in whole or in part, until December 30, 1996. The warrant may be assigned, subject to applicable securities laws. The transaction was supported by a fairness opinion from an investment banking firm retained by PasoTex. The note and warrant received by PasoTex in the sale were transferred to the Company prior to the sale of PasoTex and Franklin in January 1990.

Also in late December 1989, PasoTex surrendered its 50% common equity interest in Westwood Lighting Group, Inc., a lamp manufacturer, back to Westwood without consideration.

The disposition of the Commercial Federal preferred stock and the surrender of the Westwood common stock resulted in current Federal income tax benefits of approximately $18.6 million and $2.3 million, respectively.

On January 17, 1990, the Company sold all of the capital stock of FL&R and its 35% stock ownership of PasoTex (which was owned 65% by FL&R) to an unrelated third party special purpose corporation, whose managers have substantial experience in the ownership and operations of diverse business enterprises. The Company received as consideration in the transaction the note and warrant received by PasoTex in the disposition of the Commercial Federal investment. The Company transferred at closing of the transaction approximately $3 million to PasoTex for working capital purposes and agreed to transfer approximately $5 million to FL&R no later than July 15, 1990, to be applied against the obligations of FL&R under its mortgage debt relating to a hotel owned in El Paso. As a result of the sale of FL&R, the Company's indirect liability for FL&R's $9,756,000 borrowings under the Rio Grande Resources Trust will become a direct liability of the Company. The stock purchase agreement relating to the transaction provides for an indemnity payment, estimated at approximately $1,800,000, from the Company to the purchaser to compensate for certain Federal income tax investment tax credit recapture liability which may be incurred upon FL&R's eventual sale of the hotel. The indemnity payment is contingent upon certain tax elections which the purchaser is entitled to make with respect to the sale of FL&R and PasoTex. The consideration for the transaction was based upon the combined values of FL&R and PasoTex. The transaction was supported by a fairness opinion from the Company's financial advisor, a nationally recognized investment banking firm.

The loss on the sale of Franklin and PasoTex will generate Federal income tax benefits of approximately $18 million.

The results for the twelve months ended December 31, 1989 and 1988 include provisions for loss of approximately $58,165,000 and $35,954,000, respectively, which includes income tax credits of approximately $9,650,000 and $18,522,000, respectively. The provision for loss includes a provision of approximately $7,669,000 and $11,520,000, respectively, for expected operating losses during the phase-out period of the discontinued operations. Included in provision for loss for the twelve months ended December 31, 1989 was a provision for loss of approximately $7,169,000 related to the operations discontinued in 1988 including additional expected operating losses during the phase-out period of $2,169,000. In addition, the Company recorded a loss of approximately $41,440,000, net of tax benefits of approximately $18,560,000, for the year ended December 31, 1989 in connection with the sale of its preferred stock investment in Commercial Federal Savings and Loan Association in December 1989.

Operating results of discontinued operations have been reclassified from amounts previously reported and have been reported separately in the consolidated income statements. Revenues of discontinued operations were $250,602,000, $268,635,000 and $113,667,000 in 1989, 1988 and 1987, respectively.

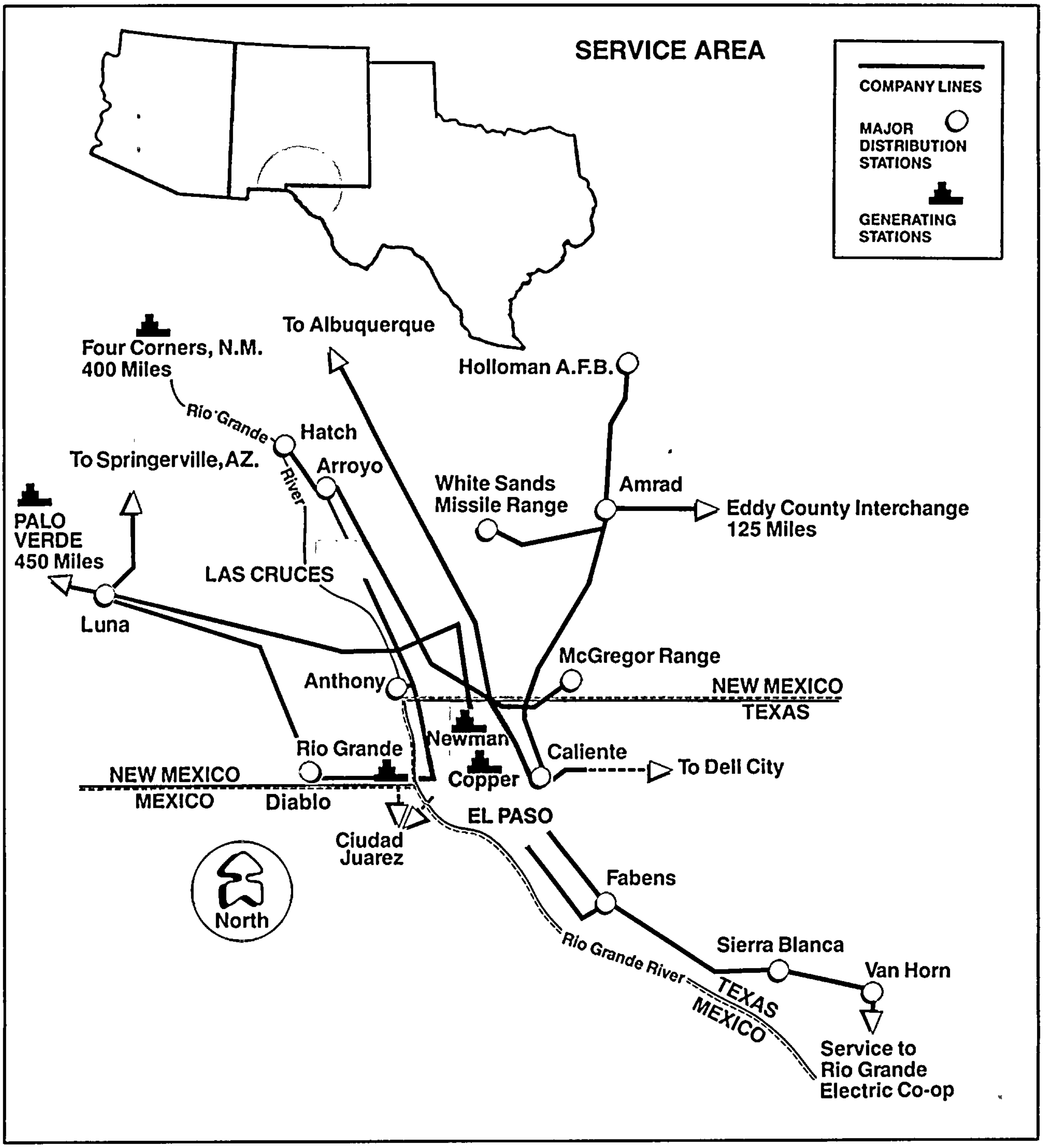
Interest paid on borrowed money related to discontinued operations was approximately $16,162,000, $14,240,000 and $10,653,000, for the twelve months ended December 31, 1989, 1988 and 1987, respectively.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

PART III and PART IV

The information set forth in Part III and Part IV has been omitted from this Annual Report to Shareholders.

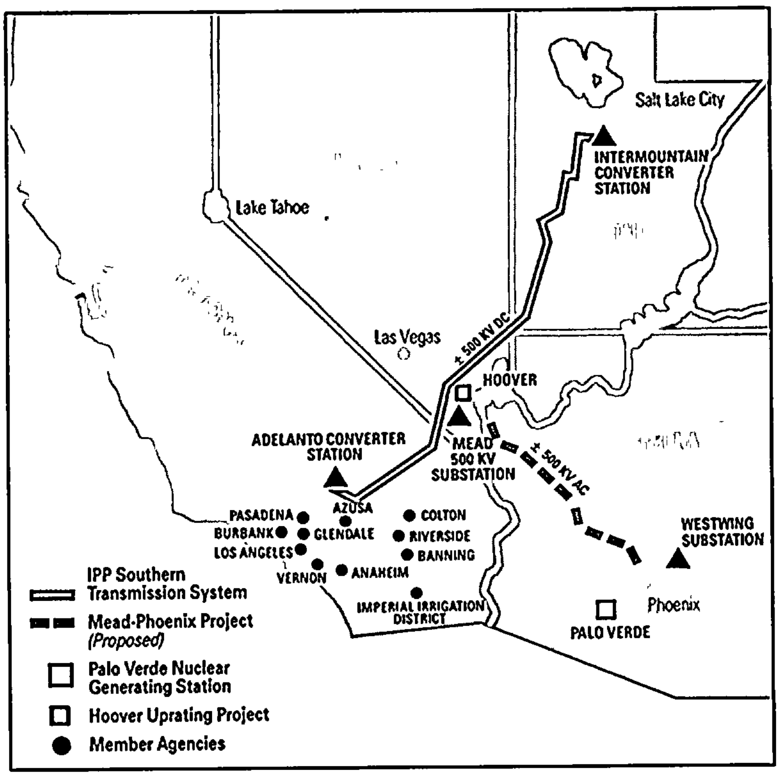

SERVICE AREA
COMPANY LINES
MAJOR DISTRIBUTION STATIONS
GENERATING STATIONS
To Albuquerque
Four Corners, N.M.
400 Miles
Holloman A.F.B.
Rio Grande River
Hatch
Arroyo
To Springerville, AZ.
White Sands
Missile Range
Amrad
Eddy County Interchange
125 Miles
PALO
VERDE
450 Miles
LAS CRUCES
Luna
McGregor Range
Anthony
NEW MEXICO
TEXAS
Newman
Rio Grande
Caliente
To Dell City
NEW MEXICO
MEXICO
Copper
Diablo
EL PASO
Ciudad
Juarez
Fabens
North
Sierra Blanca
Van Horn
Rio Grande River
TEXAS
MEXICO
Service to
Rio Grande
Electric Co-op

El Paso Electric Company
P.O. Box 982
El Paso, Texas 79960

Bulk Rate
U.S. Postage
PAID
El Paso Electric
Company

The Electric Company

3-90/75M/BP



Salt Lake City
INTERMOUNTAIN CONVERTER STATION
Lake Tahoe
Las Vegas
± 500 KV DC
HOOVER
MEAD 500 KV SUBSTATION
± 500 KV AC
ADELANTO CONVERTER STATION
AZUSA
PASADENA
BURBANK
GLENDALE
LOS ANGELES
VERNON
ANAHEIM
COLTON
RIVERSIDE
BANNING
IMPERIAL IRRIGATION DISTRICT
WESTWING SUBSTATION
Phoenix
PALO VERDE
IPP Southern Transmission System
Mead-Phoenix Project (Proposed)
Palo Verde Nuclear Generating Station
Hoover Uprating Project
Member Agencies

Southern California public power utilities have a proud tradition of providing quality electric service to their customers. As part of this continuing tradition, the Imperial Irrigation District and the municipalities of Anaheim, Azusa, Banning, Burbank, Colton, Glendale, Los Angeles, Pasadena, Riverside, and Vernon have joined together to comprise the Southern California Public Power Authority (SCPPA) as a vehicle for financing generation and transmission projects. Formed in 1980, SCPPA has gained a high level of acceptance in the financial community and has issued approximately $5.5 billion in bonds and notes, including refunding issues.

The public power members of SCPPA together serve more than 1.7 million customers and have a combined non-coincidental peak requirement of 7,183 megawatts. While there is much diversity among member utilities in terms of size, load growth patterns, and customer mix, SCPPA has proven to be effective in financing projects which economically meet power requirements of all members.

OFFICERS

Executive Director
Arthur T. Devine

Former Assistant City Attorney - City of Los Angeles
Electrical Engineer - Los Angeles Department of Water and Power

President
Gale A. Drews

Electrical Utility Director
City of Colton

Vice President
W.E. Cameron

Director of Public Service
Glendale Public Service Department

Secretary
Eldon A. Cotton

Assistant General Manager - Power
Los Angeles Department of Water and Power

Assistant Secretary
George R. Spencer

Civil Engineer for Power Contracts
Los Angeles Department of Water and Power

MESSAGE FROM THE PRESIDENT AND EXECUTIVE DIRECTOR

The Southern California Public Power Authority continued to play an instrumental role in the efforts of Southern California public power utilities to provide high quality service to utility customers in 1988-1989.

In addition to substantial progress on the Mead-Phoenix Project during the year, planning was accomplished on the Mead-Adelanto, the Palo Verde-Devers Transmission Line and the Utah-Nevada Transmission Projects.

Membership in SCPPA is one of several ways in which participating public power utilities are looking to the future to maintain a standard of excellence in serving their customers. Our member utilities have taken the lead to serve customers in more ways than only supplying power. This report describes the characteristics of individual member cities and many of the service achievements of SCPPA members.

Public power utilities are non-profit and customer owned. Therefore, the benefits derived from SCPPA and other service achievements cannot be divided into utility benefits and utility customer benefits. These benefits are one and the same since our customers are the utility.

We want to thank the staff and the Board of Directors for their hard work, dedication and professionalism in making SCPPA one of the premier financing organizations in the United States.

Gale A. Drews,
President

Arthur T. Devine,
Executive Director

MEMBER CITIES

From the power base of the Pacific Rim, Los Angeles, to the industrial town of Vernon, with only 30 residential customers, SCPPA member cities provide power to an end-user population of more than 3.5 million.

SCPPA member cities use a wide variety of power sources to provide their customers with reliable service and the lowest cost energy possible. Through their association with the SCPPA and through their own efforts, the member cities are able to include as sources for their power: the Intermountain Generating Station, entitlements in the Hoover Power Plant, Palo Verde Nuclear Generating Station, purchases from the Bonneville Power Administration, the San Onofre Nuclear Generating Station Units 2 and 3, Western Systems Power Pool, oil- and gas-fired generation in the Los Angeles Basin, and purchases from other western utilities.

Together, SCPPA member cities had total 1989 energy sales of over 30 million megawatt-hours.

Gordon W. Hoyt
General Manager
Anaheim Public Utilities Department
Anaheim, California

Mr. Hoyt is a native Californian, originally from Santa Monica. He earned his B.S. at the University of Texas and is a registered professional engineer in the state of California. Mr. Hoyt started his career in public utilities in 1947, spending 13 years with Pacific Gas & Electric, before going to work for Anaheim in 1964. He has held his current position for 25 years.

Anaheim — As one of the fastest growing population centers in the United States, the community of Anaheim continues to look forward in helping meet the energy needs of this unique community. Known the world over as the home of Disneyland and other popular tourist attractions, Anaheim is also home to over 96,000 other customers— from the California Angels baseball team to the average homeowner.

One way the Public Utilities Department better serves all its customers, large and small, is by sending a copy of its newsletter called "Currents" as a billing insert. This publication informs customers of the energy conservation programs available in their city and how to take advantage of them. One of the most successful of these efforts is the "off-peak" program which encourages customers to use their air conditioners, pool and spa motors, and other appliances during off-peak times. Customers are rewarded for participating in such energy conservation programs by a rebate, which appears as a credit on their bills. Anaheim also provides discounted "lifeline" rates for senior citizens, the handicapped, and those on life-support systems.

Partly through Anaheim's association with SCPPA, its energy rates are 23% lower than rates in nearby communities, and the Public Utilities Department is continuing to seek the lowest cost energy supplies for the future. To this end, the Anaheim Public Utilities Department has been working on many projects with SCPPA member cities, including a joint transmission line that would bring in more power from the states of Nevada and Utah. Anaheim is also financing and constructing a new combustion-turbine generator that is scheduled to start operating in 1991.

Anaheim is dedicated to providing the perfect mix of low-cost power and community services.

Joseph F. Hsu
Utility Director
City of Azusa
Azusa, California

A native of China, Mr. Hsu received his B.S. in electrical engineering from the University of Nebraska and is a registered professional engineer in the states of Nebraska and California. He moved to California in 1983 and has been the Director of Utilities in Azusa ever since.

Azusa — "Everything from A to Z in the USA" is Azusa's city slogan, and the Utilities Department is taking that slogan to heart -- both in long-term power goals and in the services offered to its residential and industrial customers.

By participating in joint transmission line projects with fellow SCPPA members and by looking for other long-term power purchase contracts, Azusa is determined to have as many options possible to supply energy and power to its citizens.

New sources of power are just one way to improve service to customers,

conservation is another. The Azusa Utilities Department has instituted a streetlight conservation plan— changing all the old mercury vapor streetlights into power-saving sodium vapor models. In this dry inland area, the deep-water well pumps also work hard; and Azusa is making sure these are all reconditioned to work at maximum efficiency.

For those customers interested in learning more on conservation, the Utilities Department provides free education materials including brochures and slide shows. Special discounted rates are offered to "total electric" homes. As with other SCPPA member cities, Azusa's main long-term energy goal is to negotiate contracts for new energy projects and continue to acquire the best options to provide energy service to its citizens.

Timothy Dempsey
Public Utilities Director
City of Banning
Banning, California

Mr. Dempsey began his career in utilities as a lineman in New York in 1961. After earning his B.S. in industrial safety from San Diego State, he then went on to law school at Western State University in San Diego. Mr. Dempsey managed an energy co-op in Washington state before joining the Banning utilities as Director in 1987.

Banning— As the gateway to California's Colorado Desert, Banning is a fast-growing community with fast-growing energy needs. To meet the power requirements, Banning's Public Utilities Department has instituted a number of building and conservation programs to serve its customers.

These programs include a new pumped-storage project, joint projects with fellow SCPPA member cities, and a transition to generating during off-peak hours to displace the high cost of peak-time generation.

Conservation is important in desert towns, and Banning is no exception. To meet its energy conservation objectives, the City of Banning has converted the city streetlights from the old mercury vapor models to power-saving sodium vapor models. They have also been upgrading the voltage level of their distribution system, which will conserve energy.

Banning's location in the high desert means a huge variance in temperatures, not only from summer to winter but day to night. Banning's temperature can slide from a high of 120 to a low near freezing in one 24-hour period. To help customers cope with these extremes, the utility provides special lifeline rates, at a base of 250 kilowatts in winter to 500 in summer for the entire community.

Another large community undertaking is Banning's new hydro project which was completed in August 1989. This project utilizes water from natural flows to provide power to the city.

A new development in the community will provide 4,500 new homes in Banning— new homes and customers that will require the full services of an efficient power company. Luckily for Banning residents, their public utility has its eyes toward the future and plans to continue the tradition of providing low-cost energy and high-quality community services.

Ronald V. Stassi
General Manager
Burbank Public Service Department
Burbank, California

A native Californian, Mr. Stassi received his B.S. in electrical engineering from San Jose State University. He added to his education by attending the University of Southern California, earning both an M.S. in electrical engineering and an MBA. Mr. Stassi worked as a principal electrical engineer for the city of Burbank before assuming his current position in 1988.

Burbank — When customers of the Burbank Public Service Department call the power company to ask that a representative visit their home, it is not because something has gone wrong. They are just using one of the new "energy audit" services provided free of charge. A utility representative will survey the residence or place of business and provide tips on how to use energy more efficiently — aiding in conservation and saving the customer money.

Burbank is a city of 91,000 residents and is home to many a major movie and television studios and aerospace firms. All of these customers keep Burbank's power demands high, and the Public Service Department is moving its programs into the future to make sure the energy needs of the community are met.

A new system to monitor system conditions and do remote switching, startup, and shutdown is in place, providing improved reliability and the ability to address outages more promptly.

Many SCPPA member agencies conduct programs to educate students about electricity, including its conservation and safe use.

In addition to providing "lifeline" rates for low-income seniors and the handicapped, the Burbank Public Service Department co-sponsors fund raisers in association with the International Brotherhood of Electrical Workers that benefit the burn ward in a local hospital.

In response to the growing concern over air pollution in the Los Angeles Basin, Burbank uses several transmission lines to bring in off-system energy from outside sources. By reducing the total generation in the Los Angeles Basin, the residents benefit both economically and in terms of improved air quality.

Gale A. Drews
Electrical Utility Director
City of Colton
Colton, California

Born in Kansas, Mr. Drews was raised on a farm and educated in his home state prior to beginning employment with the Utilities Department of Colton 30 years ago. As electric utility director for the past 13 years, he has led Colton's development of its own resources to meet its customers' needs.

Colton — Located 55 miles east of Los Angeles, Colton is a rapidly growing community of over 37,000 residents. Colton has been known as the "Hub City" for more than a century, as it was located on the main line of three major railroads. It is also the meeting point for three major interstate highways.

