ENCLOSURE

AMENDMENTS TO

OPERATING LICENSE Nos. NPF-51 AND NPF-74

TO DELETE PROVISIONS FOR EL PASO ELECTRIC COMPANY'S

SALE AND LEASEBACK TRANSACTIONS

UNITED STATES OF AMERICA
BEFORE THE
NUCLEAR REGULATORY COMMISSION

In the Matter of	)	
	)	
Arizona Public Service Company, et.al.,	)	Docket Nos. 50-529/530
	)	
	)	
(Palo Verde Nuclear Generating Station, Units 1, 2, 3)	)	

APPLICATION TO AMEND FACILITY OPERATING LICENSE NOS. NPF-51 and NPF-74 TO RESCIND PREVIOUS SALE AND LEASEBACK TRANSACTIONS BY EL PASO ELECTRIC

Arizona Public Service Company ("APS") as Operating Agent for the Palo Verde Nuclear Generating Station ("PVNGS or Palo Verde") Units 1, 2 and 3, joined by El Paso Electric Company, a licensed co-owner of PVNGS Units 1, 2, and 3, hereby respectfully submit, pursuant to Section 184 of the Atomic Energy Act of 1954[1/], as amended, and 10 C.F.R. § 50.90, this Application for an amendment to Facility Operating License Nos. NPF-51 (Unit 2) and NPF-74 (Unit 3). This license amendment requests that the NRC rescind its prior approval of sale and leaseback transactions entered into by El Paso Electric Company ("El Paso") with respect to El Paso's ownership share of PVNGS Units 2 and 3. The NRC previously approved the sale and leaseback transactions by Amendment No. 3, dated August 15, 1986 for License NPF-51, and Amendment No. 1, dated December 2, 1987 for License No. NPF-74.

Following rescission of the sale and leaseback transactions, El Paso will continue in its present capacity as a licensed co-owner of PVNGS Units 1, 2, and 3 and APS will remain the licensed

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1/ 42 U.S.C. § 2234.

operator of the facility. El Paso will simply return to its previous ownership status regarding Units 2 and 3, prior to the NRC granting approval to El Paso's sale and leaseback transactions in 1986 and 1987, respectively. Accordingly, there are no significant hazards considerations to be determined.

I. BACKGROUND

A. Current Ownership Structure of Facility. El Paso owns or leases a 15.8 percent interest in each of Palo Verde's three units. Each Palo Verde Unit is authorized for full power operation at 1,270 megawatts.2/ El Paso owns 100 percent of its percentage interest (15.8%) in Unit 1 and 60.5 percent of its interest in Unit 3. As a result of previous NRC approved sale and leaseback transactions, El Paso has sold and leased back 100 percent of its interest in Palo Verde Unit 2 and 39.5 percent of its percentage interest in Palo Verde Unit 3 (the "Leased Assets"). El Paso shares with the six other Palo Verde Participants the costs of operating and maintaining Palo Verde and is entitled to receive the output of Palo Verde in the same proportion as El Paso's percentage interests in the Palo Verde generating units.

2/ Palo Verde supplies electricity to its owners, which are electric utilities that distribute electricity in the states of California, Arizona, Nevada, New Mexico and Texas.

B. Date License Issued. The Commission issued full-power operating licenses for Units 1, 2 and 3 on June 1, 1985, April 24, 1986, and November 25, 1987, respectively. Such licenses authorize APS, as Operating Agent for Palo Verde, to operate the three Palo Verde units at full power for terms of 40 years each, beginning December 31, 1984, (NPF-41), December 9, 1985 (NPF-51), and March 25, 1987, (NPF-74), respectively. El Paso is licensed by the Commission to possess its proportionate owned and leased shares in Palo Verde.

C. Bankruptcy. El Paso is currently a debtor, and debtor in possession, for purposes of Title 11, United States Bankruptcy Code, 11 U.S.C. §§ 101 et seq., in a case pending before the United States Bankruptcy Court for the Western District of Texas, Austin Division. For several years prior to the filing on January 8, 1992 of El Paso's petition for voluntary reorganization under Chapter 11 of the Code, El Paso experienced increasing financial difficulties. Prior to filing for reorganization, El Paso attempted to negotiate a financial restructuring with its primary lenders. However, on December 26 and 27, 1991, the beneficial owners ("Sale and Leaseback Participants") of the title to El Paso's Palo Verde Unit 2 Leased Assets drew on bank letters of credit established by El Paso for the Sale and Leaseback Participants' benefit in connection with the sale and leaseback transactions relating to Palo Verde Unit 2. The banks issuing the letters of credit in turn asserted

reimbursement claims against El Paso, which totalled approximately $208 million.

During the course of the bankruptcy case, El Paso's management has continued to manage the operations and affairs of El Paso, subject to the authority of its Board of Directors, as a debtor in possession under the jurisdiction of the Bankruptcy Court (copies of the most recent interim financial statements and report on Form 10-Q for El Paso are attached as Appendix A). El Paso has continued to make all scheduled operation and maintenance payments required to be made by it with respect to Palo Verde. At all times during the pendency of the bankruptcy case, APS as operating agent, has been responsible for the day-to-day operation of the Palo Verde facility.

On January 13, 1994, APS as Operating Agent joined by El Paso, filed a license amendment request with the NRC requesting that the NRC: (1) consent to the indirect transfer of control of El Paso's interest in its "possession only" licenses for Palo Verde Units 1, 2, and 3 to a special-purpose subsidiary of Central and South West Corporation ("CSW") with and into El Paso; and (2) amend Operating License Nos. NPF-51 and NPF-74 to delete provisions of those licenses relating to sale-leaseback arrangements that were approved by the NRC and added by Amendment No. 3, dated August 15, 1986 for License No. NPF-51, and Amendment No. 1, dated December 2, 1987 for License No. NPF-74. By Federal Register notice of March 2, 1994, the NRC made a proposed determination that the requested amendments (including

rescission of the sale and leaseback transactions) involve no significant hazards consideration. See 59 Fed. Reg. 9999-10001. However, on June 9, 1995, CSW sought to terminate and revoked the Modified Third Amended Plan of Reorganization of El Paso Electric, and the NRC was, shortly thereafter, notified by El Paso and Arizona Public Service Company.

Concurrently, El Paso has acted to formulate a plan of reorganization (hereinafter, "the Plan") that would allow El Paso to emerge from bankruptcy as a financially viable entity having the continuing ability to provide reliable electric service to its customers. The Plan, following the recent failure of CSW to proceed with the proposed merger described above, will propose a reorganization of El Paso pursuant to which El Paso will emerge from bankruptcy as a "stand alone" corporation. The Plan is subject to, inter alia, the receipt of all necessary regulatory approvals needed for implementation of the Plan, including prior approval by the NRC.3/ Thus, it is requested that the NRC amend Operating Licenses NPF-51 and NPF-74 as described in Section II hereof.

II. AMENDMENT REQUEST

Pursuant to 10 CFR § 50.90, the Applicants hereby request that the Commission amend the Operating Licenses for Palo Verde Units 2 and 3 to delete Sections 2.B(7)(a) and (b) of License No.

3/ Appendix B attached hereto contains a discussion of other necessary regulatory approvals which may be needed for implementation of the Plan.

NPF-51 and Sections 2.B.(6)(a) and (b) of License No. NPF-74 and that such amendments be issued as soon as possible but become effective upon the effective date of El Paso's emergence from bankruptcy. Those provisions were added to the licenses as a result of certain previous sale and leaseback arrangements entered into by El Paso and approved by the NRC by Amendment 3, dated August 15, 1986 for License No. NPF-51, and Amendment No. 1, dated December 2, 1987 for License NPF-74. Applicants request deletion of these previously granted amendments because, pursuant to the Plan and the Settlement Agreements4/, it will be necessary for El Paso to re-acquire fee title to its interests in Palo Verde Units 2 and 3 in which it now holds only a leasehold interest. Thus, El Paso will be in the same position it had been after it had been licensed by the NRC to possess its interests in Units 2 and 3.

A. No Significant Hazards Consideration Determination.

In previously authorizing license amendments to incorporate sale and leaseback agreements, the NRC Staff concluded that where the lease expressly provides that the lessee will continue to be licensed to possess the facility, continue to serve as a participant under the facility operating agreement, and continue its responsibility for payment of its share of taxes, insurance premiums, and operating, maintenance and decommissioning costs,

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4/ See discussion in the Pubic Utility Commission of Texas regulatory approval section found in Appendix B regarding the Stipulation and Settlement Agreement between El Paso and the Commission.

the transaction presents no public health and safety concerns. NRC Policy Paper SECY-85-367 (Nov. 20, 1985) at pp. 8-9.

The Commission provides a standard for determining whether a significant hazards consideration exists as stated in 10 CFR § 50.92. A proposed amendment to an operating license for a facility involves no significant hazards consideration if operation of the facility, in accordance with a proposed amendment, would not: (1) involve a significant increase in the probability or consequences of an accident previously evaluated; or (2) create the possibility of a new or different kind of accident from any accident previously evaluated; or (3) involve a significant reduction in a margin of safety.

As previously discussed above, on January 13, 1994, when CSW and El Paso were negotiating a merger agreement, El Paso together with the operator, APS, submitted a license amendment request to the NRC to delete provisions of El Paso's sale and leaseback arrangements5/ providing a no significant hazards analysis, which is directly applicable here, as follows:

Standard 1. This amendment request does not involve a significant increase in the probability or consequences of an accident previously evaluated because the proposed change is administrative in nature. The proposed change deletes Sections 2.B.(7)(a) and (b) of License No. NPF-51, and Sections 2.B.(6)(a)

5/ That license amendment request also requested NRC consent to the indirect transfer of control of El Paso's interests in Units 1,2, and 3 to a subsidiary of CSW. This aspect of the previous request is no longer applicable due to the termination of that proposed merger.

and (b) of License No. NPF-74. These sections describe the structure of the financing of El Paso's interest in Palo Verde, specifically authorizing sale and leaseback transactions. The proposed change does not affect the assumptions used in the accident analyses, nor does the proposed change result in changes to the physical configuration of the facility, design parameters, technical specifications, or operation and maintenance of the facility. Therefore, the amendment request does not involve a significant increase in the probability or consequences of an accident previously evaluated.

Standard 2. This amendment request does not create the possibility of a new or different kind of accident from any accident previously analyzed because the proposed change is administrative in nature. The proposed change deletes Sections 2.B.(7)(a) and (b) of License No. NPF-51, and Sections 2.B.(6)(a) and (b) of License No. NPF-74. These sections describe the structure of the financing of El Paso's interest in Palo Verde Units 2 and 3, specifically authorizing sale and leaseback transactions. The proposed change does not involve modifications to any of the existing equipment nor does the change affect operation or maintenance of the facility. Therefore, the amendment request does not create the possibility of a new or different kind of accident not previously analyzed.

Standard 3. This amendment request does not involve a significant reduction in a margin of safety because it is administrative in nature. The proposed change deletes Sections

2.B.(7)(a) and (b) of License No. NPF-51, and Sections 2.B.(6)(a) and (b) of License No. NPF-74. These sections describe the structure of the financing of El Paso's interest in Palo Verde, specifically authorizing the sale and leaseback transactions. The proposed change does not involve changes to any existing plant equipment or accident analyses that provide for or establish margins of safety. There is no change to the operation or maintenance of the facility and the existing margins of safety are not changed by the proposed change. Therefore, the amendment request does not involve a significant reduction in a margin of safety.

NRC Staff review of the January 13, 1994 license amendment request with respect to the rescission of El Paso's sale and leaseback agreements concluded that "it appears that the proposed license amendment reflects only a change in the structure of the financing of El Paso's interest in Palo Verde and the three standards of 50.92(c) are satisfied. Therefore the NRC staff proposes to determine that the amendment requests involve no significant hazards consideration." 59 Fed. Reg. 10001 (March 2, 1994).

Thus, based upon the identical analyses and description of the amendment provided herein and consistent with the previously approved sale and leaseback amendments sought to be rescinded, the proposed license amendment reflects only a change in the structure of the financing of El Paso's interest in Palo Verde, will not involve a significant increase in the probability or

consequences of any accident previously evaluated, create the possibility of a new or different kind of accident from any accident previously evaluated, or involve a reduction in a margin of safety. Therefore, the proposed change does not involve a significant hazards consideration.

B. Environmental Considerations. The proposed amendment does not result in any design or physical change to the plants, any change in the transmission or other associated facilities, any change in the types, or any increase in the amounts, of any effluents that may be released offsite, change in the potential for accidental releases, any change in power level, and there will be no increase in individual or cumulative occupational radiation exposure. Therefore, pursuant to 10 C.F.R. § 51.22(c)(9), this license amendment request is excluded from the requirement of an environmental impact statement or assessment.

C. Antitrust Considerations. The proposed amendment does not warrant antitrust review because it is administrative in nature, does not present any antitrust considerations not previously considered at the time of the licensing, El Paso remains a licensee, and the operations and distribution of electrical power remain unchanged.

Subsequent to the issuance of an operating license for a nuclear power plant, no further antitrust evaluations ordinarily take place unless a license amendment is sought which is determined would result in "significant [anti-trust] changes" to

the licensed activities.6/ Three criteria define the circumstances in which a change in licensed activities is considered to be significant for antitrust purposes. Those criteria are whether the change: (1) occurred since the previous, detailed antitrust review of the licensee(s); (2) is reasonably attributable to the licensee(s); and (3) has antitrust implications that would likely warrant some antitrust remedy.7/ This third criteria has been further explained as establishing that "changes would be considered 'significant' only when the competitive structure, as changed, would likely warrant and be susceptible to a greater than de minimus license modification.8/ For antitrust review to be appropriate, the change must have more than a de minimus anti-competitive effect, its significance must be reasonably apparent, and the change must be one likely to warrant Commission review.9/

In examining past instances of the NRC's approval of sale and leaseback arrangements, review of the third requirement demonstrated that such an antitrust review was unwarranted. This license amendment request rescinding El Paso's previous sale and

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6/ See 10 C.F.R. § 50.80(b); Detroit Edison Co. (Enrico Fermi Atomic Power Plant, Unit No. 2), ALAB-475, 7 N.R.C. 752, 755 n.7 (1978); South Carolina Electric & Gas Co. (Virgil C. Summer Nuclear Station, Unit No. 1), CLI-81-14, 13 N.R.C. 862, 874 n.47 (1981).

7/ Summer, supra, CLI-80-28, 11 N.R.C. at 824; Summer, supra, CLI-81-14, 13 N.R.C. at 864 n.3, 872.

8/ Summer, supra, CLI-81-14, 13 N.R.C. at 864 n.3.

9/ Id. at 872-73.

leaseback amendments should not require different review and analyses from the granting of the sale and leaseback amendments for El Paso or the Public Service Company of New Mexico previously approved for the Palo Verde plant. See NRC Policy Paper SECY-85-367 (Nov. 20, 1985). In reviewing those transactions, the NRC staff determined that where the investor owners do not acquire the right to electric power generation at the facility, and such electricity will continue to be distributed in the same manner as is now set forth in the operating agreement, "the transaction does not present any antitrust considerations not previously considered at the time of the license." Id. at 9.

Both before and after approvals by the NRC of El Paso's sale and leaseback transactions, El Paso retains the full power and authority, to exercise all the rights and perform all the duties and responsibilities under the Arizona Nuclear Power Project Participation Agreement ("Participation Agreement"), and APS remains responsible to the Commission for the proper operation and maintenance of all Units. El Paso will remain unchanged as a licensee entitled to possession of the facility, consistent with its continuation, as the Participant under the ANPP Participation Agreement ("ANPP").

Similarly and most importantly, all electricity produced by Palo Verde will continue to be distributed in the same manner as is set forth in the Participation Agreement. El Paso will continue to retain its full generation entitlement share in the

output of all of the PVNGS units. No transmission, power pooling or reserve sharing arrangements are affected. El Paso also maintains its status as "licensee."

Thus, rescission of El Paso's previously approved sale and leaseback amendments for Palo Verde, which also did not require antitrust review, does not now warrant antitrust review because El Paso still remains the licensee, the operations and distribution of electrical power remains unchanged, and such approval of this license amendment does not present any antitrust considerations not previously considered at the time of licensing.

D. Operating and Decommissioning Costs. Under the terms of the proposed rescission to the sale and leaseback provisions, El Paso will maintain its utility participation in all three Palo Verde units and be entitled to its full 15.8% share of the power and energy generated, entitled to its full pro-rata vote with the other utilities, and obligated to pay 15.8 percent of the costs of operating, maintaining and decommissioning the units.

El Paso maintains that the source of funds for operating and decommissioning costs will continue to be the same as for other normal utility operations; i.e., revenues derived from sale of utility service to customers. As described infra., the New Mexico Public Utility Commission and Public Utility Commission of Texas continue to approve El Paso's recovery of Palo Verde operating and decommissioning expenses from its customers. Thus, El Paso asserts that there will be no change from the present in

the source of El Paso's 15.8 percent share of Palo Verde Unit 2 and 3 operating and decommissioning costs under the proposed rescission of the sale and leaseback agreements.

III. SCHEDULING

El Paso has submitted a Stipulation and Settlement Agreement dated July 27, 1995, to the Public Utility Commission of Texas for approval in its pending rate case. The Stipulation resolves the current Texas rate case and appeals of all prior cases and provides for a fixed rate increase over a 10 year period. The Stipulation is contingent upon El Paso emerging from bankruptcy with a plan of reorganization consistent with the Stipulation. Therefore, El Paso must expeditiously obtain all necessary regulatory approvals prior to the Plan Confirmation Hearing, which is anticipated to be held in December 1995, to meet the deadline for the Plan to become effective, or face possible dissolution of the Stipulation.

Besides the approval of the regulatory agencies described in Appendix B, the only regulatory or other approval necessary to permit the rescission of the sale and leaseback agreements (other than the approvals already obtained) is the NRC's approval of the amendments to Units' 2 and 3 licenses requested in this Application. To complete all of the necessary transactions in an orderly and timely manner, and to provide El Paso with some discretion in the timing of such transactions, it is desirable that NRC issue the requested license amendment as soon as

possible in order to permit El Paso sufficient time to re-acquire its ownership interests in Palo Verde Units 2 and 3 that had previously been subject to sale and leaseback agreements. Therefore, it is requested that:

(a) notice of receipt of this Application and a proposed no significant hazards determination, and the issuance of the requested amendments be published in the Federal Register as soon as practicable;

(b) the requested amendments to the licenses to become effective upon the completion of both: (1) the publication of the item in (a) above in the Federal Register, since a no significant hazards determination has in essence already been made (See 59 Fed. Reg. 9999-10001 (March 2, 1994)); and (2) the effective date of El Paso's emergence from bankruptcy as a stand-alone company.

SECTION IV

MARKED-UP LICENSE PAGES

UNITED STATES
NUCLEAR REGULATORY COMMISSION
WASHINGTON, D. C. 20555

For Reference Only

ARIZONA PUBLIC SERVICE COMPANY

SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT AND POWER DISTRICT

EL PASO ELECTRIC COMPANY

SOUTHERN CALIFORNIA EDISON COMPANY

PUBLIC SERVICE COMPANY OF NEW MEXICO

LOS ANGELES DEPARTMENT OF WATER AND POWER

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY

DOCKET NO. STN 50-529

PALO VERDE NUCLEAR GENERATING STATION, UNIT 2

FACILITY OPERATING LICENSE

License No. NPF-51

1. The Nuclear Regulatory Commission (the Commission or the NRC) has found that:

   A. The application for license filed by Arizona Public Service Company, on behalf of itself and the Salt River Project Agricultural Improvement and Power District, El Paso Electric Company, Southern California Edison Company, Public Service Company of New Mexico, Los Angeles Department of Water and Power, and Southern California Public Power Authority (licensees), complies with the standards and requirements of the Atomic Energy Act of 1954, as amended, and the Commission's regulations set forth in 10 CFR Chapter I and all required notifications to other agencies or bodies have been duly made;

   B. Construction of the Palo Verde Nuclear Generating Station, Unit 2 (facility) has been substantially completed in conformity with Construction Permit No. CPPR-142 and the application, as amended, the provisions of the Act and the regulations of the Commission;

   C. The facility will operate in conformity with the application, as amended, the provisions of the Act, and the regulations of the Commission (except as exempted from compliance in Section 2.D below);

D. There is reasonable assurance: (i) that the activities authorized by this operating license can be conducted without endangering the health and safety of the public, and (ii) that such activities will be conducted in compliance with the Commission's regulations set forth in 10 CFR Chapter I (except as exempted from compliance in Section 2.D below);

E. Arizona Public Service Company* is technically qualified to engage in the activities authorized by this operating license in accordance with the Commission's regulations set forth in 10 CFR Chapter I;

F. The licensees have satisfied the applicable provisions of 10 CFR Part 140, "Financial Protection Requirements and Indemnity Agreements", of the Commission's regulations;

G. The issuance of this license will not be inimical to the common defense and security or to the health and safety of the public;

H. After weighing the environmental, economic, technical, and other benefits of the facility against environmental and other costs, and after considering available alternatives, the issuance of this Facility Operating License No. NPF-51, subject to the conditions for protection of the environment set forth in the Environmental Protection Plan attached as Appendix B, is in accordance with 10 CFR Part 51 of the Commission's regulations and all applicable requirements have been satisfied; and

I. The receipt, possession, and use of source, byproduct and special nuclear material as authorized by this license will be in accordance with the Commission's regulations in 10 CFR Parts 30, 40 and 70.

2. Pursuant to approval by the Nuclear Regulatory Commission at a meeting held on April 23, 1986, the license for fuel loading and low power testing, License No. NPF-46, issued on December 9, 1985, is superseded by Facility Operating License No. NPF-51 hereby issued to the Arizona Public Service Company, Salt River Project Agricultural Improvement and Power District, El Paso Electric Company, Southern California Edison Company, Public Service Company of New Mexico, Los Angeles Department of Water and Power, and Southern California Public Power Authority (licensees) to read as follows:

*Arizona Public Service Company is authorized to act as agent for Salt River Project Agricultural Improvement and Power District, El Paso Electric Company, Southern California Edison Company, Public Service Company of New Mexico, Los Angeles Department of Water and Power, and Southern California Public Power Authority and has exclusive responsibility and control over the physical construction, operation and maintenance of the facility.

A. This license applies to the Palo Verde Nuclear Generating Station, Unit 2, a pressurized water reactor and associated equipment (facility) owned by the licensees. The facility is located on the licensees' site in Maricopa County, Arizona and is described in the licensees' Final Safety Analysis Report, as supplemented and amended; in the related CESSAR Final Safety Analysis Report, as supplemented and amended through Amendment No. 8; and in their Environmental Report, as supplemented and amended.

B. Subject to the conditions and requirements incorporated herein, the Commission hereby licenses:

(1) Pursuant to Section 103 of the Act and 10 CFR Part 50, Arizona Public Service Company, Salt River Project Agricultural Improvement and Power District, El Paso Electric Company, Southern California Edison Company, Public Service Company of New Mexico, Los Angeles Department of Water and Power, and Southern California Public Power Authority to possess, and Arizona Public Service Company (APS) to use and operate the facility at the designated location in Maricopa County, Arizona, in accordance with the procedures and limitations set forth in this license;

(2) Pursuant to the Act and 10 CFR Part 70, APS to receive, possess and use at any time special nuclear material as reactor fuel, in accordance with the limitations for storage and amounts required for reactor operation, as described in the licensees' Final Safety Analysis Report, as supplemented and amended, and the CESSAR Final Safety Analysis Report as supplemented and amended through Amendment No. 8;

(3) Pursuant to the Act and 10 CFR Parts 30, 40 and 70, APS to receive, possess and use at any time any byproduct, source and special nuclear material as sealed neutron sources for reactor startup, sealed sources for reactor instrumentation and radiation monitoring equipment calibration, and as fission detectors in amounts as required;

(4) Pursuant to the Act and 10 CFR Part 30, 40 and 70, APS to receive, possess and use in amounts as required any byproduct, source or special nuclear material without restriction to chemical or physical form, for sample analysis or instrument calibration or associated with radioactive apparatus or components; and

(5) Pursuant to the Act and 10 CFR Parts 30, 40, and 70, APS to possess, but not separate, such byproduct and special nuclear materials as may be produced by the operation of the facility.

UNITED STATES
NUCLEAR REGULATORY COMMISSION
WASHINGTON, D. C. 20555

ARIZONA PUBLIC SERVICE COMPANY, ET AL.*

DOCKET NO. STN 50-529

PALO VERDE NUCLEAR GENERATING STATION, UNIT NO. 2

AMENDMENT TO FACILITY OPERATING LICENSE

Amendment No. 3
License No. NPF-51

1. The Nuclear Regulatory Commission (the Commission) has found that:

   A. The present amendment, issued in response to the April 15, 1986 application (and supplemental letters dated June 3, July 30, August 7, August 8, and August 13, 1986) by the Arizona Public Service Company with respect to a sale and leaseback financing transaction by licensee, El Paso Electric Company complies with the standards and requirements of the Atomic Energy Act of 1954, as amended (the Act) and the Commission's regulations set forth in 10 CFR Chapter I;

   B. In approving the aforementioned application the Director of the Office of Nuclear Reactor Regulation, by letter of August 15, 1986, stated:

      This approval is subject to the condition that the lessor and anyone else who may acquire an interest under the transaction which is the subject of this application are prohibited from exercising directly or indirectly any control over the licensees of the Palo Verde nuclear facility. For purposes of this condition, the limitations in 10 C.F.R. 50.81 "Creditor Regulations," as now in effect and as these may be subsequently amended, are fully applicable to the named lessor and any successor in interest to that lessor as long as the license for Palo Verde Nuclear Generating Station, Unit 2, remains in effect. This financial transaction shall have no effect on the license for the Palo Verde Nuclear Generating Station, Unit 2.

*The other licensees are the Salt River Project Agricultural Improvement and Power District, El Paso Electric Company, Southern California Edison Company, Public Service Company of New Mexico, Los Angeles Department of Water and Power, and Southern California Public Power Authority.

This transaction is similar to that approved by the Commission in its Order of December 12, 1985, with regard to the sale and leaseback of PNM's interest in Palo Verde Unit 1. Subject to the foregoing, the Commission hereby approves the application under the conditions set forth in the enclosed Amendment No. 3 to the Palo Verde Unit 2 license.

C. The facility will operate in conformity with the above application and the Director of the Office of Nuclear Reactor Regulation's letter of August 15, 1986, the provisions of the Act, and the regulations of the Commission;

D. There is reasonable assurance (i) that the activities authorized by this amendment can be conducted without endangering the health and safety of the public, and (ii) that such activities will be conducted in compliance with the Commission's regulations;

E. The issuance of this amendment will not be inimical to the common defense and security or to the health and safety of the public;

F. The issuance of this amendment is in accordance with 10 CFR Part 51 of the Commission's regulations and all applicable requirements have been satisfied.

G. The present amendment authorizes any such sale and leaseback transactions made pursuant thereto until September 30, 1986.

2. Accordingly, Paragraph 2.B(7) is hereby added to read as follows:

(7)(a) El Paso Electric Company is authorized to transfer all or a portion of its 15.8% ownership share in Palo Verde Unit 2 and a proportionate share of a third of its interest in the Palo Verde common facilities to certain equity investors identified in its submission of August 7, 1986, and at the same time to lease back from such purchasers such interest sold in the Palo Verde plant. The term of the lease is for approximately 27 years subject to a right of renewal. Any such sale and leaseback transaction is subject to the representations and conditions set forth in the aforementioned application of April 15, 1986, and the subsequent submittals dated June 3, July 30, August 7, August 8, and August 13, 1986, as well as the letter of the Director of the Office of Nuclear Reactor Regulation dated August 15, 1986, consenting to such transactions. Specifically, the lessor and anyone else who may acquire an interest under this transaction are prohibited from exercising directly or indirectly any control

Delete

over the licensees of the Palo Verde Nuclear Generating Station, Unit 2. For purposes of this condition the limitations in 10 CFR 50.81, "Creditor Regulations," as now in effect and as they may be subsequently amended, are fully applicable to the lessor and any successor in interest to that lessor as long as the license for Palo Verde Unit 2 remains in effect; this financial transaction shall have no effect on the license for the Palo Verde nuclear facility throughout the term of the license.

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(b) Further, the licensees are also required to notify the NRC in writing prior to any change in: (i) the terms or conditions of any lease agreements executed as part of this transaction; (ii) the ANPP Participation Agreement, (iii) the existing property insurance coverage for the Palo Verde nuclear facility, Unit 2 as specified in licensee counsel's letter of November 26, 1985, and (iv) any action by the lessor or others that may have an adverse effect on the safe operation of the facility.

3. This license amendment is effective as of the date of issuance.

FOR THE NUCLEAR REGULATORY COMMISSION

Frank J. Miraglia

Frank J Miraglia, Director
Division of PWR Licensing-B

Date of Issuance: August 15, 1986

ARIZONA PUBLIC SERVICE COMPANY

SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT AND POWER DISTRICT

EL PASO ELECTRIC COMPANY

SOUTHERN CALIFORNIA EDISON COMPANY

PUBLIC SERVICE COMPANY OF NEW MEXICO

LOS ANGELES DEPARTMENT OF WATER AND POWER

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY

DOCKET NO. STN 50-530

PALO VERDE NUCLEAR GENERATING STATION, UNIT 3

FACILITY OPERATING LICENSE

License No. NPF-74

1. The Nuclear Regulatory Commission (the Commission or the NRC) has found that:

   A. The application for license filed by Arizona Public Service Company on behalf of itself and the Salt River Project Agricultural Improvement and Power District, El Paso Electric Company, Southern California Edison Company, Public Service Company of New Mexico, Los Angeles Department of Water and Power, and Southern California Public Power Authority (licensees) complies with the standards and requirements of the Atomic Energy Act of 1954, as amended, and the Commission's regulations set forth in 10 CFR Chapter I, and all required notifications to other agencies or bodies have been duly made;

   B. Construction of the Palo Verde Nuclear Generating Station, Unit 3 (facility) has been substantially completed in conformity with Construction Permit No. CPPR-143 and the application, as amended, the provisions of the Act, and the regulations of the Commission;

   C. The facility will operate in conformity with the application, as amended, the provisions of the Act, and the regulations of the Commission (except as exempted from compliance in Section 2.D below);

   D. There is reasonable assurance: (i) that the activities authorized by this operating license can be conducted without endangering the health and safety of the public, and (ii) that such activities will be conducted in compliance with the Commission's regulations set forth in 10 CFR Chapter I (except as exempted from compliance in Section 2.D below);

E. Arizona Public Service Company* is technically qualified to engage in the activities authorized by this operating license in accordance with the Commission's regulations set forth in 10 CFR Chapter I;

F. The licensees have satisfied the applicable provisions of 10 CFR Part 140, "Financial Protection Requirements and Indemnity Agreements," of the Commission's regulations;

G. The issuance of this license will not be inimical to the common defense and security or to the health and safety of the public;

H. After weighing the environmental, economic, technical, and other benefits of the facility against environmental and other costs, and after considering available alternatives, the issuance of this Facility Operating License No. NPF-74, subject to the conditions for protection of the environment set forth in the Environmental Protection Plan attached as Appendix B, is in accordance with 10 CFR Part 51 of the Commission's regulations and all applicable requirements have been satisfied; and

I. The receipt, possession, and use of source, byproduct, and special nuclear material as authorized by this license will be in accordance with the Commission's regulations in 10 CFR Parts 30, 40, and 70.

2. Pursuant to approval by the Nuclear Regulatory Commission at a meeting held on November 25, 1987, the license for fuel loading and low power testing, License No. NPF-65, issued on March 25, 1987, is superseded by Facility Operating License No. NPF-74 hereby issued to the Arizona Public Service Company, Salt River Project Agricultural Improvement and Power District, El Paso Electric Company, Southern California Edison Company, Public Service Company of New Mexico, Los Angeles Department of Water and Power, and Southern California Public Power Authority (licensees) to read as follows:

A. This license applies to the Palo Verde Nuclear Generating Station, Unit 3, a pressurized water reactor and associated equipment (facility) owned by the licensees. The facility is located on the licensees' site in Maricopa County, Arizona and is described in the licensees' Final Safety Analysis Report, as supplemented and amended; in the related CESSAR Final Safety Analysis Report, as supplemented and amended through Amendment No. 8; and in their Environmental Report, as supplemented and amended.

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*Arizona Public Service Company is authorized to act as agent for Salt River Project Agricultural Improvement and Power District, El Paso Electric Company, Southern California Edison Company, Public Service Company of New Mexico, Los Angeles Department of Water and Power, and Southern California Public Power Authority, and has exclusive responsibility and control over the physical construction, operation, and maintenance of the facility.

B. Subject to the conditions and requirements incorporated herein, the Commission hereby licenses:

(1) Pursuant to Section 103 of the Act and 10 CFR Part 50, Arizona Public Service Company, Salt River Project Agricultural Improvement and Power District, El Paso Electric Company, Southern California Edison Company, Public Service Company of New Mexico, Los Angeles Department of Water and Power, and Southern California Public Power Authority to possess, and Arizona Public Service Company (APS) to use and operate the facility at the designated location in Maricopa County, Arizona, in accordance with the procedures and limitations set forth in this license;

(2) Pursuant to the Act and 10 CFR Part 70, APS to receive, possess, and use at any time special nuclear material as reactor fuel, in accordance with the limitations for storage and amounts required for reactor operation, as described in the licensees' Final Safety Analysis Report, as supplemented and amended, and the CESSAR Final Safety Analysis Report, as supplemented and amended through Amendment No. 8;

(3) Pursuant to the Act and 10 CFR Parts 30, 40, and 70, APS to receive, possess, and use at any time any byproduct, source, and special nuclear material as sealed neutron sources for reactor startup, as sealed sources for reactor instrumentation and radiation monitoring equipment calibration, and as fission detectors in amounts as required;

(4) Pursuant to the Act and 10 CFR Parts 30, 40, and 70, APS to receive, possess, and use in amounts required any byproduct, source or special nuclear material without restriction to chemical or physical form, for sample analysis or instrument calibration or associated with radioactive apparatus or components; and

(5) Pursuant to the Act and 10 CFR Parts 30, 40, and 70, APS to possess, but not separate, such byproduct and special nuclear materials as may be produced by the operation of the facility.

C. This license shall be deemed to contain and is subject to the conditions specified in the Commission's regulations set forth in 10 CFR Chapter I and is subject to all applicable provisions of the Act and to the rules, regulations, and orders of the Commission now or hereafter in effect; and is subject to the additional conditions specified or incorporated below:

UNITED STATES
NUCLEAR REGULATORY COMMISSION
WASHINGTON, D. C. 20555

ARIZONA PUBLIC SERVICE COMPANY, ET AL.*

DOCKET NO. STN 50-530

PALO VERDE NUCLEAR GENERATING STATION, UNIT NO. 3

AMENDMENT TO FACILITY OPERATING LICENSE

Amendment No. 1
License No. NPF-74

1. The Nuclear Regulatory Commission (the Commission) has found that:

   A. The present amendment, issued in response to the July 23, 1987 application, as supplemented on November 6 and 9, 1987, by the Arizona Public Service Company with respect to sale and lease-back financing transaction by El Paso Electric Company, complies with the standards and requirements of the Atomic Energy Act of 1954, as amended (the Act) and the Commission's regulations set forth in 10 CFR Chapter I;

   B. In approving the aforementioned application, the Director of the Office of Nuclear Reactor Regulation, by letter of December 2, 1987, stated:

> This approval is subject to the condition that the lessors and anyone else who may acquire an interest under the transactions which are the subject of this application, are prohibited from exercising directly or indirectly any control over the licensees of the Palo Verde nuclear facilities. For purposes of this condition, the limitations in 10 CFR 50.81, "Creditor Regulations," as now in effect and as these may be subsequently amended, are fully applicable to the named lessors and any successors in interest to those lessors as long as the license for Palo Verde Nuclear Generating Station, Unit 3, remains in effect. These financial transactions shall have no effect on the license for the Palo Verde Nuclear Generating Station, Unit 3.

*The other licensees are the Salt River Project Agricultural Improvement and Power District, El Paso Electric Company, Southern California Edison Company, Public Service Company of New Mexico, Los Angeles Department of Water and Power, and Southern California Public Power Authority.

These transactions are similar to that approved by the Commission in its Order of December 12, 1985, with regard to the sale and leaseback of Public Service Company of New Mexico (PNM) interest in Palo Verde, Unit 1. Subject to the foregoing, the Commission hereby approves the application under the conditions set forth in the enclosed amendment to the license for Palo Verde, Unit 3. This amendment authorizes such sale and leaseback transactions until May 30, 1988.

C. The facility will operate in conformity with the application, the provisions of the Act, and the regulations of the Commission;

D. There is reasonable assurance (i) that the activities authorized by this amendment can be conducted without endangering the health and safety of the public, and (ii) that such activities will be conducted in compliance with the Commission's regulations;

E. The issuance of this amendment will not be inimical to the common defense and security or to the health and safety of the public;

F. The issuance of this amendment is in accordance with 10 CFR Part 51 of the Commission's regulations and all applicable requirements have been satisfied.

G. The present amendment authorizes any such sale and leaseback transactions made pursuant thereto until May 30, 1988.

2. Accordingly, Paragraph 2.B(6) is hereby added to read as follows:

(6)(a) El Paso Electric Company is authorized to transfer all or a portion of its 15.8% ownership share in Palo Verde, Unit 3 and its interest in the Palo Verde common facilities to certain equity investors identified in its submissions of November 6 and 9, 1987, and at the same time to lease back from such purchasers such interest sold in the Palo Verde, Unit 3 facility. The term of the lease is for approximately 29½ years subject to a right of renewal. Sale and leaseback transactions of all or a portion of El Paso's ownership share in Palo Verde, Unit 3 are hereby authorized until May 30, 1988. Any such sale and leaseback transaction is subject to the representations and conditions set forth in the aforementioned application of July 23, 1987, and the subsequent submittals dated November 6 and 9, 1987, as well as the letter of the Director of the Office of Nuclear Reactor Regulation dated December 2, 1987, consenting to such transactions. Specifically, the lessor and anyone else who may acquire an interest under this transaction

Delete

are prohibited from exercising directly or indirectly any control over the licensees of the Palo Verde Nuclear Generating Station, Unit 3. For purposes of this condition the limitations in 10 CFR 50.81, "Creditor Regulations," as now in effect and as they may be subsequently amended, are fully applicable to the lessor and any successor in interest to that lessor as long as the license for Palo Verde, Unit 3 remains in effect; this financial transaction shall have no effect on the license for the Palo Verde nuclear facility throughout the term of the license.

Delete

(b) Further, the licensees are also required to notify the NRC in writing prior to any change in: (1) the terms or conditions of any lease agreements executed as part of this transaction; (ii) the ANPP Participation Agreement, (iii) the existing property insurance coverage for the Palo Verde nuclear facility, Unit 3 as specified in licensee counsel's letter of November 26, 1985, and (iv) any action by the lessor or others that may have an adverse effect on the safe operation of the facility.

3. This license amendment is effective as of the date of issuance.

FOR THE NUCLEAR REGULATORY COMMISSION

Gary M. Holahan for

Dennis M. Crutchfield, Director
Division of Reactor Projects - III, IV,
V and Special Projects

Date of Issuance: December 2, 1987

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Form 10-Q

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 1995

OR

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

For the transition period from ____ to ____

Commission file number 0-296

El Paso Electric Company

(Exact name of registrant as specified in its charter)

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

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

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

As of August 1, 1995 there were 35,544,330 shares of the Company's no par value common stock outstanding.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

INDEX TO FORM 10-Q

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

BALANCE SHEETS

ASSETS

(Unaudited)

	June 30, 1995	December 31, 1994
	(In thousands)	
Utility plant:		
Electric plant in service	$ 1,711,528	$ 1,694,553
Less accumulated depreciation and amortization	442,360	419,212
Net plant in service	1,269,168	1,275,341
Construction work in progress	66,667	43,712
Nuclear fuel; includes fuel in process of $5,143,000 and $10,215,000, respectively	82,497	92,720
Less accumulated amortization	40,444	50,273
Net nuclear fuel	42,053	42,447
Net utility plant	1,377,888	1,361,500
Current assets:		
Cash and temporary investments	215,055	208,584
Accounts receivable, principally trade, net of allowance for doubtful accounts of $6,002,000 and $5,923,000, respectively	55,085	54,367
Inventories, at cost	33,305	34,327
Prepayments and other	9,304	11,091
Total current assets	312,749	308,369
Long-term contract receivable	33,605	33,603
Deferred charges and other assets	29,898	27,379
Total assets	$ 1,754,140	$ 1,730,851

(Continued)

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

BALANCE SHEETS (Continued)

CAPITALIZATION AND LIABILITIES

(Unaudited)

	June 30, 1995	December 31, 1994
	(In thousands)	
Capitalization:		
Common stock, no par value, 100,000,000 shares authorized. Issued and outstanding 35,544,330 shares	$ 339,097	$ 339,097
Accumulated deficit	(750,763)	(724,713)
Net unrealized loss on marketable securities, less applicable income tax benefits of $9,000 and $189,000, respectively	(16)	(350)
Common stock deficit	(411,682)	(385,966)
Preferred stock, cumulative, no par value, 2,000,000 shares authorized:		
Redemption required	67,266	67,266
Redemption not required	14,198	14,198
Obligations subject to compromise	1,577,449	1,537,303
Total capitalization	1,247,231	1,232,801
Current liabilities:		
Accounts payable, principally trade	20,060	23,015
Customer deposits	4,356	4,891
Taxes accrued other than federal income taxes	20,930	23,427
Net overcollection of fuel revenues	47,314	37,207
Revenues subject to refund	22,780	11,475
Other	12,306	9,550
Total current liabilities	127,746	109,565
Deferred credits and other liabilities:		
Accumulated deferred income taxes	81,627	98,106
Accumulated deferred investment tax credit	76,188	76,642
Deferred gain on sales and leasebacks	131,994	135,510
Decommissioning	42,825	38,528
Other	46,529	39,699
Total deferred credits and other liabilities	379,163	388,485
Commitments and contingencies		
Total capitalization and liabilities	$ 1,754,140	$ 1,730,851

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1995	1994	1995	1994
	(In thousands except share data)			
Operating revenues	$ 124,683	$ 138,447	$ 237,072	$ 263,923
Operating expenses:				
Operation:				
Fuel	16,193	21,035	32,280	42,235
Purchased and interchanged power	4,604	12,232	7,668	20,834
	20,797	33,267	39,948	63,069
Other	52,279	51,998	103,209	102,478
Maintenance	12,076	12,911	24,904	25,529
Depreciation and amortization	14,349	13,528	28,239	26,885
Taxes:				
Federal income tax benefits	(4,857)	(3,576)	(13,348)	(9,778)
Other	12,188	12,570	24,319	26,588
	106,832	120,698	207,271	234,771
Operating income	17,851	17,749	29,801	29,152
Other income (deductions):				
Other, net	(252)	26	(51)	(406)
Federal income (taxes) benefits applicable to other income	(127)	200	(229)	137
	(379)	226	(280)	(269)
Income before interest charges	17,472	17,975	29,521	28,883
Interest charges (credits):				
Interest	25,572	24,161	52,979	46,903
Other interest capitalized and deferred	(970)	(1,142)	(1,879)	(2,277)
	24,602	23,019	51,100	44,626
Loss before reorganization items	(7,130)	(5,044)	(21,579)	(15,743)
Reorganization items (expense):				
Professional fees and other	(4,753)	(3,887)	(9,242)	(7,344)
Interest earned on accumulated cash resulting from Bankruptcy Case	2,909	1,665	5,953	3,152
Federal income (taxes) benefits applicable to reorganization items	(628)	94	(1,182)	(426)
	(2,472)	(2,128)	(4,471)	(4,618)
Net loss	$ (9,602)	$ (7,172)	$ (26,050)	$ (20,361)
Net loss per weighted average share of common stock	$ (0.27)	$ (0.20)	$ (0.73)	$ (0.57)
Weighted average number of common shares outstanding	35,544,330	35,544,330	35,544,330	35,544,330

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

STATEMENTS OF ACCUMULATED DEFICIT

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1995	1994	1995	1994
	(In thousands)			
Accumulated deficit at beginning of period	$ (741,161)	$ (709,749)	$ (724,713)	$ (696,560)
Net Loss	(9,602)	(7,172)	(26,050)	(20,361)
Accumulated deficit at end of period	$ (750,763)	$ (716,921)	$ (750,763)	$ (716,921)

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30,	
	1995	1994
	(In thousands)	
Cash Flows From Operating Activities:		
Net loss	$ (26,050)	$ (20,361)
Adjustments for non-cash items from operating activities:		
Depreciation and amortization	33,942	31,578
Deferred income taxes and investment tax credit, net	(17,113)	(11,203)
Other operating activities	(3,516)	(3,378)
Change in:		
Accounts receivable	(718)	(6,012)
Inventories	1,022	378
Prepayments and other	1,787	163
Long-term contract receivable	(2)	(580)
Obligations subject to compromise	40,659	25,008
Accounts payable	(2,955)	(10,975)
Net overcollection of fuel revenues	10,107	(5,761)
Revenues subject to refund	11,305	–
Other current liabilities	(276)	87
Deferred charges and credits	9,174	1,639
Net cash provided by operating activities	57,366	583
Cash Flows From Investing Activities:		
Additions to utility plant	(50,430)	(35,794)
Other investing activities	48	33
Net cash used for investing activities	(50,382)	(35,761)
Cash Flows From Financing Activities:		
Redemption of long-term obligations	(513)	(466)
Net cash used for financing activities	(513)	(466)
Net increase (decrease) in cash and temporary investments	6,471	(35,644)
Cash and temporary investments at beginning of period	208,584	181,086
Cash and temporary investments at end of period	$ 215,055	$ 145,442
Supplemental Disclosures of Cash Flow Information:		
Cash paid for:		
Income taxes	$ 600	$ 2,500
Interest	39,224	42,852
Reorganization items:		
Cash interest received on accumulated cash resulting from Bankruptcy Case	6,397	3,051
Cash paid for professional fees and other	7,340	14,177

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

A. Principles of Preparation and Bankruptcy

Pursuant to the rules and regulations of the Securities and Exchange Commission, certain financial information has been condensed and certain footnote disclosures have been omitted. Such information and disclosures are normally included in financial statements prepared in accordance with generally accepted accounting principles.

