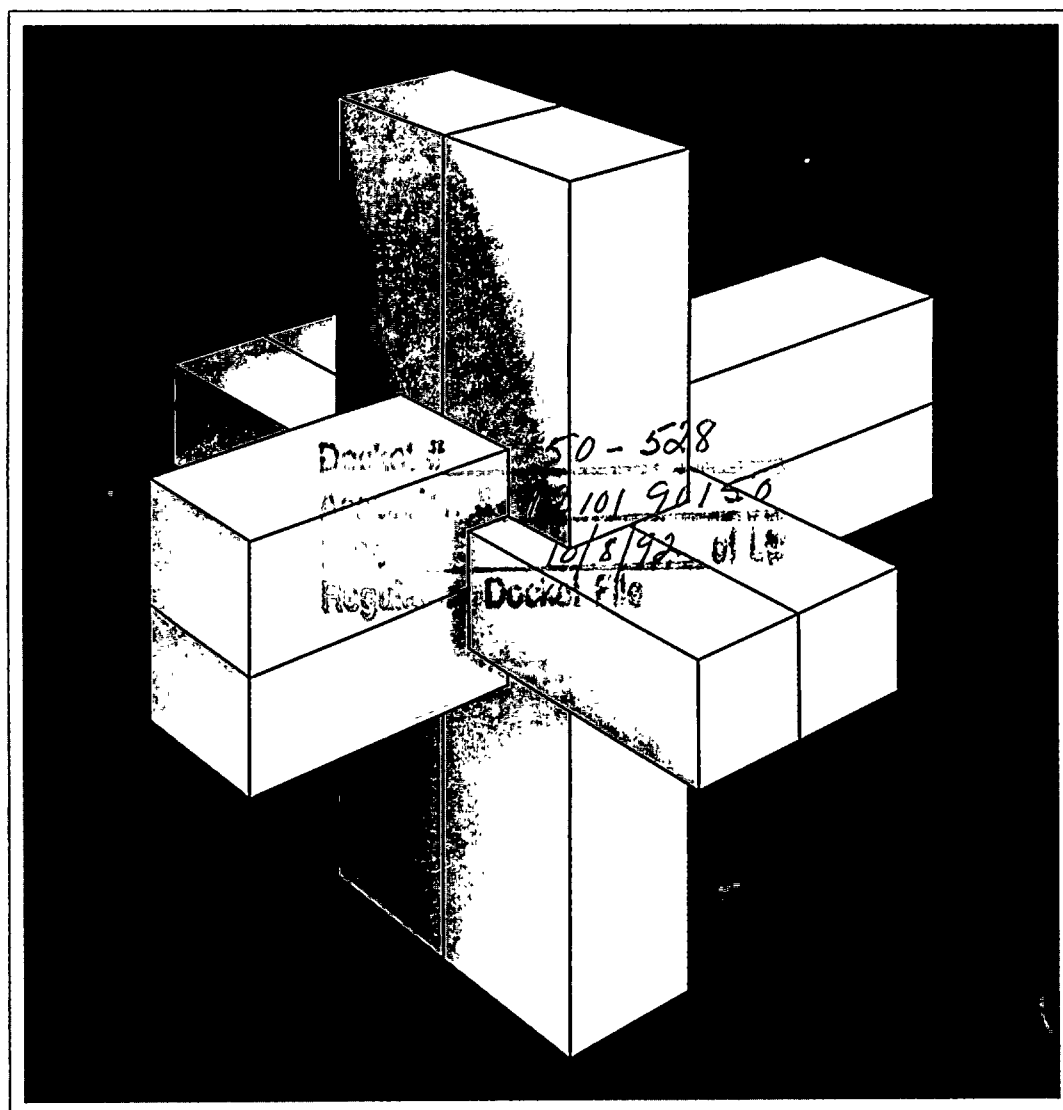


ANNUAL REPORT

1991

Public Service Company of New Mexico



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ABOUT THE COMPANY...

PUBLIC SERVICE COMPANY OF NEW MEXICO is a public utility with principal offices located at Alvarado Square, Albuquerque, New Mexico. Incorporated in 1917, we are the largest public utility headquartered in the state. Primarily an electric and natural gas utility, we also own a water company serving the city of Santa Fe, New Mexico. Our mission is to be the energy supplier of choice in New Mexico and regional markets and to provide high-quality, competitive utility products and services. □

ABOUT THE PUZZLE...

The tasks facing PUBLIC SERVICE COMPANY OF NEW MEXICO are like finding the solution to the puzzle on our cover. Each piece of the puzzle represents a challenge the company faces. We continue to fit the complex, notched pieces together, making progress toward restoring our financial health and competing in the changing retail and wholesale marketplaces. This annual report examines the primary challenges we face, and the strategies we are using to resolve them. □

FINANCIAL HIGHLIGHTS...

PUBLIC SERVICE COMPANY OF NEW MEXICO and Subsidiaries

	1991	1990	% Change
Operating revenues	\$857,168,000	\$881,186,000	(2.7)
Operating expenses	\$759,915,000	\$788,745,000	(3.7)
Net earnings	\$ 22,960,000	442,000	N/M
Return on average common equity	1.8%	(1.3)%	N/M
Earnings (loss) per common share	\$ 0.32	\$ (0.23)	N/M
Book value per common share at year-end	\$ 17.69	\$ 17.36	1.9
ELECTRIC:			
Total kilowatt-hour sales	8,231,495,000	8,546,336,000	(3.7)
GAS:			
Decatherm throughput	110,291,000	99,045,000	11.4

N/M Percent change not meaningful

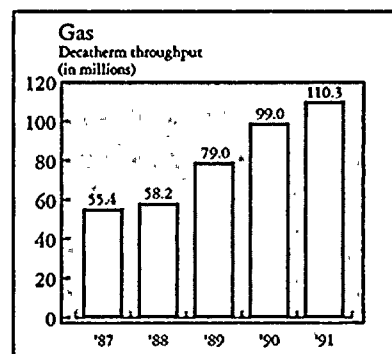
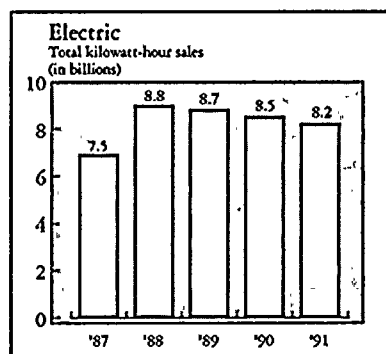
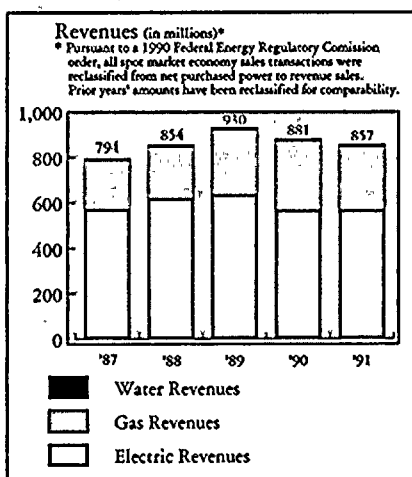
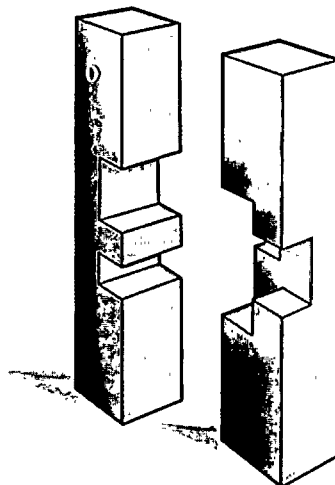


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CHAIRMAN'S LETTER...



March 12, 1992

To My Fellow Shareholders:

You have probably seen a wooden puzzle like the one pictured on the cover of this report. To us, the puzzle symbolizes our business. It has many pieces. Each piece is different. Each may change. Yet each is critical to success. And sometimes the shape of the whole changes and a new piece needs to be developed or re-fit into the puzzle to make it work.

In 1991 we added some key pieces to our business puzzle. In 1992 we'll add more. We are accommodating the pieces that change, like our marketplace. Flexibility is the key to meeting our goal of being the energy supplier of choice in New Mexico and our region. Our main thrust hasn't changed. We will deliver competitively-priced, high-quality energy products and services. In doing so, we intend to return to financial health.

WORKING TO RESTORE A DIVIDEND

Our 1991 earnings were 32 cents per common share. This represents an increase of 55 cents over last year's loss of 23 cents per share. However, 1990's results included a write-off of 46 cents per share due to a negative rate order. Our 1991 earnings were reduced by one-time charges totalling 21 cents per share related to litigation expenses and additional gas contract settlement reserves. By achieving our business plan, we expect 1992 results to continue to improve. We're gaining on our goal of restoring the common dividend, but we've got more work to do before we can commit to a date when this will happen. This critical piece of the puzzle is very much on our minds.

HITTING OUR BUDGET TARGETS

We met our 1991 targets for reductions in non-fuel operations and maintenance budgets. In some areas, we did better than that.



About mid-year I asked the work force to step up the pace. Our people responded; by year end \$15.2 million was saved. We set an even more aggressive target for 1992.

MAKING HEADWAY ON EXCESS CAPACITY

We're doing better on our biggest problem, as well — our investment in power plants which are excluded from rate base and which have remained unprofitable. This excess generating capacity is a large piece of the puzzle. Our excluded capacity created a financial drain of approximately 86 cents per share in 1991.

To temper the capacity problem, we have been aggressively pursuing wholesale power sales. Recently the Imperial Irrigation District in Southern California signed a three year 81 MW power sale agreement beginning in March 1992. It's good news. We also have been selected by another utility as one of the final candidates for a power sale agreement of five years.

And these come on the heels of 1991 wholesale power sales to the Arizona Power Pooling Association (APPA) and to the Arizona Electric Power Cooperative (AEPCO). The APPA contract and the AEPCO contract are for 17 years and three years, respectively; together, those two contracts are estimated to have contributed 3 cents per share in 1991 and are expected to contribute 5 cents per share in 1992.

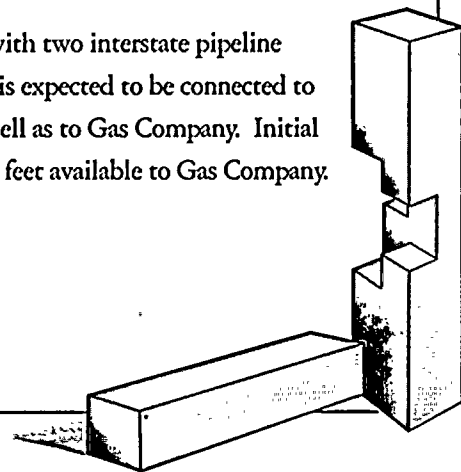
We are also investigating the sale of some of our generation assets. We believe the sale of generation assets may be necessary to help us achieve the right generation mix for the future.

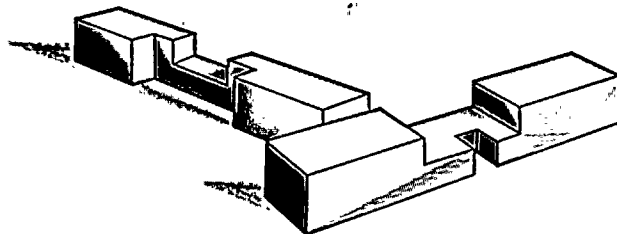
We put a good piece into the puzzle in February 1992, when we announced a stipulated agreement which will pave the way for an asset sale of approximately 50 MW of San Juan Unit 4 to the city of Anaheim, California. This stipulation also calls for the decertification of the remaining 80 MW of San Juan Unit 4 presently excluded from our rate base. Decertification should enhance future sales of the remaining capacity by eliminating the requirement for future New Mexico Public Service Commission approval. The Commission's order on the stipulated agreement is expected in May 1992.

EXPANDING GAS OPERATIONS

Our gas division, Gas Company of New Mexico, and two gas-related subsidiaries, increased volume throughput for the third consecutive year. As we said last year, new facilities — compression and transmission extensions — helped drive these increases.

In November 1991, Gas Company entered into a joint ownership agreement with two interstate pipeline companies to own and operate the Blanco Hub in the San Juan Basin. The facility is expected to be connected to two major coal-seam gas treating plants and to at least two interstate pipelines as well as to Gas Company. Initial capacity will be about 800 million cubic feet per day with about 150 million cubic feet available to Gas Company.





Blanco Hub will provide a direct source of lower cost gas supplies for consumers in New Mexico. And it will enhance our ability to move gas off Gas Company's system to the interstate market.

THE REALITY OF COMPETITION

There's been a lot of heated discussion in our industry about competition, but we think it's here. How power is generated, sold, transported and consumed — just about every aspect of this business is likely to be affected by regulatory and legislative changes. Proposed legislation could usher in a new era of competition. We've got to be ready to compete.

How do we prepare for the new world? Throughout 1991, we took steps to streamline our organization. Study teams from across the company looked at ways to increase efficiency and improve quality in our services and operations. In most cases, they are redefining how we deliver services and run our operations. We will adopt their best ideas and begin implementation in 1992. We need to be a low-cost supplier in our regional market.

This past year, natural gas prices hit their lowest levels in more than a decade. At the same time, cheap hydroelectricity became more abundant after several years of drought. It was harder for our nuclear and coal-fired generation to compete on the wholesale market. We decided to find out if there were alternatives to coal-firing some of our generation. And we decided to look again at our coal supply contract at San Juan Generating Station.

We have conducted preliminary studies of the cost of converting two units at San Juan from coal-fired to natural gas. We have solicited bids for a long-term natural gas supply to complete this evaluation. We are also working with the San Juan Coal Company, supplier at San Juan, to further reduce mining operation costs and lower contract prices for coal. The best economic choice will prevail. That's competition.

Competition is directly related to consumer costs. So, we announced a three-year rate freeze in January 1991 after Albuquerque voters passed an amendment to the City Charter in 1989 seeking competitive bidding for electric franchises.

CITY OF ALBUQUERQUE ELECTRIC FRANCHISE

In the minds of voters, competitive bidding for the electric franchise—now embodied in Article XV of the City Charter—should produce lower rates. But voters' concern for lower electric rates cannot be served by Article XV. In November 1991, the Commission issued an order which, among other things, stated that:

- A municipal franchise cannot set rates for customers other than the municipality, and the authority to approve rates rests solely with the Commission. The city is currently appealing this aspect to the New Mexico Supreme Court.
- Our company has an obligation to serve Albuquerque customers with or without a franchise.

The issue remains unresolved. The franchise has expired; but we will continue to serve. And we will continue to work with the city to reconcile this issue.

REACHING SETTLEMENTS

In December 1991, we settled the lawsuit brought at the direction of the Board's special litigation committee against our former chairman and two other former executives. The suit sought, among other things, recovery of certain bonuses, fees and compensation previously paid to these executives. The defendants denied any wrongdoing and asserted various counterclaims against the company.

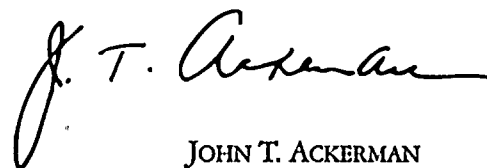
Early this month, we announced an agreement in principle settling all pending shareholder class action and derivative lawsuits. The \$33 million settlement is subject to court approval, and will be funded by the company's directors' and officers' liability insurance carriers.

These settlements represent an important step toward closing these chapters in our company's history. Because of the complexity of these settlements, I will not elaborate on them in this letter. However, a more detailed discussion appears in the company's report on Form 10-K which is a part of this annual report.

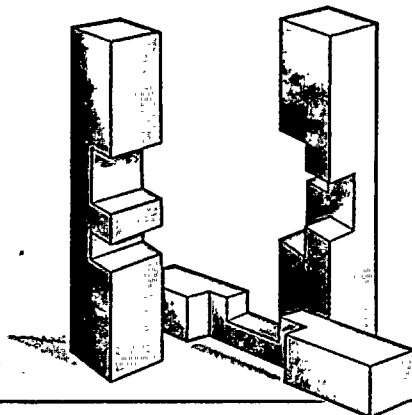
FITTING THE PIECES

As I wrote at the start of this letter, the puzzle contains many critical pieces. Moving one piece affects the positions of all the rest. In 1991, we looked at each piece from every angle. The ones we could put in place, we did. The ones that are more difficult, we're working on. But we know what they are and where they fit and what we need to do to make them fit.

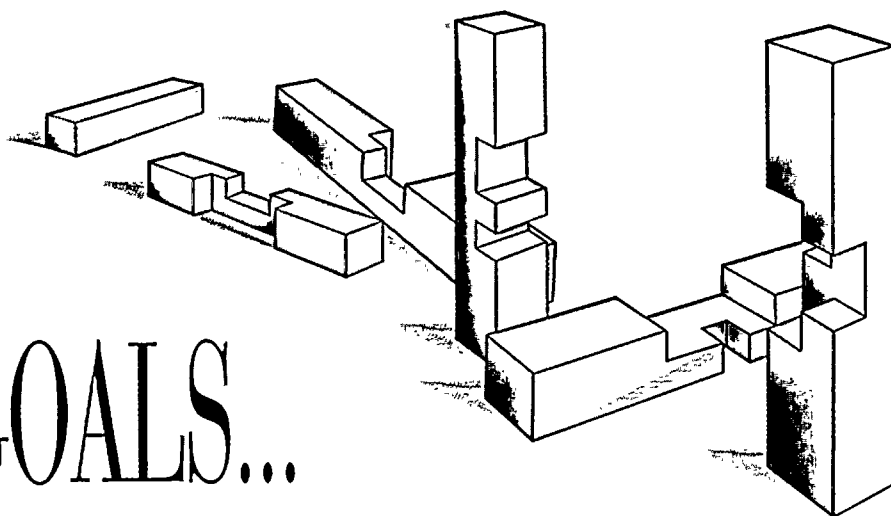
We know that in the final analysis, we must complete this puzzle for our shareholders and our customers. We must complete the overall design of a healthy organization providing low-cost, high-quality energy products and services, and a competitive return for our investors. And that is what we intend to do — PIECE BY PIECE. □



JOHN T. ACKERMAN
CHAIRMAN AND PRESIDENT



STATUS OF OUR GOALS...



PROFITABILITY

GOAL: Reinstate sustainable common dividend and improve bond rating to investment grade as soon as possible.

STATUS:

- Earnings increased 55 cents over 1990.
- Significant cost savings achieved, more to come.
- Service Design Teams promoting efficiency, quality.
- Progress made in committing excess capacity.
- Albuquerque franchise remains an open issue.

PRODUCT PRICE

GOAL: Retail electric and gas rates reach the lowest one-third of regional energy companies.

STATUS:

- Froze base rates through 1993.
- Residential electric rates in middle third, improvement needed.
- Working on reducing coal costs to compete.
- Analyzing conversion of coal-fired generation to less expensive natural gas.
- Gas rates reached lowest third for December 1991 bills.
- Gas contract litigation and regulatory proceedings continue.

MARKET EXPANSION/REVENUE GROWTH

GOAL: Increase earnings before interest and taxes (EBIT) by \$5 million for electric operations and \$2 million for gas operations over the 1990 business plan.

STATUS:

- Improved EBIT \$1.2 million over 1990 business plan.
- Innovative service, incentive rates, and economic development activities add new load.
- New Mexico continues to grow and diversify.

WORK FORCE SATISFACTION

GOAL: Increase work force satisfaction by 10 percent each year as measured by the 1990 Working Environment Survey.

STATUS:

- Improved results but did not reach goal.
- Management commitment to improved communication.

PUBLIC TRUST AND CREDIBILITY

GOAL: Improve public trust and credibility by 15 percent per year as measured by 1990 customer survey data.

STATUS:

- Exceeded goal in 1991.
- Regulatory stipulations indicate progress.
- Sangre de Cristo Water Company received Environmental Excellence Award.

In last year's annual report, we presented our Mission Statement, which set forth our commitments to our customers, investors, work force, and community. Our Mission Statement identified five broad objectives which we are striving to achieve by the end of 1993. These objectives center around profitability, product price, market expansion and revenue growth, work force satisfaction, and public trust. In the next few pages, we'll discuss the work we've done with every piece of the puzzle and the work we envision in the years ahead.

PROFITABILITY

GOAL: Reinstate sustainable common dividend and improve bond rating to investment grade as soon as possible.

OUR 1991 RESULTS

Our 1991 operating results show that we have made progress in controlling costs, but also indicate that the recession has had an effect on our revenues, especially in the wholesale power market.

We earned 32 cents per share in 1991, after non-recurring charges of approximately 21 cents per share. Our earnings before one-time charges were 53 cents per share, an improvement of 30 cents over 1990.

In 1991, we committed to reduce budgeted non-fuel operations and maintenance (O&M) expenses ten percent by 1993. In setting this goal, we called for a \$6 million reduction in 1991. We did better than that. Actual 1991 O&M was \$15.2 million less than budgeted. Compared to 1990, our operating costs only increased by 1 percent—less than the rate of inflation.

New wholesale power contracts added another 3 cents to our bottom line, although operating revenues actually declined \$24 million relative to 1990. This drop in revenues was more than offset by a \$42.7 million reduction in fuel, purchased power, and gas costs.

Our retail electric sales grew by 1.8 percent in 1991, with a better than expected increase of 3.2 percent in the fourth quarter. Wholesale revenues, however, declined 12.1 percent for the year, a result of the recession and increased competition from natural gas and hydroelectric generation. We did, however, see an improvement in the fourth quarter as wholesale revenues increased almost 3.2 percent over the same period in 1990.

LOOKING AHEAD

A crucial piece of the puzzle is reducing the financial drag created by excluded capacity, either by marketing power or selling the assets outright.

In 1991, our generation capability and purchased power commitment totaled 1,835 MW, of which the following capacity is excluded from rate base:

- 105 MW is purchased power under contract through 1994;
- 130 MW is from Unit 4, San Juan Generating Station;
- 130 MW is from Unit 3, Palo Verde Nuclear Generating Station.

Excluded capacity can offer a return through either wholesale power sales or through selling generating assets outright.

We made additional long-term and short-term power sales in 1991 which include:

- a three-year 15 MW power sale to the Arizona Electric Power Cooperative through May 1994;
- a 17-year power sale to the Arizona Power Pooling Association. This sale started at 40 MW, increases to 105 MW from June 1994 through May 1998, steps down to 15 MW by 2002, and remains at that level through 2008.

These sales contributed 3 cents per share to our 1991 earnings and are expected to contribute around 5 cents in 1992.

In March 1992, a three-year 81 MW power sale agreement was signed by the Imperial Irrigation District in California, and we have been selected by another utility as one of the final candidates for another short-term power sale agreement.

Although bulk power sales such as these absorb some of the costs of excluded assets, they do not cover them. This, coupled with our analysis of current and projected market conditions, has caused us to investigate selling our excluded assets.

Some progress has already been made. In February 1992, we reached a stipulated agreement with the staff of the New Mexico Public Service Commission and other intervenors which, upon Commission approval, will decertify the 130 MW portion of San Juan Unit 4 currently excluded from our rates. The agreement provides for the sale of 50 MW of San Juan Unit 4 to the city of Anaheim, California. We expect to complete this sale this summer at a price of \$55 million, resulting in an after-tax gain of around \$8.6 million.

This sale will benefit both shareholders and customers. The gain on the sale would add approximately 18 cents per share in 1992, and the sales proceeds will be used to reduce capital costs. The reduction of capital and operating costs should yield a net ongoing annual benefit of 6 to 8 cents per share. And our customers will receive \$1 million from the gain in the form of credits against fuel and purchased power costs. Lastly, if the agreement is approved, all of the excluded portion of San Juan Unit 4 will be decertified leaving us free to sell the remaining 80 MW without Commission approval. We will continue to investigate selling our remaining excluded capacity.

THE ALBUQUERQUE FRANCHISE

Demand for lower electric rates has led to Article XV of the City Charter. Article XV mandates competitive bidding of the electric utility franchise. What used to be a simple right-of-way agreement has become the focal point for a highly politicized debate.

In July 1991, we entered negotiations aimed at reaching a new agreement with the city. Although both parties presented innovative approaches to comply with the spirit of Article XV, the gap between what the city wanted and what the company could offer ultimately remained too vast. The negotiations ended in December. The franchise agreement has since expired, and we have not entered into a new franchise agreement with the city of Albuquerque as of this writing.

Late in 1991, the Commission affirmed its sole authority with respect to service territory and rate making over non-municipal utilities in New Mexico. Despite this ruling, city government continues to seek rate concessions or to find an alternative to our service. The city formed a "paper utility" — the Albuquerque Electric Utility — and is studying the possibility of condemning part or all of our Albuquerque distribution system. Our Albuquerque customers may eventually be asked to vote on city condemnation of our distribution facilities.

We have clearly stated that our system is not for sale. Furthermore, we do not believe that a government-run electric utility could offer lower rates. We have commissioned two studies, both of which show that a city takeover would raise customer rates as much as 33 to 40 percent over 10 years.

Early in 1992, the city requested bids for a one-year franchise agreement. Because our investment in Albuquerque represents a long-term commitment, we rejected the notion of a one-year franchise and submitted a bid for a 25-year agreement. Our bid was subsequently rejected by the city, as was the only other bid submitted.

The expired franchise provided for the collection of a franchise fee of 2 percent of our gross revenues. That fee, which amounted to \$5.2 million last year, was collected as a component of base rates and paid monthly to the city. Because franchise fees are a component of base rates, they are aggregated and collected from all our New Mexico customers, not just those in areas affected by a franchise agreement.

In submitting our bid, we advised the city that if we are unable to reach a long-term agreement by June 30, 1992, we intend to halt monthly payments. At that time, we will work to reduce our Albuquerque customers' bills by the fee amount. To that end, we have sought Commission approval to separate franchise fees from base rates. Itemizing the franchise fee on customers' bills is not new—our gas division has used this process since 1988.

Albuquerque city government is one of our biggest customers, generating revenues of \$17 million in 1991. We do not seek an adversarial relationship with the city. We want to work together to resolve the franchise issue. Recently, there have been signs pointing toward reestablishing discussions. We welcome that, and hope to report a successful resolution of this issue later this year.

PRODUCT PRICE

GOAL: Retail electric and gas rates reach the lowest one-third of regional energy companies.

Reducing our costs and improving efficiency is an important piece of the puzzle. Our relatively new electric generating stations and pollution control equipment for our coal-fired plants helped drive up our electric rates in the early 1980s. Our residential electric customers pay 9.66 cents per kWh, a price which places us in the middle third of regional utilities — above our goal.

Recognizing this, we froze our base electric and gas rates in 1991, and have pledged to keep this freeze in effect through 1993. Because several utilities in our region have recently received or applied for rate increases, we expect our relative position to improve in years to come.

CONTROLLING COSTS

We made real progress in controlling costs in 1991. To achieve our objectives, however, we must do more. In the fourth quarter of 1991, more than 120 gas, electric, and water employees formed Service Design Teams which reviewed 15 functions such as meter reading, billing, payment processing, and engineering. These teams have recommended consolidation and/or centralization in a number of these areas. The consolidation of certain functions may require Commission approval; others we plan to begin implementing by the second quarter of 1992.

We are also seeking ways to reduce our cost of fuel. To this end, we are discussing the reformation of our existing coal contract at San Juan. We have already obtained some concessions from our supplier, whose improved mining operations reduced costs by over \$5 million last year. In the third quarter of 1991, we began a series of discussions to determine if we could achieve more savings. Low natural gas prices have reduced the competitiveness of our coal-fired energy. We are working to regain our competitive edge.

Low gas prices also caused us to begin examining the feasibility of converting San Juan Units 1 and 2 from coal-fired to natural gas. If feasible, a conversion to natural gas could allow us to take advantage of the low gas prices which have lessened the competitiveness of coal. Conversion could also allow us to better match our generation to the marketplace. We would convert only if we are able to:

- secure a firm, economic, long-term gas supply contract;
- obtain support of other San Juan participants;
- secure Commission approval;
- resolve environmental permitting issues.

We will decide whether or not to proceed with a conversion in the second half of this year.

RETAIL GAS RATES

While our electric rates continue to improve relative to regional for comparisons, lower gas costs helped move our gas division's rates to the lower one-third in the region for December 1991 bills. We will strive to keep them there.

Low natural gas prices are not the only reason gas prices have become so competitive. We acquired Gas Company of New Mexico in 1985 as part of a settlement of an antitrust lawsuit related to alleged price-fixing of gas purchase contracts by producers. Many changes followed the purchase, including the pursuit of gas supply contract reformation, which yielded substantial savings in gas costs. Because the cost of gas is charged directly to our customers, these savings are passed along as well and do not affect our bottom line. Lower gas costs have made our gas competitive in the marketplace.

Despite early successes in reforming the contracts, a number of producers sued the company. To settle claims and reform contracts in a manner that would preserve the lower, market-based pricing for customers, Gas Company paid about \$76 million to certain producers. In January and February 1992, the prudence of these settlements was the subject of regulatory hearings. Although the company is seeking to recover about \$68 million, a recent proposal by the hearing examiner would, if adopted by the Commission, allow recovery of \$57 million. We expect it will be at least May before the Commission decides the case.

MARKET EXPANSION/ REVENUE GROWTH

GOAL: Increase earnings before interest and taxes (EBIT) by \$5 million for electric operations and \$2 million for gas operations over the 1990 business plan.

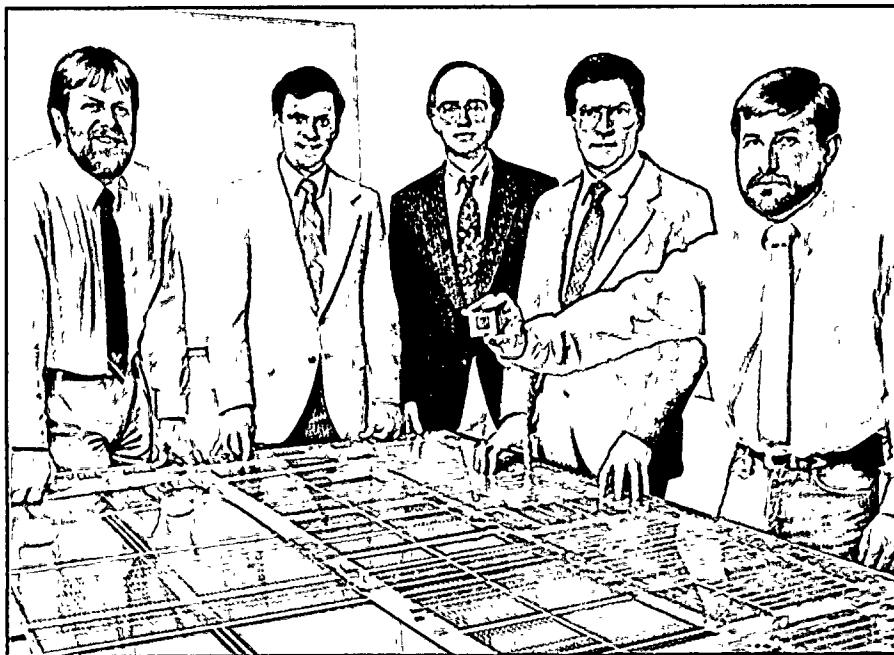
We intend to achieve this goal through added revenues. By the end of 1991, the first year of our effort, we'd increased EBIT by \$1.2 million over our 1990 business plan. This increase, in spite of a recessionary economy and a tough wholesale market, was achieved through innovative marketing efforts, new incentive rates, and economic development activities.

INNOVATIVE SERVICE

In addition to a competitive price, our customers value service and reliability. This is an area in which we continue to be competitive. Good customer service involves more than a friendly face. Our customers have come to value our expertise and willingness to respond to particular needs.

For example, the manufacturing processes of our industrial customers require a wide variety of services. Computer-controlled processes are increasingly vital parts of their operations. Such state-of-the-art controls are highly sensitive to normal power system disturbances, such as lightning strikes, or the effects of other electrical equipment operating within the facility. In many cases, such disturbances can cause significant production losses.

In early 1992, the company joined with the Electric Power Research Institute (EPRI) to address power quality at Intel's microchip fabrication facility in Rio Rancho, New Mexico. Company engineers, in conjunction with EPRI and Intel personnel, are researching power fluctuations which affect an increasing number of manufacturers who use sensitive electronic equipment. These efforts have generated inquiries from out-of-state companies whose processes require very stable electrical power.



High-tech manufacturers need high-tech solutions. Intel's Rio Rancho, New Mexico plant needs a sophisticated power supply to manufacture its silicon wafers. Public Service Company's Bill Jones, Director of Industrial Market Services, works with a team of Intel engineers to improve power quality at the plant.

ECONOMIC DEVELOPMENT

Despite a nationwide recession, New Mexico continued to gain new jobs, although at a modest rate of 1 percent. Albuquerque job growth increased just one-half of 1 percent.

Our state's economy is heavily dependent on military and other federal spending. Almost 10 percent of our state's employment is tied directly to defense spending and an additional 15 percent depends on other government dollars. There is little agreement on how and where government spending will be cut. However, even as military bases are closing around the nation, New Mexico has benefitted. Consolidation of military facilities may bring new people and projects to New Mexico's bases, including Kirtland Air Force Base in Albuquerque.