Colton has experienced a recent population boom as has much of San Bernardino County. Its energy requirements have matched this growth which has made resource procurement and energy efficiency major factors in the Utility's planning efforts.

The Utility reached a new peak power requirement of 47.2 megawatts during the year, while sales totaled over 179,000 megawatt-hours for the same period. New power contracts from the California Department of Water Resources, City of Pasadena and Pacific Gas and Electric further reduces dependence on purchases from Southern California Edison. Other resources include Palo Verde Nuclear Generation Station, Hoover Power Plant and economy energy purchases.

The Utility initiated several new energy programs for customers during the year, including load management, weatherization, residential energy audit and a community-wide information program as well as a California Energy Commission efficiency program to reduce energy costs in municipal operations. By focusing on energy efficiency in new municipal construction projects as well as for existing customers, Colton is committed to using energy resources in a prudent and efficient manner.

Glendale — With Glendale's central business district undergoing a comprehensive redevelopment effort, the Glendale Public Service Department is standing ready to serve the existing and new customers' energy needs.

W.E. Cameron
Director of Public Service
Glendale Public Service Department
Glendale, California

Mr. Cameron is celebrating his 40th year of government service. He received his B.S. from Washington State University before continuing to University of Southern California for his M.A. in public administration. Mr. Cameron has been with the Glendale Public Service Department since 1971.

The large growth in apartment house, condominiums, and commercial building market has added over 10,000 new customers in the last five years. To meet the added energy needs, Glendale is also working jointly with SCPPA members in a comprehensive study of transmission line projects to bring in low-cost power from Utah, Arizona and Nevada.

Glendale is replacing its older overhead distribution facility with a more modern underground system, improving the community's appearance in the process.

Many of the employees of the Glendale Public Service Department are active in civic projects, bringing the Public Service Department 's pledge to provide the most reliable service at a "reasonable cost" to the heart of the community.

Los Angeles — A leader in both conservation and consumer-oriented projects, the Los Angeles Department of Water and Power (DWP) is a model for many utilities across the country.

The community involvement of the DWP is wide-ranging and touches all layers of the customer base. Los Angeles was first to institute a Senior Citizen Lifeline Program, which provides low-cost energy to seniors and the handicapped. It has an

Eldon A. Cotton
Assistant General Manager - Power
Los Angeles Department of Water and Power
City of Los Angeles
Los Angeles, California

Originally from Cordell, Oklahoma, Mr. Cotton earned his B.S. in civil engineering from San Jose State University. He later attended University of Southern California, earning his certificate in public administration and M.S. in civil engineering. Mr. Cotton began his career with the Los Angeles Department of Water and Power in 1965 and was named Assistant General Manager-Power in November 1988.

innovative program that educates schools on energy conservation; if the school is able to save 10% off its regular bill, the school district rebates 5% of the money saved to the school. A $5,000 scholarship with the stated goal of encouraging women and minorities to pursue engineering is given to 13 area universities each year. DWP's community outreach program provides a liaison to between 50 and 100 community groups such as the NAACP and Southern California Businessman's Association to help these groups solve their water and power issues.

Because of the importance of the area's air quality, DWP consumer conservation programs receive great emphasis. DWP issued over $4 million in energy-incentive programs this year alone. These incentives were offered in its thermal storage program, high-efficiency heat pump program, and lighting-efficiency improvement program. In addition to the incentive programs, DWP provides energy audits free of charge to customers, surveying their homes and businesses, and suggesting ways for them to reduce energy use.

DWP is working with many of the SCPPA member cities on transmission line projects -- bringing in power from outside sources without increasing the pollutants in the basin. It is planning on repowering existing Harbor Generating units with combined cycle units to increase efficiency and reduce air pollution. Within the next three years, DWP plans to begin its COSO Geothermal Project, using steam from the earth to generate electricity -- another pollution free energy source.

Pasadena — The Pasadena Water and Power Department has gone "lite" — introducing its "Lite-Bill Program" to customers. Having received permission from the Miller Brewing Company to use their trademarked phrase, the Department will start its door-to-door energy- and water-use surveys in November 1989. Utility service personnel will visit area homes and conduct comprehensive energy- and water-use surveys. Later the customer is provided with a computer printout with suggested modifications and improvements that can result in a "Lite Bill".

The Pasadena Water and Power Department also gives an annual scholarship to a local high school student, up to $4,000 per year for four years. Financially disadvantaged students have been able to pursue engineering studies at UCLA, California Polytechnic Institute, and Howard University in Washington, D.C., thanks to this scholarship.

David C. Plumb
General Manager
Pasadena Water and Power Department
Pasadena, California

After receiving his B.S. in engineering from Arizona State University, Mr. Plumb began his work in public utilities in 1970 in Phoenix, Arizona. Subsequently, he received his MBA from ASU in 1978. He worked briefly for a consultant and managed a utility in Longmont, Colorado, before coming to Pasadena in 1987.

Pasadena had been a growing community for over a century, as evidenced by the city's celebration of the 100th anniversary of the Tournament of Roses in January 1989. However, a commercial growth-control initiative was recently passed, which may impact the growth of energy use as well. Even with the rate of future growth limited, the Pasadena Water and Power Department has been concentrating on the upgrading of systems and plans for increased energy efficiency to better its available resources.

This year Pasadena Water and Power Department conducted a feasibility study for the life extension of the Broadway Power Plant, a three-unit facility that supplies about 40% of Pasadena's power. Repowering these units will help Pasadena keep pace with the growing demand of its customers.

Riverside — Riverside recently implemented an innovative assistance program, the "SHARE Program". When customers receive their bill, they can check off a box and round it up by a dollar or two. This program provides money to elderly and low-income customers who cannot afford to pay the utility deposit. The utility pays

Bill D. Carnahan
Public Utilities Director
Riverside Public Utilites Department
Riverside, California

After earning his B.S. in electrical engineering from Colorado State University, Mr. Carnahan pursued a career in public utilities before becoming the utilities manager in Fort Collins, Colorado. He joined Riverside Public Utilities as Director in 1986.

the administrative costs of the program, and the rest is a customer-helping-customer program.

In the hot climate of Riverside, a Thermal Energy Storage Program encourages customers to install air-conditioning systems that are more efficient and shifts energy use to off-peak hours. This program also educates commercial customers about the benefits of running large equipment during the off-peak hours.

The Riverside Public Utilities Department is meeting its goal of reliable service at a low cost. In a recent survey, customers rated the Department high in all service categories. This was accomplished without raising electric rates since 1984; in fact, beginning July 1, 1989, customers received a 7% reduction in their bills.

Bruce V. Malkenhorst
Executive Director of Light and Power
City of Vernon
Vernon, California

Mr. Malkenhorst is a native of the Los Angeles area and received his B.A. from Woodbury University in Burbank. He has been the Director of Light and Power for the last eight years and is also the city administrator. Mr. Malkenhorst is pleased to be in a position where he can assist in controlling energy costs for his constituents.

Vernon — The city of Vernon was founded in 1905, a 5.06- square mile area planned from its inception as an industrial city. In fact, the Vernon Light and Power Department has over 2,000 commercial customers but only 30 residential customers!

Since the Department's biggest effort is keeping rates as low as possible, it is participating with fellow SCPPA member cities on transmission projects that will bring low-cost power to the participating cities. Vernon recently hired an energy conservation specialist who works with customers, inspects their plants, and makes energy-saving recommendations — free of charge.

The Department recently installed a Supervisory Control and Data Acquisition System, which enables more efficient system monitoring from one central location.

Imperial Irrigation District — The Coachella Power Division of the Imperial Irrigation District is on a rapid march toward the future, not only in its major building projects, but also in its plans for customer service as well.

With several building projects, the Imperial Irrigation District is busy indeed. Among the projects are a new $5 million substation, an 11-1/4-mile extension of existing transmission lines, upgrading an existing substation, upgrading the El Centro Switching Station, and upgrading the distribution system to provide power for a new fashion mall in Indio. With all this activity, it is easy to see why Imperial is also building a new operations center headquarters for the utility in the Coachella area.

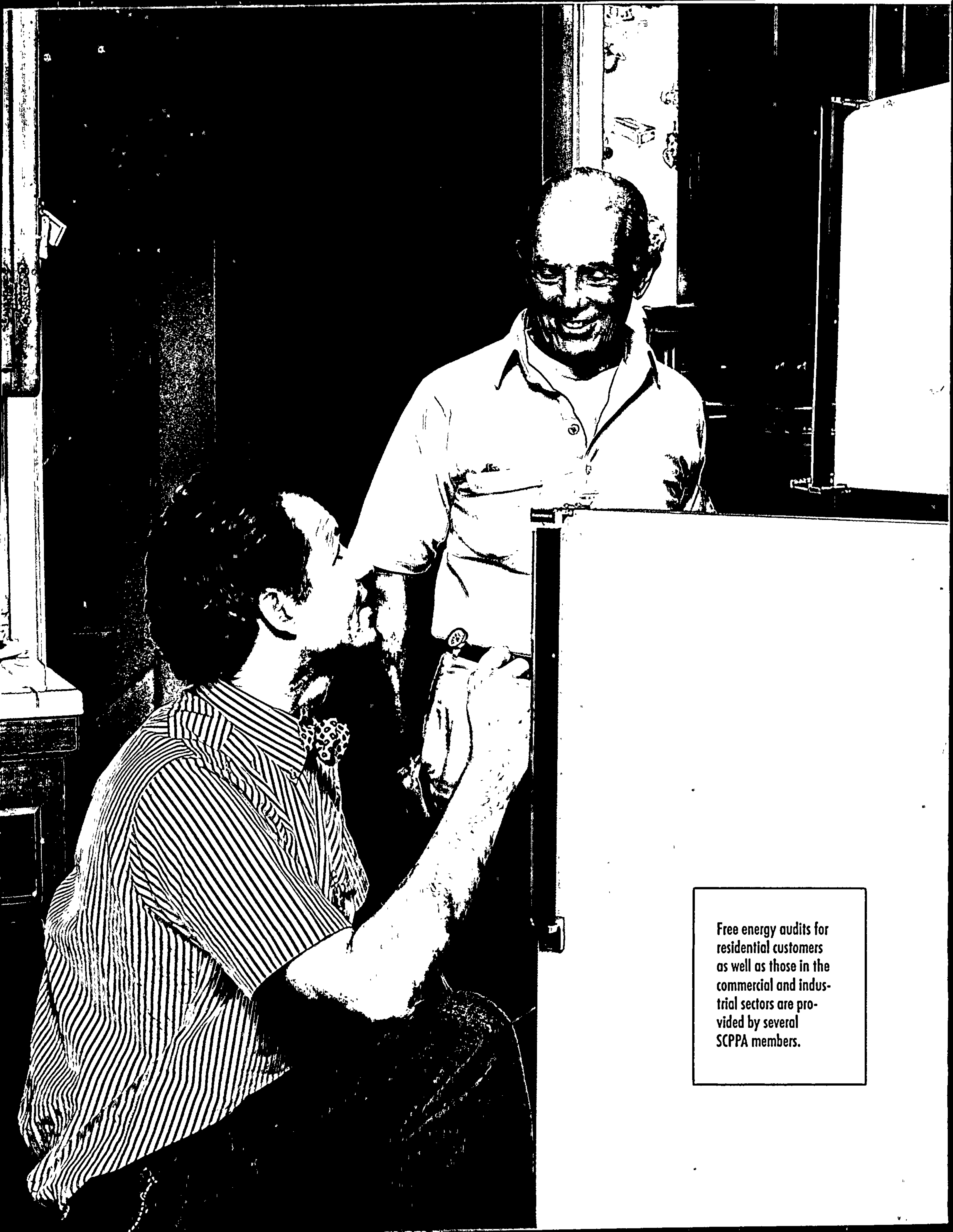
Kenneth S. Noller
Assistant Power Manager
Coachella Power Division
Imperial Irrigation District
Imperial, California

A native of Findlay, Ohio, Mr. Noller earned his B.S. in electrical engineering from Ohio Northern University. He is a licensed electrical engineer in the state of California and joined the Coachella/Imperial District in 1985.

There is also plenty of activity when it comes to its customer services. Free-of-charge energy surveys are done for customers upon request. After an in-home survey, the utility provides a computer printout showing ways to cut costs in that particular home, including weather-stripping, use of different appliances, water heater blankets, etc. Another service provides customers who install energy-saving air conditioners with rebates on their bill.

One particularly far-reaching program is the utility's energy use survey — every two years, 5% of all customers are surveyed for information on home construction, appliances, and energy use so that the utility can enhance the precision of service needs in the future. By really pinpointing potential problem areas now, the utility is effectively planning how to reduce the area's load in cost-effective ways.

The Coachella Power Division's commitment to its community shows up in its nationally-recognized electrical safety program, currently being demonstrated to police and fire departments, service clubs, schools, and churches.



Free energy audits for residential customers as well as those in the commercial and industrial sectors are provided by several SCPPA members.

AUTHORITY OPERATIONS

Palo Verde Nuclear Generating Station — SCPPA has a 5.91-percent interest in the Palo Verde Nuclear Generating Station and receives up to 216 megawatts (based on the licensed reactor thermal power level per unit of 1,221 megawatts).

With three units on line, this station, which is located about 50 miles west of Phoenix, Arizona, has a current capacity of approximately 3,810 megawatts. A net annual output of more than 23 million megawatt-hours is projected from Palo Verde by the early 1990's.

Ten member agencies have contracted with SCPPA for entitlement in Palo Verde. The station's output will be used to meet increases in demand, to replace purchased power, and to displace oil- and gas-fired generation in the Los Angeles Basin.

Additional savings for participating members were created when SCPPA took advantage of lower interest rates by issuing approximately $1.5 billion in refunding bonds. Over the life of the project, this will result in a gross debt savings of about $286 million.

The Palo Verde Nuclear Generating Station is managed by Arizona Public Service Company, with the switchyard portion operated by the Salt River Project.

Southern Transmission System — Six SCPPA members receive power via the Southern Transmission System. While the distribution to members is local, the source of the power is 488 miles away at the Intermountain Generating Station (IGS) in Utah. It is comprised of two coal-fueled generating units with a combined capacity of 1,600 megawatts of alternating current. An adjacent converter station changes the electricity to direct current. The ±500-kilovolt Southern Transmission System carries the direct current over the desert and mountains to the Adelanto Converter Station where the direct current is changed back to alternating current.

Members receiving power over the system will use it to meet load growth, reduce purchases from Edison, and to displace Los Angeles based oil- and gas-fired generation.

SCPPA's four refunding sales totaling approximately $1.3 billion will produce a gross debt savings over the life of the project of approximately $745 million.

Los Angeles manages and operates the project which is owned by the Intermountain Power Agency, a political subdivision of the State of Utah. A total of 36 utilities in Utah, California, and Nevada have power entitlements in the IGS.

Hoover Uprating Project — The Hoover Power Plant is now over 50 years old. The U.S. Bureau of Reclamation took over operation of the plant in 1986 and is in the process of uprating Hoover's 17 original generators.

Six SCPPA members have contracted with the Authority to furnish their share of the uprating costs and to help with the uprating. SCPPA has issued approximately $34.4 million in bonds to finance these costs.

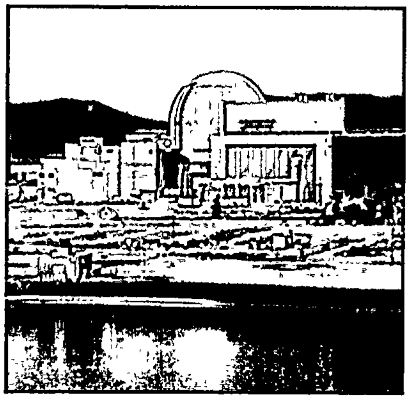
The project is scheduled for completion in 1992 and will increase Hoover's capacity from 1,450 megawatts to 1,903 megawatts. Uprated units are returned to service immediately and participating members have begun receiving energy and capacity entitlements. As more units are completed, a full entitlement of 94 megawatts is expected in 1992 for those members participating through SCPPA.

The increase is made possible by installation of modern stator windings and turbine impellers and the upgrading

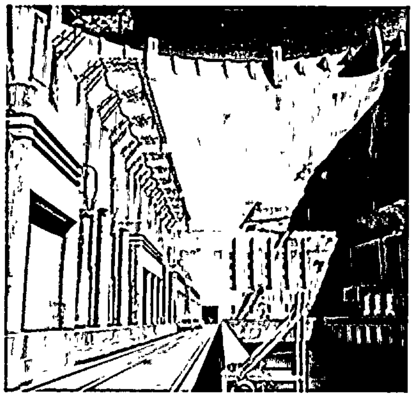
of various auxiliary equipment. Replacement of existing transformer banks will increase plant efficiency. Additional plant improvements include consolidation of control rooms and modernization to provide for automatic and remote control.

Mead-Phoenix Transmission Project — The feasibility of constructing, owning, and operating a 500-kilovolt alternating-current transmission line between Boulder City, Nevada, and the Phoenix, Arizona area is being studied by SCPPA and other agencies.

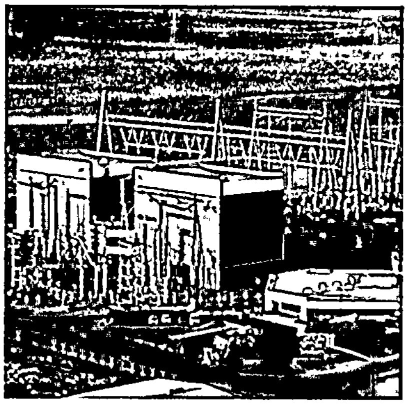
In addition to SCPPA, Salt River Project, M-S-R Public Power Agency, and Western Area Power Administration are participating in the study project. The 240-mile transmission line could be converted to a direct-current system at a future date. It is estimated that this facility, if built, would be in service in the mid-1990s.



Ten SCPPA members benefit from power produced at the Palo Verde Nuclear Generating Station.



Uprating of the units at Hoover Power Plant will result in additional capacity entitlements to six SCPPA members.



Adelanto Converter Station is the western terminus of the Southern Transmission System.

REPORT OF INDEPENDENT ACCOUNTANTS

August 25, 1989

To the Board of Directors of
Southern California Public
Power Authority

In our opinion, the accompanying combined balance sheet and the related combined statements of operations and of cash flows present fairly, in all material respects, the financial position of the Southern California Public Power Authority (Authority) at June 30, 1989 and 1988, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Authority's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

In our opinion, the accompanying separate balance sheets and the related separate statements of cash flows of the Authority's Palo Verde Project, Southern Transmission System Project, Hoover Uprating Project and Mead-Phoenix Project, and the separate statements of operations of the Palo Verde Project, Southern Transmission System Project and Hoover Uprating Project present fairly, in all material respects, the financial position of each of the Projects at June 30, 1989, and their cash flows and the results of operations of the Palo Verde Project, Southern Transmission System Project and Hoover Uprating Project for the year, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Authority's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. We believe that our audits provide a reasonable basis for the opinion expressed above.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental financial information, as listed in the accompanying index, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Price Waterhouse

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
COMBINED BALANCE SHEET
(In thousands)

	June 30, 1989					
	Palo Verde Project	*Southern Transmission System Project*	*Hoover Uprating Project*	*Mead-Phoenix Project*	*Total*	*June 30, 1988 Total*
ASSETS						
Utility plant						
Production	$ 600,778				$ 600,778	$ 600,458
Transmission	6,008	$ 661,255			667,263	662,761
General	186	18,857			19,043	18,805
	606,972	680,112			1,287,084	1,282,024
Less—Accumulated depreciation	56,180	57,272			113,452	72,288
	550,792	622,840			1,173,632	1,209,736
Construction work in progress	3,569	4,287		$12,999	20,855	15,540
Nuclear fuel, at amortized cost	26,428				26,428	31,330
Net utility plant	580,789	627,127		12,999	1,220,915	1,256,606
Special funds						
Investments	110,678	95,927	$18,747	1,089	226,441	260,146
Advance to Intermountain Power Agency		20,161			20,161	20,161
Advances for capacity and energy, net			10,218		10,218	6,009
Interest receivable	1,630	1,174	292		3,096	3,323
Cash and cash equivalents	107,672	63,295	5,640	65	176,672	141,737
	219,980	180,557	34,897	1,154	436,588	431,376
Accounts receivable	3,635	547			4,182	836
Materials and supplies	6,859				6,859	6,528
Costs recoverable from future billings to participants	58,587	80,807	(1,004)		138,390	114,648
Deferred costs						
Unamortized debt expenses, less accumulated amortization of $46,363 and $36,164 in 1989 and 1988	228,150	174,258	1,107		403,515	373,600
Other deferred costs	864				864	1,309
	229,014	174,258	1,107		404,379	374,909
	$1,098,864	$1,063,296	$35,000	$14,153	$2,211,313	$2,184,903
LIABILITIES						
Long-term debt	$1,043,540	$1,014,443	$34,296	$ 100	$2,092,379	$2,061,937
Current liabilities						
Long-term debt due within one year	14,370	5,825			20,195	29,403
Accrued interest	36,219	37,259	689	1	74,168	77,224
Accounts payable and accrued expenses	4,735	5,769	15	4	10,523	16,339
	55,324	48,853	704	5	104,886	122,966
Advances from participants				14,048	14,048	
Commitments and contingencies						
	$1,098,864	$1,063,296	$35,000	$14,153	$2,211,313	$2,184,903

The accompanying notes are an integral part of these financial statements.