These condensed financial statements should be read in conjunction with the financial statements and notes thereto in the Annual Report of El Paso Electric Company (the "Company") on Form 10-K for the year ended December 31, 1994 (the "1994 Form 10-K"). In the opinion of management of the Company, the accompanying financial statements contain all adjustments, which were of a normal recurring nature, necessary to present fairly the financial position of the Company at June 30, 1995, and the results of operations for the three and six months ended June 30, 1995 and 1994 and cash flows for the six months ended June 30, 1995 and 1994. The results of operations for the three and six months ended June 30, 1995 are not necessarily indicative of the results to be expected for the full year.

The Company filed for reorganization under Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code") on January 8, 1992 (the "Petition Date") in the United States Bankruptcy Court for the Western District of Texas, Austin Division (the "Bankruptcy Court"), as Case No. 92-10148-FM (the "Bankruptcy Case"), and on December 8, 1993, the Bankruptcy Court, issued an order confirming the Company's Modified Third Amended Plan of Reorganization (the "Merger Plan"). The Merger Plan encompassed an Agreement and Plan of Merger dated May 3, 1993, as amended (the "Merger Agreement"), pursuant to which the Company would have been acquired by Central and South West Corporation ("CSW") through a merger (the "Merger"). On June 9, 1995, CSW terminated the Merger Agreement and revoked the Merger Plan. On that same date, the Company initiated litigation against CSW asserting breach of the Merger Agreement and other causes of action. See Note F of Notes to Financial Statements.

Based on the termination of the Merger Plan, the Company began the development of a plan of reorganization under which it would emerge from bankruptcy as an independent company. The Company (at the urging and upon the recommendation of the Official Committee of Unsecured Creditors), the City of El Paso (the "City"), the Public Utility Commission of Texas General Counsel (the "General Counsel"), the Office of Public Utility Counsel (the "OPC"), and essentially all other parties to the Company's pending Texas rate case ("Docket 12700") (collectively, the "Signatories") entered into an unopposed Stipulation and Settlement Agreement dated as of July 27, 1995 (the "Stipulation") concerning the Company's rates in Texas. See Note B of Notes to Financial Statements. The Company believes that the Stipulation establishes a foundation for the development of a consensual plan of reorganization and expects to file a new plan of reorganization during the fall of 1995. The Company can give no assurance, however, that a consensual plan of reorganization can be confirmed or that all required regulatory approvals or other conditions can

be obtained or satisfied on a timely basis.

The Stipulation will result in an overall bankruptcy estate value which is substantially less than the value contemplated in the Merger Plan. Accordingly, recoveries for unsecured creditors and equity holders will be substantially less than that contemplated in the Merger Plan. The Bankruptcy Court has ordered a mediation between the Company's unsecured creditors and equity holders in an attempt to achieve a consensual resolution as to the value of their respective interests. The Company also believes that a new plan of reorganization will result in current equity holders owning less than 50 percent of the equity in the reorganized Company upon the Company's emergence from bankruptcy. Therefore, under Statement of Position 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code" ("SOP 90-7") issued by the American Institute of Certified Public Accountants in November 1990, the Company would apply "fresh-start reporting" to its financial statements upon emergence. Fresh-start reporting would result in the Company's assets and liabilities being adjusted to their fair values at the date of emergence from bankruptcy and retained earnings/accumulated deficit being reset to zero. Furthermore, the Company believes that the new plan of reorganization will include the Company's reacquisition of that portion of the Palo Verde Nuclear Generating Station ("Palo Verde") which it now leases. See Note B of Notes to Financial Statements in the 1994 Form 10-K.

Upon revocation of the Merger Plan on June 9, 1995, the Company ceased accruing quarterly interim payments to the unsecured creditors and holders of preferred stock that had been authorized by the Merger Plan. The last interim payment to the unsecured creditors and preferred stockholders was made March 30, 1995. The Company currently is evaluating whether it can make the payments for the period March 31, 1995 through June 9, 1995. The Company had been making monthly payments to holders of First Mortgage Bonds and Second Mortgage Bonds and debt secured by first or second mortgages of the Company, and three series of pollution control bonds, pursuant to the Merger Plan and pursuant to orders of the Bankruptcy Court that contained cash balance maintenance provisions related to potential administrative claims. The Company has made no payments to the secured creditors since May 31, 1995 due to these limitations on payment. The Company has accrued amounts that would have been paid to the secured creditors after that date. The Company has filed a motion with the Bankruptcy Court seeking modification of the order related to payment of interest to secured creditors to authorize the Company to make such payments through the effective date of a plan of reorganization, subject only to further order of the Bankruptcy Court.

The discussions and descriptions of Company events and the analysis of their potential impact on financial results herein are premised on the assumption that the Company's operations will be maintained within existing financial agreements. These financial statements must be read with the understanding that a plan of reorganization would alter, compromise or modify existing financial and regulatory structures. See Note A of Notes to Financial Statements in the 1994 Form 10-K. It is not possible at this time to state with certainty the nature or degree to which the existing financial

and regulatory structures will be altered, compromised or modified. Accordingly, estimates and evaluations based on the historical results of Company operations will be subject to material changes as a result of the eventual resolution of the Bankruptcy Case.

The financial statements have been prepared assuming that the Company will continue as a going concern. Continuation of the Company as a going concern is dependent upon, among other things, the Company's ability to restructure its liabilities pursuant to a successful plan of reorganization, the Company's ability to generate sufficient cash from operations, (see Note C of Notes to Financial Statements in the 1994 Form 10-K regarding rates and regulation and Note B of Notes to Financial Statements regarding the Stipulation) and its ability to restructure or obtain refinancing to meet its obligations. Further, as more fully described in Notes B, H, J and K of Notes to Financial Statements in the 1994 Form 10-K, significant claims beyond those reflected as liabilities in the financial statements have been asserted against the Company. The validity of these claims, as well as the amount and manner of payment of all valid claims, will ultimately be determined by the Bankruptcy Court. As a result of the reorganization proceedings, the Company may sell or otherwise realize assets and liquidate or settle liabilities for amounts other than those reflected in the financial statements. Further, the effectiveness of a plan of reorganization could materially change the amounts currently recorded in the financial statements and, if no reorganization plan becomes effective, it is possible that the Company's assets could be liquidated. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

The Company, prior to December 31, 1991, reported its regulated utility operations pursuant to Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation," as amended; however, the Company discontinued the application of SFAS No. 71 as of December 31, 1991 and accounted for such discontinuation in accordance with SFAS No. 101, "Regulated Enterprises–Accounting for the Discontinuation of Application of SFAS No. 71." The Company is evaluating whether it will meet the criteria of SFAS No. 71 necessary to reflect the effects of regulation in its general purpose financial statements if it emerges from bankruptcy through a plan of reorganization based on the Stipulation. Although the Company has not completed its evaluation, preliminary indications are that the Company will not meet the criteria of SFAS No. 71.

The Company has accounted for all transactions related to the reorganization proceedings in accordance with SOP 90-7. Accordingly, all prepetition liabilities of the Company that are expected to be impaired are reported separately in the Company's balance sheet as obligations subject to compromise (see Note D of Notes to Financial Statements for a description of such obligations). Pursuant to SOP 90-7, the Company accrues interest on its secured obligations as well as, to the extent allowed by the Bankruptcy Court, on its unsecured and undersecured obligations. Expenses and interest income resulting directly from the reorganization proceedings are reported separately in the Statements of Operations as reorganization items.

Certain amounts in the financial statements for 1994 have been reclassified to conform with the 1995 presentation.

B. Regulatory Matters

For a full discussion of the Company's rate matters, see Note C of Notes to Financial Statements in the 1994 Form 10-K.

Texas Rate Filing. The Company currently has an application pending with the Public Utility Commission of Texas (the "Texas Commission") requesting approval of a Texas jurisdictional base rate increase (the "Texas Rate Filing"). The application is proceeding under Docket 12700 and on March 3, 1995, the Texas Commission issued an interim order in Docket 12700 (the "Interim Order"). See Part I, Item 1, "Business–Regulation– Texas Rate Matters" in the 1994 Form 10-K.

On August 2, 1995, the Texas Commission entered an order (the "Second Interim Order"), which directed the Company to begin charging interim rates consistent with the Stipulation, under bond and subject to refund, in lieu of the bonded rate increase implemented July 16, 1994. Such interim rates are to be charged for service rendered after August 2, 1995. The Second Interim Order expressly contemplates an additional order consistent with the Stipulation, that will more specifically identify the findings and conclusions to be adopted by the Commission, which will be "included in any disclosure statement that may be filed by the Company in its Bankruptcy Case." The Texas Commission is scheduled to consider Docket 12700 on August 16, 1995, and the Company expects, but can give no assurance, that the Texas Commission will enter the contemplated order by the end of August.

Under the Stipulation, the Company will receive a $24.946 million annual base rate increase (above the rates being charged prior to filing Docket 12700) in lieu of the bonded rate increase implemented July 16, 1994, consistent with the Interim Order. During the first ten years after implementation of interim rates consistent with the Stipulation (the "Freeze Period"), the Company's Texas base rates will be maintained in accordance with the final order in Docket 12700, except for certain industrial and interruptible customers and other limited exceptions to which the rate freeze does not apply. Risks of increased costs or reduced revenues during the Freeze Period will be borne by the Company, including any increased costs of Palo Verde. The City agrees to consider a new franchise for the Company which will extend through August 1, 2005. If the new franchise is not granted within 45 days of the Second Interim Order, the Company can declare the Stipulation null and void. Upon the date the Texas Commission's order is final, the Company will retain all base rate revenues which have been, and will be, collected subject to refund. If the Company consummates a merger during the Freeze Period, the Signatories have the right to pursue a rate reduction, limited to post-merger synergy savings.

The Signatories further agree that the Company's fuel and purchased power costs for the

period July 1, 1993 through June 30, 1995 will be deemed reconciled and that, taken in conjunction with the purchased power capacity charges at issue in the remand of Docket 8588 ("Docket 14120"), discussed below, there will be no net refund or surcharge to ratepayers as a result of such fuel reconciliation. Revenues from wheeling services and profit margins on off-system sales (other than those off-system sales allocated a full share of system costs [*i.e.*, firm power sales to Imperial Irrigation District ("IID"), Texas-New Mexico Power Company and Rio Grande Electric Cooperative, Inc.]) will be divided as follows during the Freeze Period: (i) for the five years beginning July 1, 1995, the Company will retain 75% of the margins and wheeling revenues and 25% will be credited to ratepayers; and (ii) during the remainder of the Freeze Period, the sharing will be 50% to the Company and 50% to the ratepayers. The Signatories agree that reacquisition by the Company of the portions of Palo Verde that it leased is in the "public interest," and that such assets should be included in rate base at their original cost less depreciation according to the Interim Order. The Signatories further agree to settle all disputes over prior Texas regulatory proceedings concerning the Company and to dismiss their pending appeals of the Texas Commission orders concerning the Company.

The Stipulation is conditioned upon the effectiveness of a new plan of reorganization consistent with the Stipulation. The City may terminate the Stipulation if (i) the plan of reorganization is not consistent with the Stipulation, (ii) the City is not satisfied prior to confirmation of the new plan of reorganization that the Company will be financially sound, or (iii) debt of the Company as reorganized exceeds $1.3 billion. Under the Stipulation, a preliminary credit rating by any one of the four major rating agencies that the credit quality of the first mortgage bonds to be issued by the Company under a plan of reorganization will be not less than BB- (as defined by Standard & Poor's) or its equivalent will establish that the Company is financially sound. If the Company's new plan of reorganization does not become effective by April 2, 1996 (which date shall be automatically extended to a date 30 days after the City gives notice that such date shall not be further extended), then the Stipulation will be null and void *ab initio*. The Company believes, but can give no assurance, it will meet the April 2, 1996 date.

Because increases in base rates in the Texas jurisdiction implemented by the Company effective July 16, 1994 are subject to refund and bond, the Company has deferred recognition of such revenues. The increase in such revenues subject to refund was approximately $11.3 million for the six months ended June 30, 1995 and revenues subject to refund aggregate approximately $22.8 million since the implementation of the increase. Likewise, the Company will defer recognition of the revenues collected under the interim rates implemented for service rendered after August 2, 1995 pending a final order in Docket 12700.

Recovery of Fuel Expenses. The Texas Commission issued its final order in the Company's filing to reconcile fuel costs and revenues for the period April 1989 through June 1993 ("Docket 13966") on March 3, 1995. See Note C of Notes to Financial Statements in the 1994 Form 10-K. The effects of this order were recorded as of December 31, 1994. The Company and OPC have each

appealed various aspects of the order in Travis County District Court.

On July 13, 1995, an Administrative Law Judge in Docket 14120 (the remand of Docket 8588) issued a proposal for decision recommending that there is no valid basis for precluding the Company from recovering certain purchased power capacity costs, (incurred between August 1985 and April 1986), as reconcilable fuel costs. The proposal for decision recommends that the Company be allowed to include approximately $4.2 million, plus accrued interest (approximately $4.9 million), in its reconcilable fuel balance and that the Company account for these amounts in future fuel-related proceedings.

Under the Stipulation discussed above, the Signatories agreed to settle all fuel reconciliation issues and fuel factor issues in accordance with the Texas Commission's order in Docket 13966, subject to the treatment of wheeling revenues and margins on off-system sales described above, and to remand the appeals of Docket 13966 to the Texas Commission for entry of an order consistent with the Stipulation. The Stipulation provides for the calculation of margins without regard to incremental fuel costs, and reconcilable fuel and purchased power costs are not reduced by incremental costs. The Stipulation also provides that the Company's fuel and purchased power costs for the period July 1, 1993 through June 30, 1995, will be deemed reconciled, and there will be no net refund or surcharge to ratepayers as a result of such fuel reconciliation.

The Company will continue to reflect the effects of the Docket 13966 order in its financial statements until an order approving the Stipulation becomes effective, which is expected to be the effective date of a new plan of reorganization. The Company has made provisions in its financial statements for refunds to Texas jurisdictional customers, based on the Docket 13966 final order, of approximately $31.0 million, including approximately $3.5 million and $6.7 million for the three months and six months ending June 30, 1995, respectively. The provisions for refund do not reflect the approximate $9.1 million associated with the remand of Docket 8588 discussed above. Under the Stipulation, the Company would not be required to make such refunds.

Docket 9945. On July 12, 1995, the Austin Court of Appeals issued its opinion on rehearing in the appeal of Docket 9945. See Note C of Notes to Financial Statements in the 1994 Form 10-K. Following the Texas Supreme Court's recent decision in *Public Utility Commission of Texas v. GTE – Southwest, Inc.*, 38 Tex. Sup. Ct. J. 485 (April 13, 1995), the Austin Court of Appeals affirmed that the Texas Commission was not required to follow the "actual taxes incurred" method in establishing income tax expense for ratemaking purposes. The Austin Court of Appeals further affirmed in all respects the Texas Commission's inclusion of Palo Verde Units 1 and 2 deferred costs in the Company's rate base. The Signatories to the Stipulation have agreed to request that all appeals of Docket 9945 be dismissed and that all court opinions and judgments be vacated. Several other appeals of PUCT regulatory matters are subject to dismissal by agreement pursuant to the Stipulation, including the appeals of Dockets 8018, 8078, 8363 and 13966.

New Mexico Annual Filing Requirements. On May 1, 1995, the Company filed its annual New Mexico fuel reconciliation report for 1994, which showed a moderate decrease of 3.81% in its current fuel factor, with the New Mexico Public Utility Commission (the "New Mexico Commission"). The New Mexico Commission approved the Company's filing and the new fuel factor was included in bills rendered on or after June 1, 1995. The Company's annual performance standards report reflected a Palo Verde capacity factor of approximately 69.5%. As a result, neither a reward nor a penalty was incurred due to the 1994 Palo Verde operations.

C. Preferred Stock Subject to Compromise

The total amount of accumulated and unpaid preferred stock dividends as of June 30, 1995 is approximately $29.8 million, of which $3.3 million has been recorded in the accompanying financial statements. See also Note G of Notes to Financial Statements in the 1994 Form 10-K and Part II, Item 3, "Defaults Upon Senior Securities."

For a discussion of the cessation of interim payments to holders of preferred stock, see Note A of Notes to Financial Statements.

D. Obligations Subject to Compromise

Under the Bankruptcy Code, certain claims against the Company in existence prior to the Petition Date are stayed, subject to their treatment in a plan of reorganization that becomes effective. Additional claims, which may also be subject to compromise, have arisen and may continue to arise subsequent to the Petition Date as a result of rejection of executory contracts, including the leases related to Palo Verde and other leases, and from the determination by the Bankruptcy Court (or as may be agreed to by parties in interest) of allowed claims for contingencies and other disputed amounts. In accordance with SOP 90-7, these claims are reflected at amounts expected to be allowed by the Bankruptcy Court in the June 30, 1995 and December 31, 1994 balance sheets as "Obligations Subject to Compromise," which amounts could differ substantially from the settled amounts. See also Note H of Notes to Financial Statements in the 1994 Form 10-K.

The expiration date for filing creditors' claims against the Company with the Bankruptcy Court was June 15, 1992. As of June 30, 1995, unresolved claims approximate $5.0 billion, reflected by approximately 350 proofs of claim on file with the Bankruptcy Court. There also are approximately 50 proofs of claim that do not specify an amount. The Company continues the process of reviewing each proof of claim to reconcile the claimed amount with the Company's books and records and believes the outstanding claimed amounts are grossly overstated primarily due to duplicative claims. See Part I, Item 1, "Business–Bankruptcy Proceedings and Proposed Merger with CSW–Actions Related to Bankruptcy Case Prior to the Effective Date" of the 1994 Form 10-K. The Company's estimates of the allowed claims as presented in the financial statements are therefore subject to change based upon the outcome of the Bankruptcy Case.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

Since the Petition Date, the Bankruptcy Court has issued various orders authorizing payment of interest accruing since July 1, 1992 to certain secured creditors. The Company ceased making such payments with the termination of the Merger Plan on June 9, 1995 due to an applicable Bankruptcy Court order limiting such payments based on the maintenance of certain levels of cash balances tied to potential administrative claims, but has accrued approximately $6.0 million for the period of June 1, 1995 through June 30, 1995. The Company has filed a motion with the Bankruptcy Court seeking authorization to resume such payments. See Note A of Notes to Financial Statements.

Contract non-default interest expense on unsecured and undersecured debt was approximately $26.2 million and $21.3 million for the six months ended June 30, 1995 and 1994, respectively, which has not been accrued by the Company. However, interim payments, of approximately $14.5 million for the six months ended June 30, 1995, representing interest for the period from January 1, 1995 to June 9, 1995, and $11.0 million for the six months ended June 30, 1994, were accrued on unsecured and undersecured debt and recorded as interest expense. See Note A of Notes to Financial Statements of the 1994 Form 10-K.

The following is a summary of obligations subject to compromise (in thousands):

	June 30, 1995	December 31, 1994
Debt secured by first and second mortgage bonds (includes accrued interest of $51,469,000 and $46,175,000 for 1995 and 1994)	$ 823,774	$ 818,511
Debt secured by nuclear fuel (includes accrued interest of $1,279,000 and $125,000 for 1995 and 1994)	71,656	70,502
Unsecured debt (includes accrued interest of $6,153,000 and $1,137,000 for 1995 and 1994)	366,266	361,989
Palo Verde leases	287,512	260,497
Accounts payable	6,802	6,792
Other miscellaneous claims	21,439	19,012
	$ 1,577,449	$ 1,537,303

E. Commitments and Contingencies

For a full discussion of commitments and contingencies, including environmental matters related to the Company, see Note J of Notes to Financial Statements in the 1994 Form 10-K. In addition, see Note E of Notes to Financial Statements in the 1994 Form 10-K regarding liability and insurance matters and decommissioning regarding Palo Verde.

Sale/Leaseback Indemnification Obligations

Pursuant to the participation agreements and leases entered into in the sale/leaseback transactions related to portions of Palo Verde (the "Palo Verde Leases"), if the lessors incur additional tax liability or other loss as a result of federal or state tax assessments related to the sale/leaseback transactions, the lessors may have claims against the Company for indemnification. The lessors have filed proofs of claim alleging unliquidated amounts owed pursuant to the participation agreements and leases, which may encompass claims for indemnification. (See Note A of Notes to Financial Statements in the 1994 Form 10-K.)

Arizona Transaction Privilege ("Sales") Tax Indemnification. The Arizona Department of Revenue ("ADR") conducted an audit of the sales taxes paid on lease payments under the Palo Verde Leases during the audit period of August 1, 1988 through July 31, 1990. See Note J of Notes to Financial Statements in the 1994 Form 10-K. The Company, the lessors and the ADR have entered into settlement agreements with respect to each sale/leaseback transaction, subject to Bankruptcy Court approval. Under the settlement agreements, the Company would pay the ADR approximately $3.5 million plus interest accrued to the payment date in full satisfaction of sales tax owed by the lessors on lease payments made prior to January 1, 1992. Interest accrued to June 30, 1995 under the settlement agreements aggregates approximately $1.9 million.

Pursuant to the settlement agreements, payments made by the Company to the lessors after January 1, 1992 are not subject to sales tax unless the Bankruptcy Court characterizes the payments as real estate lease or rental payments in a final order. If any such payments are made and so characterized, 30% of any such payments for the period January 1, 1992 to July 1, 1992 and 34% of payments made after July 1, 1992 will be subject to sales tax. The Company has agreed to assume liability for any sales tax liability arising from such payments. On August 4, 1995, the Company filed a motion in the Bankruptcy Court seeking approval of the settlement agreements. The Company has made adequate provision in its financial statements for the amounts expected to be paid under the settlement agreements.

Federal Tax Indemnification. One of the lessors in the sale/leaseback transactions related to Unit 2 of Palo Verde has notified the Company that the Internal Revenue Service ("IRS") has raised issues, primarily related to investment tax credit claims by the lessor, regarding the income tax treatment of the sale/leaseback transactions. The Company estimates that the total amount of potential claims

for indemnification from all lessors related to the issues raised by the IRS could approximate $10 million, exclusive of any applicable interest, if the IRS prevails. This matter is at a preliminary stage and, although the Company believes the lessor has meritorious defenses to the IRS' position, the Company cannot predict the outcome of the matter or the Company's liability for any resulting claim for indemnification. The Company has made no provision in the accompanying financial statements related to this matter.

Environmental Matters

The Company is subject to expansive federal, state and local regulation related to environmental matters and incurs capital and operating costs to comply with such regulation. The Company analyzes the costs of its obligations arising from environmental matters on an ongoing basis and believes it has made adequate provisions in its financial statements to meet such obligations.

PCB Treatment, Inc. On or about September 26, 1994, the Company received a request from the Environmental Protection Agency ("EPA") to participate in the remediation of polychlorinated biphenyls ("PCBs") at two facilities in Kansas City, Missouri (the "Facilities"), which had been operated by PCB Treatment, Inc. ("PTI"). Company manifests indicate that between 1982 and 1986 the Company had sent 23 shipments of PCBs or PCB-containing electrical equipment ("PCB Equipment") to PTI, accounting for approximately 3%, by weight, of the PCBs and PCB Equipment received by PTI.

PTI has since discontinued operations and EPA has determined that its abandoned Facilities require prompt remediation. In response to EPA's request, the Company met with EPA and other similarly situated companies on October 21, 1994 to discuss PTI's compliance history, EPA's regulatory oversight of PTI, the condition of the Facilities, the identity of companies that had sent PCBs to PTI, and EPA's legal authority to initiate voluntary or mandatory cleanup.

Based upon current information, it is apparent that more than 1,400 entities sent PCBs to PTI. The Company is working with other attendees of the October 21 meeting to: (i) investigate the relationship between PTI, its affiliates and other entities that performed PCB treatment services in association with PTI; (ii) identify all financially-viable entities that sent PCBs to PTI; (iii) calculate by volume the quantities of PCBs contributed by the respective entities; and (iv) identify the most efficient framework for remediating the Facilities. The Company also is evaluating the impact of the bankruptcy filing on its responsibilities with respect to the Facilities. At this early stage, the Company is unable to determine the extent to which it may bear legal liability for the remediation of the Facilities, or the amount of any such liability. The Company has made no provision in the accompanying financial statements related to this matter.

Palo Verde Nuclear Generating Station

Tube cracking has occurred in the Palo Verde steam generators. Arizona Public Service Company ("APS"), the operating agent of Palo Verde, has developed and taken, and will continue to take, remedial actions that APS has stated it believes have slowed the rate of tube degradation. See Note E of Notes to the Financial Statements in the 1994 Form 10-K.

The projected service life of the steam generators is reassessed by APS periodically in conjunction with inspections made during scheduled outages of the Palo Verde units. On August 8, 1995, APS announced that its ongoing analysis indicates that it will be economically desirable for APS to replace the Unit 2 steam generators, which have been the most affected by tube cracking, in five to ten years. APS further stated that it expects that the steam generator replacement would be performed in conjunction with a normal refueling outage to limit incremental outage time.

APS also has stated that, based on the latest available data, it estimates that the Unit 1 and Unit 3 steam generators should operate for their designed life of 40 years (until 2025 and 2027, respectively). APS will continue to assess these steam generators periodically.

Replacement of the steam generators will require the unanimous approval of the Palo Verde participants. The Company has not yet completed its analysis of the economic feasibility of steam generator replacement as compared to other options that may be available in connection with the operation of Unit 2 and cannot predict whether it and all of the other Palo Verde participants will agree to replace the Unit 2 steam generators. The Company expects that, if the steam generators are replaced, most of such costs would be incurred after the year 2000. Assuming the Stipulation becomes effective and remains in effect, the Company would be prohibited from seeking a rate increase in its Texas jurisdiction during the Freeze Period to recover capital costs associated with the replacement. The recovery of replacement power costs would be limited to energy related costs and should be recoverable through the Company's fuel and purchased power cost adjustment provisions, subject to the Company's performance standards.

F. Litigation

See Note B of Notes to Financial Statements for a discussion of regulatory proceedings and Note G of Notes to Financial Statements for a discussion of franchises and significant customers.

Upon the filing of the bankruptcy petition, the provisions of the Bankruptcy Code operate as a stay applicable to all entities of, among other things, the commencement or continuation of judicial, administrative or other actions or proceedings against the Company that were or could have been commenced before the bankruptcy petition. The stay is subject to certain exceptions, including actions by governmental units to enforce police or regulatory powers, and the Bankruptcy Court has the discretion to terminate, annul, modify or condition the stay.

El Paso Electric Company v. Central and South West Corporation. On September 12, 1994, CSW delivered a letter to the Company stating that CSW would not close the Merger unless certain specified matters that allegedly constituted a "Material Adverse Effect" or failure of closing conditions under the Merger Agreement were favorably and timely resolved. The Company responded to the September 12, 1994 letter and denied the allegations and assertions. Thereafter, the Company and CSW exchanged numerous letters regarding interpretations of the Merger Agreement and the actions of the parties. The Company continued its efforts to satisfy all conditions precedent for the Merger, including obtaining all regulatory approvals.

On May 22, 1995, the Company sent CSW a notice requesting a six-month extension of the termination date under the Merger Agreement to allow for receipt of regulatory approvals required by the Merger Agreement based on the Company's good faith belief that the conditions to the Merger Agreement could be satisfied during such extension. On May 23, 1995, CSW delivered a letter to the Company asserting that certain actions by the Company constituted a breach of the Merger Agreement and also repeating certain other allegations of breach of the Merger Agreement previously asserted by CSW in correspondence beginning with the September 12, 1994 letter. The Company responded to CSW's allegations of breach denying that any breach by the Company existed.

On June 9, 1995, CSW delivered a letter to the Company terminating the Merger Agreement and denying the Company's request for a six-month extension of the termination date under the Merger Agreement. CSW asserted as grounds for its action that a number of closing conditions had not been fulfilled by June 8, 1995 (the termination date under the Merger Agreement) and certain alleged material breaches by the Company of certain representations, warranties, covenants and agreements under the Merger Agreement had not been remedied within ten days following receipt of CSW's May 23, 1995 letter. CSW's letter also advised the Company that CSW declared the Merger Agreement to be void and notified the Company of revocation of the Merger Plan.

In a letter to CSW dated June 9, 1995, the Company denied CSW's allegations and accused CSW of breaching the Merger Agreement. On the same day the Company filed its Original Petition against CSW, *El Paso Electric Company v. Central and South West Corporation*, 205th Judicial District Court, El Paso County, Texas Cause No. 95-7153 (the "EPE State Court Action"). The EPE State Court Action alleges, in part, breach of contract, breach of duty of good faith and fair dealing, breach of fiduciary duty, business disparagement, tortious interference with contract and fraud in the inducement. The Company seeks an unspecified amount of damages, punitive damages, reasonable attorneys fees and costs of court.

In response, on June 15, 1995, CSW filed motions and other pleadings to remove the EPE State Court Action to federal court and transfer it to the Bankruptcy Court. On June 15, 1995, CSW also filed a Complaint for Termination Fees and for Declaratory Relief against the Company in the Bankruptcy Court in an Adversary Proceeding styled *Central and South West Corporation v. El Paso*

Electric Company, Adversary No. 95-1108FM. In its complaint, CSW seeks judgment awarding termination fees in the amount of $25 million for the Company's alleged breaches of the Merger Agreement and approximately $3.7 million in fees and expenses that CSW claims it advanced on behalf of the Company in prosecution of the Company's Texas Rate Filing. CSW also seeks judgment declaring that the Company breached the Merger Agreement, CSW properly terminated the Merger Agreement, CSW properly revoked and withdrew the Merger Plan, CSW owes nothing under the termination provisions of the Merger Agreement, all payments required to be made pursuant to the Merger Plan cease to be effective as of June 9, 1995, due to the Company's breach CSW is not bound by or obligated to perform under the terms of the Merger Agreement, and the Company is not entitled to any other relief from CSW. On August 4, 1995, the Company filed two motions in the Bankruptcy Court related to the litigation with CSW. In the first motion, the Company requested that the Bankruptcy Court remand the EPE State Court Action to the state district court for determination. In the second motion, the Company requested that the Bankruptcy Court abstain from consideration of the merit's of CSW's action while the EPE State Court Action is being decided by the Texas state courts. The Company has made no provision in the accompanying financial statements related to the litigation between the Company and CSW.

G. Franchises and Significant Customers

For a full discussion of the Company's franchises and significant customers, see Note M of Notes to Financial Statements in the 1994 Form 10-K.

City of El Paso Franchise. Under the Stipulation (see Note B of the Notes to Financial Statements), the City has agreed to consider a new franchise for the Company in substantially the same form as the current franchise (granted by ordinance dated March 25, 1971 for a 30-year period), except for a provision recognizing the City's option to decline to purchase the Company's property under certain circumstances. The City has agreed to finalize any action on a new franchise for the Company within 45 days of the date the Stipulation was executed. If a new franchise is granted, it will become effective upon the termination of the current franchise and extend through August 1, 2005. The new franchise will be null and void if the Company's new amended plan of reorganization does not become effective consistent with the Stipulation.

City of Las Cruces Franchise. The Company's franchise with the City of Las Cruces, New Mexico (the "City of Las Cruces"), expired March 18, 1994 and has not been replaced or extended. The Company has continued to provide electric service to customers within the City of Las Cruces and expects and intends to continue to do so. Sales to customers in the City of Las Cruces represented approximately 8.0% of the Company's operating revenues during the six months ended June 30, 1995.

On April 7, 1995, the City of Las Cruces filed its Complaint for Declaratory Judgment against the Company in District Court in Dona Ana County, New Mexico, seeking a declaratory judgment that the City of Las Cruces has the right of eminent domain to condemn the electric distribution system and related items owned and operated by the Company and providing electricity within the municipal boundaries of the City of Las Cruces ("Case No. 485"). The Company believes that New Mexico law does not authorize condemnation of the Company's facilities by the City of Las Cruces.

On May 3, 1995, the Company removed Case No. 485 to federal district court and filed a motion for summary judgment and an answer. The Company also filed on May 3, 1995 a motion to consolidate Case No. 485 with the action for breach of implied contract, specific performance, unjust enrichment and trespass ("Case No. 385") filed by the City of Las Cruces against the Company on February 21, 1995 and subsequently transferred to New Mexico federal district court.

The federal magistrate presiding over Case No. 485 and Case No. 385 has issued orders allowing limited discovery by the Company in Case No. 485; requiring the Company to respond to the City of Las Cruces' Motion for Summary Judgment in Case No. 485 by September 1, 1995; and setting the Company's motion to consolidate both cases, the Company's motion to dismiss Case No. 385, the Company's motion for summary judgment in Case No. 485 and the City of Las Cruces' motion for abstention or remand of Case No. 485 for hearing on August 25, 1995.

The Company will continue to contest the City of Las Cruces' efforts to acquire the Company's property and/or to replace the Company as the provider of electric service in the City of Las Cruces. The Company believes that it either (i) will be successful in preventing condemnation and loss of the City of Las Cruces' load, or (ii) if unsuccessful in that effort, will receive just compensation therefor. Neither of these results would constitute a material loss to the Company.

In August 1994, Southwestern Public Service Company ("SPS") and the City of Las Cruces entered into a fifteen-year contract for SPS to provide all of the electric power and energy required by the City of Las Cruces during the term of the contract. The contract becomes effective on the completion of the last of the (i) acquisition of a distribution system by the City of Las Cruces; (ii) acquisition of the necessary transmission delivery and back-up agreements by SPS; and (iii) acquisition of the necessary regulatory approvals by the City of Las Cruces and SPS. If the specified events are not completed by July 1, 1998, either SPS or the City of Las Cruces has the right to cancel the contract. By letter dated July 31, 1995, SPS has requested that the Company provide firm point-to-point transmission service in order for SPS to provide wholesale full-requirements power and energy to the City of Las Cruces commencing upon the acquisition of a distribution system by the City of Las Cruces. The Company responded to SPS on August 10, 1995 acknowledging receipt of the request and stated that the Company was evaluating the request.

Military Installations. The Company currently provides retail electric service in New Mexico to the Air Force at Holloman Air Force Base and the Army at White Sands Missile Range. The Company's sales to such military bases represented approximately 2% of revenues during the six months ended June 30, 1995. On June 9, 1995, the parties to *El Paso Electric Company and Tom Udall, Attorney General, Plaintiffs v. The United States Department of the Air Force, et. al.*, Civil Cause No. 94-6 MV/DJS, currently pending in the United States District Court for the District of New Mexico (the "District Court Action") filed a Joint Motion to Stay Proceedings and to Extend Deadlines (the "Joint Motion") until October 12, 1995, which was granted on the basis of settlement negotiations in progress.

Significant Customers. For the three months ended June 30, 1995 and 1994, IID, a wholesale customer, accounted for approximately $10.7 million and $12.1 million, or 8.6% and 8.7%, respectively, of operating revenues. For the six months ended June 30, 1995 and 1994, IID accounted for approximately $21.3 million and $26.0 million, or 9.0% and 9.8%, respectively, of operating revenues.

Power Sales Agreement. In addition to the sales agreement that the Company has with the Comision Federal de Electricidad de Mexico ("CFE") (see Notes C and M of Notes to Financial Statements of the 1994 Form 10-K), the Company has agreed to sell CFE an incremental block of 50 MW of energy on an "as requested" basis from June 1, 1995 through September 30, 1995, which date may be extended on a month-to-month basis through December 1995.

Independent Auditors' Review Report

The Shareholders and the Board of Directors
El Paso Electric Company:

We have reviewed the accompanying condensed balance sheet of El Paso Electric Company (a debtor-in-possession) as of June 30, 1995, the related condensed statements of operations and accumulated deficit for the three and six months ended June 30, 1995 and 1994, and the related condensed statements of cash flows for the six months ended June 30, 1995 and 1994. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical review procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements referred to above for them to be in conformity with generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the balance sheet of El Paso Electric Company as of December 31, 1994, and the related statements of operations, accumulated deficit, and cash flows for the year then ended (not presented herein); and in our report dated March 30, 1995, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed balance sheet as of December 31, 1994 is fairly presented, in all material respects, in relation to the balance sheet from which it has been derived.

Our report dated March 30, 1995 on the financial statements of El Paso Electric Company as of and for the year ended December 31, 1994 contains an explanatory paragraph that states that the financial statements have been prepared assuming that El Paso Electric Company will continue as a going concern. As discussed in Note A of Notes to the 1994 Financial Statements, El Paso Electric Company filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code on January 8, 1992. The Chapter 11 case is administered by the United States Bankruptcy Court for the Western District of Texas. The Company is operating its business as debtor-in-possession which requires certain of its actions to be approved by the Bankruptcy Court. Continuation of the Company as a going concern is dependent upon, among other things, the consummation of a plan of reorganization, the Company's ability to generate sufficient cash from operations, most significantly its operations which are subject to regulation of the rates it is allowed to charge as described in Note C of Notes to the 1994 Financial Statements, and its ability to restructure or obtain financing to meet its obligations. Further, as more fully described in Notes B, H, J, and K of Notes to the 1994 Financial Statements, significant claims beyond those reflected as liabilities in the financial statements at December 31, 1994 have been or may be asserted against the Company. The validity of these claims, as well as the amount and manner of payment of all valid claims, will ultimately be determined by the Bankruptcy Court. These matters, which are further discussed in the notes to the accompanying financial statements, raise substantial doubt about the Company's ability to continue as a going concern. As a result of the reorganization proceedings, the Company may sell or otherwise realize assets and liquidate or settle liabilities for amounts other than those reflected in the financial statements. Further, the consummation of a plan of reorganization could materially change the amounts currently recorded in the financial statements, and if no reorganization plan is consummated, it is possible that the Company's assets could be liquidated. The 1994 financial statements and the accompanying financial statements do not include any adjustments that might result from the outcome of these uncertainties.

KPMG Peat Marwick LLP

El Paso, Texas
August 11, 1995

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information contained in this Item 2 updates and should be read in conjunction with the information set forth in Part II, Item 7 in the Company's Annual Report on Form 10-K for the year ended December 31, 1994 (the "1994 Form 10-K"). Capitalized terms used in this report and not defined herein have the meaning ascribed for such term in the 1994 Form 10-K.

Liquidity and Capital Resources

Overview

As reported in the 1994 Form 10-K, the Company filed a petition under Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code") on January 8, 1992 in the United States Bankruptcy Court for the Western District of Texas, Austin Division (the "Bankruptcy Court") as Case No. 92-10148-FM (the "Bankruptcy Case") and has continued operations as debtor-in-possession. For a number of years prior to the petition filing, the Company was dependent on external financing through the capital markets for liquidity needs. As a result of the filing of the Bankruptcy Case and related cessation or limitation of payments on certain of the Company's financial arrangements, the Company has generated sufficient funds internally to meet its liquidity needs. Taking into account expected revenues and ordered fuel refunds and projected costs for operations and capital expenditures and considering the payment of interest as discussed below, the Company expects its cash balances to remain stable or increase and does not anticipate any requirement for external financing until the Bankruptcy Case is concluded. The Company expects but cannot assure that upon emergence from bankruptcy its debt rating will be sufficient for it to raise adequate capital on affordable terms.

The Company has paid interest at contractual non-default rates on its First and Second Mortgage Bonds, on its financial instruments secured by the first and second mortgages and on certain issues of its pollution control bonds for the period July 1, 1992 through May 31, 1995, pursuant to its Modified Third Amended Plan of Reorganization (the "Merger Plan") and to orders of the Bankruptcy Court that contained cash balance maintenance provisions related to potential administrative claims. The Company has made no payments to the secured creditors since May 31, 1995 due to the limitations on payment contained in the applicable orders. The Company has accrued amounts that would have been paid to the secured creditors after that date. The Company has filed a motion with the Bankruptcy Court seeking modification of the order related to payment of interest to secured creditors to authorize the Company to make such payments through the effective date of a plan of reorganization, subject only to further order of the Bankruptcy Court. The Company believes, but can give no assurance, that an order authorizing the continued payment of interest to such creditors will be granted in the near future.