Attracting new or expanding industry to our service territory is another piece of the puzzle. Public Service Company of New Mexico offers special economic development rates to a wide variety of manufacturing businesses. These rates offer incentives in the early years but escalate over time. General Mills, Solo Cup, Intel, and other companies have taken advantage of these rates to either build new facilities or expand existing ones. As a result, new jobs, as well as electric load, have been created. We look forward to creating additional growth opportunities within New Mexico.

Santa Fe, New Mexico's upscale residential market, continues to grow. At our water division, Sangre de Cristo Water Company, annual customer growth in 1991 was 2.3 percent, compared to 3.0 percent in 1990. A second wet year in a row suppressed demand by our water customers, but also provided plentiful surface water supplies. With full reservoirs, demands for pumping well water will be kept at a minimum in 1992, meaning lower service costs.

A major effort is underway at the Gas Company to build a market for compressed natural gas as a fuel for automobiles and other commercial vehicles. Increasing concerns about vehicle emissions make this an attractive alternative fuel. We are working with regulators on the state and national level to improve our ability to compete in this emerging marketplace.

WORK FORCE SATISFACTION

GOAL: Increase work force satisfaction by 10 percent each year as measured by the 1990 Working Environment Survey.

Results of the 1991 Working Environment Survey revealed that, overall, employee attitudes have improved over 1990. But we did not meet our goal of a 10 percent gain over last year's survey.

More employees felt positive about their work place and believed they could contribute to the financial success of the company. The number of employees stating that they knew the company's direction also increased. Perception of leadership at the top level of the company remains essentially unchanged. There is some improvement in perception of leadership at the supervisor

level, with increased confidence in their leadership and communication abilities.

In 1991, management made a commitment to improve communications with employees concerning issues

facing the company. Formal communications were increased, and senior management met with employees around the state, listening to their concerns. Because nothing can replace a face-to-face discussion, these meetings will continue on a regular basis throughout 1992. These meetings give work force members a forum to air their concerns, as well as a chance to meet company leaders on a first-name basis.

More training is being offered to help employees adapt to a changing, competitive environment. Our people must increasingly become "problem solvers" and work cooperatively in teams. In 1991, the Service Design Teams challenged the *status quo* and proposed creative solutions to common problems. The process has fostered a new way of thinking about our company and about our roles in it.

PUBLIC TRUST AND CREDIBILITY

GOAL: Improve public trust and credibility by 15 percent per year as measured by 1990 customer survey data.

We have seen improvement in the public's trust and credibility in our company. Compared to the previous year, over twice as many customers tell us that they find our company trustworthy and believable. Customers have taken note of our actions to resolve past issues, improve our service and change our company. But restoring the public trust is a goal we know will take some time to meet.

With improved trust and credibility comes a greater ability to work cooperatively with other key constituencies. We are continually working to improve cooperation with parties in regulatory proceedings. This effort has helped to avoid protracted

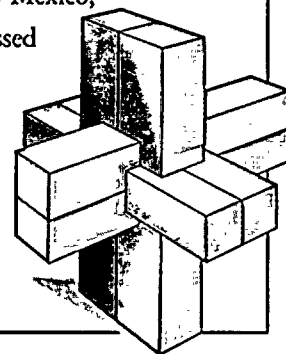
regulatory arguments and has resulted in stipulated agreements among the parties, including the previously discussed stipulation to decertify 130 MW of San Juan Unit 4.

Our Sangre de Cristo Water Company received an award from the United States Environmental Protection Agency in 1991. The water company received the Environmental Excellence Award in competition against water suppliers in a five-state area. The award is given to water companies which demonstrate a commitment to maintaining and protecting public water supplies.

The Albuquerque franchise issue also involves public trust and credibility. Progress made toward its resolution will further our success in meeting this goal during the coming months.

OUR CO-PARTICIPANTS' PROBLEMS

The financial difficulties of Tucson Electric Power, Century Power, and El Paso Electric Company have been publicized during the last year. These three companies, along with Public Service Company of New Mexico, are co-participants in certain generating stations. Financial implications for the company are discussed in the company's report on Form 10-K which is a part of this annual report. □



DIRECTORS...



JOHN T. ACKERMAN 4,6,7
Director since 1990, age 50
Chairman, President and
Chief Executive Officer
Public Service Company of New Mexico



ROBERT G. ARMSTRONG 2,5,7
Director since 1991, age 51
President
Armstrong Energy Corporation
Roswell, NM



VICKIE L. FISHER 1,3,7
Director since 1990, age 45
Vice President, Finance
Mountain States Life
Insurance Company
Albuquerque, NM



JOYCE A. GODWIN 2,3,6,7
Director since 1989, age 48
Vice President
Presbyterian
Health Care Services
Albuquerque, NM



CLAUDE E. LEYENDECKER 1,4,6
Director since 1970, age 69
Chairman of the Board
United New Mexico Bank
at Mimbres Valley
Deming, NM



ROBERT R. REHDER 1,3
Director since 1975, age 61
Professor of Management
University of New Mexico
The Robert O. Anderson Graduate
Schools of Management
Albuquerque, NM



PAUL F. ROTH 2,4,5,7
Director since 1991, age 59
President
Greater Dallas Chamber of Commerce
Dallas, TX

(Not Pictured) **ARTURO G. ORTEGA** 3,4,6 Director since 1985, age 71, Attorney, Albuquerque, NM

1 Member of Audit Committee / 2 Member of Compensation Committee / 3 Member of Corporate and Public Responsibility Committee / 4 Member of Executive Committee
5 Member of Finance Committee / 6 Member of Nominating Committee / 7 Member of Litigation Committee / Ages and committee assignments as of February 24, 1992.

OFFICERS...



Members of the EXECUTIVE LEADERSHIP TEAM include: standing left to right, William M. Eglinton, Judith A. Zanotti, John T. Ackerman and M. Phyllis Bourque; sitting left to right, Patrick T. Ortiz, Max H. Maerki, Jerry L. Godwin, William J. Real and Jeff E. Sterba.

JOHN T. ACKERMAN

Chairman, President and Chief Executive Officer
(20), age 50

WILLIAM M. EGLINTON

Executive Vice President and Chief Operating Officer
(21), age 44

WILLIAM J. REAL

Executive Vice President, Gas Operations
(13), age 43

MAX H. MAERKI

Senior Vice President and Chief Financial Officer
(8), age 52

JEFF E. STERBA

Senior Vice President, Retail Electric and Water Services
(14), age 36

M. PHYLLIS BOURQUE

Senior Vice President, Gas Management Services
(4), age 44

JUDITH A. ZANOTTI

Senior Vice President, Human Resources and Communications
(6), age 53

PATRICK T. ORTIZ

Senior Vice President, General Counsel and Corporate Secretary
age 42

JERRY L. GODWIN

Senior Vice President, Wholesale Marketing and Power Supply
(11), age 49

EDWIN A. KRAFT

Vice President, Central Rio Grande Customer Services
(21), age 43

ELLEN A. WILSON

Vice President, Human Resources
(13), age 44

LAWRENCE D. RATLIFF

Vice President, Power Production
(17), age 45

MICHAEL C. SLOTA

Vice President
(18), age 45

ALFONSO R. LUJAN

Vice President, Regional Customer Services
(19), age 43

D.A. "ZAN" JAMES

Vice President, Strategic Services
(5), age 48

JOHN RENNER

Vice President, Gas Transmission Operations
(5), age 63

JAMES A. HUNTER

Vice President, Marketing
(5), age 50

DAVID J. DAVIS

Vice President, Metropolitan Operations, Gas Operations
(18), age 47

TERRY D. RISTER

Vice President, Regional Operations, Gas Operations
(20), age 40

MILO L. MCGONAGLE

Vice President, Industrial Development Services
(4), age 61

MARC D. CHRISTENSEN

Vice President, Communications
age 43

DONNA M. BURNETT

Corporate Controller and Chief Accounting Officer
(12), age 38

THOMAS G. SATEGNA

Controller, Electric Operations
(15), age 38

ANDREW R. VOGT

Controller and Assistant Secretary, Gas Operations
(4), age 41

KAREN A. KNIGHT

Assistant Secretary
(17), age 52

MITCHELL J. MARZEC

Treasurer
(16), age 44

ROBERT G. MCMAHON

Assistant Treasurer
(15), age 48

TERRY R. HORN

Assistant Treasurer
(6), age 39

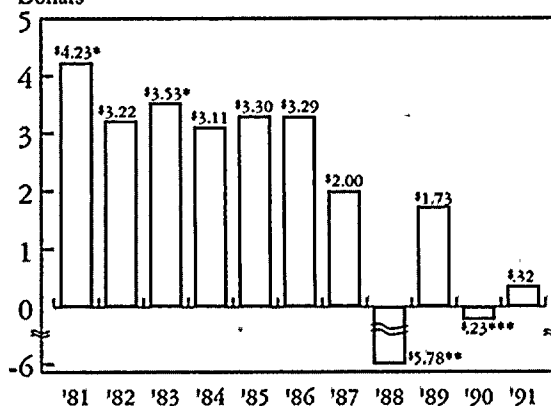
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Earnings Per Share of Common Stock

Dollars



* Includes sale of retained economic interest in coal leases which contributed \$.90 and \$.73 per share, respectively in 1981 and 1983.

** In 1988, the company reported a loss of \$5.78 per share due primarily to a provision for the estimated loss from the discontinuance of the company's non-utility operations, a provision for an extraordinary loss on discontinuation of application of regulatory accounting principles regarding certain assets, the write-off of the company's investment in a proposed coal-fired generating station, the write-off of deferred carrying costs on uncommitted electric generating capacity and one-time costs related to a work force reduction.

*** In 1990, the company recorded a write-off of 46 cents per share due to a negative electric rate order.

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 1991

Commission File Number 1-6986

Public Service Company of New Mexico

(Exact name of registrant as specified in its charter)

New Mexico
(State or other jurisdiction of
incorporation or organization)

85-0019030
(I.R.S. Employer
Identification No.)

Alvarado Square
Albuquerque, New Mexico
(Address of principal executive offices)

87158
(Zip Code)

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

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$5.00 Par Value	New York Stock Exchange

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

(Title of Class)

Cumulative Preferred Stock (\$100 stated value and without sinking fund) comprised of the following series:

1965 Series, 4.58%

8.48% Series

8.80% Series

8.75% Cumulative Preferred Stock (\$100 stated value and with a periodic sinking fund)

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

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

The total number of shares of the Company's Common Stock outstanding as of January 31, 1992 was 41,774,083. On such date, the aggregate market value of the voting stock held by non-affiliates of the Company, as computed by reference to the New York Stock Exchange composite transaction closing price of \$10% per share reported by the Wall Street Journal, was \$432,804,071.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following document are incorporated by reference into the indicated part of this report:

Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A relating to the annual meeting of stockholders to be held on May 28, 1992 — PART III.

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GLOSSARY

ACP	Ambrosia Coronado Project
AEPCO	Arizona Electric Power Cooperative
AFUDC	Allowance for funds used during construction
APPA	Arizona Power Pooling Association
APS	Arizona Public Service Company
BCD	Bellamah Community Development
BHP-Utah	BHP-Utah International, Inc.
BTU	British Thermal Unit
Century	Century Power Corporation
decatherm	1,000,000 BTUs
DOE	United States Department of Energy
EIP	Eastern Interconnection Project
El Paso	El Paso Electric Company
EPA	United States Environmental Protection Agency
EPNG	El Paso Natural Gas Company
FASB	Financial Accounting Standards Board
Farmington	City of Farmington, New Mexico
FERC	Federal Energy Regulatory Commission
Four Corners	Four Corners Power Plant
Gathering Company	Sunterra Gas Gathering Company, a wholly-owned subsidiary of the Company
GCNM	Gas Company of New Mexico, a division of the Company
KWh	Kilowatt Hour
Los Alamos	The County of Los Alamos, New Mexico
mcf	Thousand cubic feet
Meadows	Meadows Resources, Inc., a wholly-owned subsidiary of the Company
M-S-R	M-S-R Public Power Agency, a California public power agency
MW	Megawatt
MWh	Megawatt Hour
NMEIB	New Mexico Environmental Improvement Board
NMIEC	New Mexico Industrial Energy Consumers
NMPSC	New Mexico Public Service Commission
NRC	United States Nuclear Regulatory Commission
OLE	Ojo Line Extension
PGAC	GCNM's Purchased Gas Adjustment Clause
Plains	Plains Electric Generation and Transmission Cooperative, Inc.
Processing Company	Sunterra Gas Processing Company, a wholly-owned subsidiary of the Company
PVNGS	Palo Verde Nuclear Generating Station
Salt River Project	Salt River Project Agricultural Improvement and Power District
SCE	Southern California Edison Company
SDG&E	San Diego Gas and Electric Company
SJCC	San Juan Coal Company
SJGS	San Juan Generating Station
Southern Union	Southern Union Company
SPS	Southwestern Public Service Company
Sunbelt	Sunbelt Mining Company, Inc., a wholly-owned subsidiary of the Company
throughput	Volumes of gas delivered, whether or not owned by GCNM or Gathering Company
Tucson	Tucson Electric Power Company
WSCC	Western System Coordinating Council
WSPP	Western Systems Power Pool

PART I

ITEM 1. BUSINESS

THE COMPANY

Public Service Company of New Mexico was incorporated in the State of New Mexico in 1917 and has its principal offices at Alvarado Square, Albuquerque, New Mexico 87158 (telephone number 505-848-2700). The Company is a public utility engaged in the generation, transmission, distribution and sale of electricity and in the gathering, processing, transmission, distribution and sale of natural gas within the State of New Mexico. The Company also owns facilities for the pumping, storage, transmission, distribution and sale of water in Santa Fe, New Mexico.

The total population of the area served by one or more of the Company's utility services is estimated to be approximately 1.1 million, of which 52% live in the greater Albuquerque area.

For the year ended December 31, 1991, the Company derived 66.3% of its utility operating revenues from electric operations, 32.3% from natural gas operations and 1.4% from water operations.

As of December 31, 1991, the Company employed 3,150 persons.

Financial information relating to amounts of revenue and operating income and identifiable assets attributable to the Company's industry segments is contained in note 13 of the notes to consolidated financial statements.

ELECTRIC OPERATIONS

Service Area and Customers

The Company's electric operations serve four principal markets. Sales to retail customers and sales to firm-requirements wholesale customers, sometimes referred to collectively as "system" sales, comprise two of these markets. The third market consists of other contracted sales to utilities for which the Company commits to deliver a specified amount of capacity (measured in MW) or energy (measured in MWh) over a given period of time. The fourth market consists of economy energy sales made on an hourly basis to utilities at fluctuating, spot-market rates. Sales to the third and fourth markets are sometimes referred to collectively as "off-system" sales.

The Company provides retail electric service to a large area of north central New Mexico, including the cities of Albuquerque, Santa Fe, Rio Rancho, Las Vegas, Belen and Bernalillo. The Company also provides retail electric service to Deming in southwestern New Mexico and to Clayton in northeastern New Mexico. As of December 31, 1991, approximately 297,000 retail electric customers were served by the Company, the largest of which accounted for 3.5% of the Company's total electric revenues for the year ended December 31, 1991.

The Company holds 22 long-term, non-exclusive franchise agreements for its electric retail operations, expiring between August 1996 and November 2028. The City of Albuquerque franchise expired in early 1992. Customers in the area covered by the City of Albuquerque franchise represent approximately 45.4% of the Company's 1991 total electric operating revenues, and no other franchise area represents more than 7%. These franchises are essentially agreements that permit the Company to use municipal property for electric service rights-of-way. The Company believes that it remains obligated under state law to provide service to customers in the franchise area even in the absence of a franchise agreement with the City. The Company endeavors to renew franchises as they expire. For a discussion of matters related to the electric franchise for the City of Albuquerque, see PART II, ITEM 7. — "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS — CURRENT ISSUES FACING THE COMPANY — The Retail Electric Market".

Power Sales

For the years 1986 through 1991, retail KWh sales have grown at a compound annual rate of 4.0%. However, the growth rate has been lower than had been anticipated at the time the Company committed to construct new generating units in the 1970's. As a result, the Company has substantial excess capacity and must rely on off-system sales to try to recoup the cost of this capacity. The Company has contracted to sell and continues to market power at prices which only recover variable costs and a portion of the fixed costs of its excess capacity. Remaining energy produced by excess capacity is then sold in the economy energy market at prices which average only slightly above incremental operating costs. The Company's system and off-system sales (revenues and energy consumption) and system peak demands in summer and winter are shown in the following tables:

ELECTRIC SALES BY MARKET (Thousands of dollars)

	1991	1990	1989	1988	1987
Retail	\$444,594	\$427,505	\$413,644	\$404,863	\$387,542
Firm-requirements wholesale	22,390	25,739	27,679	27,554	32,312
SPS contract	—	—	109,773	100,006	91,064
Other contracted off-system sales	55,581	70,640	52,804	62,525	44,351
Economy energy sales*	29,665	26,052	14,507	12,112	8,735

ELECTRIC SALES BY MARKET (Megawatt hours)

	1991	1990	1989	1988	1987
Retail	5,139,954	5,048,830	4,909,592	4,684,588	4,447,798
Firm-requirements wholesale	308,390	376,040	397,792	362,934	396,297
SPS contract	—	—	1,618,694	1,577,950	1,585,639
Other contracted off-system sales	1,223,212	1,743,196	1,079,972	1,567,712	508,990
Economy energy sales*	1,559,939	1,378,270	735,558	621,773	515,673

*Pursuant to FERC Order No. 529, all spot market economy sale transactions were reclassified from net purchased power to revenue sales.

SYSTEM PEAK DEMAND* (Megawatts)

	1991	1990	1989	1988	1987
Summer	1,018	1,051	1,006	956	916
Winter†	955	897	896	862	880

*System peak demand relates to retail and firm-requirements wholesale markets only.

†For the winter season beginning in the year noted.

In 1991, the Company furnished firm-requirements wholesale power in New Mexico to the cities of Farmington and Gallup, Texas-New Mexico Power Company and Plains. During 1991, the Company agreed to a modification to Plains' wholesale firm power contract that increased Plains' power purchases from 10 MW to 13 MW effective August 1, 1991 through October 31, 1992. After October 31, 1992, Plains will purchase 10 MW until terminated. Such termination may occur at any time after October 31, 1992. During 1991, the Company entered into negotiations with the City of Gallup to replace its firm-requirements wholesale power contract which expires in February 1993. The City of

Gallup has tentatively selected the Company as its supplier based on those negotiations and has authorized the Company to draft a new contract. No firm-requirements wholesale customer accounted for more than 1.6% of the Company's total electric revenues for the year ended December 31, 1991.

During 1991, the Company's major off-system sale contracts in effect were with SDG&E, APPA and AEPCO. In November 1985, the Company and SDG&E executed an agreement providing for SDG&E to purchase 100 MW from the Company for the period May 1988 through April 2001. On March 7, 1991, APPA and the Company executed a power sale agreement whereby the Company would supply power under a 17-year contract. This agreement calls for a sale of 15 MW of base power beginning in June 1991, increasing to 35 MW for June 1992 through May 1994, 80 MW for June 1994 through May 2002, and 15 MW thereafter through 2008. The APPA agreement also provides for sales of an additional 25 MW of seasonal power in the months of June through September for 1991 through 1998. On March 19, 1991, AEPCO and the Company executed a power sale agreement whereby the Company would supply base power under a three-year agreement. This agreement calls for a sale of 15 MW of power beginning on June 1, 1991 and ending on May 31, 1994. On March 1, 1992, the Company began service pursuant to a three-year off-system sales agreement with the Imperial Irrigation District in Southern California. The agreement which extends through 1995 provides for 56 MW of power in each month and an additional 25 MW of power in the months of April through October each year.

For discussion of the competitive conditions affecting off-system sales and of negotiations with the City of Gallup, see PART II, ITEM 7. — "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS — CURRENT ISSUES FACING THE COMPANY — The Wholesale Power Market".

Sources of Power

The total net generation capacity of facilities owned or leased by the Company was 1,591 MW as of December 31, 1991, comprised of generation from a nuclear plant, located in Arizona, and from two coal-fired plants and two gas/oil-fired plants, located in New Mexico. The two gas/oil-fired plants are used for peaking capacity and transmission support requirements. In addition, the Company has purchase power contracts with M-S-R for 105 MW through April 1995 and with SPS for up to 100 MW of interruptible power through April 1995 and up to 200 MW from May 1995 through May 2011. The Company may reduce its purchases from SPS by 25 MW annually and upon three years' notice. Also, the Company has 39 MW of contingent capacity obtained from El Paso under a transmission capacity for generation capacity trade arrangement. The Company also is interconnected with various utilities for economy interchanges and mutual assistance in emergencies. For discussion of issues relating to co-participants in generating stations, see "Tucson Electric Power Company and Century Power Corporation" and "El Paso Electric Company" under PART II, ITEM 7. — "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS — CURRENT ISSUES FACING THE COMPANY".

Coal-fired Plants

SJGS is located in northwestern New Mexico, and consists of four units operated by the Company. Units 1, 2, 3 and 4 at SJGS have net rated capacities of 316 MW, 312 MW, 488 MW and 498 MW, respectively. SJGS Units 1 and 2 are owned on a 50% shared basis with Tucson, Unit 3 is owned on a 50% shared basis with Century and Unit 4 is owned 55.525% by the Company, 8.475% by Farmington, 28.8% by M-S-R and 7.2% by Los Alamos. The Company's net aggregate ownership in SJGS is 835 MW. In connection with the Company's sale to M-S-R in December 1983 of a 28.8% interest in SJGS Unit 4, the Company agreed to purchase under certain conditions 73.53% (105 MW) of M-S-R's capacity through April 30, 1995, an amount which may be reduced by M-S-R under certain conditions. The Company also agreed to market the energy associated with the remaining 26.47% portion of M-S-R's capacity through April 30, 1995. This marketing arrangement may be terminated by M-S-R at any time upon 30 days notice.

The Company also owns 192 MW of net rated capacity derived from its 13% interest in Units 4 and 5 of Four Corners located in northwestern New Mexico on land leased from the Navajo Nation and adjacent to available coal deposits. Units 4 and 5 at Four Corners are jointly owned with SCE, APS, Salt River Project, Tucson and El Paso and are operated by APS.

In an effort to maintain the competitiveness of power produced by SJGS, the Company is studying the feasibility of converting SJGS Units 1 and/or 2 from coal-fired generation to natural gas or dual-fired generation.

Nuclear Plant

The Company's Interest in PVNGS. The Company is participating in the three 1,270 MW units of PVNGS, also known as the Arizona Nuclear Power Project, with APS (the operating agent), Salt River Project, El Paso, SCE, Southern California Public Power Authority and The Department of Water and Power of the City of Los Angeles. The Company has a 10.2% undivided interest in PVNGS, with its interest in Units 1 and 2 held under leases. The Company's ownership and leasehold interests in PVNGS amount to 130 MW per unit, or a total of 390 MW. PVNGS Units 1, 2 and 3 were declared in commercial service by the Company in January 1986, September 1986 and January 1988, respectively. Commercial operation of PVNGS requires full power operating licenses which were granted by the NRC. Maintenance of these licenses is subject to NRC regulation. During 1991, PVNGS Units 1, 2 and 3 had capacity factors of approximately 83.7%, 74.3% and 67.6%, respectively. A stipulation adopted by the NMPSC on March 6, 1990 sets performance standards for the operation of PVNGS. Under the performance standards, a "dead band" was established at capacity factors of 60% through 75%, as measured by the capacity factor of all three PVNGS units over the fuel cycle. Within the dead band, the Company would receive no reward or penalty. The Company would be penalized with one-half of the additional fuel costs incurred for PVNGS capacity factors of 50% to 60% and would be rewarded with one-half of the avoided fuel costs if PVNGS operates at capacity factors from 75% through 85%. Capacity factors above 85% or below 50% would reward or penalize the Company by an amount equal to the additional fuel costs avoided or incurred.

In January 1991, the NRC issued a Systematic Assessment of Licensee Performance ("SALP") for PVNGS for the twelve month-period ending November 30, 1990. The SALP is the standard performance grading process used by the NRC to communicate to the public in a formal manner how each nuclear plant operates. The January 1991 SALP showed an improvement in four of the seven areas that the NRC had evaluated. Of the remaining three areas, two showed an improving trend, while one remained the same. The Company expects that the NRC will issue the next SALP for PVNGS in April 1992.

During 1991 and prior years, the NRC has proposed and assessed civil penalties for various violations at PVNGS that have been categorized as problems of Severity Level III or less severity (on a scale of I to V in accordance with the "General Statement of Policy and Procedure for NRC Enforcement Actions", with Level I being the most severe). By letter dated February 3, 1992, the NRC sent a Notice of Violation and Proposed Imposition of Civil Penalties (the "NRC Notice") notifying APS, as operating agent of PVNGS, that the NRC proposes to impose civil penalties in the cumulative amount of \$162,500 for several violations categorized as two "Severity Level III" problems. The first Severity Level III event involved the partial loss of offsite power due to a crane boom contacting a transmission line, and the second Severity Level III event involved the failure to ensure that reactor core alternation activities were supervised by a senior reactor operator. For the first event, the NRC increased the base civil penalty of \$50,000 to \$112,500 due to inadequate corrective actions and prior notice of similar events. For the second event, the NRC proposed a civil penalty of \$50,000, reflecting a mitigation of the base civil penalty because of APS's identification and reporting of the violation, and a corresponding escalation of the base civil penalty because, although corrective actions were prompt, APS did not, in the NRC's view, adequately address issues of responsibility and control. By letter dated March 2, 1992, APS responded to the NRC notice and paid the \$162,500 of penalties.

Sale and Leaseback Transactions of PVNGS Units 1 and 2. In eleven transactions consummated in 1985 and 1986, the Company sold and leased back its entire 10.2% interest in PVNGS Units 1 and 2, together with portions of the Company's undivided interest in certain PVNGS common facilities. In each transaction, the Company sold interests to an owner trustee under an owner trust agreement with an institutional equity investor. The owner trustees, as lessors, leased the interests to the Company under lease agreements having initial terms expiring January 15, 2015 (with respect to the Unit 1 leases) or January 15, 2016 (with respect to the Unit 2 leases). Each lease provides an option to the Company to extend the term of the lease as well as a repurchase option. The aggregate lease payments for the Company's PVNGS leases are approximately \$84.6 million per year. Throughout the terms of the leases, the Company continues to have full and exclusive authority and responsibility to exercise and perform all of the rights and duties of a participant in PVNGS under the Arizona Nuclear Power Project Participation Agreement and retains the exclusive right to sell and dispose of its 10.2% share of the power and energy generated by PVNGS Units 1 and 2. The Company also retains responsibility for payment of its share of all taxes, insurance premiums, operating and maintenance costs, costs related to capital improvements and decommissioning and all other similar costs and expenses associated with the leased facilities. The PVNGS leases are classified as operating leases in accordance with generally accepted accounting principles.

Each lease describes certain events, "Events of Loss" or "Deemed Loss Events", the occurrence of which could require the Company to, among other things, (1) pay the lessor and the equity investor, in return for such investor's interest in PVNGS, cash in the amount provided in the lease, which amount, primarily because of certain tax consequences, would exceed such equity investor's outstanding equity investment, and (2) assume debt obligations relating to the PVNGS lease. The "Events of Loss" generally relate to casualties, accidents and other events at PVNGS, which would severely adversely affect the ability of the operating agent, APS, to operate, and the ability of the Company to earn a return on its interests in, PVNGS. The "Deemed Loss Events" consist mostly of legal and regulatory changes (such as changes in law making the sale and leaseback transactions illegal, or changes in law making the lessors liable for nuclear decommissioning obligations). The Company believes the probability of such "Events of Loss" or "Deemed Loss Events" occurring is remote. Such belief is based on the following reasons: (a) To a large extent, prevention of "Events of Loss" and some "Deemed Loss Events" is within the control of the PVNGS participants, including the Company, and the PVNGS operating agent, through the general PVNGS operational and safety oversight process and (b) with respect to other "Deemed Loss Events," which would involve a significant change in current law and policy, the Company is unaware of any pending proposals or proposals being considered for introduction in Congress, or any state legislative or regulatory body that, if adopted, would cause any such events.

On February 21, 1992, the Company filed a case with the NMPSC for approval to purchase the beneficial interests in two owner trusts that hold PVNGS leases in which the Company is the lessee (approximately 29 MW each of PVNGS Unit 1 and 2). The purchase is expected to provide the Company with (1) added flexibility to decrease future rates, (2) the residual value of a certain portion of the PVNGS Units at no cost, (3) reduced exposure to indemnification provisions in the lease agreements and (4) added flexibility to cause the retirement of the underlying lease obligation bonds ("LOBs"). (See also note 8 of the notes to consolidated financial statements.) The retirement of the LOBs would only be caused if (1) adequate cash is available, (2) it is determined to be the best use of funds, and (3) the appropriate approvals are obtained. The closing date for the purchase is anticipated in July 1992, subject to receipt of a satisfactory, final, non-appealable order from the NMPSC by the end of June 1992.

Decommissioning Funding. The Company has a program for funding its share of decommissioning costs for PVNGS. Under this program, the Company will make a series of annual deposits to an external trust fund over the estimated useful life of each unit, and the trust funds will be invested under a plan which allows the accumulation of funds largely on a tax-deferred basis through the use of life insurance policies on certain employees. The Company began funding its share of decommissioning

costs for PVNGS Units 1 and 2 in 1987 and Unit 3 in 1988. The annual trust deposit, currently set at \$396,000 per unit, is based upon the Company's 10.2% share of total estimated PVNGS decommissioning costs and projected earnings on the trust funds over time. The NMPSC jurisdictional share of these decommissioning costs related to Units 1 and 2 are currently included in jurisdictional rates. The annual funding amount is subject to periodic adjustment for changes in decommissioning cost estimates and earnings of the trust fund. As of February 18, 1992, the Company has funded \$10.3 million to cover program costs. This includes \$4.8 million in prefunding of future contributions which were needed to satisfy cashflow requirements. The trust balance at the end of 1991 was approximately \$3.3 million, including cash surrender value of the policies. Insurance coverage at the end of 1991 was approximately \$95.7 million. The Company's share of PVNGS decommissioning costs is presently estimated, in 1991 dollars, at approximately \$85.4 million. An updated decommissioning cost study is expected to be completed mid-1992. The Company has received preliminary indications that decommissioning costs will increase due primarily to updated estimates for new permanent disposal sites for radio-active materials, but is currently unable to estimate the amount of such increase. Factors which both positively and negatively influence future cost estimates include uncertain permanent disposal sites, labor costs, robotics, technological change and NRC license extension policy. It is anticipated that a supplemental investment program may be needed.

PVNGS Liability and Insurance Matters. The PVNGS participants have insurance for public liability payments resulting from nuclear energy hazards to the full \$7.8 billion 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 rating program for each nuclear incident occurring at any nuclear power plant in the United States is approximately \$66 million, subject to an annual limit of \$10 million per incident. Based upon the Company's 10.2% interest in the three PVNGS units, the Company's maximum potential assessment per incident is approximately \$20 million, with an annual payment limitation of \$3 million. The insureds under this liability insurance include the PVNGS participants and "any other person or organization with respect to his legal responsibility for damage caused by the nuclear energy hazard".

The PVNGS participants maintain "all-risk" (including nuclear hazards) insurance for nuclear property damage to, and decontamination of, property at PVNGS in the aggregate amount of \$2.515 billion as of January 1, 1992, a substantial portion of which must be applied to stabilization and decontamination. The Company has also secured insurance against a portion of the increased cost of generation or purchased power resulting from certain accidental outages of any of the three PVNGS units.

Fuel and Water Supply

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

	Coal		Nuclear		Gas and Oil	
	Percent of Generation	Average Cost	Percent of Generation	Average Cost	Percent of Generation	Average Cost
1987	79.7	141.1	20.0	73.3	0.3	246.6
1988	70.0	142.5	29.6	75.9	0.4	320.9
1989	89.3	139.3	10.3	76.3	0.4	364.1
1990	74.6	152.0	25.2	73.1	0.2	310.3
1991	67.1	167.9	32.9	67.9	—	216.5

Although not included in the above table, start-up and test energy was available from PVNGS in 1987.

The estimated generation mix for 1992 is 68.6% coal, 31.3% nuclear and .1% gas and oil. Due to locally available natural gas and oil supplies, the utilization of locally available coal deposits and the generally abundant supply of nuclear fuel, the Company believes that adequate sources of fuel are available for its generating stations.

Coal

The coal requirements for SJGS are being supplied by SJCC, a wholly-owned subsidiary of BHP-Utah, from certain Federal, state and private coal leases under a coal sales agreement, pursuant to which SJCC will supply processed coal for operation of SJGS until 2017. BHP-Utah guaranteed the obligations of SJCC under the agreement, which contemplates the delivery of approximately 143 million tons of coal during its remaining term. Such amount would supply substantially all the requirements of SJGS through approximately 2017. The primary sources of coal are a mine adjacent to SJGS and a mine located approximately 25 miles northeast of SJGS in the La Plata area of northwestern New Mexico. The average cost of fuel, including ash disposal and land reclamation costs, for SJGS for the years 1989, 1990 and 1991 was 145.9 cents, 161.9 cents and 183.3 cents, respectively, per million BTU (\$28.80, \$32.38 and \$36.63 per ton, respectively). (See PART II, ITEM 7. — "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS — CURRENT ISSUES FACING THE COMPANY — Coal Sales Agreement".)