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
COMBINED STATEMENT OF OPERATIONS
(In thousands)

	Year ended June 30, 1989				
	Palo Verde Project	*Southern Transmission System Project*	*Hoover Uprating Project*	*Total*	*Year ended June 30, 1988*
Operating revenues					
Sales of electric energy	$110,164		$2,760	$112,924	$ 88,358
Sales of transmission services		$94,769		94,769	82,332
Total operating revenues	110,164	94,769	2,760	207,693	170,690
Operating expenses					
Nuclear fuel expenses	10,628			10,628	9,042
Other operation	19,635	8,137	1,127	28,899	23,194
Maintenance	5,518	3,205		8,723	9,547
Depreciation	17,427	19,207		36,634	33,564
Decommissioning	5,699			5,699	4,652
Expense charged to project during construction					(520)
Total operating expenses	58,907	30,549	1,127	90,583	79,479
Operating income	51,257	64,220	1,633	117,110	91,211
Investment income	18,239	10,784	2,033	31,056	35,060
Income before debt expenses	69,496	75,004	3,666	148,166	126,271
Debt expenses					
Interest on debt	85,116	84,035	2,757	171,908	173,308
Allowance for borrowed funds used during construction					(16,699)
Total debt expenses	85,116	84,035	2,757	171,908	156,609
Costs recoverable from future billings to participants	$(15,620)	$(9,031)	$ 909	$(23,742)	$(30,338)

The accompanying notes are an integral part of these financial statements.

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
COMBINED STATEMENT OF CASH FLOWS
(In thousands)

	Year ended June 30, 1989					
	Palo Verde Project	*Southern Transmission System Project*	*Hoover Uprating Project*	*Mead-Phoenix Project*	*Total*	*Year ended June 30, 1988 Total*
Cash flows from operating activities:						
Costs recoverable from future billings to participants	$ (15,620)	$ (9,031)	$ 909		$ (23,742)	$ (30,338)
Adjustments to arrive at net cash provided by operating activities:						
Depreciation	26,955	19,207			46,162	41,119
Decommissioning	5,699				5,699	4,652
Amortization of debt costs	12,017	9,125	54		21,196	17,692
Changes in current assets and liabilities:						
Interest receivable	574	(319)	(28)		227	1,900
Accounts receivable	(2,799)	(547)			(3,346)	4,751
Materials and supplies	(331)				(331)	(6,528)
Other assets	15				15	(198)
Accrued interest	(1,354)	(1,352)			(2,706)	119
Accounts payable and accrued expenses	(7,582)	1,767	7		(5,808)	(1,994)
Net cash provided by operating activities	17,574	18,850	942		37,366	31,175
Cash flows from investing activities:						
Payments for construction of facility	(7,781)	(7,990)			(15,771)	(39,197)
Advances for capacity of energy, net			(4,209)		(4,209)	(2,945)
Payments for feasibility study				$ (703)	(703)	(1,061)
Purchases of investments	(101,134)	(61,515)	(10,248)	(4,818)	(177,715)	(285,881)
Proceeds from sale of investments	130,015	63,748	12,085	5,572	211,420	311,526
Refund from Intermountain Power Agency						820
Net cash provided by (used for) investing activities	21,100	(5,757)	(2,372)	51	13,022	(16,738)
Cash flows from financing activities:						
Proceeds from sale of refunding bonds	185,200	156,050			341,250	
Payment for bond issue costs	(4,325)	(2,457)			(6,782)	
Payment for defeasance of revenue bonds	(180,827)	(153,739)			(334,566)	
Payment for principal of long-term debt	(13,095)	(2,260)		(14,048)	(29,403)	
Proceeds from advances from participants				14,048	14,048	
Net cash used for financing activities	(13,047)	(2,406)		—	(15,453)	
Net increase (decrease) in cash and cash equivalents	25,627	10,687	(1,430)	51	34,935	14,437
Cash and cash equivalents at beginning of year	82,045	52,608	7,070	14	141,737	127,300
Cash and cash equivalents at end of year	$ 107,672	$ 63,295	$ 5,640	$ 65	$ 176,672	$ 141,737
Supplemental disclosure of cash flow information:						
Cash paid during the year for interest (net of amount capitalized)	$ 73,871	$ 72,906	$ 2,757	$ —	$ 149,534	$ 138,306

The accompanying notes are an integral part of these financial statements.

NOTE A—Organization and purpose:
Southern California Public Power Authority (Authority), a public entity organized under the laws of the State of California, was formed by a Joint Powers Agreement dated as of November 1, 1980 pursuant to the Joint Exercise of Powers Act of the State of California. The Authority's participant membership consists of ten Southern California cities and one public district of the State of California. The Authority was formed for the purpose of planning, financing, developing, acquiring, constructing, operating and maintaining projects for the generation and transmission of electric energy for sale to its participants. The Joint Powers Agreement has a term of fifty years.

The members have the following participation percentages in the Authority's interest in the four projects:

Participant	Palo Verde	Southern Transmission System	Hoover Uprating	Mead-Phoenix
City of Los Angeles	67.0%	59.5%		61.2%
City of Anaheim		17.6	42.6%	15.0
City of Riverside	5.4	10.2	31.9	6.0
Imperial Irrigation District	6.5			
City of Vernon	4.9			3.0
City of Azusa	1.0		4.2	.6
City of Banning	1.0		2.1	.6
City of Colton	1.0		3.2	.6
City of Burbank	4.4	4.5	16.0	5.0
City of Glendale	4.4	2.3		5.0
City of Pasadena	4.4	5.9		3.0
	100.0%	100.0%	100.0%	100.0%

Palo Verde Project—The Authority, pursuant to an assignment agreement dated as of August 14, 1981 with the Salt River Project Agricultural Improvement and Power District, purchased a 5.91% interest in the Palo Verde Nuclear Generating Station (PVNGS), a 3,810 megawatt nuclear-fueled generating station near Phoenix, Arizona, and a 6.55% share of the right to use certain portions of the Arizona Nuclear Power Project Valley Transmission System (collectively, the Palo Verde Project). As of July 1, 1981, ten participants had entered into power sales contracts with the Authority to purchase the Authority's share of PVNGS capacity and energy. Units 1, 2 and 3 of the Palo Verde Project began commercial operation in January and September 1986, and January 1988, respectively.

Southern Transmission System Project—The Authority, pursuant to an agreement dated as of May 1, 1983 with the Intermountain Power Agency (IPA), has agreed to make payments-in-aid of construction to IPA to defray all the costs of acquisition and construction of the Southern Transmission System Project (STS), a transmission line which will provide for the transmission of energy from the Intermountain Power Project (IPP) in Utah to Southern California. The Authority entered into an agreement also dated as of May 1, 1983 with six of its participants pursuant to which each member assigned its entitlement to capacity of STS to the Authority in return for the Authority's agreement to make payments-in-aid of construction to IPA. STS commenced commercial operations in July 1986. The Department of Water and Power of the City of Los Angeles, a member of the Authority, has served as project manager and operating agent of IPP.

Hoover Uprating Project—The Authority and six participants entered into an agreement dated as of March 1, 1986, pursuant to which each participant assigned its entitlement to capacity and associated firm energy to the Authority in return for the Authority's agreement to make advance payments to the United States Bureau of Reclamation (USBR) on behalf of such participants. Construction is scheduled for completion by September 1992. The Authority will have an 18.68% interest in the contingent capacity of the Hoover Uprating Project. Several "uprated" generators of the Hoover Uprating Project commenced commercial operations during June 1987.

Mead-Phoenix Project—The Authority has also studied the feasibility of constructing the proposed Mead-Phoenix Project, a transmission line from Arizona to Nevada. The Authority's present interest in the Mead-Phoenix Project is 93.75%. The feasibility study is substantially complete and present plans call for the Authority to decide whether to continue with the project in fiscal year 1990.

NOTE B—Summary of significant accounting policies:
The financial statements of the Authority are presented in conformity with generally accepted accounting principles, and substantially in conformity with accounting principles prescribed by the Federal Energy Regulatory Commission and the California Public Utilities Commission. The Authority is not subject to regulations of such commissions.

Utility plant—All expenditures, including general administrative and other overhead expenses, payments-in-aid of construction, interest net of related investment income, deferred cost amortization and the fair value of test power generated and delivered to the participants are capitalized as utility plant construction work in progress until a facility begins commercial operation.

The Authority's share of costs associated with PVNGS is included as utility plant. Depreciation expense is computed using the straight-line method based on the estimated service life of thirty-five years. Nuclear fuel is amortized and charged to expense on the basis of actual thermal energy produced relative to total thermal energy expected to be produced over the life of the fuel. Under the provisions of the Nuclear Waste Policy Act of 1982, the Authority is charged one mill per kilowatt-hour on its share of electricity produced by PVNGS. The Authority records this charge as a current year expense.

The costs associated with STS are included as utility plant. Depreciation expense is computed using the straight-line method based on the estimated service lives, principally thirty-five years.

Advances for capacity and energy—Advance payments to USBR for the uprating of the 17 generators at the Hoover Power Plant are included in advances for capacity and energy. These advances are being reduced by USBR billings to participants for energy and capacity.

Nuclear decommissioning—Decommissioning of PVNGS is projected to start sometime after 2027. The Authority is providing for its share of the estimated future decommissioning costs

over the life of the nuclear power plant through annual charges to expense.

A Nuclear Decommissioning Fund has been established. The deposits to the fund plus the interest earnings on the fund balances are expected to be sufficient to pay the Authority's share of the decommissioning costs.

Deferred costs—Deferred costs are shown net of accumulated amortization. Unamortized debt issue costs, including the cost of refunding, are amortized over the terms of the respective issues. Other deferred costs are amortized generally over five years.

Investments—Investments include United States Government and governmental agency securities and repurchase agreements which are collateralized by such securities. These investments are stated at amortized cost, which in general is not in excess of market. As discussed in Note C, all of the investments are restricted as to their use.

Cash and cash equivalents—Cash and cash equivalents include cash and all investments with maturities less than ninety days.

Revenues—Revenues consist of billings to participants for the sales of electric energy and of transmission service in accordance with the participation agreements. Generally, revenues are fixed at a level to recover all operating and debt service costs over the commercial life of the plant. (See Note F).

Debt expenses—Debt expenses include interest on debt, and the amortization of bond discounts, debt issue and refunding costs.

NOTE C—Special funds:

The Bond Indentures for three of the four projects require the following special funds to be established to account for the Authority's receipts and disbursements. The moneys and investments held in these funds are restricted in use to the purposes stipulated in the bond indentures. A summary of these funds follows:

Fund	Held by	Purpose
Construction	Trustee	To disburse funds for the acquisition and construction of the Project
Debt Service	Trustee	To pay interest and principal related to the Revenue Bonds
Revenue	Trustee	To initially receive all revenues and disburse them to other funds
Operating	Trustee	To pay operating expenses
Reserve and Contingency	Trustee	To pay capital improvements and make up deficiencies in other funds and, in the case of the Palo Verde Project, accumulate funds for decommissioning
General Reserve	Trustee	To make up any deficiencies in other funds
Advance Payments	Trustee	To disburse funds for the cost of acquisition of capacity

Special funds, in thousands, were as follows:

	June 30,			
	1989		1988	
Project	Carrying Value	Market	Carrying Value	Market
Palo Verde	$219,980	$225,200	$223,808	$231,600
Southern Transmission System	180,557	180,400	171,784	171,100
Hoover Uprating	34,897	34,800	33,927	33,600
Mead-Phoenix	1,154	1,200	1,857	1,900
	$436,588	$441,600	$431,376	$438,200

Palo Verde Project—The special funds required by the Bond Indenture contain balances, in thousands, as follows:

	June 30,	
	1989	1988
Construction Fund—		
Initial Facilities Account	$ 49,415	$ 48,666
Debt Service Fund—		
Debt Service Account	63,733	63,780
Debt Service Reserve Account	90,217	90,050
Bond Anticipation Note Fund	30	30
Revenue Fund	353	421
Operating Fund	5,644	11,155
Reserve and Contingency Fund	10,588	9,706
Total Special Funds	$219,980	$223,808

Southern Transmission System Project—The special funds required by the Bond Indenture contain balances, in thousands, as follows:

	June 30,	
	1989	1988
Construction Fund—		
Initial Facilities Account	$ 5,309	$ 10,310
Debt Service Fund—		
Debt Service Account	43,548	41,086
Debt Service Reserve Account	88,948	89,079
Revenue Fund		1
Operating Fund	6,814	7,239
General Reserve Fund	15,777	3,908
Total Special Funds	$160,396	$151,623

At June 30, 1989 and 1988, the Authority had non-interest bearing advances outstanding to IPA of $20,161,000.

Hoover Uprating Project—The special funds required by the Bond Indenture contain balances, in thousands, as follows:

	June 30,	
	1989	1988
Advance Payments Fund	$19,947	$23,244
Revenue Fund	7	
Operating Working Capital Fund	400	340
Debt Service Fund—		
Debt Service Account	710	714
Debt Service Reserve Account	3,615	3,620
Total Special Funds	$24,679	$27,918

At June 30, 1989 and 1988, the Authority had non-interest bearing advances to USBR of $10,218,000 and $6,009,000, respectively.

Mead-Phoenix Project—At June 30, 1989 and 1988, the balance in the Development Fund was $1,154,000 and $1,857,000, respectively, of which substantially all were invested in securities of the United States Government.

NOTE D—Long-term debt:

Palo Verde Project—To finance the purchase and construction of the Authority's share of the Palo Verde Project, the Authority issued Power Project Revenue Bonds pursuant to the Authority's Indenture of Trust dated as of July 1, 1981 (Bond Indenture), as amended and supplemented. Reference is made to the Combined Schedule of Long-Term Debt at June 30, 1989 for details related to outstanding bonds.

The Bond Indenture provides that the Revenue Bonds shall be special, limited obligations of the Authority payable solely from and secured solely by (1) proceeds from the sale of bonds; (2) all revenues, incomes, rents and receipts attributable to the Palo Verde Project (see Note E) and interest on all moneys or securities (other than in the Construction Fund) held pursuant to the Bond Indenture; and (3) all funds established by the Bond Indenture (excluding the Decommissioning Account in the Reserve and Contingency Fund); subject to the provisions of the Palo Verde Project Bond Indenture providing for the application thereof.

All outstanding Power Project Revenue Term Bonds, at the option of the Authority, are subject to redemption prior to maturity.

The Bond Indenture requires mandatory sinking fund instalments to be made beginning in fiscal year 1998 for the 1982 Series A Bonds, 1999 for the 1982 Series B Bonds and the 1983 Series A Bonds, 2001 for the 1984 Series A Bonds and the 1985 Series A Bonds, 2003 for the 1986 Series A Bonds, the 1986 Series B Bonds and the 1987 Series A Bonds and 2005 for the 1985 Series B Bonds and 1989 Series A Bonds. Scheduled principal maturities for the Palo Verde Project during the five fiscal years following June 30, 1989 are $14,370,000 in 1990, $15,255,000 in 1991, $16,325,000 in 1992, $17,530,000 in 1993 and $18,860,000 in 1994. The average interest rate on outstanding debt during fiscal years 1989 and 1988 was 7.0% and 7.2%, respectively.

Southern Transmission System Project—To finance payments-in-aid of construction to IPA for construction of STS, the Authority issued Transmission Project Revenue Bonds pursuant to the Authority's Indenture of Trust dated as of May 1, 1983 (Bond Indenture), as amended and supplemented. Reference is made to the Combined Schedule of Long-Term Debt at June 30, 1989 for details related to the outstanding bonds.

The Bond Indenture provides that the Revenue Bonds shall be special, limited obligations of the Authority payable solely from and secured solely by (1) proceeds from the sale of bonds; (2) all revenues, incomes, rents and receipts attributable to STS (see Note E) and interest on all moneys or securities (other than in the Construction Fund) held pursuant to the Bond Indenture; and (3) all funds established by the Bond Indenture; subject to the provisions of the Bond Indenture providing for the application thereof.

NOTE D—Long-term debt: (continued)

All outstanding Transmission Project Revenue Term Bonds, at the option of the Authority, are subject to redemption prior to maturity.

The Bond Indenture requires mandatory sinking fund instalments to be made beginning in fiscal year 2000 for the 1984 Series A Bonds, 2001 for the 1984 Series B Bonds and the 1985 Series A Bonds, 2003 for the 1986 Series A Bonds, 2002 for the 1986 Series B Bonds, and 2007 for the 1988 Series A Bonds. Scheduled principal maturities for STS during the five fiscal years following June 30, 1989 are $5,825,000 in 1990, $9,890,000 in 1991, $10,545,000 in 1992, $11,295,000 in 1993 and $12,100,000 in 1994. The average interest rate on outstanding debt during fiscal years 1989 and 1988 was 7.4% and 7.7%, respectively.

Hoover Uprating Project—To finance advance payments to USBR for application to the costs of the Hoover Uprating Project, the Authority issued Hydroelectric Power Project Revenue Bonds pursuant to the Authority's Indenture of Trust dated as of March 1, 1986 (Bond Indenture). Reference is made to the Combined Schedule of Long-Term Debt at June 30, 1989 for details related to the outstanding bonds.

The Bond Indenture provides that the Revenue Bonds shall be special, limited obligations of the Authority payable solely from and secured solely by (1) the proceeds from the sale of the bonds; (2) all revenues from sales of energy to participants (see Note E); (3) interest or other receipts derived from any moneys or securities held pursuant to the Bond Indenture; and (4) all funds established by the Indenture of Trust (except for the Interim Advance Payments Account in the Advance Payment Fund); subject to the provisions of the Bond Indenture providing for the application thereof.

All outstanding Hydroelectric Power Project Revenue Term Bonds, at the option of the Authority, are subject to redemption prior to maturity.

The Bond Indenture requires mandatory sinking fund instalments to be made beginning in fiscal year 2002 for the 1986 Series A Bonds. The next scheduled principal maturity for the Hoover Uprating Project is $490,000 in 1994. The average interest rate on outstanding debt during fiscal years 1989 and 1988 was 8.0%.

The Authority estimates that the total financing requirements for its interest in the Hoover Uprating Project will approximate $34 million, substantially all of which will be expended for payments for capacity and associated firm energy and the acquisition of entitlements to capacity.

Mead-Phoenix Project—The Authority borrowed $14,148,000 to finance the feasibility study and development costs of the Mead-Phoenix Project. During April 1988, the Authority adopted a note retirement plan. The plan involved voluntary payments by each participant of its proportionate share of the liability with respect to the loan. During the year ended June 30, 1989, the Authority received from the participants $14,048,000 retiring all the notes but $100,000. These receipts are shown as Advances from Participants. Authority management anticipates repaying these advances during fiscal 1991 or later.

Refunding bonds—During fiscal year 1989, the proceeds from the sale of $295,005,000 of Power Project Refunding Bonds were used to advance refund $187,635,000 of previously issued bonds and the proceeds from the sale of $239,320,000 of Transmission Project Revenue Bonds were issued to refund $147,995,000 of previously issued bonds. In connection therewith, the net proceeds of the refunding bonds have been invested in securities of the United States Government, the principal and interest from which will be sufficient to fund the remaining principal, interest and call premium payments on the refunded bonds until the stated first call dates of the respective issues. Accordingly, all amounts related to the refunded bonds have been removed from the balance sheets and the cost of refunding the debt is included in unamortized debt expenses. At June 30, 1989 the aggregate amount of debt considered to be extinguished was $2,210,680,000.