The Company also ceased making interim payments to the unsecured and undersecured creditors, holders of lease obligation bonds related to the sale and leaseback transactions of portions of Palo Verde and holders of preferred stock upon the termination of the Merger Agreement and revocation of the Merger Plan on June 9, 1995. The last payment made to such creditors and holders was March 30, 1995. For the three months ended March 31, 1995, the Company paid a total of

approximately $24.1 million to such classes of unsecured creditors and holders. For the period March 31, 1995 through June 9, 1995, interim payments were calculated to be approximately $18.4 million of which $6.3 million was accrued on unsecured debt and $1.1 million was accrued on preferred stock. The Company is evaluating whether it can make such payments under the provisions of the Bankruptcy Code.

Obligations Subject to Compromise

In late December 1991, the Company ceased paying principal, interest and fees on portions of its secured and unsecured debt except as described herein. The Company also failed to make lease payments of approximately $19.3 million on Palo Verde Units 2 and 3 due January 2, 1992, and on January 8, 1992, instituted the Bankruptcy Case. As a result, all of the Company's debt is in default and will remain so until a plan of reorganization becomes effective pursuant to the Bankruptcy Case. Ordinarily, these defaults would entitle the Company's creditors to accelerate the outstanding principal amounts of debt and pursue other remedies available under the applicable agreements. As a result of the automatic stay imposed by the provisions of the Bankruptcy Code, however, such creditors generally are prevented from taking any action to collect such amounts or pursue any remedies against the Company other than through the Bankruptcy Case. The terms and provisions of the Company's financing arrangements, including the maturity dates, are subject to modification pursuant to a plan of reorganization that becomes effective in the Bankruptcy Case.

First Mortgage Bonds. The Company has approximately $299.3 million of First Mortgage Bonds outstanding. The Company has not made either the final maturity principal payment of approximately $10.4 million that was due in 1992, the approximate $7 million in cash sinking fund payments due in each of 1992, 1993 and 1994, or the approximate $12 million in cash sinking fund payments due for the period from January 1, 1995 through June 30, 1995 under the Indenture of the First Mortgage Bonds. The Company does not anticipate making the approximate $10.9 million cash sinking fund payment due December 1995. Additionally, the Company has not made approximately $18.2 million in prepetition and postpetition interest payments accrued through June 30, 1992. Due to certain defined limitations in the Bankruptcy Court's order authorizing payment of interest on First Mortgage Bonds, approximately $5.0 million was accrued but not paid for the period June 1, 1995 through July 31, 1995. As discussed above, the Company has filed a motion with the Bankruptcy Court seeking modification of the order authorizing the June and July payments and, pending applicable Bankruptcy Court orders, the Company expects to resume and continue to make monthly interest payments on its First Mortgage Bonds. Approximately $30 million of interest accrues annually at the contractual rates on the First Mortgage Bonds outstanding.

Second Mortgage Bonds. The Company has $165 million of Second Mortgage Bonds outstanding. The Company has not made the approximate $8.8 million cash sinking fund payment due in 1994 under the Indenture of the Second Mortgage Bonds. The Company does not anticipate making the approximate $8.8 million cash sinking fund payment due December 1995. The Company has not made approximately $11.7 million in prepetition and postpetition interest payments accrued through June 30, 1992. Due to certain defined limitations in the Bankruptcy Court's order authorizing payment of interest on Second Mortgage Bonds, approximately $3.4 million was accrued but not paid for the period June 1, 1995 through July 31, 1995. As discussed above, the Company has filed a motion with the Bankruptcy Court seeking modification of the order authorizing the June and July

payments and, pending applicable Bankruptcy Court orders, the Company expects to resume and continue to make monthly interest payments on its Second Mortgage Bonds. Approximately $20.3 million of interest accrues annually, based on contract rates, on the Second Mortgage Bonds outstanding.

Pollution Control Bonds. The Company has approximately $193.1 million of tax exempt Pollution Control Bonds outstanding consisting of four issues, of which three issues aggregating approximately $159.8 million are secured by Second Mortgage Bonds. Each of the tax exempt issues is credit enhanced by a letter of credit. Prior to the petition date, interest and other payments on the Pollution Control Bonds were made through draws on the letters of credit and the Company reimbursed the letter of credit bank for such draws. Subsequent to the petition filing, interest on all the bonds has continued to be paid by draws on the letters of credit. The Company has paid a portion of the resulting reimbursement obligations to the issuing banks on three Pollution Control Bond issues through interest payments authorized by applicable orders of the Bankruptcy Court. Due to certain defined limitations in the Bankruptcy Court's order authorizing reimbursement of payments of interest on three series of the Pollution Control Bonds, approximately $1.2 million was accrued but not paid for the period June 1, 1995 through July 31, 1995. As discussed above, the Company has filed a motion with the Bankruptcy Court seeking modification of the order authorizing the June and July payments and, pending applicable Bankruptcy Court orders, the Company expects to resume and continue to make monthly payments to reimburse the payments of interest on the three series of Pollution Control Bonds. The Company has not reimbursed the letter of credit banks approximately $8.2 million in prepetition and postpetition interest payments accrued through June 30, 1995 on the three series of Pollution Control Bonds. Additionally, the Company has not reimbursed the letter of credit bank for approximately $6.1 million in prepetition and postpetition interest through July 1, 1995 paid on the fourth pollution control issue through draws on the letter of credit.

Because of the pendency of the Company's Bankruptcy Case as well as other defaults, including the failure of the Company to reimburse the letter of credit issuing banks as described above, the bonds are subject to acceleration at any time. In the event that the bonds are accelerated and redeemed, the tax-advantaged interest rate of the bonds may no longer be available to the Company. The letters of credit for two series of Pollution Control Bonds have been extended to March 15, 1996. The letters of credit that support the two remaining series of Pollution Control Bonds each have expiration dates during 1995. The Company is discussing the extension of such letters of credit with the issuing banks and believes, but cannot assure, that the issuing banks also will agree to extend the letters of credit into 1996. If the letters of credit expire, the Pollution Control Bonds would be redeemed through draws on the applicable letter of credit and the tax-advantaged interest rate of the bonds may no longer be available to the Company.

RCF. The Company currently has a total of $150 million of debt outstanding under its RCF. The RCF, which originally involved a syndicate of money center banks, provided for substantially all of the Company's short-term borrowing prior to the filing of the bankruptcy petition. The RCF became due and payable on January 9, 1992. The RCF is secured by $50 million of First Mortgage Bonds and $100 million of Second Mortgage Bonds. The Company has not paid approximately $7.9 million of interest accrued through June 30, 1992. Due to certain defined limitations in the Bankruptcy Court's order authorizing payment of interest on the RCF, approximately $2.5 million was accrued but not paid for the period June 1, 1995 through July 31, 1995. Interest on the RCF

is calculated at the contract non-default rate, which is the administrating bank's currently quoted prime rate plus 1%. As discussed above, the Company has filed a motion with the Bankruptcy Court seeking modification of the order authorizing the June and July payments and, pending applicable Bankruptcy Court orders, the Company expects to resume and continue to make monthly interest payments on the RCF.

Palo Verde Leases. The Company has not made lease payments aggregating approximately $340 million on Palo Verde Units 2 and 3 for the period from January 2, 1992 through July 2, 1995. Although the Company has not been paying postpetition obligations arising under the Palo Verde Leases, except as described below, the Company has expensed contract rents for financial reporting purposes of approximately $20.8 million each quarter.

Fuel Financing. The Company has a nuclear fuel financing of approximately $60.6 million secured by nuclear fuel and a note payable of approximately $9.8 million. The Company has not made payments of any principal on the nuclear fuel financing and note payable since the filing of the bankruptcy petition. The Company also has not made any interest payments on such amounts through September 10, 1993. As a result of the confirmation of the Merger Plan, which has been revoked, the Company made quarterly payments on the nuclear fuel financing and note payable beginning from September 10, 1993 through March 30, 1995 at a specified interest rate, which was lower than the contract rate and accrued approximately $1.2 million for the period of March 31, 1995 through June 9, 1995. The total amounts of principal and interest payments that came due but were not paid on the nuclear fuel financing and the note payable totaled $59.9 million at June 30, 1995.

Unsecured Debt. The Company's unsecured debt consists primarily of: (i) notes payable to banks of approximately $288.4 million associated with draws on letters of credit related to the Company's sale and leaseback transactions for Palo Verde Units 2 and 3; (ii) the series of Pollution Control Bonds issued in connection with the Four Corners Plant in the amount of $33.3 million (on which the Company did not make approximately $6.1 million in interest payments through July 1, 1995 as discussed above); (iii) a term loan note of $25 million; (iv) a capitalized obligation of approximately $79.2 million associated with a Palo Verde Unit 2 lease; (v) a capitalized obligation of approximately $7.6 million associated with another lease; (vi) an approximate $3.3 million obligation related to a terminated fuel oil financing trust arrangement; and (vii) a $2.5 million obligation related to a guaranty by the Company of a loan to its Leveraged Employee Stock Ownership Plan. The Company has not made any payments on the unsecured debt, except for lease payments on the $7.6 million capitalized obligation and payments aggregating approximately $2.3 million related to the fuel oil financing in connection with the sale of a portion of the fuel oil inventory. As discussed above, subsequent to the confirmation of the Merger Plan, which has been revoked, the Company made quarterly payments on the allowed claims of certain classes of the creditors, including the unsecured creditors and the class consisting of holders of bonds issued in connection with the Palo Verde sale/leaseback transactions through March 30, 1995.

For a discussion of defaults related to the Company's preferred stock, see Part II, Item 3, "Defaults Upon Senior Securities."

Results of Operations

The Company recorded a net loss of $9.6 million ($.27 per share) for the three months ended June 30, 1995, compared to a net loss of $7.2 million ($.20 per share) for the same period in 1994. The net loss for the six months ended June 30, 1995 aggregated $26.1 million ($.73 per share) while the net loss for the same period in 1994 aggregated $20.4 million ($.57 per share). The principal factor giving rise to the reported losses is that revenues continue to be insufficient to recover the Company's operating expenses (including expenses associated with the leased portion of Palo Verde and the bankruptcy reorganization) and cost of debt expenses (including increased interest costs resulting from interim payments and increased interest rates for 1995).

The ten year rate freeze contemplated by the proposed Stipulation in Texas, together with the contracts with wholesale customers (which expire in 2002) will determine approximately 83% of the Company's revenues for the foreseeable future. In addition, the Company is assuming, but cannot assure, that, for the foreseeable future, it will maintain its existing New Mexico customer base at rates not materially different from those currently in force. Accordingly, the Company is developing a business plan to reduce operating expenditures and is working with creditors to develop a plan of reorganization that will reduce the Company's cost of debt.

The primary reasons for increases or decreases in revenues, expenses and other items affecting results of operations for the three and six months ended June 30, 1995 compared to the three and six months ended June 30, 1994 are as follows:

Operating Revenues

Operating revenues for the three and six month period in 1995 were 9.9% and 10.2% less than operating revenues reported for the same periods in 1994. The changes in operating revenues were attributable to the following (in thousands):

	Three Months	Six Months
Base revenues	$ (1,322)	$ (502)
Fuel revenues and economy energy sales	(12,436)	(26,245)
Other	(6)	(104)
	$ (13,764)	$ (26,851)

Base Revenues. Base revenues decreased $1.3 million and $0.5 million for the three and six month periods ended June 30, 1995 compared to the same periods in 1994, primarily due to a reduction in sales for resale due to lower KWH sales to a major wholesale customer and lower KWH sales in 1995 compared to 1994 when the weather was warmer than usual. The decreases were offset in part by changes in the Company's customer sales mix and a 2.5% increase in the number of customers served.

Changes in base revenues and related KWH sales for the three and six months ended June 30, 1995 compared to the same periods ended June 30, 1994 by customer class are as follows:

	Three Months		Six Months	
	Base Revenues	KWH	Base Revenues	KWH
Native system:				
Residential	(2.2)%	(2.1)%	(1.7)%	(1.4)%
Commercial and industrial - small	0.2	2.1	1.6	4.1
Commercial and industrial - large	1.2	2.2	5.2	4.0
Public authorities	(2.9)	(2.0)	(1.9)	(1.0)
Native system composite	(1.1)	0.2	0.2	1.5
Sales for resale	(1.9)	(14.8)	(2.3)	(15.9)
Total system composite	(1.2)	(3.7)	(0.2)	(3.2)

The Company achieved record peak demand in 1995, recording an all-time total system peak demand of 1,373 MW on July 27, 1995 which was a .6% increase over 1994's record peak of 1,365 MW.

Because increases in base rates in the Texas jurisdiction implemented by the Company effective July 16, 1994 are subject to refund and bond, the Company has deferred recognition of such revenues and, therefore, such revenues are not included in the above analysis. The increase in such revenues subject to refund for 1995 was approximately $5.9 million and $11.3 million for the three and six month periods, respectively, and revenues subject to refund aggregate approximately $22.8 million since the implementation of the increase. Likewise, the Company will defer recognition of the revenues collected under the interim rates implemented for service rendered after August 2, 1995 pending a final order. If the Stipulation had been implemented during 1995, such revenues would have been recognized and base revenues would have increased 5.6% and 5.5%, respectively.

Fuel Revenues and Economy Energy Sales. Changes in fuel revenues are a function of changes in fuel and purchased and interchanged power expenses since such costs are generally passed through directly to customers. Fuel revenues decreased approximately $12.3 million and $26.3 million for the three and six month periods ended June 30, 1995 compared to the three and six month periods ended June 30, 1994 primarily due to decreased fuel and purchased and interchanged power costs that are generally passed through directly to customers.

If the Stipulation had been implemented during the three and six month periods ended June 30, 1995, fuel revenues would have increased by approximately $3.5 million and $6.7 million, respectively. If the Stipulation is implemented, the Company will not be required to refund its Texas jurisdictional customers approximately $31.0 million which is accrued as a provision for refund in the financial statements. See Note B of Notes to Financial Statements in Part I, Item 1, "Financial Statements."

Fuel and Purchased and Interchanged Power Expense

The decrease in fuel and purchased and interchanged power expense for the three and six months ended June 30, 1995 compared to the same periods in 1994 was due primarily to changes

in generation supply from higher cost purchased power to Company owned generation and reduced cost of fuel for Company owned generation.

Operation and Maintenance Expense

Operation and maintenance expense decreased for the three month period ended June 30, 1995 primarily as a result of: (i) decreased Palo Verde costs of approximately $1.2 million; and (ii) decreased maintenance costs of approximately $0.7 million at Company owned generating plants. These decreases were offset in part by: (i) increased pension and benefits costs of approximately $0.4 million due to increased medical insurance costs; and (ii) increased outside service costs of approximately $1.5 million primarily related to condemnation and franchise issues for the City of Las Cruces.

Operation and maintenance expense increased for the six month period ended June 30, 1995 primarily as a result of: (i) increased outside service costs of approximately $2.1 million primarily related to condemnation and franchise issues for the City of Las Cruces; (ii) increased maintenance costs of approximately $0.8 million at Company owned generating plants; and (iii) increased pension and benefits costs of approximately $0.8 million primarily related to increased medical insurance. These increases were largely offset primarily by decreased Palo Verde costs of approximately $3.2 million.

Depreciation and Amortization Expense

Depreciation expense increased for the three and six month periods ended June 30, 1995 compared to the same periods in 1994 primarily due to increases in depreciable plant balances and an approximate $0.4 million inflation adjustment to the Department of Energy's Assessment on Palo Verde related to a Decontamination and Decommissioning Fund established by the Energy Policy Act.

Federal Income Tax

For the three and six months ended June 30, 1995 compared to the same periods in 1994, federal income tax benefits included in operating expenses increased by approximately $1.3 and $3.6 million, respectively, primarily due to an increase in 1995 pretax losses and the accrual of accumulated deferred income tax on estimated investment tax credit utilized in 1995.

Other Taxes

Taxes other than federal income taxes decreased by approximately $0.4 million for the three months ended June 30, 1995 from the same period in 1994 primarily due to decreased accruals for Texas franchise tax, state income taxes and Arizona property tax.

Taxes other than federal income taxes decreased approximately $2.3 million for the six months ended June 30, 1995 from the same period in 1994 due to: (i) a $0.7 million decrease in Texas franchise tax primarily due to an increase in pretax losses; (ii) a $0.6 million decrease in state income

taxes due to an increase in pretax losses; (iii) a $0.5 million decrease in Arizona property tax due to a decrease in the taxable base resulting from depreciation of assets; and (iv) a $0.9 million decrease in Arizona sales tax primarily due to an accrual in 1994 for prior years taxes with no comparative accrual in 1995.

Interest Charges

Interest charges increased for the three and six month periods ended June 30, 1995 compared to the same period ended June 30, 1994 primarily due to increased interest rates for interim payments to certain secured and unsecured creditors. The increase in interest rates more than offset the Company's discontinuance of interest accruals on unsecured debt when the Merger Agreement was terminated and the Merger Plan revoked on June 9, 1995.

Effect of Recently Issued Accounting Standards

The Financial Accounting Standards Board issued Statement of Financial Accounting Standards ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 121 requires that long-lived assets and certain identifiable intangibles to be held and used by the Company be reviewed for impairment whenever events indicate that the carrying amount of an asset may not be recoverable. The effective date of SFAS No. 121 is for fiscal years beginning after December 15, 1995. The Company has not performed an analysis to determine what effect, if any, SFAS No. 121 will have on its financial statements.

PART II. OTHER INFORMATION

The information contained in this Part II, "Other Information," updates and should be read in conjunction with the information set forth in Part I of the 1994 Form 10-K and Part II, "Other Information," in the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1995 (the "March 1995 Form 10-Q").

Item 1. Legal Proceedings

Information concerning the Bankruptcy Case and other legal proceedings described above in Part I and below in Item 5 are incorporated herein by reference.

Texas Rate Matters

Texas Rate Filing. As previously reported, the Company has an application pending ("Docket 12700") with the Public Utility Commission of Texas (the "Texas Commission") requesting approval of a Texas jurisdictional base rate increase (the "Texas Rate Filing"). The application is proceeding under Docket 12700, and on March 3, 1995, the Texas Commission issued an Order (the "Interim Order"). See Part I, Item 1, "Business– Regulation–Texas Rate Matters" in the 1994 Form 10-K.

Because increases in base rates in the Texas jurisdiction implemented by the Company effective July 16, 1994 are subject to refund and bond, the Company has deferred recognition of such revenues. The increase in such revenues subject to refund was approximately $11.3 million for the six months ended June 30, 1995 and revenues subject to refund aggregate approximately $22.8 million since the implementation of the increase. Likewise, the Company will defer recognition of the revenues collected under the interim rates implemented for service rendered after August 2, 1995 pending a final order in Docket 12700.

The Company (at the urging and upon the recommendation of the Official Committee of Unsecured Creditors), the City of El Paso (the "City"), the Public Utility Commission of Texas General Counsel (the "General Counsel"), the Office of Public Utility Counsel ("OPC"), and essentially all other parties to Docket 12700, (collectively, the "Signatories") entered into an unopposed Stipulation and Settlement Agreement dated as of July 27, 1995 (the "Stipulation") concerning the Company's rates in Texas. The discussion of the Stipulation contained herein is a summary of the major provisions only and is qualified in its entirety by the terms and provisions of the Stipulation, a copy of which is filed with this report as an exhibit.

On August 2, 1995, the Texas Commission entered an order (the "Second Interim Order"), which directed the Company to begin charging interim rates consistent with the Stipulation, under bond and subject to refund, in lieu of the bonded rate increase implemented July 16, 1994. Such interim rates are to be charged for service rendered after August 2, 1995. The Second Interim Order expressly contemplates an additional order consistent with the Stipulation, that will more specifically identify the findings and conclusions to be adopted by the Commission, which will be "included in any disclosure statement that may be filed by the Company in its Bankruptcy Case." The Texas Commission is scheduled to consider Docket 12700 on August 16, 1995, and the Company expects, but can give no assurance, that the Texas Commission will enter the

contemplated order by the end of August.

Under the Stipulation, the Company will receive a $24.946 million annual base rate increase (above the rates being charged prior to filing Docket 12700) in lieu of the bonded rate increase implemented July 16, 1994, consistent with the Interim Order. During the first ten years after implementation of interim rates consistent with the Stipulation (the "Freeze Period"), the Company's Texas base rates will be maintained in accordance with the final order in Docket 12700, except for certain industrial and interruptible customers and other limited exceptions to which the rate freeze does not apply. Risks of increased costs or reduced revenues during the Freeze Period will be borne by the Company, including any increased costs of Palo Verde. The City agrees to consider a new franchise for the Company which will extend through August 1, 2005. If the new franchise is not granted within 45 days of the Second Interim Order, the Company can declare the Stipulation null and void. Upon the date the Texas Commission's order is final, the Company will retain all base rate revenues which have been, and will be, collected subject to refund. If the Company consummates a merger during the Freeze Period, the Signatories have the right to pursue a rate reduction, limited to post-merger synergy savings.

The Signatories further agree that the Company's fuel and purchased power costs for the period July 1, 1993 through June 30, 1995 will be deemed reconciled and that, taken in conjunction with the purchased power capacity charges at issue in the remand of Docket 8588 ("Docket 14120"), discussed below, there will be no net refund or surcharge to ratepayers as a result of such fuel reconciliation. Revenues from wheeling services and profit margins on off-system sales (other than those off-system sales allocated a full share of system costs [*i.e.*, firm power sales to Imperial Irrigation District, Texas-New Mexico Power Company and Rio Grande Electric Cooperative, Inc.]) will be divided as follows during the Freeze Period: (i) for the five years beginning July 1, 1995, the Company will retain 75% of the margins and wheeling revenues and 25% will be credited to ratepayers; and (ii) during the remainder of the Freeze Period, the sharing will be 50% to the Company and 50% to the ratepayers. The Signatories agree that reacquisition by the Company of the portions of Palo Verde that it leased is in the "public interest," and that such assets should be included in rate base at their original cost less depreciation according to the Interim Order. The Signatories further agree to settle all disputes over prior Texas regulatory proceedings concerning the Company and to dismiss their pending appeals of the Texas Commission orders concerning the Company.

The Stipulation is conditioned upon the effectiveness of a new plan of reorganization consistent with the Stipulation. The City may terminate the Stipulation if (i) the plan of reorganization is not consistent with the Stipulation, (ii) the City is not satisfied prior to confirmation of the new plan of reorganization that the Company will be financially sound, or (iii) debt of the Company as reorganized exceeds $1.3 billion. Under the Stipulation, a preliminary credit rating by any one of the four major rating agencies that the credit quality of the first mortgage bonds to be issued by the Company under a plan of reorganization will be not less than BB- (as defined by Standard & Poor's) or its equivalent will establish that the Company is financially sound. If the Company's new plan of reorganization does not become effective by April 2, 1996 (which date shall be automatically extended to a date 30 days after the City gives notice that such date shall not be further extended), then the Stipulation will be null and void *ab initio*. The Company believes, but can give no assurance, it will meet the April 2, 1996 date.

Recovery of Fuel Expenses. The Texas Commission issued its final order in the Company's filing to reconcile fuel costs and revenues for the period April 1989 through June 1993 ("Docket 13966") on March 3, 1995. See Note C of Notes to Financial Statements in the 1994 Form 10-K. The effects of this order were recorded as of December 31, 1994. The Company and OPC have each appealed various aspects of the order in Travis County District Court.

On July 13, 1995, an Administrative Law Judge in Docket 14120 (the remand of Docket 8588) issued a proposal for decision recommending that there is no valid basis for precluding the Company from recovering certain purchased power capacity costs, (incurred between August 1985 and April 1986), as reconcilable fuel costs. The proposal for decision recommends that the Company be allowed to include approximately $4.2 million, plus accrued interest (approximately $4.9 million), in its reconcilable fuel balance and that the Company account for these amounts in future fuel-related proceedings.

Under the Stipulation discussed above, the Signatories agreed to settle all fuel reconciliation issues and fuel factor issues in accordance with the Texas Commission's order in Docket 13966, subject to the treatment of wheeling revenues and margins on off-system sales described above, and to remand the appeals of Docket 13966 to the Texas Commission for entry of an order consistent with the Stipulation. The Stipulation provides for the calculation of margins without regard to incremental fuel costs; and reconcilable fuel and purchased power costs are not reduced by incremental costs. The Stipulation also provides that the Company's fuel and purchased power costs for the period July 1, 1993 through June 30, 1995, will be deemed reconciled, and there will be no net refund or surcharge to ratepayers as a result of such fuel reconciliation.

The Company will continue to reflect the effects of the Docket 13966 order in its financial statements until an order approving the Stipulation becomes effective, which is expected to be the effective date of a new plan of reorganization. The Company has made provisions in its financial statements for refunds to Texas jurisdictional customers, based on the Docket 13966 final order, of approximately $31.0 million, including approximately $3.5 million and $6.7 million for the three months and six months ending June 30, 1995, respectively. The provisions for refunds do not reflect the approximate $9.1 million associated with the remand of Docket 8588 discussed above. Under the Stipulation, the Company would not be required to make such refunds.

Docket 9945. On July 12, 1995, the Austin Court of Appeals issued its opinion on rehearing in the appeal of Docket 9945. See Part II, Item 1, "Legal Proceedings–Texas Rate Matters–Docket 9945" in the March 1995 Form 10-Q. Following the Texas Supreme Court's recent decision in *Public Utility Commission of Texas v. GTE – Southwest, Inc.*, 38 Tex. Sup. Ct. J. 485 (April 13, 1995), the Austin Court of Appeals affirmed that the Texas Commission was not required to follow the "actual taxes incurred" method in establishing income tax expense for ratemaking purposes. The Austin Court of Appeals further affirmed in all respects the Texas Commission's inclusion of Palo Verde Units 1 and 2 deferred costs in the Company's rate base. The Signatories to the Stipulation have agreed to request that all appeals of Docket 9945 be dismissed and that all court opinions and judgments be vacated. Several other appeals of PUCT regulatory matters are subject to dismissal by agreement pursuant to the Stipulation, including the appeals of Dockets 8018, 8078, 8363 and 13966.

New Mexico Rate Matters

New Mexico Annual Filing Requirements. As previously reported, the Company has annual fuel filing requirements in New Mexico. See Part I, Item 1, "Business–Regulation–New Mexico Rate Matters–Annual Filing Requirements" in the 1994 Form 10-K. On May 1, 1995, the Company filed its annual New Mexico fuel reconciliation report for 1994, which showed a moderate decrease of 3.81% in its current fuel factor, with the New Mexico Public Utility Commission (the "New Mexico Commission"). The New Mexico Commission approved the Company's filing and the new fuel factor was included in bills rendered on or after June 1, 1995. The Company's annual performance standards report reflected a Palo Verde capacity factor of approximately 69.5%. As a result, neither a reward nor a penalty was incurred due to the 1994 Palo Verde operations.

City of Las Cruces Franchise

The Company's franchise with the City of Las Cruces, New Mexico (the "City of Las Cruces"), expired March 18, 1994 and has not been replaced or extended. See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations–Operational Challenges–City of Las Cruces" in the 1994 Form 10-K and Part II, Item 1, "Legal Proceedings–City of Las Cruces," in the March 1995 Form 10-Q. The Company has continued to provide electric service to customers within the City of Las Cruces and expects and intends to continue to do so. Sales to customers in the City of Las Cruces represented approximately 8.0% of the Company's operating revenues during the six months ended June 30, 1995.

On April 7, 1995, the City of Las Cruces filed its Complaint for Declaratory Judgment against the Company in the District Court, Dona Ana County, New Mexico, seeking a declaratory judgment that the City of Las Cruces has the right of eminent domain to condemn the electric distribution system and related items owned and operated by the Company and providing electricity within the municipal boundaries of the City of Las Cruces. The Company believes that New Mexico law does not authorize condemnation of the Company's facilities by the City of Las Cruces. The case is styled *City of Las Cruces, New Mexico v. El Paso Electric Co.*, Civ.-95-485HB ("Case No. 485"), and, as discussed below, is currently pending in the United States District Court for the District of New Mexico.

On May 3, 1995, the Company removed Case No. 485 to federal district court and filed a motion for summary judgment and an answer. The Company also filed on May 3, 1995 a motion to consolidate Case No. 485 with the action for breach of implied contract, specific performance, unjust enrichment and trespass ("Case No. 385") filed by the City of Las Cruces against the Company on February 21, 1995 and subsequently transferred to New Mexico federal district court. That case is pending as *City of Las Cruces v. El Paso Electric Co.*, Civil Action No. 95-385-HB/LCS in the United States District Court for the District of New Mexico ("Case No. 385").

The federal magistrate presiding over Case No. 485 and Case No. 385 has issued orders allowing limited discovery by the Company in Case No. 485; requiring the Company to respond to the City of Las Cruces' Motion for Summary Judgment in Case No. 485 by September 1, 1995; and setting the Company's motion to consolidate both cases, the Company's motion to dismiss Case No. 385, the Company's Motion for Summary Judgment in Case No. 485 and the City of Las Cruces' motion for abstention or remand of Case No. 485 for hearing on August 25, 1995.

The Company will continue to contest the City of Las Cruces' efforts to acquire the Company's property and/or to replace the Company as the provider of electric service in the City of Las Cruces. The Company believes that it either (i) will be successful in preventing condemnation and loss of the City of Las Cruces' load, or (ii) if unsuccessful in that effort, will receive just compensation therefor. Neither of these results would constitute a material loss to the Company.

In August 1994, Southwestern Public Service Company ("SPS") and the City of Las Cruces entered into a fifteen-year contract for SPS to provide all of the electric power and energy required by the City of Las Cruces during the term of the contract. The contract becomes effective on the completion of the last of the (i) acquisition of a distribution system by the City of Las Cruces; (ii) acquisition of the necessary transmission delivery and back-up agreements by SPS; and (iii) acquisition of the necessary regulatory approvals by the City of Las Cruces and SPS. If the specified events are not completed by July 1, 1998, either SPS or the City of Las Cruces has the right to cancel the contract. By letter dated July 31, 1995, SPS has requested that the Company provide firm point-to-point transmission service in order for SPS to provide wholesale full-requirements power and energy to the City of Las Cruces commencing upon the acquisition of a distribution system by the City of Las Cruces. The Company responded to SPS on August 10, 1995 that the request is premature and therefore, that the request cannot be evaluated at this time.

Military Installations

The Company currently provides retail electric service in New Mexico to the Air Force at Holloman Air Force Base and the Army at White Sands Missile Range. See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations–Operational Challenges–Military Installations" in the 1994 Form 10-K. The Company's sales to such military bases represented approximately 2% of revenues during the six months ended June 30, 1995. On June 9, 1995, the parties to *El Paso Electric Company and Tom Udall, Attorney General, Plaintiffs v. The United States Department of the Air Force, et. al.*, Civil Cause No. 94-6 MV/DJS, currently pending in the United States District Court for the District of New Mexico (the "District Court Action") filed a Joint Motion to Stay Proceedings and to Extend Deadlines (the "Joint Motion") until October 12, 1995, which was granted on the basis of settlement negotiations in progress.

Arizona Transaction Privilege ("Sales") Tax Indemnification

As previously reported, the Arizona Department of Revenue ("ADR") has assessed a sales tax on the lease payments made by the Company for the period of August 1, 1988 through July 31, 1990 and could assert additional assessments for lease payments made after that date. See Part I, Item 3, "Legal Proceedings–Sale/Leaseback Indemnification Obligations–Arizona Transaction Privilege ("Sales") Tax Indemnification in the 1994 Form 10-K. The Company, the ADR and each of the Owner Trusts have entered into settlement agreements, subject to Bankruptcy Court approval, to resolve the sales tax owed on all payments made prior to January 1, 1992 and to provide for the treatment of any payments made by the Company for the period after January 1, 1992. Under the settlement agreements, the Company would pay the ADR approximately $3.5 million plus interest accrued to the payment date in full satisfaction of sales tax owed by the lessors on lease payments made prior to January 1, 1992. Interest accrued to June 30, 1995 under the settlement agreements aggregates approximately $1.9 million.

Pursuant to the settlement agreements, payments made by the Company to the lessors after January 1, 1992 are not subject to sales tax unless the Bankruptcy Court characterizes the payments as real estate lease or rental payments in a final order. If any such payments are made and so characterized, 30% of any such payments for the period January 1, 1992 to July 1, 1992 and 34% of payments made after July 1, 1992 will be subject to sales tax. The Company has agreed to assume liability for any sales tax liability arising from such payments. On August 4, 1995, the Company filed a motion in the Bankruptcy Court seeking approval of the settlement agreements. The Company has made adequate provision in its financial statements for the amounts expected to be paid under the settlement agreements.

Item 3. Defaults Upon Senior Securities

As previously reported, the Company's Board of Directors voted to suspend payment of dividends and mandatory sinking fund payments on the Company's outstanding cumulative preferred stock commencing with dividend and sinking fund payments due October 1, 1991. Such suspension has continued through the date of this report. Sinking fund payments in the following amounts have been missed: (i) $750,000 (7,500 shares at $100 per share) due each of October 1, 1991, October 1, 1992, October 1, 1993 and October 1, 1994 on the Company's $8.95 Dividend Preferred Stock; (ii) $600,000 (6,000 shares at $100 per share) due each of October 1, 1991, October 1, 1992, October 1, 1993 and October 1, 1994 on the Company's $8.44 Dividend Preferred Stock; (iii) $400,000 (4,000 shares at $100 per share) due each of January 1, 1992, January 1, 1993, January 1, 1994 and January 1, 1995 on the Company's $10.75 Dividend Preferred Stock; (iv) $10 million (100,000 shares at $100 per share) due each of July 1, 1992, July 1, 1993 and July 1, 1994 on the Company's $11.375 Dividend Preferred Stock and (v) $5 million (50,000 shares at $100 per share) due each of July 1, 1992 and July 1, 1993 on the Company's $10.125 Dividend Preferred Stock. At June 30, 1995, the total arrearage of dividends on the preferred stock is approximately $29.8 million and the total arrearage of mandatory sinking fund payments is approximately $47.0 million.

See Part II, Item 5, "Market for Registrant's Common Equity and Related Stockholder Matters," and Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations–Liquidity and Capital Resources–Preferred Stock Dividends and Sinking Fund Payments," in the 1994 Form 10-K.

For a discussion on defaults in the payment of principal and interest with respect to indebtedness of the Company and a discussion of payments made to preferred shareholders pursuant to the Merger Plan, see Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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

The annual meeting of shareholders of the Company was held May 15, 1995. The following directors were elected to hold office for a three-year term expiring at the annual meeting of the shareholders of the Company held in 1998:

Director	Votes For	Votes Against
Thomas C. Simpson	30,054,116	987,820
James A. Cardwell	30,044,066	997,870
Wilson K. Cadman	30,026,243	1,015,693

In addition to the individuals set forth above, the following individuals continued as directors following the meeting: David H. Wiggs, Jr., Curtis L. Hoskins, Sidney G. Baucom, George W. Edwards, Jr., and Wilfred E. Binns. Josefina Salas-Porras retired after the annual meeting.

No other matters were voted upon at the annual meeting of shareholders.

Item 5. Other Information

Status of the Bankruptcy, Plan of Reorganization and Merger

As previously reported, the Company filed for reorganization under Chapter 11 of the Bankruptcy Code on January 8, 1992 and, on December 8, 1993, the Bankruptcy Court issued an order confirming the Merger Plan. The Merger Plan encompassed an Agreement and Plan of Merger dated May 31, 1993, as amended (the "Merger Agreement"), pursuant to which the Company would have been acquired by CSW through a merger (the "Merger"). See Part I, Item 1, "Business–Bankruptcy Proceedings and Proposed Merger" in the 1994 Form 10-K. As discussed below, the Merger Agreement was terminated and the Merger Plan was revoked on June 9, 1995 when CSW refused the Company's request to extend the termination date of June 8, 1995. The Company and CSW are currently engaged in litigation, as discussed below.

The termination and revocation of the Merger Plan followed a period beginning on September 12, 1994, when CSW delivered a letter to the Company stating that CSW would not close the Merger unless certain specified matters that allegedly constituted a "Material Adverse Effect" or failure of closing conditions under the Merger Agreement were favorably and timely resolved. The Company responded to the September 12, 1994 letter and denied the allegations and assertions. Thereafter, the Company and CSW exchanged numerous letters regarding interpretations of the Merger Agreement and the actions of the parties. The Company continued its efforts to satisfy all conditions precedent for the Merger, including obtaining all regulatory approvals.

On May 22, 1995, the Company sent CSW a notice requesting a six-month extension of the termination date under the Merger Agreement to allow for receipt of regulatory approvals required by the Merger Agreement based on the Company's good faith belief that the conditions to the Merger Agreement could be satisfied during such extension. On May 23, 1995, CSW delivered a letter to the Company asserting that certain actions by the Company constituted a breach of the Merger Agreement and also repeating certain other allegations of breach of the Merger Agreement

previously asserted by CSW in correspondence beginning with the September 12, 1994 letter. The Company responded to CSW's allegations of breach denying that any breach by the Company existed.

On June 9, 1995, CSW delivered a letter to the Company terminating the Merger Agreement and denying the Company's request for a six-month extension of the termination date under the Merger Agreement. In the letter, CSW asserted as grounds for its actions that a number of closing conditions had not been fulfilled by the termination date of June 8, 1995, and that certain alleged material breaches by the Company of certain representations, warranties, covenants and agreements under the Merger Agreement had not been remedied within ten days following receipt of CSW's May 23, 1995 letter requesting remedy thereof. CSW's letter also advised the Company that CSW declared the Merger Agreement to be void and notified the Company of revocation of the Merger Plan.

In a letter to CSW dated June 9, 1995, the Company denied CSW's allegations and accused CSW of breaching the Merger Agreement. On the same day the Company filed its Original Petition against CSW, *El Paso Electric Company v. Central and South West Corporation*, 205th Judicial District Court, El Paso County, Texas Cause No. 95-7153 (the "EPE State Court Action"). The EPE State Court Action alleges, in part, breach of contract, breach of duty of good faith and fair dealing, breach of fiduciary duty, business disparagement, tortious interference with contract and fraud in the inducement. The Company seeks an unspecified amount of damages, punitive damages, reasonable attorneys fees and costs of court.

In response to the lawsuit, on June 15, 1995, CSW filed motions and other pleadings to remove the EPE State Court Action to federal court and transfer it to the Bankruptcy Court. On June 15, 1995, CSW filed in the Bankruptcy Court a Complaint for Termination Fees and for Declaratory Relief, as an Adversary Proceeding styled *Central and South West Corporation v. El Paso Electric Company*, Adversary No. 95-1108FM. Pursuant to their Complaint, CSW seeks judgment awarding it termination fees in the amount of $25 million and approximately $3.7 million in fees and expenses that CSW claims it advanced on behalf of the Company in prosecution of the Company's Texas Rate Filing. CSW also seeks certain other declaratory judgments, including declarations that the Company breached the Merger Agreement, CSW properly terminated the Merger Agreement, CSW properly revoked and withdrew the Merger Plan, CSW owes nothing under the termination provisions of the Merger Agreement, all payments required to be made pursuant to the Merger Plan cease to be effective as of June 9, 1995, due to the Company's breach CSW is not bound by or obligated to perform under the terms of the Merger Agreement, and the Company is not entitled to any other relief from CSW. On August 4, 1995, the Company filed two motions in the Bankruptcy Court related to the litigation with CSW. In the first motion, the Company requested that the Bankruptcy Court remand the EPE State Court Action to the state district court for determination. In the second motion, the Company requested that the Bankruptcy Court abstain from consideration of the merits of CSW's action while the EPE State Court Action is being decided by the Texas state courts. No provision has been made in the accompanying financial statements for the outcome of any of the above litigation.

As a result of CSW's notice of termination of the Merger Agreement and revocation of the Merger Plan, the Company also began the development of a plan of reorganization under which it would emerge from bankruptcy as an independent company. As discussed above, the Company has

entered into the Stipulation with the other Signatories. See Item 1, "Legal Proceedings–Texas Rate Matters–Texas Rate Filing," for a discussion of the Stipulation. The Company believes that the Stipulation establishes a foundation for the development of a consensual plan of reorganization. The Company believes that it will file a new plan of reorganization during the fall of 1995. The Company can give no assurance, however, that a consensual plan of reorganization can be developed or that all required regulatory approvals or other conditions can be obtained or satisfied on a timely basis. The Stipulation will result in an overall bankruptcy estate value which is substantially less than the value contemplated in the Merger Plan. Accordingly, recoveries for unsecured creditors and equity holders will be substantially less than that contemplated in the Merger Plan. The Bankruptcy Court has ordered a mediation between the Company's unsecured creditors and equity holders in an attempt to achieve a consensual resolution as to the value of their respective interests. The Company also believes that a new plan of reorganization will result in current equity holders owning less than 50 percent of the equity in the reorganized company upon the Company's emergence from bankruptcy. Furthermore, the Company believes that the new plan of reorganization will include the Company's reacquisition of that portion of the Palo Verde Nuclear Generating Station which it now leases.

Palo Verde Nuclear Generating Station

As previously reported, tube cracking has occurred in the Palo Verde steam generators. Arizona Public Service Company ("APS"), the operating agent of Palo Verde, has developed and taken, and will continue to take, remedial actions that APS has stated it believes have slowed the rate of tube degradation. See Part I, Item 1, "Business–Facilities–Palo Verde Station" in the 1994 Form 10-K.

The projected service life of the steam generators is reassessed by APS periodically in conjunction with inspections made during scheduled outages of the Palo Verde units. On August 8, 1995, APS announced that its ongoing analysis indicates that it will be economically desirable for APS to replace the Unit 2 steam generators, which have been the most affected by tube cracking, in five to ten years. APS further stated that it expects that the steam generator replacement would be performed in conjunction with a normal refueling outage to limit incremental outage time.

APS also has stated that, based on the latest available data, it estimates that the Unit 1 and Unit 3 steam generators should operate for their designed life of 40 years (until 2025 and 2027, respectively). APS will continue to assess these steam generators periodically.

Replacement of the steam generators will require the unanimous approval of the Palo Verde participants. The Company has not yet completed its analysis of the economic feasibility of steam generator replacement as compared to other options that may be available in connection with the operation of Unit 2 and cannot predict whether it and all of the other Palo Verde participants will agree to replace the Unit 2 steam generators. The Company expects that, if the steam generators are replaced, most of such costs would be incurred after the year 2000. Assuming the Stipulation becomes effective and remains in effect, the Company would be prohibited from seeking a rate increase in its Texas jurisdiction during the Freeze Period to recover capital costs associated with the replacement. The recovery of replacement power costs would be limited to energy related costs and should be recoverable through the Company's fuel and purchased power cost adjustment provisions, subject to the Company's performance standards.