Four Corners is supplied with coal under a fuel agreement between the owners and BHP-Utah, under which BHP-Utah agreed to supply all the coal requirements for the life of the plant. BHP-Utah holds a long-term coal mining lease, with options for renewal, from the Navajo Nation and operates a strip mine adjacent to Four Corners with the coal supply expected to be sufficient to supply the units for their estimated useful lives. The average cost of fuel, including ash disposal and land reclamation costs, for the years 1989, 1990 and 1991 at Four Corners was 108.3 cents, 112.2 and 112.6 cents, respectively, per million BTU (\$18.96, \$19.92 and \$19.94 per ton, respectively).

Natural Gas

The natural gas used as fuel for the Company's Albuquerque electric generating plant is delivered by GCNM. (See "NATURAL GAS OPERATIONS".) In addition to rate changes under filed tariffs, the Company's cost of gas increases or decreases according to the average cost of gas supplied by GCNM or other sources.

Nuclear Fuel

The fuel cycle for PVNGS 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 hexafluoride, (3) the enrichment of uranium hexafluoride, (4) the fabrication of fuel assemblies, (5) the utilization of fuel assemblies in reactors, and (6) the storage of spent fuel and the disposal thereof. The PVNGS participants have made arrangements to obtain quantities of uranium concentrates anticipated to be sufficient to meet operational requirements through 1997. Existing contract options could be utilized to meet approximately 30% of requirements from 1998 through 2000. Spot purchases in the uranium market will be made, as appropriate. The PVNGS participants have contracted for all conversion services required through 1994 and for up to 65% of conversion services required through 1998, with options to continue through the year 2000. The PVNGS participants, including the Company, have an enrichment services contract with DOE which obligates DOE to furnish enrichment services required for the operation of the three PVNGS units over a term expiring in November 2014, with annual options to terminate each year of the contract with ten years prior notice. The participants have exercised this option, terminating 30% of requirements for 1996 and 100% of requirements during the years 1999 through 2001. In addition, existing contracts will provide fuel assembly fabrication services for at least ten years from the date of operation of each PVNGS unit and through contract options, approximately fifteen additional years are available.

Spent fuel storage facilities at PVNGS have sufficient capacity with certain modifications to store all fuel expected to be discharged from normal operation of all of the PVNGS units through at least the year 2003. Pursuant to the Nuclear Waste Policy Act of 1982, as amended in 1987 (the "Waste 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 Waste Act, also requires operators of nuclear power reactors to enter into spent fuel disposal contracts with DOE. APS, the operating agent, on its own behalf and on behalf of the other PVNGS 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 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 a permanent disposal facility will not be in operation until at least 2010. As a result, under DOE's current criteria for shipping allocation rights, PVNGS would begin spent fuel shipments to the DOE disposal facility in 2017. APS indicates that alternative interim spent fuel storage methods will be available for use by PVNGS until DOE's scheduled shipments from PVNGS begin.

Water

Water for Four Corners and SJGS is obtained from the San Juan River. (See ITEM 3. — "LEGAL PROCEEDINGS — SAN JUAN RIVER ADJUDICATION".) BHP-Utah holds rights to San Juan River water and has committed a portion of such rights to the Four Corners plant. The Company and Tucson have a contract with the United States Bureau of Reclamation for consumption of 16,200 acre feet of water per year for SJGS, which contract expires in 2005, and in addition, the Company has been granted the authority to consume 8,000 acre feet per year of water under a state permit that is held by BHP-Utah. The Company is of the opinion that sufficient water is under contract for SJGS until 2005. Steps are being taken to extend water rights permits to the year 2045.

Sewage effluent used for cooling purposes in the operation of the PVNGS units has been obtained under contracts with certain municipalities in the area. The contracted quantity of effluent exceeds the amount required for the three PVNGS units. The validity of these effluent contracts is the subject of litigation in state and Federal courts. (See ITEM 3. — "LEGAL PROCEEDINGS — PVNGS WATER SUPPLY LITIGATION".)

NATURAL GAS OPERATIONS

Acquisition of Natural Gas Properties

On January 28, 1985, the Company acquired substantially all of the New Mexico natural gas utility assets of Southern Union (principally a natural gas retail distribution system operated by Southern Union as the Gas Company of New Mexico division and now operated by the Company as GCNM) and Sunbelt acquired all of the stock of Southern Union Gathering Company (subsequently renamed Sunterra Gas Gathering Company), a wholly-owned subsidiary of Southern Union, in connection with the settlement of antitrust litigation against Southern Union in which the Company and others were plaintiffs. In a separate transaction, Transwestern, a wholly-owned subsidiary of Sunbelt, acquired from Southern Union all of the stock of Southern Union Processing Company (subsequently renamed Sunterra Gas Processing Company) on December 31, 1986. In January 1990, the Company acquired all of the common stock of Gathering Company and Processing Company from Sunbelt and Transwestern, respectively. Together with GCNM, Gathering Company and Processing Company are referred to as the Company's natural gas operations.

Gas Company of New Mexico Division

The Company distributes natural gas through GCNM to most of the major communities in New Mexico, including Albuquerque and Santa Fe, serving approximately 353,000 customers as of December 31, 1991. The Albuquerque metropolitan area accounts for approximately 54% of the Company's total customers. The Company holds long-term, non-exclusive franchises with varying expiration dates in all incorporated communities requiring franchise agreements. The expiration dates for the Company's franchises in Albuquerque and Santa Fe are 1998 and 1995, respectively. GCNM's customer base includes both "sales-service" customers and "transportation-service" customers. Sales-service customers purchase natural gas and receive transportation and delivery services from GCNM for which GCNM receives both cost-of-gas and cost-of-service revenues. Cost-of-gas revenues collected from sales service customers are a recovery of the cost of purchased gas in accordance with NMPSC rules and regulations and in that sense do not affect the net earnings of the Company. Transportation-service customers, who procure gas independently of GCNM and contract with GCNM for transportation and related services, provide GCNM with cost-of-service revenues only. Transportation services are provided both to gas marketers generally for delivery to locations throughout GCNM's distribution systems and to natural gas producers generally for delivery to other interstate pipelines.

For the twelve months ended December 31, 1991, GCNM had throughput of approximately 85.0 million decatherms, including sales of 46.1 million decatherms to sales-service customers. No single customer accounted for more than 3% of GCNM's therm sales in 1991.

GCNM's total operating revenues for the year ended December 31, 1991, were approximately \$235 million. Cost-of-gas revenues, received from sales-service customers, accounted for approximately 55% of GCNM's total operating revenues.

Since a major portion of GCNM's load is related to heating, levels of therm sales are affected by the weather. Approximately 47% of GCNM's total therm sales in 1991 occurred in the months of January, February and December.

During the 1980's, FERC and NMPSC orders relating to the nondiscriminatory transportation of gas in certain instances, as well as other changes in the natural gas industry, led to increased competition for sales of natural gas within New Mexico. An order issued by the NMPSC requires New Mexico gas utilities to offer transportation service to all customers on an available capacity basis. Thus, GCNM's customers may choose to purchase natural gas from sources other than GCNM and require transportation by GCNM, subject to the capacity of GCNM's system. During 1991, approximately 46% of GCNM's total gas throughput was related to transportation gas deliveries. GCNM's transportation rates are unbundled, and transportation customers only pay for the amount of transportation service they receive from GCNM.

Natural Gas Supply

GCNM obtains its supply of natural gas primarily from New Mexico wells pursuant to contracts with producers and brokers. A significant portion of GCNM's natural gas supply is provided through Gathering Company. (See "Gathering Company".) The contracts of GCNM and Gathering Company are generally sufficient to meet GCNM's peak-day demand.

GCNM serves certain cities which depend on EPNG or Transwestern Pipeline Company for transportation of gas supplies purchased from sources that are not on GCNM's system. Because these cities are not directly connected to GCNM's transmission facilities, gas purchased from or transported by these companies is the sole supply source for those cities. Such transportation is regulated by FERC.

Prior to 1985, the Company had no gas utility operations. At the time of the Company's acquisition of GCNM and Gathering Company, GCNM obtained its natural gas supply generally pursuant to long-term contracts with producers that obligated GCNM and Gathering Company to take volumes of gas in excess of GCNM's sales-service customers' annual demand. At that time, GCNM and Gathering Company were able to sell all excess gas to interstate pipelines. At about the same time as the acquisition of the gas operations, the FERC began promulgating a series of orders that have dramatically altered the way gas is bought, transported and sold nationwide.

In essence these orders allowed customers of the interstate pipelines to purchase non-pipeline supplies and use the interstate pipeline's transmission facilities to transport that gas. Since Gathering Company traditionally had sold off-peak excess supplies to interstate pipelines, the regulatory changes dramatically altered the Company's ability to market these non-peak supplies. Over the past several years, GCNM and Gathering Company have sought and are seeking reformation or termination of certain gas supply contracts with producers in an effort to match their obligations to take gas with the demand of GCNM's sales-service customers. GCNM and Gathering Company have renegotiated or terminated a significant portion of their long-term contracts.

Over the past several years these reformed contracts, along with new contracts, have allowed both GCNM and Gathering to create a flexible gas supply portfolio which allows the Company to meet its customers' demand profile. During 1991, approximately 35% of the gas supplies from all sources came from contracts which have some form of take-or-pay requirement. Approximately 9% of the gas supplies came from sources that have a reservation/demand fee that the Company might be obligated to pay the supplier for standing ready to serve during the contract's purchase period. These reservation

fee contracts enable the Company to compare contract prices to prevailing market prices and make the best economic choice for our customers. Any reservation fees which might be paid are charged to sales-service customers through the PGAC. The remaining 56% of gas supplies came from gas contracts with no minimum purchase obligation. As a result of the above mix of gas supplies, the Company expects to have minimal exposure to litigation resulting from the Company's 1991 gas purchasing activities.

Although numerous claims relating to natural gas contracts have been settled in recent years and those contracts reformed or terminated, GCNM and Gathering Company are still disputing claims related to prior years by some natural gas producers relating to take-or-pay obligations, contract pricing and other matters. (See ITEM 3. — "LEGAL PROCEEDINGS — Natural Gas Supply Litigation" and PART II, ITEM 7. — "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS — CURRENT ISSUES FACING THE COMPANY — Gas Litigation and Regulatory Issues".)

Gathering Company

Gathering Company is engaged in the ownership and operation of gas gathering facilities primarily in the San Juan Basin in northwestern New Mexico, the purchase of gas from sources in the San Juan Basin, the sale of gas to GCNM and third parties and the gathering of gas for third parties. In 1991, Gathering Company sold approximately 24.1 million decatherms to GCNM and 1.6 million decatherms to third parties primarily in the spot market and gathered 23.6 million decatherms for third parties.

In January 1990, Gathering Company entered into a natural gas sale and gas gathering contract with GCNM. The contract allows Gathering Company to recover from GCNM, effective January 1988, substantially all of its operating costs, net of its third-party revenues (including revenues received from Processing Company), and to earn a regulated return on its investment in its operating assets. In addition, Gathering Company is permitted under the contract to charge to GCNM all costs arising from take-or-pay obligations and from contract reformation. (See "RATES AND REGULATION — Natural Gas Supply Matters".)

Processing Company

Processing Company processes natural gas for GCNM, Gathering Company and others. The natural gas is processed at Processing Company's plants under separate contracts. Both GCNM and Gathering Company executed new contracts with Processing Company in January of 1990. The GCNM contract provides that GCNM will reimburse Processing Company for all of its operating costs, net of its third-party revenues (including fees from Gathering Company), and provides a return on Processing Company's investment in its operating assets, in return for providing the service of processing GCNM's natural gas. Additionally, Processing Company reimburses GCNM for all revenues from liquid by-products derived from GCNM's throughput processed at the plants. Such revenues, including all third party processing fees, are ultimately credited to GCNM's sales-service customers through the PGAC. The Gathering Company's contract with Processing Company provides the same service for Gathering Company and in return for such service, Gathering Company pays Processing Company a fee per mcf of gas which is processed on behalf of Gathering Company. Processing Company reimburses Gathering Company for all revenues from liquid by-products derived from Gathering Company's throughput processed at the plants.

Natural Gas Sales

The following table shows gas throughput by customer class:

GAS THROUGHPUT (Millions of decatherms)

	1991	1990	1989	1988	1987
Residential	26.2	25.2	23.2	24.7	24.5
Commercial	11.4	11.3	10.7	11.5	11.4
Industrial	0.8	1.3	1.5	1.7	2.2
Public authorities	4.9	5.3	5.5	6.2	6.8
Irrigation	1.4	1.8	2.0	1.4	1.4
Sales for resale	1.4	3.5	4.6	2.7	1.2
Transportation*†	62.6	42.5	19.6	9.1	5.1
Spot market sales†	1.6	8.1	11.1	—	—
Brokerage	—	—	0.8	0.9	2.8
	<u>110.3</u>	<u>99.0</u>	<u>79.0</u>	<u>58.2</u>	<u>55.4</u>

The following table shows gas revenues by customer class:

GAS REVENUES (Thousands of dollars)

	1991	1990	1989	1988	1987
Residential	\$137,436	\$137,633	\$130,130	\$122,592	\$114,164
Commercial	46,676	49,575	47,876	45,235	42,120
Industrial	2,754	4,993	5,693	6,063	8,102
Public authorities	17,711	20,392	21,757	22,289	22,729
Irrigation	4,495	5,934	7,001	4,546	3,781
Sales for resale	3,848	7,253	9,874	6,969	3,819
Transportation†	16,997	11,939	7,618	4,841	4,315
Liquids†	30,500	39,086	25,294	—	—
Processing fees†	5,819	3,127	448	—	—
Spot market sales†	1,771	13,880	19,810	—	—
Brokerage	—	—	1,378	1,514	5,213
Other	9,062	8,292	5,948	9,742	6,391
	<u>\$277,069</u>	<u>\$302,104</u>	<u>\$282,827</u>	<u>\$223,791</u>	<u>\$210,634</u>

*Customer-owned gas.

†Includes gas revenues from Gathering Company and Processing Company beginning January 1, 1989 due to a change in regulatory treatment.

RATES AND REGULATION

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

Electric Rate Case

On April 5, 1989, the NMPSC issued an order addressing the Company's excess capacity situation which, among other things, provides for the inclusion in NMPSC jurisdictional electric rates of the Company's jurisdictional interests in PVNGS Units 1 and 2, 147 MW of SJGS Unit 4 and the power purchase contract with SPS. However, the order provides for the exclusion from New Mexico jurisdictional rates of the Company's 130 MW interest in PVNGS Unit 3, 130 MW of SJGS Unit 4 and the power purchase contract with M-S-R. The order, which was appealed to the New Mexico Supreme Court by two parties in the case, was upheld by the court on February 20, 1991.

On June 12, 1989, the Company filed a rate request with the NMPSC to increase its retail electric rates by \$13.7 million, later revised to \$12.2 million, from the then-current annualized electric revenues. On April 12, 1990, the NMPSC issued its final order in the rate case. As a result of the order, the Company was required to reduce its annualized existing base rates by approximately \$2.9 million. Also, as a result of the order, the Company wrote off approximately \$19.4 million, net of taxes, in March 1990, which resulted primarily from the NMPSC's treatment of prior years' tax benefits from debt retirement and losses on hedge transactions as well as the NMPSC's treatment of amortization periods for gains resulting from sale and leaseback transactions of PVNGS Units 1 and 2 consummated in previous years. The April 12, 1990 order also stated that as long as there is excess capacity in the Company's jurisdictional rates, then that excess capacity will share off-system sales equitably with the capacity excluded. In April 1990, the Company implemented the allocation procedures associated with off-system sales between the jurisdictional excess capacity, FERC excess capacity and that capacity excluded from the NMPSC jurisdictional rates.

PVNGS Cost Investigation

On March 6, 1990, the NMPSC issued a final order, adopting a stipulation reached by the NMPSC staff and the Company. Pursuant to the stipulation, all issues of prudence existing at May 31, 1989, as they related to the Company's system planning and construction costs on the Company's 10.2% interest in PVNGS Units 1 and 2, were settled. The stipulation also set performance standards for the operation of PVNGS Units 1 and 2. (See "ELECTRIC OPERATIONS — Sources of Power — *Nuclear Plant*".) In addition, the stipulation provides that if a FERC audit of the Company's interest in PVNGS Units 1 and 2 construction costs were conducted and resulted in a reduction of more than \$90 million, such further reduction shall be reflected on an allocated basis in the next New Mexico rate case.

Decertification of Electric Generating Plant

On August 28, 1989, the Company filed with the NMPSC a request for regulatory abandonment and decertification of its interest in PVNGS Unit 3, 130 MW of SJGS Unit 4 and in certain related common and transmission facilities.

On May 21, 1990, the NMPSC approved the Company's request to decertify PVNGS Unit 3.

On August 3, 1990, the NMPSC issued an order adopting the recommended decision of the hearing examiner denying the Company's request for decertification of 130 MW of SJGS Unit 4. On August 29, 1990, the Company filed a motion for a rehearing of the case, which the NMPSC also denied. On September 28, 1990, the Company appealed the NMPSC decision to the New Mexico Supreme Court. On July 9, 1991, the New Mexico Supreme Court upheld the NMPSC's ruling.

Following the Supreme Court ruling, the Company filed a request with the NMPSC on August 9, 1991 for decertification of the 50 MW which the Company agreed to sell to the City of Anaheim. In January 1992, the Company reached a stipulated agreement with the NMPSC Staff and intervenors

approving the sale of 50 MW to the City of Anaheim and decertification of 130 MW of SJGS Unit 4. The stipulation is subject to NMPSC approval and a final order from the NMPSC is expected in the second quarter of 1992. (See PART II, ITEM 7. — "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS — CURRENT ISSUES FACING THE COMPANY — Sale of 50 MW of SJGS Unit 4".)

Other Electric Matters

The Company has electric fuel adjustment clauses covering all retail and firm-requirements wholesale KWh sales. There is an approximate 60-day time lag in implementation of the fuel adjustment clause for billing purposes, except for firm-requirements wholesale customers for which there is an approximate 30-day time lag.

On October 18, 1990, the New Mexico Attorney General filed a complaint requesting the NMPSC to initiate a rulemaking proceeding in the matter of amendments to NMPSC Rule 550 (Fuel and Purchased Power Cost Adjustment Clauses for Electric Utilities). The New Mexico Attorney General specifically requested the NMPSC to institute a rulemaking for notice and hearings similar to those imposed on GCNM which provides for mandatory public hearings, with notice to the Attorney General, on any gas cost factor statement which shows a 10% increase in the cost of gas from the previous gas cost factor statement. On October 25, 1990, the NMIEC filed a Joinder in the New Mexico Attorney General's Complaint and Petition for Rulemaking.

On November 19, 1990, the NMPSC dismissed the complaint filed by the New Mexico Attorney General and NMIEC; however, the NMPSC requested that all electric utilities and interested parties file comments on the matter. In addition, the responses were to address if and why the NMPSC should issue a Notice of Proposed Rulemaking as requested by the New Mexico Attorney General and NMIEC.

On December 21, 1990, the Company issued its response to the New Mexico Attorney General and NMIEC's Complaint and Petition for Rulemaking stating that the Company opposes the Notice of Proposed Rulemaking. In the response, however, the Company stated that it would be willing to have informal discussions with interested parties regarding possible mechanisms for levelizing monthly fluctuations in fuel cost recovery. No additional action has been taken on this issue by the NMPSC at this time.

For a discussion of NMPSC proceedings relating to OLE, see PART II, ITEM 7. — "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS — CURRENT ISSUES FACING THE COMPANY — The Retail Electric Market".

Natural Gas Supply Matters

On February 29, 1988, the NMPSC initiated a proceeding to examine imbalances in GCNM's gas supply and demand. (See "NATURAL GAS OPERATIONS — Natural Gas Supply".) The proceeding led to a stipulation which was filed with the NMPSC on July 19, 1989. The stipulation, which was approved by an NMPSC order on December 18, 1989, provides for the partial recovery of certain gas costs arising from reformation of gas purchase contracts and from claims by certain producers relating to take-or-pay obligations, contract pricing and other matters. Under the order, GCNM bears 25% of producer take-or-pay costs (including such costs paid by GCNM to Gathering Company under their gas sale and gas gathering contract) for claims settled or for which litigation had been commenced by December 31, 1990, but in any event the mechanism does not apply to any suits not settled or for which no initial judgement on the merits has been rendered by December 31, 1993. GCNM will be permitted to recover from its sales and transportation customers the remaining 75% of take-or-pay costs over a period of years. The order allows GCNM to recover from its customers all take-or-pay costs assessed by interstate pipelines. The order also provides that GCNM may recover all costs (including costs paid by Gathering Company under their gas sale and gas gathering contract) determined by the prudently incurred or just and reasonable (on a case-by-case basis) as the result of the payment of claims ("MDL contract claims") arising from certain intrastate gas purchase

contracts that were the subject of the antitrust litigation that resulted in the Company's acquisition of GCNM from Southern Union in January 1985. (See "NATURAL GAS OPERATIONS — Natural Gas Supply".) On September 21, 1990, GCNM filed with the NMPSC seeking approval to recover approximately \$73 million of costs from settlement of MDL contract claims and approximately \$3 million of producer take-or-pay costs. Hearings on this case were held in January and February 1992. At issue in these proceedings are (i) the allocation of this amount between take-or-pay claims and MDL contract claims and (ii) the prudence of costs relating to the latter. During the hearings, GCNM amended its request to approximately \$68 million. On March 11, 1991, the hearing examiner issued a recommended decision which, if adopted by the NMPSC, would allow GCNM to recover a total of approximately \$57.3 million (see PART II, ITEM 7. — "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS — CURRENT ISSUES FACING THE COMPANY. — Gas Litigation and Regulatory Issues"). A final order in this case is not expected before May 1992.

On June 16, 1990, GCNM filed with the NMPSC for approval of a rate rider that would be the mechanism to recover all costs described above plus interest. An order was issued in this case by the NMPSC on January 21, 1992. The order allows implementation of a rate rider mechanism that will provide recovery of costs as described above. The mechanism provides for recovery of interest after the first year of collection on unamortized balances over the five-year recovery period of each claim. The order denies GCNM's request for recovery of interest costs incurred prior to the implementation of the rate rider. GCNM will request recovery of outstanding eligible take-or-pay costs upon completion of the NMPSC's compliance review of the rate-rider. GCNM expects that recovery of these amounts will commence later in 1992 unless implementation is suspended in whole or part by the NMPSC. Recovery of MDL costs will not commence until an order on the hearing examiners recommended decision is received.

Other Natural Gas Matters.

GCNM's retail gas rate schedules contain a PGAC which provides for timely recovery of the cost of gas purchased by GCNM for resale to its sales-service customers. On August 20, 1990, GCNM filed its biannual application for continued use of its PGAC pursuant to NMPSC rules. Hearings on this case were held in June 1991 and a decision is expected later in 1992. The NMPSC, through its review of the PGAC costs, has jurisdiction over amounts charged by Gathering Company and Processing Company to GCNM for gas purchases and for gathering and processing services provided.

ENVIRONMENTAL FACTORS

The Company, in common with other electric and gas utilities, is subject to stringent regulations for protection of the environment by both state and Federal authorities. PVNGS is subject to the jurisdiction of the NRC, which has authority to issue permits and licenses and to regulate nuclear facilities in order to protect the health and safety of the public from radioactive hazards and to conduct environmental reviews pursuant to the National Environmental Policy Act. (See "ELECTRIC OPERATIONS — Sources of Power — Nuclear Plant".) The Company does not currently expect that material expenditures for additional pollution control equipment for its facilities will be required in 1992 and 1993.

On November 15, 1990, amendments to the Clean Air Act (the "Act") were adopted which, among other things, impose stringent emission control limitations on sulfur and nitrous oxides from fossil fuel-fired utility boilers. The Act is intended to reduce air contamination from every sizeable source of air pollution in the nation. Electric utilities with fossil fuel generating units will be affected particularly by the section of the Act which deals with acid rain. To be in compliance with the Act, many utilities will be faced with installing expensive sulfur dioxide removal equipment, securing low sulfur coal, or sulfur dioxide emission allowances, or a combination of these. Due to the existing air pollution equipment on the coal-fired SJGS and Four Corners, the Company believes that it will incur with any material capital expenditures in order to be in compliance with the acid

Act. Under other provisions of the Act, the Company will be required to obtain operating permits for its coal- and gas-fired generating units and to pay annual fees associated with the operating permit program.

It is anticipated that in April 1992, the New Mexico Oil Conservation Division ("OCD") will issue a ruling which would affect the Company's gas gathering facilities. It is expected that the OCD will prohibit the further discharge of fluids associated with the production of natural gas into unlined open pits as of some point in the future. In addition, it is expected that sites where this has occurred in the past will be required to be remediated in some fashion. The areas targeted by the OCD for this project are in the Northwestern part of New Mexico and are deemed by the OCD to be environmentally sensitive due to their proximity to water table areas. It is anticipated that the proposed order will affect other natural gas producers and gatherers as well. Because of uncertainties such as the final form of the proposed order, the regulatory treatment and the producer involvement with respect to cost sharing, the Company cannot currently conclude what effect the ruling will have on the Company, but does not believe the impact will be material.

NON-UTILITY SUBSIDIARY OPERATIONS

In 1988, the Company discontinued the non-utility operations of its subsidiaries. (See note 10 of the notes to consolidated financial statements.) Such operations consisted primarily of fiberboard manufacturing, real estate, coal mining, telecommunications manufacturing, venture capital activities and financial services and were carried out by Meadows, Sunbelt or their subsidiaries. During 1988, the Company's subsidiaries ceased all coal mining activities (although mine-reclamation activities continue). During 1989, the Company's subsidiaries disposed of the fiberboard manufacturing and telecommunications manufacturing operations. In 1990 and 1991, additional non-utility properties were sold, and the remaining assets are expected to be sold in 1992.

During 1989, Meadows defaulted on obligations owed to secured creditors and the creditors subsequently made claims against the Company, asserting that the Company was fully liable for the obligations of Meadows to the secured creditors. Although the Company denied the claims, and without admitting any liability, the Company, in November 1989, entered into an agreement with the secured creditors which provides for the Company to pay damages. The amount of the damage payments would depend on, among other things, the amount of Meadows' debt payments received and retained by the creditors. In return, the secured creditors released the Company from all claims. At the time of the signing of the settlement, the Company estimated that there would be no damages to be paid by the Company. Upon further evaluation, however, the Company projected damage payments which were recorded in the 1989 consolidated financial statements. (See note 10 of the notes to the consolidated financial statements.) Based on debt payments made by Meadows to the secured creditors in 1989 and 1990, and subject to the secured creditors retaining all the debt payments, the Company made the damage payments of \$17.8 million required under the settlement agreement. The settlement agreement would require the Company to make additional damage payments in the event that Meadows, or (among others) any creditor or any trustee, receiver or other person acting on behalf of Meadows or its creditors, recovers from any of the secured creditors certain Meadows debt payments. (See ITEM 3. — "LEGAL PROCEEDINGS — DIVERSIFICATION CLAIMS".) Under the settlement agreement, the Company is entitled to recapture from the secured creditors any excess payments (up to \$17.8 million) made by Meadows over the agreed amount. As of December 31, 1991, the Company has recaptured approximately \$4.5 million from the secured creditors. Meadows, on its own behalf, entered into an agreement dated as of February 14, 1990 with its secured creditors, which precludes such creditors from exercising their remedies under the loan documents to allow Meadows' orderly disposition of the remaining Meadows' assets.

On April 18 and July 20, 1990, the NMPSC issued orders docketing a formal investigation regarding the settlement agreement between the Company and secured creditors and the Company's discontinuance of its non-utility subsidiary operations. The Company is required to show cause, if any, as to why the settlement agreement, the discontinuance of the Company's non-utility operations and

the disposal of non-utility assets are not subject to prior NMPSC approval and why the resulting effect of the Company's actions has not materially and adversely affected the Company's ability to provide utility service at fair, just and reasonable rates. The formal investigation also inquired into whether the Company's actions are in compliance with other applicable law and whether sanctions should be imposed. Hearings were held beginning May 6, 1991 and a recommended decision in the case is pending before the hearing examiner.

On November 15, 1991, the Company filed with the NMPSC for approval of the Meadows Status Report and Asset Disposition Plan. As part of the plan, the Company requested NMPSC approval to (1) consent to the use by Meadows of up to \$991,000 of the proceeds from the disposition of Meadows' assets to fund Meadows' liquidation expenses during 1992 (which proceeds would otherwise be reimbursable to the Company as recapture payments under the settlement agreement) and (2) to the extent the timing of asset sales by Meadows does not generate funds for liquidation expenses, allow the Company to loan up to \$750,000 to Meadows to fund such liquidation expenses, with such loan to be repaid out of asset sales proceeds. The NMPSC granted interim approval to the Company to proceed with the \$750,000 loan to Meadows.

ITEM 2. *PROPERTIES*

Substantially all of the Company's utility plant is mortgaged to secure its first mortgage bonds.

ELECTRIC

As of December 31, 1991, the total net generation capacity of facilities owned or leased by the Company was 1,591 MW. The Company's electric generating stations in commercial service as of December 31, 1991, were as follows:

Type	Name	Location	Net MW Generation Capacity
Nuclear	PVNGS (a)	Wintersburg, Arizona	390
Coal	SJGS (b)	Waterflow, New Mexico	835
Coal	Four Corners (c)	Fruitland, New Mexico	192
Gas/Oil	Reeves	Albuquerque, New Mexico	154
Gas/Oil	Las Vegas	Las Vegas, New Mexico	20
			<u>1,591</u>

- (a) The Company is entitled to 10.2% of the power and energy generated by PVNGS Units 1 and 2 under leasehold interests. The Company has a 10.2% ownership interest in PVNGS Unit 3.
- (b) SJGS Units 1, 2 and 3 are 50% owned by the Company; SJGS Unit 4 is 55.525% owned by the Company.
- (c) Four Corners Units 4 and 5 are 13% owned by the Company.

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

As of December 31, 1991, the Company owned, jointly owned or leased 2,789 circuit miles of electric transmission lines, 4,791 miles of distribution overhead lines, 2,528 cable miles of underground distribution lines (excluding street lighting) and 212 substations.

The Company, with Plains, continues to pursue licensing activities for ACP, which involves construction of a 230 kV transmission line connecting the Plains Escalante Generating Station in New

Mexico to the Salt River Project Coronado Station in Arizona. ACP would provide the Company additional transmission capability to deliver power to western markets, including Nevada and southern California, and would give Plains a direct transmission connection to serve its member cooperative located in eastern Arizona. This project would also enhance the Company's seasonal interchange capabilities. The line could be completed as early as 1995; however, the Company's continued participation in the project is subject to various conditions including the Company's wholesale sales activities and regulatory approvals.

On May 1, 1984, the Company's Board of Directors approved plans to proceed with OLE, which involves construction of a 345 kV transmission line connecting the existing Ojo 345 kV line to the existing Norton Station. For discussion of issues relating to OLE, see PART II, ITEM 7. — "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS — CURRENT ISSUES FACING THE COMPANY — The Retail Electric Market".

GAS

The property owned by GCNM, as of December 31, 1991, consisted primarily of natural gas gathering, storage, transmission and distribution systems. The gathering systems consisted of approximately 1,200 miles (approximately 360 miles of which are leased to Gathering Company) of pipe with compression and treatment facilities. Provisions for storage made by GCNM include ownership and operation of an underground storage facility located near Albuquerque and an agreement with owners of a unitized oil field located near Artesia, New Mexico, in which GCNM has injection and redelivery rights. The transmission systems consisted of approximately 1,300 miles of pipe with appurtenant compression facilities. The distribution systems consisted of approximately 9,000 miles of pipe.

GCNM leases approximately 130 miles of transmission pipe from the DOE for transportation of natural gas to Los Alamos and to certain other communities in northern New Mexico. The lease can be terminated by either party on 30 days written notice, although the Company would have the right to use the facility for two years thereafter.

The property of Gathering Company includes approximately 550 miles of gathering pipe with appurtenant compression facilities.

Processing Company owns facilities located in northwestern New Mexico having an aggregate design capacity for processing of natural gas of approximately 300,000 mcf per day.

WATER

The Company's water property consists of wells, water rights, pumping and treatment plants, storage reservoirs and transmission and distribution mains.

OTHER INFORMATION

The electric and gas transmission and distribution lines are generally located within easements and rights-of-way on public, private and Indian lands. The Company leases interests in PVNGS Units 1 and 2 and related property (see ITEM 1. — "BUSINESS — ELECTRIC OPERATIONS — Sources of Power — Nuclear Plant"), EIP and associated equipment, data processing, communication, office and other equipment, office space, utility poles (joint use), vehicles and real estate. The Company also owns and leases service and office facilities in Albuquerque and in other operating divisions throughout its service territory.