NOTE E—Power sales and transmission service contracts: The Authority has sold its entitlement to the output of the Palo Verde Project pursuant to power sales contracts with ten participants (see Note A). Under the terms of the contracts, the participants are entitled to power output from the Palo Verde Nuclear Generating Station and are obligated to make payments on a "take or pay" basis for their proportionate share of operating and maintenance expenses and debt service on Power Project Revenue Bonds and other debt, whether or not the Palo Verde Project or any part thereof has been completed, is operating or operable, or its output is suspended, interfered with, reduced or curtailed or terminated. The contracts expire in 2030 and, as long as any Power Project Revenue Bonds are outstanding, cannot be terminated or amended in any manner which will impair or adversely affect the rights of the bondholders.

The Authority has entered into transmission service contracts with six participants of STS (see Note A). Under the terms of the contracts, the participants are entitled to transmission service utilizing STS and are obligated to make payments on a "take or pay" basis for their proportionate share of operating and maintenance expenses and debt service on Transmission Project Revenue Bonds and other debt, whether or not STS or any part thereof has been completed, is operating or operable, or its service is suspended, interfered with, reduced or curtailed or terminated. The contracts expire in 2027 and, as long as any Transmission Project Revenue Bonds are outstanding, cannot be terminated or amended in any manner which will impair or adversely affect the rights of the bondholders.

In March 1986, the Authority entered into power sales contracts with six participants of the Hoover Uprating Project (see Note A). Under the terms of the contracts, the participants are entitled to capacity and associated firm energy of the Hoover Uprating Project and are obligated to make payments on a "take or pay" basis for their proportionate share of operating and maintenance expenses and debt service whether or not the Hoover Uprating Project or any part thereof has been completed, is operating or is operable, or its service is suspended, interfered with, reduced or curtailed or terminated in whole or in part. The contracts expire in 2018 and, as long as the Hydroelectric Power Project Revenue Bonds are outstanding, cannot be terminated or amended in any manner which will impair or adversely affect the rights of the bondholders.

NOTE F—Costs recoverable from future billings to participants:
Billings to participants are designed to recover "costs" as defined by the power sales and transmission service agreements. The billings are structured to systematically provide for debt service requirements, operating funds and reserves in accordance with these agreements. Those expenses, according to generally accepted accounting principles (GAAP), which are not included as "costs" are deferred to such periods as they are intended to be recovered through billings.

Costs recoverable from future billings to participants are comprised of the following:

	June 30, 1988	Fiscal 1989 Activity	June 30, 1989
GAAP items not included in billings to participants:			
Depreciation of plant	$ 63,521	$ 36,634	$100,155
Amortization of bond discount, debt issue costs, and cost of refunding	32,951	20,845	53,796
Nuclear fuel amortization and decommissioning	11,327	6,810	18,137
Interest expense	6,214	(3)	6,211
Bond requirements included in billings to participants:			
Investment income, operations and maintenance, net	(23,533)	(6,731)	(30,267)
Cost of acquisition of capacity—STS		(11,750)	(11,750)
Reduction in debt service due to excess construction	40,999		40,999
Principal repayments	(15,355)	(20,195)	(35,550)
Other	(1,476)	(1,868)	(3,341)
	$114,648	$ 23,742	$138,390

NOTE G—Commitments and contingencies:
As a participant in the PVNGS, the Authority could be subject to assessment of retroactive insurance premium adjustments in the event of a nuclear incident at the PVNGS or at any other licensed reactor in the United States.

The Authority is involved in various legal actions. In the opinion of management, the outcome of such litigation or claims will not have a material effect on the financial position of the Authority or the respective separate projects.

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
INDEX TO SUPPLEMENTAL FINANCIAL INFORMATION

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
COMBINED SCHEDULE OF LONG-TERM DEBT
AT JUNE 30, 1989
(In thousands)

	Series	*Date of Sale*	*Effective Interest Rate*	*Maturity on July 1*	*Total*
Palo Verde Project Revenue and Refunding Bonds	1982A	8/13/82	10.9%	1989 to 2017	$ 13,795
	1982B	11/12/82	7.7%	1989 to 2017	37,115
	1983A	4/ 8/83	8.8%	1989 to 2017	15,610
	1984A	7/18/84	10.3%	1990 to 2004	12,315
	1985A	5/22/85	8.7%	1989 to 2014	10,415
	1985B	7/ 2/85	9.1%	1989 to 2017	38,465
	1986A	3/13/86	8.2%	1989 to 2015	79,050
	1986B	12/16/86	7.2%	1989 to 2017	353,675
	1987A	2/11/87	6.9%	1989 to 2017	348,955
	1989A	2/15/89	7.2%	1989 to 2015	295,005
					1,204,400
Southern Transmission System Project Revenue and Refunding Bonds	1984A	2/ 9/84	9.3%	1990 to 2004	29,790
	1984B	10/17/84	10.2%	1990 to 2000	11,610
	1985A	8/15/85	8.9%	1989 to 2021	16,940
	1986A	3/18/86	8.0%	1989 to 2021	371,365
	1986B	4/29/86	7.5%	1989 to 2023	478,105
	1988A	11/22/88	7.2%	1989 to 2015	239,320
					1,147,130
Hoover Uprating Project Revenue Bonds	1986A	8/13/86	8.1%	1993 to 2017	34,435
Mead-Phoenix Bank Loan					100
Total Principal Amount					2,386,065
Less: Unamortized Bond Discount—					
Palo Verde Project Revenue and Refunding Bonds					146,490
Southern Transmission System Project Revenue and Refunding Bonds					126,862
Hoover Uprating Power Project Revenue Bonds					139
Total Unamortized Bond Discount					273,491
Total Long-Term Debt Less Unamortized Bond Discount					2,112,574
Long-Term Debt Due Within One Year					20,195
					$2,092,379

Bonds which have been refunded are excluded from this schedule.

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
PALO VERDE PROJECT
SUPPLEMENTAL BALANCE SHEET
(In thousands)

	June 30, 1989	June 30, 1988
ASSETS		
Utility plant		
Production	$ 600,778	$ 600,458
Transmission	6,008	5,988
General	186	81
	606,972	606,527
Less—Accumulated depreciation	56,180	34,224
	550,792	572,303
Construction work in progress	3,569	2,028
Nuclear fuel, at amortized cost	26,428	31,330
Net utility plant	580,789	605,661
Special funds		
Investments	110,678	139,559
Interest receivable	1,630	2,204
Cash and cash equivalents	107,672	82,045
	219,980	223,808
Accounts receivable	3,635	836
Materials and supplies	6,859	6,528
Costs recoverable from future billings to participants	58,587	42,967
Deferred costs		
Unamortized debt expenses, less accumulated amortization of $24,106 and $18,643 in 1989 and 1988	228,150	210,841
Other deferred costs	864	1,309
	229,014	212,150
	$1,098,864	$1,091,950
LIABILITIES		
Long-term debt	$1,043,540	$1,028,965
Current liabilities		
Long-term debt due within one year	14,370	13,095
Accrued interest	36,219	37,573
Accounts payable and accrued expenses	4,735	12,317
	55,324	62,985
Commitments and contingencies		
	$1,098,864	$1,091,950

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
PALO VERDE PROJECT
SUPPLEMENTAL STATEMENT OF OPERATIONS
(In thousands)

	Year ended June 30, 1989	1988
Operating revenues		
Sales of electric energy	$110,164	$ 85,828
Operating expenses		
Nuclear fuel	10,628	9,042
Other operation	19,635	13,313
Maintenance	5,518	6,388
Depreciation	17,427	13,589
Decommissioning	5,699	4,652
Expense charged to projects during construction		(520)
Total operating expenses	58,907	46,464
Operating income	51,257	39,364
Investment income	18,239	11,072
Income before debt expenses	69,496	50,436
Debt expenses		
Interest on debt	85,116	84,033
Allowance for borrowed funds used during construction		(16,699)
Total debt expenses	85,116	67,334
Costs recoverable from future billings to participants	$(15,620)	$(16,898)

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
PALO VERDE PROJECT
SUPPLEMENTAL STATEMENT OF CASH FLOWS
(In thousands)

	Year ended June 30, 1989	1988
Cash flows from operating activities:		
Costs recoverable from future billings to participants	$ (15,620)	$ (16,898)
Adjustments to arrive at net cash provided by operating activities:		
Depreciation	26,955	21,144
Decommissioning	5,699	4,652
Amortization of debt costs	12,017	10,818
Changes in current assets and liabilities:		
Interest receivable	574	(451)
Accounts receivable	(2,799)	2,023
Materials and supplies	(331)	(6,528)
Other assets	15	(198)
Accrued interest	(1,354)	119
Accounts payable and accrued expenses	(7,582)	(1,952)
Net cash provided by operating activities	17,574	12,729
Cash flows from investing activities:		
Payments for construction of facility	(7,781)	(13,890)
Purchases of investments	(101,134)	(141,956)
Proceeds from sale of investments	130,015	160,638
Net cash provided by investing activities	21,100	4,792
Cash flows from financing activities:		
Proceeds from sale of refunding bonds	185,200	
Payment for bond issue costs	(4,325)	
Payment for defeasance of revenue bonds	(180,827)	
Payment for principal of long-term debt	(13,095)	
Net cash used for financing activities	(13,047)	–
Net increase in cash and cash equivalents	25,627	17,521
Cash and cash equivalents at beginning of year	82,045	64,524
Cash and cash equivalents at end of year	$ 107,672	$ 82,045
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest (net of amount capitalized)	$ 73,871	$ 58,328

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
PALO VERDE PROJECT
SUPPLEMENTAL SCHEDULE OF RECEIPTS AND DISBURSEMENTS IN FUNDS REQUIRED BY THE BOND INDENTURE
Year Ended June 30, 1989
(In thousands)

	Construction Fund Initial Facilities Account	*Debt Service Fund*	*Bond Anticipation Note Fund*	*Revenue Fund*	*Operating Fund*	*Reserve & Contingency Fund*	*Total*
Balance at June 30, 1988	$47,767	$154,374	$29	$ 418	$11,057	$ 9,683	$223,328
Additions							
Bond and note proceeds	2,250	(92)					2,158
Investment earnings	4,384	13,069	2	164	854	846	19,319
Transfer of investment earnings	6	(13,554)	(2)	15,241	(854)	(839)	(2)
Revenue from power sales				101,670			101,670
Distribution of revenues		84,835		(113,902)	25,106	3,961	
Other income	10				76		86
Transfer for interest payment		102,906					102,906
Transfer of investments	672	3,259		(2,844)	(1,087)		
Miscellaneous transfers	(1,090)	661		(398)	605	221	(1)
Total	6,232	191,084	—	(69)	24,700	4,189	226,136
Deductions							
Construction expenditures	2,621					2,506	5,127
Operating expenditures					22,333	776	23,109
Fuel cost					5,678		5,678
Payment of principal		13,095					13,095
Interest paid		177,667					177,667
Property tax	76				1,995		2,071
Financing costs	2,208						2,208
Interest paid on investment purchases	263	273			115	10	661
Premium paid on investment purchases	3						3
Loss on sale of investment						7	7
Total	5,171	191,035	—	—	30,121	3,299	229,626
Balance at June 30, 1989	$48,828	$154,423	$29	$ 349	$ 5,636	$10,573	$219,838

This schedule summarizes the receipts and disbursements in funds required under the bond indenture and has been prepared from the trust statements. The balances in the funds consist of cash and investments at original cost. These balances do not include accrued interest receivable of $1,630 and $2,204 at June 30, 1989 and 1988, nor do they include total amortized net investment premiums of $1,488 and $1,724 at June 30, 1989 and 1988.

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
SOUTHERN TRANSMISSION SYSTEM PROJECT
SUPPLEMENTAL BALANCE SHEET
(In thousands)

	June 30, 1989	June 30, 1988
ASSETS		
Utility plant		
Transmission	$ 661,255	$ 656,773
General	18,857	18,724
	680,112	675,497
Less—Accumulated depreciation	57,272	38,064
	622,840	637,433
Construction work in progress	4,287	912
Net utility plant	627,127	638,345
Special funds		
Investments	95,927	98,160
Advance to Intermountain Power Agency	20,161	20,161
Interest receivable	1,174	855
Cash and cash equivalents	63,295	52,608
	180,557	171,784
Accounts receivable	547	
Costs recoverable from future billings to participants	80,807	71,776
Deferred costs		
Unamortized debt expenses, less accumulated amortization of $21,539 and $16,910 in 1989 and 1988	174,258	161,546
	$1,063,296	$1,043,451
LIABILITIES		
Long-term debt	$1,014,443	$ 998,578
Current liabilities		
Long-term debt due within one year	5,825	2,260
Accrued interest	37,259	38,611
Accounts payable and accrued expenses	5,769	4,002
	48,853	44,873
Commitments and contingencies		
	$1,063,296	$1,043,451

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
SOUTHERN TRANSMISSION SYSTEM PROJECT
SUPPLEMENTAL STATEMENT OF OPERATIONS
(In thousands)

	Year ended June 30, 1989	Year ended June 30, 1988
Operating revenues		
Sales of transmission services	$94,769	$ 82,332
Operating expenses		
Other operation	8,137	8,750
Maintenance	3,205	3,159
Depreciation	19,207	19,975
Total operating expenses	30,549	31,884
Operating income	64,220	50,448
Investment income	10,784	19,996
Income before debt expenses	75,004	70,444
Debt expense		
Interest on debt	84,035	83,979
Costs recoverable from future billings to participants	$ (9,031)	$(13,535)

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
SOUTHERN TRANSMISSION SYSTEM PROJECT
SUPPLEMENTAL STATEMENT OF CASH FLOWS
(In thousands)

	Year ended June 30, 1989	1988
Cash flows from operating activities:		
Costs recoverable from future billings to participants	$ (9,031)	$ (13,535)
Adjustments to arrive at net cash provided by operating activities:		
Depreciation	19,207	19,975
Amortization of debt costs	9,125	6,820
Changes in current assets and liabilities:		
Interest receivable	(319)	2,113
Accounts receivable	(547)	2,662
Accrued interest	(1,352)	
Accounts payable and accrued expenses	1,767	774
Net cash provided by operating activities	18,850	18,809
Cash flows from investing activities:		
Payments for construction of facility	(7,990)	(25,307)
Purchases of investments	(61,515)	(133,287)
Proceeds from sale of investments	63,748	133,657
Refund from Intermountain Power Agency		820
Net cash used for investing activities	(5,757)	(24,117)
Cash flows from financing activities:		
Proceeds from sale of refunding bonds	156,050	
Payment for bond issue costs	(2,457)	
Payment for defeasance of revenue bonds	(153,739)	
Payment for principal of long-term debt	(2,260)	
Net cash used for financing activities	(2,406)	—
Net increase (decrease) in cash and cash equivalents	10,687	(5,308)
Cash and cash equivalents at beginning of year	52,608	57,916
Cash and cash equivalents at end of year	$ 63,295	$ 52,608
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest (net of amount capitalized)	$ 72,906	$ 77,221

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
SOUTHERN TRANSMISSION SYSTEM PROJECT
SUPPLEMENTAL SCHEDULE OF RECEIPTS AND DISBURSEMENTS IN FUNDS REQUIRED BY THE BOND INDENTURE
Year Ended June 30, 1989
(In thousands)

	Construction Fund-Initial Facilities Account	*Debt Service Fund*	*Revenue Fund*	*Operating Fund*	*General Reserve Fund*	*Total*
Balance at June 30, 1988	$10,096	$129,132	$ —	$ 7,230	$ 3,834	$150,292
Additions						
Bond and note interest received		518				518
Investment earnings	910	8,835	241	570	587	11,143
Revenue from transmission sales			94,534			94,534
Transfer of investments		1,788	(912)		(876)	
Transfer of investment earnings		(8,684)	9,740	(522)	(534)	
Transfer of funds	(1,863)	(3,893)				(5,756)
Distribution of revenue		79,102	(103,603)	11,816	12,685	
Transfer for interest payment		91,578				91,578
Other receipts	2,393					2,393
Total	1,440	169,244	—	11,864	11,862	194,410
Deductions						
Payments-in-aid of construction	6,192					6,192
Operating expenditures				12,306		12,306
Principal payment		2,260				2,260
Interest paid		164,484				164,484
Interest paid on investment purchases	31	153		48	62	294
Premium paid on investment purchases	11	2			3	16
Total	6,234	166,899	—	12,354	65	185,552
Balance at June 30, 1989	$ 5,302	$131,477	$ —	$ 6,740	$15,631	$159,150

This schedule summarizes the receipts and disbursements in funds required under the bond indenture and has been prepared from the trust statements. The balances in the funds consist of cash and investments at original cost. These balances do not include accrued interest receivable of $1,174 and $855 at June 30, 1989 and 1988, nor do they include total amortized net investment discounts of $72 and $477 at June 30, 1989 and 1988.

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
HOOVER UPRATING PROJECT
SUPPLEMENTAL BALANCE SHEET
(In thousands)

	June 30, 1989	*1988*
ASSETS		
Special funds		
Investments	$18,747	$20,584
Advances for capacity and energy, net	10,218	6,009
Interest receivable	292	264
Cash and cash equivalents	5,640	7,070
	34,897	33,927
Billings to participants in excess of costs recoverable	(1,004)	(95)
Deferred costs		
Unamortized debt expenses, less accumulated amortization of $155 and $102 in 1989 and 1988	1,107	1,159
	$35,000	$34,991
LIABILITIES		
Long-term debt	$34,296	$34,294
Current liabilities		
Accrued interest	689	689
Accounts payable and accrued expenses	15	8
	704	697
Commitments and contingencies		
	$35,000	$34,991

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
HOOVER UPRATING PROJECT
SUPPLEMENTAL STATEMENT OF OPERATIONS
(In thousands)

	Year ended June 30, 1989	1988
Operating revenues		
Sales of electric energy	$2,760	$2,530
Operating expenses		
Capacity charges	391	235
Energy charges	596	652
Other operation	140	244
Total operating expenses	1,127	1,131
Operating income	1,633	1,399
Investment income	2,033	3,992
Income before debt expenses	3,666	5,391
Debt expense		
Interest on debt	2,757	5,296
Billings to participants in excess of costs recoverable	$ 909	$ 95

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
HOOVER UPRATING PROJECT
SUPPLEMENTAL STATEMENT OF CASH FLOWS
(In thousands)

	Year ended June 30, 1989	1988
Cash flows from operating activities:		
Billings to participants in excess of costs recoverable	$ 909	$ 95
Adjustments to arrive at net cash provided by (used for) operating activities:		
Amortization of debt costs	54	54
Changes in current assets and liabilities:		
Interest receivable	(28)	238
Accounts receivable		66
Accounts payable and accrued expenses	7	(816)
Net cash provided by (used for) operating activities	942	(363)
Cash flows from investing activities:		
Advances for capacity and energy, net	(4,209)	(2,945)
Purchases of investments	(10,248)	(6,159)
Proceeds from sale of investments	12,085	11,685
Net cash (used for) provided by investing activities	(2,372)	2,581
Cash flows from financing activities:	—	—
Net (decrease) increase in cash and cash equivalents	(1,430)	2,218
Cash and cash equivalents at beginning of year	7,070	4,852
Cash and cash equivalents at end of year	$ 5,640	$ 7,070
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest (net of amount capitalized)	$ 2,757	$ 2,757

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
HOOVER UPRATING PROJECT
SUPPLEMENTAL SCHEDULE OF RECEIPTS AND DISBURSEMENTS IN FUNDS REQUIRED BY THE BOND INDENTURE
Year Ended June 30, 1989
(In thousands)

	Advance Payments Fund	*Interim Advance Payments Fund*	*Revenue Fund*	*Operating Working Capital Fund*	*Debt Service Account*	*Debt Service Reserve Account*	*Total*
Balance at June 30, 1988	$19,754	$4,081	$ —	$340	$ 714	$3,624	$28,513
Additions							
Investment earnings	1,758	204	3	37	46	295	2,343
Transfer of investment earnings	518	(204)	(3)	30	(46)	(295)	
Sales			2,760				2,760
Transfer of sales receipts			(2,753)		2,753		
Transfer of investments	(4,699)	4,699					
Miscellaneous transfers	3,258	(3,258)					
Total	835	1,441	7	67	2,753	—	5,103
Deductions							
Advances for capacity and energy		5,195					5,195
Administrative expenditures	135						135
Interest paid					2,757		2,757
Interest paid on investment purchases	20			7			27
Premium paid on investment purchases	425						425
Total	580	5,195	—	7	2,757	—	8,539
Balance at June 30, 1989	$20,009	$ 327	$ 7	$400	$ 710	$3,624	$25,077

This schedule summarizes the receipts and disbursements in funds required under the bond indenture and has been prepared from the trust statements. The balances in the funds consist of cash and investments at original cost. These balances do not include accrued interest receivable of $292 and $264 at June 30, 1989 and 1988, nor do they include total amortized net investment premiums of $690 and $858 at June 30, 1989 and 1988.