Unit 2 was removed from service for a regularly scheduled refueling outage February 4, 1995 and was returned to service March 30, 1995. Unit 1 was removed from service for a refueling outage April 1, 1995 and was returned to service May 27, 1995. Unit 3 is scheduled to be refueled beginning in October 1995.

Power Sales Agreement

In addition to the sales agreement that the Company has with the Comision Federal de Electricidad de Mexico ("CFE") (See Part I, Item 1, "Business–Regulation–Other Wholesale Customer" in the 1994 Form 10-K), the Company has agreed to sell CFE an incremental block of 50 MW of energy during the summer of 1995 on an "as requested" basis. The term of the sale is from June 1, 1995 through September 30, 1995, and may be extended on a month-to-month basis through December 1995.

Common Stock

On June 22, 1995, the Company's common stock ceased to be traded on the Nasdaq Stock Market System following the decision of the Nasdaq Listing Qualifications Committee to delist the stock based on the Company's failure to meet the net tangible asset requirements for continued listing. See Part II, Item 5, "Market for Registrant's Common Equity and Related Stockholder Matters," in the 1994 Form 10-K. The Company is appealing the decision of the Nasdaq Listing Qualifications Committee to the Nasdaq Hearings Review Committee. Effective June 30, 1995, the Company's common stock began trading through the Nasdaq OTC Bulletin Board under the symbol "ELPAQ."

FERC Rulemaking Proceedings

On March 29, 1995, the FERC issued a Notice of Proposed Rulemaking (the "NOPR"), which proposed to require utilities to file open access transmission tariffs and further refined its proposals regarding stranded investment. In the NOPR the FERC seeks comments on these proposals, which it believes will encourage a more fully competitive wholesale electric power market. Upon receipt of the comments, the FERC may issue final rules as proposed, issue revised rules based on the comments received or issue no rules. In any event, rules do not become binding until they are issued in final form; the NOPR, as such, establishes no legal requirements.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits: See Index to Exhibits incorporated herein by reference.

(b) Reports on Form 8-K:

Date of Reports	Item Numbers	Financial Statements Required to be Filed
May 3, 1995	5 and 7	None
June 9, 1995	5 and 7	None
June 21, 1995	5	None
July 17, 1995	5	None

SIGNATURES

Pursuant to the requirements 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.

EL PASO ELECTRIC COMPANY

By: /s/ Michael L. Blough
Michael L. Blough
Vice President and Controller
(Duly Authorized Officer and
Chief Accounting Officer)

Dated: August 11, 1995

EL PASO ELECTRIC COMPANY

INDEX TO EXHIBITS

Exhibit Number	Exhibit	Sequentially Numbered Page
4.1	First Amendment dated as of June 8, 1995 between the Company and Citibank, N.A. to the Letter of Credit and Reimbursement Agreement dated as of July 1, 1994, related to $63,500,000 principal amount of Maricopa County, Arizona Pollution Control Corporation Adjustable Tender Pollution Control Revenue Bonds, 1994 Series A (El Paso Electric Company Palo Verde Project).	
10.1	Stipulation and Settlement Agreement between the Company and parties to Docket 12700 in the Public Utility Commission of Texas.	
15	Letter Regarding Unaudited Interim Financial Information	

Form 10-K

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (FEE REQUIRED)
For the fiscal year ended December 31, 1994

OR

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

For the transition period from _____ to _____

Commission file number 0-296

El Paso Electric Company

(Exact name of registrant as specified in its charter)

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

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

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

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

COMMON STOCK, NO PAR VALUE
(Title of Class)

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

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. [ ]

As of March 1, 1995, the aggregate market value of the voting stock held by non-affiliates of the registrant was $53,241,666.

As of March 1, 1995, there were outstanding 35,544,330 shares of common stock, no par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 1995 annual meeting of its shareholders are incorporated by reference into Part III of this report.

DEFINITIONS

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

Abbreviations, Acronyms or Defined Terms	Terms
ADR	Arizona Department of Revenue
AFUDC	Allowance for Funds Used During Construction
AIP	Arizona Interconnection Project
ANPP Participation Agreement	Arizona Nuclear Power Project Participation Agreement dated August 23, 1973, as amended
APB	Accounting Principles Board
APS	Arizona Public Service Company
Bankruptcy Case	The case commenced January 8, 1992 by El Paso Electric Company in the Bankruptcy Court as Case No. 92-10148-FM
Bankruptcy Court	United States Bankruptcy Court for the Western District of Texas, Austin Division
Bankruptcy Code	United States Bankruptcy Code, 11 U. S. C. §101 et seq.
CCN	Certificate of Convenience and Necessity
CFE	Comision Federal de Electricidad de Mexico
Common Plant or Common Facilities	Facilities at or related to the Palo Verde Station that are common to all three Palo Verde Units
Company	El Paso Electric Company
Confirmation Date	December 8, 1993; the date the Plan was confirmed by the Bankruptcy Court
CSW	Central and South West Corporation
CSW Sub	A wholly-owned special purpose subsidiary of CSW to be formed in connection with the transactions contemplated by the Merger Agreement
CWIP	Construction Work in Progress
Disclosure Statement	Disclosure Statement related to Modified Third Amended Plan of Reorganization
DOE	United States Department of Energy
DOJ	United States Department of Justice
EPA	United States Environmental Protection Agency
Effective Date	The date the Plan becomes effective
EPE	El Paso Electric Company
FERC	Federal Energy Regulatory Commission
FPA	Federal Power Act
Four Corners	Four Corners Project or Four Corners Plant
FTC	Federal Trade Commission
HSR Act	Hart-Scott Rodino Antitrust Improvements Act of 1976
IID	Imperial Irrigation District, an irrigation district in Southern California
IRS	Internal Revenue Service
KV	Kilovolt(s)
KW	Kilowatt(s)
KWH	Kilowatt-hour(s)
LIBOR	The rate of interest, per annum, equal to the London Interbank Offered Rate (90-day LIBOR for 1995 is assumed to be 6.5%)
Merger	Proposed merger between the Company and CSW Sub pursuant to the Merger Agreement and pursuant to which the Company would become a wholly-owned subsidiary of CSW at the Effective Date
Merger Agreement	Agreement and Plan of Merger dated as of May 3, 1993 among the Company, CSW and CSW Sub, as amended

Abbreviations, Acronyms or Defined Terms	Terms
MW	Megawatt(s)
MWH	Megawatt-hour(s)
NASD	National Association of Securities Dealers, Inc.
Navajo Nation	Navajo Nation of Indians
New Mexico Commission or NMPUC	New Mexico Public Utility Commission
NMED	New Mexico Environment Department
NOL	Net Operating Loss
NRC	Nuclear Regulatory Commission
OPC	Texas Office of Public Utility Counsel
Owner Participants	The entities that participate as equity investors in the trusts that, through the Owner Trustee, purchased and leased back portions of the Company's interests in Palo Verde Units 2 and 3
Owner Trustee	The First National Bank of Boston, which acted as purchaser and lessor under the sale and leaseback transactions involving Palo Verde Units 2 and 3, in its capacity as trustee for the trusts established for the benefit of the Equity Participants
Owner Trusts	The trusts that, through the Owner Trustee, purchased and leased back portions of the Company's interest in Palo Verde Units 2 and 3
Palo Verde Participants	Those utilities who share in power and energy entitlements, and bear certain allocated costs, with respect to PVNGS pursuant to the ANPP Participation Agreement
Palo Verde Station or Palo Verde Project or Palo Verde or PVNGS	Palo Verde Nuclear Generating Station
Plan	Modified Third Amended Plan of Reorganization
PNM	Public Service Company of New Mexico
PUHCA	Public Utility Holding Company Act of 1935
RCF	Revolving Credit Facility pursuant to the Credit Agreement dated as of October 26, 1989, as amended, among El Paso Electric Company, each of the Banks signatory thereto, and Chemical Bank, as Agent Bank
Reorganized EPE	El Paso Electric Company after completion of its reorganization in bankruptcy
RFP	Request for Proposal
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
SPS	Southwestern Public Service Company
TEP	Tucson Electric Power Company
Texas Commission	Public Utility Commission of Texas
Texas District Court	State District Court of Travis County, Texas
TNP	Texas-New Mexico Power Company
TNRCC	Texas Natural Resources Conservation Commission, successor to the Texas Air Control Board and the Texas Water Commission

TABLE OF CONTENTS

PART I

Item 1. Business

Introduction

The Company was incorporated in Texas in 1901. It generates and distributes electricity through an interconnected system to approximately 268,000 customers in El Paso, Texas, and an area of the Rio Grande Valley in West Texas and Southern New Mexico, and to wholesale customers located in such diverse locations as Southern California and Mexico. On January 8, 1992, the Company filed a voluntary petition for reorganization under Chapter 11 of the Bankruptcy Code and has operated as a debtor in possession since then. The Company's principal offices are located at 303 North Oregon Street, El Paso, Texas 79901 (telephone 915/543-5711).

The Company's service area extends approximately 110 miles northwest from El Paso to the Caballo Dam in New Mexico and approximately 120 miles southeast from El Paso to Van Horn, Texas. The service area has an estimated population of 818,000, including approximately 658,000 people in the metropolitan area of El Paso. Copper smelting and refining, oil refining, garment manufacturing, cattle production and agriculture are significant industries in El Paso, which is also an important transportation and distribution center.

Historically, the Company's major franchises have been with the cities of El Paso, Texas, and Las Cruces, New Mexico. The franchise with the City of El Paso expires in March 2001 and does not contain renewal provisions. The Company's 25-year franchise with the City of Las Cruces expired in March 1993 and the Company and the City of Las Cruces entered into a one-year franchise agreement which expired on March 18, 1994. The Company is challenging attempts by the City of Las Cruces to acquire the Company's system serving the City of Las Cruces. Alternatives to litigation continue to be explored, but with no material progress. See "Bankruptcy Proceedings and Proposed Merger with CSW – CSW Positions with Respect to the Merger" and Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation – Operational Challenges – City of Las Cruces."

The Company also currently provides retail electric service in its New Mexico service territory to the United States Department of the Air Force (the "Air Force") at Holloman Air Force Base and to the United States Department of the Army (the "Army") at White Sands Missile Range. Both the Air Force and the Army have issued solicitations for proposals to provide the service currently being provided by the Company. The Army's contract at White Sands had been scheduled to expire in 1993, but was indefinitely extended by the Army. However, the Company's contract with the Air Force expired on February 28, 1994. The Company continues to provide service to both military bases pursuant to its right and obligation to provide the service under New Mexico law. See "Bankruptcy Proceedings and Proposed Merger with CSW – CSW Positions with Respect to the Merger" and Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Operational Challenges – Military Installations."

The Company had approximately 1,100 employees as of December 31, 1994, approximately 29% of which are covered by a collective bargaining agreement that effectively has been extended beyond its stated termination date of February 28, 1995. The agreement remains in effect until negotiations on a new agreement are concluded or until the agreement is canceled upon sixty (60) days written notice. The Company believes that negotiations will result in a new agreement and that the current agreement will remain in effect until that time.

Bankruptcy Proceedings and Proposed Merger with CSW

General

On January 8, 1992, the Company filed a voluntary petition for reorganization under Chapter 1 of the Bankruptcy Code in the Bankruptcy Court. The filing followed an attempt by the Company during 1991 to negotiate a restructuring of its obligations with creditors, culminating with the draws in late 1991 on letters of credit related to the Company's sales and leasebacks of portions of its interest in Palo Verde. The Company's management has continued to manage the operations and affairs of the Company, subject to the authority of the Company's Board of Directors, as debtor in possession. Certain actions of the Company during the pendency of the bankruptcy proceedings, including, without limitation, transactions outside of the ordinary course of business, are subject to the approval of the Bankruptcy Court. In addition, the Merger Agreement between the Company and CSW prohibits or limits certain actions by the Company without consent of or notice to, as the case may be, CSW.

On May 3, 1993, the Company and CSW executed the Merger Agreement, which provides for the Company to become a wholly-owned subsidiary of CSW at the Effective Date as specified in the Merger Agreement. On May 5, 1993, as contemplated by the Merger Agreement, the Company filed its Third Amended Plan of Reorganization and Third Amended Disclosure Statement in the Bankruptcy Court, seeking approval of the Plan, which is predicated upon the Merger with CSW. After modifications to the Plan and Disclosure Statement, amendments to the Merger Agreement and solicitation of the affected classes, the Plan was confirmed by the Bankruptcy Court on December 8, 1993. Thereafter, with CSW designating lead counsel pursuant to the Merger Agreement, the Company and CSW commenced the process of obtaining the various regulatory approvals required for consummation of the Plan and the Merger. As set forth below, CSW has, since September 12, 1994, engaged in conduct and expressed views that cast doubt upon its intention to close the Merger unless certain matters, including the City of Las Cruces situation and the situation at Palo Verde are "timely and favorably resolved." The Company vigorously disputes that CSW's positions are supported by the Merger Agreement and continues to exert its best efforts to consummate the Merger. See "CSW Positions with Respect to the Merger," below.

Effect of Bankruptcy on Disclosures Contained Herein

The discussions and descriptions of Company events and the analysis of their potential impact on financial results herein are premised on the assumption that the Company's operations will be maintained within existing financial agreements, as modified by the Plan, and regulatory structures prior to the Effective Date. This report must be read with the understanding that the Plan, which has been confirmed by the Bankruptcy Court, but has not become effective, will alter, compromise or modify the existing financial and regulatory structures if it becomes effective. Conditions to the Plan becoming effective exist, as discussed herein. The Company can give no assurance that such conditions will be satisfied. In addition, CSW has stated that the Merger is in jeopardy. Accordingly, the Plan may not become effective. See "CSW Positions with Respect to the Merger," below. If the Plan does not become effective, another plan of reorganization also would alter, compromise or modify existing financial and regulatory structures. See "Alternatives to the Company if the Plan and Merger Fail," below. It is therefore not possible at this time to state with certainty the nature or degree to which the existing financial and regulatory structures will be altered, compromised or modified. Accordingly, estimates and evaluations based on the historical results of Company operations could be subject to material changes as a result of the eventual resolution of the Bankruptcy Case.

Description of the Plan and Merger

The Plan contemplates a merger between the Company and CSW Sub, a new subsidiary of CSW, under which the Company would become a wholly-owned subsidiary of CSW at the Effective Date.

The Plan provides for the Company's creditors and equity security holders to receive in respect of their claims, cash, securities of Reorganized EPE and/or securities of CSW. Certain creditors would have their claims allowed and reinstated pursuant to the Bankruptcy Code. The Company would continue to operate as a public utility as a direct, wholly-owned subsidiary of CSW, a registered public utility holding company under PUHCA. A detailed description of the consideration to be received by all claim holders, including holders of the Company's various classes of debt and equity securities, is set forth in "Treatment of Claims Under the Plan," below.

CSW, a Delaware corporation, owns all of the outstanding common stock of Central Power and Light Company ("CPL"), Public Service Company of Oklahoma ("PSO"), Southwestern Electric Power Company ("SWEPCO"), and West Texas Utilities Company ("WTU") (collectively, the "CSW Electric Operating Companies"), and has certain other subsidiaries and affiliates. The CSW Electric Operating Companies are public utility companies engaged in generating, purchasing, transmitting, distributing and selling electricity. CPL and WTU operate in portions of south and central west Texas, respectively; PSO operates in portions of eastern and southwestern Oklahoma; and SWEPCO operates in portions of northeastern Texas, northwestern Louisiana and western Arkansas.

Conditions to Effectiveness of the Plan and Merger

The Plan and the Merger Agreement specify certain conditions that must be satisfied at or prior to the Effective Date for the Merger to be consummated and the Plan to become effective. As discussed below in "Termination of the Merger Agreement," time periods exist for satisfaction of such conditions. Other than certain regulatory or statutory approvals and receipt of investment grade ratings on certain securities to be issued under the Plan, CSW and the Company may waive all or any portion of any of the conditions to effectiveness of the Plan and the Merger. The principal conditions are the receipt by the Company and CSW of certain regulatory approvals and orders, as set forth in detail in the Merger Agreement. Such regulatory approvals and orders include those of the FERC, the SEC, the Texas Commission, the New Mexico Commission and the NRC, as well as determinations under the HSR Act, and the expiration or termination of waiting periods specified thereunder. In addition, the Merger Agreement requires that at the time of closing, unless waived by the affected party or otherwise excused, there be no Material Adverse Effect (including a Regulatory Material Adverse Effect), as such terms are defined in the Merger Agreement, nor any fact or circumstance which could reasonably lead to such a Material Adverse Effect. See "CSW Positions with Respect to the Merger," below.

Certain of the conditions to the closing of the Merger have already been satisfied or events have occurred resulting in significant progress toward satisfaction: the Plan was confirmed on December 8, 1993; settlements (which become operative on the Effective Date) were entered into on November 15, 1993, and thereafter approved by the Bankruptcy Court, resolving the adversary proceeding between the Company and the Palo Verde Owner Participants and providing for the transfer back to the Company of title to the leased portions of Palo Verde on the Effective Date; a capital structure for the Company as of the Effective Date has been designed to meet the requirement for an investment-grade rating from the rating agencies; and proceedings or reviews are being conducted with respect to rates, public interest findings and/or approvals of the Merger before the FERC, the Texas Commission, the New Mexico Commission, the NRC and the SEC. See "Regulatory Aspects of the Plan and Merger," below. The Company believes that the requisite regulatory orders and approvals will be obtained. However, the Company expects that certain of such regulatory orders and approvals will not be final before the expiration of the initial time period established by the Merger Agreement (i.e., by June 8, 1995), and an agreement with CSW to extend the time to close the Merger may be required pursuant to provisions therefor in the Merger Agreement. See "Termination of the Merger Agreement" below.

CSW Positions with Respect to the Merger

On September 12, 1994, CSW delivered a letter to the Company (the "September 12 Letter") stating that CSW would not close the Merger unless there was (i) a favorable and timely resolution of

the Company's dispute with the City of Las Cruces involving its municipalization efforts and (ii) a determination of the significance of the tube-cracking problems at Palo Verde (see Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation – Operational Challenges – City of Las Cruces" and "Facilities – Palo Verde Station – Palo Verde Operations"), both of which would have to be accomplished by the Effective Date. CSW further stated that these two matters, together with (i) the potential loss of other customers in the Company's service area, including the Holloman Air Force Base and the White Sands Missile Range in New Mexico; (ii) Texas regulatory issues related to rate relief and to approval of the Merger; and (iii) the announced "comparable transmission service" standard being applied to the Merger by the FERC, place the completion of the Merger in jeopardy. Further, the September 12 Letter asserted that such matters, individually and cumulatively, constitute a Material Adverse Effect or failure of other closing conditions under the Merger Agreement which, unless "timely and favorably resolved" in accordance with the Merger Agreement, will preclude the closing of the proposed Merger.

On September 16, 1994, the Company responded to CSW's September 12 Letter, stating that "the Merger Agreement does not condition CSW's obligation to close the transaction on either a favorable resolution of the Las Cruces situation or a determination of the significance, if any, of the Palo Verde 'problems'." The Company further disagreed with each of the assertions made by CSW and noted that CSW's September 12 Letter had inflicted irreparable harm on the Company and the Merger process. Since September 1994, the parties have exchanged numerous letters regarding interpretations of the Merger Agreement and the actions of the parties thereunder. CSW has maintained the positions stated in its September 12 Letter and also has asserted claims of "loss of value" to the Merger. The Company has reiterated the views expressed in its September 16, 1994 letter to CSW and does not believe that CSW's positions are supported by the Merger Agreement.

In view of the repeated assertions by CSW of its intention, under certain circumstances, not to close the Merger, the Company has retained litigation counsel to advise the Company of its rights and obligations under the Plan and the Merger Agreement. If CSW attempts to terminate the Merger Agreement without proper justification or if CSW otherwise breaches the Merger Agreement, litigation could ensue. The Merger Agreement provides for specific performance as a remedy and other damages may be payable in the event of a breach of the Merger Agreement.

Termination of the Merger Agreement

The Merger Agreement provides that it may be terminated (i) by mutual written consent approved by the Boards of Directors of CSW and the Company, or (ii) by CSW or the Board of Directors of the Company if the Effective Date has not occurred within 18 months from the Confirmation Date (i.e., by June 8, 1995) or, if extended by mutual consent, if the Effective Date has not occurred within 24 months of the Confirmation Date (i.e., by December 8, 1995).

The Merger Agreement also states that CSW may terminate the Merger Agreement by written notice to the Company's Board of Directors if:

(i) the Company withdraws or modifies in a manner adverse to CSW its recommendation or approval of the Plan, the Merger Agreement or the Merger, or approves or recommends a proposal or acquisition with a party other than CSW or a subsidiary of CSW;

(ii) there is a material breach of any representation, warranty, covenant or agreement of the Merger Agreement by the Company;

(iii) there is a failure to obtain any required statutory approvals or regulatory determinations that are conditions to the effectiveness of the Merger;

(iv) the Company files an independent case related to rates before the Texas Commission, except as permitted by the Merger Agreement; or

(v) there shall exist with respect to Company a Material Adverse Effect or a fact or circumstance which could reasonably lead to a Material Adverse Effect.

The Merger Agreement states that the Company may terminate the Merger Agreement if any of the following events occur:

(i) there is a failure to obtain any required statutory approvals or regulatory determinations that are conditions to the effectiveness of the Plan and Merger;

(ii) there is a material breach of any representation, warranty, covenant or agreement of the Merger Agreement by CSW;

(iii) CSW withdraws or modifies in a manner adverse to the Company its recommendation or approval of the Plan, the Merger Agreement or the Merger;

(iv) the Company determines in accordance with its fiduciary duties as debtor-in-possession to engage in an acquisition transaction with a party unrelated to CSW; or

(v) there shall exist with respect to CSW a Material Adverse Effect or a fact or circumstance that could reasonably lead to a Material Adverse Effect.

Under certain circumstances, termination of the Merger Agreement may result in a $25 million termination fee payable by one party to the other and the payment by CSW to the Company of certain interest costs estimated to be approximately $14.6 million as of December 31, 1994, and certain fees and expenses incurred by the Company pursuant to the Plan. The principal circumstances under which a $25 million fee may be payable by one party to the other party would be (i) the denial by one party of a request by the other party to extend the termination date for up to six months, where such request is made because one or more conditions to the Merger Agreement has not been satisfied and which request states that the requesting party believes in good faith and on reasonable grounds that such conditions can be satisfied within the requested extension period, i.e., by December 8, 1995; or (ii) a material breach of a representation, warranty, covenant or agreement by one party that has not been remedied within ten days after receipt of written notice from the other party.

Alternatives for the Company if the Plan and Merger Fail

If the Plan does not become effective and the confirmation order is vacated, the Company would consider alternatives to the Merger, including another merger or business combination with an entity not affiliated with CSW, a stand-alone plan that could involve a restructuring under FERC jurisdiction or a stand-alone plan under existing regulatory frameworks. Under each of these alternatives, the treatment of Palo Verde assets and the pending adversary proceeding (which is the subject of the conditional settlement described under "Treatment of Palo Verde" below), may be reevaluated by the Company. In addition, the Bankruptcy Court could allow third parties, including various creditor constituencies and other interested companies, to file a plan of reorganization that might involve a merger, business combination or acquisition or conversion of a portion of the Company's outstanding debt into preferred or common stock of the Company.

Any plan of reorganization other than the Plan may provide for different securities and treatments than those provided in the Plan, and could result in lower recoveries for creditors and interest holders and/or could require larger rate increases than proposed pursuant to the Plan. The Company cannot predict (i) what the treatment of claims and interests would be under any alternate plan of reorganization, (ii) in what respects actions proposed under the Plan would be modified, or (iii) the amount of time or expense that would be required before any such alternate plan of reorganization were effective.

Although the Company believes it is unlikely, if the Merger does not occur and no other plan of reorganization proves viable, the Bankruptcy Court could order the liquidation of the Company.

Regulatory Aspects of the Plan and Merger

Consummation of the Plan and Merger is conditioned on receipt of required regulatory approvals and determinations, including those discussed below. In addition, Section 1129 (a) (6) of the Bankruptcy Code provides that a plan of reorganization may be confirmed only if any governmental regulatory commission with jurisdiction, after confirmation of the plan, over rates of the debtor has approved any rate change provided in the plan, or such rate change is expressly conditioned on such approval. The effectiveness of the Plan is conditioned upon obtaining Texas and New Mexico orders, including a rate order in Texas, establishing certain ratemaking, accounting and regulatory treatments, certain of which orders may be waived by CSW and the Company.

Under the Merger Agreement, CSW is given the right to designate lead counsel with respect to, and to control all applications, notices, petitions and filings relating to, the regulatory approvals and determinations described herein that are conditions to the effectiveness of the Merger. The Merger Agreement provides that both CSW and the Company are required to use reasonable best efforts to secure such approvals and determinations. The Merger Agreement further provides that CSW must use reasonable efforts in controlling the applications, notices, petitions and filings to preserve the Company's ability to file independent rate proceedings with and seek rates from appropriate Texas regulatory authorities based upon the Company's own cost of service components (assuming the Merger is not consummated), in the event that the Company seeks rate relief in any independent proceeding not precluded by the Merger Agreement. No assurances can be given that the respective regulatory authorities will grant the regulatory approvals and determinations required under the Plan and the Merger Agreement, or upon what terms or conditions such approvals or determinations might be given.

Proposed Texas Regulatory Treatment. The effectiveness of the Plan and the Merger is conditioned upon the receipt by the Company and CSW of the following Texas regulatory approvals and determinations unless such conditions are waived by CSW and the Company: (i) a final order of the Texas Commission authorizing a base rate increase of $25 million to be effective for the Company in 1994 and authorizing certain ratemaking, accounting and regulatory treatments of the assets, expenditures, costs and revenues of the Company; (ii) a final order of the Texas Commission to the effect that the combination of the Company with CSW Sub contemplated under the Plan is in the public interest and authorizing certain regulatory treatments with respect to the combination; and (iii) a final order of the Texas Commission to the effect that the reacquisition by the Company of the previously leased Palo Verde Unit 2 and 3 assets and the ratemaking treatment for the repurchased assets as plant-in-service in rate base at their original cost less depreciation are in the public interest.

On January 10, 1994, the Company filed a request with the Texas Commission for a base rate increase (the "Texas Rate Filing") incorporating, among other things, the Company's fifth increase under the terms of the Rate Moderation Plan ordered by the Texas Commission in Docket 7460, and a base rate increase under the inventory plan for Palo Verde Unit 3 established in Docket 9945. See "Regulation — Texas Rate Matters," below. The filing is proceeding under Docket 12700.

In the event the Merger is terminated prior to the Texas Commission's order in Docket 12700 becoming final, the Company anticipates that it will seek to proceed with the Texas Rate Filing on a non-merged basis to obtain a final rate order. The Company believes that, on a non-merged basis it would be entitled to a cash base rate increase in excess of both the Company's bonded rate increase and the rate increase provided by the Texas Commission's Interim Order in Docket 12700 (the "Interim Order"). See "Regulation – Texas Rate Matters – Texas Rate Filing," below. The Company anticipates that some parties to Docket 12700 will assert that the rate case should be dismissed if the Merger is terminated. In this regard, the Company and CSW entered into a stipulation with the OPC on February 16, 1994, agreeing to procedures whereby, in the event the Merger is terminated, the

Texas Rate Filing can be converted to reflect the Company on a non-merged basis with provision for additional discovery and evidentiary hearings, if necessary, to address adjustments to reflect the Company's cost of service on a non-merged basis. No other party to Docket 12700 entered into the stipulation. The Company believes, but can give no assurance, that the Texas Commission would allow the Texas Rate Filing to proceed to a final order on a non-merged basis.

In addition to the Texas Rate Filing, the Company and CSW filed, on January 10, 1994, a Joint Report and Application (the "Texas Merger Application") with the Texas Commission requesting (i) a determination that the acquisition by CSW of one hundred percent of the Company's common stock is consistent with the public interest; and (ii) certain determinations regarding the regulatory treatment of the Company's proposed reacquisition of the portions of Palo Verde that it previously sold and leased back. See "Regulation – Texas Rate Matters," below.

As part of the Texas Merger Application and as a basis of settlement, CSW has proposed rates for Texas jurisdictional customers of the Company that are substantially less than those reflected in the Texas Rate Filing. The CSW settlement offer is contingent on the determination by the Texas Commission that CSW's acquisition of the Company is consistent with the public interest and certain other regulatory determinations and approvals requested in the Texas Merger Application. CSW's efforts to settle the case have been unsuccessful. See "Regulation – Texas Rate Matters," below.

On March 3, 1995, the Texas Commission entered the Interim Order concerning the Texas Merger Application and the Texas Rate Filing. See "Regulation – Texas Rate Matters."

New Mexico Regulatory Treatment. The effectiveness of the Plan and the Merger is conditioned on the receipt by the Company and CSW of the following regulatory approvals and determinations unless such conditions are waived by CSW and the Company: (i) a final order of the New Mexico Commission approving the combination of the Company with CSW; (ii) a final order of the New Mexico Commission authorizing certain ratemaking, accounting and regulatory treatments of the assets, expenditures, costs and revenues of the Company; (iii) a final order of the New Mexico Commission authorizing the issuance by the Company of the securities required for the consummation of the Plan; (iv) a final determination by the New Mexico Commission that none of the transactions between the Company and CSW contemplated by either the Plan or Merger Agreement involve a Class II transaction (which generally relate to certain investments or transactions with affiliates) or, if a Class II transaction is involved, a final order of the New Mexico Commission approving a diversification plan relating to the combination of the Company and CSW and the transactions between the Company and other CSW subsidiaries; and (v) a final determination by the New Mexico Commission that a new CCN is not required by the Company as a result of the transactions between the Company and CSW as contemplated in either the Plan or the Merger Agreement or if the New Mexico Commission determines a new CCN is required, a final order issuing a new CCN to the Company.

The Company and CSW filed an application (the "New Mexico Merger Application") with the New Mexico Commission on March 14, 1994, which has been docketed as NMPUC Case No. 2575. The New Mexico Merger Application requests the New Mexico Commission, to the extent necessary and appropriate under the law, to approve (i) the acquisition by CSW of the outstanding common stock of the Company; (ii) the accounting treatment of the Merger; (iii) the reacquisition of portions of Palo Verde by the Company and the proposed accounting, regulatory and tax treatment associated with the reacquisition; and (iv) a General Diversification Plan for the Company for activities that will occur as a result of the Merger. Under New Mexico Commission rules, a General Diversification Plan is required for certain transactions among a public utility and its affiliates. As a result of the Merger, the Company would become affiliated with CSW and its subsidiaries and affiliates. The New Mexico Merger Application does not include any request related to the issuance of securities pursuant to the Plan; such request will be included in a separate application which the Company anticipates will be filed in April 1995.

On May 23, 1994 CSW announced its proposal to freeze base rates at current levels for the New Mexico jurisdiction following the Effective Date. On August 19, 1994, CSW and the Company filed a formal statement with the New Mexico Commission, contingent on the closing of the Merger, committing to the rate freeze proposal. Under the proposal, the Company would not request an increase in base rates charged to New Mexico customers through 2002 except for a one-time potential base rate increase of no more than 6% of total New Mexico jurisdictional revenues during the period 1998 to 2002.

On February 10, 1995, the New Mexico Commission Staff filed testimony recommending that the New Mexico Commission approve the New Mexico Merger Application. Hearings on the New Mexico Merger Application began on February 27, 1995 and were concluded on March 2, 1995. The Company anticipates receiving an order from the New Mexico Commission during the first half of 1995. While the Company believes that the approvals and ratemaking, accounting and regulatory treatments being sought are in accordance with the relevant provisions of New Mexico law and the New Mexico Commission's rules, no assurances can be given that the New Mexico Commission will grant the approvals requested or make the determinations sought.

FERC Approvals. The Company and Central and South West Services, Inc. ("CSWS") have applications pending before the FERC (i) seeking an order from the FERC requiring SPS to allow the Company and the CSW Electric Operating Companies to transmit power across SPS' transmission system after the Merger is consummated; (ii) requesting a determination that the Merger is consistent with the public interest; and (iii) seeking approval of an amendment to the CSW System Operating Agreement and to make the Company a party to the agreement. A FERC order which approves the Merger and which contains conditions not substantially more onerous than those imposed in recent FERC orders with respect to mergers involving electric utility companies will meet the requirements of the Merger Agreement.

On November 4, 1993, CSWS filed an application on behalf of the CSW Electric Operating Companies and the Company seeking an order under Section 211 of the FPA requiring SPS to provide transmission service in connection with transfers of power between certain CSW Electric Operating Companies and the Company in connection with post-merger operations. On January 10, 1994, as supplemented January 13, 1994, CSWS filed on behalf of the CSW Electric Operating Companies and the Company, a joint application under Sections 203 and 205 of the FPA requesting FERC approval of the Merger and authorization to amend the CSW System Operating Agreement. On August 1, 1994, the FERC issued orders in these proceedings.

In an order issued in connection with the Section 211 proceedings, the FERC preliminarily found that a final order requiring SPS to provide transmission service would comply with the statutory standards once reliability concerns had been met. The order directed that additional studies be performed to enable the FERC to address these reliability concerns. Such studies and supplemental pleadings addressing the studies have been filed with the FERC and the proceeding is ripe for a FERC decision.

Also on August 1, 1994, the FERC issued an order in connection with the Sections 203 and 205 proceedings. The order consolidated the Sections 203 and 205 proceedings, required, as a condition to approval of the Merger, that the merging utilities offer transmission service to others on a basis that is comparable to their own use of their transmission systems and determined that a hearing would be necessary in order to resolve certain factual issues. Requests for rehearing were filed by the Company and CSW and certain parties; such requests are still pending. On August 31, 1994, form transmission service tariffs intended to meet the comparable service condition were filed. In filing the form tariffs, CSW and the Company stated that they did not intend to waive their rights to seek rehearing or judicial review of the comparable service condition or any orders issued in connection therewith.

The Sections 203 and 205 proceeding is pending before a FERC administrative law judge. Hearings were completed January 25, 1995 and the initial decision of the administrative law judge is

expected no later than April 14, 1995. No assurance can be given that the FERC will grant the required approvals under the FPA, when such approvals might be granted, or the terms and conditions that may be imposed if conditional approval is granted.

SEC and PUHCA Issues. CSW is a public utility holding company as defined in the PUHCA and is registered under such act. CSW is required to obtain the approval of the SEC prior to consummating the Merger. The SEC is directed to approve a proposed merger unless it finds that (i) the acquisition would tend toward interlocking relations or a concentration of control of public utility companies, of a kind or to an extent detrimental to the public interest or the interest of investors or consumers; (ii) the consideration to be paid in connection with the acquisition is not reasonable or does not bear a fair relation to the sums invested in or the earning capacity of the utility assets underlying the securities to be acquired; or (iii) the acquisition would unduly complicate the capital structure of the applicant's holding company system or would be detrimental to the public interest or the interest of investors or consumers or the proper functioning of such holding company system. To approve a proposed acquisition, the SEC must find that the acquisition would tend toward the economical and efficient development of an integrated public utility system and would otherwise conform to the PUHCA's integration and corporate simplification standards. The SEC also must find that all state laws that apply to the Merger have been satisfied, unless it determines that compliance with such state laws would be detrimental to the purposes of the PUHCA.

Under the PUHCA, the SEC must find that after the Merger the Company and CSW will constitute an integrated electric system. The Company and CSW propose to coordinate their operations by means of transmission service to be provided by SPS. In the past, the SEC has determined that integration may be effected by means of transmission rights on unaffiliated systems.

SEC approval under the PUHCA will also be required for certain proposed transactions relating to the Merger. SEC approval will be required for the formation of CSW Sub. In addition, SEC approval (unless an exception is granted) will be required in connection with (i) the issuance of CSW common stock to the holders of the Company's common stock and certain creditors, and (ii) the issuance of Reorganized EPE's securities to holders of the Company's securities and certain creditors pursuant to the Plan.

CSW filed an Application-Declaration on Form U-1 with the SEC on January 10, 1994 pursuant to the PUHCA to seek authorization (i) of the merger of CSW Sub with and into the Company and the acquisition of the Company by CSW through such merger; and (ii) of the issuance of securities by the Company and CSW in connection with the Plan and Merger and certain related transactions.

CSW has received a favorable no-action letter from the SEC with respect to the issuance of CSW common stock and Reorganized EPE preferred stock pursuant to the Plan without registration under the Securities Act of 1933, as amended, and related matters.

NRC and Atomic Energy Act Issues. The Company holds NRC operating licenses in connection with its ownership interests in Palo Verde, which authorize the Company to be a participant in the facility. The Atomic Energy Act of 1954, as amended (the "Atomic Energy Act"), provides that such licenses or any rights thereunder may not be transferred or in any manner disposed of, directly or indirectly, to any person through transfer of control unless the NRC finds that such transfer is in accordance with the Atomic Energy Act and applicable NRC requirements and consents to the transfer. On January 13, 1994, APS, as Operating Agent for Palo Verde, joined by the Company, filed a request with the NRC (i) for consent to the indirect transfer of the Company's possession and ownership interest in the Operating Licenses for Palo Verde Units 1, 2, and 3 that would occur as a result of the Merger; and (ii) to amend the Operating Licenses for Units 2 and 3 to delete provisions related to the Company's sale and leaseback transactions involving those units. The NRC has proposed to determine that the requested amendment would not: (i) involve a significant increase in the probability or consequences of an accident previously evaluated; (ii) create the possibility of a new

or different kind of accident from any previously evaluated; or (iii) involve a significant reduction in a margin of safety.

The NRC requested public comments to the application on March 14, 1994 and the period for submitting comments has expired. The request to the NRC specifies that the requested amendments to the Operating Licenses and consent become effective on the Effective Date upon notification by the applicants that all necessary regulatory approvals have been obtained, but the Company cannot predict at this time whether and when the approvals and consent will be granted.

Other Regulatory Filings. Under the FPA and the Department of Energy Act, the DOE must authorize persons to transmit electric energy from the United States. The Company holds an authorization to transmit electric energy to CFE. Under the Plan, CSW would become the owner of the common stock of the Company. The DOE requires that notice of a succession of ownership be filed with the DOE. In general, this notice must be filed at least 30 days prior to the effective date of any succession in ownership. The Company intends to file a notice of succession in ownership with the DOE at the appropriate time.

The Company and CSW also must file a notice related to the Merger with the FTC and DOJ pursuant to the HSR Act. The applicable waiting period following such filing must have expired before the Effective Date without an adverse ruling or other action by the FTC and DOJ with respect to any anticompetitive effects of the Merger. The Company intends to file a notice pursuant to the HSR Act at the appropriate time.

Treatment of Palo Verde

Major aspects of the Plan include (i) the rejection of the Company's leases relating to Palo Verde (the "Palo Verde Leases"), which extend to the Company's entire interest in Palo Verde Unit 2, approximately 40% of the Company's interest in Palo Verde Unit 3 and approximately one-third of its interest in the Common Plant; (ii) the resolution of any and all claims relating to such leases by the agreement that an amount equal to $700 million would be the allowed claim of holders of lease obligation bonds related to the Palo Verde Leases and pursuant to settlement agreements entered into between the Company, the Owner Trustee and each of the Owner Participants; (iii) reacquisition of the leased portions of Palo Verde by the Company; and (iv) the Company's assumption and cure of the ANPP Participation Agreement and related agreements.

The treatment of Palo Verde under the Plan constitutes a comprehensive resolution of all aspects and issues involving the Company's interest in the plant, from its relationship with the other utility participants to the treatment of the sale and leaseback transactions. The treatment would resolve an adversary proceeding pending in the Bankruptcy Case pursuant to which the Company sought to reject the Palo Verde Leases and establish the damages, if any, payable for such rejection. If the Plan does not become effective, the Company would have to consider the appropriate treatment of Palo Verde, including whether to continue the treatment of relevant claims as proposed under the Plan, propose some other resolution and settlement with affected parties or pursue the adversary proceeding.

Owner Participant and Owner Trustee Settlement Agreements. The Company entered into settlement agreements with each of the Owner Participants and the Owner Trustee in its sale and leaseback transactions related to Palo Verde. The settlement agreements were approved by the Bankruptcy Court, and became effective immediately, although certain provisions become operative only at the Effective Date. The settlement agreements provide for the resolution of disputes between the Owner Participants, Owner Trustee and the Company under the Plan or, unless terminated by the Owner Participants, under another plan of reorganization that the Company supports. Such disputes are the subject of an adversary proceeding filed by the Company in the Bankruptcy Court in September 1992 in connection with the Company's proposed rejection of the Palo Verde Leases, including the amount of damages, if any, resulting from such rejection and the treatment of draws on

letters of credit by the Owner Participants. The Owner Participants and Owner Trustee had asserted claims against the Company for rent, fees and expenses in the adversary proceeding. Pursuant to the settlement agreements, the Owner Participants would receive no additional recovery under a plan of reorganization, other than a release from the Company, the continuation of certain indemnification obligations set forth in the participation agreements entered into in connection with the sale and leaseback transactions, and the payment of certain expenses incurred by the Owner Participants. At the effective date of a plan of reorganization, the Owner Participants would transfer their interests in the leased portions of Palo Verde to the Company, mutual releases among the Company, the Owner Trustee and Owner Participant would be executed and become effective and the adversary proceeding would be dismissed with prejudice. The settlement agreements also contain tolling provisions related to the adversary proceeding for the interim period. The Owner Participants and the Company have the right to terminate the settlement agreements under certain circumstances prior to the effective date of a plan of reorganization.

ANPP Participation Agreement. The Company and the other Palo Verde Participants have entered into a Cure and Assumption Agreement, pursuant to which the Company would assume the ANPP Participation Agreement and all other operating agreements related to Palo Verde at the Effective Date. The Cure and Settlement Agreement was approved by the Bankruptcy Court on November 19, 1993. If the Plan does not become effective, the Cure and Assumption Agreement would be rescinded, in effect, and APS would be obligated to return $9.2 million in prepetition costs that were paid following confirmation of the Plan. See "Facilities – Palo Verde Station – ANPP Participation Agreement."

Treatment of Claims Under the Plan

The Plan generally provides for creditors and interest holders to receive shares of CSW common stock, cash and/or securities of Reorganized EPE or to have their claims cured and reinstated. Secured creditors would receive value equal to 100% of their allowed claim in the form of debt securities of Reorganized EPE and interest on accrued unpaid interest. As discussed below, the Company has paid interest on secured obligations from July 1, 1992 and would continue to pay such interest through the Effective Date. The trust used to finance nuclear fuel would receive value equal to 100% of the principal amount of their allowed claim in the form of debt securities of Reorganized EPE and the payment of 85% of accrued and unpaid interest, plus the payment of interest quarterly through the Effective Date. Unsecured creditors would receive a combination of debt securities of Reorganized EPE and CSW common stock in an amount equal to 95.5% of the principal amount of their allowed claim and interest on such 95.5% amount quarterly through the Effective Date. The holders of Palo Verde lease obligation bonds would receive 95.5% of the amount of their allowed claim, which is designated at $700 million, in the form of debt securities of Reorganized EPE and CSW common stock, and interest on such 95.5% amount quarterly through the Effective Date. See "Treatment of Palo Verde." Small unsecured creditors would receive 100% of their allowed claim in cash.