Additional information required by this item is included in ITEM 1. — "BUSINESS".

ITEM 3. *LEGAL PROCEEDINGS*

SHAREHOLDER LITIGATION

An agreement in principle has been reached potentially settling all of the shareholder class action and derivative lawsuits reported below. (See PART II, ITEM 7. — "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS — CURRENT ISSUES FACING THE COMPANY — Shareholder Litigation".)

Securities Law-Related Litigation

A civil suit, filed in the United States District Court for the District of New Mexico on April 18, 1989 against the Company and three individuals who formerly served as officers or directors of the Company, alleges misrepresentations and omissions of material facts in the Company's shareholder reports, Securities and Exchange Commission filings, news releases and other communications. The 1989 suit has been brought as a class action, in which the plaintiff has sought to represent shareholders claimed to be "similarly situated". Generally, the complaint alleges misrepresentations and omissions relating to, among other things, (i) the recovery of investment in excess electric generating capacity, (ii) diversification, (iii) dividends on the Company's common stock and (iv) the attempted restructuring of the Company. It is alleged that the market prices of the common stock were artificially inflated during the class period of March 14, 1987 through April 14, 1989 and that the plaintiffs were damaged by their purchases in reliance upon "the integrity of the market or upon statements disseminated by the defendants". The plaintiff seeks to recover damages, fees and costs. On December 3, 1990, the court granted the plaintiff's motion for class certification with respect to claims based on alleged conduct in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The court's order denied class certification with respect to the plaintiff's claim based on a common-law theory of negligent misrepresentation.

On April 6, 1990, a civil suit was filed in the United States District Court for the District of New Mexico against the Company and three individuals who currently serve, or formerly served, as officers or directors of the Company, alleging violation of federal securities law and common-law causes of action. On May 24, 1991, the court permitted the substitution of a new named plaintiff in this action. The new plaintiff claims to have purchased 100 shares of the Company's common stock on March 27, 1990, and requests unspecified compensatory and punitive damages as well as fees and costs. The plaintiff is also seeking class action certification, with the plaintiff class to consist of all persons who purchased the Company's common stock during the class period of April 15, 1989 through April 6, 1990. The complaint alleges that the Company and the individual defendants engaged in conduct in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Generally, the complaint alleges misrepresentations and omissions and other fraudulent conduct relating to, among other things, Company disclosures of (i) non-utility subsidiary losses, (ii) risks to the Company resulting from the financial condition of Meadows and (iii) the Company's settlement with creditors of Meadows in November 1989. (See ITEM 1. — "BUSINESS — NON-UTILITY SUBSIDIARY OPERATIONS".) It is alleged that market prices of the Company's stock were artificially inflated during the class period and that the plaintiff and others were damaged by their purchases in reliance upon statements made by the defendants in the Company's public documents or the integrity of the market price of the stock during the class period. The complaint also seeks recovery based on common-law theories of fraud and negligent misrepresentation.

On September 24, 1990, a shareholder of the Company filed a class action lawsuit in the United States District Court for the District of New Mexico against the Company and eight individual defendants who currently serve, or formerly served, as directors or officers of the Company or its subsidiaries. The plaintiff seeks to bring this action on behalf of all persons who purchased the Company's stock through the consumer stock plan or in sales transacted within the state of New Mexico during the period from October 1, 1985 through April 15, 1989. The complaint alleges, among other things, that the defendants overstated the net earnings of the Company's diversified non-utility operations in the financial statements of the Company, resulting in inflated market prices of the

Company's common stock. The complaint further alleges that the Company's public reports and financial statements were materially false and misleading, because they allegedly failed to disclose negative information about the Company's financial condition. The plaintiff claims, among other things, Federal and state securities law violations, common-law fraud, negligent misrepresentation and violations of the New Mexico Unfair Practices Act and seeks compensatory and punitive damages as well as fees and costs. In December 1990, all defendants in this suit filed a joint motion to dismiss the complaint. In July 1991, the district court dismissed the suit due to a statute of limitations, with respect to the federal-law claims, adopted retroactively by the United States Supreme Court in June 1991 in an unrelated case. The plaintiff appealed this decision to the United States Court of Appeals for the Tenth Circuit. In December 1991, the President of the United States signed legislation which purports to reverse the retroactive application of the Supreme Court's ruling. Pursuant to this new legislation, the Tenth Circuit remanded the case to the district court to consider reinstatement of this action.

The plaintiff in the September 24, 1990 federal class action lawsuit filed a lawsuit on July 26, 1991, and in November 1991 an amended complaint, in the District Court of Bernalillo County, New Mexico reasserting her state-law claims against the same defendants as in the federal action and adding a claim under the New Mexico Racketeering Act against the Company and three of the individual defendants. The plaintiff seeks to represent a class of New Mexico residents who purchased common stock from September 24, 1986 through January 31, 1991. The plaintiff also seeks rescission of the proposed class members' stock purchase transactions, or, in the alternative, damages. In addition, plaintiff seeks treble damages, punitive damages and attorneys' fees.

On April 22, 1991, a civil suit was filed in the United States District Court for the Southern District of California against the Company and eight individuals who currently serve, or formerly served, as officers or directors of the Company or its subsidiaries, alleging violation of securities laws and other causes of action. The plaintiff, who claims to be a citizen of California and to have purchased shares of the Company's common stock in December 1985 and June 1988, is requesting unspecified compensatory and punitive damages as well as fees and costs. The suit has been brought as a class action. Following dismissal of her federal claims without prejudice based upon the June 1991 United States Supreme Court decision referenced above, the plaintiff filed an amended complaint on October 16, 1991 seeking to bring this action on behalf of all California residents who purchased the Company's common stock from April 23, 1988 through January 31, 1991. Generally, the complaint alleges that the Company and the individual defendants engaged in conduct in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. As amended, the complaint also seeks recovery based on allegations under the Racketeer Influenced and Corrupt Organizations Act and unfair practice laws (for which the plaintiff seeks treble damage) and on theories of common law fraud and negligent misrepresentation. On December 2, 1991, the court certified the requested class.

Shareholder Derivative Litigation and the Special Litigation Committee

The Company is a nominal defendant in four civil actions which shareholders seek to bring derivatively on behalf of the Company. The first suit was filed in the United States District Court for the District of New Mexico on September 14, 1989. The remaining three suits were filed on May 11, 1990, June 14, 1990 and May 29, 1991 in the District Court of Bernalillo County, New Mexico and have been consolidated.

The four actions claim breaches of fiduciary duty, mismanagement and waste by four individual defendants who formerly served as directors or officers of the Company or its subsidiaries. The complaints allege that each of the defendants, because of his position as an officer or director, owed fiduciary duties to the Company and its shareholders in connection with the operations, management and direction of the Company. The complaints allege further that each breached those duties by (1) causing the Company to invest in diversified, non-utility operations, which in turn was a cause of a deficit in the retained earnings of the Company that resulted in suspension of common stock dividends, (2) causing Meadows to borrow from various lenders in order to continue funding real estate operations, (3) causing the Company to provide assurances to Meadows' lenders that the Company would be

responsible for any losses sustained with respect to a substantial portion of the loans to Meadows (see ITEM 1. — "BUSINESS — NON-UTILITY SUBSIDIARY OPERATIONS"), (4) wrongdoing in connection with the Company's discontinuance of non-utility operations, and (5) acting to conceal their alleged wrongdoing, thereby exposing the Company to liability.

Initially, the first three actions contained additional claims and also named other current and former officers and directors as defendants. On July 25, 1989, the Company's Board of Directors created a special litigation committee (the "Committee") to conduct an independent investigation, generally encompassing the matters alleged initially in these actions, and to determine whether it would be in the best interest of the Company to continue to seek dismissal of, or otherwise resolve, litigation. The Committee originally consisted of the director newly-elected to the Board at the May 1989 annual meeting of shareholders and acted with the assistance of independent legal counsel and independent business advisors. In January 1991, the Committee issued its report, which concluded that it would not be in the Company's best interest to pursue all of the initial claims. Subsequently, the plaintiffs amended their complaints in these actions. In addition, at the direction of the Committee, the Company joined with Meadows in filing a lawsuit against three of the remaining individual defendants and a consulting firm. (See "OTHER PROCEEDINGS".)

In September 1991, three of the individual defendants filed third-party complaints in all four actions against current and former directors, as well as unnamed persons, as third-party defendants. The third-party complaints assert that, in the event that the defendants are found liable to the derivative plaintiffs, the defendants are entitled to indemnification or, in the alternative, contribution from the third-party defendants. The fourth individual defendant is seeking to file cross-claims against the Company and two of its current directors and third-party complaints against past and present directors of the Company who were previously dismissed as defendants.

PVNGS WATER SUPPLY LITIGATION

The validity of the primary effluent contract under which water necessary for the operation of the PVNGS units is obtained was challenged in a suit filed in January 1982 by the Salt River Pima-Maricopa Indian Community (the "community") against the Department of the Interior, the Federal agency alleged to have jurisdiction over the use of the effluent. The PVNGS participants, including the Company, were named as additional defendants in the proceeding, which is before the United States District Court for the District of Arizona. The portion of the action challenging the effluent contract has been stayed until the community litigates certain claims in the same action against the Department of the Interior and other defendants. 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. However, certain contingencies are to be performed before the settlement is finalized and the suit is dismissed. One of these contingencies is the approval of the settlement by the court in the Lower Gila River Watershed litigation referred to below.

The Company understands that a summons served on APS in early 1986 required all water claimants in the Lower Gila River Watershed of Arizona to assert any claims to water on or before January 20, 1987, in an action pending in the Maricopa County Superior Court. PVNGS is located within the geographic area subject to the summons and the rights of the PVNGS participants to the use of groundwater and effluent at PVNGS are potentially at issue in this action. APS, as the PVNGS project manager, filed claims that dispute the court's jurisdiction over the PVNGS participants' groundwater rights and their contractual rights to effluent relating to PVNGS 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 expects that the described litigation will not have a material adverse impact on the operation of PVNGS.

SAN JUAN RIVER ADJUDICATION

In 1975, the State of New Mexico filed an action entitled *State of New Mexico v. United States, et al.*, in the District Court of San Juan County, New Mexico, to adjudicate all water rights in the "San Juan River Stream System". The Company was made a defendant in the litigation in 1976. The action was expected to adjudicate water rights used at the Four Corners plant, at SJGS and at Santa Fe. (See ITEM 1. — "BUSINESS — ELECTRIC OPERATIONS — Fuel and Water Supply".) The Company cannot at this time anticipate the effect, if any, of any water rights adjudication on the present arrangements for water at SJGS and Four Corners, nor can it determine what effect the action will have on water for Santa Fe. It is the Company's understanding that final resolution of the case cannot be expected for several years.

DIVERSIFICATION CLAIMS

BCD, a general partnership that engaged in real estate operations in the southwestern United States, is the debtor in a proceeding in the United States Bankruptcy Court for the District of New Mexico that commenced on June 1, 1989 under Chapter 11 of the Bankruptcy Code and converted to a Chapter 7 proceeding by order entered on January 29, 1990. The general partners of BCD include Meadows.

During 1990, the trustee in the bankruptcy case (the "BCD Trustee") filed an adversary proceeding against the general partners of BCD, including Meadows, seeking contribution for all debts of BCD. The BCD Trustee has threatened further to assert that the claims of Meadows against BCD (including administrative, secured, and unsecured claims of approximately \$87 million) should be subordinated to the claims of all other creditors. It has been the position of Meadows that it made loans to BCD secured by mortgage liens and it has therefore resisted the BCD Trustee's position. The Company currently estimates that the claims against BCD (excluding the claims of Meadows) exceed BCD's assets by a range of \$40 million to \$60 million. The assets of the general partners are inadequate to fund such excess.

In January 1991, the BCD Trustee placed the Company on notice that it believed that the bankruptcy estate has strong claims against the Company and certain of its officers by reason of tax-sharing payments, amounting to approximately \$22 million, made by the Company to Meadows during 1989 and utilized by Meadows to make payments to its secured creditors, the effect of which was to reduce partially the damages that the Company would otherwise have paid to the secured creditors of Meadows. (See ITEM 1. — "BUSINESS — NON-UTILITY SUBSIDIARY OPERATIONS".) The BCD Trustee asserted that certain members of the BCD management committee were acting in a representative capacity for the Company and that the Company knew of, endorsed and/or approved of the actions of such management committee members. The BCD Trustee further asserted that the bankruptcy estate may have a direct claim against the Company based on the theory that Meadows was the alter ego of the Company. The Company denies any liability to the BCD Trustee.

On May 31, 1991, the BCD Trustee filed an action in the District Court of Bernalillo County, New Mexico, against the Company, Meadows and five individuals who served as members of the BCD management committee, including three who also served as directors or officers of the Company or its subsidiaries. The complaint alleges that, without authority and to the detriment of BCD, the BCD management committee approved certain bonus plan payments by BCD in excess of \$4 million to individual defendants, designated employees of the Company and Meadows, and others. The plaintiff alleges that the defendants are liable for such payments and seeks damages or restitution under various theories.

On August 5, 1991, the BCD Trustee, the Company and Meadows negotiated the essential terms of a settlement of all disputes, as between these parties, relating to the BCD bankruptcy proceedings and the state-court action. Among other things, the proposed settlement would require release by Meadows

of its claims against BCD in the bankruptcy proceedings and payment of \$1.5 million to the BCD Trustee by Meadows or the Company. The settlement would also be subject to several contingencies, including final approval by the secured creditors of Meadows, the Bankruptcy Court and the NMPSC.

NATURAL GAS SUPPLY LITIGATION

Near the end of 1990 and in response to a December 1989 order of the NMPSC relating to GCNM's recovery of settlement and reformation costs (see ITEM 1. — "BUSINESS — RATES AND REGULATION — Natural Gas Supply Matters"), eight producers, including Conoco, Inc. ("Conoco") and Amoco Production Company ("Amoco"), commenced or amended lawsuits against GCNM or Gathering Company or both seeking to recover damages relating to GCNM's or Gathering Company's performance under gas purchase contracts. Four of the eight lawsuits have been dismissed or settled by the Company and Gathering Company. An agreement in principle has been reached for the fifth lawsuit. During 1991, no new significant claims were asserted by natural gas producers for damages relating to the performance of GCNM or Gathering Company under gas purchase contracts.

One of the pending proceedings against GCNM and Gathering Company is a lawsuit in the United States District Court for the District of New Mexico by Conoco and Amoco. Conoco initially filed the action on February 20, 1990 asserting claims under two gas purchase contracts. The complaint was subsequently amended to assert take-or-pay and pricing claims relating to 20 contracts with GCNM and Gathering Company in northwestern New Mexico. The claims quantified in the complaint total approximately \$54 million, with approximately \$16.9 million attributed to pricing claims. However, not all take-or-pay claims have been quantified, and the Company anticipates that the asserted claims will ultimately be much higher.

A second pending lawsuit is one that was filed on August 31, 1990 in the United States District Court for the District of New Mexico. This action was brought by three producers of natural gas — Caulkins Producing Company, DeKalb Energy Company, Marathon Oil Company — and a number of small-interest owners in a long-term natural gas contract with GCNM. The suit alleges that GCNM has take-or-pay obligations for the period 1986 to the present and further that GCNM failed to take gas ratably from the producers during that same period of time. The suit does not specify a dollar figure being claimed. However, a preliminary report by plaintiffs' expert indicates take-or-pay claims of approximately \$26.1 million and ratable-take claims of approximately \$45.2 million. The Company believes that substantial portions of these claims are duplicative.

A third pending lawsuit is one that was filed on March 20, 1990 in Texas state court but subsequently removed to the United States District Court for Northern District of Texas, Dallas Division. The plaintiffs, known as the Hill Group, allege that GCNM and Gathering failed to pay the price required by five contracts, failed to take the plaintiffs' gas ratably, and owe take-or-pay obligations to the plaintiffs. The complaint does not set forth a specific monetary demand, but the plaintiffs' experts have computed their alleged damages in the amount of approximately \$7 million. A bifurcated trial began on February 18, 1992.

GCNM and Gathering Company are vigorously defending against the claims in these three pending actions.

OTHER PROCEEDINGS

See ITEM 1. — "BUSINESS — RATES AND REGULATION" and "BUSINESS — NON-UTILITY SUBSIDIARY OPERATIONS" for a discussion of other proceedings and disputes.

On January 23, 1991, the Company and Meadows filed a lawsuit in the District Court of Bernalillo County, New Mexico, against three individual defendants who formerly served as directors or officers of the Company or its subsidiaries, including the Company's former Chairman and President, as well as against a consulting firm formed by one of the individual defendants. The decision to file the complaint was made by the special litigation committee appointed by the Company's Board of Directors in 1989

Name	Age	Office	Initial Effective Date
M. Phyllis Bourque	44	Senior Vice President, Gas Management Services	June 19, 1990
		Vice President, Gas Supply, Gas Company of New Mexico Division	March 2, 1987
J. A. Zanotti	52	Senior Vice President, Human Resources and Communications	July 26, 1990
		Vice President, Human Resources and Staff Services, Gas Company of New Mexico Division	September 1, 1988
		District Vice President, Southwest, Gas Company of New Mexico Division	April 26, 1988
		Director, Public Affairs, Gas Company of New Mexico Division	July 15, 1980
P. T. Ortiz	41	Senior Vice President, General Counsel	October 14, 1991

All officers are elected annually by the Board of Directors of the Company.

All of the above executive officers have been employed by the Company and/or its subsidiaries for more than five years in executive or management positions, with the exception of M. Phyllis Bourque and P. T. Ortiz. M. Phyllis Bourque has been employed as an officer of the Company for approximately five years. Prior to employment with the Company, M. Phyllis Bourque was employed by Mid Con Service Company during the period of March 1986 through February 1987 as Assistant Vice President — Gas Acquisition and Contract Management. Mid Con Service Company, a subsidiary of Occidental Petroleum Co., processes, transmits and sells natural gas. Prior to employment with the Company, P. T. Ortiz was employed by U S WEST Communications during the period of January 1988 to October 1991 as Chief Counsel — New Mexico and during the period of June 1985 to January 1988, as an attorney by U S WEST Communications (then known as Mountain Bell). The principal business of U S WEST Communications is telecommunications.

PART II

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

The Company's common stock is traded on the New York Stock Exchange. Ranges of sales prices of the Company's common stock, reported as composite transactions (Symbol: PNM) for 1991 and 1990, by quarters, are as follows:

<u>Quarter Ended</u>	<u>Range of Sales Prices</u>	
	<u>High</u>	<u>Low</u>
1991:		
December 31	9½	8½
September 30	10½	8¾
June 30	11½	9½
March 31	9½	7½
Fiscal Year	11½	7½
1990:		
December 31	9¾	8
September 30	12¾	9¼
June 30	12¾	9¾
March 31	15½	12¼
Fiscal Year	15½	8

On January 31, 1992, there were 30,736 holders of record of the Company's common stock.

In April 1989, the Company announced the suspension of dividend payments on the Company's common stock as a result of a deficit in retained earnings. For a discussion of the suspension of dividends on the Company's common stock, see note 2 of the notes to consolidated financial statements and ITEM 7. — "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS".

Cumulative Preferred Stock

While isolated sales of the Company's cumulative preferred stock have occurred in the past, the Company is not aware of any active trading market for its cumulative preferred stock. Quarterly cash dividends were paid on each series of the Company's cumulative preferred stock at their stated rates during 1991 and 1990.

ITEM 6. SELECTED FINANCIAL DATA

	1991	1990	1989	1988	1987
	(In thousands except per share amounts and ratios)				
Total Operating Revenues*	\$ 857,168	\$ 881,186	\$ 929,817	\$ 854,036	\$ 793,959
Earnings (Loss) from Continuing Operations	\$ 22,960	\$ 442	\$ 82,593	\$ (9,942)†	\$ 117,121
Net Earnings (Loss)	\$ 22,960	\$ 442	\$ 82,593	\$ (230,137)	\$ 95,389
Earnings (Loss) per Common Share					
From Continuing Operations	\$ 0.32	\$ (0.23)	\$ 1.73	\$ (0.50)†	\$ 2.52
Earnings (Loss) per Common Share	\$ 0.32	\$ (0.23)	\$ 1.73	\$ (5.78)	\$ 2.00
Total Assets	\$ 2,344,332	\$ 2,313,709	\$ 2,387,005	\$ 2,392,749	\$ 2,717,141
Preferred Stock with Mandatory Redemption Requirements	\$ 26,982	\$ 45,581	\$ 49,268	\$ 55,242	\$ 60,513
Long-Term Debt, less Current Maturities	\$ 786,279	\$ 790,126	\$ 801,706	\$ 980,767	\$ 862,962
Common Stock Data:					
Dividends paid per common share	\$ —	\$ —	\$ 0.38	\$ 1.87	\$ 2.92
Dividend pay-out ratio	—	—	22.0%	N/M	146.0%
Market price per common share at year end	\$ 9.75	\$ 8.375	\$ 14.625	\$ 12.50	\$ 18.75
Book value per common share at year end	\$ 17.69	\$ 17.36	\$ 18.02	\$ 18.03	\$ 25.68
Average number of common shares outstanding	41,774	41,774	41,774	41,761	41,647
Return on Average Common Equity	1.8%	(1.3)%	9.5%	(23.9)%	7.7%
Capitalization:					
Common stock equity	45.8%	44.8%	45.3%	40.7%	52.2%
Preferred stock:					
Without mandatory redemption requirements	3.7	3.6	3.5	3.2	2.9
With mandatory redemption requirements	1.7	2.8	3.0	3.0	2.9
Long-term debt, less current maturities	48.8	48.8	48.2	53.1	42.0
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

*Includes gas operating revenues (excluding intercompany sales) of Gathering Company and Processing Company beginning with 1989 due to a change in regulatory treatment.

†Includes charges for the write-off of deferred carrying costs on uncommitted electric generating capacity, the write-off of a proposed generating station and other non-recurring charges aggregating \$120.3 million (\$2.88 per share).

N/M — Not meaningful

The selected financial data should be read in conjunction with the consolidated financial statements, the notes to consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations contained elsewhere in this report.

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

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

LIQUIDITY AND CAPITAL RESOURCES

Construction expenditures for the years 1992-1996 are expected to consist primarily of upgrading generating systems, upgrading and expanding the electric and gas transmission and distribution systems and purchasing nuclear fuel. For the period 1992-1996, the Company expects to incur \$508 million of construction expenditures. This amount includes \$63 million for the purchase of nuclear fuel and \$10 million in AFUDC (a non-cash item that reflects the Company's costs of debt and equity capital used to finance utility construction). This projection of construction expenditures includes costs for OLE (see "The Wholesale Power Market" and "The Retail Electric Market" under "CURRENT ISSUES FACING THE COMPANY") but assumes all costs for ACP would be paid by other parties. The Company currently has no material capital commitments beyond 1996 which would significantly differ from the levels reflected in the five-year construction projections.

Cash requirements for construction expenditures for 1991 and the Company's projections for 1992-1996 are shown below:

	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
			(In millions)			
Cash	\$80	\$115	\$94	\$98	\$ 99	\$92
AFUDC	<u>3</u>	<u>3</u>	<u>4</u>	<u>1</u>	<u>1</u>	<u>1</u>
Total	<u>\$83</u>	<u>\$118</u>	<u>\$98</u>	<u>\$99</u>	<u>\$100</u>	<u>\$93</u>

These projections are under continuing review and are subject to periodic adjustments.

The Company's other major cash requirements include payments of long-term debt maturities, redemption of preferred stock, purchase of certain PVNGS lease interests (see "CURRENT ISSUES FACING THE COMPANY — Purchase of Beneficial Interests in PVNGS Leases"), and settlements of certain gas contract disputes (see PART I, ITEM 1. — "BUSINESS — NATURAL GAS OPERATIONS — Natural Gas Supply"). Cash requirements for the above items are estimated at \$65 million for 1992 and a total of \$35 million for 1993-1996. These estimates are under continuing review and are subject to periodic adjustments. (See also note 8 of the notes to consolidated financial statements concerning lease payments.)

The Company currently estimates that its total internal cash generation during the years 1992-1996 will be adequate to meet its cash requirements for construction expenditures and other major cash requirements for that five-year period. However, the Company anticipates that in 1992 internally generated cash after meeting operating expenditures will meet approximately 63% of its 1992 cash requirements for construction expenditures and other major cash requirements. In addition to internally generated cash, the Company anticipates receiving approximately \$55 million in proceeds from the sale of a portion of SJGS Unit 4 to the City of Anaheim. (See "CURRENT ISSUES FACING THE COMPANY — Sale of 50 MW of SJGS Unit 4".) To cover differences in the amounts and timing of cash generation and cash requirements, the Company intends to utilize short-term borrowings under revolving credit facilities with various banks. The Company currently estimates its peak short-term borrowing requirements for 1992 to be no greater than \$80 million.

In addition, continuing efforts to improve the Company's cash position include cost control programs, increased efforts to market excess electric generating capacity and power, and efforts to settle various pending Company litigation issues.

As of December 31, 1991, the Company had a \$225 million revolving credit facility (the "Facility") with major banks and \$11 million in other, unsecured revolving credit facilities. The Facility is secured through first mortgage bonds of the Company and is currently scheduled to terminate on December 31, 1993. The Facility is subject to annual extensions at the banks' sole discretion and the Company expects to request such extensions. The Facility contains a provision that could prevent the Company from borrowing under the Facility in the event of a material adverse change in the financial condition, results of operations, assets, business or prospects of the Company. Additional provisions in the

Facility (a) generally restrict the Company from making dividend payments or other distributions with respect to common stock or from acquiring shares of common stock and (b) impose a maximum total debt to total capitalization ratio. However, the Facility allows the Company to declare cash dividends on the Company's common stock or acquire shares of the Company's common stock during any twelve month period in an amount not to exceed 100% of the Company's net earnings (excluding extraordinary gains and losses), less the amount of preferred stock dividends.

The Company has a letter of credit ("LOC") from a bank, which secures \$37.3 million of the Company's pollution control revenue bonds and requires either extension, reissuance, renewal, or substitution on December 4, 1992. The LOC is subject to annual extension at the sole discretion of the bank. It is the Company's intention to keep the bonds outstanding and to request an extension of the LOC. In addition, the Company could replace the debt with draws under the Facility.

The Company's ability to raise external capital and the cost of such funds depends on, among other things, its results of operations, credit ratings, regulatory approvals and financial market conditions. Currently, the ratings by Standards & Poor's Corporation ("S&P") of the Company's first mortgage bonds, including pollution control bonds secured through the Company's first mortgage bonds, are "investment grade" (BBB-). However, the ratings of such bonds by Moody's Investor Service ("Moody's") and the ratings by both S&P and Moody's of the Company's other securities, including lease obligation bonds (which are secured indirectly by an assignment of rentals to be paid by the Company) are below "investment grade". One impact of the Company's current ratings, together with covenants in the Company's PVNGS Unit 1 and Unit 2 lease agreements (see PART I, ITEM 1. — "BUSINESS — ELECTRIC OPERATIONS — Sources of Power — Nuclear Plant"), is to limit the Company's ability, without consent of the owner participants and bondholders in the lease transactions, (i) to enter into any merger or consolidation, or (ii) except in connection with normal dividend policy, to convey, transfer, lease or dividend more than 5% of its assets, including cash, in any single transaction or series of related transactions. The Company's revolving credit facility imposes similar restrictions irrespective of credit ratings.

The issuance of first mortgage bonds by the Company is subject to earnings coverage and bondable property provisions of the Company's first mortgage indenture. The Company has the capability under the mortgage indenture, without regard to the earnings test but subject to other conditions, to issue first mortgage bonds on the basis of certain previously retired bonds. However, the Company is unable to issue any significant amounts of first mortgage bonds at this time. The earnings tests in the Company's Restated Articles of Incorporation currently limit the issuance of preferred stock (other than in connection with certain exchanges, redemptions or retirements of preferred stock) and any issuance would require the consent of the holders of a majority of the shares of preferred stock then outstanding until such time as the earnings tests are met.

The Company's board of directors has not declared dividends on its common stock since January 1989. The Company's board of directors reviews its dividend policy on a continuing basis. The payment of future dividends is dependent upon earnings, the financial condition of the Company, market conditions and other factors.

The Company's capital structure at December 31, 1991 consisted of 48.8 percent long-term debt, less current maturities, 1.7 percent preferred stock with mandatory redemption requirements, 3.7 percent preferred stock without mandatory redemption requirements and 45.8 percent common stock equity.

RESULTS OF OPERATIONS

Net earnings per common share in 1991 were \$.32, compared to a loss of \$.23 per common share in 1990 and earnings of \$1.73 per common share in 1989. The results of operations in 1990 reflect after-tax write-offs of \$19.4 million resulting from the NMPSC's decision on the Company's electric rate case. The write-offs resulted primarily from the NMPSC's treatment of prior years' tax benefits from debt

retirement and losses on hedge transactions as well as the NMPSC's treatment of amortization periods for gains resulting from the sale and leaseback transactions on PVNGS Units 1 and 2 consummated in previous years.

Resources excluded from NMPSC jurisdiction rates ("excluded capacity") have had a negative effect on the Company's results of operations. (See note 11 of the notes to consolidated financial statements.) For 1991 and May to December of 1990, selected financial information for this excluded capacity is shown below:

	1991	1990
	(In thousands, except per share amounts)	
Operating revenues	\$ 59,248	\$ 38,076
Operating income (loss)	\$(17,324)	\$(10,697)
Net earnings (loss)	\$(33,729)	\$(19,804)
Net earnings (loss) per share of common stock	\$ (0.86)	\$ (0.51)
Net utility plant at year-end	\$377,262	\$392,408

The following discussion highlights other significant items which affected the results of operations in 1991 and 1990, and certain items impacting future earnings.

Electric operating revenues increased \$1.1 million in 1991 due primarily to higher energy sales of 1.8% to retail customers. Partially offsetting such increases were lower sales for resale reflecting the soft wholesale power market. Electric operating revenues decreased \$67.5 million in 1990 due mainly to the expiration on December 31, 1989 of the long-term power sale contract with SPS. However, the decrease was partially offset by higher energy sales to retail customers, which increased by 2.8% in 1990.

Gas operating revenues decreased \$25.0 million and gas purchased for resale decreased \$38.8 million in 1991, due primarily to lower purchased gas costs (which are recovered from customers through the PGAC) and a decrease in spot-market sales. Despite the decrease in total gas operating revenues, cost-of-service revenues and the gas operations margin (gas revenues less gas purchased for resale) increased primarily as a result of an increase in retail natural gas rates approved by the NMPSC in August 1990 and an increase in transportation throughput. The \$19.3 million increase in gas operating revenues in 1990 was due mainly to increased gas liquids revenues resulting from increased prices and throughput, to increased gas consumption by residential and commercial customers in the spring of 1990 and to an increase in transportation throughput. The 1990 gas rate increase also contributed to the increased revenues for that year. The \$15.1 million increase in gas purchased for resale in 1990 was due primarily to a higher net cost of gas and increased gas deliveries to residential and commercial customers.

Fuel and purchased power expense decreased \$3.8 million in 1991 due mainly to a decrease in coal-fuel costs as a result of reduced generation at both SJGS and Four Corners. The soft wholesale power market has caused lower load conditions for those plants. Partially offsetting this decrease was increased nuclear fuel expense due to increased availability of the PVNGS units.

Other operation and maintenance expenses increased \$2.4 million in 1991 due primarily to mercury meter clean-up costs by gas operations, increased salary expenses and an increase in employee benefits due to reduced accruals in 1990 resulting from over-funding for health and dental expenses. Such increases were partially offset by decreased maintenance expenses at SJGS due to two major outages in 1990 versus one major outage in 1991 and the 1990 write-off of obsolete stores material. Other operation and maintenance expenses increased \$12.7 million in 1990 due primarily to increased operating costs resulting from increased availability of the PVNGS units along with additional personnel and training costs at PVNGS and increased Arizona property taxes on the leased PVNGS units. Increased scheduled outages at SJGS Unit 4 also contributed to such increase in other operation and maintenance expenses.

Operating income taxes increased by \$6.3 million in 1991 due primarily to higher pre-tax operating income in 1991. Operating income taxes for 1990 decreased \$18.5 million due primarily to lower pre-tax operating income in 1990 partially offset by the absence in 1990 of certain tax benefits which were flowed through in 1989.

Other, under the caption Other Income and Deductions, net of taxes, decreased \$4.5 million in 1991 due mainly to a write-off of AFUDC and depreciation related to Four Corners, increased litigation expense, an additional provision for disputes related to gas purchase contracts and losses related to the M-S-R energy brokerage agreement caused by the poor wholesale power market. Such expenses were partially offset by the recapture of damage payments related to the Company's exit from diversification. Other, under the caption Other Income and Deductions, net of taxes, decreased \$7.6 million in 1990 due primarily to a reserve for costs related to retirement of utility property and additional provision for defending shareholders' litigation.

Interest charges decreased \$3.3 million in 1991 due primarily to a decrease in short-term borrowings along with a decrease in interest rates. Interest charges decreased \$7.0 million in 1990 due primarily to the retirement of \$30 million of 13 1/8 % first mortgage bonds in August 1989, and a decrease in other long-term debt outstanding during 1990.