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
MEAD-PHOENIX PROJECT
SUPPLEMENTAL BALANCE SHEET
(In thousands)

	June 30, 1989	1988
ASSETS		
Utility plant		
Construction work in progress	$12,999	$12,600
Special funds		
Investments	1,089	1,843
Cash and cash equivalents	65	14
	1,154	1,857
Deferred charges		
Unamortized debt expenses, less accumulated amortization of $563 and $509 in 1989 and 1988		54
	$14,153	$14,511
LIABILITIES		
Long-term debt	$ 100	$ 100
Current liabilities		
Long-term debt due within one year		14,048
Accrued interest	1	351
Accounts payable and accrued expenses	4	12
	5	14,411
Advances from participants	14,048	
Commitments and contingencies		
	$14,153	$14,511

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY
MEAD-PHOENIX PROJECT
SUPPLEMENTAL STATEMENT OF CASH FLOWS
(In thousands)

	Year ended June 30, 1989	Year ended June 30, 1988
Cash flows from operating activities:	$ —	$ —
Cash flows from investing activities:		
Payments for feasibility study	(703)	(1,061)
Purchases of investments	(4,818)	(4,479)
Proceeds from sale of investments	5,572	5,546
Net cash provided by investing activities	51	6
Cash flows from financing activities:		
Payment of long-term debt	(14,048)	
Proceeds from advances from participants	14,048	
Net cash provided by financing activities	—	—
Net increase in cash and cash equivalents	51	6
Cash and cash equivalents at beginning of year	14	8
Cash and cash equivalents at end of year	$ 65	$ 14
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest (net of amount capitalized)	$ —	$ —

Technical assistance from the Los Angeles Department of Water and Power played a meaningful role in rebuilding two communities struck by natural disaster in the autumn of 1989.

A team of 18 distribution workers and two superintendents flew to Puerto Rico on September 27 to help with repairs on that island's power system in the wake of devastation from Hurricane Hugo. The crews worked for two weeks under the direction of the Puerto Rico Electric Power Authority.

Three weeks later, the DWP dispatched two giant circuit breakers via truck to Santa Cruz, near the epicenter of the 7.1 magnitude earthquake that shook much of the San Francisco Bay area on Oct. 17, helping to restore power to beleaguered residents.

At the same time, a crew of water utility workers and an engineer-adviser were sent to a rural system outside of Santa Cruz to assist in getting that community's water system back into operation.

Both the Puerto Rico and Santa Cruz assistance efforts were carried out under cooperative agreements with utility industry councils.

We are pleased to present this 88th annual report of the Department of Water and Power for the fiscal year 1988-89, reviewing 12 months of challenge and achievement. The decade of the 1990s promises new challenges for the public utility industry, which has undergone significant changes over the last 10 years. This report details the many ways the DWP is preparing to meet those challenges.

As a financial and cultural capital on the Pacific Rim, Los Angeles depends more than ever on ample supplies of quality water and reliable electrical power to survive and prosper. Providing those resources, as well as encouraging water conservation and energy efficiency, is a responsibility the DWP gladly accepts.

The job of providing water and electric power to this large and diverse community requires the dedication and commitment of thousands of people who make up the DWP family. As always, we are in their debt.

Once again, we owe a large measure of our success to the support and leadership of the Mayor and City Council, as well as the other elected City officials and City departments.

Rick J. Caruso
President

COMPARATIVE HIGHLIGHTS

	Water			Power		
Year ended June 30	1989	1988	% Increase (Decrease)	1989	1988	% Increase (Decrease)
Service	Gallons in billions			Kilowatt hours in billions		
Sales	208.1	203.6	2.2%	21.9	21.1	3.8%
Customers—average number (thousands)	640.6	637.8	0.4%	1,325.3	1,304.6	1.6%
Financial	In millions			In millions		
Revenue(A)	$ 306.7	$ 259.7	18.1%	$1,734.6	$1,588.1	9.2%
Operating costs(B)	206.0	172.4	19.5%	1,301.2	1,191.7	9.2%
Net income	42.3	34.4	23.0%	193.4	175.6	10.1%
Payments to City of Los Angeles	12.9	12.4	4.0%	78.5	70.2	11.8%
Capital expenditures	118.1	97.8(C)	20.8%	336.2	317.3(C)	6.0%
Net utility plant	1,202.0	1,114.7	7.8%	3,523.9	3,324.9	6.0%
Capitalization—equity and long-term debt	1,250.3	1,172.5	6.6%	3,626.1	3,444.7	5.3%

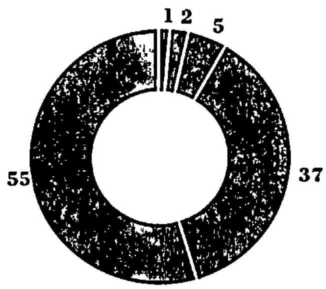
(A)*Includes other income—net*

(B)*Excluding depreciation expense*

(C)*Restated due to change in accounting method*

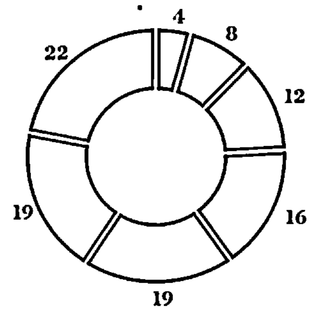
WATER AND POWER DOLLAR

WATER REVENUE DOLLAR IN CENTS



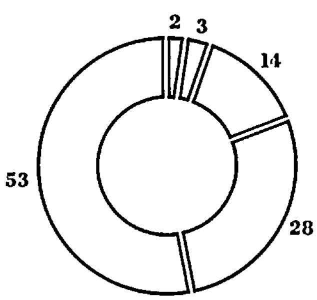
1 Other
2 Fire Hydrant rentals
5 Governmental
37 Residential
55 Commercial and industrial

WATER EXPENDITURE DOLLAR IN CENTS



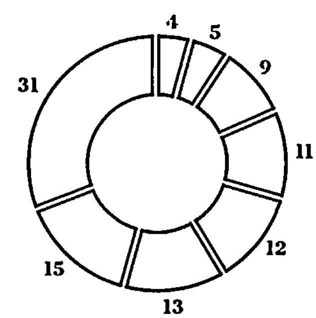
4 Payments to the City
8 Retirement Plan costs related to operations
12 Capital improvements
16 Debt service costs
19 Purchased water and energy
19 Other operating expenses
22 Operating salaries and wages

POWER REVENUE DOLLAR IN CENTS



2 Street lighting
3 Other
14 Industrial
28 Residential
53 Commercial

POWER EXPENDITURE DOLLAR IN CENTS



4 Retirement Plan costs related to operations
5 Payments to the City
9 Debt service costs
11 Capital improvements
12 Operating salaries and wages
13 Other operating expenses
15 Fuel
31 Purchased energy

"Accommodating our customers, large and small, will be the measure of our success in the 1990s," says Norman E. Nichols, General Manager and Chief Engineer of the Department of Water and Power. "We view the next decade as a dress rehearsal for the 21st Century."

These words capture the essence of the utility sector's New Age, an era in which deregulation and competition will forge profound changes in an industry long known for its predictability. Three strategic concepts underpin the DWP's response to the new era:

- Increased efficiency and cost containment.
- Realistic rate structures.
- Commitment to excellent service.

On the next several pages, this Annual Report reviews some of the ways the Department of Water and Power is preparing for the challenges ahead. These examples symbolize the new spirit of service shared by the DWP's more than 11,000 employees.

The Los Angeles Department of Water and Power supplies water and electricity to the approximately 3.4 million residents of the nation's second largest city. As the largest municipally owned utility in the nation, DWP has more than 11,000 employees serving a 465-square-mile area ranging from the San Gabriel Mountains to the Pacific Ocean. It began municipal distribution of water in 1902 and electricity in 1916.

As a proprietary agency of the Los Angeles City government, the DWP receives no tax support. Its operations are financed entirely by the sale of water and electricity. Revenue bonds are its main source of external financing.

The DWP is administered by the Board of Water and Power Commissioners, whose five members are appointed by the Mayor and confirmed by the City Council for terms of five years. The Board establishes water and electric rates, subject to approval by the City Council.

DEPARTMENT OF WATER AND POWER

Norman E. Nichols
General Manager and Chief Engineer

Eldon A. Cotton
Assistant General Manager—Power

Duane L. Georgeson
Assistant General Manager—Water

Daniel W. Waters
Assistant General Manager—External and Organizational Services

Norman J. Powers
Chief Financial Officer

Tomorrow's most successful utilities will be those that provide the highest quality service. To remain a leader in its industry, the DWP is putting new emphasis on this element of its business.

On the next several pages are four examples. As these case studies show, innovation and flexibility lie at the heart of a good service-oriented operation — finding new ways to do the job better...

- In Northridge, a DWP account executive smooths the way for a major customer's future expansion.
- In Eastern Los Angeles, another DWP representative helps a large central market keep its customers happy.
- Large customers near Griffith Park consider a switch to reclaimed water.
- Home builders everywhere learn the advantages of heat pumps.

In these and a thousand other ways, the DWP is building a new service culture to greet the 21st Century.

With the emergence of the Pacific Rim as a major economic and cultural arena, Los Angeles has become a gateway for hundreds of thousands of new arrivals—making it the most internationalized of all U.S. cities.

As the community has become multilingual and cross-cultural, Department of Water and Power services have adapted accordingly—with bilingual phone and field personnel, with customer materials now printed in several languages and training programs designed to accommodate a variety of ethnic and cultural backgrounds.

The influx of newcomers to Los Angeles has been accompanied by a rapid growth in ethnic enterprise, with special utility service needs that can be complicated by language barriers. A four-person bilingual team within the DWP's Major Accounts Group works with managers of Hispanic businesses like El Mercado, the bustling Hispanic marketplace in Eastern Los Angeles. With more than 60 vendors doing a total annual business of over $10 million, it is a major consumer of electricity and water, and as such warrants its own account executive from the DWP's Major Accounts Group.

"Any establishment this big needs special attention," says Fred Herrera, the account executive for El Mercado. "Power reliability is critical for merchants who must keep their products refrigerated. Water quality is essential for vendors serving the public. But there are hundreds of other needs." Herrera's command of Spanish is an important adjunct to his technical expertise. Although the general manager of El Mercado, Pedro Rosado, is also bilingual, many of the employees there are proficient only in Spanish.

"Having someone available to us who knows our situation, knows the utility business and is fluent in Spanish is a real benefit," says Rosado, who has managed El Mercado for 12 years. "In this case, I guess you could say the DWP speaks our language in more ways than one."

Philip Hengler
Line Patrol Mechanic
DWP

Rudolph Harris
Electrical Distribution
Mechanic/DWP


LA LUZ DEL DIA

A growing Los Angeles has traditionally solved its water needs through "supply-side" measures—by importing from water-rich areas to the north and east. As environmental concerns intensify, however, the emphasis has shifted to "demand side" solutions.

Today, the DWP is looking toward the newest horizon in water resource management — reclaiming and recycling "used" water for irrigation and for recharging the underground water table.

Under joint programs of the City's Department of Recreation and Parks and the Department of Public Works, reclaimed water is already used to irrigate two Griffith Park golf courses, and it will soon be watering 1,400 recreational acres in the Sepulveda Dam Basin. Now the DWP hopes to find customers for this water in the private sector.

"Large water users are very interested in this opportunity," says Steve Ott, an engineer/planner for the Greenbelt Project of the DWP. "As supplies of fresh water get tighter, they know deliveries of reclaimed water won't be cut off."

A DWP marketing team under Saturo Matsuda has approached four closely clustered companies with heavy irrigation needs (Forest Lawn and Mt. Sinai Memorial Parks, Lakeside Country Club and Universal City) as prospects for the Greenbelt Reclamation Project.

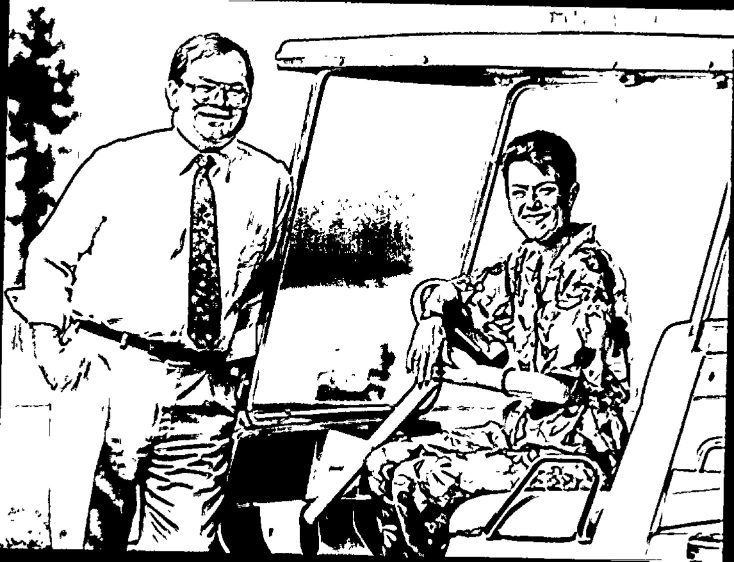
"We're under a lot of pressure during drought periods," says Jack Clough, Vice President of Architecture and Engineering for the Forest Lawn Company, which has more than 100 acres of lawn to irrigate at its Hollywood Hills Memorial Park. "The Greenbelt Project may be our answer."

Matsuda's marketing team has been working with Clough and his counterparts at the other prospect firms for about six months. They hope to have an agreement by early 1990, and reclaimed Greenbelt water could start flowing as early as the summer of 1990.

Matsuda sees this as a good start, but adds: "We're just scratching the surface."

Richard Zubiate
Senior Water Utility Worker/DWP

Rebecca Rosenfeld
Assistant District Clerk DWP



While no two DWP customers are exactly alike, all share one thing in common: When they turn on an electrical switch or water faucet, they expect something good to happen.

This expectation prompted the Department of Water and Power early in 1988 to institute its Major Accounts Group (MAG), to serve the special needs of the DWP's 1,500 largest customers, for whom reliability of service is critical. These customers account for around 33 percent of DWP's total power demand.

Burgeoning California State University in Northridge, with a student population of 30,000 and growing, is an example of a major DWP account. And in a couple of years CSUN will be even bigger, thanks to an ambitious expansion program now under way.

New buildings inevitably mean new demands for water and power, and Susan Smith, a 17-year DWP employee and the executive in charge of the CSUN account, is responsible for seeing that these needs are met. Though she handles many other major accounts (including L.A. International Airport), CSUN has been getting the lion's share of her time lately.

"Right now, their needs are pretty great," says Smith, whose optimism is a major asset in her work, "so this is where my priorities belong. These problems can't wait."

Among the needs CSUN has put before Smith are three new industrial stations, box car-size units that DWP has been asked to install on the campus in the next 18 months. These units lower the voltage of incoming power to make it compatible with the university's system.

It's her responsibility to put the CSUN development team in touch with the right people at DWP to get this done, then to follow through and make sure everything comes together.

"We're moving our project along generally on schedule," says CSUN Director of Facilities Planning, Steven C. Lohr. "Sue Smith is one of the people helping us keep it there."

Richard Ito
Electrical Conduit
Handler/DWP

Regina Cato
Electric Meter Setter
DWP

Part of the new environment facing public utilities in the 1990s is a stronger emphasis on marketing the products and services they provide. The DWP has moved boldly into this arena with its new Heat Pump Group.

Heat pumps, first introduced in the early 1950s, work on the same principle as room air conditioners, which transfer warmth from the interior to the outdoors. But heat pumps work both directions, extracting warmth from outside air (even when it seems cold) to heat inside spaces in winter, and reversing the process during hot weather.

Heat pumps have become more efficient in recent years, and their costs have gone down. As a result, the DWP in 1987 began promoting their use as a substitute for conventional heating and cooling units, especially for small spaces. The program provides financial incentives for builders and homeowners who equip new buildings, or retrofit old ones. Again, service is the key.

"We have to make the builder or homeowner aware of the advantages over conventional heating and air conditioning," says Steve Matsuda, Director of the DWP Heat Pump Group. "People like their flexibility, convenience and clean operation." So far, the DWP has paid out more than $4 million in incentives to contractors for installing some 25,000 units in the DWP service area.

"The program has done wonders for DWP in the marketplace," says Dan S. Palmer, a partner in G.H. Palmer Associates, a Brentwood development company that installed heat pumps in a 760-unit project completed in 1989. "The DWP really pulled with us. We're very pleased."

So, evidently, are other people. The program has been steadily accelerating since its inception, to the extent that sales during the second quarter of 1989 exceeded sales for the entire first year of the program.

Barry Jones
Electrical Conduit
Mechanic/DWP

Linda Sawlsville
Senior Clerk Typist
DWP

Another year of below-average precipitation in Southern California, the watersheds of the Colorado and Sacramento Rivers and Eastern Sierra Nevada gave new urgency to conservation efforts by the Department of Water and Power in 1988-89.

The third shortfall in Sierra snowmelt in as many years lowered water deliveries from the Los Angeles Aqueduct to 70 percent of the 20-year average. Electrical production from the Aqueduct was down 21 percent from the previous year. Colorado River water and power production were also lower.

These reductions were made up through additional purchases of water from the Metropolitan Water District and of electrical power from out-of-state generating facilities. These purchases resulted in higher costs that had to be passed on to DWP customers.

In all, the DWP Water System supplied approximately 208.1 billion gallons to some 640,572 customers in 1988-89, compared with 203.6 billion gallons and 637,793 customers in the previous year. The record year for water use was 1986-87, when the DWP sold more than 210 billion gallons.

The Power System in fiscal 1988-89 sold 21.9 thousand gigawatt-hours of electricity to around 1,325,300 customers (both new highs), compared with 21.1 thousand gigawatt-hours and 1,305,000 customers in 1987-88.

In February 1989, Norman E. Nichols was confirmed as General Manager and Chief Engineer, replacing Paul H. Lane, who retired after 40 years' service. Mr. Nichols' replacement as Assistant General Manager—Power is Eldon A. Cotton.

WATER SYSTEM HIGHLIGHTS

Major developments occurred this year in two long-standing legal issues surrounding DWP water rights in the Owens Valley and at Mono Lake. The Inyo County Board of Supervisors and the DWP Board have given preliminary approval to an environmental protection plan that clears the way for implementing a long-term Owens Valley underground water management plan.

An El Dorado County superior court granted a petition for a preliminary injunction sought by the National Audubon Society and Mono Lake Committee. The injunction granted through March 3, 1990, halts DWP diversions of water from the Mono Basin until the water level at Mono Lake rises to 6,377 feet.

Replacing the water the City will lose from this injunction, along with lost electricity generated by Mono Basin runoff, will require increased water imports from the Sacramento Delta and will cost Los Angeles consumers around $15 million annually.

Improvements in water quality continued last year, with the new Los Angeles Aqueduct Filtration Plant discharging water with average turbidity more than 500 percent better than state standards. More than two-thirds of the City's total water demand goes through this plant. Levels of trichloroethylene in San Fernando Valley groundwater also showed improvement in 1988-89, falling to a level nearly five times better than regulatory requirement.

Work has begun on environmental impact studies in connection with improving water quality at ten open reservoirs in the City to help meet expected tighter federal and state standards. Planned improvements at several of the reservoirs have met with local community resistance, and legislation to restrict such an action was passed by the state legislature but vetoed by the Governor.

More than $30 million was invested last year in improvements to some 95 miles of the DWP's vast underground water delivery system (infrastructure). This work consisted of cement-lining 65 miles of small distribution mains and replacing over 30 miles of deteriorated mains to improve water quality and public fire protection.

Design of the Greenbelt Project, which will distribute reclaimed water for irrigation by large private customers around Griffith Park, moved toward completion in 1989-90 (see page 12).

Over a million low-flow shower heads and toilet tank water bags have been distributed free to homeowners in the DWP's continuing efforts at encouraging water conservation.

Meanwhile, Phase I of the City's water conservation ordinance, which restricts use of water for such purposes as driveway and sidewalk cleaning, remains in effect. Beginning July 1989 a 10 percent surcharge will apply to commercial and industrial customers who fail to comply with the City's sewer flow reduction ordinance.