Pollution control bonds issued in connection with the Company's interests in Palo Verde and Four Corners would be cured and reinstated at the Effective Date and, thus, would remain outstanding. Issuers of letters of credit related to the three series of pollution control bonds related to Palo Verde would receive debt securities of Reorganized EPE with respect to outstanding draws and the payment of letter of credit fees and interest on certain amounts of unpaid interest and unreimbursed draws at the Effective Date. The issuer of the letter of credit for the pollution control bonds related to Four Corners would be treated essentially in the same manner as an unsecured creditor.

Preferred shareholders of the Company would receive shares of Reorganized EPE preferred stock having a value in the amount of $68 million in the aggregate for their allowed interests. In addition, periodic payments are being paid quarterly and would continue through the Effective Date on the amount of the preferred stock distribution.

The issued and outstanding shares of Company common stock (other than treasury shares and any shares held by CSW) would be converted into CSW common stock. Outstanding options to purchase Company common stock would be converted into options to purchase shares of CSW common stock. The conversions would be made at the Effective Date and would be based on the ratio of the number of shares of CSW common stock credited to the CSW Common Stock Acquisition Fund (which is defined in the Merger Agreement and is referred to herein as the "Fund") to the number of outstanding shares of Company common stock at the Effective Date. The Fund is a tracking mechanism and not an actual escrow or other repository for funds; no shares of CSW common stock or cash are placed in the Fund.

The actual number of shares of CSW common stock that would be issued to Company shareholders cannot be finally determined until the Effective Date and the method of conversion would be as provided in the Merger Agreement and set forth above. In general terms, the number of shares of CSW common stock credited to the Fund would be based on the sum of (i) the conversion of the number of shares of Company common stock outstanding at the Confirmation Date (35,544,330 shares) to CSW common stock, assuming a value of $3.00 per share of Company common stock and a value of $29.4583 per share of CSW common stock, (ii) the conversion of up to $1.50 per share of Company common stock outstanding at the Confirmation Date as additional consideration deemed to be realized through the resolution of certain claims and the disposition of certain assets described in the Merger Agreement, with such conversion based on a value of CSW common stock equal to $29.4583 for items realized prior to the Confirmation Date and the closing price on the date of the resolution of such item for items resolved after the Confirmation Date, and (iii) the conversion of dividends that would be deemed to accrue on the amounts described in (i) and (ii) above from the Confirmation Date or the date the additional consideration is realized, as the case may be, through the Effective Date, plus dividends on such dividends.

The Company believes that it has resolved the contingencies or realized proceeds from the items designated in the Merger Agreement in amounts sufficient such that at the Effective Date, the maximum additional consideration would be reached. As of March 1, 1995, the Company estimates that approximately 5,821,665 shares of CSW common stock would be credited to the Fund, including shares credited due to dividends paid by CSW. However, this number does not include the number of shares that would be credited as a result of the conversion of up to $13.8 million in additional consideration because such conversion would be made one day prior to the Effective Date based on the closing price of CSW common stock on such date. This calculation has not been submitted to CSW for review or approval. The closing price of CSW common stock on March 1, 1995 was $24.625 per share.

If the maximum amount of additional consideration (an amount equal to $1.50 per share of Company common stock outstanding on the Confirmation Date) has not been realized at the Effective Date, a liquidation trust would be established and the Company's rights to and interests in certain contingent items designated in the Merger Agreement would be assigned to the trust. Any cash proceeds realized by the trust would be distributed pro rata to the holders of the Company's common stock at the Effective Date up to the maximum consideration amount and any excess would be returned to the Company.

If another plan of reorganization involving CSW or an affiliate of CSW were to become effective, then pursuant to the terms of the Merger Agreement, unless the Company has withdrawn the Plan or proposed a stand-alone plan of reorganization inconsistent with the Merger Agreement or has breached the Merger Agreement in a material manner, CSW would be required to pay to holders of the Company's common stock an amount equal to the difference between the aggregate amount that would have been paid to such holders under the Plan and the amount actually paid under the other plan of reorganization.

Actions Related to Bankruptcy Case Prior to the Effective Date

Prior to the Effective Date, current management of the Company will continue to manage and run the Company, subject to the oversight of the Board of Directors and required approvals of the Bankruptcy Court for certain actions. Under the Merger Agreement, the Company is prohibited from undertaking certain actions, which generally are extraordinary in nature; may be required to notify or obtain the approval of CSW prior to undertaking other actions; and its ability to take certain actions is limited in other respects. With those limitations, the Company is continuing to operate and to use its best efforts to complete the actions required to reach the Effective Date.

Interim payments will be made prior to and at the Effective Date, as set forth in the Plan, and as described above in "Treatment of Claims Under the Plan." The Company and CSW continue to meet periodically with an oversight committee representing all classes of creditors to inform them of the status of the conditions to effectiveness of the Plan and to provide other information.

The Company is continuing its analysis of executory contracts to determine whether the Company should assume or reject all or a portion of these contracts. Any contracts not affected would be assumed at the Effective Date.

The Company also is continuing its analysis of the proofs of claim filed in the Bankruptcy Case in an effort to reconcile the claimants and the claimed amounts with the Company's books and records and, prior to the Effective Date, will determine which it will object to. The general deadline for filing creditors' claims against the Company with the Bankruptcy Court was June 15, 1992. Approximately 350 proofs of claim or interest had been filed with the Bankruptcy Court as of December 31, 1994. Many of the proofs of claim are voluminous and duplicative. The Company's counsel is also involved in the process of analyzing the factual and legal bases of many of the proofs of claim.

Based on the evaluation to date, the following table represents the proofs of claims, exclusive of proofs of claims that have been withdrawn voluntarily or for which objections by the Company have been upheld and those for which amounts have been paid, as of December 31, 1994, that have been filed and that include a specified amount.

Category of Claims	Amount (In thousands)
Prepetition claim amounts recorded on the Company books and records	$ 1,216,337
Palo Verde lease obligation bond claims	742,725
Litigation claims	30,983
Executory contract claims	6,401
Other	17,266
Subtotal	2,013,712
Claims that are duplicative of the above	2,982,857
Total	$ 4,996,569

The Company does not acknowledge the validity of any proofs of claim represented in the table and reserves its right to object to all proofs of claim. Claims related to the Palo Verde lease obligation bonds are unliquidated claims that would be allowed claims in the amount of $700 million under the Plan. Litigation claims primarily reflect miscellaneous personal injury litigation (for which the Company has adequate liability insurance) and commercial litigation. The Company believes that the duplicate claims will not be allowed claims in the Bankruptcy Case. The claims for executory contracts are for unliquidated damages for leases or other executory contracts the Company has not rejected. There also are approximately 50 proofs of claims that do not specify an amount and, therefore, are not reflected in the table above. The Company cannot predict the amount of claims that ultimately will be allowed by the Bankruptcy Court in the Bankruptcy Case.

Regulation

Overview

Effect of Bankruptcy on Regulation. The Bankruptcy Code provides that the Bankruptcy Court shall confirm the Company's plan of reorganization only if "any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval." As discussed above in "Bankruptcy Proceedings and Proposed Merger with CSW – Regulatory Aspects of the Plan and Merger," the Company or, where appropriate, CSW, CSWS or APS, have filed or will file applications with various regulatory bodies to seek approvals or determinations necessary to consummate the Merger and otherwise satisfy the conditions to the effectiveness of the Plan. To date, the Company has reserved arguments in the regulatory proceedings that the provisions of the Bankruptcy Code, together with applicable provisions of other federal statutes, grant the Bankruptcy Court the authority to preempt otherwise applicable regulatory jurisdiction, and it is uncertain whether the Company would prevail on such arguments, if asserted. The Company, however, has asserted that the Texas Commission, the New Mexico Commission, the OPC and the City of El Paso, which are parties to the Bankruptcy Case, are collaterally estopped from challenging certain of the Bankruptcy Court's findings in confirming the Plan and that the Supremacy Clause of the United States Constitution preempts such parties from relitigating the reasonableness of the purchase price offered by CSW. See "Texas Rate Matters – Bankruptcy Court Adversary Proceeding," below. The discussion of the applications filed or to be filed before the regulatory bodies pursuant to the Plan and the pending regulatory appeals discussed below in "Texas Rate Matters" and "New Mexico Rate Matters" should be read in the context of the preemption issue discussed above.

Pursuant to orders entered by the Bankruptcy Court, the automatic stay imposed by the Bankruptcy Code, if and to the extent applicable, has been lifted with respect to all pending appeals of regulatory decisions of the Texas Commission. See Item 3, "Legal Proceedings – Automatic Stay of Litigation Due to Bankruptcy." Accordingly, such appeals are being prosecuted through the applicable courts.

Texas. The rates and services of the Company in Texas municipalities are regulated by those municipalities and in unincorporated areas by the Texas Commission. The largest municipality in the Company's service area in Texas is the City of El Paso. The Texas Commission has exclusive *de novo* appellate jurisdiction to review municipal orders and ordinances regarding rates and services, and its decisions are subject to judicial review.

The Texas Commission has jurisdiction to grant and amend CCNs for service territory and certain facilities, including generation and transmission facilities. Although the Texas Commission does not have the authority to approve transfers of utility assets, it is required to evaluate certain transfers of utility assets and mergers and consolidations of regulated utility companies to determine if those transactions are consistent with the public interest. Upon a finding that such a transaction is not in the public interest, the Texas Commission is required to consider the effects of the transaction in future ratemaking proceedings and is required to disallow the effects of the transaction if it will unreasonably affect rates or service.

New Mexico. The New Mexico Commission has jurisdiction over the Company's rates and services in New Mexico. The New Mexico Commission must grant prior approval of the issuance, assumption or guarantee of securities; the creation of liens on property located within the state; the consolidation, merger or acquisition of some or all of the stock of another utility; and the sale, lease, rental, purchase or acquisition of any public utility plant or property constituting all or part of an operating unit or system. The New Mexico Commission also has jurisdiction as to the valuation of utility property and business; certain extensions, improvements and additions; Class I and II transactions (as defined by the New Mexico Public Utility Act); abandonment of facilities and the certification and decertification of utility plant. The New Mexico Commission's decisions are subject to judicial review.

FERC: The Company is subject to regulation by the FERC in certain matters, including rates for wholesale power sales and the issuance of securities. In 1992, the Congress enacted the Energy Policy Act, which, among other things, removes certain restrictions on utility participation in the competitive wholesale generation market. In addition, subject to certain limitations, the legislation provides that the FERC also may order electric utilities, including the Company, to provide certain transmission services. The legislation also expands the authority of state utility commissions to examine the books and records of electric utilities. See "Bankruptcy Proceedings and Proposed Merger with CSW – Regulatory Aspects of the Plan and Merger – FERC Approvals," above.

NRC. The Palo Verde Station is subject to the jurisdiction of the NRC, which has authority to issue permits and licenses, to regulate nuclear facilities in order to protect the health and safety of the public from radiation hazards and to conduct environmental reviews pursuant to the National Environmental Policy Act. See "Facilities – Palo Verde Station" and "Bankruptcy Proceedings and Proposed Merger with CSW – Regulatory Aspects of the Plan and Merger – NRC and Atomic Energy Act Issues."

Accounting for the Effects of Regulation. Prior to December 31, 1991, the financial statements of the Company were prepared pursuant to the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," as amended, which provides for the recognition of the economic effects of regulation. In early 1992, the Company determined that there existed substantial doubt concerning whether the criteria for reflecting the economic effects of regulation continued to be met as a result of continuing cash flow problems arising from inadequate rate relief and the uncertainty surrounding regulation during the reorganization process. The Company concluded that it was not reasonable to assume that its rates were, or will be, without giving consideration to possible outcomes of the reorganization process, designed to recover its costs on a timely basis. Because of the uncertainty of the nature of any reorganization plan ultimately consummated and the assessment of the nature of regulation, the Company concluded that it did not then and does not currently have sufficient assurance to reflect the economic effects of regulation in its general purpose financial statements. Therefore, as required by generally accepted accounting principles, the Company eliminated from its 1991 balance sheet the aggregate effects of regulation, which resulted in a $311 million extraordinary charge to results of operations for the year ended December 31, 1991. This amount included approximately $200 million of operating expenses and carrying costs, primarily related to Palo Verde, and approximately $80 million of income taxes related to the Palo Verde sale/leaseback transactions which had been deferred by the Company's regulators for recovery in future periods. Furthermore, the Company did not record the letters of credit draws amounting to $288.4 million as an asset and has not recorded any new assets reflecting the economic effects of regulation since 1991 in its general purpose financial statements.

Although the outcome of the reorganization process cannot presently be determined, the Company believes that the rates established in conjunction with any reorganization plan will be designed to recover the Company's costs, including a return on equity, after the establishment of an appropriate capital structure, as well as to reflect other changes that may result from the reorganization. The Company expects that, upon effectiveness of any plan of reorganization, its regulated operations will meet the SFAS No. 71 criteria necessary to reflect the effects of regulation in its general purpose financial statements. Such rates may include the recovery of some or all items that, at that time, are not reflected as regulatory assets on the Company's general purpose financial statements. However, in the absence of application of purchase accounting applied in the event of a change in control occurring as part of the reorganization, there does not appear to be any applicable accounting precedent for the restoration of such amounts as assets created prior to the re-adoption of SFAS No. 71. Restoration of such amounts as assets will depend upon a number of factors, including intervening developments in accounting standards and other accounting literature, the outcome of which cannot currently be determined. In March 1993, the Financial Accounting Standards Board's Emerging Issues Task Force reached a consensus that if a rate-regulated enterprise initially fails to meet the regulatory asset recognition requirements of SFAS No. 71, but meets those requirements in a

subsequent period, then regulatory assets should be recognized in the period the requirements are met. Although the Emerging Issues Task Force's consensus applied to rate-regulated enterprises currently meeting the requirements of SFAS No. 71, the Company believes that this consensus supports the Company's position regarding restoring previous net regulatory assets in its general purpose financial statements. In the event it is concluded that such restoration is not appropriate under generally accepted accounting principles, the Company would be precluded from recognizing historical amounts as regulatory assets in its general purpose financial statements. If it is determined that such restoration is appropriate, regulatory assets would be recorded to the extent items allowed to be recovered in the rate making process have not been reflected as assets in the Company's general purpose financial statements.

Texas Rate Matters

On January 10, 1994, the Company and CSW filed the Texas Merger Application with the Texas Commission requesting (i) a determination that the acquisition by CSW of one hundred percent (100%) of the Company's common stock is consistent with the public interest and (ii) certain determinations regarding the regulatory treatment of the Company's proposed reacquisition of the portions of Palo Verde that it previously sold and leased back. The filing is proceeding as part of Docket 12700.

In addition to the Texas Merger Application filed by CSW and EPE, the Company filed the Texas Rate Filing incorporating, among other things, the Company's fifth increase under the terms of the Rate Moderation Plan ordered by the Texas Commission in Docket 7460 and a base rate increase under the inventory plan established for Palo Verde Unit 3 in Docket 9945. The Texas Rate Filing was consolidated with the Texas Merger Application under Docket 12700. The Company filed its rate request with both the Texas Commission and the various municipalities retaining original jurisdiction over the Company's rates. See "Texas Rate Filing." In Docket 12700, the Company further proposed to reconcile its Texas fuel costs and revenues for the period from April 1989 through June 1993 and to decrease its current fixed fuel factors (the "Texas Fuel Filing").

As part of the Texas Merger Application and as a basis of settlement, CSW has proposed rates for Texas jurisdictional customers of the Company that are substantially less than those reflected in the Company's rate case filing. The CSW settlement offer is contingent on the determination by the Texas Commission that CSW's acquisition of the Company is consistent with the public interest and the other regulatory determinations and approvals requested in the Texas Merger Application. The proposed settlement offers (i) to limit the non-fuel base rate increase for Texas jurisdictional customers to $25 million; (ii) a proposed $12.8 million annual reduction in future fuel revenues from the Company's fixed fuel factors; (iii) a refund of $16.4 million over a 12-month period of over-recovered fuel costs and other fuel-related items; and (iv) a rate case expense surcharge of $4.1 million related to previous rate cases to be collected over a 12-month period. Taking into account the annual reduction in fuel costs and the proposed fuel refund, the Company's revenues from Texas jurisdictional customers would not increase during the first year after the rate change goes into effect. The settlement rate plan proposed by CSW also provides for (i) no additional base rate increase until 1997; (ii) a limitation in the frequency of base rate increases following the rate freeze period through 2001 to not more than once every other year (i.e., 1997, 1999 and 2001); and (iii) a limitation on the amount of the 1997, 1999 and 2001 base rate increases, such that each increase would not exceed eight percent of total revenues. CSW's efforts to settle the case, however, have been unsuccessful to date.

During the preliminary stages of Docket 12700, the Company and CSW entered into a stipulation with the City of El Paso, the General Counsel of the Texas Commission, and the OPC whereby the parties agreed that, if at the time the Texas Commission's statutory deadline to enter a rate order would expire all other regulatory approvals or authorizations required by the Merger Agreement have not been issued and CSW is not in a position to state that it is ready to consummate the Merger, the Texas Commission could (i) issue an interim order in Docket 12700 pending the receipt of notification from CSW of the receipt or waiver of such other regulatory orders from other governmental bodies and

(ii) remand the proceeding to its hearings division for the limited purpose of receiving such notice from CSW and considering the comments of all parties regarding the effect, if any, of the orders from other governmental bodies on the Interim Order issued by the Texas Commission.

Docket 12700 proceeded to hearing, and on January 3, 1995, a Proposal for Interim Decision was issued. The Texas Commission considered the Proposal for Interim Decision in hearings conducted in February 1995. On March 3, 1995, the Texas Commission issued the Interim Order concerning both the Texas Merger Application and the Texas Rate Filing. The Interim Order was issued after the two Commissioners sitting in deliberation had reached an impasse concerning certain issues. The third Texas Commission seat was vacant pending the confirmation of a new Commissioner. During deliberations on February 22, 1995, and in a separate concurring opinion issued March 3, 1995, the Chairman of the Texas Commission reserved his option to reconsider his vote on certain issues after receipt of motions for reconsideration from the parties to Docket 12700. The significant issues on which the Chairman specifically reserved his option included the following and are described more particularly below: (i) the conditional nature of the finding that the Merger is in the public interest; (ii) whether to modify the level and amortization period of the acquisition adjustment; (iii) whether to authorize rate treatment of the accounting deferrals for Palo Verde Unit 3 and, if so, the magnitude of such authorization; and (iv) whether to modify the treatment of the tax benefit arising from payment of the Palo Verde lease rejection damages. Motions for reconsideration of these issues were filed March 23, 1995, and replies are due April 3, 1995. The Company anticipates that the Texas Commission will hold a hearing on the motions for reconsideration, and that a Second Interim Order will be issued within the next 60 days. It is also expected that the new third Commissioner, who was confirmed by the Texas Senate on February 22, 1995, will take part in the deliberations and vote on the Second Interim Order.

In light of the stipulation concerning the Interim Order and the uncertainty as to when other federal and state governmental bodies will act on the merger-related filings before them, the Company cannot predict when any order of the Texas Commission in Docket 12700 will become final. The Company also cannot predict whether and to what extent parties to Docket 12700 might appeal any final order to the Texas District Court.

The Texas Commission severed the Texas Fuel Filing from Docket 12700 and issued a separate final order in the Texas Fuel Filing on March 3, 1995, under Docket 13966. The Texas Commission's rulings in the Texas Merger Application, the Texas Rate Filing and the Texas Fuel Filing are described below.

Texas Merger Application. In its Interim Order, the Texas Commission determined that the acquisition of the Company's stock by CSW and the reacquisition of the leased portions of the Palo Verde assets are consistent with the public interest pursuant to Section 63 of the Public Utility Regulatory Act. The Texas Commission, however, issued a finding of fact and conclusion of law to the effect that the acquisition by CSW of the Company's stock is at a reasonable price and is in the public interest subject to successful resolution of certain matters relating to Palo Verde and the City of Las Cruces. See "Facilities – Palo Verde Station – Palo Verde Operations," and Part II, Item 7, "Management's Discussion and Analysis of Financial Conditions and Results of Operations – Operational Challenges – City of Las Cruces."

With respect to the previously leased portions of the Palo Verde assets, the Interim Order adopts the Company's and CSW's proposal to include the assets in rate base at their original cost less depreciation through December 31, 1994. The Interim Order also concludes that synergy cost savings will accrue to the merged companies in the range of approximately $309 million to $379 million over the first ten years of the Merger. The Interim Order rejects CSW's primary request that it retain the tax benefits arising from the damages resulting from the Company's rejection of the Palo Verde Leases, and instead utilizes the tax benefits to reduce the Company's rate base by approximately $133 million. At the same time, the Interim Order provides for the Company to recover from ratepayers a $151 million acquisition adjustment to be amortized to cost of service over 33 years, without inclusion of the unamortized balance in rate base. CSW has stated that the alternative $151 million acquisition

adjustment does not provide CSW with the economic equivalence of CSW's primary request that it retain the tax benefits of the lease rejection damages.

Texas Rate Filing. The total amount of the Company's requested cash base rate increase, exclusive of fuel, is approximately $41.4 million. The total cash base rate increase consists of (i) a base rate increase of $8.3 million, constituting the proposed 3.5 percent increase contemplated under the Rate Moderation Plan established in Docket 7460 for costs other than those associated with Palo Verde Unit 3 and (ii) a base rate increase of $33.1 million, constituting the proposed increase under the inventory plan for Palo Verde Unit 3. The Company also requested the addition of approximately $10.9 million to its Docket 7460 Rate Moderation Plan deferral balance. As discussed above, CSW made a contemporaneous settlement offer that proposed rates lower than those reflected in the Company's rate filing, but that settlement offer has not been accepted.

The Company did not include in the Texas Rate Filing a request to recover the costs of bankruptcy reorganization or the $288.4 million from the draws on the letters of credit related to the Company's sales and leasebacks of portions of its interest in Palo Verde, which draws occurred in late December 1991 and early January 1992. The Company has reserved the ability to seek recovery of such costs if the Plan does not become effective.

By ordinance signed on June 22, 1994, the El Paso City Council denied the Company's requested rate increase and adopted a recommendation from the City of El Paso's Public Utility Regulation Board that base rates for residents in the City of El Paso be reduced by $15.7 million annually. The Company appealed this order to the Texas Commission where it was consolidated with the current rate case in Docket 12700 and is being reviewed de novo by the Texas Commission.

Effective July 16, 1994, the Company implemented a cash base rate increase of approximately $25 million annually, under bond and subject to refund depending on the outcome of the rate case, for its Texas jurisdictional customers. The Company deposited approximately $4.7 million of United States Treasury securities in escrow to provide security for the bonded rates. The bonded rate increase was authorized by applicable statute and regulation. Because of the current uncertainty as to the final outcome of the proceeding, the Company has deferred recognition of the revenue resulting from the increased rates aggregating approximately $11.5 million as of December 31, 1994.

In the Interim Order issued March 3, 1995, the Texas Commission approved a total annual increase in Texas base revenues of approximately $24.9 million. The Texas Commission also approved a rate case expense surcharge of $9.7 million to be recovered over twelve months. The Company expenses rate case costs as incurred on its general purpose financial statements. The order, however, was not immediately placed in effect, due to the Texas Commission's decision to entertain motions for reconsideration. While these motions are pending, the Company's bonded rate increase of approximately $25 million will remain in place.

With respect to the rate treatment of Unit 3, the Texas Commission approved the Company's request to include eighty-five percent (85%) of the cost of the unit in rate base in accordance with the inventory plan established by the Texas Commission in Docket 9945. The Texas Commission disallowed the Company's request to include in rate base approximately $43.3 million at June 30, 1993, net of deferred taxes, of costs deferred on Palo Verde Unit 3 between the unit's in-service date and the date of its inclusion in Texas rates. In addition, the Texas Commission disallowed related depreciation of approximately $12 million. These deferred costs and the depreciation disallowance are subject, however, to reconsideration pursuant to the Interim Order. See "Deferred Accounting Cases" below.

With respect to the rate treatment of Units 1 and 2, the Interim Order discontinues the Rate Moderation Plan established in Docket 7460. In Docket 7460, the Texas Commission established a Rate Moderation Plan, pursuant to which the Texas jurisdictional portion of the Company's cost of

service, excluding Palo Verde Unit 3 capital costs, were to be phased-in to rates in four steps. All approved cost of service amounts not phased-in to rates were deferred for future recovery pursuant to the terms and conditions of the Rate Moderation Plan. In lieu of the Rate Moderation Plan, the Interim Order places in rate base all amounts deferred in connection with the Rate Moderation Plan through February 1993 and eliminates from recovery all amounts that would have been deferred thereafter. The Interim Order would remove approximately $16.0 million, net of deferred taxes, in Rate Moderation Plan deferrals as of December 31, 1994.

As a result of the Company's elimination of net regulatory assets from its balance sheet as of December 31, 1991, and subsequent non-recording of any new assets reflecting the economic effects of regulation since 1991, the denial of rate base recognition of the Palo Verde Unit 3 deferred costs and the removal of deferred amounts associated with the Rate Moderation Plan after February 1993 will have no effect on the Company's general purpose financial statements.

Texas Fuel Filing. As a result of the fuel reconciliation and treatment of other fuel-related items, the Company proposed in the Texas Fuel Filing to refund to Texas jurisdictional customers (as a credit to fuel revenue collections) approximately $16.4 million over a 12-month period. The Company also proposed in the Texas Fuel Filing a decrease in its fixed fuel factors that was anticipated to reduce future fuel revenues by approximately $14.3 million annually. Although the Texas Fuel Filing was considered by the Texas Commission as part of the Texas Rate Filing in Docket 12700, the Texas Commission severed the fuel-related proceedings from the rate proceeding and issued a separate final order in the Texas Fuel Filing on March 3, 1995, under Docket 13966. The Texas Commission ordered a fuel cost refund to Texas customers of approximately $13.7 million. The Texas Commission also ordered, consistent with the Company's request, a reduction in the Company's fixed fuel factors that will result in a reduction in fuel cost recovery on a prospective basis of approximately $14.3 million annually.

For the fuel reconciliation period, the Company was allowed to retain all margins on off-system sales to CFE, consistent with the Texas Commission's order in Docket 9945. For reconciliation period off-system sales of contingent capacity to the IID, the Texas Commission decided to split the margins, with seventy-five percent (75%) going to ratepayers and twenty-five percent (25%) going to Company shareholders. The Commission adopted the same 75/25 split, but adjusted for incremental costs, for all off-system sales on a prospective basis including CFE, IID-Contingent and economy energy sales.

Based on the Texas Commission's rulings on fuel reconciliation matters and off-system sales, the Company has recorded a provision representing an overrecovery of Texas jurisdictional fuel costs for the period from the end of the last fuel reconciliation period (June 1993) through December 1994. The total overrecovery from July 1993 to December 1994 is approximately $19.6 million. Under a new fuel rule adopted in January 1993 by the Texas Commission, the Company may petition the Commission to refund this overrecovery. The Company may consider the remand of Docket 8588 in its calculation of any refund. See "Recovery of Fuel Expenses." The Company would propose to make any refund over a 12-month period.

Motions for rehearing of the Texas Commission's final order in Docket 13966 were filed on March 23, 1995. Replies to the motions are due April 3, 1995. The Texas Commission will be required to act on the motions by April 18, 1995, or the motions will be overruled by operation of law.

Bankruptcy Court Adversary Proceeding. The Company and CSW filed a joint motion with the Bankruptcy Court on July 21, 1994, seeking an order that would prohibit relitigation in the Texas Merger Application and Texas Rate Filing of issues that were resolved by the Bankruptcy Court in connection with the confirmation of the Plan. The matters at issue were converted to an adversary proceeding by the Company and CSW filing a complaint for declaratory judgment on August 19, 1994. The complaint identifies the following issues and requests that the Bankruptcy Court enter an order declaring that no party before the Texas Commission, including OPC, the City of El Paso or the General Counsel of the Texas Commission, may relitigate any of the following issues: (i) whether the

litigation related to the Palo Verde Leases between the Company and the lease bondholders, the Owner Trustee and other persons asserting a claim or interest related to the Palo Verde Leases should have been settled and if so on what terms, (ii) whether liquidation should have been considered or pursued as a viable option to reorganization, (iii) whether the Plan is feasible, and (iv) whether the enterprise value for the Company and the consideration to be provided to creditors and equity holders established by the Plan is excessive. On September 14, 1994 CSW filed a notice of dismissal from the adversary proceeding, stating that "while it supports a timely resolution to the preemption issues, its participation is not necessary to a full and complete adjudication of the matters."

On August 30, 1994, the Company filed a motion for summary judgment, which has not yet been ruled upon by the Bankruptcy Court. On December 29, 1994, the Bankruptcy Court issued an order denying motions to dismiss filed by the City of El Paso, the New Mexico Commission, the Texas Commission and OPC. In a memorandum opinion accompanying its order, the Bankruptcy Court stated that, to the extent the ratemaking authorities (the City of El Paso, the Texas Commission and the New Mexico Commission) participated as parties-in-interest in the confirmation of the Plan, the Bankruptcy Court has jurisdiction over those parties to determine if they are attempting to relitigate findings of fact the Bankruptcy Court made in confirming the Plan or if the factual issues ripe for determination in the regulatory process are different from those which the Bankruptcy Court decided in the confirmation process. On January 20, 1995, the Company filed its Second Motion for Summary Judgment asserting that the Bankruptcy Court's finding in the confirmation order that the price to be paid by CSW to acquire the stock of the Company is reasonable precludes the Texas Commission from concluding otherwise in Docket 12700. See "Texas Merger Application." On March 1, 1995, the Company filed a motion to continue the Bankruptcy Court's March 6, 1995 docket call on the Company's Second Motion for Summary Judgment and March 8, 1995 hearing on certain motions for abstention and for more definite statement filed by the defendants. In its motion to continue, the Company cited the Texas Commission's decision in its Interim Order in Docket 12700 to allow motions for reconsideration of its conditional conclusion that the Merger is in the public interest, subject to successful resolution of the City of Las Cruces and Palo Verde matters. See "Texas Rate Filing." On March 3, 1995, the Bankruptcy Court entered an order continuing the March 6, 1995 docket call and the March 8, 1995 hearing. The ultimate outcome of the adversary proceeding in the Bankruptcy Court and any possible appeals thereof cannot be predicted at this time.

Docket 9945. The Texas Commission issued its final order in Docket 9945 on November 12, 1991, approving a total increase in Texas base revenues of approximately $47 million, consisting of $37 million in cash and $10 million of phase-in deferrals. The increase did not include any current return of or return on the owned portion of Unit 3 or recovery of the lease expenses related to Unit 3. Recovery of these costs has been held in abeyance to be included subsequently in Texas rates over a scheduled period of time. See "Texas Rate Filing" and "Deferred Accounting Cases."

With respect to the rate treatment of Unit 3, the Texas Commission disallowed approximately $32 million of Unit 3 capitalized costs, on a total Company basis, as imprudently incurred. The Texas Commission also adopted an inventory plan, pursuant to which the Company's investment in Unit 3 was neither included in rates nor expressly disallowed, but instead held in abeyance to be included subsequently in Texas rates over a scheduled period of time. In justifying the inventory plan, the Texas Commission found (i) the Company was imprudent in not attempting to sell a portion of its interest in Palo Verde between 1978 and 1981; (ii) the Company failed to demonstrate that it would not have been able to sell such interest if it had attempted to do so; and (iii) as a result of such imprudent action, the addition of Unit 3 to the Company's system would result in excess capacity. However, the Texas Commission further found that Unit 3 would become "used and useful" to the Texas jurisdiction in the following percentages: 0% (in Docket 9945), and 40%, 65%, 85% and 100% thereafter. It is the Company's position that the successive phases of the inventory plan were to be implemented on an annual basis. In the Texas Rate Filing, some parties have contested whether the inventory plan constituted a proper determination by the Texas Commission of when Unit 3 would become used and useful. These parties further contest whether the inventory plan requires implementation of a five year schedule for inclusion of the investment. The Commission's current

Interim Order in Docket 12700 adopts the Company's position concerning the inventory plan. See "Texas Rate Filing."

The Company disputes there was any imprudence in retaining its full investment in Palo Verde. The Company challenged the Texas Commission's ruling in the Company's Motions for Rehearing and has continued such challenge on appeal to the Texas District Court. The City of El Paso and two intervenors also appealed certain other issues. On October 27, 1993, the Texas District Court affirmed the final order of the Texas Commission except in two respects. The Texas District Court held the Texas Commission erred (i) by refusing to include certain disallowed and below-the-line utility expenses as deductions when computing federal income tax expense for ratemaking purposes, further discussed below under "Ratemaking Treatment of Federal Income Taxes," and (ii) by granting rate base treatment for post-in-service deferred carrying costs associated with Units 1 and 2 of Palo Verde. The District Court affirmed the Commission's decision regarding Palo Verde Unit 3 deferrals, whereby the Commission had postponed the determination of the appropriate regulatory treatment of the deferrals to future cases. The District Court's holding regarding Unit 1 and 2 accounting deferrals is now inconsistent with the subsequent decision of the Texas Supreme Court in the appeal of Docket 7460, discussed below under "Deferred Accounting Cases." The Company appealed the decision to the Court of Appeals, as did the City of El Paso and two other intervenors. The Court of Appeals heard oral argument in the case on November 9, 1994 and has not yet issued its decision. The ultimate outcome of the appeals and their results or the materiality thereof cannot be predicted at this time.

Recovery of Fuel Expenses. The Company's prior reconciliation of fuel expenses, Docket 8588, was for the period August 1, 1985 through March 31, 1989. The Company and the City of El Paso appealed the Texas Commission's order in Docket 8588 to the Texas District Court. On November 25, 1991, the Texas District Court entered judgment on the appeals, upholding the Texas Commission's order on all points except the Company's appeal of the treatment of certain purchased power capacity costs incurred during 1985 and 1986. With regard to those costs, totaling approximately $4.2 million, the Texas District Court held that the Texas Commission erred in failing to justify adequately its decision not to allow the Company to recover such costs through its reconcilable fuel account. The Texas District Court remanded the case to the Texas Commission with instructions to reconsider the allowance of such costs. Both the Texas Commission and the City of El Paso appealed the Texas District Court's decision to the Court of Appeals. On March 10, 1993, the Court of Appeals affirmed the decision of the Texas District Court. On February 2, 1994, the Texas Supreme Court denied the applications for writ of error filed by the City of El Paso and the Texas Commission. The case has been remanded to the Texas Commission for a new hearing to address whether the Company should be allowed to include the purchased power capacity charges as reconcilable fuel costs and recover such costs. The ultimate outcome of this remand cannot be predicted at this time.

Deferred Accounting Cases. The Company has received a series of orders authorizing the deferral of operating costs incurred, and carrying charges accrued, on each unit of Palo Verde between the unit's in-service date and the date of its inclusion in Texas rates. Certain rate orders have also permitted the Company to include in rate base and amortize into rates the deferred costs associated with Units 1 and 2 (approximately 40 years for ratemaking purposes).

The Company's first order allowing the recovery of accounting deferrals (in Docket 7460 regarding Units 1 and 2) has been finally resolved by the Texas Supreme Court. On June 22, 1994, the Texas Supreme Court reversed the decision of the Court of Appeals and upheld the Texas Commission's authority to include both the Company's deferred operating costs and deferred carrying costs in rate base in City of El Paso v. Public Utility Commission, 883 S.W.2d 179 (Tex.1994) ("City v. PUCT"). On October 6, 1994, the Texas Supreme Court overruled motions for rehearing of the matters. As a result of the Texas Supreme Court's ruling, the Company expects to be able to continue to include in rate base and to amortize into rates the deferred carrying and operating costs associated with Palo Verde Units 1 and 2.

In Docket 9069, the Texas Commission granted the Company a deferred accounting order authorizing it to defer operating and carrying costs associated with Palo Verde Unit 3 between the plant's in-service date and the date its costs were included in rates. The City of El Paso and the State of Texas appealed this order to the Texas District Court. The City of El Paso, however, dismissed its appeal. The State of Texas' appeal remains pending, with a hearing expected in June of 1995. Subsequent to the filing of these appeals, the Texas Supreme Court issued its decision in the appeal of Docket 7460 upholding the legality of deferred accounting orders. The Company believes that the deferred accounting order in Docket 9069 complies in all respects with the Texas Supreme Court's decision, but the ultimate outcome of the appeal and its result or the materiality thereof cannot be predicted at this time. For further discussion of Unit 3 deferrals, see "Docket 9945" and " Texas Rate Filing."

The recovery of the Palo Verde Unit 3 accounting deferrals is currently an issue in the Texas Rate Filing. In City v. PUCT, the Texas Supreme Court established a new requirement that, in the first rate case in which deferrals are included in rates, a utility must demonstrate that the deferrals are needed to protect the utility's financial integrity. The Company initially requested inclusion of the Palo Verde Unit 3 deferrals in rates in Docket 9945. The Texas Commission, however, postponed the review of those deferrals until the Company's next rate case. See "Docket 9945." Consequently, the Company once again requested recovery of the Palo Verde Unit 3 deferrals in rates in Docket 12700. See "Texas Rate Filing." Because the Texas Supreme Court's opinion in City v. PUCT was issued after the Company had filed its testimony in Docket 12700, the Company filed supplemental testimony demonstrating that all of the Palo Verde Unit 3 deferrals were needed to protect the Company's financial integrity during the deferral period. The Texas Commission Staff filed supplemental testimony which concurred with the Company's position.

Certain of the intervenors in Docket 12700 have taken the position that the Texas Supreme Court's opinion in City v. PUCT requires proof that recovery of the accounting deferrals must be necessary to protect the financial integrity of the utility at the time of the subsequent rate case. It is the Company's position that it must demonstrate that recovery of the accounting deferrals is instead necessary to preserve financial integrity during the deferral period. However, the Texas Commission has not conclusively reached a decision on this issue. The ultimate outcome of the Texas Commission's decision and any possible appeals of the Commission's decision cannot be predicted at this time.

Rate Case Expenses Incurred in Docket 7460. The issue of recovery of expenses incurred by the Company and the City of El Paso in connection with Docket 7460 was severed from the issues ruled upon by the Texas Commission in that docket and was assigned to a new Docket 8018 for consideration. On September 20, 1991, the Texas Commission issued its final order in the case and approved the reimbursement of approximately $10.8 million for expenses incurred by the Company and approximately $1.1 million for expenses incurred by the City of El Paso. The Texas Commission further directed that such amounts be surcharged to the Company's Texas customers over a one-year period, which the Company completed in November 1992. The City of El Paso filed an appeal of the Texas Commission's order in Docket 8018 with the Texas District Court. The Texas District Court affirmed the Texas Commission's decision on March 18, 1994. On April 15, 1994, the City of El Paso filed notice of intent to appeal to the Court of Appeals the decision of the Texas District Court. Briefs have been filed by the parties in the Court of Appeals, and the parties presented oral arguments to the Court of Appeals on February 15, 1995. The ultimate outcome of the appeal and its result or the materiality thereof cannot be predicted at this time.

Texas Recognition of Palo Verde Sales and Leasebacks. The Texas Commission found the Company's sales and leasebacks involving Units 2 and 3 of Palo Verde to be in the public interest in two different cases. The City of El Paso's appeal of the Texas Commission's decision related to the Unit 2 sales and leasebacks (Docket 8363) is pending before the Texas District Court. The Texas District Court affirmed the Texas Commission's order with respect to Unit 3 (Docket 8078) in all respects in August 1994 and the City of El Paso's appeal of such decision is pending before the Court of

Appeals. The Company cannot predict the outcomes of the appeals of Dockets 8363 and 8078 or the materiality thereof.

Performance Standards for Palo Verde. In 1991, the Texas Commission established performance standards in Docket 8892 for the operation of the Palo Verde units. Each Palo Verde unit included in Texas rates is evaluated annually to determine if its three-year rolling average capacity factor entitles the Company to a reward or a penalty. There are five performance bands based around a target capacity factor of 70%. Neither a penalty nor a reward would result from capacity factors from 62.5% to 77.5%. Capacity factors are calculated as the ratio of actual generation to maximum possible generation. If the capacity factor for any unit is 35% or less, the Texas Commission is required to initiate a proceeding to determine whether such unit should continue to be included in rate base. The performance standards are effective as of the date each unit is included in Texas rates, which was April 22, 1988 for Units 1 and 2 and December 16, 1991 based on the inventory percentages, as discussed above, for Unit 3. The Company has previously accrued performance penalties of approximately $5.1 million for the performance periods of April 1988 through April 1992, which the Texas Commission included in ordering a refund in Docket 13966. See "Texas Fuel Filing."

In June 1994, the Company filed its annual performance report with the Texas Commission for Units 1 and 2. In February 1995, the Company filed its initial performance report on Unit 3 reflecting 0% in rates for 1992, 40% in rates for 1993 and 65% in 1994, all based on the inventory percentages ordered in Docket 9945. The Company incurred neither a penalty nor a reward for either report. The three-year capacity factor was 73.5% for Unit 1, 62.8% for Unit 2 and 74.5% for Unit 3. The Company expects the report to be filed for Units 1 and 2 with the Texas Commission in 1995 to reflect performance for Unit 1 resulting in neither a reward nor a penalty and for Unit 2 resulting in a penalty of approximately $162,000. Based on historical performance and projected performance, including planned outages and a provision for unplanned outages, and the three-year rolling average for capacity measurement, current projections are that Unit 2 will incur an additional penalty for the period ending in April 1996 of approximately $369,000. The Company has made provisions for these possible penalties in its financial statements. Projections for Unit 1 and Unit 3, using the methodology discussed above, reflect no penalty for the next reporting period.

Ratemaking Treatment of Federal Income Taxes. In a 1987 case, Public Utility Commission of Texas v. Houston Lighting & Power Co., 748 S.W.2d 439 (Tex. 1987), the Texas Supreme Court stated that, under certain circumstances, it is appropriate to allow only "actual taxes incurred" for ratemaking purposes. The Court of Appeals has applied the Texas Supreme Court decision to several other utilities, most notably Public Utility Commission of Texas v. GTE-Southwest, 833 S.W.2d 153 (Tex. App. - Austin 1992, writ granted). The Texas Supreme Court heard oral argument in the GTE-Southwest case in September 1993 but has not yet issued its decision.

There is significant uncertainty as to the application of the "actual taxes incurred" methodology by the Texas Commission. Prior to 1992, the Texas Commission historically granted rates that included an income tax component based on a "stand alone" basis and on the utility's allowed return on equity. The Texas Commission has altered this policy and applied various forms of the "actual taxes incurred" methodology in recent rate proceedings involving other utilities. The application of that methodology is currently at issue in the Texas Rate Filing. In its Interim Order, the Texas Commission has applied a form of the actual taxes methodology. See "Texas Rate Filing."