CURRENT ISSUES FACING THE COMPANY

The Company believes that the excess capacity of its electric operations, combined with competitive conditions in the wholesale electric market, will cause the Company's results of operations to be depressed over the next several years.

The Company's future financial condition and results of operations may be also affected by other issues discussed below.

The Company's management has been evaluating possible strategic options in an effort to maximize shareholders' investment value and improve its standing with its customers and the communities in which it serves. In 1990, the Company's management announced specific objectives and established action plans designed to achieve these objectives. The plans include, among other things, no increase in base rates through 1993, reduction of budgeted non-fuel operation and maintenance expenses by 10 percent by the end of 1993 (excluding PVNGS operation and maintenance expenses), concentration on increased opportunities for revenue growth, marketing of excess energy and capacity, resolution of the Albuquerque franchise issue and improvements in the level of public and customers trust and satisfaction of the Company's performance.

The Wholesale Power Market

System Sales — During 1991, the Company entered into negotiations with the City of Gallup to replace its firm-requirements wholesale power contract which expires in February 1993. The City of Gallup has tentatively selected the Company as its supplier based on those negotiations and has authorized the Company to draft a new contract. It is anticipated that this tentative contract, if executed, would have a slight negative impact on the Company's revenues from the current level.

Off-System Sales — The Company's interest in PVNGS Unit 3 (130 MW), a portion of SJGS Unit 4 (130 MW) and the power purchase contract with M-S-R (105 MW) are excluded from the NMPSC jurisdictional rates. (See "ELECTRIC OPERATIONS — Sources of Power" and "RATES AND REGULATION — Electric Rate Case" under PART I, ITEM 1. — "BUSINESS".) The Company is dependent on the wholesale power market for the recovery of its investment in this excluded capacity.

The off-system markets for contracted sales to utilities and for economy energy are highly competitive. The Company has contracted to sell, and continues to market, power at prices which recover variable costs and a portion of the fixed costs of its excess capacity. Remaining energy produced by excess capacity is then sold in the economy energy market at prices which average only slightly above

incremental operating costs. An April 12, 1990 NMPSC order provides that as long as there is excess capacity in the Company's jurisdictional rates, then that excess capacity will share off-system sales equitably with the capacity excluded from NMPSC jurisdictional rates.

During 1991, the Company's sales in the off-system markets accounted for approximately 33.8 percent of its total KWh sales and approximately 15.4 percent of its total revenues from energy sales. The net operating loss for the Company's excluded capacity was \$17.3 million in 1991. The Company expects contracts with APPA and AEPCO, under which sales began in June 1991 (see PART I, ITEM 1. — "BUSINESS — ELECTRIC OPERATIONS — Power Sales"), to have a positive impact (approximately 3 cents and 5 cents per common share in 1991 and 1992, respectively) on the Company's results of operations. On March 1, 1992, the Company began service pursuant to a three-year off-system sales agreement with the Imperial Irrigation District in Southern California. The agreement which extends through 1995 provides for 56 MW of power in each month and an additional 25 MW of power in the months of April through October each year. The sale will further reduce the Company's excess capacity and positively impact the Company's results of operations. However, the Company's ability to market its excluded capacity will continue to be under pressure as a result of both price competition and limited transmission availability.

The Company expects price competition in the wholesale market to continue to be intense due to the availability of surplus capacity from other utilities, projected natural gas fuel prices and the existence of cogeneration, independent power producers and self-generation as competing energy sources. The on-going recession, the availability of hydro power and the abundance of inexpensive natural gas have had a negative effect on the Company's ability to market its excess power. The Company expects the supplies of lower-cost natural gas to be available for some time, as a result of tax credits on coal-seam gas, increased use of gas storage, and recently-increased ability to transport natural gas to markets in which the Company competes for off-system sales. The use of lower-cost natural gas in intermediate and peaking power generation has established a new ceiling for wholesale electric prices. The Company's market assessments indicate that other southwestern and western utilities will have increasing requirements for capacity and energy in the 1990s. However, the Company projects that the current soft wholesale power market will continue into the mid-1990s and that, as a result, there will continue to be downward pressure on near-term wholesale power prices.

Given its reliance on coal and nuclear fuel for electric generation for base load, the Company expects that off-system sales will continue to be negatively affected. The Company is assessing its future course of action to regain competitiveness in the wholesale electric power markets and is reviewing its cost structure and its fuel and electricity generation resource mix based on its customers needs. The Company has marketed a portion of its interest in SJGS Unit 4. (See "Sale of 50 MW of SJGS Unit 4".) In addition, the Company is currently evaluating the market for its interest in PVNGS Unit 3. Initial indications are that if the Company's interest in PVNGS Unit 3 were to be sold, the sales price would be significantly below book value. However, the Company believes that if it continues to own its interest in PVNGS Unit 3, it will be able to recover its costs and investment, on an undiscounted basis, through sales of power from the unit. Once the market evaluation is completed, the Company will evaluate the results, and consider whether or not to pursue selling its interest in PVNGS Unit 3.

The Company considers its potential market for wholesale power sales to be defined generally by those entities interconnected within the WSCC. The Company's ability to sell its power within the WSCC has been enhanced for short-term sales by the WSPP experiment. The WSPP has allowed for market level pricing and negotiated transactions for transmission services. Orders issued on April 23, 1991 and June 27, 1991 by the FERC allow the WSCC experiment's concept to continue with certain cost-based price ceilings, under a permanent agreement.

"Environmental externalities" is a subject of discussion before regulatory bodies throughout the United States, and of particular note to the Company, in California. As a result, a competitive pricing disadvantage could be imposed on the energy produced by fossil-fueled generators, affecting the

Company's off-system sales strategies. The Company is currently unable to predict the ultimate outcome of these discussions, but has taken an active position as an intervenor, opposing any penalty on existing generation resources which meet all applicable environmental regulations.

Technical limitations and jurisdictional service concerns of other utilities in the WSCC have made and are making long-term transmission service commitments difficult to obtain. Environmental, technical and economic constraints combine to make the construction of new transmission facilities also difficult.

The Company currently provides transmission services to other utilities operating within New Mexico. The Company's ability to continue or expand these services in northern New Mexico depends, in part, on the completion of OLE. (See "The Retail Electric Market".)

Sale of 50 MW of SJGS Unit 4

On April 26, 1991, the Company executed a purchase and participation agreement with the City of Anaheim, California to sell a 10.04% (50 MW) undivided ownership interest in SJGS Unit 4 for approximately \$55 million. The Company filed a request with the NMPSC in August 1991 for decertification of the 50 MW of SJGS Unit 4 for the anticipated sale.

In January 1992, the Company reached a stipulated agreement with the NMPSC Staff and intervenors which approves this sale and the decertification of 130 MW of SJGS Unit 4. The stipulation requires, among other things, the Company to pass through to New Mexico ratepayers \$1 million of the estimated \$8.6 million after-tax gain from the sale and allows the Company to retain any gain on future sales of the remaining 80 MW. The stipulation also provides that the cost per installed KW for the next 130 MW of supply-side resource added by the Company before December 2002 can not exceed the depreciated book value of SJGS Unit 4 plus \$175 per KW. The stipulation is subject to NMPSC approval and a decision from the NMPSC is expected in the second quarter of 1992.

The closing of this sale is currently anticipated in the third quarter of 1992. In addition to the gain from the transaction, the Company estimates that the transaction would have a positive impact on the Company's future results of operations through avoided operating costs.

The Retail Electric Market

Albuquerque Franchise Issue — The Company's non-exclusive electric service franchise with the City of Albuquerque (the "City") expired in early 1992. The franchise agreement provided for the Company's use of City property for electric service rights-of-way. The Company's facilities located on City property account for less than 20% of the total distribution equipment within the geographic area. The Company continues service to the area, which contributed 45.4% of the Company's total 1991 electric operating revenues. The Company will take vigorous action to protect the value of its distribution system in the City franchise area.

In a municipal election held on November 1, 1989, voters approved an amendment to the City's charter that provides that the City has no power to grant or extend any franchises, licenses or other rights to provide electricity to the public or to wholesalers unless the franchise, license or right has been awarded by competitive bid to the lowest cost suppliers. The charter provision also provides that the total term of any franchise will not exceed 25 years. The City has conducted studies on alternatives available to it, including municipalization of the Company's distribution system, the viability of other alternatives, and the methods that may be available to implement the charter provision.

The Company continues to challenge the charter provision. In December 1990, the Company filed with the NMPSC a petition for a declaratory order regarding inconsistencies between the charter provision and the NMPSC's exclusive jurisdiction over public utility rates and service areas under state law. In November 1991, the NMPSC issued an order concluding, among other things, that the City could bid for services to its own facilities, but not for service to other customers. In reaching this conclusion, the NMPSC noted that New Mexico law reflects a legislative choice to vest the NMPSC with exclusive control over utility rates and services. The NMPSC also noted that the Company's obligation to serve its customers in Albuquerque will continue irrespective of whether the municipal franchise is renewed. The City has appealed the NMPSC's order to the New Mexico Supreme Court.

Representatives of the Company and the City have met in attempts to resolve the franchise renewal issue. While the Company cannot predict the ultimate outcome of the issue, it currently believes that such outcome will not have a material adverse effect on the Company's financial condition or results of operations. The failure to obtain a franchise renewal may make it more difficult for the Company to serve customers in the Albuquerque area by potentially requiring the Company to obtain right-of-way permits on a case-by-case basis for line extension or maintenance work on property owned by the City. The lack of a franchise renewal may also have adverse implications regarding the Company's provision of service to some portion of the City's municipal loads. In 1991, Albuquerque municipal loads generated approximately \$17 million in annual revenue. However, the Company believes the absence of a franchise does not change its right and obligation to serve those customers under state law. The Company's transmission and distribution facilities are the only existing facilities which could be used to provide service to customers in the franchise area. If the City were to pursue condemnation of the Company's system, the Company believes the City would have to compensate the Company for the fair value for all assets deployed to serve the Albuquerque area. The Company believes that municipalization, which would require voter approval, is not an economically viable alternative for the City.

OLE Transmission Project — In May 1984, the Company's Board of Directors approved plans to construct OLE, a 345kV transmission line connecting the existing Ojo 345kV line to the existing Norton Station. The Company had spent approximately \$10 million on OLE as of December 31, 1991, and it currently estimates that project costs will total approximately \$47 million. OLE is designed to provide a needed improvement to the northern New Mexico transmission system and to allow greater delivery of power from SJGS, Four Corners and PVNGS into the Company's two largest service territories, the greater Albuquerque area and the Santa Fe/Las Vegas area. The timing of the project, currently scheduled for completion in April 1994, is important since the existing transmission system limits the amount of additional retail load that can be reliably served. However, OLE faces considerable opposition by persons concerned primarily about the environmental impacts of the project.

The Company has obtained right-of-way permits from two of the three Federal agencies having authority over the lands involved in the project. A Federal district court has upheld the record of decision on the OLE environmental impact statement, but opponents have appealed to the United States Court of Appeals for the Tenth Circuit. The Company expects that the Tenth Circuit will rule in the third quarter of 1992. On March 11, 1991, the Company filed for the NMPSC approval for construction of OLE. Although the NMPSC Staff generally supports the project, several opposing parties have intervened in the case. Hearings are scheduled to begin in April 1992, and the Company expects the NMPSC will issue its decision in the third quarter of 1992.

Coal Sales Agreement

The Company is party to a Coal Sales Agreement with SJCC, a subsidiary of BHP-Utah International Inc., under which SJCC is required to provide all of the coal required by SJGS. The agreement expires in 2017 and contains minimum take provisions and a pricing mechanism that includes elements for capital improvements and operating cost reimbursement.

The Company is concerned that the terms of the agreement and SJCC's interpretation of its provisions, particularly with respect to the capital investment element, causes energy produced from coal mined thereunder to become less and less competitive in the wholesale power market compared to energy produced from abundant supplies of inexpensive natural gas. (See "Wholesale Power Market".) In addition, the Company established a goal for NMPSC jurisdictional base rates to be in the lowest one-third of regional competitors. Keeping coal costs competitive must therefore be one of the Company's major strategic objectives. The Company has begun negotiations with SJCC to reform the agreement, with the goal of raising productivity, reducing minimum take obligations, and including incentives and escalation factors which would keep coal delivered under the agreement competitive with natural gas. The Company has also notified SJCC that it is paying the current invoices for coal delivered under protest.

While the Company believes that maintaining the competitiveness of power generated by SJGS is of material importance because in excess of 50% of its total electricity supply is generated by SJGS, there can be no guarantee as to a favorable outcome of the discussions with SJCC.

Gas Litigation and Regulatory Issues

In 1989, 1990 and 1991, GCNM and Gathering Company settled litigation involving substantial claims relating to gas purchase contracts. Even though numerous claims relating to natural gas contracts have been settled and those contracts reformed or terminated, and no significant new claims were asserted in 1991, GCNM and Gathering Company are still disputing claims by certain natural gas producers relating to take-or-pay obligations, contract pricing and other matters. (See PART I, ITEM 3. — "LEGAL PROCEEDINGS — NATURAL GAS SUPPLY LITIGATION".) In a case filed on September 21, 1990, the Company seeks NMPSC approval to recover \$68 million of costs arising from the settlement of certain contract claims. At issue in this proceeding are (i) GCNM's allocation of costs between take-or-pay claims and MDL-contract claims and (ii) the prudence of costs relating to the latter. On March 11, 1992, the hearing examiner in the case issued a recommended decision which, if adopted by the NMPSC, would allocate to take-or-pay claims all costs GCNM had previously allocated to MDL-contract claims and would allow GCNM to recover approximately \$57.3 million. (See PART I, ITEM 1. — "BUSINESS — RATES AND REGULATION — Natural Gas Supply Matters".)

In 1989 and 1990, the Company provided a reserve in its financial statements for losses arising from natural gas contract disputes, considering the anticipated regulatory treatment. The Company reevaluates periodically the adequacy of the reserve and made an additional provision in 1991. The reserve is based on (a) consultations with counsel with respect to pending litigation, taking into account the Company's past experience in resolving natural gas contract claims, (b) the amounts of the settlements the Company has achieved to-date, and (c) the amounts the Company believes are recoverable under a 1989 NMPSC order. GCNM is contesting the March 11, 1992 recommended decision, which it believes, is inconsistent with both the evidence presented in the case and the express provisions of the 1989 order. If the NMPSC adopts the recommended decision, a further adjustment of the Company's reserve would be required. However, the Company currently believes it is unlikely that the pending regulatory proceedings or the remaining disputes with natural gas producers will have a material adverse impact on the Company's future financial condition or results of operations.

Tucson Electric Power Company and Century Power Corporation

The Company operates and jointly owns SJGS, in which Tucson and Century have certain ownership interests. In July 1991, a group of Tucson's creditors in Tucson's sale and leaseback transactions filed an involuntary petition for reorganization of Tucson under Chapter 11 of the United States Bankruptcy Code. A similar petition was filed against Century. On December 31, 1991, the United States Bankruptcy Court for the District of Arizona dismissed, without prejudice, the pending involuntary petition for the reorganization of Tucson under Chapter 11. In addition, Tucson has been granted rate relief and is in the process of restructuring its financial obligations.

Tucson transferred its 50% ownership interest in SJGS Unit 3 to Alamito Company (currently known as Century), then a wholly-owned subsidiary of Tucson, in 1984. Alamito Company was subsequently spun off by Tucson. In September 1991, Century informed the Company that Century's 178 MW power sale contract with SDG&E was not renewed and would expire on December 31, 1991 and that the loss of this contract might cause Century to be unable to meet its obligations under the SJGS operation agreement. Since this time, however, it is the Company's understanding that Century has executed a short-term agreement with SDG&E to purchase at least Century's minimum generation requirement from SJGS Unit 3 through May of 1992, with possible extensions thereafter. The Company believes that Tucson is ultimately liable for Century's SJGS obligations under the original contracts executed prior to the transfer of ownership from Tucson. Century's share of SJGS obligations is approximately \$3.2 million per month. The Company understands that Tucson and Century have reached an agreement whereby, after December 1, 1992 and through 1996, Tucson would advance funds on Century's behalf directly to the Company (as the operating agent of SJGS) for costs and expenses associated with Century's ownership share of SJGS Unit 3. Such advances are not to exceed \$45 million in the aggregate or \$15 million in any one year.

The Company believes that the current financial difficulties of Tucson and Century will not have a material impact on the Company's future financial condition or results of operations. However, as a co-participant in and operating agent of SJGS, the Company has certain contingent obligations under the

plant operating agreement and joint and several liability with Tucson under the coal supply agreement. The Company bases its belief on its understanding that (1) Tucson would have an on-going need for power and that SJGS is one of Tucson's least expensive resources, (2) Tucson's interests in SJGS Units 1 and 2 are in its rate base, (3) Tucson is ultimately liable for Century's SJGS obligations and (4) the best way to maintain SJGS's value in the market place would be to keep it operational.

El Paso Electric Company

The Company owns or leases a 10.2% interest in PVNGS and owns a 13.0% interest in Four Corners Units 4 and 5, which are operated by APS. El Paso owns or leases a 15.8% interest in PVNGS and owns a 7.0% interest in Four Corners Units 4 and 5.

On January 8, 1992, El Paso filed a voluntary petition to reorganize under Chapter 11 of the United States Bankruptcy Code. Pursuant to an agreement among the participants in PVNGS and an agreement among the participants in Four Corners Units 4 and 5, each participant is required to fund its proportionate share of operation and maintenance, capital, and fuel costs of PVNGS and Four Corners Units 4 and 5. APS estimates El Paso's total monthly share of these costs to be approximately \$9 million for PVNGS and \$1 million for Four Corners Units 4 and 5. The agreements provide that if a participant fails to meet its payment obligations, each non-defaulting participant shall pay its proportionate share of the payments owed by the defaulting participant. On February 13, 1992, the bankruptcy court approved a stipulation between El Paso and APS, as the operating agent of PVNGS, pursuant to which El Paso agreed to pay its proportionate share of all PVNGS invoices delivered to El Paso after February 6, 1992. El Paso agreed to make these payments until such time as an order is entered by the bankruptcy court, if ever, authorizing or directing El Paso's rejection of the participation agreement governing the relations among the PVNGS participants. As long as El Paso continues to make these payments, APS and the other PVNGS participants have agreed not to file a motion prior to December 31, 1992, seeking a deadline for the assumption or rejection of the participation agreement. If El Paso defaults, APS and the other participants may take steps to pursue other available remedies. The stipulation also specifies that approximately \$9.3 million of El Paso's PVNGS payment obligations invoiced prior to February 7, 1992, are to be considered "pre-petition" general unsecured claims of the other PVNGS participants. The Company paid \$1.1 million as its proportionate share of the pre-petition obligation. In addition, El Paso has unpaid invoices for the Company's transmission services and economy energy deliveries of approximately \$6 million which is considered to be a pre-petition amount. The Company cannot currently predict the outcome of this matter. However, the Company is participating in the El Paso bankruptcy proceedings. The Company consults on an on-going basis with its counsel, as well as with APS, the PVNGS and Four Corners operating agent, concerning the proceedings and continues to evaluate the potential impacts of the El Paso bankruptcy.

Shareholder Litigation

The Company and certain individuals who currently serve, or formerly served, as officers or directors of the Company or its subsidiaries are defendants in five class action suits brought by shareholders of the Company. These suits allege misrepresentations and omissions of material facts in the various reports filed with the Securities and Exchange Commission and in other communications primarily related to the Company's excess electric generating capacity and diversified non-utility operations. In addition, there are four suits against former officers and directors that shareholders have sought to bring derivatively on behalf of the Company. The suits allege, among other things, mismanagement and breach of fiduciary duty relating primarily to diversified non-utility operations. (See PART I, ITEM 3. — "LEGAL PROCEEDINGS — SHAREHOLDER LITIGATION".)

In early 1992, the respective courts entered orders staying proceedings in this shareholder litigation and appointing Honorable Harry R. McCue, United States Magistrate Judge for the Southern District of California, to act as a settlement judge. Following extensive discussions conducted by Judge McCue, the parties agreed in principle to settle all of the litigation. The Company's directors' and officers' liability insurance carriers would fund the \$33 million settlement amount, of which the Company would receive \$3 million as partial reimbursement of litigation-related expenses. On March 3, 1992, Judge McCue

approved an agreement in principle, which would settle the class action and derivative lawsuits brought against the Company and each of the other named defendants. Final settlement of the litigation requires approval by the respective courts.

In 1990, the Company made a provision for the estimated cost of defending shareholder lawsuits. In 1991, the Company recorded additional provisions for costs it incurred in excess of the reimbursement to be received in the settlement.

Postretirement Benefits

In December 1990, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 106, *Employers' Accounting for Postretirement Benefits Other than Pensions*, effective for fiscal years beginning after December 15, 1992. The Company plans to adopt SFAS No. 106 effective January 1, 1993. SFAS No. 106 will require accrual of postretirement benefits (such as medical and dental benefits) during the years employees provide services. The costs of these benefits are currently expensed on a pay-as-you-go basis. The Company's study on the adoption of SFAS No. 106 indicates that its unrecognized postretirement benefit obligation as of January 1, 1993 would be approximately \$37.3 million which would be amortized over a 20-year period and that in the first year the expense would be approximately \$5.6 million as compared to an estimate of \$1.5 million on a pay-as-you-go basis. The Company is evaluating various funding alternatives in an effort to reduce the additional benefit expense. In addition, the Company has been notified that its portion of other postretirement benefits for PVNGS is anticipated to increase about \$1.2 million. Although the Company has discussed with the NMPSC Staff the impact of SFAS No. 106 and believes that this additional expense is reasonable and should be recoverable from the ratepayers, the Company has not requested a ruling on the rate treatment of the additional expense. The Company is currently unable to predict the ultimate effect on the Company's financial condition and results of operations since it is unknown if this additional expense will be recovered from the ratepayers.

Transaction Privilege Tax

In 1991, the Company was verbally notified by the Arizona Department of Revenue ("DOR") that the DOR plans to issue an audit finding that additional transaction privilege (sales) tax is due on the lease payments associated with the Company's sale and leaseback transactions of PVNGS Units 1 and 2. The Company currently pays transaction privilege tax based on approximately 9% of the payments which are classified by the Company as payments for leases of real property.

The DOR has indicated that the preliminary assessment will classify and tax 100% of the leased property as real property. The Company does not agree with DOR's position, and will appeal DOR's findings, if necessary. If the lease payments are classified entirely as leases of real property, the amount of tax due would be approximately \$14 million in tax and interest from January 1, 1988 through December 31, 1991 and approximately \$4.2 million in tax per year thereafter. The Company does not agree with DOR's position, and will appeal DOR's findings, if necessary. Under the terms of the PVNGS lease agreements, the Company is liable for all transaction privilege tax due on the lease payments. The Company has recorded no provision for this potential tax assessment.

Purchase of Beneficial Interests in PVNGS Leases

As of February 7, 1992, the Company entered into a purchase agreement, subject to NMPSC approval, whereby the Company would purchase approximately 22% of the lessors' interests in the PVNGS Units 1 and 2 leases for approximately \$17.5 million in cash. While legally the leases would remain in effect, for accounting purposes, this transaction would be recorded as a purchase. Accordingly, the Company would record approximately \$158.8 million as utility plant and \$141.3 million as long-term debt on the Company's consolidated balance sheet and reduce the annual operating lease commitments by approximately \$18.2 million. It is anticipated that for regulatory purposes these would continue to be classified as operating leases and the lease costs would continue to be recovered in rates. The Company is proposing to reduce rates by \$1.8 million beginning in 1999 through the remainder of the lease term. The transaction, as proposed in the NMPSC filing, would reduce net earnings in the years 1992 through 1996 by \$1.9 million, \$1.1 million, \$.8 million, \$.5 million and \$.2 million, respectively, and gradually increase net earnings thereafter over the remainder lease terms. On February 21, 1992, the Company filed a case with the NMPSC for approval of this purchase.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

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

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

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

The independent auditors, KPMG Peat Marwick, are engaged to audit the Company's consolidated financial statements in accordance with generally accepted auditing standards.

INDEPENDENT AUDITORS' REPORT

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

We have audited the consolidated financial statements of Public Service Company of New Mexico and subsidiaries as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedules as listed in the accompanying index. These consolidated financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedules 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 Public Service Company of New Mexico and subsidiaries as of December 31, 1991 and 1990, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1991, in conformity with generally accepted accounting principles. Also in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

KPMG PEAT MARWICK

Albuquerque, New Mexico
February 18, 1992, except as to note 12
which is as of March 3, 1992

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF EARNINGS (LOSS)

	Year Ended December 31,		
	1991	1990	1989
	(In thousands except per share amounts)		
Operating Revenues:			
Electric (note 1)	\$568,486	\$567,382	\$634,888
Gas	277,069	302,104	282,827
Water	11,613	11,700	12,102
Total operating revenues	<u>857,168</u>	<u>881,186</u>	<u>929,817</u>
Operating Expenses:			
Fuel and purchased power (note 1)	164,711	168,534	169,786
Gas purchased for resale	131,479	170,320	155,232
Other operation expenses	282,418	275,851	268,826
Maintenance and repairs	52,229	56,385	50,755
Depreciation and amortization	76,053	73,204	71,981
Taxes, other than income taxes	39,214	36,961	34,043
Income taxes (note 4)	13,811	7,490	25,958
Total operating expenses	<u>759,915</u>	<u>788,745</u>	<u>776,581</u>
Operating income	<u>97,253</u>	<u>92,441</u>	<u>153,236</u>
Other Income and Deductions, net of taxes (note 4):			
Allowance for equity funds used during construction	1,105	—	2,909
Write-offs due to electric regulatory order (note 11)	—	(19,396)	—
Other	(9,666)	(5,188)	2,392
Net other income and deductions	<u>(8,561)</u>	<u>(24,584)</u>	<u>5,301</u>
Income before interest charges	<u>88,692</u>	<u>67,857</u>	<u>158,537</u>
Interest Charges:			
Interest on long-term debt	59,928	61,176	71,572
Other interest charges	7,608	9,697	6,283
Allowance for borrowed funds used during construction	(1,804)	(3,458)	(1,911)
Net interest charges	<u>65,732</u>	<u>67,415</u>	<u>75,944</u>
Net Earnings	22,960	442	82,593
Preferred Stock Dividend Requirements	<u>9,474</u>	<u>10,002</u>	<u>10,456</u>
Net Earnings (Loss) Available for Common Stock	<u>\$ 13,486</u>	<u>\$ (9,560)</u>	<u>\$ 72,137</u>
Average Number of Common Shares Outstanding	<u>41,774</u>	<u>41,774</u>	<u>41,774</u>
Net Earnings (Loss) per Share of Common Stock	<u>\$ 0.32</u>	<u>\$ (0.23)</u>	<u>\$ 1.73</u>
Dividends Paid per Share of Common Stock	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 0.38</u>

See accompanying notes to consolidated financial statements.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF RETAINED EARNINGS (DEFICIT)

	Year Ended December 31,		
	1991	1990	1989
		(In thousands)	
Balance at Beginning of Year	\$46,703	\$ 56,263	\$(144,004)
Elimination of deficit through quasi-reorganization of equity accounts (note 2)	—	—	144,004
Net Earnings	22,960	442	82,593
Dividends:			
Cumulative preferred stock	(9,474)	(10,002)	(10,456)
Common stock	—	—	(15,874)
Balance at End of Year	<u>\$60,189</u>	<u>\$ 46,703</u>	<u>\$ 56,263</u>

See accompanying notes to consolidated financial statements.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

	December 31,	
	1991	1990
	(In thousands)	
ASSETS		
Utility Plant, at original cost (notes 2, 3, 6, and 11):		
Electric plant in service	\$1,990,782	\$1,938,243
Gas plant in service	465,474	445,814
Water plant in service	53,169	49,946
Common plant in service	37,709	40,085
Plant held for future use	1,258	1,258
	<u>2,548,392</u>	<u>2,475,346</u>
Less accumulated depreciation and amortization	760,180	697,744
	<u>1,788,212</u>	<u>1,777,602</u>
Construction work in progress	75,007	86,127
Nuclear fuel, net of accumulated amortization of \$34,273 and \$26,743	42,094	50,732
Net utility plant	<u>1,905,313</u>	<u>1,914,461</u>
Other Property and Investments:		
Non-utility property, at cost, net of accumulated depreciation, partially pledged	11,040	9,869
Other investments, at cost, partially pledged	23,494	31,146
Total other property and investments	<u>34,534</u>	<u>41,015</u>
Current Assets:		
Cash	10,705	4,588
Temporary investments, at cost	4,105	1,365
Receivables	95,707	104,053
Income taxes receivable	20,141	11,008
Fuel, materials and supplies, at average cost	51,929	48,013
Gas in underground storage, at weighted average cost	10,756	11,499
Prepaid expenses	8,094	7,775
Total current assets	<u>201,437</u>	<u>188,301</u>
Deferred charges	<u>203,048</u>	<u>169,932</u>
	<u>\$2,344,332</u>	<u>\$2,313,709</u>
CAPITALIZATION AND LIABILITIES		
Capitalization (note 2):		
Common stock equity:		
Common stock outstanding—41,774,083 shares	\$ 208,870	\$ 208,870
Additional paid-in capital*	469,823	469,688
Retained earnings since January 1, 1989	60,189	46,703
Total common stock equity	<u>738,882</u>	<u>725,261</u>
Cumulative preferred stock without mandatory redemption requirements	59,000	59,000
Cumulative preferred stock with mandatory redemption requirements	26,982	45,581
Long-term debt, less current maturities	<u>786,279</u>	<u>790,126</u>
Total capitalization	<u>1,611,143</u>	<u>1,619,968</u>
Current Liabilities:		
Short-term debt (note 3)	13,000	15,000
Accounts payable	157,060	127,516
Current maturities of long-term debt (note 2)	120	9,214
Accrued interest and taxes	29,517	30,918
Other current liabilities	45,976	33,946
Total current liabilities	<u>245,673</u>	<u>216,594</u>
Deferred Credits:		
Accumulated deferred investment tax credits (note 4)	108,173	116,495
Accumulated deferred income taxes (note 4)	187,541	146,642
Other deferred credits	<u>191,802</u>	<u>214,010</u>
Total deferred credits	<u>487,516</u>	<u>477,147</u>
Commitments and Contingencies (notes 5 through 12)	<u>\$2,344,332</u>	<u>\$2,313,709</u>

* A deficit in retained earnings of \$144.0 million was eliminated against additional paid-in capital through a quasi-reorganization as of January 1, 1989.

See accompanying notes to consolidated financial statements.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended December 31,		
	1991	1990	1989
	(In thousands)		
Cash Flows From Operating Activities:			
Net earnings	\$22,960	\$ 442	\$ 82,593
Adjustments to reconcile net earnings to net cash flows from operating activities:			
Depreciation and amortization	97,226	88,852	80,286
Allowance for equity funds used during construction	(1,105)	—	(2,909)
Accumulated deferred investment tax credit	(8,323)	(7,063)	(6,475)
Accumulated deferred income tax	25,539	28,755	42,254
Write-offs due to electric regulatory order	—	19,707	—
Changes in certain assets and liabilities:			
Receivables	(787)	40,897	(38,000)
Fuel, materials and supplies	(3,916)	1,718	9,778
Deferred charges	(27,312)	(49,101)	(33,998)
Accounts payable	29,592	(22,549)	(5,020)
Accrued interest and taxes	(1,401)	(1,217)	23,361
Deferred credits	(17,372)	24,971	1,005
Other	(2,602)	(572)	(10,101)
Other, net	(5,456)	1,053	(10,281)
Net cash flows from operating activities	<u>107,043</u>	<u>125,893</u>	<u>132,493</u>
Cash Flows From Investing Activities:			
Utility plant additions	(79,894)	(81,290)	(74,088)
Other property additions	(6,827)	(11,156)	(12,081)
Other property sales	15,878	1,605	7,560
Temporary investments, net	(2,061)	9,765	152,877
Net cash flows from investing activities	<u>(72,904)</u>	<u>(81,076)</u>	<u>74,268</u>
Cash Flows From Financing Activities:			
Redemptions and repurchases of preferred stock	(3,462)	(3,813)	(5,510)
Proceeds from long-term debt	—	—	3,043
Repayments of long-term debt	(12,938)	(14,570)	(206,170)
Net increase (decrease) in short-term debt	(2,000)	(18,880)	33,880
Dividends paid	(9,622)	(9,626)	(26,723)
Net cash flows from financing activities	<u>(28,022)</u>	<u>(46,889)</u>	<u>(201,480)</u>
Increase (Decrease) in Cash	6,117	(2,072)	5,281
Cash at Beginning of Period	4,588	6,660	1,379
Cash at End of Year	<u>\$10,705</u>	<u>\$ 4,588</u>	<u>\$ 6,660</u>
Supplemental cash flow disclosures:			
Interest paid	<u>\$66,200</u>	<u>\$ 68,415</u>	<u>\$ 86,444</u>
Income taxes paid (refunded)	<u>\$ 2,065</u>	<u>\$(52,865)</u>	<u>\$ 12,397</u>
Cash consists of currency on hand and demand deposits.			