A new $2 million aeration tower for treating ground water from DWP wells in the San Fernando Valley was completed in March 1989. The facility employs new technology developed jointly by the DWP and UCLA.

The average water bill in Los Angeles increased around $2.35 per month in 1988-89 because of higher costs of purchased water and a 9.2 percent revenue increase that became effective in October 1988.

WATER SYSTEM FACTS IN BRIEF

Year ended June 30	1989	1988
Use of Water		
Average Los Angeles population served	3,427,000	3,388,000
Average daily use per capita (gallons)	181.2	180.8
Water sales for fiscal year (billion gallons)	208.1	203.6
Maximum daily demand (million gallons)	833.1	841.0
Water Supply (in cubic feet per second)		
Local supply	188.3	166.9
DWP Aqueduct	451.9	573.6
Metropolitan Water District (California Aqueduct and Colorado River Aqueduct)	319.2	207.7
Gross supply	959.4	948.2
Diversion from (to) local storage	1.5	(0.3)
Net supply to distribution systems	960.9	947.9

POWER SYSTEM HIGHLIGHTS

The Power System completed several steps in 1988-89 to improve service and increase the reliability of electrical supplies to its customers.

The Scattergood Generating Station in Playa del Rey received approval from the South Coast Air Quality Management District (SCAQMD) to operate its Unit 3 at the full 460-megawatt capacity, a 24-percent increase from its original permit limit. Until testing is completed, however, the unit will continue to operate at 358 megawatts. DWP overall power capability was 7,093 megawatts on June 30, 1989, 0.71 percent above the prior year.

A $171 million expansion of the Sylmar converter station, the Southern California "gateway" for power from the Pacific Intertie system, was completed in 1989. This allows the DWP and its partners in the Intertie to increase the amount of electricity they can receive from the Pacific Northwest by more than 50 percent.

Major electrical customers of the DWP are the focus of a new Major Accounts Group formed within the Power System last year as an outgrowth of the System's long-range plan completed in 1988. The new unit will provide a wide range of customized services to nearly 1,500 accounts responsible for about a third of the City's power revenues. (See page 7.)

Release of the SCAQMD's plan and new rules affecting boiler emissions for cleaning up Southern California air pollution held significant implications for the DWP. The plan calls for major changes in the way power is produced and used in the Los Angeles Basin, including widespread use of electric vehicles by the year 2000.

The plan also calls for major nitrogen oxides (NOx) emission reductions from power plants, while facilitating the repowering of existing facilities. The 240-megawatt Harbor Repowering Project was an outgrowth of this plan.

Because the Southern California Gas Company demands exceeded supply, natural gas for electrical generation in the Los Angeles Basin was curtailed during three periods totalling 165 days in 1988-89. It was the first year in which curtailments occurred during summer months. Because of the cutbacks, the DWP burned an extra 1,725,000 barrels of low-sulfur fuel oil to meet demand.

The Power System continues to emphasize conservation and efficient energy use with programs such as the City's mandatory curtailment ordinance, which saved an estimated 1,475 gigawatt-hours (six percent of demand) in 1988-89. The DWP also offers financial incentives to encourage customers' use of efficient appliances and lighting systems, heat pumps (page 20) and thermal energy storage units.

Meanwhile, the DWP's record on air quality continued to improve, with NOx emissions averaging 83 percent below levels recorded 20 years ago. DWP power plants now account for only approximately one tenth of one percent of total air emissions in the Basin. Emissions from employee vehicles have also been reduced through an active ride-sharing effort at the DWP.

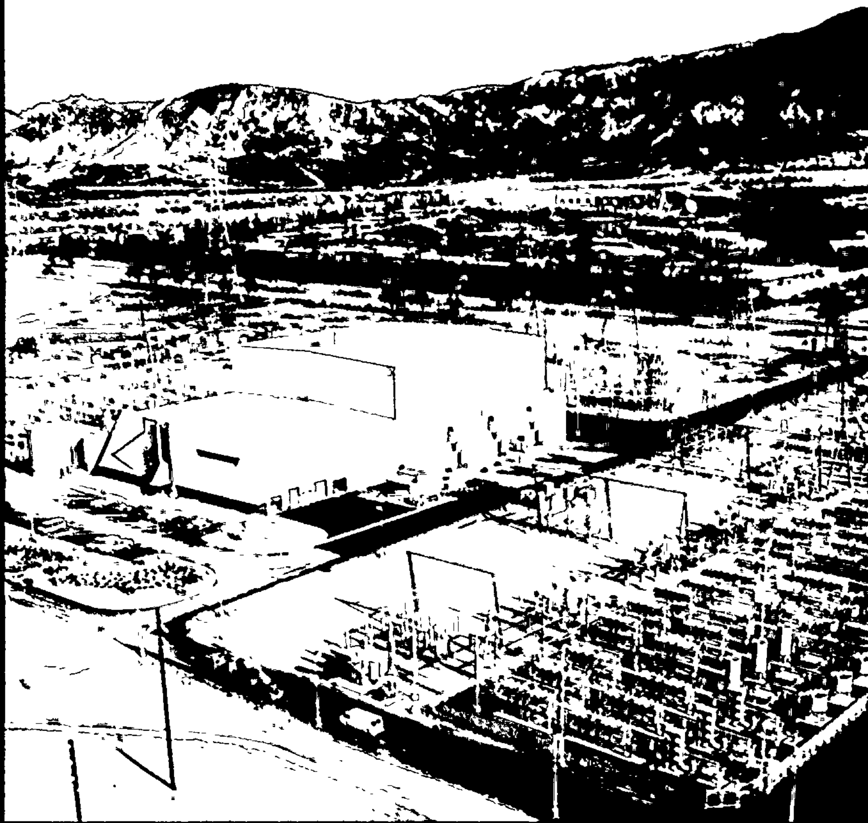
Development of safe, efficient electric vehicles remains a DWP priority. Six preproduction copies of the electric "G-Van," developed by General Motors and two other companies, will join the DWP vehicle fleet sometime this year. And, in cooperation with the Mayor and City Council, the DWP issued a request for proposal for 10,000 electric vehicles as a stimulus to commercial introduction, with deliveries beginning in 1990. Currently, 19 proposals have been received and are being evaluated.

To meet higher costs of purchased fuel and electric power, electric revenue increases of 4.4 percent (about $1.42 per month per average residential customer) were approved by the City Council and became effective in October 1988.

POWER SYSTEM FACTS IN BRIEF

Year ended June 30	1989	1988
Power Use		
Domestic customers	1,135,017	1,116,806
Commercial customers	168,031	165,229
Industrial customers	19,370	19,740
All others	2,864	2,828
Total customers—all classes	1,325,282	1,304,603
Sales to ultimate consumers—kilowatt-hours	21,460,324,000	20,936,158,000
Sales to other utilities—kilowatt-hours	437,311,000	169,800,000
Average annual kilowatt-hours per domestic customer	5,181	5,029
Status of System		
Utility plant (less accumulated provision for depreciation)	$ 3,523,937,000	$ 3,324,924,000
Generating Stations		
Net dependable capability, kilowatts	7,280,000*	7,280,000*

**Included purchased capacity; does not deduct short-term sales of excess capacity.*



EXTERNAL AND ORGANIZATIONAL SERVICES

EOS became a focal point in 1988-89 for the DWP's new accent on customer services, with new programs and systems to increase customer convenience and access to information.

A major objective has been to reduce response time on incoming calls to the DWP, which averaged about 193,000 per month last year, up nearly a third from 1987-88. Despite this increase, the response time was below 20 seconds on 62 percent of the calls.

Delinquent accounts are being reduced under programs introduced or expanded in 1988-89. An Essential Public Utility Ordinance and Lien Assessment Program are two tools the DWP uses in this effort. The former program continues service where property owners, not tenants, are delinquent on utility bills. More than $10 million has been collected to date under the Lien Assessment Program, where unpaid balances are added to delinquent customers' property tax bills. Bills considered uncollectible were cut $450,000 last year.

Recognizing the special vulnerability of older customers, the DWP instituted its "Serving Our Seniors" (SOS) program last year. Under the program, DWP personnel watch for signs of seniors in distress. When a problem is found, DWP personnel report it to the City's Department of Aging for follow-up.

Other community involvement activities in 1988-89 included an audio and video production on earthquake preparedness, along with a bilingual earthquake pamphlet, that were distributed to homeowners and organizations throughout the area.

The DWP's school safety program has reached more than 100,000 students since 1984 with information on electric safety. It was furthered last year with on-site demonstrations to more than 2,000 pupils a month in the Los Angeles Unified School District, private and parochial schools.

The 75th anniversary of the opening of the Los Angeles Aqueduct was marked with an event recreating the original opening ceremonies in 1913. Attended by civic leaders and well covered by the press, the event used period costumes and vintage autos to recapture the spirit of the original.

Significant strides were made during 1988-89 in the area of affirmative action. Minorities and/or women now occupy one third of all "officials and administrators" positions and half of all professional positions in the DWP. Programs to build minority representation throughout the organization are continuing.

A four-year decline in lost-workday injuries continued last year, with a 6.8-percent reduction. This represents a 36-percent reduction over the last four years. Extensive training of field personnel on handling encounters with customers' pets resulted in a 40-percent decline in dog bites suffered by DWP personnel.

The second phase of a computerized management support system has just been completed, giving one-third of DWP management access to a wide range of computer services, including electronic mail and numerous data bases. This instant access to information improves DWP efficiency and productivity.

FINANCIAL REVIEW

Operations for fiscal year 1988–89 resulted in an increase of 3.8 percent in sales of electric energy and a 2.2 percent increase in water sales.

Operating revenues of the Department's Water and Power Systems totaled more than $2.0 billion, a gain of $189 million over the previous fiscal year. The Power System accounted for $146 million of the increase, primarily due to higher energy costs billed to customers, the increase in sales mentioned above and the effect of the October 1988 revenue increase of 4.0 percent. The Water System added $43 million to the total, mostly from higher purchased water and energy costs billed to customers, the increase in sales mentioned above and the effect of the October 1988 revenue increase of 9.2 percent.

Higher Water System operating revenues resulted in net income of $42 million, up 24 percent from 1987–88s total of $34 million.

A total of $118 million was spent by the Water System on capital construction, most of which went towards the improvement of the water distribution and supply system, as well as water quality programs.

The operating revenue of the Power System increased by 9.3 percent from 1987–88, to a total of $1.7 billion. Net income amounted to $193 million, or 10 percent above the $176 million in the previous fiscal year.

The Power System invested $336 million in capital construction for the year. Major expenditures were additions and modifications to the electrical distribution and transmission facilities.

Total assets of the Department at June 30, 1989, were approximately $5.6 billion. Of this amount, $4.2 billion was recorded in the Power System and the remainder in the Water System.

FINANCING ACTIVITIES

During the year, the Power System sold one issue of $100 million revenue bonds at the interest rate of 7.36 percent. The Water System sold one issue of $50 million revenue bonds at the interest rate of 7.22 percent.

Outstanding bonds, notes and revenue certificates at June 30, 1989, totaled $1.74 billion for the Power System and $400 million for the Water System. Both systems met their maturing payments on bonds and notes.

COSTS AND TRANSFERS

In accordance with its basic fiscal policy, the Department pays all costs of operation, debt service and part of the cost of capital improvements from current revenues. The remainder of the cost of capital improvements is met through sales of revenue bonds or notes and from contributions in aid of construction.

Besides meeting all costs of operation from current revenues, the Department paid more than $91 million into the Reserve Fund of the City in support of general City government.

Approximately 86 percent of that amount came from the Power Revenue Fund. Operations of the Water and Power Systems are entirely self-supporting and no financial obligation or tax burden is placed on the citizens of Los Angeles.

REPORT OF MANAGEMENT

The management of the Department of Water and Power of the City of Los Angeles is responsible for the integrity of the financial statements and the other related financial data contained in this Annual Report. The financial statements and accompanying footnotes which follow were prepared by the Department in accordance with generally accepted accounting principles applied on a consistent basis. Where necessary, the financial information provided in this report include amounts based on the best estimates and judgments of management.

The Department maintains a system of internal accounting control that is delineated to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and that the pecuniary records properly reflect the authorized transactions of the Department. This system is supported by written policies and procedures, organization structures that assign appropriate division of responsibility, the selection and training of qualified personnel and is augmented by programs of internal audits. Management recognizes that there are inherent limitations in the effectiveness of any internal control system based upon the recognition that the cost of such systems should not exceed the benefits to be derived. The Department believes that its system of internal accounting control appropriately balances this cost-benefit relationship.

The Department's financial statements have been audited by Price Waterhouse and Simpson & Simpson, Certified Public Accountants, in accordance with generally accepted auditing standards. Their audit included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement preparation. Additionally, the independent accountants review the Department's quarterly financial information. A review is substantially less in scope than an audit in accordance with generally accepted auditing standards and, accordingly, the independent accountants do not express an opinion on the quarterly financial information. The independent accountants meet regularly with management to discuss their audit and their findings as to the integrity of the financial statements and the adequacy of the internal controls.

The Board of Water and Power Commissioners is responsible for reviewing the Department's financial reports and monitoring accounting practices. The Board, composed of commissioners who are not officers or employees of the Department, receives and reviews the reports submitted by the independent accountants.

WATER SYSTEM STATEMENT OF INCOME

(In Thousands) Year ended June 30	1989	1988	1987
Operating Revenues			
Residential	$110,069	$ 94,525	$ 92,436
Commercial and industrial	166,558	142,456	135,163
Other	23,621	20,051	20,775
Total operating revenues	300,248	257,032	248,374
Operating Expenses			
Purchased water	44,988	31,072	26,765
Purchased energy	12,991	11,613	8,806
Other operating expenses	109,627	95,443	87,634
Maintenance	38,424	34,243	28,691
Depreciation	32,814	30,584	26,586
Total operating expenses	238,844	202,955	178,482
Operating Income	61,404	54,077	69,892
Loss on Abandonment of Chatsworth Reservoir	—	—	(10,675)
Other Income and Expenses, Net	6,477	2,685	4,524
Income before debt expenses	67,881	56,762	63,741
Debt Expenses			
Interest on debt	27,556	23,749	22,039
Allowance for borrowed funds used during construction	(2,006)	(1,380)	(2,939)
Total debt expenses	25,550	22,369	19,100
Net Income	$ 42,331	$ 34,393	$ 44,641

STATEMENT OF RETAINED INCOME REINVESTED IN THE BUSINESS

(In Thousands) Year ended June 30	1989	1988	1987
Balance at beginning of year	$464,500	$442,526	$409,186
Net income for the year	42,331	34,393	44,641
	506,831	476,919	453,827
Less—Payments to the reserve fund of the City	12,852	12,419	11,301
Balance at end of year	$493,979	$464,500	$442,526

The accompanying notes are an integral part of these financial statements.

WATER SYSTEM BALANCE SHEET

(In Thousands) June 30	1989	1988
Assets		
Utility Plant, at original cost		
Source of water supply	$ 243,355	$ 236,592
Pumping	53,499	48,969
Purification	139,947	132,699
Distribution	1,105,323	1,022,138
General	122,252	110,029
	1,664,376	1,550,427
Less—Accumulated depreciation	542,259	510,225
	1,122,117	1,040,202
Construction work in progress	79,947	74,526
Net utility plant	1,202,064	1,114,728
Current Assets		
Cash and investments	89,091	84,329
Customer and other accounts receivable	54,166	54,772
Accrued unbilled revenue	29,056	21,671
Materials and supplies, at average cost	16,112	15,489
Prepayments and other current assets	11,539	14,906
Total current assets	199,964	191,167
Total utility plant and assets	$1,402,028	$1,305,895
Capitalization and Liabilities		
Capitalization		
Equity		
Retained income reinvested in the business	$ 493,979	$ 464,500
Contributions in aid of construction	376,599	357,829
	870,578	822,329
Long-term debt	379,724	350,188
Total capitalization	1,250,302	1,172,517
Current Liabilities		
Long-term debt due within one year	20,180	20,270
Accrued interest	9,432	7,752
Accounts payable and accrued expenses	83,472	69,544
Customer deposits	38,642	35,812
Total current liabilities	151,726	133,378
Commitments and Contingencies		
Total capitalization and liabilities	$1,402,028	$1,305,895

The accompanying notes are an integral part of these financial statements.

WATER SYSTEM STATEMENT OF CASH FLOWS

(In Thousands) Year ended June 30	1989	1988	1987
Cash Flows From Operating Activities:			
Net income	$ 42,331	$ 34,393	$ 44,641
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	32,814	30,584	26,586
Loss on Abandonment of Chatsworth Reservoir	—	—	10,675
Allowance for borrowed funds used during construction	(2,006)	(1,380)	(2,939)
Changes in current assets and liabilities:			
Customer and other accounts receivable	606	(9,252)	(10,511)
Accrued unbilled revenue	(7,385)	3,983	(7,764)
Materials and supplies	(623)	(999)	(1,067)
Prepayments and other current assets	3,367	(65)	1,026
Accrued interest	1,680	1,287	(281)
Accounts payable and accrued expenses	13,928	97	2,574
Customer deposits	2,830	1,571	6,414
Net cash provided by operating activities	87,542	60,219	69,354
Cash Flows From Financing Activities:			
Sale of revenue bonds	49,500	84,626	—
Contributions in aid of construction	18,770	31,878	23,005
Reduction of long-term debt	(20,054)	(19,327)	(19,248)
Payments to the reserve fund of the City	(12,852)	(12,419)	(11,301)
Net cash provided by (used in) financing activities	35,364	84,758	(7,544)
Cash Flows From Investing Activities:			
Expenditures for plant and equipment	(118,144)	(97,784)	(91,673)
Cash and Investments:			
Net increase (decrease)	4,762	47,193	(29,863)
Beginning of year	84,329	37,136	66,999
End of year	$ 89,091	$ 84,329	$ 37,136
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	$ 32,223	$ 28,820	$ 28,233

The accompanying notes are an integral part of these financial statements.

WATER SYSTEM NOTES TO FINANCIAL STATEMENTS

Note A—Summary of Significant Accounting Policies

The Department—The Department of Water and Power of the City of Los Angeles exists under and by virtue of the City Charter enacted in 1925 as a separate proprietary agency of the City. The Water System is responsible for the quality and distribution of water for sale in the City.

Financial statement presentation—The financial statements of the Water System are presented in conformity with generally accepted accounting principles, and substantially in conformity with the uniform system of accounts prescribed by the California Public Utilities Commission except for the method of accounting for contributions in aid of construction described below. The Department is not subject to regulations of such commission.

Utility plant—The cost of additions to utility plant and replacements of retired units of property are capitalized. Costs include labor, materials and allocated indirect charges such as engineering, supervision, transportation and construction equipment, retirement plan contributions, and certain administrative and general expenses. The cost of repairs and minor replacements are charged to appropriate maintenance accounts. The original cost of property retired, plus removal cost, less salvage, is charged to accumulated depreciation.

Cash and investments—The Department's cash is deposited with the City Treasurer who invests the funds in short-term securities under the City Treasurer's pooled investment program, whereby available funds of the City and its independent operating departments are invested on a combined basis. These investments are valued at cost, which approximates market. At June 30, 1989 and 1988, cash and investments include $6 million and $4 million, respectively, of restricted balances related to bond redemption and interest funds and self-insurance fund.

Contributions in aid of construction—Under the provisions of the City Charter, amounts received from customers and others for constructing utility plant are combined with retained income reinvested in the business to represent equity for purposes of computing the Water System's borrowing limits. Accordingly, contributions in aid of construction are shown in the accompanying balance sheet as an equity account and are not offset against utility plant.

Revenues—Revenues consist of billings to customers for water consumption and include amounts resulting from a purchased water and energy cost adjustment formula designed to permit the full recovery of purchased water and energy costs. The Department projects these costs to establish the cost recovery component of customer billings and any difference between billed and actual costs, resulting in over- or under-recovery of purchased water and energy costs, is adjusted in subsequent billings.

The Water System recognizes purchased water and energy costs in the period incurred and accrues for estimated unbilled revenues for water sold but not billed at the end of a fiscal year.

The Water System's rates are established by a rate ordinance which is approved by the City Council. The Water System sells water to other Departments of the City at regular rates provided in the ordinance.

Depreciation—Depreciation expense is computed by the straight-line method based on estimated service lives. Depreciation provision as a percentage of average depreciable utility plant in service was 2.5%, 2.4% and 2.4% for fiscal years 1989, 1988 and 1987, respectively.