The appeals related to Dockets 8363 and 9945 include claims that the Texas Commission failed to adhere to the "actual taxes incurred" methodology in setting the federal income tax expense component of the Company's rates. As a result, any remand of Dockets 8363 or 9945 to the Texas Commission could include a reconsideration of the respective federal income tax components, which were based on the "stand alone" methodology previously used by the Commission.

Depending on the outcome of any such remand, the Company may be required to refund certain amounts collected in rates during the period the Docket 8363 and 9945 rates were in effect. The

likelihood and amount of any refunds are uncertain at this time because the ultimate outcome of the pending appeals is unknown, and the Company cannot predict the result of any remand.

New Mexico Rate Matters

Rate Moderation Plan - Palo Verde. In 1987, the New Mexico Commission approved a Stipulation in Case No. 2009 establishing a rate moderation plan, pursuant to which the New Mexico jurisdictional portion of the Company's interest in Palo Verde Unit 1 and one-third of Common Plant and approximately 83% of the lease payments on Unit 2 and the related Common Plant were phased-in to rates in three steps. After the third step of the phase-in, the rate moderation plan required the Company to freeze New Mexico rates through December 31, 1994. CSW has agreed to keep this rate freeze in effect for an additional three years if the Merger becomes effective. The rate moderation plan also required the Company to file a cost of service report every two years through the end of 1996 to enable the New Mexico Commission to determine whether the Company was overearning. See "Annual Filing Requirements" below. The Case No. 2009 Stipulation also required, that in lieu of a prudence review of the Company's participation in the Palo Verde project, all costs associated with Unit 3, and the associated Common Plant, would be permanently excluded from New Mexico rates.

The Company must recover the New Mexico jurisdictional portion of the Company's investment in Unit 3 through off-system sales in the economy energy market. For several years, market prices for economy energy sales have not been at levels sufficient to recover the New Mexico portion of the Company's current operating expenses related to Unit 3, including decommissioning costs and lease payments. The Company expects these market prices to remain at such levels in the near term. The Company projects, but cannot assure, that the market prices of economy energy ultimately will rise to a level sufficient to recover the New Mexico jurisdictional portion of the Company's investment in Unit 3 over the remaining life of the asset.

Performance Standards for Palo Verde. In 1986, the New Mexico Commission established performance standards in Case No. 1833 for the operation of Palo Verde. The entire station is evaluated annually to determine if its achieved capacity factor entitles the Company to a reward or a penalty. There are five performance bands based around a target capacity factor of 67.5%. Neither a penalty nor a reward would result from capacity factors from 60% to 75%. The capacity factor is calculated as the ratio of actual generation to maximum possible generation. Since Unit 3 is not in rate base for purpose of New Mexico rates, any penalty or reward calculated on a total station basis is limited to two-thirds of such penalty or reward. If the annual capacity factor is 35% or less, the New Mexico Commission is required to initiate a proceeding to reconsider the rate base treatment of Palo Verde. See "Annual Filing Requirements" below.

Annual Filing Requirements. Pursuant to the New Mexico Commission's order in Case 1833 the Company must make annual filings, at least through the term of the rate moderation plan, to reconcile fuel costs and establish the fixed fuel factor for New Mexico customers. An annual performance standards report is included in the fuel reconciliation and any resulting rewards or penalties are included in the establishment of a new fixed fuel factor, if a new fuel factor is warranted. The Company has received an extension through April 3, 1995 to file its annual fuel reconciliation report for 1994. The Company anticipates that the fuel report will show a moderate decrease in its current fuel factor. The Company expects the annual performance standards report to show a Palo Verde capacity factor of approximately 69.5%. As a result, neither a reward nor a penalty will be incurred due to the 1994 Palo Verde operations. The new fuel factor should be included in bills rendered on or after May 1, 1995, unless otherwise ordered by the Commission.

As noted above, the rate moderation plan also requires the Company to file a cost of service report every two years through the end of 1996 to enable the New Mexico Commission to determine whether the Company is overearning. The last such report was filed on June 17, 1994. This report indicated the Company, on a stand-alone basis, was not overearning, and in fact had a non-fuel revenue deficiency of $12.6 million for the New Mexico service territory if the letter of credit draws on the

Unit 2 portion of the Company's sale and leaseback transactions and administrative costs of the Bankruptcy Case were factored into the calculation. The Company cannot assure that these costs would be recognized for ratemaking purposes by the New Mexico Commission, or that the New Mexico Commission would grant the Company a rate increase based upon the information in this compliance filing. If the Merger becomes effective, CSW has agreed to freeze base rates at current levels for the New Mexico jurisdiction following the Effective Date.

FERC Regulatory Matters

The majority of the Company's rates for wholesale power and transmission services are subject to regulation by FERC. Sales of wholesale power subject to FERC regulation make up a significant portion, approximately 12% in 1994, of the Company's operating revenues. Although rates to wholesale customers require FERC approval, the Company and its wholesale customers generally have established such rates through negotiation, based on certain cost of service assumptions, subject to FERC acceptance of the negotiated rates.

The Company has a long-term firm power sales agreement with IID providing for the sale of 100 MW of firm capacity to IID through April 2002. The Company also provides contingent capacity of 50 MW to IID. The agreement generally provides for level sales prices over the life of the agreement, which were intended to recover fully the Company's projected costs, as well as a return. Because of the levelized rate, such costs and return were anticipated to exceed revenues for a number of the early years of the agreement with a reciprocal effect in the later years of the agreement. The Company has accrued revenues under the terms of the agreement in the amounts of $1.2 million, $2.4 million, and $2.9 million in 1994, 1993 and 1992, respectively. Such accrued amounts, which since the inception of the agreement aggregate $34 million as of December 31, 1994, are recorded as a long-term contract receivable on the Company's balance sheets. Based on the contractual payments, recovery of the unbilled amounts should begin in 1995. The agreement also provides that the Company may seek increases in the sales price if sufficient evidence exists to determine that certain operating costs have increased above those used in determining the original sales price.

The Company has a firm power sales agreement with TNP, providing for sales to TNP in the amount of 75 MW through 2002, subject to provisions in the agreement that allow a reduction to a minimum of 25 MW in the amount of demand on a yearly basis. TNP has provided the Company notice that it would take advantage of the provisions to reduce the contract demand to 25 MW for 1994, 1995 and 1996, while preserving its option to maintain or increase its contract demand in subsequent years. Sales prices, which decline over the life of the agreement, are based on substantially the same scheduled and projected costs and return as the IID agreement discussed above.

Rate tariffs currently applicable to IID and TNP contain fuel and purchased power cost adjustment provisions designed to recover the Company's fuel and purchased power costs.

Additionally, the Company supplies Rio Grande Electric Cooperative, Inc. with the full electric requirements for its Van Horn and Dell City, Texas, service areas.

Other Wholesale Customers

The Company has a sales agreement with CFE to provide capacity and associated energy to CFE over a base term that began May 1, 1991 and ends December 31, 1996. The agreement may be extended monthly after that date upon the agreement of the parties. The power sales will be 150 MW during the summer months and 120 MW at other times of the year through the remaining term of the agreement. To support the requirements of the agreement with CFE, the Company entered into a firm power purchase agreement with SPS for at least 50 MW during the base term of the CFE contract. The obligations of CFE under the agreement are subject to continued budgetary authorization by the Ministry of Programming and Budgeting of Mexico for each calendar year. Pricing for the power sales includes an escalating capacity charge and recovery of energy costs at system-average costs plus third

party energy charges. The agreement provides for payments to be made by CFE in United States dollars.

Construction Program

The Company has no current plans to construct any new generating facilities through the year 2000. Utility construction expenditures reflected in the table below consist primarily of expanding and updating the electric transmission and distribution systems and the cost of betterments and improvements relating to the Palo Verde Station. The Company's estimated cash construction costs for 1995 through 1998 set forth in the table below are approximately $232 million. Actual costs may vary from the construction program estimates set forth below. Such estimates are reviewed and updated periodically to reflect changed conditions.

By Year (1) (In millions)		By Function (In millions)	
1995	$ 80	Production (1)	$ 59
1996	39	Transmission	54
1997	43	Distribution	94
1998	70	General	25
Total	$ 232	Total	$ 232

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

Facilities

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

Palo Verde Station

As of the date it filed the bankruptcy petition, the Company owned or leased a 15.8% interest in each of the three 1,270 MW nuclear generating units and Common Plant at the Palo Verde Nuclear Generating Station located west of Phoenix, Arizona. The Palo Verde Participants include the Company and six other utilities: APS, Southern California Edison Company, PNM, Southern California Public Power Authority, Salt River Project Agricultural Improvement and Power District and the Los Angeles Department of Water and Power. APS serves as operating agent for Palo Verde.

Operation of each of three Palo Verde units requires an operating license from the NRC. The NRC granted facility operating licenses for Unit 1, Unit 2 and Unit 3 at Palo Verde for terms of forty years each, beginning December 31, 1984, December 9, 1985, and March 25, 1987, respectively. Full power operating licenses, each valid for forty years, were issued by the NRC for Units 1, 2, and 3 in June 1985, April 1986, and November 1987, respectively. The full power operating licenses authorized APS, as operating agent for Palo Verde, to operate the three Palo Verde units at full power. In addition, the Company (along with the Palo Verde Participants other than APS) is separately licensed by the NRC to own its proportionate share of Palo Verde.

ANPP Participation Agreement. Pursuant to the ANPP Participation Agreement, the Palo Verde Participants share costs and generating entitlements in the same proportion as their percentage interests in the generating units and each Palo Verde Participant is required to fund its proportionate

share of operation and maintenance, capital and fuel costs. The Company's total monthly share of these costs is approximately $7 million. The ANPP 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. See "Bankruptcy Proceedings and Proposed Merger with CSW – Treatment of Palo Verde," above.

Sale and Leaseback Transactions. The Company sold and leased back all of its undivided 15.8% interest in Unit 2 and one-third of its undivided interest in certain Common Plant at Palo Verde in August and December 1986 and approximately 40% of its undivided 15.8% interest in Unit 3 in December 1987. The sales were to an Owner Trustee as trustee for the Owner Participants. Of the total sales price of approximately $934.4 million, the Owner Participants paid approximately $192 million. The balance of the sales price was obtained through the issuance of lease obligation bonds secured through a pledge by the Owner Trustee of its rights under the leases with the Company and, with respect to Unit 3, a pledge of the undivided interest. Pursuant to the Plan, the leases would be rejected and the Owner Participants would reconvey all of their respective interests subject to the sale/leaseback transactions back to the Company so the Company would hold an undivided 15.8% interest in each Unit and the Common Plant. See "Bankruptcy Proceedings and Proposed Merger with CSW – Treatment of Palo Verde," above.

Liability and Insurance Matters. The Palo Verde Participants have insurance for public liability payments resulting from nuclear energy hazards to the full limit of liability under federal law. This potential liability is covered by primary liability insurance provided by commercial insurance carriers in the amount of $200 million and the balance by an industry-wide retrospective assessment program. The maximum assessment per reactor under the retrospective rating program for each nuclear incident is approximately $79.2 million, subject to an annual limit of $10 million per incident. Based upon the Company's 15.8% interest in the three Palo Verde units, the Company's maximum potential assessment per incident is approximately $37.6 million, with an annual payment limitation of approximately $4.7 million.

The Palo Verde Participants maintain "all risk" (including nuclear hazards) insurance for property damage to, and decontamination of, property at Palo Verde in the aggregate amount of $2.7 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 the accidental outage of any of the three units if the outage exceeds 21 weeks.

Decommissioning. For information regarding the obligations of the Company to plan and fund, over the service life of Palo Verde, its share of the estimated costs to decommission Palo Verde, see Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Operational Challenges – General Industry" and Item 8, "Financial Statements and Supplementary Data – Note E of Notes to Financial Statements." The Company is currently collecting a portion of decommissioning costs for its investment in Palo Verde Units 1 and 2 in all three jurisdictions, and for Unit 3 in its Texas and FERC jurisdictions. The Company must fund the decommissioning requirements for its New Mexico jurisdictional portion of Unit 3 through off-system sales of economy energy. Because the Company is under fixed price contracts with its FERC customers, increases in decomissioning costs must be absorbed through reduced margins on these contracts.

Palo Verde Operations. Palo Verde has experienced degradation in the steam generator tubes of each unit. The degradation includes axial tube cracking in the upper regions of the two steam generators in Unit 2 and, to a lesser degree, in Unit 3. This form of tube degradation is uncommon in the nuclear industry. The units also have experienced a more common type of tube cracking. The tube degradation was discovered following a steam generator tube rupture in Unit 2 in March 1993 and, since that time, APS has undertaken an ongoing investigation and analysis and has performed corrective actions designed to mitigate further degradation.

The corrective actions have included changes in operational procedures designed to lower the operating temperatures of the units, chemical cleaning and implementation of other technical improvements. From September 1993 through mid-summer 1994, the units were operated at reduced power levels of approximately 86% to reduce the operating temperatures. The units were returned to full power with operational modifications that enabled the units to be operated at lower temperatures.

Since the discovery of the tube degradation, each of the units has been removed from service periodically for inspections. The inspections have been performed during regularly scheduled refueling outages and mid-cycle inspection outages. During 1994, Unit 2 was removed from service for two mid-cycle inspection outages and Unit 3 was removed from service for one mid-cycle inspection outage; an inspection also was made during the spring 1994 Unit 3 refueling outage. When tube cracks are detected during an inspection, the affected tubes are taken out of service by plugging. That has occurred in a number of tubes in all three units, particularly in Unit 2, which has the most tubes affected by cracking and plugging. APS has stated that it expects that the remedial actions undertaken will slow the rate of plugging to an acceptable level. APS also has stated that it currently believes that the Palo Verde steam generators are capable of operating for their designed life of forty years, although, at some point in the future, long-term economic considerations may make steam generator replacement a desirable option.

Unit 3 was removed from service for a regularly scheduled refueling outage beginning March 19, 1994 and was returned to service on June 20, 1994. Unit 2 was removed from service for a regularly scheduled refueling outage beginning February 4, 1995 and was returned to service March 30, 1995. Unit 1 is scheduled to be removed from service for a refueling outage beginning in early April 1995 and Unit 3 is scheduled to be refueled again in the fall of 1995.

Water Supply. In connection with the construction and operation of Palo Verde, APS entered into contracts with certain municipalities granting APS the right to purchase effluent for cooling purposes at Palo Verde. In early 1986, a summons was served on APS that required all water claimants in the Lower Gila River Watershed in Arizona to assert any claims to water in an action pending in Maricopa County Superior Court, titled In re The General Adjudication of All Rights to Use Water in the Gila River System and Source, Supreme Court Nos. WC-79-0001 through WC-79-0004 (Consolidated) [WC-1, WC-2, WC-3 and WC-4 (Consolidated)], Maricopa County Nos. W-1, W-2, W-3 and W-4 (Consolidated). Palo Verde is located within the geographic area subject to the summons and the rights of the Palo Verde Participants to the use of groundwater and effluent at Palo Verde is potentially at issue in the action. APS, as operating agent, filed claims that dispute the court's jurisdiction over the Palo Verde Participants' groundwater rights and their contractual rights to effluent relating to Palo Verde and, alternatively, seek confirmation of such rights. On December 10, 1992, the Arizona Supreme Court heard oral argument on certain issues in this matter that are pending on interlocutory appeal. Issues important to the Palo Verde Participants' claims were remanded to the trial court for further action and the trial court certified its decision for interlocutory appeal to the Arizona Supreme Court. On September 28, 1994, the Arizona Supreme Court granted review of the June 30, 1994 trial court decision. No trial date has been set in the matter. The ultimate outcome of this case and the materiality thereof cannot be determined at this time.

Four Corners Project

The Company has an undivided 7% interest in Units 4 and 5 at Four Corners located in northwestern New Mexico. Each of the coal burning generating units has a 739 MW capability. Both units are located adjacent to a surface-mined supply of coal and are jointly owned by the Company, APS (which is the operating agent for Four Corners), TEP, PNM, Southern California Edison Company and Salt River Project Agricultural Improvement and Power District.

Pursuant to 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 Four Corners Units 4 and 5. The Company's total monthly share of these costs is

approximately $1.1 million. The 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. The Company has been paying operating and maintenance, capital and fuel costs related to Four Corners incurred after the date of the Company's bankruptcy petition, but has not paid any amounts incurred prepetition. Under the Plan, the Company intends to assume all of the contracts related to Four Corners. The Company would be obligated to pay the prepetition claims related to such contracts, which approximate $1.2 million.

The Four Corners Plant is located on land held under easements from the federal government and also under a lease from the Navajo Nation. Certain of the transmission lines and almost all of the contracted coal sources for the Four Corners Plant are also located on Navajo land.

The participants in Four Corners are among the defendants in a suit filed by the State of New Mexico in March 1975 in state district court in New Mexico against the United States of America, the City of Farmington, New Mexico, the Secretary of the Interior as Trustee for the Navajo Nation and other Indian tribes and certain other defendants (State of New Mexico ex rel. S. E. Reynolds, New Mexico State Engineer v. United States of America, et al., Eleventh Judicial District Court, County of San Juan, State of New Mexico, Cause No. 75-184). The suit seeks adjudication of the water rights of the San Juan River Stream System in New Mexico, which, among other things, supplies the water used at Four Corners. No trial date has been set in this matter and the case has been inactive for some time. An agreement reached with the Navajo Nation in 1985, however, provides that if Four Corners loses a portion of its rights in the adjudication, the Navajo Nation will provide, at a cost to be determined at that time, sufficient water from its allocation to offset the loss. The ultimate outcome of this case and the materiality thereof cannot be determined at this time.

Newman Power Station

The Newman Power Station, located in El Paso, Texas, consists of three steam-electric units with an aggregate capability of 266 MW and one combined-cycle unit with a capability of 212 MW. The units primarily operate on intrastate natural gas, but also are capable of operating on interstate natural gas and fuel oil. See "Energy Sources–Natural Gas."

Rio Grande Power Station

The Rio Grande Power Station, located in Sunland Park, New Mexico, adjacent to El Paso, Texas, consists of three steam-electric generating units which have an aggregate capability of 246 MW when operating entirely on natural gas. The units operate primarily on interstate natural gas, but are also capable of operating on fuel oil. See "Energy Sources–Natural Gas."

Copper Power Station

The Copper Power Station, located in El Paso, Texas, consists of a 69 MW combustion turbine capable of operating on fuel oil or natural gas and is used for peaking purposes. The combustion turbine and other generation equipment at the station were sold and leased-back by the Company in 1980 pursuant to a twenty-year lease with an option to renew of up to seven years. Such lease is subject to review as an executory contract and would be assumed by the Company under the Plan. The station operates primarily on intrastate natural gas, but also is capable of operating on fuel oil. See "Energy Sources–Natural Gas."

Transmission Lines

The following are the major transmission facilities that the Company owns:

1. A 310-mile, 345 KV transmission line from TEP's Springerville Generating Plant near Springerville, Arizona, to the Luna Substation near Deming, New Mexico, to the Diablo Substation

near Sunland Park, New Mexico. This line is known as the Arizona Interconnection Project (AIP) and provides an interconnection with TEP for delivery of the Company's generation entitlements from Palo Verde and Four Corners. The AIP also enables the Company to import low cost energy from the Arizona/New Mexico power grid, enhances the Company's transmission system reliability, better equips the Company to meet future strategic generating resource mix requirements and further enables the Company to benefit from economy energy purchases.

2. A 202-mile, 345 KV transmission line from the Arroyo Substation, located near Las Cruces, New Mexico, to PNM's West Mesa Substation located near Albuquerque, New Mexico. This line provides the Company's primary interconnection with PNM over which the Company's Four Corners entitlement is delivered. This entitlement is delivered from Four Corners to West Mesa over PNM's 345 KV and 230 KV transmission system in northern New Mexico. Additionally, through the Company's interconnection with PNM, the Company has a major interconnection with the other five participants in Four Corners, plus access to power the Company obtains from the economy markets west and north of Four Corners.

3. Undivided interests in a 196-mile, 345 KV transmission line from the Newman Power Station across southwestern New Mexico, to TEP's Greenlee Substation in Arizona. Specifically, the Company owns an undivided 40% interest in the 60-mile, 345 KV line between TEP's Greenlee Substation and the Hidalgo Substation near Lordsburg, New Mexico; an undivided 57.2% interest in the 50-mile, 345 KV line between the Hidalgo Substation and the Luna Substation near Deming, New Mexico; and a 100% interest in the 86-mile, 345 KV line between the Luna Substation and the Newman Power Station. This line provides an interconnection with TEP for delivery of the Company's entitlements from Four Corners and Palo Verde, as well as providing added stability, flexibility and reliability to the Company's system.

4. An undivided 66.67% interest in a 125-mile, 345 KV transmission line between the AMRAD Substation near Oro Grande, New Mexico, and SPS's Eddy County Substation near Artesia, New Mexico. This line terminates at a high-voltage direct current converter facility connected with SPS, providing the Company with access to the Southwestern Power Pool power market.

Environmental Matters

The Company is subject to regulation with respect to air, soil and water quality, solid waste disposal and other environmental matters by federal, state and local authorities. These authorities govern current facility operations and exercise continuing jurisdiction over facility modifications. Environmental regulations can change at a rapid pace and cannot be predicted with certainty. The construction of new facilities is subject to standards imposed by environmental regulation and substantial expenditures may be required to comply with such regulations. Recognition in rates of the capital expenditures and operating costs incurred in response to environmental considerations will be subject to normal regulatory review and standards. The Company analyzes the costs of its obligations arising from environmental matters on an ongoing basis and believes it has made adequate provision in its financial statements to meet such obligations.

Clean Air Act. The Clean Air Act Amendments of 1990 (the "Clean Air Act") established new regulatory and permitting programs administered by EPA or delegated to state agencies. Many provisions of the Clean Air Act will affect operations by electric utilities, including the Company. In particular, the following sections may have a significant impact on the Company: Title I dealing with nonattainment of national air ambient quality standards, Title IV dealing with acid rain, and Title V covering operating permits. In addition, provisions addressing mobile sources of pollutants and hazardous air pollutants may have a lesser impact on the Company's operations.

The Company has completed an evaluation of the impact of the Clean Air Act on the Company's operations and has instituted a five-year plan in 1993 to implement Clean Air Act requirements on existing facilities. As part of the plan, the Company will make modifications to existing facilities at

the Newman Power Station and the Rio Grande Power Station, including modifications to the steam generators and combustion turbines and the installation of continuous emissions monitoring equipment. The projected costs of these capital improvements are approximately $5 million over the five-year period of the plan.

Rio Grande Power Station. The Company notified NMED of a spill of approximately 510 barrels of fuel oil which occurred at the Rio Grande Power Station in August 1986. The remedial action plan has been approved, and remediation is progressing. Clean-up costs are currently estimated to be less than $500,000 to be incurred over the next two to three years. The New Mexico Water Quality Act provides for a potential penalty of $1,000 for each day of violation, which for a five-year period could result in a penalty of approximately $2 million. The Company has been in close communication with the NMED and does not believe that a penalty of such magnitude will be assessed. The NMED has filed a proof of claim in the Bankruptcy Case reflecting an alleged obligation in an unspecified sum based on alleged ground water or soil contamination at the Rio Grande Power Station. The Company has recorded the estimated clean-up costs, but has made no provision for any penalty in the accompanying financial statements.

Col-Tex Refinery Site. In November 1991, the Company was notified by the TNRCC that the Company had been identified as a potentially responsible party ("PRP") at the Col-Tex Refinery Texas Superfund Site in Colorado City, Mitchell County, Texas (the "Col-Tex Site"). The State of Texas, on behalf of TNRCC, filed a proof of claim in the Bankruptcy Case for remediation and oversight costs as administrative expenses. In addition, the following entities filed proofs of claim in the Bankruptcy Case related to potential claims for contribution in the event any of such entities has liability for remediation and oversight costs of the Col-Tex Site: ASARCO, Inc., Tesoro Petroleum Company, Fina Oil & Chemical Company and Missouri Pacific Railroad Company. The Bankruptcy Court has approved a Joint Motion for Order Approving the Withdrawal of Proofs of Claim filed by the State of Texas over the objection of Fina Oil. Fina Oil appealed the Bankruptcy Court's order. On January 9, 1995, the Bankruptcy Court approved a settlement agreement between the Company and Fina Oil pursuant to which the Company paid Fina $50,000 and Fina (i) withdrew its proof of claim related to the Col-Tex Site, (ii) released all claims it may have against the Company related to the Col-Tex Site, and (iii) withdrew its appeal of the District Court's order affirming the withdrawal of the State of Texas' Proof of Claim. On March 13, 1995, ASARCO, Inc. filed a notice of withdrawal of its proof of claim. While the protective proofs of claim by the two other entities remain, the Company believes these parties have incurred minimal response costs.

PCB Treatment, Inc. On or about September 26, 1994, the Company received a request from the EPA to participate in the remediation of polychlorinated biphenyls ("PCBs") at two facilities in Kansas City, Missouri (the "Facilities"), which had been operated by PCB Treatment, Inc. ("PTI"). Company manifests indicate that between 1982 and 1986 the Company sent 23 shipments of PCBs or PCB-containing electrical equipment ("PCB Equipment") to PTI, accounting for approximately 3%, by weight, of the PCBs and PCB Equipment received by PTI.

PTI has since discontinued operations and EPA has determined that its abandoned Facilities require prompt remediation. In response to EPA's request, the Company and other similarly situated companies met with EPA on October 21, 1994 to discuss PTI's compliance history, EPA's regulatory oversight of PTI, the condition of the Facilities, the identity of companies that had sent PCBs to PTI, and EPA's legal authority to initiate voluntary or mandatory cleanup.

Based upon current information, it is apparent that more than 1,400 entities sent PCBs to PTI. The Company is working informally with other attendees of the October 21 meeting to: (i) investigate the relationship between PTI, its affiliates and other entities that performed PCB treatment services in association with PTI; (ii) identify all financially-viable entities that sent PCBs to PTI; (iii) calculate by volume the quantities of PCBs contributed by the respective entities; and (iv) identify the most efficient framework for remediating the Facilities. The Company also is evaluating the impact of the bankruptcy filing on its responsibilities with respect to the Facilities. At this early stage, the

Company is unable to determine the extent to which it may bear legal liability for the remediation of the Facilities, or the amount of any such liability. The Company has made no provision in the accompanying financial statements related to this matter.

Energy Sources

General

The following table lists the percentage contribution of coal, gas, uranium, and purchased power to the total KWH energy mix of the Company.

	Uranium	Gas	Coal	Purchased Power
1992	51%	31%	10%	8%
1993	43	29	10	18
1994	45	32	9	14

For a discussion of the recovery by the Company of its fuel costs, see "Regulation — Texas Rate Matters — Recovery of Fuel Expenses," "Regulation — New Mexico Rate Matters — Annual Filing Requirements," and "Regulation — FERC Regulatory Matters."

Nuclear Fuel

Nuclear Fuel Cycle. The fuel cycle for Palo Verde is comprised of the following stages: (i) the mining and milling of uranium ore to produce uranium concentrates; (ii) the conversion of uranium concentrates to uranium hexafluoride; (iii) the enrichment of uranium hexafluoride; (iv) the fabrication of fuel assemblies; (v) the utilization of fuel assemblies in reactors; and (vi) the storage of spent fuel and the disposal thereof. The Palo Verde Participants, including the Company, have made arrangements through contract flexibilities to obtain quantities of uranium concentrate anticipated to be sufficient to meet operational requirements through 1996. Existing contract options could be utilized to meet approximately 50% of requirements from 1997 through 1999 and 30% of requirements for 2000 through 2002. Spot purchases in the uranium market will be made, as appropriate, in lieu of any uranium that might be obtained through contract flexibilities and options. The Palo Verde Participants, including the Company, have contracted for up to 65% of conversion services required through 1998, with options to continue through the year 2000. The Palo Verde Participants, including the Company, have an enrichment services contract with DOE which obligates DOE to furnish the enrichment services required for the operation of the three Palo Verde units over a term expiring in November 2014, with annual options to terminate each year of the contract with ten years prior notice. In view of other alternatives, the Palo Verde Participants have exercised this option, terminating 30% of requirements for 1996 through 1998 and 100% of requirements during the years 1999 through 2002. Purchasers of enrichment services from the DOE are assessed for the costs of the decontamination and decommissioning of DOE enrichment facilities pursuant to provisions of the Energy Policy Act of 1992. Existing contracts will provide fuel assembly fabrication services for at least ten years from the operation date of each Palo Verde unit and, through contract options, approximately fifteen additional years are available.

Spent fuel storage facilities at Palo Verde have sufficient capacity with certain modifications to store all fuel expected to be discharged from normal operation of all of the Palo Verde units through at least the year 2005. 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, on behalf of itself and the other Palo Verde Participants, including the Company, has executed a

spent fuel disposal contract with DOE. The Waste Act also obligates DOE to develop the facilities necessary for the permanent disposal of all spent fuel generated and to be generated by domestic power reactors and to have the first such facility in operation by 1998 under prescribed procedures. In November 1989, DOE reported that such permanent disposal facility will not be in operation until 2010, seven years later than previously reported. As a result, under DOE's current criteria for shipping allocation rights, Palo Verde's spent fuel shipments to the DOE permanent disposal facility would begin in approximately 2025. In addition, APS has indicated that on-site storage of spent fuel may be required beyond the life of Palo Verde's generating units. APS also has indicated that alternative interim spent fuel storage methods will be available on-site or off-site for use by Palo Verde to allow its continued operation beyond 2005 and to store spent fuel safely until DOE's scheduled shipments from Palo Verde begin.

Nuclear Fuel Financing. Pursuant to the ANPP Participation Agreement, the Company has an undivided interest in nuclear fuel purchased and to be purchased in connection with Palo Verde. The Company has a nuclear fuel purchase contract with an independent trust for the purpose of financing the Company's purchases of nuclear fuel. Prior to the filing of the Company's bankruptcy petition, the trust generally financed nuclear fuel and all costs in connection with the acquisition of the Company's share of nuclear fuel for use at Palo Verde up to $125 million pursuant to a borrowing facility that is supported by a letter of credit. The Company had the option of either paying for the fuel from the trust at the time the fuel was loaded into the reactor or paying for the fuel at the time heat was generated by the fuel. Prior to the petition date of the Bankruptcy Case, the Company elected to pay for the fuel as the heat was produced from the fuel. Since the Company filed its bankruptcy petition, the Company has not sought to finance its fuel costs from the trust, but has instead paid for nuclear fuel with internally generated funds.

The trust has filed a proof of claim in the Bankruptcy Case, alleging an unliquidated prepetition amount owed by the Company to it of not less than approximately $70.9 million, plus an additional unliquidated amount for postpetition interest on the obligation and other fees and costs, plus an additional unliquidated amount for fuel consumed by the Company after the petition date (which amount the trust asserts is an administrative expense claim). The trust also has filed a proof of claim in the Bankruptcy Case based on a related note payable to the trust, alleging an unsecured prepetition claim of approximately $9.9 million. The trust contends that it has an enforceable property interest in Palo Verde nuclear fuel, power, energy and revenues, which the Company is disputing in the Bankruptcy Case. The trust and the Company entered into an interim adequate protection order in the Bankruptcy Case, which essentially preserves the rights, positions and arguments of each party, but does not resolve disputes as to the trust's claims and interests in property. See "Bankruptcy Proceedings and Proposed Merger with CSW – Treatment of Claims Under the Plan," above.

Natural Gas

In 1994, the Company's interstate natural gas requirements at the Rio Grande Power Station were met solely with spot natural gas purchases from various suppliers. The Company's interstate gas is transported under a firm gas transportation agreement, which became effective September 1, 1991 and expires in 2001. Based on the current availability of economic and reliable spot natural gas, the Company anticipates it will continue to purchase spot natural gas for the Rio Grande Power Station for the near term. For the long term, the Company will evaluate the continued availability of spot natural gas versus other supplies in obtaining a reliable and economical supply for the Rio Grande Power Station.

The intrastate natural gas requirements for the Newman Power Station and the Copper Power Station are supplied and transported pursuant to an intrastate natural gas contract with Meridian Oil Transportation ("MoTrans"), which is effective through December 31, 1995. Prior to the contract expiring in 1995, the Company will evaluate a continued relationship with MoTrans versus other suppliers to ensure the continued supply of reliable and economic natural gas for the Newman and Copper Power Stations.

The Company's agreements to purchase natural gas are generally executory contracts subject to assumption or rejection in the Bankruptcy Case. The Company has filed a statement with the Bankruptcy Court indicating that it intends to assume the MoTrans Agreement on the Effective Date.

Coal

The Company believes that the Four Corners Plant has sufficient reserves of low sulfur coal (the sulfur content of which is currently running at 0.8%) committed to the plant to continue operating it for its useful life. APS purchases all of the coal which fuels the Four Corners Plant from a coal supplier with a long-term lease of coal reserves owned by the Navajo Nation. In 1994, the prices paid for coal were relatively stable, although applicable contract clauses permit escalations under certain conditions. In addition, major price changes from time to time result from contract renegotiation. APS, as operating agent for Four Corners, entered into an incentive coal price agreement on behalf of the Four Corners Participants effective November 1991 and continued through 1994 providing for price reductions on amounts of coal purchased in excess of a set base amount. The 1991 through 1994 estimated savings was $1.4 million due to the reduction in the base coal price. The incentive coal price agreement has been renegotiated and will continue through 1995.

Executive Officers of the Company

Name	Age	Current Position and Business Experience
David H. Wiggs, Jr.	47	Chairman of the Board since May 1989; Chief Executive Officer since March 1989; Director since January 1988; President from January 1988 to January 1994.
Curtis L. Hoskins	57	President since January 1994; Chief Operating Officer since May 1990; Executive Vice President from May 1990 to January 1994; Director since April 1992; Executive Vice President, Utah Power & Light Company, Salt Lake City, Utah, for more than five years prior to April 1989.
Eduardo A. Rodriguez	39	Senior Vice President since January 1994; Vice President from April 1992 to January 1994; Secretary from January 1989 to January 1994; General Counsel since 1988.
J. Frank Bates	44	Vice President – Operations since May 1994; Vice President – Customer Services Texas Division from June 1989 to May 1994.
Michael L. Blough	39	Controller and Chief Accounting Officer since November 1994; Assistant Vice President – Financial Planning from September 1990 to November 1994, other managerial positions for more than one year prior to September 1990.
John E. Droubay	56	Vice President and Treasurer since September 1990; President, Chief Executive Officer and Chairman of the Board, Energy Mutual Insurance Company and Electric Life Insurance Company, Salt Lake City, Utah, from May 1989 to September 1990.
Gary R. Hedrick	40	Vice President – Financial Planning and Rate Administration since September 1990; Treasurer from 1988 to September 1990; Assistant Vice President, Finance from February 1990 to September 1990.
John C. Horne	46	Vice President – Power Supply since May 1994; Vice President – Transmission Systems Division from August 1989 to May 1994.
Robert C. McNiel	48	Vice President – New Mexico Division since December 1989.
Guillermo Silva, Jr.	42	Secretary since January 1994, Assistant Secretary from June 1989 to January 1994.

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

Operating Statistics

	December 31,		
	1994	1993	1992
Operating Revenues (In thousands):			
Retail:			
Residential	$ 153,255	$ 147,966	$ 144,059
Commercial and industrial, small	152,876	147,418	142,133
Commercial and industrial, large	54,739	50,516	51,108
Sales to public authorities	76,003	74,611	72,039
Other	(10,294)	(8,152)	(337)
	426,579	412,359	409,002
Wholesale:			
Sales for resale	104,509	128,157	110,776
Economy sales	5,672	3,078	4,982
Total operating revenues	$ 536,760	$ 543,594	$ 524,760
Number of customers (End of year):			
Residential	240,368	235,151	228,688
Commercial and industrial, small	23,857	23,338	22,883
Commercial and industrial, large	80	74	68
Other	3,470	3,395	3,251
Total	267,775	261,958	254,890
Average annual use and revenue per residential customer:			
KWH	6,299	6,142	6,169
Revenue	$ 644.82	$ 637.68	$ 636.93
Average revenue per KWH:			
Residential	10.24¢	10.38¢	10.32¢
Commercial and industrial, small	8.91	9.12	9.14
Commercial and industrial, large	5.02	5.79	5.61
Energy supplied, net, KWH (In thousands):			
Generated	7,018,423	6,625,162	7,330,004
Purchased and interchanged	1,051,251	1,416,172	589,288
Total	8,069,674	8,041,334	7,919,292
Energy sales, KWH (In thousands):			
Retail:			
Residential	1,497,094	1,424,935	1,395,387
Commercial and industrial, small	1,715,409	1,616,434	1,555,047
Commercial and industrial, large	1,089,695	872,477	911,750
Sales to public authorities	1,078,800	1,034,231	997,483
	5,380,998	4,948,077	4,859,667
Wholesale:			
Sales for resale	1,925,668	2,484,128	2,361,204
Economy sales	320,026	164,559	264,654
Total sales	7,626,692	7,596,764	7,485,525
Losses and company use	442,982	444,570	433,767
Total	8,069,674	8,041,334	7,919,292
Native system:			
Peak load, KW	1,093,000	997,000	974,000
Net generating capacity for peak, KW	1,497,000	1,497,000	1,497,000
Load factor	61.1%	62.1%	62.3%
Total system:			
Peak load, KW	1,365,000	1,335,000	1,302,000
Net generating capacity for peak, KW	1,497,000	1,497,000	1,497,000
Load factor	63.7%	66.4%	66.4%

Item 2. Properties

The principal properties of the Company are described in Item 1, "Business," and such descriptions are incorporated herein by reference thereto. Transmission lines are located either on private rights-of-way, easements or on streets or highways by public consent. See Part II, Item 8, "Financial Statements and Supplementary Data–Note H of Notes to Financial Statements" for information regarding encumbrances against the principal properties of the Company.

Item 3. Legal Proceedings

Automatic Stay of Litigation Due to Bankruptcy

Upon the filing of the bankruptcy petition, the provisions of the Bankruptcy Code operate as a stay applicable to all entities of, among other things, the commencement or continuation of judicial, administrative, or other actions or proceedings against the Company that were or could have been commenced before the bankruptcy petition. The stay is subject to certain exceptions, including actions by governmental units to enforce police or regulatory powers, and the Bankruptcy Court has the discretion to terminate, annul, modify or condition the stay. The Bankruptcy Court has entered orders lifting the stay in connection with the City of Las Cruces' attempt to condemn portions of the Company's properties, as discussed in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Operational Challenges – City of Las Cruces," and with respect to appeals of Texas regulatory matters, to the extent applicable. See Item 1, "Business – Regulation – Effect of Bankruptcy on Regulation."

Plains Electric Generation and Transmission Cooperative Litigation

On September 21, 1994, the Company and Plains Electric Generation and Transmission Cooperative, Inc. ("Plains") entered into a Settlement Agreement and Release to resolve the disputes between the two and provide for the dismissal of the lawsuit filed by Plains against the Company in the United States District Court for the District of New Mexico, Cause No. CIV91-1199. On December 5, 1994, the Bankruptcy Court approved the settlement, which provides for the dismissal with prejudice of the lawsuit upon the effective date of the Long Term Transmission Agreement between the parties. Under the Long Term Firm Transmission Agreement, which is subject to FERC approval, Plains will purchase firm transmission service in New Mexico from the Company for a period of thirty years. The transmission services would be based upon an annual schedule established by the parties (with the initial service at 30-35 MW), which can be increased at Plains' election up to 50 MW over time or decreased. The Company filed for approval from the FERC on January 13, 1995, but has not yet received such approval.

Sale/Leaseback Indemnification Obligations

Pursuant to the participation agreements and leases entered into in the sale/leaseback transactions, if the Owner Trustee or Owner Participants incur additional tax liability or other loss as a result of federal or state tax assessments related to the sale/leaseback transaction, the Owner Trustee and Owner Participants may have claims against the Company for indemnification. The Owner Trustee and Owner Participants have filed proofs of claim alleging unliquidated amounts owed pursuant to the participation agreements and leases, which may encompass claims for indemnification. Pursuant to settlement agreements entered into between the Company, the Owner Trustee and each Owner Participant in connection with the Plan, the Company's indemnity obligations related to tax matters generally would continue in effect following the Effective Date. See Item 1,"Business – Bankruptcy Proceedings and Proposed Merger with CSW – Treatment of Palo Verde."

Arizona Transaction Privilege ("Sales") Tax Indemnification. The Arizona Department of Revenue ("ADR") conducted an audit of the sales taxes paid on lease payments under the Palo Verde

Leases during the audit period of August 1, 1988 through July 31, 1990. On March 10, 1992, the Company received copies of Notices of Proposed Assessment issued by the ADR to each of the Owner Trusts. On February 22, 1993, the ADR filed Notices of Jeopardy Assessment totaling approximately $7.8 million, including interest thereon through February 28, 1993, to convert the proposed deficiencies for the audit period into jeopardy assessments, which are immediately collectible. On February 23, 1993, the ADR filed Notices of Tax Lien in the Maricopa County Recorder's Office and with the Secretary of State of Arizona against the Owner Trusts' interests in Palo Verde. Although the ADR can take action immediately to collect the alleged deficiency from the Owner Trusts, the ADR has taken no action in that regard. The ADR also may assert additional tax deficiencies for the period from August 1, 1990 through 1991, when the last lease payments were received by the Owner Trusts. The Owner Trusts can contest both the jeopardy assessment and the underlying assessment. The Company and the Owner Trusts have engaged in settlement discussions with the ADR and, based on these discussions, the ADR has postponed further action on the assessments. The Company believes it has made adequate provision in its financial statements for any indemnification obligations resulting from the claim.

Federal Tax Indemnification. One of the Owner Participants in the sale/leaseback transactions related to Unit 2 of Palo Verde has notified the Company that the IRS has raised issues, primarily related to investment tax credit claims by the Owner Participant, regarding the income tax treatment of the sale/leaseback transactions. The Company estimates that the total amount of potential claims for indemnification from all Owner Participants related to the issues raised by the IRS could approximate $10 million, exclusive of any applicable interest, if the IRS prevails. This matter is at a preliminary stage and, although the Company believes the Owner Participant has meritorious defenses to the IRS' position, the Company cannot predict the outcome of the matter or the Company's liability for any resulting claim for indemnification. The Company has made no provision in the accompanying financial statements related to this matter.

Other Legal Proceedings

Information regarding legal proceedings related to the Company's Bankruptcy Case, Palo Verde, Four Corners, rates and regulatory proceedings, and environmental matters is included in Item 1, "Business" under the subcaptions "Bankruptcy Proceedings and Proposed Merger with CSW," "Regulation," "Facilities," and "Environmental Matters" and is incorporated herein by reference.

Information regarding legal proceedings related to the Company's disputes with the City of Las Cruces and with the Air Force and the Army is included in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Operational Challenges" under the subcaptions "City of Las Cruces" and "Military Installations," respectively, and is incorporated herein by reference.

The Company is a party to various other claims, legal actions and complaints, the ultimate disposition of which, in the opinion of management, will not have a material adverse effect on the operations or financial position of the Company.