See accompanying notes to consolidated financial statements.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CAPITALIZATION

		December 31,	
		1991	1990
		(In thousands)	
Common Stock Equity (note 2):			
Common Stock, par value \$5 per share		\$ 208,870	\$ 208,870
Additional paid-in capital		469,823	469,688
Retained earnings since January 1, 1989		60,189	46,703
Total common stock equity		<u>738,882</u>	<u>725,261</u>
	Stated Value	Shares Outstanding at December 31, 1991	Current Redemption Price
Cummulative Preferred Stock (note 2):			
Without mandatory redemption requirements:			
1965 Series, 4.58%	\$100	130,000	\$ 102.00
8.48% Series	100	200,000	103.00
8.80% Series	100	260,000	103.10
		<u>590,000</u>	<u>59,000</u>
With mandatory redemption requirements:			
8.75% Series	100	269,821	102.90
12.52% Series	50	346,700	52.97
		<u>616,521</u>	<u>44,317</u>
Redeemable within one year		<u>346,700</u>	<u>17,335</u>
		<u>269,821</u>	<u>26,982</u>
			<u>45,581</u>
Long-Term Debt (note 2):			
Issue and Final Maturity		Interest Rates	
First mortgage bonds:			
1991 through 1996		4 7/8 %	8,655
1997 through 2001		5 7/8 % to 8 1/8 %	44,634
2002 through 2006		7 1/2 % to 10 1/8 %	83,465
2007 through 2011		8 1/8 % to 9 %	85,038
2012 through 2013		12 7/8 %	540
1993 through 2013—pollution control series, securing pollution control revenue bonds		5.9% to 10 3/4 %	437,045
Total first mortgage bonds			<u>650,182</u>
Pollution control revenue bonds:			
2003 through 2013		10% to 10 1/4 %	100,000
2009		variable rate	37,300
Other, including unamortized premium and (discount)			<u>(1,083)</u>
Total long-term debt			<u>786,399</u>
Less current maturities			<u>120</u>
Long-term debt, less current maturities			<u>786,279</u>
Total Capitalization			<u>\$1,611,143</u>

See accompanying notes to consolidated financial statements.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1991, 1990 and 1989

(1) Summary of Significant Accounting Policies

Systems of Accounts

The Company maintains its accounts for utility operations primarily in accordance with the uniform systems of accounts prescribed by the Federal Energy Regulatory Commission ("FERC") and the National Association of Regulatory Utility Commissioners ("NARUC"), and adopted by the New Mexico Public Service Commission ("NMPSC"). As a result of the ratemaking process, the application of generally accepted accounting principles by the Company differs in certain respects from the application by non-regulated businesses. Such differences generally regard the time at which certain items enter into the determination of net earnings in order to follow the principle of matching costs and revenues.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and subsidiaries in which it owns a majority voting interest. All significant intercompany transactions and balances have been eliminated.

Utility Plant

Utility plant is stated at original cost, which includes capitalized payroll-related costs such as taxes, pension and other fringe benefits, administrative costs and an allowance for funds used during construction. Utility plant includes certain electric assets not subject to NMPSC regulation. The results of operations of such electric assets are included in operating income. (See note 11.)

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

Depreciation and Amortization

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

	<u>1991</u>	<u>1990</u>	<u>1989</u>
Electric plant	2.90%	2.88%	2.87%
Gas plant	3.13%	3.13%	3.11%
Water plant	2.58%	2.68%	2.78%
Common plant	6.53%	7.36%	9.54%

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

Depreciation of non-utility property is computed on the straight-line method. Amortization of nuclear fuel is computed based on the units of production method.

Allowance for Funds Used During Construction ("AFUDC")

As provided by the uniform systems of accounts, AFUDC, a noncash item, is charged to utility plant. AFUDC represents the cost of borrowed funds (allowance for borrowed funds used during construction) and a return on other funds (allowance for equity funds used during construction). The Company capitalizes AFUDC on construction work in progress and nuclear fuel in the process of enrichment to the extent allowed by regulatory commissions.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(1) Summary of Significant Accounting Policies (Continued)

AFUDC is computed using the maximum rate permitted by the FERC. In calculating AFUDC rates for 1990, the average short-term debt balance exceeded the average construction work in progress balance, resulting in a zero AFUDC rate for equity funds. The total AFUDC rates used were 8.96%, 8.96% and 10.94% for 1991, 1990 and 1989, respectively, compounded semi-annually.

Fuel, Purchased Power and Gas Purchase Costs

The Company uses the deferral method of accounting for the portion of fuel, net purchased power and gas purchase costs which are reflected in subsequent periods under fuel and purchased power clauses and gas adjustment clauses. Future recovery of these costs is based on orders issued by the regulatory commissions.

Economy Energy Sales

In 1991, the Company implemented a FERC order requiring classification of economy sales as operating revenues. Previously, such sales were accounted for as a reduction in fuel and purchased power expense. Prior years amounts have been reclassified for comparability purposes.

Amortization of Debt Discount, Premium and Expense

Discount, premium and expense related to the issuance and retirement of long-term debt are amortized over the lives of the respective issues.

Income Taxes

Certain revenue and expense items in the consolidated statement of earnings (loss) are recorded for financial reporting purposes in years different from those in which they are recorded for income tax purposes. Customers under NMPSC jurisdiction are charged currently for the tax effects of certain of these differences (normalization). However, the income tax effects of certain other differences result in reductions of income tax expense for ratemaking purposes in the current year as required by the NMPSC (flow-through). This flow-through method is used primarily for certain capitalized start-up and pre-operational costs at the Palo Verde Nuclear Generating Station ("PVNGS"), accelerated amortization of pollution control facilities and for minor differences between book and tax depreciation. A 1990 NMPSC order in an electric rate case required reversal of the flow-through treatment previously accorded the premiums on retirement of first mortgage bonds and losses on hedging transactions, and retroactively required tax normalization of these items. (See note 11.) In addition, rates subject to FERC jurisdiction allow recovery of amounts necessary to provide additional tax normalization of the differences described above which are treated in ratemaking under the flow-through method for other customers.

Deferred income taxes are recorded to reflect tax normalization using the liability method. Deferred tax liabilities are computed using the enacted tax rates scheduled to be in effect when the temporary differences reverse. For regulated operations, any changes in tax rates applied to accumulated deferred income taxes may not be immediately recognized because of ratemaking and tax accounting provisions contained in the Tax Reform Act of 1986. For items accorded flow-through treatment under NMPSC orders, deferred income taxes and the future ratemaking effects of such taxes, as well as corresponding regulatory assets and liabilities, are recorded.

In February 1992, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 109, *Accounting for Income Taxes*, which changes the conditions under which deferred tax assets may be recognized. The Company does not expect that future operating results will be significantly affected by the adoption of the new standard.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(1) Summary of Significant Accounting Policies (Continued)

The Company defers investment tax credits related to utility assets and amortizes them over the estimated useful lives of those assets.

Revenues

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

(2) Capitalization

Changes in common stock, additional paid-in capital and cumulative preferred stock are as follows:

	Common Stock		Additional Paid-In Capital	Cumulative Preferred Stock			
	Number of Shares	Aggregate Par Value		Without Mandatory Redemption Requirements		With Mandatory Redemption Requirements	
				Number of Shares	Aggregate Stated Value	Number of Shares	Aggregate Stated Value
	(Dollars in thousands)						
Balance at December 31, 1988 . .	41,774,083	\$208,870	\$688,392	590,000	\$59,000	792,429	\$ 55,242
Quasi-reorganization of equity accounts:							
Elimination of deficit in retained earnings	—	—	(144,004)	—	—	—	—
Adoption of SFAS No. 96 . . .	—	—	(32,302)	—	—	—	—
Other adjustments	—	—	(24,767)	—	—	—	—
Redemption of preferred stock	—	—	146	—	—	(53,232)	(3,323)
Redeemable within one year	—	—	—	—	—	(49,837)	(2,651)
Balance at December 31, 1989 . .	41,774,083	208,870	487,465	590,000	59,000	689,360	49,268
Adjustments related to quasi-reorganization of equity accounts	—	—	(17,968)	—	—	—	—
Redemption of preferred stock	—	—	191	—	—	(13,537)	(1,354)
Redemption within one year . .	—	—	—	—	—	(46,660)	(2,333)
Balance at December 31, 1990 . .	41,774,083	208,870	469,688	590,000	59,000	629,163	45,581
Redemption of preferred stock	—	—	135	—	—	(12,642)	(1,264)
Redeemable within one year . .	—	—	—	—	—	(346,700)	(17,335)
Balance at December 31, 1991 . .	41,774,083	\$208,870	\$469,823	590,000	\$59,000	269,821	\$ 26,982

Quasi-Reorganization

On May 4, 1989, the Company's board of directors adopted a resolution approving elimination of the Company's deficit in retained earnings through a quasi-reorganization effective January 1, 1989. The quasi-reorganization resulted in the transfer of a portion of additional paid-in capital to retained earnings to eliminate the \$144.0 million deficit in retained earnings and set the retained earnings balance to zero as of January 1, 1989.

In implementing the quasi-reorganization, the Company adopted SFAS No. 96, *Accounting for Income Taxes*, effective January 1, 1989. Such adoption resulted in a direct charge to additional paid-in capital of \$32.3 million in 1989, which represents the cumulative effect of applying SFAS No. 96. This

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(2) Capitalization (Continued)

amount relates primarily to deferred income taxes accrued under SFAS No. 96 for utility plant assets excluded from New Mexico jurisdictional electric rate base in an order issued by the NMPSC on April 5, 1989. (See note 11.)

The Company also evaluated other assets and liabilities recorded as of January 1, 1989 for the purpose of adjusting such assets and liabilities to fair value. Adjustments were made based on further evaluation of discontinued operations, provisions for settlements of gas purchase contract disputes, abandoned assets, regulatory adjustments and the income tax effects thereof totaling approximately \$24.8 million in 1989. In 1990, adjustments of approximately \$18.0 million were made, primarily reflecting the results of a FERC examination of the Company's accounts for years prior to 1989. Such amounts have been recorded as charges to additional paid-in capital.

Common Stock

The number of authorized shares of common stock with par value of \$5 per share is 80 million shares.

The payment of cash dividends on the common stock of the Company is subject to certain restrictions, including those contained in the Company's mortgage indenture, which effectively prevent the payment of dividends on common stock unless the Company has retained earnings. In April 1989, the Company announced the suspension of dividend payments on the Company's common stock as a result of the deficit in retained earnings as of December 31, 1988. Although the implementation of the Company's quasi-reorganization, effective as of January 1, 1989, eliminated the retained earnings deficit, the Company's board of directors has not declared dividends on its common stock since January 1989. The board of directors reviews its dividend policy on a continuing basis. The payment of future dividends is dependent upon earnings, the financial condition of the Company, market requirements and other factors.

Cumulative Preferred Stock

The number of authorized shares of cumulative preferred stock is 10 million shares. The earnings tests in the Company's Restated Articles of Incorporation currently limit the issuance of preferred stock (other than in connection with certain exchanges, redemption or retirements of preferred stock) and any issuance would require the consent of the holders of a majority of the shares of preferred stock then outstanding until such time as the earnings tests are met.

The Company, upon 30 days notice, may redeem the cumulative preferred stock at stated redemption prices plus accrued and unpaid dividends. Redemption prices are at reduced premiums in future years. On February 10, 1992, the Company redeemed all 346,700 shares of its Cumulative Preferred Stock, 12.52% series, \$50.00 stated value at a redemption price of \$52.97 per share plus accrued and unpaid dividends. Accordingly, such series is shown as a current liability in the accompanying consolidated balance sheet.

Mandatory redemption requirements are \$1.3 million annually for 1993 through 1996. There are no mandatory redemption requirements for 1992.

Long-Term Debt

Substantially all utility plant is pledged to secure the Company's first mortgage bonds. A portion of certain series of long-term debt will be redeemed serially prior to their due dates. The issuance of first mortgage bonds by the Company is subject to earnings coverage and bondable property provisions of the Company's first mortgage indenture. The Company has the capability under the mortgage

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(2) Capitalization (Continued)

indenture, without regard to the earnings test but subject to other conditions, to issue first mortgage bonds on the basis of previously retired bonds. However, the Company is unable to issue any significant amount of first mortgage bonds at this time.

The Company has a letter of credit ("LOC") from a bank which secures \$37.3 million of the Company's pollution control revenue bonds and requires either extension, reissuance, renewal, or substitution on December 4, 1992. The LOC is subject to annual extension at the sole discretion of the bank. It is the Company's intention to keep the bonds outstanding and to request an extension of the LOC. In addition, the Company could replace the debt with draws under its revolving credit facility, which expires on December 31, 1993 (note 3).

The aggregate amounts (in thousands) of maturities through 1996 on long-term debt outstanding at December 31, 1991, are as follows:

1992	\$ 120
1993	\$10,917
1994	\$ 2,334
1995	\$ 2,235
1996	\$ 2,255

(3) Short-Term Debt

As of December 31, 1991, the Company has a \$225 million revolving credit facility with major banks and \$11 million in other, unsecured revolving credit agreements. The facility is secured through first mortgage bonds of the Company and is currently scheduled to terminate on December 31, 1993. The facility is subject to annual extensions at the banks' sole discretion and the Company expects to request such extensions. The facility contains a provision that could prevent the Company from borrowing under the facility in the event of a material adverse change in the financial condition, results of operations, assets, business or prospects of the Company. As of December 31, 1991, \$13 million of these commitments were being used for bank borrowings. The Company generally pays commitment fees with banks to assure availability of its credit commitments.

(4) Income Taxes

Income taxes consist of the following components:

	1991	1990	1989
	(In thousands)		
Current Federal income tax	\$ (436)	\$21,155	\$ 5,425
Current State income tax	4	6,611	(920)
Deferred Federal income tax	16,494	(1,667)	26,852
Deferred State income tax	2,453	(3,878)	6,669
Investment tax credit carryforward	(2,240)	(730)	—
Amortization of accumulated investment tax credits	(6,082)	(6,332)	(6,475)
Total income taxes	\$10,193	\$15,159	\$31,551
Charged to operating expenses	\$13,811	\$ 7,490	\$25,958
Charged (credited) to other income and deductions	(3,618)	7,669	5,593
Total income taxes	\$10,193	\$15,159	\$31,551

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(4) Income Taxes (Continued)

The Company's provision for income taxes differed from the Federal income tax computed at the statutory rate for each of the years shown. The differences are attributable to the following factors:

	1991	1990	1989
	(In thousands)		
Federal income tax at statutory rate of 34%	\$11,272	\$ 5,304	\$38,809
Allowance for funds used during construction	(110)	—	(989)
Investment tax credits	(6,082)	(6,332)	(6,475)
PVNGS start-up and pre-operational costs	—	(1,479)	(3,354)
Depreciation of flow-through items	2,367	1,687	1,079
Gains on the sale and leaseback of PVNGS	(491)	1,027	(960)
Amortization of pollution control facilities	—	—	(1,533)
Reversal of basis difference resulting from sale of investment	1,328	—	—
Reversal of flow through treatment for debt retirements and hedge transactions as ordered by the NMPSC	—	14,043	—
State income tax	1,582	308	3,855
Tax rate differential on capital loss carryback	—	—	2,197
Other	327	601	(1,078)
Total income taxes	<u>\$10,193</u>	<u>\$15,159</u>	<u>\$31,551</u>

Deferred income taxes result from certain differences between the recognition of income and expense for tax and financial reporting purposes, as described in note 1. The major sources of these differences for which deferred taxes have been provided and the tax effects of each are as follows:

	1991	1990	1989
	(In thousands)		
Deferred fuel costs	\$ 6,380	\$ (3,591)	\$ 4,366
Depreciation and cost recovery	14,489	12,317	19,504
Contributions in aid of construction	(1,932)	(1,397)	(1,776)
Advance lease payments	—	—	14,710
Unbilled revenues	(2,036)	(650)	(1,880)
Alternative minimum tax in excess of regular tax	2,696	1,671	(6,548)
Write-off of proposed utility facilities	—	11,756	2,008
Net operating losses utilized (carryforward)	4,066	(43,606)	—
Reversal of flow through treatment for debt retirements and hedge transactions as ordered by the NMPSC	—	14,043	—
Other	(4,716)	3,912	3,137
Total deferred taxes	<u>\$18,947</u>	<u>\$ (5,545)</u>	<u>\$33,521</u>

In addition, the balance of deferred income taxes at December 31, 1991 includes amounts for temporary differences related to premiums on retirement of bonds, deferred gains on sale and lease-back transactions, settlements of gas contract disputes, deferred investment tax credits and regulatory assets and liabilities.

At December 31, 1991, the Company had net operating loss carryforwards for Federal income tax purposes of \$13.0 million, \$82.0 million and \$62.2 million which expire in 2003, 2004 and 2005, respectively.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(4) Income Taxes (Continued)

The application of SFAS No. 96 to regulated enterprises results in the creation of regulatory assets and liabilities. At December 31, 1991 and 1990, deferred charges included regulatory assets of \$69.3 million and \$59.4 million, respectively, and deferred credits included regulatory liabilities of \$77.1 million and \$82.4 million, respectively.

(5) Employee and Post-Employment Benefits

Pension Plan

The Company and its subsidiaries have a pension plan covering substantially all of their employees, including officers. The plan is non-contributory and provides for benefits to be paid to eligible employees at retirement based primarily upon years of service with the Company and their compensation rates near retirement. The Company's policy is to fund actuarially-determined contributions. Contributions to the plan reflect benefits attributed to employees' years of service to date and also for services expected to be provided in the future. Plan assets primarily consist of common stock, fixed income securities (United States government obligations), cash equivalents and real estate.

The components of pension cost (in thousands) are as follows:

	1991	1990	1989
Service cost	\$ 6,027	\$ 6,287	\$ 4,165
Interest cost	13,204	13,404	12,191
Actual return on plan assets	(35,903)	(2,469)	(25,360)
Asset gain deferred (amortized)	20,422	(13,930)	11,015
Other	(1,130)	(1,130)	(1,205)
Net periodic pension cost	<u>\$ 2,620</u>	<u>\$ 2,162</u>	<u>\$ 806</u>

The following sets forth the plan's funded status and amounts (in thousands) at December 31, 1991 and 1990:

	1991	1990
Vested benefits	\$140,600	\$115,162
Non-vested benefits	646	634
Accumulated benefit obligation	141,246	115,796
Effect of future compensation levels	42,176	48,324
Projected benefit obligation	183,422	164,120
Fair value of plan assets	193,729	167,389
Assets in excess of projected benefit obligation	<u>\$ 10,307</u>	<u>\$ 3,269</u>

The components of assets in excess of projected benefit obligation (in thousands) are as follows:

	1991	1990
Net unrecognized gain (loss) from past experience different from assumed	\$ (400)	\$(10,885)
Unamortized asset at transition, being amortized through the year 2002	11,634	12,798
Accrued pension (asset) liability	(529)	1,788
Unrecognized prior service cost	(398)	(432)
	<u>\$10,307</u>	<u>\$ 3,269</u>

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(5) Employee and Post-Employment Benefits (Continued)

The weighted average discount rate used to measure the projected benefit obligation was 8.0% for 1991 and 9.0% for 1990 and the expected long-term rate of return on plan assets was 9.5% for 1991 and 10.0% for 1990. The rate of increase in future compensation levels based on age-related scales was 5.0% for 1991 and 7.0% for 1990.

Other Post-employment Benefits

The Company provides medical and dental benefits to eligible retirees. Currently, retirees are offered the same benefits as active employees after reflecting Medicare coordination. The cost of providing these benefits for retirees is expensed when paid and was \$1,139,000, \$1,323,000, and \$1,348,000 for 1991, 1990 and 1989, respectively.

In December 1990, the FASB issued SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other than Pensions*, which is effective for fiscal years beginning after December 15, 1992. The Company plans to adopt SFAS No. 106 effective January 1, 1993. SFAS No. 106 will require accrual of postretirement benefits (such as medical and dental benefits) during the years employees provide services. The Company's study on the adoption of SFAS No. 106 indicates that its unrecognized postretirement benefit obligation as of January 1, 1993 would be approximately \$37.3 million which would be amortized over a 20-year period and that in the first year the expense would be approximately \$5.6 million as compared to an estimated \$1.5 million on a pay-as-you-go basis. The Company is evaluating various funding alternatives in an effort to reduce the additional benefit expense. In addition, the Company has been notified that its portion of other postretirement benefits for PVNGS is anticipated to increase about \$1.2 million. Although the Company has discussed with the NMPSC Staff the impact of SFAS No. 106 and believes that this additional expense is reasonable and should be recoverable from the ratepayers, the Company has not requested a ruling on the rate treatment of the additional expense. The Company is currently unable to predict the ultimate effect on the Company's financial condition and results of operations since it is unknown if this additional expense will be recovered from the ratepayers.

Employee Stock Ownership Plan

Effective January 1, 1989, the Company adopted an Employee Stock Ownership Plan covering substantially all of its employees. Under the plan, the Company makes cash contributions which are utilized to purchase the Company's common stock on the open market. Contributions to the plan were approximately \$5.3 million in 1989. No contributions or accruals were made in 1990 and 1991.

(6) Construction Program and Jointly-Owned Plants

It is estimated that the Company's construction expenditures (including AFUDC) for 1992 will approximate \$118 million, including expenditures on jointly-owned projects. In connection therewith, substantial commitments have been made.

The Company's proportionate share of expenses for the jointly-owned plants is included in operating expenses in the consolidated statement of earnings.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(6) Construction Program and Jointly-Owned Plants (Continued)

At December 31, 1991, the Company's ownership interest and investments in jointly-owned generating facilities are:

Station (Fuel Type)	Plant in Service	Accumulated Depreciation	Construction Work in Progress	Composite Ownership Interest
		(In thousands)		
San Juan Generating Station (Coal)	\$826,211	\$270,858	\$ 2,995	51.6%
Palo Verde Nuclear Generating Station Unit 3 (Nuclear)*	\$339,815	\$ 38,358	\$26,880	10.2%
Four Corners Generating Station Units 4 and 5 (Coal)	\$114,870	\$ 27,357	\$ 2,754	13.0%

*Includes the Company's remaining interest in common facilities for all PVNGS units.

San Juan Generating Station

The Company operates and jointly owns the San Juan Generating Station ("SJGS"). At December 31, 1991, SJGS Units 1 and 2 are owned on a 50% shared basis with Tucson Electric Power Company ("Tucson"), Unit 3 is owned on a 50% shared basis with Century Power Corporation ("Century") and Unit 4 is owned 55.525% by the Company, 8.475% by the City of Farmington, 28.8% by the M-S-R Public Power Agency ("M-S-R") and 7.2% by the County of Los Alamos.

Both Tucson and Century have been experiencing financial difficulties. In July 1991, an involuntary petition for reorganization of Tucson was filed. A similar petition was filed against Century. On December 31, 1991, the pending involuntary petition for Tucson was dismissed. In addition, Tucson has been granted rate relief and is in the process of restructuring its financial obligations.

Century, formerly known as Alamito Company, acquired its interest in SJGS Unit 3 from Tucson in 1984 when Century was a wholly-owned subsidiary of Tucson. The Company believes that Tucson is ultimately liable for Century's SJGS obligations under the original contracts executed prior to the transfer of ownership from Tucson. Century's share of SJGS obligations is approximately \$3.2 million per month. Tucson and Century have reached an agreement whereby, after December 1, 1992 and through 1996, Tucson would advance funds on Century's behalf directly to the Company (as the operating agent of SJGS Unit 3). Such advances are not to exceed \$45 million in the aggregate or \$15 million in any one year.

The Company believes that the current financial difficulties of Tucson and Century will not have a material impact on the Company's future financial condition or results of operations. However, as a co-participant in and operating agent of SJGS, the Company has certain contingent obligations under the plant operating agreement and joint and several liability with Tucson under the coal supply agreement. The Company bases its belief on its understanding that (1) Tucson would have an on-going need for power and that SJGS is one of Tucson's least expensive resources, (2) Tucson's interests in SJGS Units 1 and 2 are in its rate base, (3) Tucson is ultimately liable for Century's SJGS obligations and (4) the best way to maintain SJGS's value in the market place would be to keep it operational.

Palo Verde Nuclear Generating Station

The Company has a 10.2% undivided ownership interest in PVNGS. Commercial operation commenced in 1986 for Unit 1 and Unit 2 and 1988 for Unit 3. In 1985 and 1986, the Company completed sale and leaseback transactions for its undivided interests in Units 1 and 2 and certain related common facilities.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(6) Construction Program and Jointly-Owned Plants (Continued)

The PVNGS participants have insurance for public liability payments resulting from nuclear energy hazards to the full \$7.8 billion 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 rating program for each nuclear incident occurring at any nuclear power plant in the United States is approximately \$66 million, subject to an annual limit of \$10 million per incident. Based upon the Company's 10.2% interest in the three PVNGS units, the Company's maximum potential assessment per incident is approximately \$20 million, with an annual payment limitation of \$3 million. The insured, under this liability insurance include the PVNGS participants and "any other person or organization with respect to his legal responsibility for damage caused by the nuclear energy hazard".

The PVNGS participants maintain "all-risk" (including nuclear hazards) insurance for nuclear property damage to, and decontamination of, property at PVNGS in the aggregate amount of \$2.515 billion, a substantial portion of which must first be applied to stabilization and decontamination. The Company has also secured insurance against portions of any increased cost of generation or purchased power resulting from certain accidental outages of any of the three PVNGS units if outage exceeds 21 weeks.

The Company has a program for funding its share of decommissioning costs for PVNGS. Under this program, the Company will make a series of annual deposits to an external trust fund over the estimated useful life of each unit, and the trust funds will be invested under a plan which allows the accumulation of funds largely on a tax-deferred basis through the use of life insurance policies on certain employees. The annual trust deposit, currently set at \$396,000 per unit, is based upon the Company's 10.2% share of total estimated PVNGS decommissioning costs and projected earnings on the trust funds over time. The NMPSC jurisdictional share of these decommissioning costs related to Units 1 and 2 are currently included in jurisdictional rates. The annual funding amount is subject to periodic adjustment for changes in decommissioning cost estimates and earnings of the trust fund. The trust balance at the end of 1991 was approximately \$3.3 million, including cash surrender value of the policies. Insurance coverage at the end of 1991 was approximately \$95.7 million. The Company's share of PVNGS decommissioning costs is presently estimated, in 1991 dollars, at approximately \$85.4 million.

El Paso Electric Company ("El Paso") owns or leases a 15.8% interest in PVNGS. On January 8, 1992, El Paso filed a voluntary petition to reorganize under Chapter 11 of the United States Bankruptcy Code. The operating agent of PVNGS estimates El Paso's total monthly share of operating costs to be approximately \$9 million for PVNGS. The PVNGS participation agreement provides that if a participant fails to meet its payment obligations, each non-defaulting participant shall pay its proportionate share of the payments owed by the defaulting participant. On February 13, 1992, the bankruptcy court approved a stipulation between El Paso and the operating agent of PVNGS, pursuant to which El Paso agreed to pay its proportionate share of all PVNGS invoices delivered to El Paso after February 6, 1992. El Paso agreed to make these payments until such time as an order is entered by the bankruptcy court, if ever, authorizing or directing El Paso's rejection of the participation agreement governing the relations among the PVNGS participants. As long as El Paso continues to make these payments, APS and the other PVNGS participants have agreed not to file a motion prior to December 31, 1992, seeking a deadline for the assumption or rejection of the participation agreement. If El Paso defaults, APS and the other participants may take steps to pursue other available remedies. The stipulation also specifies that approximately \$9.3 million of El Paso's PVNGS payment obligations

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(6) Construction Program and Jointly-Owned Plants (Continued)

invoiced prior to February 7, 1992, are to be considered "pre-petition" general unsecured claims of the other PVNGS participants. The Company paid \$1.1 million as its proportionate share of the pre-petition obligation. The Company cannot currently predict the outcome of this matter. However, the Company is participating in the El Paso Bankruptcy proceedings. The Company consults on an on-going basis with its counsel, as well as with APS, the PVNGS and Four Corners operating agent, concerning the proceedings and continues to evaluate the potential impacts of the El Paso Bankruptcy.

(7) Long-Term Power Contracts and Franchises

The Company has entered into contracts for the purchase of electric power. Under a contract with M-S-R, which contract expires in 1995, the Company is obligated to pay certain minimum amounts and a variable component representing the expenses associated with the energy purchased and debt service costs associated with capital improvements. Total payments under this contract amounted to approximately \$41 million for each of 1991, 1990 and 1989. The minimum payment for each of the next four years under this contract is \$28.5 million annually.

The Company has a long-term contract with Southwestern Public Service Company ("SPS") requiring the Company to purchase interruptible power beginning in June 1991. Total payments under this contract amounted to approximately \$5.6 million in 1991. Minimum payments under the contract amount to approximately \$7.0 million for each of 1992, 1993 and 1994. In addition, the Company will be required to pay for any energy purchased under the contract. The amount of minimum payments after 1994 will depend on whether the Company exercises certain options to reduce its purchase obligations.

The contract with SPS also required SPS to purchase power from the Company through the end of 1989. Revenues from such sales accounted for approximately 11.9% of total revenues and contributed approximately \$1.13 to earnings per share in 1989.

The Company holds long-term, non-exclusive franchises of varying durations in all incorporated communities where it is necessary to do so in order to provide utility services within those communities. The Company's electric franchise in Albuquerque, covering an area which contributed 45.4% of the Company's total 1991 electric operating revenues, expired in early 1992. The failure to obtain a franchise renewal may make it more difficult for the Company to serve customers in the Albuquerque area by potentially requiring the Company to obtain right-of-way permits on a case-by-case basis for line extension or maintenance work on property owned by the City. However, the Company believes the absence of a franchise does not change its right and obligation to serve those customers under state law. The City of Albuquerque is studying alternatives, including municipalization of the Company's distribution system. While the Company cannot predict the ultimate outcome of the franchise renewal issues, it believes that such outcome will not have a material adverse effect on the Company's financial condition or results of operations.

(8) Lease Commitments

The Company classifies its leases in accordance with generally accepted accounting principles. The Company leases Units 1 and 2 of PVNGS, transmission facilities, office buildings and other equipment under operating leases. The aggregate lease payments for the PVNGS leases are \$84.6 million per year over base lease terms expiring in 2015 and 2016. Each PVNGS lease contains renewal and fair market value purchase options at the end of the base lease term.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(8) Lease Commitments (Continued)

Future minimum operating lease payments (in thousands) at December 31, 1991 are:

1992	\$ 96,346
1993	95,759
1994	94,771
1995	94,674
1996	94,619
Later years	<u>1,750,162</u>
Total minimum lease payments	<u>\$2,226,331</u>

Operating lease expense was approximately \$96.8 million in 1991, \$96.0 million in 1990 and \$95.8 million in 1989. The aggregate minimum payments to be received in future periods under noncancelable subleases are approximately \$8.6 million.

In 1991, the Company was verbally notified by the Arizona Department of Revenue ("DOR") that the DOR plans to issue an audit finding that additional transaction privilege (sales) tax is due on the lease payments associated with the Company's sale and leaseback transactions of PVNGS Units 1 and 2. The Company currently pays transaction privilege tax based on approximately 9% of the payments which are classified by the Company as payments for leases of real property.

The DOR has indicated that the preliminary assessment will classify and tax 100% of the leased property as real property. If the lease payments are classified entirely as leases of real property, the amount of tax due would be approximately \$14 million in tax and interest from January 1, 1988 through December 31, 1991 and approximately \$4.2 million in tax per year thereafter. The Company does not agree with DOR's position, and will appeal DOR's findings, if necessary. Under the terms of the PVNGS lease agreements, the Company is liable for all transaction privilege tax due on the lease payments. The Company has recorded no provision for this potential tax assessment.

As of February 7, 1992, the Company entered into a purchase agreement, subject to NMPSC approval, whereby the Company would purchase approximately 22% of the beneficial interests in the PVNGS Units 1 and 2 leases for approximately \$17.5 million in cash. While legally the leases would remain in effect, for accounting purposes, this transaction would be recorded as a purchase. Accordingly, the Company would record approximately \$158.8 million as utility plant and \$141.3 million as long-term debt on the Company's consolidated balance sheet and reduce the annual operating lease commitments shown above by approximately \$18.2 million. It is anticipated that for regulatory purposes these would continue to be classified as operating leases and the lease costs would continue to be recovered in rates. The transaction is estimated to reduce net earnings in the years 1992 through 1996 by \$1.9 million, \$1.1 million, \$.8 million, \$.5 million and \$.2 million, respectively, and gradually increase net earnings thereafter over the remainder of the lease terms.