Debt expenses—Debt premium, discount and issue expenses are deferred and amortized to expense over the lives of the related issues.

Allowance for funds used during construction (AFUDC)—AFUDC represents the cost of borrowed funds used for the construction of new facilities. AFUDC is capitalized as part of the cost of utility plant and is credited to income as a reduction of debt expenses, but does not represent cash earnings. The average AFUDC rates were 8.1%, 8.4% and 9.4% for fiscal years 1989, 1988 and 1987, respectively.

Note B—Loss on Abandonment of Chatsworth Reservoir

From 1969 to 1972, the Water System incurred costs totaling $10.7 million to enlarge and improve the Chatsworth Reservoir. Following the 1971 earthquake in the Los Angeles area, the State of California enacted more stringent safety standards for earth filled dams which would have required the replacement of the Chatsworth Reservoir Dams at significant additional costs prior to refilling. During 1987, the Water System completed various studies and concluded that the additional costs of upgrading the dams and complying with increased water quality standards precluded refilling the reservoir. Therefore, the project was formally abandoned, resulting in a utility plant write-off of $10.7 million as of June 30, 1987.

Note C—Long-Term Debt

Long-term debt outstanding at June 30, 1989, consisted of revenue bonds and notes due serially in varying annual amounts through 2028. Interest rates, which vary among individual maturities, averaged approximately 7.4% at June 30, 1989 and 1988. The revenue bonds generally are callable ten years after issuance. Scheduled annual principal maturities during the five years succeeding June 30, 1989 are $20 million, $12 million, $12 million, $13 million and $13 million, respectively.

Note D—Shared Operating Expenses

The Water System shares certain administrative functions with the Department's Power System. Generally, the costs of these functions are allocated on the basis of benefits provided to the Systems.

Operating expenses shared with the Power System were $251 million, $256 million and $235 million for fiscal years 1989, 1988 and 1987, respectively, of which $85 million, $89 million and $82 million were allocated to the Water System.

Note E—Employee Benefits

The Department has a funded contributory retirement, disability and death benefit insurance plan covering substantially all of its employees. Plan benefits are generally based on years of service, age at retirement and the employees' highest 12 consecutive months of salary before retirement. The Department funds retirement plan costs on a level premium actuarial method as determined by the plan's independent actuary. For funding purposes, prior service costs relating to the plan are amortized generally over a 30-year period ending June 30, 2003.

In fiscal year 1988, the Department adopted the provisions of Statement of Financial Accounting Standards No. 87, "Employers' Account for Pensions." The adoption of this statement did not materially affect the Department's results of operations. As required by the new standard, retirement cost is determined using the projected unit credit actuarial cost method. Total benefit plan costs for fiscal years 1989 and 1988 for the Water System include the following (amounts in millions):

	1989	1988
Service cost	$ 10	$ 11
Interest cost	41	38
Actual return on plan assets	(61)	(10)
Net amortization and deferral	39	(11)
Net retirement plan cost	29	28
Disability and death benefit plan costs and administrative expenses	5	4
Total benefit plan costs	$ 34	$ 32

The Water System was allocated 24% of the plan's total costs for fiscal year 1987 amounting to $33 million.

The following schedule reconciles the funded status of the plan with amounts reported in the financial statements (amounts in millions):

	June 30, 1989	June 30, 1988
Actuarial present value of benefit obligations:		
Vested benefits	$481	$ 411
Non-vested benefits	1	2
Accumulated benefit obligation	482	413
Projected future compensation level	95	72
Projected benefit obligation	577	485
Plan assets at fair value	432	367
Projected benefit obligation in excess of plan assets	145	118
Unrecognized net gain and effects of changes in assumptions	(26)	8
Unrecognized net obligation at July 1, 1987 being recognized over 15 years	(94)	(101)
Accrued pension liability	$ 25	$ 25

The increase in the projected benefit obligation was primarily attributable to a decrease in the discount rate from 8.25% in fiscal year 1988 to 7.75% in fiscal year 1989. The assumed rate of increase in future compensation levels was 6.0% in both years. The long-term rate of return on plan assets was 8.0% in both 1989 and 1988. Plan assets consist primarily of corporate and government bonds, common stocks, mortgage-backed securities and short-term investments.

In addition to the retirement plan, the Department provides certain health care benefits to active and retired employees. Health care costs are expensed as paid under a self-insured plan. The cost of providing such benefits to retired employees amounted to $2 million, $3 million and $2 million for fiscal years 1989, 1988 and 1987, respectively.

Note F — Commitments and Contingencies

Payments to the reserve fund of the City — Under the provisions of the City Charter, the Water System transfers funds at its discretion to the reserve fund of the City. Such payments are not in lieu of taxes and are recorded as distributions of retained income. The Department expects to make payments of $15 million in fiscal year 1990 from the Water System to the reserve fund of the City.

Litigation — A number of claims and suits are pending against the Department for alleged damages to persons and property and for other alleged liabilities arising out of its operations. In the opinion of management, any ultimate liability which may arise from these actions will not materially affect the Water System's financial position as of June 30, 1989.

REPORT OF INDEPENDENT ACCOUNTANTS

August 28, 1989

To the Board of Water and Power Commissioners
Department of Water and Power
City of Los Angeles

In our opinion, the accompanying balance sheet and the related statements of income, retained income reinvested in the business and cash flows present fairly, in all material respects, the financial position of the Water System of the Department of Water and Power of the City of Los Angeles at June 30, 1989 and 1988, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 1989, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Department's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse
Simpson & Simpson

POWER SYSTEM STATEMENT OF INCOME

(In Thousands) Year ended June 30	1989	1988	1987
Operating Revenues			
Residential	$ 484,591	$ 430,696	$ 388,730
Commercial and industrial	1,162,027	1,085,557	963,151
Other	69,703	53,775	51,560
Total operating revenues	1,716,321	1,570,028	1,403,441
Operating Expenses			
Fuel for generation	253,576	228,499	219,944
Purchased power	534,462	470,957	355,975
Other operating expenses	364,394	339,219	307,960
Maintenance	148,742	153,062	147,673
Depreciation	136,954	124,004	115,629
Total operating expenses	1,438,128	1,315,741	1,147,181
Operating Income	278,193	254,287	256,260
Other Income and Expenses, Net	18,257	18,037	19,754
Income before debt expenses	296,450	272,324	276,014
Debt Expenses			
Interest on debt	110,289	102,437	96,926
Allowance for borrowed funds used during construction	(7,268)	(5,674)	(7,759)
Total debt expenses	103,021	96,763	89,167
Net Income	$ 193,429	$ 175,561	$ 186,847

STATEMENT OF RETAINED INCOME REINVESTED IN THE BUSINESS

(In Thousands) Year ended June 30	1989	1988	1987
Balance at beginning of year	$1,785,701	$1,680,322	$1,561,388
Net income for the year	193,429	175,561	186,847
	1,979,130	1,855,883	1,748,235
Less—Payments to the reserve fund of the City	78,502	70,182	67,913
Balance at end of year	$1,900,628	$1,785,701	$1,680,322

The accompanying notes are an integral part of these financial statements.

POWER SYSTEM BALANCE SHEET

(In Thousands) June 30	1989	1988
Assets		
Utility Plant, at original cost		
Production	$1,756,070	$1,749,777
Transmission	641,473	561,178
Distribution	2,005,735	1,845,703
General	320,030	284,625
	4,723,308	4,441,283
Less—Accumulated depreciation	1,458,485	1,356,344
	3,264,823	3,084,939
Construction work in progress	241,729	215,435
Nuclear fuel, at amortized cost	17,385	24,550
Net utility plant	3,523,937	3,324,924
Current Assets		
Cash and investments	143,183	179,170
Customer and other accounts receivable, less $2,400 and $2,500 allowance for losses	169,084	143,310
Receivable from Intermountain Power Agency	49,573	—
Accrued unbilled revenue	94,576	88,782
Materials and supplies, at average cost	85,061	74,663
Fuel inventory	60,721	56,123
Prepayments and other current assets	27,663	37,776
Total current assets	629,861	579,824
Total utility plant and assets	$4,153,798	$3,904,748
Capitalization and Liabilities		
Capitalization		
Equity		
Retained income reinvested in the business	$1,900,628	$1,785,701
Contributions in aid of construction	123,041	104,825
	2,023,669	1,890,526
Long-term debt	1,602,469	1,554,170
Total capitalization	3,626,138	3,444,696
Current Liabilities		
Long-term debt due within one year	51,930	53,545
Revenue certificates	90,000	90,000
Accrued interest	36,526	30,648
Accounts payable and accrued expenses	238,036	212,380
Over-recovered energy costs	47,687	57,552
Extension and other deposits	13,908	15,927
Deferred credit—Intermountain Power Agency	49,573	—
Total current liabilities	527,660	460,052
Commitments and Contingencies		
Total capitalization and liabilities	$4,153,798	$3,904,748

The accompanying notes are an integral part of these financial statements.

POWER SYSTEM STATEMENT OF CASH FLOWS

(In Thousands) Year ended June 30	1989	1988	1987
Cash Flows From Operating Activities:			
Net income	$ 193,429	$ 175,561	$ 186,847
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	136,954	124,004	115,629
Amortization of nuclear fuel	7,527	7,516	5,936
Allowance for borrowed fund used during construction	(7,268)	(5,674)	(7,759)
Changes in current assets and liabilities:			
Customer and other accounts receivable	(25,774)	(3,023)	(244)
Receivable from Intermountain Power Agency	(49,573)	—	—
Accrued unbilled revenue	(5,794)	(4,247)	(806)
Materials and supplies	(10,398)	(11,654)	(1,189)
Fuel inventory	(4,598)	9,774	(4,078)
Deferred energy costs	—	8,928	17,856
Prepayments and other current assets	10,113	(7,509)	(18,659)
Accrued interest	5,878	4,191	(47)
Accounts payable and accrued expenses	25,656	(30,593)	(72,546)
Over-recovered energy costs	(9,865)	(15,644)	3,935
Extension and other deposits	(2,019)	(3,750)	2,228
Deferred credit—Intermountain Power Agency	49,573	—	—
Net cash provided by operating activities	313,841	247,880	227,103
Cash Flows From Financing Activities:			
Sale of revenue bonds	99,527	198,108	—
Sale of advance refunding bonds	—	—	47,312
Contributions in aid of construction	18,216	13,473	6,644
Reduction of long-term debt	(52,843)	(67,223)	(60,835)
Amount deposited in escrow account and offset against advance refunding bonds	—	—	(47,312)
Payments to the reserve fund of the City	(78,502)	(70,182)	(67,913)
Net cash provided by (used in) financing activities	(13,602)	74,176	(122,104)
Cash Flows From Investing Activities:			
Expenditures for plant and equipment	(336,226)	(317,316)	(303,360)
Cash and Investments:			
Net increase (decrease)	(35,987)	4,740	(198,361)
Beginning of year	179,170	174,430	372,791
End of year	$ 143,183	$ 179,170	$ 174,430
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest	$ 105,602	$ 100,435	$ 98,358

The accompanying notes are an integral part of these financial statements.

POWER SYSTEM NOTES TO FINANCIAL STATEMENTS

Note A—Summary of Significant Accounting Policies

The Department—The Department of Water and Power of the City of Los Angeles exists under and by virtue of the City Charter enacted in 1925 as a separate proprietary agency of the City. The Power System is responsible for the generation, transmission and distribution of electric power for sale in the City.

Financial statement presentation—The financial statements of the Power System are presented in conformity with generally accepted accounting principles, and substantially in conformity with the uniform system of accounts prescribed by the Federal Energy Regulatory Commission and the California Public Utilities Commission except for the method of accounting for contributions in aid of construction described below. The Department is not subject to regulations of such commissions.

Utility plant—The cost of additions to utility plant and replacements of retired units of property are capitalized. Costs include labor, materials and allocated indirect charges such as engineering, supervision, transportation and construction equipment, retirement plan contributions, and certain administrative and general expenses. The cost of repairs and minor replacements are charged to appropriate maintenance accounts. The original cost of property retired, plus removal cost, less salvage, is charged to accumulated depreciation.

Nuclear fuel—Nuclear fuel is amortized and charged to Fuel for Generation in the Statement of Income on the basis of actual thermal energy produced relative to total thermal energy expected to be produced over the life of the fuel. Under the provisions of the Nuclear Waste Policy Act of 1982, the federal government assumed responsibility for the future disposal of spent nuclear fuel.

Nuclear decommissioning—Decommissioning of the Palo Verde Nuclear Generating Station, in which the Power System has an ownership interest, is projected to start sometime after 2022. Based upon a study performed by an independent engineering firm, the Department's share of the estimated decommissioning costs is $35 million in 1986 dollars. Decommissioning costs are charged as part of depreciation expense over the life of the nuclear power plant.

A Nuclear Decommissioning Fund has been established and the Power System is setting aside funds for its share of the estimated future decommissioning costs.

Cash and investments—The Department's cash is deposited with the City Treasurer who invests the funds in short-term securities under the City Treasurer's pooled investment program, whereby available funds of the City and its independent operating departments are invested on a combined basis. These investments are valued at cost, which approximates market. At June 30, 1989 and 1988, cash and investments include $18 million and $12 million, respectively, of restricted balances relating to bond redemption and interest funds, self-insurance fund and nuclear decommissioning fund.

Fuel inventory—Coal inventories are stated at average cost. Fuel oil inventories are stated at cost, using the last-in, first-out method.

Contributions in aid of construction—Under the provisions of the City Charter, amounts received from customers and others for constructing utility plant are combined with retained income reinvested in the business to represent equity for purposes of computing the Power System's borrowing limits. Accordingly, contributions in aid of construction are shown in the accompanying balance sheet as an equity account and are not offset against utility plant.

Revenues—Revenues consist of billings to customers for consumption of electric energy and include amounts resulting from an energy cost adjustment formula designed to permit the full recovery of energy costs. The Department projects these costs to establish the energy cost recovery component of customer billings and any difference

between billed and actual energy costs, resulting in over- or under-recovery of energy costs, is adjusted in subsequent billings.

The Power System recognizes energy costs in the period incurred and accrues for estimated unbilled revenues for energy sold but not billed at the end of a fiscal year.

The Power System's rates are established by a rate ordinance which is approved by the City Council. The Power System sells electric energy to other Departments of the City at regular rates provided in the ordinance.

Depreciation — Depreciation expense is computed by the straight-line method for all major projects completed after July 1, 1973 and for all office and shop structures, related furniture and equipment, and transportation and construction equipment. Depreciation for facilities completed prior to this date is computed by the 5% sinking fund method based on estimated service lives. Depreciation provision as a percentage of average depreciable utility plant in service was 3.2% for each of the 1989, 1988 and 1987 fiscal years.

Debt expenses — Debt premium, discount and issue expenses are deferred and amortized to expense over the lives of the related issues.

Allowance for funds used during construction (AFUDC) — AFUDC represents the cost of borrowed funds used for the construction of new facilities. AFUDC is capitalized as part of the cost of utility plant and is credited to income as a reduction of debt expenses, but does not represent cash earnings. The average AFUDC rates were 7.6%, 7.9% and 8.8% for fiscal years 1989, 1988 and 1987, respectively.

Note B — Receivable and Deferred Credit — Intermountain Power Agency

As of July 1, 1988, an amendment to an Intermountain Power Agency (IPA) bond resolution provided for the use of surplus construction funds from the Intermountain Power Project. As a member participant of this project, the Department's share of such surplus funds totaled $110 million at July 1, 1988, to be received over a three to four year period. At June 30, 1989, the Department had a receivable from IPA of $50 million which represented a deferred credit for use as a future reduction of purchased power expense.

Note C — Revenue Certificates

At June 30, 1989 and 1988, the average interest rate of revenue certificates payable was 6.4% and 4.9% with various maturities of up to 130 and 242 days, respectively. The Department has an unsecured standby line of credit of $90 million which may be used if the certificates cannot be refinanced as they mature.

Note D — Jointly-Owned Utility Plant

The Power System has an undivided interest in several electrical generating stations and transmission systems which are jointly-owned with other utilities. Each project participant is responsible for financing its share of construction and operating costs. The following schedule shows the Power System's investment in each jointly-owned utility plant as included in the balance sheet at June 30, 1989 (dollar amounts in millions):

Projects	Ownership Interest	Plant in Service: Cost	Plant in Service: Accumulated Depreciation	Work In Progress
Palo Verde Nuclear Generating Station (Note H)	5.7%	$490	$ 31	$10
Navajo Steam Generating Station	21.2%	180	71	5
Mohave Coal Generating Station	20.0%	75	23	9
Pacific Intertie DC Transmission System	40.0%	161	14	—
Other transmission systems	Various	72	15	1
		$978	$154	$25

The Power System will incur certain minimum operating costs on the jointly-owned facilities, regardless of the amount of energy generated or the ability to take delivery of its share of energy generated. The proportionate share of these expenses is included in the appropriate categories of operating expenses.

Note E—Long-Term Debt

Long-term debt outstanding at June 30, 1989, consisted of revenue bonds due serially in varying annual amounts through 2029. Interest rates, which vary among individual maturities, averaged approximately 6.8% and 6.7% at June 30, 1989 and 1988, respectively. The revenue bonds generally are callable ten years after issuance. Scheduled annual principal maturities during the five years succeeding June 30, 1989 are $52 million, $53 million, $55 million, $56 million and $58 million, respectively.

In fiscal year 1987, the Power System sold advance refunding bonds totaling $48 million. Until the bonds to be refunded are called, interest on the advance refunding bonds is payable from interest earned on securities of the United States government purchased out of the proceeds of the sales and held in escrow accounts with Citibank, N.A., New York. At June 30, 1989, $48 million of these escrow accounts have been offset against the advance refunding bonds in the accompanying balance sheet (during fiscal year 1989 there were no refunded bonds redeemed). After the monies in the escrow accounts are applied to redeem the bonds to be called, principally through 1994, interest on the advance refunding bonds will be payable from Power System revenues.

Note F—Shared Operating Expenses

The Power System shares certain administrative functions with the Department's Water System. Generally, the costs of these functions are allocated on the basis of benefits provided to the Systems.

Operating expenses shared with the Water System were $251 million, $256 million and $235 million for fiscal years 1989, 1988 and 1987, respectively, of which $166 million, $167 million and $153 million were allocated to the Power System.

Note G—Employee Benefits

The Department has a funded contributory retirement, disability and death benefit insurance plan covering substantially all of its employees. Plan benefits are generally based on years of service, age at retirement and the employees' highest 12 consecutive months of salary before retirement. The Department funds retirement plan costs on a level premium actuarial method as determined by the plan's independent actuary. For funding purposes, prior service costs relating to the plan are amortized generally over a 30-year period ending June 30, 2003.

In fiscal year 1988, the Department adopted the provisions of Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions." The adoption of this statement did not materially affect the Department's results of operations. As required by the new standard, retirement cost is determined using the projected unit credit actuarial cost method. Total benefit plan costs for fiscal years 1989 and 1988 for the Power System include the following (amounts in millions):

	1989	1988
Service cost	$ 33	$ 35
Interest cost	130	120
Actual return on plan assets	(194)	(31)
Net amortization and deferral	122	(37)
Net retirement plan cost	91	87
Disability and death benefit plan cost and administrative expenses	13	12
Total benefit plan costs	$104	$ 99

The Power System was allocated 76% of the plan's total costs for fiscal year 1987 amounting to $102 million.

POWER SYSTEM NOTES TO FINANCIAL STATEMENTS

The following schedule reconciles the funded status of the plan with amounts reported in the financial statements (amounts in millions):

	June 30, 1989	June 30, 1988
Actuarial present value of benefit obligations:		
Vested benefits	$1,527	$1,300
Non-vested benefits	1	5
Accumulated benefit obligation	1,528	1,305
Projected future compensation level	300	227
Projected benefit obligation	1,828	1,532
Plan assets at fair value	1,368	1,163
Projected benefit obligation in excess of plan assets	460	369
Unrecognized net gain and effects of changes in assumptions	(83)	25
Unrecognized net obligation at July 1, 1987 being recognized over 15 years	(299)	(322)
Accrued pension liability	$ 78	$ 72

The increase in the projected benefit obligation was primarily attributable to a decrease in the discount rate from 8.25% in fiscal year 1988 to 7.75% in fiscal year 1989. The assumed rate of increase in future compensation levels was 6.0% in both years. The long-term rate of return on plan assets was 8.0% in both 1989 and 1988. Plan assets consist primarily of corporate and government bonds, common stocks, mortgage-backed securities and short-term investments.