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

Not applicable.

PART II

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

The Company's common stock is traded on the Nasdaq National Market. The trading symbol for the Company's common stock is "ELPAQ," with the "Q" indicating that the Company is the subject of bankruptcy proceedings. Under the terms of the Company's listing agreement with Nasdaq and Nasdaq's bylaws, Nasdaq may, as a result of the Company's Chapter 11 bankruptcy filing, apply additional or more stringent criteria for continued inclusion of the Company's common stock in the Nasdaq system or suspend or terminate the stock's inclusion in Nasdaq. In addition, because the Company does not meet certain net worth requirements set forth in Schedule D to the bylaws of Nasdaq, it may delist the Company's common stock from Nasdaq.

The Company has paid no dividends on shares of its common stock since March 1989. The high and low per share sale prices for the Company's common stock, as reported by Nasdaq, for the periods during 1994 and 1993 indicated below, were as follows:

	Sale Price	
	High	Low
1994		
First Quarter	$ 2 7/8	$ 2 9/16
Second Quarter	3	1 13/16
Third Quarter	2 5/16	1 1/4
Fourth Quarter	1 5/16	11/16
1993		
First Quarter	$ 3 5/8	$ 2
Second Quarter	3 3/8	2
Third Quarter	3 3/16	2 7/16
Fourth Quarter	2 7/8	2 1/2

At March 1, 1995, there were 23,402 holders of record of the Company's common stock.

The Board of Directors voted to suspend payment of dividends and mandatory sinking fund payments on the Company's outstanding cumulative preferred stock commencing with dividend and redemption payments due October 1, 1991. Such suspension has continued through the date of this report, although the Company has made interim payments to holders of preferred stock pursuant to the Plan. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Preferred Stock Dividends and Sinking Fund Payments."

Under the Company's articles of incorporation, as of July 1, 1992, the holders of preferred stock have the right (subject to satisfaction of certain procedural requirements) to elect two additional directors to the Board of Directors. This right has accrued because dividends on the outstanding preferred stock have accumulated and remained unpaid in a cumulative amount at least equal to four quarterly dividends. Because preferred stock dividends in an amount equal to twelve full quarterly dividends are unpaid, the holders of the preferred stock also are entitled to elect the smallest number of directors necessary to constitute a majority of the full Board of Directors until all dividends of preferred stock have been fully paid. However, under the Plan, by voting in favor of the Plan, the preferred shareholders have waived any right to elect a majority of the Board of Directors under the Company's articles of incorporation.

The Company has not received notice of any preferred shareholder's desire or intent to exercise the right to elect two additional directors and cannot predict whether or when any such action might

be taken. The PUHCA defines a "holding company" as, among other things and except as therein provided, (i) any company that directly or indirectly owns, controls or holds with power to vote 10% or more of the outstanding "voting securities" of a public utility company or another "holding company;" or (ii) any person or company which the SEC determines, directly or indirectly, to exercise (either alone or pursuant to an arrangement or understanding with one or more persons) such a controlling influence over the management or policies of any public utility as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that such person or company be subject to the regulation of the PUHCA. A "voting security" is defined as, among other things, any security presently entitling the owner or holder thereof to vote in the direction or management of the affairs of a company. Previously, the shares of the Company's common stock were the only "voting securities" outstanding. Now that the holders of the Company's preferred stock have the voting rights described in the preceding paragraph, shares of the preferred stock also may constitute "voting securities" under the PUHCA. Holders of significant positions in the preferred stock (if such shares constitute "voting securities" under the PUHCA) and/or in the common stock could, depending on the circumstances, be deemed to be "holding companies." Any holder so deemed to be a "holding company" would, subject to certain exceptions, be required to register as such under the PUHCA and, if such registration were required, such holder, as well as the Company, would become subject to extensive regulation under the PUHCA.

Item 6. Selected Financial Data

As of and for the years ended December 31:

	1994	1993	1992	1991	1990
	(In thousands except per share data)				
Operating revenues	$ 536,760 (1)	$ 543,594	$ 524,760	$ 462,405	$ 445,309
Operating income	73,011	64,971	67,036	50,722	44,799
Loss before extraordinary item and cumulative effect of a change in accounting principle	(28,153)	(41,855)	(28,180)	(266,912) (2)	(21,864)
Extraordinary item	–	–	–	(289,102) (3)	–
Cumulative effect of a change in accounting principle	–	(96,044) (4)	–	–	–
Net loss per weighted average share of common stock:					
Loss before extraordinary item and cumulative effect of a change in accounting principle	(0.79)	(1.18)	(0.79)	(7.75) (2)	(0.96)
Extraordinary item	–	–	–	(8.14) (3)	–
Cumulative effect of a change in accounting principle	–	(2.70) (4)	–	–	–
Total assets	1,730,851	1,715,406	1,702,778 (5)	1,566,281 (6)	1,901,928
Additions to utility plant, before allowance for equity funds used for construction	60,113	58,215	60,570	63,394	80,139
Obligations subject to compromise	1,537,303	1,495,315	1,440,968	–	–
In default	–	–	–	1,286,703	–
Long-term, financing and capital lease obligations	–	–	–	–	798,111
Preferred stock - redemption required	67,266 (7)	67,266 (7)	67,266 (7)	67,266 (7)	79,360
Common stock equity (deficit)	(385,966)	(357,463)	(220,508)	(191,434)	371,690

(1) Reflects a decrease in fuel revenues due to a change in the calculation of Texas jurisdictional fuel costs based on the Texas Docket 13966 Final Order of approximately $7.5 million and lower contract demand revenues from TNP. In addition, increases in base rates, effective July 16, 1994, have been deferred and, therefore, they are not included in operating revenues.

(2) Includes approximately $221.1 million after-tax loss attributable to letters of credit draws and approximately $25.2 million after-tax write-off primarily for regulatory disallowance in Texas Docket 9945.

(3) Reflects the after-tax effect resulting from the discontinuance of the application of SFAS No. 71.

(4) Reflects the change in accounting for income taxes due to the implementation of SFAS No. 109.

(5) Increase from 1991 primarily is due to increase in cash and temporary investment which results from the nonpayment of interest and Palo Verde lease costs.

(6) Decrease from 1990 primarily is due to the write-off of regulatory assets.

(7) Includes approximately $3.3 million of dividends in arrears.

The selected financial data should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and Item 8, "Financial Statements and Supplementary Data," below.

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

Liquidity and Capital Resources

Overview

The Company filed a petition under Chapter 11 of the Bankruptcy Code on January 8, 1992 and has continued operations as debtor-in-possession. For a number of years prior to the petition filing, the Company was dependent on external financing through the capital markets for liquidity needs. As a result of the filing of the Bankruptcy Case and related cessation or limitation of payments on certain of the Company's financial arrangements, the Company has generated sufficient funds internally to meet its liquidity needs from 1992 through 1994. At December 31, 1994, the Company had approximately $209 million in cash and temporary investments.

The Company has paid interest at contractual non-default rates on its First and Second Mortgage Bonds, on its RCF, which is secured by pledged First and Second Mortgage Bonds, and on three series of pollution control bonds, which are secured by pledged Second Mortgage Bonds, from July 1, 1992 through the current date pursuant to applicable orders of the Bankruptcy Court. As discussed below in "Obligations Subject to Compromise," the Company expects to continue such payments. As discussed in Part I, Item 1, "Business – Bankruptcy Proceedings and Proposed Merger with CSW – Treatment of Claims Under the Plan" and in "Obligations Subject to Compromise" below, pursuant to the requirements under the Plan, at the Confirmation Date, the Company made interest and periodic payments at rates and for periods specified in the Plan to additional classes of creditors and interest holders, together with certain fees and expenses for which payment was provided under the Plan. Interest payments were made quarterly to such creditors in 1994. Pursuant to the Plan, interest payments will continue to be made to such creditors quarterly and on the Effective Date. In addition, periodic payments to holders of the Company's preferred stock were made on the Confirmation Date and quarterly in 1994 and will be made quarterly and on the Effective Date pursuant to the Plan. Through December 31, 1994, such payments totaled approximately $105.1 million. The Company estimates that such interest and periodic payments will be approximately $24.1 million per quarter (assuming 90-day LIBOR of 6.5%).

Taking into account the estimated payment of the interest and fees pursuant to the Plan, as well as expected revenues and projected costs for operations and capital expenditures, the Company expects its cash balances will decline; however, the Company does not anticipate any requirement for external financing until the Bankruptcy Case is concluded.

Obligations Subject to Compromise

In late December 1991, the Company ceased paying principal, interest and fees on portions of its secured and unsecured debt except as described below. The Company also failed to make lease payments of approximately $19.3 million on Palo Verde Units 2 and 3 due January 2, 1992, and on January 8, 1992, instituted the Bankruptcy Case. As a result, all of the Company's debt is in default and will remain so until a plan of reorganization becomes effective pursuant to the Bankruptcy Case. Ordinarily, these defaults would entitle the Company's creditors to accelerate the outstanding principal amounts of debt and pursue other remedies available under the applicable agreements. As a result of the automatic stay imposed by the provisions of the Bankruptcy Code, however, such creditors generally are prevented from taking any action to collect such amounts or pursue any remedies against the Company other than through the Bankruptcy Case. The terms and provisions of the Company's financing arrangements, including the maturity dates, are subject to modification pursuant to a plan of reorganization that becomes effective in the Bankruptcy Case.

First Mortgage Bonds. The Company has approximately $299.3 million of First Mortgage Bonds outstanding. The Company has not made either the final maturity principal payment of

approximately $10.4 million that was due in 1992 or the approximate $7 million in cash sinking fund payments due in each of 1992, 1993 and 1994 under the Indenture of the First Mortgage Bonds. The Company does not anticipate making the approximate $22.9 million cash sinking fund payments due in 1995. Additionally, the Company has not made approximately $18.2 million in prepetition and postpetition interest payments accrued through June 30, 1992. Pursuant to applicable Bankruptcy Court orders, the Company is making and expects to make monthly interest payments on its First Mortgage Bonds through the anticipated effective date of the Plan. Approximately $30 million of interest accrues annually at the contractual rates on the First Mortgage Bonds outstanding.

Second Mortgage Bonds. The Company has $165 million of Second Mortgage Bonds outstanding. The Company has not made the approximate $8.8 million in cash sinking fund payment due in 1994 under the Indenture of the Second Mortgage Bonds. The Company does not anticipate making the approximate $8.8 million cash sinking fund payment due in 1995. The Company has not made approximately $11.7 million in prepetition and postpetition interest payments accrued through June 30, 1992. Pursuant to applicable Bankruptcy Court orders, the Company is making and expects to make monthly interest payments on its Second Mortgage Bonds through the anticipated effective date of the Plan. Approximately $20.3 million of interest accrues annually, based on contract rates, on the Second Mortgage Bonds outstanding.

Pollution Control Bonds. The Company has approximately $193.1 million of tax exempt Pollution Control Bonds outstanding consisting of four issues, of which three issues aggregating approximately $159.8 million are secured by Second Mortgage Bonds. Each of the tax exempt issues is credit enhanced by a letter of credit. Prior to the petition date, interest and other payments on the Pollution Control Bonds were made through draws on the letters of credit and the Company reimbursed the letter of credit bank for such draws. Subsequent to the petition filing, interest on all the bonds has continued to be paid by draws on the letters of credit. The Company has paid a portion of the resulting reimbursement obligations to the issuing banks on three Pollution Control Bond issues through interest payments authorized by applicable orders of the Bankruptcy Court. The Company has not reimbursed the letter of credit banks approximately $7.3 million in prepetition and postpetition interest payments accrued and paid through draws on the letters of credit through June 30, 1992 on the three series of Pollution Control Bonds. Additionally, the Company has not reimbursed the letter of credit bank for approximately $5.3 million in prepetition and postpetition interest through December 31, 1994 paid on the fourth pollution control issue through draws on the letter of credit.

In May 1992, one series of Pollution Control Bonds was accelerated and the letter of credit supporting such series was drawn upon for the principal and accrued interest, aggregating approximately $37.9 million. In May 1994, the acceleration was rescinded and amendments were made to the governing documents related to this series of Pollution Control Bonds to allow the Bonds to be remarketed during the Company's Bankruptcy Case, at the option of the letter of credit issuer. The amendments also provide for more flexibility in interest rate features, and a letter of credit issuing bank repurchase option that would be effective at the Effective Date of the Plan. The Bonds were remarketed in May 1994. The letter of credit bank received a total of approximately $37.1 million in proceeds from the remarketing as reimbursement for the letter of credit draw upon acceleration. The series of Pollution Control Bonds currently bears interest at a rate that is repriced weekly.

With respect to a second series of Pollution Control Bonds, the letter of credit issuer purchased all of the outstanding bonds of that series. The governing documents related to this series of Pollution Control Bonds also were amended in May 1994 to allow the Bonds to be remarketed during the Company's Bankruptcy Case, at the option of the letter of credit issuer. The amendments also provide for more flexibility in interest rate features and a letter of credit issuing bank repurchase option that would be effective at the Effective Date of the Plan. The Bonds continue to be held by the letter of credit issuer. The series of Pollution Control Bonds currently bears interest at a rate that is repriced weekly.

A third series of Pollution Control Bonds had been remarketed annually in June of each year. Changes to the governing documents were made effective July 1, 1994, including additional interest term options and a repurchase option for the letter of credit bank that would be effective at the Effective Date of the Plan. The changes were made by redeeming the outstanding Bonds in the series and issuing a new series of Pollution Control Bonds with governing documents containing the new provisions, but otherwise substantially equivalent to the former series. The new series of Pollution Control Bonds currently bears interest at a rate that is repriced weekly.

The fourth series of Pollution Control Bonds, which were issued in connection with the Four Corners Plant and which are not secured by Second Mortgage Bonds, had been remarketed annually in November of each year. On November 1, 1994, the outstanding bonds were redeemed and a new series of Pollution Control Bonds, were issued, with modifications similar to the other series of Pollution Control Bonds. This series also now provides for shorter interest rate periods, which eliminates the need for annual remarketings, and a repurchase option for the letter of credit bank that would be effective at the Effective Date of the Plan. The aggregate principal amount of the bonds issued in the series was reduced by approximately $2.5 million through the application of proceeds held by the trustee from the original issuance of the bonds. The new series of Pollution Control Bonds currently bears interest at a rate that is repriced weekly.

Because of the pendency of the Company's Bankruptcy Case as well as other defaults, including the failure of the Company to reimburse the letter of credit issuing banks as described above, the bonds are subject to acceleration at any time. In the event that the bonds are accelerated and redeemed, the tax-advantaged interest rate of the bonds may no longer be available to the Company. The letters of credit that support the Pollution Control Bonds each have expiration dates during 1995. The Company is discussing the extension of such letters of credit with the issuing banks and believes, but cannot assure, that the issuing banks will agree to extend the letters of credit into 1996. If the letters of credit expire, the Pollution Control Bonds would be redeemed through draws on the applicable letter of credit and the tax-advantaged interest rate of the bonds may no longer be available to the Company.

RCF. The Company currently has a total of $150 million of debt outstanding under its RCF. The RCF, which originally involved a syndicate of money center banks, provided for substantially all of the Company's short-term borrowing prior to the filing of the bankruptcy petition. The RCF became due and payable on January 9, 1992. The RCF is secured by $50 million of First Mortgage Bonds and $100 million of Second Mortgage Bonds. The Company has not paid approximately $7.9 million of interest accrued through June 30, 1992. Interest on the RCF is calculated at the contract non-default rate, which is the administrating bank's currently quoted prime rate plus 1%. Pursuant to applicable Bankruptcy Court orders, the Company is making and expects to make monthly interest payments on the RCF through the anticipated Effective Date.

Palo Verde Leases. The Company has not made lease payments aggregating approximately $292 million on Palo Verde Units 2 and 3 for the period from January 2, 1992 through January 2, 1995. There would be no obligation to make such payments under the Plan. Although the Company has not been paying postpetition obligations arising under the Palo Verde Leases, except as described below, the Company has expensed contract rents for financial reporting purposes of approximately $20.8 million for each quarter.

Fuel Financing. The Company has a nuclear fuel financing of approximately $60.6 million secured by nuclear fuel and a note payable of approximately $9.8 million. The Company has not made payments of any principal on the nuclear fuel financing and note payable since the filing of the bankruptcy petition. The Company also has not made any interest payments on such amounts through September 10, 1993. As a result of the confirmation of the Plan, the Company began paying interest on the nuclear fuel financing and note payable beginning from September 10, 1993 at an interest rate specified in the Plan, which currently is lower than the contract rate. The total amounts

of principal and interest payments that came due but were not paid on the nuclear fuel financing and the note payable totaled $55.6 million at December 31, 1994.

Unsecured Debt. The Company's unsecured debt consists primarily of: (i) notes payable to banks of approximately $288.4 million associated with draws on letters of credit related to the Company's sale and leaseback transactions for Palo Verde Units 2 and 3; (ii) the series of Pollution Control Bonds issued in connection with the Four Corners Plant (discussed above) in the amount of $33.3 million (on which the Company did not make approximately $1.2 million interest payments due each of May 1, 1992 and November 2, 1992 and approximately $700,000 interest payments due on each of May 3, 1993, November 1, 1993, May 1, 1994 and November 1, 1994 as discussed above); (iii) a term loan note of $25 million; (iv) a capitalized obligation of approximately $79.2 million associated with the Palo Verde Unit 2 lease; (v) a capitalized obligation of approximately $8.1 million associated with another lease; (vi) an approximate $3.5 million obligation related to a terminated fuel oil financing trust arrangement; and (vii) a $2.5 million obligation related to a guaranty by the Company of a loan to its Leveraged Employee Stock Ownership Plan. The Company has not made any payments on the unsecured debt, except for lease payments on the $8.1 million capitalized obligation and payments aggregating approximately $2.1 million related to the fuel oil financing in connection with the sale of a portion of the fuel oil inventory. Subsequent to the confirmation of the Plan, the Company has made quarterly interest payments on the allowed claims of certain classes of the creditors, including the unsecured creditors and the class consisting of holders of bonds issued in connection with the sale/leaseback transactions, as provided for in the Plan.

Preferred Stock Dividends and Sinking Fund Payments

Under their existing terms, dividends of approximately $1.86 million on the Company's outstanding cumulative preferred stock are due each January 1, April 1, July 1 and October 1 and mandatory sinking fund redemption payments are due on certain series of the Company's preferred stock on certain of these quarterly dates. On September 19, 1991, the Board of Directors voted to suspend payment of dividends and sinking fund payments on the Company's preferred stock, commencing with dividend and sinking fund payments due October 1, 1991. Accordingly, the Company has defaulted on its obligation to pay all dividends on all such quarterly dates, beginning October 1, 1991. Sinking fund payments in the following amounts have been missed: (i) $750,000 (7,500 shares at $100 per share) due each of October 1, 1991, October 1, 1992, October 1, 1993 and October 1, 1994 on the Company's $8.95 Dividend Preferred Stock; (ii) $600,000 (6,000 shares at $100 per share) due each of October 1, 1991, October 1, 1992, October 1, 1993 and October 1, 1994 on the Company's $8.44 Dividend Preferred Stock; (iii) $400,000 (4,000 shares at $100 per share) due each of January 1, 1992, January 1, 1993, January 1, 1994 and January 1, 1995 on the Company's $10.75 Dividend Preferred Stock; (iv) $10 million (100,000 shares at $100 per share) due each of July 1, 1992, July 1, 1993 and July 1, 1994 on the Company's $11.375 Dividend Preferred Stock and (v) $5 million (50,000 shares at $100 per share) due each of July 1, 1992 and July 1, 1993 on the Company's $10.125 Dividend Preferred Stock. At December 31, 1994 the total arrearage of dividends on the preferred stock is approximately $26.1 and the total arrearage of mandatory sinking fund payments is $46.6 million. The Company's aggregate mandatory sinking fund redemption payments due during 1995, including the $400,000 due on January 1, 1995, is approximately $1.8 million, none of which has been or is anticipated to be paid.

The Company cannot predict when the preferred stock dividends and sinking fund payments will be resumed, but such payments are precluded by the Bankruptcy Code during the Bankruptcy Case. Resumption of these payments also will depend on the plan of reorganization ultimately adopted in the Company's bankruptcy case, which could substantially alter or eliminate the rights of the preferred and common stockholders.

Operational Challenges

The Company's major franchise is with the City of El Paso, Texas. The franchise agreement provides an arrangement for the Company's utilization of public rights of way necessary to serve its retail customers within the City of El Paso. The franchise with the City of El Paso expires in March 2001 and does not contain renewal provisions. The Company is facing serious near term challenges in connection with certain of its New Mexico customers, including customers within the City of Las Cruces and the military installations of White Sands Missile Range and Holloman Air Force Base.

City of Las Cruces

The Company's franchise with the City of Las Cruces expired in March 1994, and the City of Las Cruces is attempting to acquire the Company's distribution system within the city limits through negotiation or condemnation. CSW has stated that this dispute must be favorably and timely resolved before it will close the Merger. See Part I, Item 1, "Business – Bankruptcy Proceedings and Proposed Merger with CSW – CSW Positions with Respect to the Merger." The Company has continued to provide electric service to customers in the City of Las Cruces, consistent with its view that its right and obligation to serve customers within the City of Las Cruces is derived from the New Mexico Public Utility Act, and other New Mexico law. The City of Las Cruces has acknowledged this obligation in a press release issued March 12, 1994. Sales to customers in the City of Las Cruces represented approximately 7% of the Company's operating revenues in 1994.

The City of Las Cruces has authority from the New Mexico State Board of Finance to issue up to $90 million in revenue bonds to finance a purchase of a distribution system. On August 30, 1994, voters in the City of Las Cruces approved a resolution in a special election allowing the city government to proceed with efforts to acquire the distribution facilities of the Company within the city limits by negotiated purchase or eminent domain. In August of 1994, SPS and the City of Las Cruces entered into a fifteen-year contract for SPS to provide all of the electric power and energy required by the City of Las Cruces during the term of the contract. The contract becomes effective on the completion of the last of the (i) acquisition of a distribution system by the City of Las Cruces; (ii) acquisition of the necessary transmission delivery and back-up agreements by SPS; and (iii) receipt of the required regulatory approvals by the City of Las Cruces and SPS. If the specified events are not completed by July 1, 1998, either SPS or the City of Las Cruces has the right to cancel the contract. On June 6, 1994, the Las Cruces City Council approved a resolution selecting the proposal of SPS for the provision of operation and maintenance services for the proposed City of Las Cruces electric distribution system, substations and associated transmission facilities and authorizing the staff of the City of Las Cruces to negotiate a contract with SPS related to such services.

On June 14, 1994, the City of Las Cruces filed a motion with the Bankruptcy Court to lift the automatic stay imposed by the bankruptcy filing to allow it to (i) commence action against the Company for failure to pay franchise fees after expiration of the franchise in March 1994; (ii) enter the Company's property to conduct an appraisal of the electric distribution system and any suitability studies; (iii) give notice of intent to file a condemnation action; and (iv) commence state court condemnation proceedings against the Company to condemn the Company's distribution system within the Las Cruces city limits. The Bankruptcy Court granted the City of Las Cruces' motion to lift the automatic stay, effective January 1, 1995, to allow the City of Las Cruces to take all legal action and give all notices which the City of Las Cruces deems appropriate and necessary to become the provider of electric power for the City of Las Cruces and its citizens, specifically including eminent domain proceedings, but excluding the authority to seek from any court other than the Bankruptcy Court, immediate, actual, physical, or constructive possession of the assets the City of Las Cruces seeks to condemn. The Bankruptcy Court also ordered that any action to collect franchise fees be brought in the Bankruptcy Court.

The Company believes that New Mexico law does not authorize condemnation of the Company's facilities by the City of Las Cruces. The Las Cruces City Council has authorized the filing of a New

Mexico state court declaratory judgment action to "clarify the right of the City to acquire [the Company's] system." The Company intends to contest the City of Las Cruces' authority to acquire the Company's property and to continue to challenge in all appropriate forums the City of Las Cruces' efforts to replace the Company as the provider of electric service in the City of Las Cruces.

The Company believes that it will either (i) be successful in preventing condemnation and loss of the City of Las Cruces' load, or (ii) if unsuccessful in that effort, receive just compensation therefor. Neither of these results would constitute a material loss to the Company. For this and other reasons, the dispute with the City of Las Cruces does not, in the Company's opinion, constitute a Material Adverse Effect under the Merger Agreement. See Part I, Item 1, "Business–Bankruptcy Proceedings and Proposed Merger with CSW – CSW Positions With Respect to the Merger."

On February 21, 1995, the City of Las Cruces filed its Complaint for Breach of Implied Contract, Specific Performance, Unjust Enrichment, and Trespass against the Company in the Bankruptcy Court. The City seeks to enforce what it claims are the Company's continued payment obligations under an allegedly implied continuation of the municipal franchise ordinance which expired by its own terms on March 18, 1994. Alternatively, the City of Las Cruces seeks, the reasonable value of the Company's use, occupation and rental of the rights of way or damages for trespass. On March 24, 1995, the Company filed a motion to dismiss all counts of the City of Las Cruces' complaint. The Company intends to vigorously defend against the lawsuit.

Military Installations

The Company currently provides retail electric service in New Mexico to the Air Force at Holloman Air Force Base and the Army at White Sands Missile Range. The Company's sales to such military bases represented approximately 2% of revenues in 1994. The Company's right to provide this service was authorized by the New Mexico Commission in 1956 by the issuance of a CCN to the Company. The contract with the Army was due to expire on December 31, 1993 but has been extended by unilateral action of the Army for an indefinite period. The contract with the Air Force expired on February 28, 1994. The Company continues to provide the electric service to the Air Force and the Army under state approved tariffs and CCN authority.

On June 15, 1993, the Air Force issued a Request for Proposal ("RFP") to prospective electric utility service providers to provide electric service to Holloman Air Force Base upon expiration of its service agreement with the Company. The Company submitted its proposal to the Air Force on August 12, 1993 and filed a protest to the issuance and terms of the Air Force's RFP. The protest was upheld, but on technical grounds that have allowed the Air Force to proceed with a delayed competitive bidding process. The Air Force issued a Memorandum requesting that the "best and final offer" of entities participating in the competitive bid process be submitted no later than May 10, 1994. On June 15, 1994 and December 14, 1994, the Company received letters from the Air Force requesting responses to certain questions posed by the Air Force. The Company responded to the requests and anticipates that the Air Force will again request best and final offers prior to awarding the bid.

On January 4, 1994, the Company filed an action against the Air Force and related parties in the United States District Court for the District of New Mexico challenging the authority of the Air Force to conduct a competitive bidding procedure to determine the provider of electric service to Holloman Air Force Base. The New Mexico Attorney General intervened in the case on August 15, 1994. The United States District Court has ruled that it has jurisdiction over the case and, in June 1994, entered an order denying the Company's request for a preliminary injunction. The Air Force has not appealed the jurisdictional ruling and has filed an answer in the case. By a joint motion filed January 27, 1995, the parties sought and were granted a stay of proceedings and extension of deadlines on the grounds that the parties are engaged in serious settlement negotiations. Pursuant to the order entered February 7, 1995, the parties must complete discovery by July 17, 1995, unless otherwise extended.

The Army has issued a request for proposal related to the provision of all of the electric service requirements for White Sands Missile Range. In addition to the Company, three electric cooperatives serve White Sands Missile Range. Responses to the request were due February 28, 1995. The Company submitted its proposal to the Army on February 28, 1995 and filed a protest to the issuance and terms of the Army's RFP. On March 29, 1995, the Army suspended the RFP indefinitely in response to the Company's protest while the Army reviews the RFP in its entirety. The Army stated that the review could take several months. The Company is of the opinion that the competitive bidding process established by the request for proposal, as it relates to public utility providers, would not be permitted pursuant to New Mexico and federal law and regulations and intends to contest vigorously the use of the competitive bidding process. As in the case of electric service for Holloman Air Force Base, the Company intends to challenge the process through the New Mexico Commission and the federal courts.

The Company believes that the procurement of retail electric service by the United States Department of Defense by competitive bidding procedures is prohibited by federal procurement law and that participation by public utilities in this process in an attempt to obtain the right to provide this retail electric service is contrary to New Mexico law and a violation of the Company's state-authorized right to provide this service. On April 1, 1993, the Company filed a Petition for Declaratory Order with the New Mexico Commission (NMPUC Case No. 2505) seeking, among other things, a declaration that the Company currently is the only public utility authorized under New Mexico utility regulatory law to offer and provide this particular retail electric service to Holloman Air Force Base and White Sands Missile Range. The hearing examiner in the case has recommended that the New Mexico Commission determine that the case is not ripe for determination. In September 1993, the Attorney General of New Mexico filed exceptions to the hearing examiner's recommended decision. By order issued February 6, 1995, the New Mexico Commission directed that the record in the case be reopened for the limited purposes of determining the current status of the case and updating, to the extent necessary, the record in the case. The hearing examiner has ordered the Company to file a report to update the status of the competitive bidding process at both military bases. The Company filed its response on March 24, 1995.

The Company believes but can give no assurance that it will continue to provide long-term electric service to Holloman Air Force Base and White Sands Missile Range. If the Company is unable to do so, however, the Company will pursue all available regulatory and legal avenues to obtain the appropriate recovery of its investment related to these customers.

General Industry

In addition to these specific challenges, the Company faces many of the challenges facing the electric utility industry as a whole, including competitive factors and the costs of nuclear investment and decommissioning. The level of competition has increased as a result of changes in federal regulatory provisions related to transmission practices and independent power production, including cogeneration projects. The Energy Policy Act includes provisions authorizing the FERC to order electric utilities to transmit power at wholesale at the request of third parties, such as independent power producers and other utilities. Implementation of these provisions may involve changes in the method of transmission pricing and increased compliance reporting to the FERC regarding transmission system availability. State legislatures such as the New Mexico legislature also have indicated they are considering retail wheeling policies that could result in increases in competition. The Company believes one benefit of the proposed Merger would be an improved ability to meet these industry challenges.

Decommissioning costs continue to be significant to the Company. The costs are based on studies that are updated periodically (generally every three years). The most recent study, dated December 1993, estimates the cost to decommission the Company's share of Palo Verde to be approximately $221 million (stated in 1993 dollars). As of December 31, 1994, the Company has accrued approximately $38.5 million for decommissioning costs and the balance of funds in decommissioning

trusts established by the Company totaled approximately $20.8 million. The updated studies have continually reflected increases in costs to decommission as new developments unfold surrounding the technical and safety aspects of decommissioning a nuclear facility. Although the Company is funding and recording costs based on the latest information available, there can be no assurances that decommissioning costs will not continue to increase in the future. Due to delays in the construction of nuclear waste storage facilities as a result of opposition at the state and local level to the siting of facilities, the Company will incur additional costs for the construction and operation of temporary or permanent storage facilities at Palo Verde estimated to be approximately $50 million (stated in 1993 dollars). This amount is included in the $221 million cost estimate set forth above. See Item 8, "Financial Statements and Supplementary Data – Note E of Notes to Financial Statements."

The Energy Policy Act also provided for an assessment for the decontamination and decommissioning of DOE's uranium enrichment facilities. The Company has been advised by APS that, based on preliminary indications, the annual assessment for Palo Verde is expected to be approximately $3.0 million for fifteen years, plus increases for inflation. The Company will pay 15.8% of the annual Palo Verde assessment. The Company has accrued $7.1 million for this assessment as its portion of the entire assessment, and paid $1.0 million and $0.4 million to APS in 1994 and 1993, respectively.

Results of Operations

The Company recorded a net loss of $28.2 million or $.79 per share in 1994. This compares to a net loss of $137.9 million ($3.88 per share) in 1993 and $28.2 million ($.79 per share) in 1992. The principal factors giving rise to the loss in 1994 are (i) revenues that are not sufficient to recover fully the Company's costs of service and debt service; (ii) increased interest costs resulting from the confirmation of the Plan in December 1993; and (iii) reorganization expenses incurred in connection with the Bankruptcy Case. The losses in 1993 and 1992 also resulted from insufficient revenues and reorganization expenses. Also included in the 1993 and 1992 loss was the recognition of the effects of a change in accounting principle for income taxes and the write-off of debt issuance costs, respectively. The Company does not anticipate any significant improvements in results of operations until it completes a successful reorganization. See Part I, Item 1, "Business – Bankruptcy Proceedings and Proposed Merger with CSW – Regulatory Aspects of the Plan and Merger" and "– Treatment of Claims Under the Plan."

The primary reasons for increases or decreases in revenues, expenses and other items affecting results of operations for the year ended December 31, 1994 compared to the year ended December 31, 1993, and for the year ended December 31, 1993 compared to the year ended December 31, 1992 are discussed below.

Operating Revenues

Approximately 61% of the Company's total revenues for the year ended December 31, 1994 were generated from sales to Texas retail customers, principally in the City of El Paso, at rates approved by the Texas Commission. Sales to New Mexico retail customers, the largest number of which are in the City of Las Cruces and in two major military installations, represent 17% of the Company's total revenues for such period. The balance of the Company's revenues are generated through (i) negotiated long-term contracts which are approved by the FERC (12% of the Company's revenues for such period) and (ii) sales to CFE and economy energy sales which are based upon current market prices (collectively, 10% of the Company's revenues for such period). Sales to (i) residential customers (ii) small commercial and industrial customers (iii) large commercial and industrial customers and (iv) public authorities accounted for approximately 35%, 35%, 13% and 17%, respectively, of the Company's operating revenue from retail sales. In 1994, IID, a wholesale customer, accounted for 9.5% of operating revenues. No retail customer accounted for more than 3% of operating revenues. See Item 8, "Financial Statements and Supplementary Data – Note M of Notes to Financial Statements."

Revenues by quarter typically vary due to changes in climate throughout the year, reflecting higher temperatures and rate tariffs in the summer months. Traditionally, operating revenues during the third quarter (the highest sales quarter) tend to be 20-25% greater than operating revenues generated during the first quarter (the lowest sales quarter).

Operating revenues in 1994 were 1.3% less than operating revenues reported in 1993, while operating revenues in 1993 were 3.6% greater than in 1992. The changes in operating revenues were attributable to the following (In thousands):

	1994 versus 1993	1993 versus 1992
Base revenues	$ 4,479	$ 16,064
Fuel revenues and economy energy sales	(10,930)	13,553
Other	(383)	(10,783)
	$ (6,834)	$ 18,834

Base Revenues. Base revenues increased $4.5 million in 1994 compared to 1993. The increase is largely due to (i) a 2.2% increase in the number of customers served, (ii) record high summer temperatures, (iii) changes in the Company's customer sales mix, and (iv) the resumption of operation of a major industrial facility that ceased operating in the first quarter of 1993 following the bankruptcy filing of the prior owner of the facility. These increases were offset in part by a reduction in sales for resale due to lower contract demand revenues from TNP. The base revenue increase of $16.1 million in 1993 compared to 1992 is principally the result of (i) increases in total system KWH sales of approximately 2.9%, (ii) increases in demand and capacity charges to CFE, and (iii) increases in capacity for IID.

Changes in base revenues and related KWH sales for 1994 compared to 1993 and 1993 compared to 1992 by customer class are as follows:

	1994 versus 1993		1993 versus 1992	
	Base Revenues	KWH	Base Revenues	KWH
Native system:				
Residential	5.0%	5.1%	0.0%	2.1%
Commercial and industrial - small	5.3	6.1	0.4	3.9
Commercial and industrial - large	9.1	24.9	(6.3)	(4.3)
Public authorities	4.8	4.3	(0.4)	3.7
Native system composite	5.5	8.7	(0.6)	1.8
Sales for resale	(15.7)	(22.5)	11.4	5.2
Total system composite	1.0	(1.7)	1.7	2.9

Total system firm energy sales decreased from 7,432,205 MWH in 1993 to 7,306,666 MWH in 1994. Native system firm sales increased 432,921 MWH over the same time period.

The Company achieved record peak demands in 1994, recording an all-time total system peak demand of 1,365 MW on June 28, 1994, a 2.2% increase over 1993's record peak of 1,335 MW. The Company's 1994 native system peak demand of 1,093 MW on June 27, 1994, which was also a new record, was a 9.6% increase from the record of 997 MW set in 1993. The new records were the result of an increase in number of customers and higher than usual temperatures during the summer months.

Although the Company implemented increases in base rates effective July 16, 1994, the Company has deferred recognition of such revenues and, therefore, they are not included in the above analysis.

Fuel Revenues. The changes in fuel revenues are a function of changes in fuel and purchased and interchanged power expenses since such costs are generally passed through directly to customers. Fuel revenues decreased $13.5 million in 1994 when compared to 1993 due to (i) decreased fuel costs that are passed through directly to customers; and (ii) a change in the method of calculating Texas jurisdictional fuel costs based on the Docket 13966 final order of approximately $7.5 million. Such decrease was offset in part by increased economy energy sales of approximately $2.6 million.

Fuel revenues increased $15.5 million in 1993 when compared to 1992 due to increased fuel costs offset by a provision for a potential refund related to the anticipated change in the method of calculating Texas jurisdictional fuel cost as discussed above. Such increase was offset in part by decreased economy energy sales of approximately $1.9 million.

Other. The 1993 reduction in other revenues is principally due to the discontinuance of approximately $11.7 million of surcharges (related to the recovery of regulatory expenses) recorded in 1992.

Fuel and Purchased and Interchanged Power Expenses

The decrease in fuel and purchased and interchanged power expense in 1994 compared to 1993 was due primarily to changes in the fuel mix from higher cost purchased power to gas and nuclear fuel which decrease was offset in part by increased power production at Palo Verde and at local gas facilities.

The increase in fuel and purchased and interchanged power expense in 1993 compared to 1992 was due primarily to increased purchased power cost as a result of decreased power production at Palo Verde and at local gas facilities, and increased unit gas costs.

Operation and Maintenance Expense

Operation and maintenance expense increased in 1994 as a result of (i) increased pension and benefit expenses of $3.0 million related to increased costs of postretirement benefits, pensions and other employee benefit plans; (ii) increased Palo Verde costs of approximately $2.2 million; (iii) increased regulatory expenses of approximately $2.1 million resulting from the rate case filing in Texas; (iv) increased outside services of approximately $1.9 million primarily due to the reissuance and the remarketing of several pollution control bonds; (v) an additional provision for increased environmental costs of approximately $1.6 million related to remediation projects at the Company's local facilities; and (vi) increased maintenance costs of approximately $1.5 million at one of the Company's local generating plants (see "Liquidity and Capital Resources–Obligations Subject to Compromise"). These increases were offset in part by (i) decreased pensions and benefits due to the recording of approximately $4.0 million in 1993 for retirement agreements with five former officers who retired in early 1994; (ii) decreased transmission costs due to a provision of approximately $1.9 million recorded in 1993 for the settlement of certain transmission disputes; and (iii) an additional provision of approximately $1.0 million recorded in the first quarter of 1993 for uncollectible amounts.

Operation and maintenance expense increased in 1993 as a result of (i) increased pension and benefit costs, including an additional expense of $6.3 million in connection with the adoption of SFAS No. 106 on January 1, 1993 and the recording of approximately $4.0 million for retirement agreements with five former officers who retired in early 1994; and (ii) the settlement of certain transmission disputes of approximately $1.9 million in 1993. These increases were offset in part by (i) decreased outside services resulting from decreased legal costs of approximately $5.0 million; (ii) decreased Palo Verde costs of approximately $3.6 million; and (iii) a decrease in bad debt expense of approximately $2.0 million.

Depreciation and Amortization Expense

Depreciation expense decreased in 1993 compared to 1992 due primarily to a $7.1 million DOE decommissioning charge reported in 1992 in connection with the Energy Policy Act, with no comparable adjustment in 1993. The decrease was partially offset by an increase in the Company's share of decommissioning expense related to Palo Verde, based on an updated study. For a discussion of decommissioning costs, see "Operational Challenges – General Industry" above and Item 8, "Financial Statements and Supplementary Data–Note E of Notes to Financial Statements."

Federal Income Taxes

The Company recorded federal income tax benefits of approximately $16.8 million in 1994. The increase in tax benefits in 1994 compared to tax benefits of approximately $7.9 million recognized in 1993 results primarily from a decline in nondeductible bankruptcy costs partially offset by a decrease in pretax losses.

The Company recorded federal income tax benefits of approximately $7.9 million in 1993. The increase in tax benefits in 1993 compared to tax benefits of approximately $4 million recognized in 1992 results from (i) differences in recognizing income taxes under the provisions of SFAS No. 109 in 1993 as compared to APB Opinion No. 11 in 1992, primarily the recognition of the one percent increase in the federal income tax rate; (ii) an increase in pre-tax loss, net of non-deductible reorganization costs; and (iii) other adjustments to deferred taxes.

Taxes Other Than Federal Income Taxes

Taxes other than federal income taxes decreased in 1994 compared to 1993 due primarily to the accrual of approximately $6.2 million in the first quarter of 1993 for the settlement and anticipated settlement of state income and other tax claims partially offset by increases in revenue related taxes and Texas franchise taxes in 1994.

Taxes other than federal income taxes increased in 1993 compared to 1992 due primarily to the accrual of approximately $6.2 million for the settlement and anticipated settlement of state income and other tax claims.

Other Income, Net

Other income, net in 1994 includes a gain of approximately $2.4 million recognized in the third quarter of 1994 on the sale of the Company's interest in Triangle Electric Supply Company.

Other income, net increased in 1993 compared to 1992 due to a gain of approximately $3.0 million recognized in the second quarter of 1993 for the settlement of civil litigation.

Interest Charges

Interest charges increased in 1994 compared to 1993 primarily due to payments to unsecured and undersecured creditors pursuant to the Plan. These interim payments, which are recorded as interest expense, totaled approximately $24.8 million and $10.2 million in 1994 and 1993, respectively. The increase in interim payments was due to increased interest rates and the recording of expenses for a full year in 1994 versus approximately half a year in 1993.

Interest charges increased in 1993 compared to 1992 primarily due to payments of approximately $10.2 million to unsecured and undersecured creditors pursuant to the Plan, as discussed above, and a $1.6 million charge in 1993 in connection with the settlement and anticipated settlement of state income and other tax claims as discussed above. The increase was partially offset by a reduction in interest rates on certain secured obligations.

Reorganization Items

Pursuant to the provision of Statement of Position 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code" ("SOP 90-7"), the Company reports net expenses incurred as a result of the bankruptcy proceedings in a separate section in the statements of operations. The reduction of reorganization items was due to decreased professional fees and other costs in 1994 compared to 1993 as a result of additional payments in 1993 pursuant to the Plan, and increased interest earned on accumulated cash in 1994 partially offset by increased periodic payments to preferred stockholders as provided in the Plan.

Professional fees and other costs increased in 1993 as a result of additional payments pursuant to the Plan following the Confirmation Date. This increase was offset as the Company incurred a one-time write-off in 1992 of debt issuance cost of approximately $13.3 million.