(9) Natural Gas Proceedings, Contract Disputes and Supply Contracts

Gas Company of New Mexico ("GCNM"), a division of the Company, and Sunterra Gas Gathering Company ("Gathering Company"), a subsidiary of the Company, have been disputing claims by certain natural gas producers relating to contract pricing, take-or-pay obligations and other matters, some of which are, or have been, the subject of litigation. GCNM and Gathering Company are vigorously defending against these claims. Certain matters have been settled and the Company intends to continue active pursuit of negotiations to resolve the remaining matters. The Company has evaluated, and will continue to evaluate, the impact of these matters on the Company.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(9) Natural Gas Proceedings, Contract Disputes and Supply Contracts (Continued)

On December 18, 1989, the NMPSC issued an order which provides for the partial recovery of certain gas costs incurred for take-or-pay obligations, contract pricing and other matters. Under the order, the Company bears 25% of producer take-or-pay costs. The Company will be permitted to recover from its sales and transportation customers the remaining 75% of such costs over a period of years. The order allows the Company to recover 100% of take-or-pay costs assessed by interstate pipelines. The order also provides that the Company may recover all costs determined by the NMPSC to be prudently incurred or just and reasonable (on a case-by-case basis) as the result of the settlement or litigation of claims arising from certain intrastate gas purchase contracts that were the subject of antitrust litigation that resulted in the Company's acquisition of GCNM from Southern Union Company in January 1985. On September 21, 1990, GCNM filed with the NMPSC seeking approval to recover \$76 million of costs arising from settlement of these contract claims. Hearings on this case were held in January and February 1992. During the hearings, GCNM amended its request to approximately \$68 million. A final order in this case is not expected before May 1992.

Provisions for losses arising from natural gas contract disputes were made in 1988 and 1989. In 1991, the Company made an adjustment to the provision reflecting the Company's further evaluation of claims by natural gas producers and the related regulatory environment. Based on the amounts it believes are recoverable under the December 1989 NMPSC order, the amounts of the settlements achieved and the provisions made, the Company currently believes it is unlikely that remaining disputes with natural gas producers and regulatory proceedings will have a material adverse impact on the Company's future financial condition or results of operations.

Approximately 56% of the Company's 1991 gas supplies from all sources came from contracts that allowed the Company, without penalty, to not purchase gas during its off-peak season or have no take-or-pay requirements. The remaining 44% of the gas supplies from all sources came from contracts which have some form of penalty associated with the failure to take the volume of gas set forth in the contract. The Company believes that the payment of any penalties not recovered from customers would not materially affect the financial condition or results of operations of the Company.

(10) Discontinuance of Non-Utility Operations

In 1988, the Company discontinued the non-utility operations of its subsidiaries. Such operations consisted primarily of fiberboard manufacturing, real estate, coal mining, telecommunications manufacturing and financial services and were carried out by or through the Company's wholly-owned subsidiaries.

Substantial portions of the discontinued operations were disposed of in 1988 and 1989. In 1989, the Company reevaluated the cost of disposing of the discontinued operations including the related income tax effects, and recorded appropriate adjustments. (See note 2.) In 1990 and 1991, additional non-utility properties were sold, and the remaining assets are expected to be sold in 1992.

During 1989, a subsidiary of the Company defaulted on obligations owed to secured creditors and such creditors subsequently made claims against the Company. Although the Company denied such claims, the Company, in November 1989, entered into an agreement with the secured creditors which provided for the Company to pay damages to such creditors. The Company originally estimated that there would be no damages to be paid by the Company. Upon further evaluation, however, the Company projected damage payments of \$17.8 million which were recorded in the 1989 consolidated financial statements. The Company is entitled to recapture the damage payments from the secured creditors if payments are made by the subsidiary to the secured creditors. During 1991, the Company recaptured approximately \$4.5 million from the secured creditors.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(10) Discontinuance of Non-Utility Operations (Continued)

On April 18 and July 20, 1990, the NMPSC issued orders docketing a formal investigation regarding the settlement agreement between the Company and secured creditors of Meadows and the Company's discontinuance of its non-utility subsidiary operations. The Company is required to show cause, if any, as to why the settlement agreement, the discontinuance of the Company's non-utility operations and the disposal of non-utility assets are not subject to prior NMPSC approval and why the resulting effect of the Company's actions has not materially and adversely affected the Company's ability to provide utility service at fair, just and reasonable rates. The formal investigation also inquired into whether the Company's actions are in compliance with other applicable law and whether sanctions should be imposed. Hearings were held on May 6, 1991 and a recommended decision in the case is pending before the hearing examiner. The Company does not believe that the ultimate outcome of the current investigation will have a material impact on its financial condition or results of operations.

(11) Regulatory Issues — Electric Operations

The Company's investment in PVNGS has been the subject of regulatory inquiry in recent years. On April 5, 1989, the NMPSC issued an order addressing the Company's excess capacity situation which, among other things, provides for the inclusion in NMPSC jurisdictional electric rates of the Company's jurisdictional interests in PVNGS Units 1 and 2, 147 MW of SJGS Unit 4 and the power purchase contract with SPS. However, the order provides for the exclusion from New Mexico jurisdictional rates of the Company's 130 MW interest in PVNGS Unit 3, 130 MW of SJGS Unit 4 and the power purchase contract with M-S-R. The order states that as long as there is excess capacity in the Company's jurisdictional rates, then that excess capacity will share off-system sales equitably with the capacity excluded in the order. Because of the conditions in the wholesale power market, the revenues generated from the sale of power and energy from the excluded resources is currently insufficient to cover operating costs and has a significant impact on the Company's results of operations. In April 1990, the Company and the NMPSC Staff reached an agreement on the methodology, which was to be applied prospectively, for sharing off-system sales. For 1991 and May to December of 1990, selected financial information for the excluded capacity is shown below:

	1991	1990
	(In thousands, except per share amounts)	
Operating revenues	\$ 59,248	\$ 38,076
Operating income (loss)	\$(17,324)	\$(10,697)
Net earnings (loss)	\$(33,729)	\$(19,804)
Net utility plant at year-end	\$377,262	\$392,408

In determining the operating results of the excluded capacity, operating revenues were specifically assigned pursuant to the agreed-to methodology. The majority of operating expenses are specifically identified and interest charges are based on the ratio of excluded capacity ratebase to total electric ratebase.

On April 26, 1991, the Company executed a purchase and participation agreement with the City of Anaheim, California to sell a 10.04% (50 MW) undivided ownership interest in SJGS Unit 4 for approximately \$55 million. In January 1992, the Company reached a stipulated agreement with the NMPSC Staff and intervenors which approves this sale and the decertification of 130 MW of SJGS Unit 4. The stipulation requires, among other things, the Company to pass through to New Mexico ratepayers \$1 million of the estimated \$8.6 million after-tax gain from the sale and allows the Company to retain any gain on future sales of the remaining 80 MW. The stipulation also provides that the cost

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(11) Regulatory Issues — Electric Operations (Continued)

per installed KW for the next 130 MW of supply-side resource added by the Company before December 2002 could not exceed the depreciated book value of SJGS Unit 4 plus \$175 per KW. The stipulation is subject to NMPSC approval.

On April 12, 1990, the NMPSC issued its final order in an electric rate case, which required the Company to reduce its existing annualized base rates by approximately \$2.9 million. Also, as a result of the order, the Company wrote off approximately \$19.4 million, net of taxes, in March 1990, which resulted primarily from the NMPSC's treatment of prior years' tax benefits from debt retirement and losses on hedge transactions of \$14.0 million as well as the NMPSC's treatment of amortization periods for gains resulting from sale and leaseback transactions of \$4.5 million on PVNGS Units 1 and 2 consummated in previous years.

(12) Shareholder Litigation

The Company and certain individuals who currently serve, or formerly served, as officers or directors of the Company or its subsidiaries are defendants in five class action suits brought by shareholders of the Company. These suits alleged misrepresentations and omissions of material facts in the various reports filed with the Securities and Exchange Commission and in other communications primarily related to the Company's excess electric generating capacity and diversified non-utility operations. In addition, there are four lawsuits against former officers and directors that shareholders brought derivatively on behalf of the Company.

On March 3, 1992, a U.S. Magistrate Judge approved an agreement in principle, which would settle the class action and derivative lawsuits brought against the Company and each of the other named defendants. The settlement provides for the establishment of a \$33 million settlement fund by the Company insurers, of which the Company would receive \$3 million as reimbursements for its defense costs and is subject to court approval.

In 1990, the Company made a provision for the estimated cost of defending the shareholder lawsuits. In 1991, the Company recorded additional provisions for costs it incurred in excess of the reimbursement to be received in the settlement.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(13) Segment Information

The financial information pertaining to the Company's electric, gas (see note 1) and other operations for the years ended December 31, 1991, 1990 and 1989 are as follows:

	Electric*	Gas	Other	Total
	(In thousands)			
1991:				
Operating revenues	\$ 568,486	\$277,069	\$11,613	\$ 857,168
Operating expenses excluding income taxes	503,428	236,403	6,273	746,104
Pre-tax operating income	65,058	40,666	5,340	111,064
Operating income tax	2,114	10,222	1,475	13,811
Operating income	<u>\$ 62,944</u>	<u>\$ 30,444</u>	<u>\$ 3,865</u>	<u>\$ 97,253</u>
Depreciation and amortization expense	\$ 59,469	\$ 15,452	\$ 1,132	\$ 76,053
Construction expenditures	<u>\$ 54,431</u>	<u>\$ 24,620</u>	<u>\$ 8,520</u>	<u>\$ 87,571</u>
Identifiable assets:				
Net utility plant	\$1,554,776	\$306,655	\$43,882	\$1,905,313
Other	254,157	167,669	17,193	439,019
Total assets	<u>\$1,808,933</u>	<u>\$474,324</u>	<u>\$61,075</u>	<u>\$2,344,332</u>
1990:				
Operating revenues	\$ 567,382	\$302,104	\$11,700	\$ 881,186
Operating expenses excluding income taxes	505,311	269,556	6,388	781,255
Pre-tax operating income	62,071	32,548	5,312	99,931
Operating income tax	(973)	7,032	1,431	7,490
Operating income	<u>\$ 63,044</u>	<u>\$ 25,516</u>	<u>\$ 3,881</u>	<u>\$ 92,441</u>
Depreciation and amortization expense	\$ 57,745	\$ 14,416	\$ 1,043	\$ 73,204
Construction expenditures	<u>\$ 53,080</u>	<u>\$ 24,499</u>	<u>\$ 6,657</u>	<u>\$ 84,236</u>
Identifiable assets:				
Net utility plant	\$1,574,670	\$297,877	\$41,914	\$1,914,461
Other	219,135	152,459	27,654	399,248
Total assets	<u>\$1,793,805</u>	<u>\$450,336</u>	<u>\$69,568</u>	<u>\$2,313,709</u>
1989:				
Operating revenues	\$ 634,888	\$282,827	\$12,102	\$ 929,817
Operating expenses excluding income taxes	489,912	254,677	6,034	750,623
Pre-tax operating income	144,976	28,150	6,068	179,194
Operating income tax	20,411	3,759	1,788	25,958
Operating income	<u>\$ 124,565</u>	<u>\$ 24,391</u>	<u>\$ 4,280</u>	<u>\$ 153,236</u>
Depreciation and amortization expense	\$ 58,129	\$ 12,730	\$ 1,122	\$ 71,981
Construction expenditures	<u>\$ 55,334</u>	<u>\$ 20,375</u>	<u>\$ 2,580</u>	<u>\$ 78,289</u>
Identifiable assets:				
Net utility plant	\$1,603,242	\$287,779	\$40,824	\$1,931,845
Other	284,314	146,085	24,761	455,160
Total assets	<u>\$1,887,556</u>	<u>\$433,864</u>	<u>\$65,585</u>	<u>\$2,387,005</u>

*Includes the resources excluded from NMPSC regulations (see note 11).

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 1991, 1990 and 1989

(14) Supplemental Income Statement Information

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

	1991	1990	1989
	(In thousands)		
Ad valorem	\$19,809	\$18,345	\$16,473
City franchise	6,983	6,940	6,664
Payroll	7,938	7,749	7,052
Other	4,484	3,927	3,854
Total	<u>\$39,214</u>	<u>\$36,961</u>	<u>\$34,043</u>

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

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
SCHEDULE V — PROPERTY, PLANT AND EQUIPMENT

Years Ended December 31, 1991, 1990 and 1989

Classification December 31, 1991	Balance at Beginning of Year	Additions at Cost	Retirements	Other Changes		Balance at End of Year
				Add	Deduct	
(In thousands)						
Utility plant:						
Electric plant in service:						
Intangible	\$ 31,024	\$ 1,862	\$ 26	\$ 4	\$ 3,599	\$ 29,265
Production	1,235,215	28,015	1,099	2,230	—	1,264,361
Transmission	215,430	7,068	666	141	81	221,892
Distribution	390,470	15,326	2,628	215	650	402,733
General	66,104	6,420	277	303	19	72,531
	<u>1,938,243</u>	<u>58,691</u>	<u>4,696</u>	<u>2,893</u>	<u>4,349</u>	<u>1,990,782</u>
Gas plant in service:						
Intangible	9,479	5,362	—	5	11	14,835
Production	110,189	679	315	515	—	111,068
Natural gas storage	4,761	—	—	43	—	4,804
Transmission	66,969	1,023	161	645	—	68,476
Distribution	214,717	8,920	1,622	1,093	—	223,108
General	39,699	3,994	711	201	—	43,183
	<u>445,814</u>	<u>19,978</u>	<u>2,809</u>	<u>2,502</u>	<u>11</u>	<u>465,474</u>
Water plant in service:						
Intangible	151	39	—	—	—	190
Source of supply plant	7,510	938	—	281	—	8,729
Pumping plant	2,375	27	—	—	—	2,402
Water treatment plant	4,038	—	—	—	—	4,038
Transmission and distribution	33,721	1,975	75	—	1	35,620
General	2,151	39	—	—	—	2,190
	<u>49,946</u>	<u>3,018</u>	<u>75</u>	<u>281</u>	<u>1</u>	<u>53,169</u>
Common plant in service:						
Intangible	18,364	1,661	7,741	—	—	12,284
General	21,721	4,093	356	—	33	25,425
	<u>40,085</u>	<u>5,754</u>	<u>8,097</u>	<u>—</u>	<u>33</u>	<u>37,709</u>
Construction work in progress	86,127	(11,120)	—	—	—	75,007
Electric plant held for future use	1,258	—	—	—	—	1,258
Nuclear fuel	77,475	9,981	8,019	47	3,117	76,367
Total utility plant	<u>2,638,948</u>	<u>86,302</u>	<u>23,696</u>	<u>5,723</u>	<u>7,511</u>	<u>2,699,766</u>
Non-utility property	10,687	1,269	207	665	518	11,896
Total property, plant and equipment	<u>\$2,649,635</u>	<u>\$87,571</u>	<u>\$23,903</u>	<u>\$ 6,388</u>	<u>\$ 8,029</u>	<u>\$2,711,662</u>

Description of other changes

Transfers between accounts	\$ 32	\$ 32
Transfers of expired contract deposits to plant in service	—	496
Transfers of termination fees to deferred debits	—	2,685
Miscellaneous corrections and adjustments	6,356	4,816
	<u>\$ 6,388</u>	<u>\$ 8,029</u>

(Continued)

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
SCHEDULE V — PROPERTY, PLANT AND EQUIPMENT (Continued)

Years Ended December 31, 1991, 1990 and 1989

Classification December 31, 1990	Balance at Beginning of Year	Additions at Cost	Retirements	Other Changes Add	Deduct	Balance at End of Year
			(In thousands)			
Utility plant:						
Electric plant in service:						
Intangible	\$ 30,876	\$ 1,460	\$ 357	\$ 63	\$ 1,018	\$ 31,024
Production	1,235,981	8,262	2,429	15	6,614	1,235,215
Transmission	214,667	858	7	2	90	215,430
Distribution	375,872	17,741	1,611	151	1,683	390,470
General	63,149	2,960	317	836	524	66,104
	<u>1,920,545</u>	<u>31,281</u>	<u>4,721</u>	<u>1,067</u>	<u>9,929</u>	<u>1,938,243</u>
Gas plant in service:						
Intangible	7,136	2,357	—	—	14	9,479
Production	107,454	3,161	563	137	—	110,189
Natural gas storage	4,897	—	—	—	136	4,761
Transmission	66,489	700	56	—	164	66,969
Distribution	203,951	13,140	2,373	—	1	214,717
General	36,739	3,856	1,316	475	55	39,699
	<u>426,666</u>	<u>23,214</u>	<u>4,308</u>	<u>612</u>	<u>370</u>	<u>445,814</u>
Water plant in service:						
Intangible	296	—	—	—	145	151
Source of supply plant	4,977	686	841	2,688	—	7,510
Pumping plant	2,130	248	3	—	—	2,375
Water treatment plant	3,963	—	—	75	—	4,038
Transmission and distribution	32,140	1,277	154	459	1	33,721
General	5,395	1	98	—	3,147	2,151
	<u>48,901</u>	<u>2,212</u>	<u>1,096</u>	<u>3,222</u>	<u>3,293</u>	<u>49,946</u>
Common plant in service:						
Intangible	18,536	881	1,135	145	63	18,364
General	28,043	367	6,692	5	2	21,721
	<u>46,579</u>	<u>1,248</u>	<u>7,827</u>	<u>150</u>	<u>65</u>	<u>40,085</u>
Construction work in progress	67,981	18,159	—	—	13	86,127
Electric plant held for future use	16,782	—	428	122	15,218	1,258
Nuclear fuel	88,670	7,955	18,384	—	766	77,475
Total utility plant	2,616,124	84,069	36,764	5,173	29,654	2,638,948
Non-utility property	15,370	167	1,590	15,544	18,804	10,687
Total property, plant and equipment	<u>\$2,631,494</u>	<u>\$84,236</u>	<u>\$38,354</u>	<u>\$20,717</u>	<u>\$48,458</u>	<u>\$2,649,635</u>
<u>Description of other changes</u>						
Transfers between accounts				\$16,335	\$16,335	
Transfers of expired contract deposits to plant in service				—	1,515	
Write-off of plant-in-service				—	6,245	
Write-off of non-utility property				—	18,200	
Miscellaneous corrections and adjustments				4,382	6,163	
				<u>\$20,717</u>	<u>\$48,458</u>	

(Continued)

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
SCHEDULE V — PROPERTY, PLANT AND EQUIPMENT (Continued)

Years Ended December 31, 1991, 1990 and 1989

Classification December 31, 1989	Balance at Beginning of Year	Additions at Cost	Retirements	Other Changes		Balance at End of Year
				Add	Deduct	
				(In thousands)		
Utility plant:						
Electric plant in service:						
Intangible	\$ 12,169	\$18,364	\$ 35	\$ 378	\$ —	\$ 30,876
Production	1,214,366	4,270	1,092	18,438	1	1,235,981
Transmission	210,984	3,092	32	669	46	214,667
Distribution	361,772	18,040	3,162	143	921	375,872
General	64,845	100	1,889	114	21	63,149
	<u>1,864,136</u>	<u>43,866</u>	<u>6,210</u>	<u>19,742</u>	<u>989</u>	<u>1,920,545</u>
Gas plant in service:						
Intangible	2,826	4,353	—	20	63	7,136
Production	57,949	580	767	50,190	498	107,454
Natural gas storage	4,885	12	—	—	—	4,897
Transmission	64,992	805	27	719	—	66,489
Distribution	195,341	10,577	1,958	—	9	203,951
General	32,538	4,141	1,485	1,545	—	36,739
	<u>358,531</u>	<u>20,468</u>	<u>4,237</u>	<u>52,474</u>	<u>570</u>	<u>426,666</u>
Water plant in service:						
Intangible	259	111	74	—	—	296
Source of supply plant	4,964	13	—	—	—	4,977
Pumping plant	2,110	36	16	—	—	2,130
Water treatment plant	3,968	6	11	—	—	3,963
Transmission and distribution	30,164	1,988	47	50	15	32,140
General	2,221	3,209	35	—	—	5,395
	<u>43,686</u>	<u>5,363</u>	<u>183</u>	<u>50</u>	<u>15</u>	<u>48,901</u>
Common plant in service:						
Intangible	14,389	3,346	1,735	2,536	—	18,536
General	27,139	527	454	893	62	28,043
	<u>41,528</u>	<u>3,873</u>	<u>2,189</u>	<u>3,429</u>	<u>62</u>	<u>46,579</u>
Construction work in progress	72,401	(6,450)	—	2,030	—	67,981
Electric plant held for future use	21,975	—	5,193	—	—	16,782
Nuclear fuel	77,971	10,706	—	1,238	1,245	88,670
Total utility plant	<u>2,480,228</u>	<u>77,826</u>	<u>18,012</u>	<u>78,963</u>	<u>2,881</u>	<u>2,616,124</u>
Non-utility property	<u>82,206</u>	<u>463</u>	<u>10,339</u>	<u>144</u>	<u>57,104</u>	<u>15,370</u>
Total property, plant and equipment	<u>\$2,562,434</u>	<u>\$78,289</u>	<u>\$28,351</u>	<u>\$79,107</u>	<u>\$59,985</u>	<u>\$2,631,494</u>
<u>Description of other changes</u>						
Transfers between accounts				\$57,143	\$57,143	
Transfers of expired contract deposits to plant in service				—	847	
Adoption of SFAS No. 96				20,798	—	
Miscellaneous corrections and adjustments				1,166	1,995	
				<u>\$79,107</u>	<u>\$59,985</u>	

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
SCHEDULE VI — ACCUMULATED DEPRECIATION AND AMORTIZATION
OF PROPERTY, PLANT AND EQUIPMENT

Years Ended December 1991, 1990 and 1989

Description December 31, 1991	Balance at Beginning of Year	Additions		Retirements	Other Changes		Balance at End of Year
		Charged to Operating Expenses	Charged to Other Accounts		Add	Deduct	
		(In thousands)					
Utility plant:							
Accumulated provision for depreciation of utility plant:							
Electric plant in service . . .	\$506,490	\$55,108	\$ 552	\$ 4,690	\$1,600	\$2,106	\$556,954
Gas plant in service	149,132	12,796	934	(207)	—	35	163,034
Water plant in service	9,722	1,251	43	79	282	22	11,197
Common plant in service . . .	10,930	1,880	624	357	12	21	13,068
	676,274	71,035	2,153	4,919	1,894	2,184	744,253
Accumulated provision for amortization of intangible assets—franchises and computer software	20,196	5,430	119	7,767	29	160	17,847
Accumulated provision for amortization of nuclear fuel . .	26,743	—	15,549	8,019	—	—	34,273
Retirement work in progress . .	1,274	—	—	3,194	—	—	(1,920)
Total utility plant	724,487	76,465	17,821	23,899	1,923	2,344	794,453
Non-utility property	818	—	41	3	—	—	856
	<u>\$725,305</u>	<u>76,465</u>	<u>\$17,862</u>	<u>\$23,902</u>	<u>\$1,923</u>	<u>\$2,344</u>	<u>\$795,309</u>
Other		(412)					
		<u>\$76,053</u>					

Description of other additions and changes

Depreciation and amortization of equipment charged to clearing accounts for distribution in accordance with use	\$ 2,272	\$ —	\$ —
Amortization of nuclear fuel charged to fuel and purchased power	15,549	—	—
Depreciation of non-utility property charged to other income and deductions	41	—	—
Transfers between accounts	—	21	21
Miscellaneous corrections and adjustments	—	1,902	2,323
	<u>\$17,862</u>	<u>\$1,923</u>	<u>\$2,344</u>

(Continued)

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
SCHEDULE VI — ACCUMULATED DEPRECIATION AND AMORTIZATION
OF PROPERTY, PLANT AND EQUIPMENT (Continued)

Years Ended December 1991, 1990 and 1989

Description December 31, 1990	Balance at Beginning of Year	Additions		Retirements (In thousands)	Other Changes		Balance at End of Year
		Charged to Operating Expenses	Charged to Other Accounts		Add	Deduct	
Utility plant:							
Accumulated provision for depreciation of utility plant:							
Electric plant in service . .	\$469,266	\$53,453	\$ 593	\$ 4,737	\$ 2,275	\$14,360	\$506,490
Gas plant in service	139,893	12,391	827	4,160	219	38	149,132
Water plant in service . . .	9,578	981	53	1,110	223	3	9,722
Common plant in service	15,005	1,912	707	6,695	1	—	10,930
	633,742	68,737	2,180	16,702	2,718	14,401	676,274
Accumulated provision for amortization of intangible assets—franchises and computer software	17,570	5,000	221	1,493	3	1,105	20,196
Accumulated provision for amortization of nuclear fuel	31,389	—	13,899	18,384	—	161	26,743
Retirement work in progress	1,578	—	—	304	—	—	1,274
Total utility plant	684,279	73,737	16,300	36,883	2,721	15,667	724,487
Non-utility property	2,769	—	41	—	14,152	16,144	818
	<u>\$687,048</u>	<u>73,737</u>	<u>\$16,341</u>	<u>\$36,883</u>	<u>\$16,873</u>	<u>\$31,811</u>	<u>\$725,305</u>
Other		(533)					
		<u>\$73,204</u>					

Description of other additions and changes

Depreciation and amortization of equipment charged to clearing accounts for distribution in accordance with use	\$ 2,401	\$ —	\$ —
Amortization of nuclear fuel charged to fuel and purchased power	13,899	—	—
Depreciation of non-utility property charged to other income and deductions	41	—	—
Transfers between accounts	—	14,515	14,515
Write-off of non-utility property	—	—	15,945
Miscellaneous corrections and adjustments	—	2,358	1,351
	<u>\$16,341</u>	<u>\$16,873</u>	<u>\$31,811</u>

(Continued)

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES

SCHEDULE IX — SHORT-TERM BORROWINGS

Years Ended December 31, 1991, 1990 and 1989

<u>Category of Aggregate Short-Term Borrowings</u>	<u>Balance at End of Year</u>	<u>Weighted Average Interest Rate at End of Year</u>	<u>Maximum Amount Outstanding During the Year</u>	<u>Average Amount Outstanding During the Year</u>	<u>Average Interest Rate During the Year</u>
(Dollars in thousands)					
December 31, 1991:					
Notes payable to banks	\$13,000	6.05%	\$37,300	\$24,324	7.63%
December 31, 1990:					
Notes payable to banks	\$15,000	8.90%	\$86,750	\$40,943	9.81%
Commercial paper	\$ —	— %	\$71,230	\$13,401	9.11%
December 31, 1989:(1)					
Notes payable to banks	\$19,100	9.50%	\$19,100	\$ 1,492	9.52%
Commercial paper	\$14,780	8.91%	\$62,250	\$18,203	9.61%

(1) Effective June 30, 1989, certain banks loans and commercial paper were reclassified as short-term debt consistent with management's current intent not to refinance by long-term credit arrangements.

The average amount outstanding during the year is calculated using month-end balances. The average interest rate during the year is calculated by dividing interest expense by the average amount outstanding during the year.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
SCHEDULE VI — ACCUMULATED DEPRECIATION AND AMORTIZATION
OF PROPERTY, PLANT AND EQUIPMENT (Continued)

Years Ended December 1991, 1990 and 1989

Description December 31, 1989	Balance at Beginning of Year	Additions		Retirements (In thousands)	Other Changes		Balance at End of Year
		Charged to Operating Expenses	Charged to Other Accounts		Add	Deduct	
Utility plant:							
Accumulated provision for depreciation of utility plant:							
Electric plant in service . .	\$419,827	\$53,065	\$ 598	\$ 5,642	\$ 1,470	\$ 52	\$469,266
Gas plant in service	116,689	11,457	706	2,216	14,231	974	139,893
Water plant in service . . .	8,490	1,160	50	122	—	—	9,578
Common plant in service	10,395	1,680	1,440	426	1,943	27	15,005
	555,401	67,362	2,794	8,406	17,644	1,053	633,742
Accumulated provision for amortization of intangible assets—franchises and computer software	13,984	5,217	231	1,843	—	19	17,570
Accumulated provision for amortization of nuclear fuel	26,624	—	6,220	—	—	1,455	31,389
Retirement work in progress	(724)	—	—	(2,310)	(8)	—	1,578
Total utility plant	595,285	72,579	9,245	7,939	17,636	2,527	684,279
Non-utility property	19,209	—	98	385	—	16,153	2,769
	<u>\$614,494</u>	<u>72,579</u>	<u>\$9,343</u>	<u>\$ 8,324</u>	<u>\$17,636</u>	<u>\$18,680</u>	<u>\$687,048</u>
Other		(598)					
		<u>\$71,981</u>					

Description of other additions and changes

Depreciation and amortization of equipment charged to clearing accounts for distribution in accordance with use	\$3,025	\$ —	\$ —
Amortization of nuclear fuel charged to fuel and purchased power	6,220	—	—
Depreciation of non-utility property charged to other income and deductions	98	—	—
Transfers between accounts	—	16,180	16,180
Miscellaneous corrections and adjustments	—	1,456	2,500
	<u>\$9,343</u>	<u>\$17,636</u>	<u>\$18,680</u>

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
QUARTERLY OPERATING RESULTS

The unaudited operating results by quarters for 1991 and 1990 are as follows:

	Quarter Ended			
	March 31	June 30	September 30	December 31
	(In thousands except per share amounts)			
1991:				
Operating Revenues (1)	\$248,483	\$194,248	\$199,156	\$215,281
Operating Income	\$ 31,429	\$ 17,345	\$ 25,822	\$ 22,657
Net Earnings (Loss)	\$ 13,249	\$ (1,623)	\$ 8,934	\$ 2,400
Net Earnings (Loss) per Share	\$ 0.26	\$ (0.10)	\$ 0.16	\$ —
1990:				
Operating Revenues (1)	\$260,088	\$201,198	\$201,053	\$218,847
Operating Income	\$ 31,539	\$ 16,277	\$ 25,903	\$ 18,722
Net Earnings (Loss)	\$ (4,718)	\$ (769)	\$ 8,099	\$ (2,170)
Net Earnings (Loss) per Share	\$ (0.17)	\$ (0.08)	\$ 0.13	\$ (0.11)

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

(1) In 1991, the Company implemented a FERC order requiring classification of economy sales as operating revenues. Prior period amounts have been reclassified for comparability purposes.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
COMPARATIVE OPERATING STATISTICS

	1991	1990	1989	1988	1987
Electric Service					
Energy Sales—KWh (in thousands):					
Residential	1,606,993	1,575,622	1,527,108	1,493,009	1,448,989
Commercial	2,299,213	2,270,380	2,203,037	2,097,277	2,003,735
Industrial	1,025,420	999,823	961,251	899,508	787,901
Other ultimate customers	208,328	203,005	218,196	194,794	207,173
Total sales to ultimate customers . .	5,139,954	5,048,830	4,909,592	4,684,588	4,447,798
Sales for resale	3,091,541	3,497,506	3,832,016	4,130,369	3,006,599
Total KWh sales	8,231,495	8,546,336	8,741,608	8,814,957	7,454,397
Electric Revenues (in thousands):					
Residential	\$ 155,162	\$ 147,059	\$ 141,465	\$ 140,731	\$ 136,194
Commercial	207,929	200,041	192,273	187,800	179,653
Industrial	67,031	66,351	64,519	62,401	56,534
Other ultimate customers	14,472	14,054	15,387	13,931	15,161
Total revenues to ultimate customers	444,594	427,505	413,644	404,863	387,542
Sales for resale	107,636	122,431	204,763	202,197	176,462
Total revenues from energy sales . .	552,230	549,936	618,407	607,060	564,004
Miscellaneous electric revenues	16,256	17,446	16,481	12,369	8,348
Total electric revenues	\$ 568,486	\$ 567,382	\$ 634,888	\$ 619,429	\$ 572,352
Customers at Year End:					
Residential	264,425	259,546	254,864	250,076	244,427
Commercial	31,666	31,295	31,402	31,024	29,882
Industrial	385	392	393	390	399
Other ultimate customers	499	454	415	376	332
Total ultimate customers	296,975	291,687	287,074	281,866	275,040
Sales for Resale	33	34	33	30	27
Total customers	297,008	291,721	287,107	281,896	275,067
Reliable Net Capability—KW	1,591,000	1,591,000	1,591,000	1,591,000	1,461,000
Coincidental Peak Demand—KW	1,018,000	1,051,000	1,006,000	956,000	916,000
Average Fuel Cost per Million BTU . . .	\$ 1.3696	\$ 1.3384	\$ 1.3445	\$ 1.2460	\$ 1.2894
BTU per KWh of Net Generation	11,086	11,181	11,034	11,146	11,526
Water Service					
Water Sales-Gallon (in thousands) . . .	2,996,587	3,001,391	3,179,711	2,726,666	2,683,961
Revenues (in thousands)	\$ 11,613	\$ 11,700	\$ 12,102	\$ 10,816	\$ 10,973
Customers at Year End	21,522	21,134	20,565	19,713	19,448

Note: In 1991, the Company implemented a FERC order requiring classification of economy sales as operating revenues. Prior period amounts have been reclassified for comparability purposes.