In addition to the retirement plan, the Department provides certain health care benefits to active and retired employees. Health care costs are expensed as paid under a self-insured plan. The cost of providing such benefits to retired employees amounted to $8 million, $9 million and $7 million for fiscal years 1989, 1988 and 1987, respectively.

Note H—Commitments and Contingencies

Payments to the reserve fund of the City—Under the provisions of the City Charter, the Power System transfers funds at its discretion to the reserve fund of the City. Such payments are not in lieu of taxes and are recorded as distributions of retained income. The Department expects to make payments of $86 million in fiscal year 1990 from the Power System to the reserve fund of the City.

Long-term purchased power and transmission contracts—The Department has entered into a number of energy and transmission service contracts which involve substantial commitments. These include an agreement with the Intermountain Power Agency, a Utah State Agency, for purchase of energy from the Intermountain Power Project (IPP) for which the Power System has served as the project manager and operating agent. The Department's total interest in IPP includes a 44.6% "take or pay" obligation and an excess power contract for 18.2% for a total of 62.8%. The Department also has two agreements with the Southern California Public Power Authority (SCPPA), a California Joint Powers Agency, for 67% of SCPPA's 5.9% entitlement to the energy generated at the Palo Verde Nuclear Generating Station and for 59.5% in the capacity of the Southern Transmission System, which transmits energy from IPP in Utah to Southern California. Significant data related to these agreements, which are scheduled to expire from 2022 to 2027, at June 30, 1989 are as follows:

	Total Bonds Outstanding (millions)	Department Share of Capacity (megawatts)
Palo Verde Nuclear Generating Station (through SCPPA)	$1,058	145
Intermountain Power Project	5,047	1,004
Southern Transmission System (for IPP power through SCPPA)	1,020	1,142

All these agreements require the Power System to make certain minimum payments, which are based upon debt service requirements. While these payments are fixed charges (of approximately $340 million in each of the next five years), the Department is also required to pay additional amounts (of approximately $120 million in each of the next five years) for operating and maintenance costs related to actual deliveries of energy under these agreements. Total payments under these contracts were approximately $440 million, $320 million and $260 million in fiscal years 1989, 1988 and 1987, respectively. These aggregate purchased power costs are recovered through the energy cost recovery component of customer billings.

The Department also has a contract through 2017 with the U.S. Department of Energy for the purchase of available energy generated at the Hoover Power Plant. The Department's share of capacity at Hoover is approximately 500 megawatts.

Nuclear insurance — As a participant in the Palo Verde Nuclear Generating Station, the Department could be subject to assessment of retrospective insurance premium adjustments in the event of a nuclear incident at Palo Verde or at any other licensed reactor in the United States.

Litigation — A number of claims and suits are pending against the Department for alleged damages to persons and property and for other alleged liabilities arising out of its operations. In the opinion of management, any ultimate liability which may arise from these actions will not materially affect the Power System's financial position as of June 30, 1989.

REPORT OF INDEPENDENT ACCOUNTANTS

August 28, 1989

To the Board of Water and Power Commissioners
Department of Water and Power
City of Los Angeles

In our opinion, the accompanying balance sheet and the related statements of income, retained income reinvested in the business and cash flows present fairly, in all material respects, the financial position of the Power System of the Department of Water and Power of the City of Los Angeles at June 30, 1989 and 1988, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 1989, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Department's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse
Simpson & Simpson

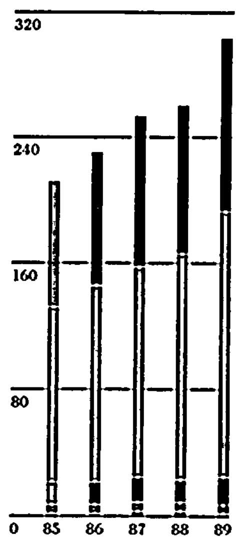
WATER SYSTEM SELECTED FINANCIAL DATA AND STATISTICS

($ Millions)	1989	1988	1987	1986	1985
Statement of Income					
Operating revenues					
Residential	$ 110.1	$ 94.5	$ 92.4	$ 84.2	$ 79.0
Commercial and industrial	166.5	142.4	135.2	122.9	111.1
Governmental and other	17.8	14.3	14.8	13.4	13.0
Fire hydrants	4.4	4.1	4.1	4.0	4.0
Miscellaneous	1.4	1.7	1.9	1.5	1.2
Total revenues	$ 300.2	$ 257.0	$ 248.4	$ 226.0	$ 208.3
Operating income	61.4	54.1	69.9	69.4	67.8
As % of revenues	20.5%	21.1%	28.1%	30.7%	32.6%
Net income	$ 42.3	$ 34.4	$ 44.6	$ 61.8	$ 63.3
Balance Sheet					
Net utility plant	$1,202.1	$1,114.7	$1,046.1	$ 988.8	$ 902.2
Capital expenditures	118.1	97.8(A)	91.7(A)	102.0(A)	90.9(A)
Capitalization					
Equity	870.6	822.3	768.5	712.1	642.6
Long-term debt	379.7	350.2	285.6	305.0	324.6
Total capitalization	1,250.3	1,172.5	1,054.1	1,017.1	967.2
Debt as % of net utility plant*	31.6%	30.2%	25.3%	28.0%	32.1%
Interest on debt	27.6	23.7	22.0	23.2	23.3
Payments to City of L.A.	12.9	12.4	11.3	10.4	9.9
Operations					
Gallons sold (billions)	208.1	203.6	210.1	204.3	203.4
Customers — average number (thousands)	640.6	637.8	632.3	630.1	630.4
Average revenue per hundred cu. ft. sold (in cents)					
Residential	106.0	92.8	87.2	81.8	75.7
Commercial and industrial	107.9	93.6	87.5	81.7	75.8
Water supply (in cu. ft. per second — c.f.s.)					
Local supply	188.3	166.9	137.0	144.5	164.8
DWP Aqueduct	451.9	573.6	661.4	671.8	709.3
Metropolitan Water District	319.2	207.7	177.1	123.9	64.8
Gross supply	959.4	948.2	975.5	940.2	938.9
Diversion from (to) local storage	1.5	(0.3)	(1.7)	(6.6)	(6.4)
Net supply to distribution systems	960.9	947.9	973.8	933.6	932.5

** Excludes revenue notes and advance refunding revenue bonds.*

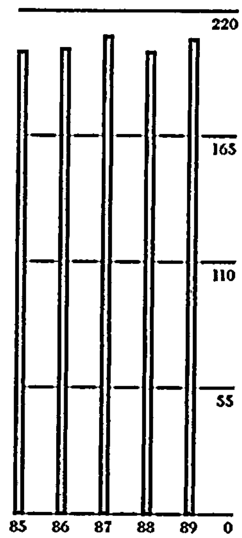
(A) Restated due to change in accounting method.

OPERATING REVENUES
$ in Millions

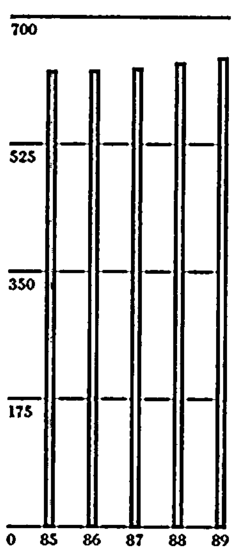


■ Residential
■ Commercial and Industrial
■ Other
■ Fire Hydrant
■ Miscellaneous

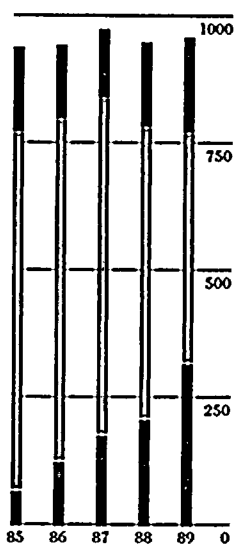
GALLONS SOLD
In Billions



AVERAGE NUMBER OF CUSTOMERS
In Thousands



WATER SUPPLY
In Cu. Ft. per Second



■ Local Supply
■ DWP Aqueduct
■ Metropolitan Water District

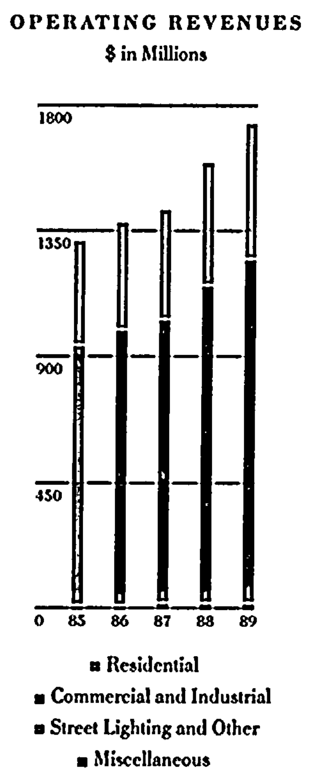
POWER SYSTEM SELECTED FINANCIAL DATA AND STATISTICS

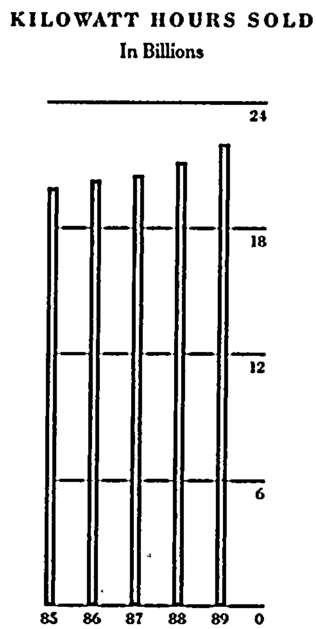
($ Millions)	1989	1988	1987	1986	1985
Statement of Income					
Operating revenues					
Residential	$ 484.6	$ 430.7	$ 388.7	$ 379.5	$ 373.0
Commercial and industrial	1,162.0	1,085.5	963.1	932.2	859.2
Street lighting and other	53.5	39.7	38.2	37.9	48.5
Miscellaneous	16.2	14.1	13.4	8.5	7.3
Total revenues	$1,716.3	$1,570.0	$1,403.4	$1,358.1	$1,288.0
Operating income	278.2	254.3	256.3	259.5	274.5
As % of revenues	16.2%	16.2%	18.3%	19.1%	21.3%
Net income	$ 193.4	$ 175.6	$ 186.8	$ 193.6	$ 213.6
Balance Sheet					
Net utility plant	$3,523.9	$3,324.9	$3,133.5	$2,943.9	$2,656.1
Capital expenditures	336.2	317.3(A)	303.4(A)	392.6(A)	166.6(A)
Capitalization					
Equity	2,023.7	1,890.5	1,771.7	1,646.1	1,511.8
Long-term debt	1,602.4	1,554.2	1,408.9	1,476.1	1,440.2
Total capitalization	3,626.1	3,444.7	3,180.6	3,122.2	2,952.0
Debt as % of net utility plant*	45.5%	46.7%	44.5%	49.3%	52.0%
Interest on debt	110.3	102.4	96.9	97.5	96.1
Payments to City of L.A.	78.5	70.2	67.9	64.4	58.9
Operations					
Killowatt hours sold (billions)	21.9	21.1	20.5	20.3	19.9
Customers—average number (thousands)	1,325.3	1,304.6	1,275.9	1,262.0	1,251.2
Average revenue per kwh sold (in cents)					
Residential	8.2	7.7	7.1	6.9	6.7
Commercial and industrial	7.7	7.3	6.8	6.6	6.3
Energy production (billion kwh)					
Hydro	1.1	1.8	2.9	3.8	4.9
Thermal	19.7	20.2(B)	16.0(B)	13.3	12.3
Total generation	20.8	22.0	18.9	17.1	17.2
Purchases	4.7	2.6	4.3	5.8	6.5
Total production	25.5	24.6(B)	23.2(B)	22.9	23.7
Net system capability (thousand megawatts)					
Hydro	1.4	1.9	1.9	1.9	1.9
Oil and gas owned	3.1	3.1	3.3	3.3	3.2
	4.5	5.0	5.2	5.2	5.1
Jointly owned	2.2	1.1	1.1	1.0	1.1
Firm purchases	.6	1.2	1.3	1.1	0.3
	7.3	7.3	7.6	7.3	6.5

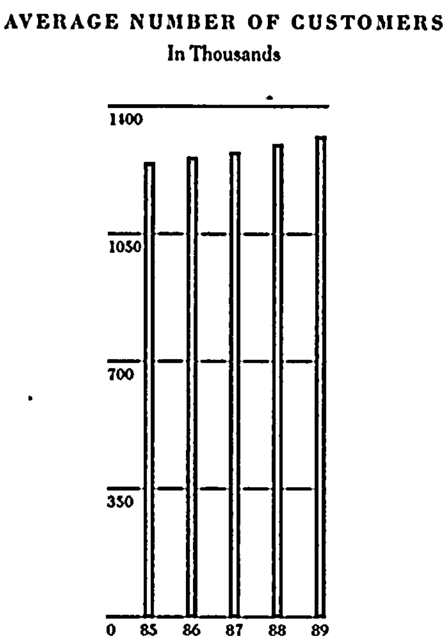
**Excludes revenue notes and advance refunding revenue bonds.*

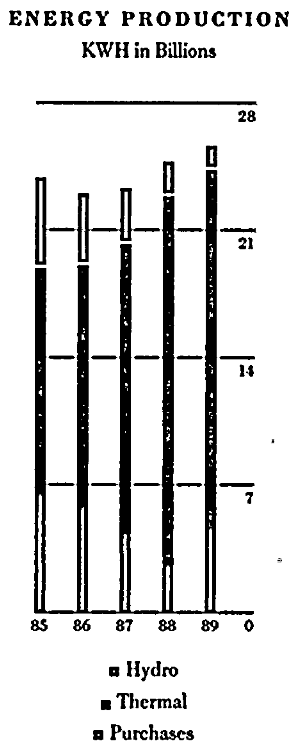
(A) Restated due to change in accounting method.

(B) Restated to include cogeneration.

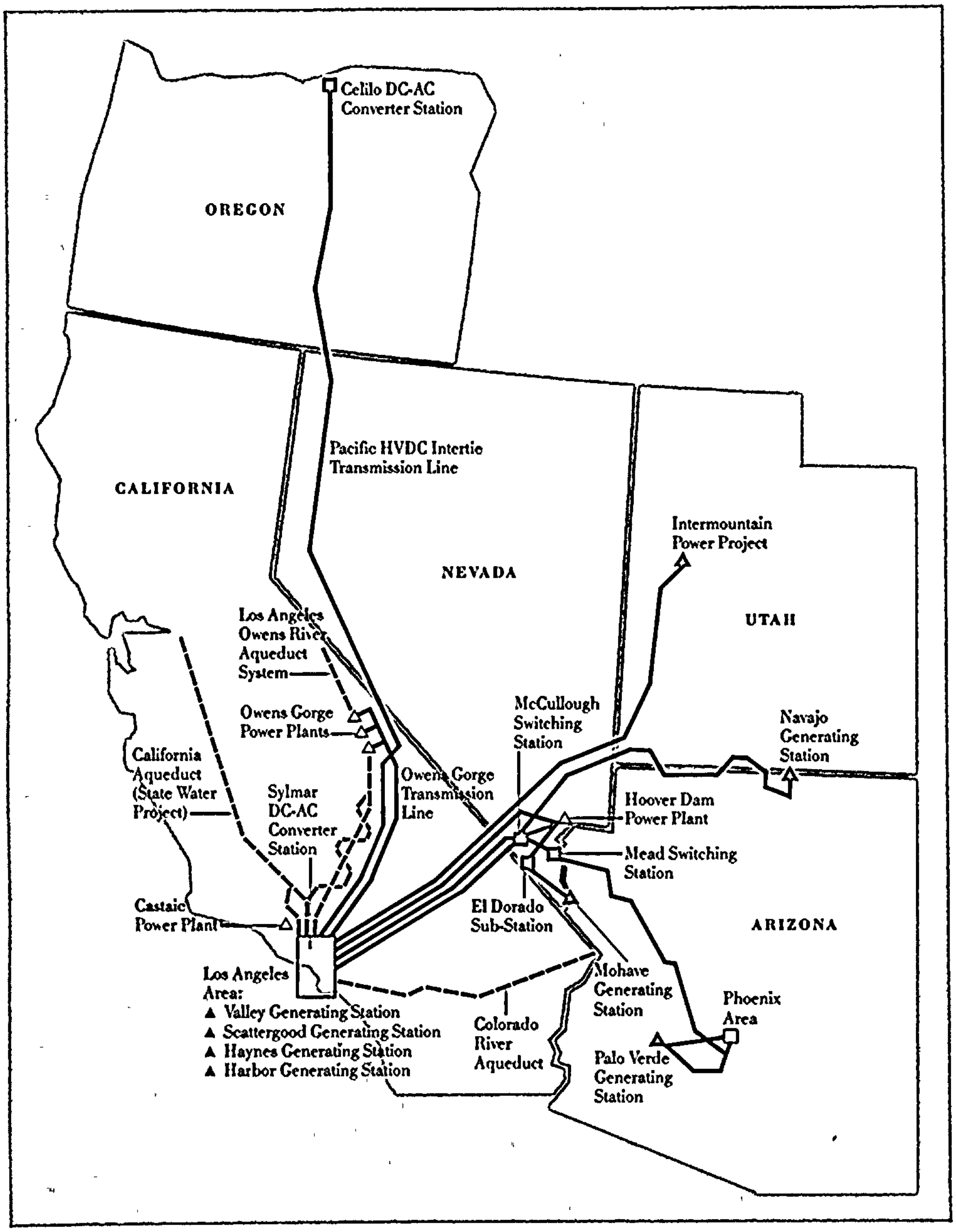

OPERATING REVENUES
$ in Millions
1800
1350
900
450
0
85
86
87
88
89
Residential
Commercial and Industrial
Street Lighting and Other
Miscellaneous


KILOWATT HOURS SOLD
In Billions
24
18
12
6
0
85
86
87
88
89


AVERAGE NUMBER OF CUSTOMERS
In Thousands
1400
1050
700
350
0
85
86
87
88
89


ENERGY PRODUCTION
KWH in Billions
28
21
14
7
0
85
86
87
88
89
Hydro
Thermal
Purchases

WATER/POWER NETWORK



--- Water System —— Power Supply

Generating facilities in other western states are playing larger roles in the City's power supply. Water, also imported from hundreds of miles away, is brought to L.A. by aqueduct to serve the needs of the 3.4 million population.

INFORMATION OF INTEREST

Water

The amount of water consumed *every second* in the City of Los Angeles would fill a medium-sized swimming pool.

The first water meter in Los Angeles was installed at a winery near the corner of Macy Street and Mission Road in 1889.

Los Angeles' largest body of water in terms of surface area is the Los Angeles Reservoir in Mission Hills, covering 176.1 acres.

Los Angeles' largest body of water in terms of volume is Lower Stone Canyon Reservoir above Bel Air, holding 3.4 billion gallons.

Peak daily water demand in the City of Los Angeles last year occurred on August 22, 1988, when 833 million gallons were delivered.

Annual rainfall in Los Angeles over the last decade has ranged from a high of more than 30 inches in 1982–83 to a low of less than 10 inches in 1980–81.

Daily per capita water consumption here over the last decade has ranged from a high of around 190 gallons in 1984–85 to a low of less than 170 gallons in 1978–79.

The first water works system in America was built in Boston, Mass. in 1652.

The first municipal water system in Los Angeles was established in 1854.

Prolonged drought conditions in 1930 cut water flow through the Los Angeles Aqueduct to just over 50 percent of normal, the lowest level ever recorded.

The highest single day usage of water in Los Angeles—923 million gallons—occurred on June 16, 1981.

Power

America's first electrical power for street lighting was generated by the California Electric Light Company of San Francisco in 1879.

The first electricity sold to private customers was generated by the Edison Electric Illuminating Company in 1882.

It would take the physical labor of every adult male in California working steadily from 9 to 5 to produce as much energy as the DWP delivers in an hour.

Peak electrical demand in Los Angeles last year occurred on September 6, 1988, when 4,991 megawatts were delivered.

The DWP owns, jointly or with partners, nearly 300,000 power poles.

Cables used to carry DWP electricity, if joined end to end, would reach from coast to coast more than five times.

The typical residential electric bill in Los Angeles last year was around $35.43 per month.

The DWP maintains nearly 3,500 portable and mobile radio transmitters, nearly 1,500 individual pagers and 123 telephone switchboards, in order to communicate effectively and provide efficient customer services.

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