PUBLIC SERVICE COMPANY OF NEW MEXICO AND SUBSIDIARIES
COMPARATIVE OPERATING STATISTICS (Continued)

	1991	1990	1989	1988	1987
Gas Service					
Gas Throughput — Decatherms (in thousands)					
GCNM:					
Residential	26,237	25,190	23,253	24,692	24,510
Commercial	11,375	11,344	10,730	11,460	11,359
Industrial	766	1,278	1,478	1,726	2,196
Public authorities	4,951	5,300	5,492	6,206	6,811
Irrigation	1,374	1,780	2,010	1,440	1,402
Sales for resale	1,357	3,539	4,557	2,667	1,211
Brokerage	—	—	776	879	2,796
GCNM sales	46,060	48,431	48,296	49,070	50,285
Transportation throughput	38,976	31,717	16,041	9,133	5,149
GCNM throughput	85,036	80,148	64,337	58,203	55,434
Gathering Company:					
Spot market sales	1,624	8,112	11,081	—	—
Transportation throughput	23,631	10,785	3,597	—	—
Total gas throughput	110,291	99,045	79,015	58,203	55,434
Gas Revenues (in thousands)					
GCNM:					
Residential	\$137,436	\$137,633	\$130,130	\$122,592	\$114,164
Commercial	46,676	49,575	47,876	45,235	42,120
Industrial	2,754	4,993	5,693	6,063	8,102
Public authorities	17,711	20,392	21,757	22,289	22,729
Irrigation	4,495	5,934	7,001	4,546	3,781
Sales for resale	3,848	7,253	9,874	6,969	3,819
Brokerage	—	—	1,378	1,514	5,213
Revenues from gas sales	212,920	225,780	223,709	209,208	199,928
Transportation	13,386	10,246	6,788	4,841	4,315
Other	9,062	8,292	5,948	9,742	6,391
GCNM gas revenues	235,368	244,318	236,445	223,791	210,634
Gathering Company:					
Spot market sales	1,771	13,880	19,810	—	—
Transportation	3,611	1,693	830	—	—
Processing Company:					
Sales of liquids	30,500	39,086	25,294	—	—
Processing fees	5,819	3,127	448	—	—
Total gas revenues	\$277,069	\$302,104	\$282,827	\$223,791	\$210,634
Customers at Year End					
GCNM:					
Residential	320,546	312,899	306,604	303,173	297,204
Commercial	29,608	29,305	28,949	28,858	28,661
Industrial	72	81	103	105	118
Public authorities	2,153	2,125	2,242	2,469	2,425
Irrigation	1,043	1,224	1,252	1,261	1,257
Sales for resale	7	4	7	6	5
Transportation	41	40	28	20	16
Brokerage	—	—	1	2	2
GCNM customers	353,470	345,678	339,186	335,894	329,688
Gathering Company:					
Off-system sales	13	12	13	—	—
Transportation	8	9	5	—	—
Processing Company	21	20	23	—	—
Total customers	353,512	345,719	339,227	335,894	329,688

Starting in 1989, Gas Throughput includes Gathering Company's gas throughput and Gas Revenues includes revenues of Gathering Company and Processing Company due to a change in regulatory treatment.

ITEM 9. CHANGES IN AND DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

Reference is hereby made to "Election of Directors" in the Company's Proxy Statement relating to the annual meeting of stockholders to be held on May 28, 1992 (the "1992 Proxy Statement") and to PART I, SUPPLEMENTAL ITEM — "EXECUTIVE OFFICERS OF THE COMPANY".

ITEM 11. EXECUTIVE COMPENSATION

Reference is hereby made to "Executive Compensation" in the 1992 Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Reference is hereby made to "Voting Information" and "Election of Directors" in the 1992 Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Reference is hereby made to the 1992 Proxy Statement for such disclosure, if any, as may be required by this item.

PART IV

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

(a) — 1. See Index to Financial Statements under Item 8.

(a) — 2. The following consolidated financial information for the years 1991, 1990, and 1989 is submitted under Item 8.

- Schedule V —Property, plant and equipment.
- Schedule VI —Accumulated depreciation and amortization of property, plant and equipment.
- Schedule IX —Short-term borrowings.

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

(a) — 3-A. Exhibits Filed:

Exhibit No.	Description
3.2	Bylaws of Public Service Company of New Mexico With All Amendments to and Including December 3, 1991.
10.3	Fourth Supplement to Four Corners Fuel Agreement No. 2 effective as of January 1, 1981, between Utah International Inc. and the participants in the Four Corners Project, including the Company.
10.8.1	Amendments No. 1 through No. 6 to Arizona Nuclear Power Project Participation Agreement.
10.9	Coal Sales Agreement executed August 18, 1980 among San Juan Coal Company, the Company and Tucson Electric Power Company, together with Amendments No. One, Two, Four, and Six thereto.

Exhibit No.	Description
10.9.2	Amendment No. Five to Coal Sales Agreement dated May 29, 1990 among San Juan Coal Company, the Company and Tucson Electric Power Company (confidentiality treatment has been requested and exhibit is not filed herewith).
10.10	Modifications No. 1 to San Juan Project Agreements.
10.25.1	Description of Medical Reimbursement Plan Amendment.
10.37	Executive Retention Plan.
10.38	Stipulation in the matter of the application of Public Service Company of New Mexico for NMPSC approval to sell a 10.04% undivided interest in San Juan Generating Station Unit 4 to the City of Anaheim, California, and for related orders and approvals.
10.39	Purchase agreement dated February 7, 1992 between Burnham Leasing Corporation and Public Service Company of New Mexico.
10.40	Director Restricted Stock Retainer Plan.

(a) — 3-B. Exhibits Incorporated By Reference:

In addition to those Exhibits shown above, the Company hereby incorporates the following Exhibits pursuant to Exchange Act Rule 12b-32 and Regulation 201.24 by reference to the filings set forth below:

Exhibit No.	Description	Filed as Exhibit	File No.
Articles of Incorporation and By-laws			
3.1	Restated Articles of Incorporation of the Company, as amended through May 10, 1985.	4-(b) to Registration Statement No. 2-99990 of the Company.	2-99990
Instruments Defining the Rights of Security Holders, Including Indentures			
4.1	Indenture of Mortgage and Deed of Trust dated as of June 1, 1947, between the Company and The Bank of New York (formerly Irving Trust Company), as Trustee, together with the Ninth Supplemental Indenture dated as of January 1, 1967, the Twelfth Supplemental Indenture dated as of September 15, 1971, the Fourteenth Supplemental Indenture dated as of December 1, 1974 and the Twenty-second Supplemental Indenture dated as of October 1, 1979 thereto relating to First Mortgage Bonds of the Company.	4-(d) to Registration Statement No. 2-99990 of the Company.	2-99990

Exhibit No.	Description	Filed as Exhibit:	File No.
4.2	Portions of sixteen supplemental indentures to the Indenture of Mortgage and Deed of Trust dated as of June 1, 1947, between the Company and The Bank of New York (formerly Irving Trust Company), as Trustee, relevant to the declaration or payment of dividends or the making of other distributions on or the purchase by the Company of shares of the Company's Common Stock.	4-(e) to Registration Statement No. 2-99990 of the Company.	2-99990
4.3	Agreement of the Company pursuant to Item 601(b)(4)(iii) of Regulation S-K.	4-C to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1983.	1-6986
Material Contracts			
10.1	Supplemental Indenture of Lease dated as of July 19, 1966 between the Company and other participants in the Four Corners Project and the Navajo Indian Tribal Council.	4-D to Registration Statement No. 2-26116 of the Company.	2-26116
10.1.1	Amendment and Supplement No. 1 to Supplemental and Additional Indenture of Lease dated April 25, 1985 between the Navajo Tribe of Indians and Arizona Public Service Company, El Paso Electric Company, Public Service Company of New Mexico, Salt River Project Agricultural Improvement and Power District, Southern California Edison Company, and Tucson Electric Power Company.	10.1.1 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1985.	1-6986
10.2	Fuel Agreement, as supplemented, dated as of September 1, 1966 between Utah Construction & Mining Co. and the participants in the Four Corners Project including the Company.	4-H to Registration Statement No. 2-35042 of the Company.	2-35042
10.4	Contract between the United States and the Company dated April 11, 1968, for furnishing water.	5-L to Registration Statement No. 2-41010 of the Company.	2-41010
10.4.1	Amendatory Contract between the United States and the Company dated September 29, 1977 for furnishing water.	5-R to Registration Statement No. 2-60021 of the Company.	2-60021
10.5	Co-Tenancy Agreement between the Company and Tucson Gas & Electric Company dated February 15, 1972 pertaining to the San Juan generating plant.	5-O to Registration Statement No. 2-44425 of the Company.	2-44425

Exhibit No.	Description	Filed as Exhibit:	File No.
10.5.1	Modification No. 4 to Co-Tenancy Agreement between the Company and Tucson Electric Power Company dated October 25, 1984.	10.5.1 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1985.	1-6986
10.5.2	Modification No. 5 to Co-Tenancy Agreement between the Company and Tucson Electric Power Company dated July 1, 1985.	10.5.2 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1985.	1-6986
10.6	San Juan Project Construction Agreement between the Company and Tucson Gas & Electric Company, executed December 21, 1973.	5-R to Registration Statement No. 2-50338 of the Company.	2-50338
10.6.1	Modification No. 4 to San Juan Project Construction Agreement between the Company and Tucson Electric Power Company dated October 25, 1984.	10.6.1 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1985.	1-6986
10.6.2	Modification No. 5 to San Juan Project Construction Agreement between the Company and Tucson Electric Power Company dated July 1, 1985.	10.6.2 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1985.	1-6986
10.7	San Juan Project Operating Agreement between the Company and Tucson Gas & Electric Company, executed December 21, 1973.	5-S to Registration Statement No. 2-50338 of the Company.	2-50338
10.7.1	Modification No. 4 to San Juan Project Operating Agreement between the Company and Tucson Electric Power Company dated October 25, 1984.	10.7.1 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1985.	1-6986
10.7.2	Modification No. 5 to San Juan Project Operating Agreement between the Company and Tucson Electric Power Company dated July 1, 1985.	10.7.2 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1985.	1-6986
10.8	Arizona Nuclear Power Project Participation Agreement among the Company and Arizona Public Service Company, Salt River Project Agricultural Improvement and Power District, Tucson Gas & Electric Company and El Paso Electric Company, dated August 23, 1973.	5-T to Registration Statement No. 2-50338 of the Company.	2-50338
10.8.2	Amendment No. 7, effective April 1, 1982, to the Arizona Nuclear Power Project Participation Agreement.	10-BB to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1982.	1-6986
10.8.3	Amendment No. 8 effective September 12, 1983, to the Arizona Nuclear Power Project Participation Agreement.	10-JJ to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1983.	1-6986

Exhibit No.	Description	Filed as Exhibit:	File No.
10.8.4	Amendment No. 9 to Arizona Nuclear Power Project Participation Agreement dated as of June 12, 1984.	10-JJ to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1984.	1-6986
10.8.5	Amendment No. 10 to Arizona Nuclear Power Project Participation Agreement dated as of November 21, 1985.	10.8.7 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1985.	1-6986
10.8.6	Amendment No. 11 to Arizona Nuclear Power Project Participation Agreement dated June 13, 1986 and effective January 10, 1987.	10.8.8 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1986.	1-6986
10.8.7	Amendment No. 12 to Arizona Nuclear Power Project Participation Agreement dated June 14, 1988, and effective August 5, 1988.	19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1990.	1-6986
10.8.8	Amendment No. 13 to the Arizona Nuclear Power Project Participation Agreement dated April 4, 1990, and effective June 15, 1991.	10.8.10 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1990.	1-6986
10.9.1	Amendment No. Three to Coal Sales Agreement dated April 30, 1984 among San Juan Coal Company, the Company and Tucson Electric Power Company.	10-NN to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1984 (confidentiality treatment was requested and exhibit was not filed therewith).	1-6986
10.11	San Juan Unit 4 Early Purchase and Participation Agreement dated as of September 26, 1983, between the Company and M-S-R Public Power Agency, and Modifications No. 2 to the San Juan Project Agreements dated December 31, 1983.	10-KK to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1983.	1-6986
10.11.1	Amendment No. 1 to the Early Purchase and Participation Agreement between Public Service Company of New Mexico and M-S-R Public Power Agency, executed as of December 16, 1987, for San Juan Unit 4.	10.11.1 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1987.	1-6986
10.12	Amended and Restated San Juan Unit 4 Purchase and Participation Agreement dated as of December 28, 1984 between the Company and the Incorporated County of Los Alamos.	10-OO to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1984.	1-6986
10.13	Modifications No. 3 to San Juan Project Agreements dated July 17, 1984.	10-KK to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1984.	1-6986

Exhibit No.	Description	Filed as Exhibit:	File No.
10.14	Participation Agreement among the Company, Tucson Electric Power Company and certain financial institutions relating to the San Juan Coal Trust dated as of December 31, 1981.	10-W to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1981.	1-6986
10.15	Participation Agreement dated as of June 30, 1983 among Security Trust Company, as Trustee, the Company, Tucson Electric Power Company and certain financial institutions relating to the San Juan Coal Trust.	10-II to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1983.	1-6986
10.16	Interconnection Agreement dated November 24, 1982, between the Company and Southwestern Public Service Company.	10-II to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1982.	1-6986
10.17*	Lease dated February 5, 1985 between The First National Bank of Boston, Lessor, and the Company, Lessee.	10.28 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1985.	1-6986
10.17.1*	Supplement No. 1 dated September 30, 1985, to Lease dated February 5, 1985 between The First National Bank of Boston, Lessor, and the Company, Lessee.	10.28.1 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1985.	1-6986
10.18*	Facility Lease dated as of December 16, 1985, between The First National Bank of Boston, as Owner Trustee, and Public Service Company of New Mexico.	28(a) to the Company's Current Report on Form 8-K dated December 31, 1985.	1-6986
10.18.1*	Amendment No. 1 dated as of July 15, 1986, to Facility Lease dated as of December 16, 1985.	28.1 to the Company's Current Report on Form 8-K dated July 17, 1986.	1-6986
10.18.2*	Amendment No. 2 dated as of November 18, 1986, to Facility Lease dated as of December 16, 1985.	28.1 to the Company's Current Report on Form 8-K dated November 25, 1986.	1-6986
10.18.3*	Amendment No. 3 dated as of March 30, 1987, to Facility Lease dated as of December 16, 1985.	10.21.3 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1987.	1-6986
10.19	Facility Lease dated as of July 31, 1986, between The First National Bank of Boston, as Owner Trustee, and Public Service Company of New Mexico.	28.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1986.	1-6986
10.19.1	Amendment No. 1 dated as of November 18, 1986, Facility Lease dated as of July 31, 1986.	28.5 to the Company's Current Report on Form 8-K dated November 25, 1986.	1-6986

Exhibit No.	Description	Filed as Exhibit:	File No..
10.19.2	Amendment No. 2 dated as of December 11, 1986, to Facility Lease dated as of July 31, 1986.	10.22.2 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1986.	1-6986
10.19.3	Amendment No. 3 dated as of April 8, 1987, to Facility Lease dated as of July 31, 1986.	10.22.3 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1987.	1-6986
10.20*	Facility Lease dated as of August 12, 1986, between The First National Bank of Boston, as Owner Trustee, and Public Service Company of New Mexico.	28.1 to the Company's Current Report on Form 8-K dated August 18, 1986.	1-6986
10.20.1*	Amendment No. 1 dated as of November 18, 1986, to Facility Lease dated as of August 12, 1986.	28.9 to the Company Current Report on Form 8-K dated November 25, 1986.	1-6986
10.20.2	Amendment No. 2 dated as of November 25, 1986, to Facility Lease dated as of August 12, 1986.	10.23.2 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1986.	1-6986
10.21	Facility Lease dated as of December 15, 1986, between The First National Bank of Boston, as Owner Trustee, and Public Service Company of New Mexico (Unit 1 Transaction).	28.1 to the Company's Current Report on Form 8-K dated December 17, 1986.	1-6986
10.21.1	Amendment No. 1 dated as of April 8, 1987, to Facility Lease dated as of December 15, 1986.	10.24.1 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1987.	1-6986
10.22	Facility Lease dated as of December 15, 1986, between The First National Bank of Boston, as Owner Trustee, and Public Service Company of New Mexico (Unit 2 Transaction).	28.9 to the Company's Current Report on Form 8-K dated December 17, 1986.	1-6986
10.22.1	Amendment No. 1 dated as of April 8, 1987, to Facility Lease dated as of December 15, 1986.	10.25.1 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1987.	1-6986
10.23	Restated and Amended Public Service Company of New Mexico Accelerated Management Performance Plan (1988). (August 16, 1988.)	19.5 to the Company's Report on Form 10-Q for the quarter ended September 30, 1988.	1-6986
10.23.1	First Amendment to Restated and Amended Public Service Company of New Mexico Accelerated Management Performance Plan (1988). (August 30, 1988.)	19.6 to the Company's Report on Form 10-Q for the quarter ended September 30, 1988.	1-6986

Exhibit No.	Description	Filed as Exhibit:	File No.
10.23.2	Second Amendment to Restated and Amended Public Service Company of New Mexico Accelerated Management Performance Plan (1988)(December 29, 1989).	10.26.2 to Annual Report of the Registrant on Form 10-K for the fiscal year ended December 31, 1989.	1-6986
10.24	Management Life Insurance Plan (July 1985) of the Company.	10.39 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1985.	1-6986
10.25	Amended and Restated Medical Reimbursement Plan of Public Service Company of New Mexico.	19.6 to the Company's Quarterly Report on Form 10-Q for quarter ended March 31, 1987.	1-6986
10.26	Republic Holding Company Series M Preferred Stock Program.	19.4 to the Company's Quarterly Report on Form 10-Q for quarter ended June 30, 1987.	1-6986
10.27	Amendment No. 2 dated as of April 10, 1987, to the Facility Lease dated as of August 12, 1986, between The First National Bank of Boston, as Owner Trustee, and Public Service Company of New Mexico. (Unit 2 Transaction.) (This is an amendment to a Facility Lease which is substantially similar to the Facility Lease filed as Exhibit 28.1 to the Company's Current Report on Form 8-K dated August 18, 1986.)	10.53 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1987.	1-6986
10.28	Amendment No. 3 dated as of March 30, 1987, to the Facility Lease dated as of December 16, 1985, between The First National Bank of Boston, as Owner Trustee, and Public Service Company of New Mexico. (Unit 1 Transaction.) (This is an amendment to a Facility Lease which is substantially similar to the Facility Lease filed as Exhibit 28(a) to the Company's Current Report on Form 8-K dated December 31, 1985.)	10.54 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1987.	1-6986
10.29	Decommissioning Trust Agreement between Public Service Company of New Mexico and First Interstate Bank of Albuquerque dated as of July 31, 1987.	10.55 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1987.	1-6986
10.30	New Mexico Public Service Commission Order dated July 30, 1987, and Exhibit 1 thereto, in NMPSC Case No. 2004, regarding the PVNGS decommissioning trust fund.	10.56 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1987.	1-6986

Exhibit No.	Description	Filed as Exhibit:	File No.
10.31	Executive Retention Agreements.	10.42 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1990.	1-6986
10.32	Supplemental Employee Retirement Agreements dated August 4, 1989.	19.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989.	1-6986
10.33	Supplemental Employee Retirement Agreement dated March 6, 1990.	10.47 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1989.	1-6986
10.34	Settlement Agreement between Public Service Company of New Mexico and Creditors of Meadows Resources, Inc. dated November 2, 1989.	10.48 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1989.	1-6986
10.35	U.S. \$225,000,000 Credit Agreement dated as of March 8, 1991 among that Company and the banks and co-agents named therein.	10.50 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1990.	1-6986
10.35.1	Amendment dated April 11, 1991 among Public Service Company of New Mexico, certain banks and Chemical Bank and Citibank, N.A., as agents for the banks.	19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1991.	1-6986
10.36	San Juan Unit 4 Purchase and Participation Agreement Public Service Company of New Mexico and the City of Anaheim, California dated April 26, 1991.	19.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1991.	1-6986
Additional Exhibits			
22	Certain Subsidiaries of the Registrant.	22 to Annual Report of the Registrant on Form 10-K for the fiscal year ended December 31, 1990.	1-6986
28.1	Collateral Trust Indenture dated as of December 16, 1985, among First PV Funding Corporation, Public Service Company of New Mexico and Chemical Bank, as Trustee.	28(i) to the Company's Current Report on Form 8-K dated December 31, 1985.	1-6986
28.1.1	Series 1986A Bond Supplemental Indenture dated as of July 15, 1986, to Collateral Trust Indenture dated as of December 16, 1985.	28.4 to the Company's Current Report on Form 8-K dated July 17, 1986.	1-6986
28.1.2	Series 1986B Bond Supplemental Indenture dated as of November 18, 1986, to Collateral Trust Indenture dated as of December 16, 1985.	28.1.2 to the Company's Current Report on Form 8-K dated November 25, 1986.	1-6986

Exhibit No.	Description	Filed as Exhibit:	File No.
28.1.3	Unit 1 Supplemental Indenture of Pledge (Lease Obligation Bonds, Series 1986B) dated as of December 15, 1986, to the Collateral Trust Indenture dated as of December 16, 1985.	28.8 to the Company's Current Report on Form 8-K dated December 17, 1986.	1-6986
28.1.4	Unit 2 Supplemental Indenture of Pledge (Lease Obligation Bonds, Series 1986B) dated as of December 15, 1986, to the Collateral Trust Indenture dated as of December 16, 1985.	28.16 to the Company's Current Report on Form 8-K dated December 17, 1986.	1-6986
28.2*	Participation Agreement dated as of December 16, 1985, among the Owner Participant named therein, First PV Funding Corporation. The First National Bank of Boston, in its individual capacity and as Owner Trustee (under a Trust Agreement dated as of December 16, 1985 with the Owner Participant), Chemical Bank, in its individual capacity and as Indenture Trustee (under a Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of December 16, 1985 with the Owner Trustee), and Public Service Company of New Mexico, including Appendix A definitions.	2 to the Company's Current Report on Form 8-K dated December 31, 1985.	1-6986
28.2.1*	Amendment No. 1 dated as of July 15, 1986, to Participation Agreement dated as of December 16, 1985.	2.1 to the Company's Current Report on Form 8-K dated July 17, 1986.	1-6986
28.2.2*	Amendment No. 2 dated as of November 18, 1986, to Participation Agreement dated as of December 16, 1985.	2.1 to the Company's Current Report on Form 8-K dated November 25, 1986.	1-6986
28.3*	Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of December 16, 1985, between The First National Bank of Boston, as Owner Trustee, and Chemical Bank, as Indenture Trustee.	28(b) to the Company's Current Report on Form 8-K dated December 31, 1985.	1-6986
28.3.1*	Supplemental Indenture No. 1 dated as of July 15, 1986, to the Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of December 16, 1985.	28.2 to the Company's Current Report on Form 8-K dated July 17, 1986.	1-6986
28.3.2*	Supplemental Indenture No. 2 dated as of November 18, 1986, to the Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of December 16, 1985.	28.2 to the Company's Current Report on Form 8-K dated November 25, 1986.	1-6986

Exhibit No.	Description	Filed as Exhibit:	File No.
28.4*	Assignment, Assumption and Further Agreement dated as of December 16, 1985, between Public Service Company of New Mexico and The First National Bank of Boston, as Owner Trustee.	28(e) to the Company's Current Report on Form 8-K dated December 31, 1985.	1-6986
28.5	Participation Agreement dated as of July 31, 1986, among the Owner Participant named therein, First PV Funding Corporation. The First National Bank of Boston, in its individual capacity and as Owner Trustee (under a Trust Agreement dated as of July 31, 1986, with the Owner Participant), Chemical Bank, in its individual capacity and as Indenture Trustee (under a Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of July 31, 1986, with the Owner Trustee), and Public Service Company of New Mexico, including Appendix A definitions.	2.1 to the Company's Quarterly Report on Form 10-Q for quarter ended June 30, 1986.	1-6986
28.5.1	Amendment No. 1 dated as of November 18, 1986, to Participation Agreement dated as of July 31, 1986.	28.4 to the Company's Current Report on Form 8-K dated November 25, 1986.	1-6986
28.6	Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of July 31, 1986, between The First National Bank of Boston, as Owner Trustee, and Chemical Bank, as Indenture Trustee.	28.2 to the Company's Quarterly Report on Form 10-Q for quarter ended June 30, 1986.	1-6986
28.6.1	Supplemental Indenture No. 1 dated as of November 18, 1986, to the Trust Indenture, Mortgage, Security Agreement and Assignments of Rents dated as of July 31, 1986.	28.6 to the Company's Current Report on Form 8-K dated November 25, 1986.	1-6986
28.7	Assignment, Assumption, and Further Agreement dated as of July 31, 1986, between Public Service Company of New Mexico and The First National Bank of Boston, as Owner Trustee.	28.3 to the Company's Quarterly Report on Form 10-Q for quarter ended June 30, 1986.	1-6986

Exhibit No.	Description	Filed as Exhibit:	File No.
28.8*	Participation Agreement dated as of August 12, 1986, among the Owner Participant named therein, First PV Funding Corporation. The First National Bank of Boston, in its individual capacity and as Owner Trustee (under a Trust Agreement dated as of August 12, 1986, with the Owner Participant), Chemical Bank, in its individual capacity and as Indenture Trustee (under a Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of August 12, 1986, with the Owner Trustee), and Public Service Company of New Mexico, including Appendix A definitions.	2.1 to the Company's Current Report on Form 8-K dated August 18, 1986.	1-6986
28.8.1*	Amendment No. 1 dated as of November 18, 1986, to Participation Agreement dated as of August 12, 1986.	28.8 to the Company's Current Report on Form 8-K dated November 25, 1986.	1-6986
28.9*	Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of August 12, 1986, between The First National Bank of Boston, as Owner Trustee, and Chemical Bank, as Indenture Trustee.	28.2 to the Company's Current Report on Form 8-K dated August 18, 1986.	1-6986
28.9.1*	Supplemental Indenture No. 1 dated as of November 18, 1986, to the Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of August 12, 1986.	28.10 to the Company's Current Report on Form 8-K dated November 25, 1986.	1-6986
28.10*	Assignment, Assumption, and Further Agreement dated as of August 12, 1986, between Public Service Company of New Mexico and The First National Bank of Boston, as Owner Trustee.	28.3 to the Company's Current Report on Form 8-K dated August 18, 1986.	1-6986

Exhibit No.	Description	Filed as Exhibit:	File No.
28.11	Participation Agreement dated as of December 15, 1986, among the Owner Participant named therein, First PV Funding Corporation. The First National Bank of Boston, in its individual capacity and as Owner Trustee (under a Trust Agreement dated as of December 15, 1986, with the Owner Participant), Chemical Bank, in its individual capacity and as Indenture Trustee (under a Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of December 15, 1986, with the Owner Trustee), and Public Service Company of New Mexico, including Appendix A definitions (Unit 1 Transaction).	2.1 to the Company's Current Report on Form 8-K dated December 17, 1986.	1-6986
28.12	Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of December 15, 1986, between The First National Bank of Boston, as Owner Trustee, and Chemical Bank, as Indenture Trustee (Unit 1 Transaction).	28.2 to the Company's Current Report on Form 8-K dated December 17, 1986.	1-6986
28.13	Assignment, Assumption and Further Agreement dated as of December 15, 1986, between Public Service Company of New Mexico and The First National Bank of Boston, as Owner Trustee (Unit 1 Transaction).	28.3 to the Company's Current Report on Form 8-K dated December 17, 1986.	1-6986
28.14	Participation Agreement dated as of December 15, 1986, among the Owner Participant named therein, First PV Funding Corporation, The First National Bank of Boston, in its individual capacity and as Owner Trustee (under a Trust Agreement dated as of December 15, 1986, with the Owner Participant), Chemical Bank, in its individual capacity and as Indenture Trustee (under a Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of December 15, 1986, with the Owner Trustee), and Public Service Company of New Mexico, including Appendix A definitions (Unit 2 Transaction).	2.2 to the Company's Current Report on Form 8-K dated December 17, 1986.	1-6986

Exhibit No.	Description	Filed as Exhibit:	File No.
28.15	Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of December 15, 1986, between the First National Bank of Boston, as Owner Trustee, and Chemical Bank, as Indenture Trustee (Unit 2 Transaction).	28.10 to the Company's Current Report on Form 8-K dated December 17, 1986.	1-6986
28.16	Assignment, Assumption, and Further Agreement dated as of December 15, 1986, between Public Service Company of New Mexico and The First National Bank of Boston, as Owner Trustee (Unit 2 Transaction).	28.11 to the Company's Current Report on Form 8-K dated December 17, 1986.	1-6986
28.17*	Waiver letter with respect to "Deemed Loss Event" dated as of August 18, 1986, between the Owner Participant named therein, and Public Service Company of New Mexico.	28.12 to the Company's Current Report on Form 8-K dated August 18, 1986.	1-6986
28.18*	Waiver letter with respect to "Deemed Loss Event" dated as of August 18, 1986, between the Owner Participant named therein, and Public Service Company of New Mexico.	28.13 to the Company's Current Report on Form 8-K dated August 18, 1986.	1-6986
28.19	Agreement No. 13904 (Option and Purchase of Effluent), dated April 23, 1973, among Arizona Public Service Company, Salt River Project Agricultural Improvement and Power District, the Cities of Phoenix, Glendale, Mesa, Scottsdale, and Tempe, and the Town of Youngtown.	28.19 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1986.	1-6986
28.20	Agreement for the Sale and Purchase of Wastewater Effluent, dated June 12, 1981, among Arizona Public Service Company, Salt River Project Agricultural Improvement and Power District and the City of Tolleson, as amended.	28.20 to Annual Report of the Registrant on Form 10-K for fiscal year ended December 31, 1986.	1-6986

*One or more additional documents, substantially identical in all material respects to this exhibit, have been entered into, relating to one or more additional sale and leaseback transactions. Although such additional documents may differ in other respects (such as dollar amounts and percentages); there are no material details in which such additional documents differ from this exhibit.

(b) Reports on Form 8-K:

The Company filed no reports on Form 8-K during the quarter ended December 31, 1991, and during the period beginning January 1, 1992 and ended March 13, 1992.

SIGNATURES

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

PUBLIC SERVICE COMPANY OF NEW MEXICO (Registrant)

Date: March 13, 1992

By: /s/ J. T. ACKERMAN

J. T. Ackerman
Chairman, President
and Chief Executive Officer

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

<u>Signature</u>	<u>Capacity</u>	<u>Date</u>
<u>/s/ J. T. ACKERMAN</u> J. T. Ackerman Chairman, President and Chief Executive Officer	Principal Executive Officer and Director	March 13, 1992
<u>/s/ M. H. MAERKI</u> M. H. Maerki Senior Vice President and Chief Financial Officer	Principal Financial Officer	March 13, 1992
<u>/s/ D. M. BURNETT</u> D. M. Burnett Corporate Controller and Chief Accounting Officer	Principal Accounting Officer	March 13, 1992
<u>/s/ R. G. ARMSTRONG</u> R. G. Armstrong	Director	March 13, 1992
<u>/s/ V. L. FISHER</u> V. L. Fisher	Director	March 13, 1992
<u>/s/ J. A. GODWIN</u> J. A. Godwin	Director	March 13, 1992
<u>/s/ C. E. LEYENDECKER</u> C. E. Leyendecker	Director	March 13, 1992
<u>A. G. Ortega</u>	Director	March 13, 1992
<u>/s/ R. R. REHDER</u> R. R. Rehder	Director	March 13, 1992
<u>/s/ P. F. ROTH</u> P. F. Roth	Director	March 13, 1992

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SHAREHOLDER INFORMATION...

PUBLIC SERVICE COMPANY OF NEW MEXICO is the sole transfer agent and registrar for our common and preferred stock. As of December 31, 1991, there were 31,433 registered shareholders.

LISTING:

The common stock of the company is listed on the New York Stock Exchange and is also traded on the Pacific and Philadelphia Stock Exchanges. A consolidated quote is published in numerous daily stock tables carried by many newspapers. The ticker symbol for the common stock is PNM. The most common newspaper symbol is PSvNM.

ANNUAL MEETING:

Date: May 28, 1992

Time: 9:30 a.m. (Mountain Daylight Time)

Location: UNM Continuing Education Center
1634 University Boulevard N.E.
Albuquerque, New Mexico

Notice of meeting, proxy statement and proxy will be mailed to shareholders on or about April 13, 1992.

FOR ADDITIONAL SHAREHOLDER INFORMATION, WRITE OR CALL:

PUBLIC SERVICE COMPANY OF NEW MEXICO

Attn: Shareholder Records

Alvarado Square

Albuquerque, NM 87158

(505) 848-2054 - Albuquerque

1-800-545-4425 - Other than Albuquerque

QUARTERLY HIGH AND LOW SHARE PRICES:

	1991		1990	
	High	Low	High	Low
First Quarter	9 ³ / ₈	7 ³ / ₈	15 ¹ / ₂	12 ¹ / ₈
Second Quarter	11 ³ / ₈	9 ¹ / ₈	12 ³ / ₈	9 ⁷ / ₈
Third Quarter	10 ¹ / ₂	8 ³ / ₈	12 ³ / ₈	9 ¹ / ₄
Fourth Quarter	9 ⁷ / ₈	8 ¹ / ₂	9 ³ / ₄	8

SUSPENSION OF COMMON STOCK DIVIDENDS:

In April 1989, the company announced the suspension of dividend payments on the company's common stock as a result of a deficit in retained earnings. For a discussion of the suspension of dividends on the company's common stock, please refer to the 1991 Form 10-K which is a part of this annual report.

Public Service Company of New Mexico

Alvarado Square
Albuquerque, New Mexico 87158

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