Cumulative Effect of a Change in Accounting Principle

Effective January 1, 1993, the Company began reporting its financial results pursuant to the provisions of SFAS No. 109. The standard requires the use of the asset and liability method of accounting for income taxes as opposed to the deferred method. The Company recognized a charge to operations in January 1993 of approximately $96 million as a result of adopting SFAS No. 109. The charge to operations consists of federal income tax benefits of approximately $153.2 million and state income tax benefits of approximately $12.2 million, less valuation allowances of approximately $219.2 million and $42.2 million, respectively.

Effects of Inflation

Over the recent past, inflation has been relatively low. As such, its impact to the Company's results of operations and financial condition have not been significant.

Environmental Matters

For a discussion of environmental matters, see Part I, Item 1, "Business–Environmental Matters."

Item 8. Financial Statements and Supplementary Data

INDEX TO FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

The Shareholders and Board of Directors
El Paso Electric Company:

We have audited the financial statements of El Paso Electric Company (a debtor-in-possession as of January 8, 1992) as listed in the accompanying index. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of El Paso Electric Company as of December 31, 1994 and 1993, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1994 in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that El Paso Electric Company will continue as a going concern. As discussed in Note A of Notes to Financial Statements, El Paso Electric Company filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code on January 8, 1992. The Chapter 11 case is administered by the United States Bankruptcy Court for the Western District of Texas. The Company is operating its business as debtor-in-possession which requires certain of its actions to be approved by the Bankruptcy Court. The Bankruptcy Court has confirmed the Company's proposed plan of reorganization which contemplates the Company would be acquired by Central and South West Corporation. Consummation of the plan of reorganization is subject to the satisfaction of certain conditions, including numerous regulatory approvals. Continuation of the Company as a going concern is dependent upon, among other things, the consummation of a plan of reorganization, the Company's ability to generate sufficient cash from operations, most significantly its operations which are subject to regulation of the rates it is allowed to charge as described in Note C of Notes to Financial Statements, and its ability to restructure or obtain financing to meet its obligations. Further, as more fully described in Notes B, H, J, and K of Notes to Financial Statements, significant claims beyond those reflected as liabilities in the financial statements at December 31, 1994 have been or may be asserted against the Company. The validity of these claims, as well as the amount and manner of payment of all valid claims, will ultimately be determined by the Bankruptcy Court. These matters raise substantial doubt about the Company's ability to continue as a going concern. As a result of the reorganization proceedings, the Company may sell or otherwise realize assets and liquidate or settle liabilities for amounts other than those reflected in the financial statements. Further, the consummation of a plan of reorganization could materially change the amounts currently recorded in the financial statements, and if no reorganization plan is consummated, it is possible that the Company's assets could be liquidated. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

As discussed in Notes I and L of Notes to Financial Statements, the Company changed its methods of accounting for income taxes and postretirement benefits other than pensions effective January 1, 1993.

KPMG Peat Marwick LLP

El Paso, Texas
March 30, 1995

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

BALANCE SHEETS

ASSETS

	December 31,	
	1994	1993
	(In thousands)	
Utility plant (Notes C, D and E):		
Electric plant in service	$ 1,694,553	$ 1,650,899
Less accumulated depreciation and amortization	419,212	381,309
Net plant in service	1,275,341	1,269,590
Construction work in progress	43,712	51,267
Nuclear fuel; includes fuel in process of $10,215,000 and $9,937,000, respectively	92,720	93,909
Less accumulated amortization	50,273	41,948
Net nuclear fuel	42,447	51,961
Net utility plant	1,361,500	1,372,818
Current assets:		
Cash and temporary investments (Note C)	208,584	181,086
Accounts receivable, principally trade, net of allowance for doubtful accounts of $5,923,000 and $6,004,000, respectively	54,367	54,652
Inventories, at cost	34,327	34,595
Prepayments and other	11,091	10,035
Total current assets	308,369	280,368
Long-term contract receivable (Note C)	33,603	32,420
Deferred charges and other assets	27,379	29,800
Total assets	$ 1,730,851	$ 1,715,406

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

BALANCE SHEETS

CAPITALIZATION AND LIABILITIES

	December 31, 1994	December 31, 1993
	(In thousands)	
Capitalization (Notes A, F, G and H):		
Common stock, no par value, 100,000,000 shares authorized. Issued and outstanding 35,544,330 shares	$ 339,097	$ 339,097
Accumulated deficit	(724,713)	(696,560)
Net unrealized loss on marketable securities, less applicable income tax benefits of $189,000 in 1994	(350)	–
Common stock deficit	(385,966)	(357,463)
Preferred stock, cumulative, no par value, 2,000,000 shares authorized:		
Redemption required	67,266	67,266
Redemption not required	14,198	14,198
Obligations subject to compromise	1,537,303	1,495,315
Total capitalization	1,232,801	1,219,316
Current liabilities:		
Accounts payable, principally trade	23,015	37,032
Customer deposits	4,891	4,905
Taxes accrued other than federal income taxes	23,427	21,658
Net overcollection of fuel revenues (Note C)	37,207	13,874
Revenues subject to refund (Note C)	11,475	–
Other	9,550	9,408
Total current liabilities	109,565	86,877
Deferred credits and other liabilities:		
Accumulated deferred income taxes (Note I)	98,106	123,935
Accumulated deferred investment tax credit (Note I)	76,642	68,992
Deferred gain on sales and leasebacks (Note B)	135,510	142,543
Decommissioning (Note E)	38,528	30,101
Other	39,699	43,642
Total deferred credits and other liabilities	388,485	409,213
Commitments and contingencies (Notes A, B, C, J, K and L)		
Total capitalization and liabilities	$ 1,730,851	$ 1,715,406

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

STATEMENTS OF OPERATIONS

For the years ended December 31, 1994, 1993 and 1992

	1994	1993	1992
	(In thousands except per share data)		
Operating revenues	$536,760	$ 543,594	$524,760
Operating expenses:			
Operation:			
Fuel	89,893	93,007	90,840
Purchased and interchanged power	29,929	39,997	16,858
	119,822	133,004	107,698
Other	209,814	206,576	204,334
Maintenance	44,022	39,450	39,351
Depreciation and amortization	53,841	53,050	56,869
Taxes:			
Federal income tax benefits (Note I)	(18,234)	(10,360)	(1,067)
Other	54,484	56,903	50,539
	463,749	478,623	457,724
Operating income	73,011	64,971	67,036
Other income (deductions):			
Other, net	3,378	2,838	754
Federal income taxes applicable to other income (Note I)	(516)	(831)	(343)
	2,862	2,007	411
Income before interest charges	75,873	66,978	67,447
Interest charges (credits):			
Interest	97,616	82,237	73,176
Other interest capitalized and deferred	(2,581)	(3,998)	(3,917)
	95,035	78,239	69,259
Loss before reorganization items and cumulative effect of a change in accounting principle	(19,162)	(11,261)	(1,812)
Reorganization items (expense):			
Debt costs	—	—	(13,264)
Professional fees and other	(15,866)	(35,150)	(20,194)
Interest earned on accumulated cash resulting from Bankruptcy case	7,771	6,152	3,806
Federal income (taxes) benefits applicable to reorganization items	(896)	(1,596)	3,284
	(8,991)	(30,594)	(26,368)
Loss before cumulative effect of a change in accounting principle	(28,153)	(41,855)	(28,180)
Cumulative effect of a change in accounting principle (Note I)	—	(96,044)	—
Net loss	$ (28,153)	$ (137,899)	$ (28,180)
Net loss per weighted average share of common stock:			
Loss before cumulative effect of a change in accounting principle	$ (0.79)	$ (1.18)	$ (0.79)
Cumulative effect of a change in accounting principle	—	(2.70)	—
Net loss	$ (0.79)	$ (3.88)	$ (0.79)

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

STATEMENTS OF ACCUMULATED DEFICIT

For the years ended December 31, 1994, 1993 and 1992

	1994	1993	1992
		(In thousands)	
Accumulated deficit at beginning of year	$ (696,560)	$ (558,661)	$ (530,481)
Net loss	(28,153)	(137,899)	(28,180)
Accumulated deficit at end of year	$ (724,713)	$ (696,560)	$ (558,661)
Weighted average number of common shares outstanding	35,544,330	35,539,480	35,530,264

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

STATEMENTS OF CASH FLOWS

For the years ended December 31, 1994, 1993 and 1992

	1994	1993	1992
		(In thousands)	
Cash Flows From Operating Activities:			
Loss before cumulative effect of a change in accounting principle	$ (28,153)	$ (41,855)	$ (28,180)
Adjustments for non-cash items from operating activities:			
Depreciation and amortization	67,189	66,901	69,219
Deferred income taxes and investment tax credit, net	(17,990)	(24,077)	(4,008)
Debt costs	–	–	13,264
Other operating activities	(5,429)	(1,787)	(1,784)
Change in:			
Accounts receivable	285	(2,756)	(1,582)
Inventories	268	1,983	6,090
Prepayments and other	(1,056)	1,316	5,815
Long-term contract receivable	(1,183)	(2,371)	(2,850)
Obligations subject to compromise	42,943	55,214	103,023
Accounts payable	(14,017)	10,912	26,119
Net overcollection of fuel revenues	23,333	239	13,635
Revenues subject to refund	11,475	–	–
Other current liabilities	1,897	(3,152)	14,709
Deferred charges and credits	8,867	16,637	4,402
Net cash provided by operating activities	88,429	77,204	217,872
Cash Flows From Investing Activities:			
Additions to utility plant	(60,113)	(58,215)	(60,570)
Other investing activities	137	409	–
Net cash used for investing activities	(59,976)	(57,806)	(60,5
Cash Flows From Financing Activities:			
Redemption of long-term obligations	(955)	(867)	(788)
Other financing activities	–	20	30
Net cash used for financing activities	(955)	(847)	(758)
Net increase in cash and temporary investments	27,498	18,551	156,544
Cash and temporary investments at beginning of year	181,086	162,535	5,991
Cash and temporary investments at end of year	$ 208,584	$ 181,086	$ 162,535
Supplemental Disclosures of Cash Flow Information:			
Cash paid during the year for:			
Income taxes	$ 4,700	$ 17,064	$ –
Interest	92,474	64,712	32,498
Reorganization items:			
Cash interest received on accumulated cash resulting from Bankruptcy case	6,802	6,107	3,343
Cash paid for professional fees and other	26,406	28,531	11,759

See accompanying notes to financial statements.

A. Bankruptcy and Going Concern Presentation

On January 8, 1992 ("Petition Date") El Paso Electric Company (the "Company") filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code ("Bankruptcy Code") in the United States Bankruptcy Court for the Western District of Texas, Austin Division (the "Bankruptcy Court"). The filing followed an attempt by the Company during 1991 to negotiate a restructuring of its obligations with its creditors, culminating with the draws in late 1991 on letters of credit related to the Company's sales and leasebacks of portions of its interest in the Palo Verde Nuclear Generating Station ("Palo Verde"). Since the Petition Date, the Company's management has continued to manage the operations and affairs of the Company, subject to the authority of the Company's Board of Directors, as debtor in possession. Certain actions of the Company, during the pendency of the bankruptcy proceedings, including, without limitation, transactions outside of the ordinary course of business, are subject to the approval of the Bankruptcy Court. On December 8, 1993 (the "Confirmation Date"), the Bankruptcy Court entered an order confirming the Company's Modified Third Amended Plan of Reorganization, as corrected through December 6, 1993 (the "Plan"). The effectiveness of the Plan is subject to satisfying certain conditions, discussed below.

As of January 8, 1992, actions to collect prepetition indebtedness or pursue prepetition claims were stayed and contractual obligations incurred prepetition may not be enforced against the Company. The Company has rejected certain executory contracts and leases as permitted by the Bankruptcy Code and claims arising from such rejections have been or will be addressed through the reorganization process. Substantially all liabilities as of the Petition Date would be modified pursuant to the Plan. (See Note H for a description of estimated liabilities subject to compromise).

The discussions and descriptions of Company events and the analysis of their potential impact on financial results herein are premised on the assumption that the Company's operations will be maintained within existing financial agreements, as modified by the Plan, and regulatory structures prior to the effective date of the Plan ("Effective Date"). These financial statements must be read with the understanding that the Plan, which has been confirmed by the Bankruptcy Court, but has not become effective, will alter, compromise or modify the existing financial and regulatory structures if it becomes effective. Conditions to the Plan becoming effective exist, as discussed herein. The Company can give no assurance, that such conditions will be satisfied. In addition, Central and South West Corporation ("CSW") has stated that the Merger (as defined below) is in jeopardy. Accordingly, the Plan may not become effective. See "CSW Positions with Respect to the Merger," below. If the Plan does not become effective, another plan of reorganization also would alter, compromise or modify existing financial and regulatory structures. See "Alternatives for the Company if the Plan and Merger Fail," below. It is therefore not possible at this time to state with certainty the nature or degree to which the existing financial and regulatory structures will be altered, compromised or modified. Accordingly, estimates and evaluations based on the historical results of Company operations could be subject to material changes as a result of the eventual resolution of the case commenced January 8, 1992 by the Company in the Bankruptcy Court as Case No. 92-10148-FM ("Bankruptcy Case").

The Company faces many of the challenges facing the electric utility industry as a whole, including competitive factors and the costs of nuclear investment and decommissioning. The level of competition has increased as a result of changes in federal regulatory provisions related to transmission practices and independent power production, including cogeneration projects. The Energy Policy Act includes provisions authorizing the Federal Energy Regulatory Commission ("FERC") to order electric utilities to transmit power at wholesale at the request of third parties, such as independent power producers and other utilities. Implementation of these provisions may involve changes in the method of transmission pricing and increased compliance reporting to the FERC regarding transmission system availability. State legislatures such as the New Mexico legislature

also have indicated they are considering retail wheeling policies that could result in increases in competition.

The financial statements have been prepared assuming that the Company will continue as a going concern. Continuation of the Company as a going concern is dependent upon, among other things, a plan of reorganization becoming effective, the Company's ability to generate sufficient cash from operations, most significantly its operations which are subject to regulation of the rates it is allowed to charge as described in Note C, and its ability to restructure or obtain refinancing to meet its obligations. Further, as more fully described in Notes B, H, J and K, significant claims beyond those reflected as liabilities in the financial statements at December 31, 1994 have been asserted against the Company. The validity of these claims, as well as the amount and manner of payment of all valid claims, will ultimately be determined by the Bankruptcy Court. As a result of the reorganization proceedings, the Company may sell or otherwise realize assets and liquidate or settle liabilities for amounts other than those reflected in the financial statements. Further, the effectiveness of a plan of reorganization could materially change the amounts currently recorded in the financial statements and if no reorganization plan becomes effective, it is possible that the Company's assets could be liquidated. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

The Plan and Proposed Merger

Background

On May 5, 1993, as contemplated by an Agreement and Plan of Merger dated May 3, 1993, as amended (the "Merger Agreement"), the Company filed its Third Amended Plan of Reorganization and Third Amended Disclosure Statement, which provides for the reorganization of the Company and its acquisition by CSW, a registered public utility holding company under the Public Utility Holding Company Act of 1935, as amended (the "PUHCA"). Pursuant to the Merger Agreement and effective simultaneously with the effectiveness of the Plan, CSW Sub, Inc., a wholly-owned special purpose subsidiary of CSW ("CSW Sub"), would merge with and into the Company (the "Merger"), and CSW would become the owner of all of the issued and outstanding shares of common stock of the Company. The Company would continue to operate as a public utility as a direct, wholly-owned subsidiary of CSW. The Plan provides for the Company's creditors and equity security holders to receive in respect of their claims, cash, securities of the Company as reorganized ("Reorganized EPE"), and/or securities of CSW. Certain creditors would have their claims allowed and reinstated pursuant to the Bankruptcy Code. A description of the consideration to be received by all claim holders, including holders of the Company's various classes of debt and equity securities, is set forth in "Treatment of Claims Under the Plan," below.

After the Confirmation Date, the Company and CSW commenced the process of obtaining the various regulatory approvals required for consummation of the Plan and the Merger. As set forth below, CSW has, since September 12, 1994, engaged in conduct and expressed views that cast doubt upon its intention to close the Merger unless certain matters, including the City of Las Cruces situation and the situation at Palo Verde are "timely and favorably resolved." The Company vigorously disputes that CSW's positions are supported by the Merger Agreement, and continues to exert its best efforts to consummate the Merger. See "CSW Positions with Respect to the Merger," below.

Conditions to Effectiveness of the Plan and Merger

The Plan and the Merger Agreement specify certain conditions that must be satisfied at or prior to the Effective Date for the Merger to be consummated and the Plan to become effective. As discussed below in "Termination of the Merger Agreement," time periods exist for satisfaction of such

conditions. Other than certain regulatory or statutory approvals and receipt of investment grade ratings on certain securities to be issued under the Plan, CSW and the Company may waive all or any portion of any of the conditions to effectiveness of the Plan and the Merger. The principal conditions are the receipt by the Company and CSW of certain regulatory approvals and orders, as set forth in detail in the Merger Agreement. Such regulatory approvals and orders include those of the FERC, the Securities and Exchange Commission ("SEC"), the Public Utility Commission of Texas ("Texas Commission"), the New Mexico Public Utility Commission ("New Mexico Commission") and the Nuclear Regulatory Commission ("NRC"), as well as determinations under the Hart-Scott Rodino Antitrust Improvements Act of 1976 ("HSR Act"), and the expiration or termination of waiting periods specified thereunder. In addition, the Merger Agreement requires that at the time of closing, unless waived by the affected party or otherwise excused, there be no Material Adverse Effect (including a Regulatory Material Adverse Effect), as such terms are defined in the Merger Agreement, nor any fact or circumstance which could reasonably lead to such a Material Adverse Effect. See "CSW Positions with Respect to the Merger," below.

Certain of the conditions to the closing of the Merger have already been satisfied or events have occurred resulting in significant progress toward satisfaction: the Plan was confirmed on December 8, 1993; settlements (which become operative on the Effective Date) were entered into on November 15, 1993, and thereafter approved by the Bankruptcy Court, resolving the adversary proceeding between the Company and the Palo Verde lessors and providing for the transfer back to the Company of title to the leased portions of Palo Verde on the Effective Date; a capital structure for the Company as of the Effective Date has been designed to meet the requirement for an investment-grade rating from the rating agencies; and proceedings or reviews are being conducted with respect to rates, public interest findings and/or approvals of the Merger before the FERC, the Texas Commission, the New Mexico Commission, the NRC and the SEC. See "Regulatory Aspects of the Plan and Merger," below. The Company believes that the requisite regulatory orders and approvals will be obtained. However, the Company expects that certain of such regulatory orders and approvals will not be final before the expiration of the initial time period established by the Merger Agreement (i.e., June 8, 1995), and an agreement with CSW to extend the time to close the Merger may be required pursuant to provisions therefor in the Merger Agreement. See "Termination of the Merger Agreement," below.

CSW Positions with Respect to the Merger

On September 12, 1994, CSW delivered a letter to the Company (the "September 12 Letter") stating that CSW would not close the Merger unless there was (i) a favorable and timely resolution of the Company's dispute with the City of Las Cruces involving its municipalization efforts and (ii) a determination of the significance of the tube-cracking problems at Palo Verde and (see Notes E and M), both of which would have to be accomplished by the Effective Date. CSW further stated that these two matters, together with (i) the potential loss of other customers in the Company's service area, including the Holloman Air Force Base and the White Sands Missile Range in New Mexico; (ii) Texas regulatory issues related to rate relief and to approval of the Merger; and (iii) the announced "comparable transmission service" standard being applied on the Merger by the FERC, place the completion of the Merger in jeopardy. Further, the September 12 Letter asserted that such matters, individually and cumulatively, constitute a Material Adverse Effect or failure of other closing conditions under the Merger Agreement which, unless "timely and favorably resolved" in accordance with the Merger Agreement, will preclude the closing of the proposed Merger.

On September 16, 1994, the Company responded to CSW's September 12 Letter, stating that "the Merger Agreement does not condition CSW's obligation to close the transaction on either a favorable resolution of the Las Cruces situation or a determination of the significance, if any, of the Palo Verde 'problems'." The Company further disagreed with each of the assertions made by CSW and noted that CSW's September 12 Letter had inflicted irreparable harm on the Company and the Merger process. Since September 1994, the parties have exchanged numerous letters regarding interpretations of the

Merger Agreement and the actions of the parties thereunder. CSW has maintained the positions stated in its September 12 Letter and also has asserted claims of "loss of value" to the Merger. The Company has reiterated the views expressed in its September 16, 1994 letter to CSW and does not believe that CSW's positions are supported by the Merger Agreement.

In view of the repeated assertions by CSW of its intention, under certain circumstances, not to close the Merger, the Company has retained litigation counsel to advise the Company of its rights and obligations under the Plan and the Merger Agreement. If CSW attempts to terminate the Merger Agreement without proper justification or if CSW otherwise breaches the Merger Agreement, litigation could ensue. The Merger Agreement provides for specific performance as a remedy, and other damages may be payable in the event of a breach of the Merger Agreement.

Termination of the Merger Agreement

The Merger Agreement provides that it may be terminated (i) by mutual written consent approved by the Boards of Directors of CSW and the Company, or (ii) by CSW or the Board of Directors of the Company if the Effective Date has not occurred within 18 months from the Confirmation Date (i.e., by June 8, 1995) or, if extended by mutual consent, if the Effective Date has not occurred within 24 months of the Confirmation Date (i.e., by December 8, 1995).

The Merger Agreement also states that CSW may terminate the Merger Agreement by written notice to the Company's Board of Directors if:

(i) the Company withdraws or modifies in a manner adverse to CSW its recommendation or approval of the Plan, the Merger Agreement or the Merger, or approves or recommends a proposal or acquisition with a party other than CSW or a subsidiary of CSW;

(ii) there is a material breach of any representation, warranty, covenant or agreement of the Merger Agreement by the Company;

(iii) there is a failure to obtain any required statutory approvals or regulatory determinations that are conditions to the effectiveness of the Merger;

(iv) the Company files an independent case related to rates before the Texas Commission, except as permitted by the Merger Agreement; or

(v) there shall exist with respect to Company a Material Adverse Effect or a fact or circumstance which could reasonably lead to a Material Adverse Effect.

The Merger Agreement states that the Company may terminate the Merger Agreement if any of the following events occur:

(i) there is a failure to obtain any required statutory approvals or regulatory determinations that are conditions to the effectiveness of the Plan and Merger;

(ii) there is a material breach of any representation, warranty, covenant or agreement of the Merger Agreement by CSW;

(iii) CSW withdraws or modifies in a manner adverse to the Company its recommendation or approval of the Plan, the Merger Agreement or the Merger;

(iv) the Company determines in accordance with its fiduciary duties as debtor-in-possession to engage in an acquisition transaction with a party unrelated to CSW; or

(v) there shall exist with respect to CSW a Material Adverse Effect or a fact or circumstance that could reasonably lead to a Material Adverse Effect.

Under certain circumstances, termination of the Merger Agreement may result in a $25 million termination fee payable by one party to the other and the payment by CSW to the Company of certain interest costs estimated to be approximately $14.6 million as of December 31, 1994, and certain fees and expenses incurred by the Company pursuant to the Plan. The principal circumstances under which a $25 million fee may be payable by one party to the other party would be (i) the denial by one party of a request by the other party to extend the termination date for up to six months, where such request is made because one or more conditions to the Merger Agreement has not been satisfied and which request states that the requesting party believes in good faith and on reasonable grounds that such conditions can be satisfied within the requested extension period, i.e., by December 8, 1995; or (ii) a material breach of a representation, warranty, covenant or agreement by one party that has not been remedied within ten days after receipt of written notice from the other party.

Alternatives for the Company if the Plan and Merger Fail

If the Plan does not become effective and the confirmation order is vacated, the Company would consider alternatives to the Merger, including another merger or business combination with an entity not affiliated with CSW, a stand-alone plan that could involve a restructuring under FERC jurisdiction or a stand-alone plan under existing regulatory frameworks. Under each of these alternatives, the treatment of Palo Verde assets and the pending adversary proceeding (see "Treatment of Palo Verde" below and Note B) may be reevaluated by the Company. In addition, the Bankruptcy Court could allow third parties, including various creditor constituencies and other interested companies, to file a plan of reorganization that might involve a merger, business combination or acquisition or conversion of a portion of the Company's outstanding debt into preferred or common stock of the Company.

Any plan of reorganization other than the Plan may provide for different securities and treatments than those provided in the Plan, and could result in lower recoveries for creditors and interest holders and/or could require larger rate increases than proposed pursuant to the Plan. The Company cannot predict (i) what the treatment of claims and interests would be under any alternate plan of reorganization, (ii) in what respects actions proposed under the Plan would be modified, or (iii) the amount of time or expense that would be required before any such alternate plan of reorganization were effective.

Although the Company believes it is unlikely, if the Merger does not occur and no other plan of reorganization proves viable, the Bankruptcy Court could order the liquidation of the Company.

Regulatory Aspects of the Plan and Merger

Consummation of the Plan and Merger is conditioned on receipt of required regulatory approvals and determinations, including those discussed below. The effectiveness of the Plan is conditioned upon obtaining Texas and New Mexico orders, including a rate order in Texas, establishing certain ratemaking, accounting and regulatory treatments, certain of which orders may be waived by CSW and the Company. No assurances can be given that the respective regulatory authorities will grant the regulatory approvals and determinations required under the Plan and the Merger Agreement, or upon what terms or conditions such approvals or determinations might be given. (See Note C.)

Proposed Texas Regulatory Treatment. The effectiveness of the Plan and the Merger is conditioned upon the receipt by the Company and CSW of the following Texas regulatory approvals

and determinations unless such conditions are waived by CSW and the Company: (i) a final order of the Texas Commission authorizing a base rate increase of $25 million to be effective for the Company in 1994 and authorizing certain ratemaking, accounting and regulatory treatments of the assets, expenditures, costs and revenues of the Company; (ii) a final order of the Texas Commission to the effect that the combination of the Company with CSW Sub contemplated under the Plan is in the public interest and authorizing certain regulatory treatments with respect to the combination and (iii) a final order of the Texas Commission to the effect that the reacquisition by the Company of the previously leased Palo Verde Unit 2 and 3 assets and the ratemaking treatment for the repurchased assets as plant-in-service in rate base at the original cost less depreciation are in the public interest. (See Note C.)

New Mexico Regulatory Treatment. The effectiveness of the Plan and the Merger is conditioned on the receipt by the Company and CSW of the following regulatory approvals and determinations unless such conditions are waived by CSW and the Company: (i) a final order of the New Mexico Commission approving the combination of the Company with CSW; (ii) a final order of the New Mexico Commission authorizing certain ratemaking, accounting and regulatory treatments of the assets, expenditures, costs and revenues of the Company; (iii) a final order of the New Mexico Commission authorizing the issuance by the Company of the securities required for the consummation of the Plan; (iv) a final determination by the New Mexico Commission that none of the transactions between the Company and CSW contemplated by either the Plan or the Merger Agreement involve a Class II transaction (which generally relate to certain investments or transactions with affiliates) or, if a Class II transaction is involved, a final order of the New Mexico Commission approving a diversification plan relating to the combination of the Company and CSW and the transactions between the Company and other CSW subsidiaries; and (v) a final determination by the New Mexico Commission that a new Certificate of Convenience and Necessity ("CCN") is not required by the Company as a result of the transactions between the Company and CSW as contemplated in either the Plan or the Merger Agreement or, if the New Mexico Commission determines a new CCN is required, a final order issuing a new CCN to the Company.

The Company and CSW filed an application the ("New Mexico Merger Application") with the New Mexico Commission on March 14, 1994, which has been docketed as NMPUC Case No. 2575. The New Mexico Merger Application requests the New Mexico Commission, to the extent necessary and appropriate under the law, to approve (i) the acquisition by CSW of the outstanding common stock of the Company; (ii) the accounting treatment of the Merger; (iii) the reacquisition of portions of Palo Verde by the Company and the proposed accounting, regulatory and tax treatment associated with the reacquisition; and (iv) a General Diversification Plan for the Company for activities that will occur as a result of the Merger. The New Mexico Merger Application does not include any request related to the issuance of securities pursuant to the Plan; such request will be included in separate applications which the Company anticipates will be filed in April 1995.

On May 23, 1994 CSW announced its proposal to freeze base rates at current levels for the New Mexico jurisdiction following the Effective Date. On August 19, 1994, CSW and the Company filed a formal statement with the New Mexico Commission, contingent on the closing of the Merger, committing to the rate freeze proposal. Under the proposal, the Company would not request an increase in base rates charged to New Mexico customers through 2002 except for a one-time potential base rate increase of no more than 6% of total New Mexico jurisdictional revenues during the period 1998 to 2002.

FERC. The Company and Central and South West Services, Inc. ("CSWS") have applications pending before the FERC (i) seeking an order from the FERC requiring Southwestern Public Service Company ("SPS") to allow the Company and CSW to transmit power across SPS's transmission system after the Merger is consummated; (ii) requesting a determination that the Merger is consistent with the public interest; and (iii) seeking approval of an amendment to the CSW System Operating

Agreement and to make the Company a party to the agreement. A FERC order which approves the Merger and which contains conditions not substantially more onerous than those imposed in recent FERC orders with respect to mergers involving electric utility companies will meet the requirements of the Merger Agreement. No assurance can be given that the FERC will grant the required approvals under the Federal Power Act ("FPA"), when such approvals might be granted, or the terms and conditions that may be imposed, if conditional approval is granted.

SEC. As a registered public utility holding company subject to the PUHCA, CSW is required to obtain the approval of the SEC prior to consummating the Merger. Under the PUHCA, the SEC must find that after the Merger the Company and CSW will constitute an integrated electric system. As noted above, the Company and CSW propose to coordinate their operations by means of transmission service to be provided by SPS. In the past, the SEC has determined that integration may be effected by means of transmission rights on unaffiliated systems. SEC approval will also be required for the formation of CSW Sub, the issuance of CSW common stock to the holders of the Company's common stock and certain creditors, and the issuance of Reorganized EPE's securities to holders of the Company's securities and certain creditors pursuant to the Plan.

NRC. Approval of the NRC is required for the indirect transfer of control of the Company's interest in the Palo Verde operating licenses and amendment of those licenses to delete previously approved sale/leaseback arrangements.

Other Regulatory Filings. Under the FPA and the Department of Energy Act, the Department of Energy ("DOE") must authorize persons to transmit electric energy from the United States. The Company holds an authorization to transmit electric energy to Comision Federal de Electricidad de Mexico ("CFE"). Under the Plan, CSW would become the owner of the common stock of the Company. The DOE requires that notice of a succession of ownership be filed with the DOE. In general, this notice must be filed at least 30 days prior to the effective date of any succession in ownership. The Company intends to file a notice of succession in ownership with the DOE at the appropriate time.

The Company and CSW also must file a notice related to the Merger with the Federal Trade Commission ("FTC") and United States Department of Justice ("DOJ") pursuant to the HSR Act. The applicable waiting period following such filing must have expired before the Effective Date without an adverse ruling or other action by the FTC and DOJ with respect to any anticompetitive effect is of the Merger. The Company intends to file a notice pursuant to the HSR Act at the appropriate time..

Treatment of Palo Verde

Major aspects of the Plan include (i) the rejection of the Company's leases relating to Palo Verde (the "Palo Verde Leases"), which extend to the Company's entire interest in Palo Verde Unit 2, approximately 40% of the Company's interest in Palo Verde Unit 3 and approximately one-third of its interest in the Common Plant; (ii) the resolution of any and all claims relating to such leases by the agreement that an amount equal to $700 million would be the allowed claim of holders of lease obligation bonds (which bonds are not reflected in the Company's financial statements) related to the Palo Verde Leases and pursuant to settlement agreements entered into between the Company and the lessors; (iii) reacquisition of the leased portions of Palo Verde by the Company; and (iv) the Company's assumption and cure of the ANPP Participation Agreement and related agreements. (See Notes B and E.)

The treatment of Palo Verde under the Plan constitutes a comprehensive resolution of all aspects and issues involving the Company's interest in the plant, from its relationship with the other utility participants to the treatment of the sale and leaseback transactions. The treatment would resolve an adversary proceeding pending in the Bankruptcy Case pursuant to which the Company sought to reject the Palo Verde Leases and establish the damages, if any, payable for such rejection. If the Plan

does not become effective, the Company would have to consider the appropriate treatment of Palo Verde, including whether to continue the treatment of relevant claims as proposed under the Plan, propose some other resolution and settlement with affected parties or pursue the adversary proceeding.

Treatment of Claims Under the Plan

The Plan generally provides for creditors and interest holders to receive shares of CSW common stock, cash and/or securities of Reorganized EPE or to have their claims cured and reinstated. Secured creditors would receive value equal to 100% of their allowed claim in the form of debt securities of Reorganized EPE and interest on accrued unpaid interest. The trust used to finance nuclear fuel would receive value equal to 100% of the principal amount of their allowed claim in the form of debt securities of Reorganized EPE. Unsecured creditors would receive a combination of debt securities of Reorganized EPE and CSW common stock in an amount equal to 95.5% of the principal amount of their allowed claim and interest on such 95.5% amount quarterly through the Effective Date. The holders of Palo Verde lease obligation bonds would receive 95.5% of the amount of their allowed claim, which is designated at $700 million, in the form of debt securities of Reorganized EPE and CSW common stock, and interest on such 95.5% amount quarterly through the Effective Date. See "Treatment of Palo Verde." Small unsecured creditors would receive 100% of their allowed claim in cash. Pollution control bonds issued in connection with the Company's interests in Palo Verde and the Four Corners Project ("Four Corners") would be cured and reinstated at the Effective Date and, thus, would remain outstanding. Preferred shareholders of the Company would receive shares of Reorganized EPE preferred stock having a value in the amount of $68 million in the aggregate for their allowed interests.

The issued and outstanding shares of Company common stock would be converted into CSW common stock. Outstanding options to purchase Company common stock would be converted into options to purchase shares of CSW common stock. The conversions would be made at the Effective Date and would be based on the ratio of the number of shares of CSW common stock credited to the CSW Common Stock Acquisition Fund (the "Fund") to the number of outstanding shares of Company common stock at the Effective Date. The Fund is a tracking mechanism and not an actual escrow or other repository for funds; no shares of CSW common stock or cash are placed in the Fund.

The actual number of shares of CSW common stock that would be issued to Company shareholders cannot be finally determined until the Effective Date and the method of conversion would be as provided in the Merger Agreement and set forth above. In general terms, the number of shares of CSW common stock credited to the Fund would be based on the sum of (i) the conversion of the number of shares of Company common stock outstanding at the Confirmation Date (35,544,330 shares) to CSW common stock, assuming a value of $3.00 per share of Company common stock and a value of $29.4583 per share of CSW common stock, (ii) the conversion of up to $1.50 per share of Company common stock outstanding at the Confirmation Date as additional consideration deemed to be realized through the resolution of certain claims and the disposition of certain assets described in the Merger Agreement, with such conversion based on a value of CSW common stock equal to $29.4583 for items realized prior to the Confirmation Date and the closing price on the date of the resolution of such item for items resolved after the Confirmation Date, and (iii) the conversion of dividends that would be deemed to accrue on the amounts described in (i) and (ii) above from the Confirmation Date or the date the additional consideration is realized, as the case may be, through the Effective Date, plus dividends on such dividends.

The Company believes that it has resolved the contingencies or realized proceeds from the items designated in the Merger Agreement in amounts sufficient such that at the Effective Date, the maximum additional consideration would be reached. As of March 1, 1995, the Company estimates that approximately 5,821,665 shares of CSW common stock would be credited to the Fund, including

shares credited due to dividends paid by CSW. However, this number does not include the number of shares that would be credited as a result of the conversion of up to $13.8 million in additional consideration because such conversion would be made one day prior to the Effective Date based on the closing price of CSW common stock on such date. This calculation has not been submitted to CSW for review or approval. The closing price of CSW common stock on March 1, 1995 was $24.625 per share.

Interim Payments

In addition to the treatment of the prepetition claims of each class of creditors and security holders, as discussed above, the Plan provides for the Company to make certain payments at the Confirmation Date and thereafter until the Effective Date. These payments are in addition to periodic interest payments on secured debt that the Company has been making since July 1, 1992 pursuant to orders of the Bankruptcy Court. The payments were negotiated as part of the process to achieve approval of the Plan and are intended to compensate certain holders of claims and interests during the period from the Confirmation Date to the Effective Date. These interim payments consist of (i) amounts characterized as interest on unsecured and undersecured debt and on the claims of the holders of the bonds related to the financing of the Palo Verde sale/leaseback transactions; (ii) amounts characterized as periodic payments to holders of the Company's preferred stock, which the Bankruptcy Court has ruled are not dividends; and (iii) fees of advisors and other expenses of the various classes of creditors and interest holders. The amounts paid under (i) and (ii) are calculated at variable rates, primarily at 90-Day LIBOR plus 2% (8.5% at December 31, 1994).

To the extent that liabilities and expenses related to these payments have been accrued by the Company since the filing for bankruptcy, the Company has reduced such liabilities by the interim payments. Otherwise, the interim payments have been expensed as interest or reorganization items. Accordingly, approximately $42.9 million and $15.5 million in 1994 and 1993, respectively, paid to the Palo Verde Leases bondholders have been offset against lease expense accruals which the Company has been recording on a regular basis (Note B); amounts aggregating approximately $24.8 million and $10.2 million for 1994 and 1993, respectively, paid on unsecured debt for which the Company had not been accruing interest were charged to interest expense; and amounts aggregating approximately $5.4 million and $14.7 million for 1994 and 1993, respectively, paid to holders of preferred stock as periodic payments and certain amounts paid to advisors of creditors and interest holders were charged to reorganization items. The Company estimates that interim payments aggregating approximately $24.1 million per quarter will be made through the Effective Date, of which approximately $14.3 million would be offset against lease expense accruals which the Company has been recording on a regular basis; approximately $8.3 million would be expensed as interest expense and approximately $1.5 million would be expensed as reorganization items. These amounts are based upon current levels of interest rates and are in addition to the monthly payments of approximately $5.4 million on secured debt that the Company has been making and expects to continue to make.

The Plan provides for other amounts to be paid at only the Effective Date representing interest on certain claims and fees incurred by certain classes, which are not included in the interim payments set forth in the Plan, as described above. These amounts are estimated to aggregate approximately $18 million at December 31, 1994, of which approximately $14 million has not been accrued by the Company because it is uncertain if the Plan will become effective.

B. Sale and Leaseback Transactions and Letters of Credit Draws

In August and December 1986 and December 1987, the Company consummated ten separate sale/leaseback transactions involving all of its undivided interest in Palo Verde Unit 2, one-third of its undivided interest in certain common plant at Palo Verde and approximately 40% of its undivided interest in Unit 3. Pursuant to applicable agreements, the Company remains responsible, during the terms of the Palo Verde Leases, for all operating and maintenance costs, nuclear fuel costs, other

related operating costs of the leased-back facilities, and for decommissioning costs. Under their terms, the leases related to Unit 2 and common plant expire in October 2013, while the leases related to Unit 3 expire in January 2017. All of the Palo Verde Leases contain certain renewal options and provide for repurchase options, at fair market value, at the termination of the lease. See Note A for a discussion of the treatment of the Palo Verde Leases under the Plan.

The aggregate consideration received by the Company in the sale/leaseback transactions was $934.4 million ($684.4 million in 1986 and $250 million in 1987). Nine of the ten transactions are accounted for as operating leases; one transaction (sales price of $87.4 million) is accounted for as a financing transaction. For the transactions accounted for as operating leases, the proceeds exceeded the cost of the assets sold by $194 million, which amount has been deferred and is being amortized into income, as a reduction to lease expense, over the primary terms of the leases.

All of the Palo Verde Leases and related documents provide that upon the occurrence of specified events of loss or deemed loss events, as defined, the Company is obligated to pay the related equity investor an amount in cash (secured by letters of credit) which may exceed the equity investor's unrecovered equity investment. The Palo Verde Leases also contain provisions related to the indemnification of the lessors in certain circumstances against certain losses, including the loss of certain tax benefits, resulting from specified events.

The letters of credit related to the Unit 2 leases had expiration dates of December 31, 1991 and January 2, 1992. During the second half of 1991, the Company pursued a comprehensive financial restructuring which would have provided, among other things, for the issuance of required replacement letters of credit by December 1, 1991, the earliest date required pursuant to the leases. However, the Company failed to provide the replacement letters of credit by such date. On December 26 and 27, 1991, beneficiaries holding the letters of credit issued on the account of the Company in connection with the Unit 2 sales and leasebacks drew and were paid the full available amount of such letters of credit of approximately $208 million. As discussed in Note A, the Company filed its bankruptcy petition on January 8, 1992. On January 9, 1992 the beneficiaries of the letters of credit issued in connection with the Unit 3 sale and leaseback transactions also drew and were paid the full available amount of such letters of credit of approximately $80.4 million.

As a consequence of the letters of credit draws, the Company incurred direct obligations totaling approximately $288.4 million to the banks issuing these letters of credit. The obligations are unsecured prepetition claims of the banks (see Notes A and H). The banks are precluded from taking any action to collect their claim against the Company outside of the Bankruptcy Case and the Company is presently precluded from paying the amount as a result of the bankruptcy filing. The Company has not made lease payments on the Palo Verde Leases and the non-payment of rent by the applicable grace period provided in the Palo Verde Leases constitutes events of default under the leases, which ordinarily would entitle the lessors to various remedies pursuant to the terms of the applicable agreements, including, rescission or termination of the leases and liquidated damages. As a result of the bankruptcy filing, however, the lessors are stayed from exercising any remedies under the Palo Verde Leases except through the Bankruptcy Case. In connection with the Bankruptcy Case, the lessors and the holders of bonds issued to finance the lessors' purchase of the interests in Palo Verde have filed proofs of claims that collectively assert damages of approximately $742.7 million.

On September 9, 1992, the Company filed an adversary proceeding against the lessors and the indenture trustees of the lease obligation bonds seeking to resolve issues related to the Palo Verde Leases. The defendants in the adversary proceeding have asserted other claims against the Company. As discussed in Note A, the Plan contemplates that the assets subject to the Palo Verde Leases would be reacquired by the Company. In addition, if the Plan becomes effective, the adversary proceeding

would be resolved without additional payment to the lessor. Accordingly, no provision has been made in the Company's financial statements.

The Company is continuing to accrue the cost of, but is not paying, the contractual rental rates (See Note H).

During 1994, 1993 and 1992, contractual lease requirements including amortization of transaction costs under the Palo Verde Leases accounted for as operating leases amounted to approximately $83.0 million, $83.1 million, and $83.2 million. Future contractual minimum annual rental payments required under such leases are as follows (In thousands):

Year Ending December 31,	
1995	$ 82,757
1996	82,757
1997	82,757
1998	82,757
1999	82,757
Thereafter	1,209,020

The table does not reflect any of the potential effects upon future contractual rental payments that would result from the Plan becoming effective.

C. Rate Matters

Overview

Effect of Bankruptcy on Regulation. The Bankruptcy Code provides that the Bankruptcy Court shall confirm the Company's plan of reorganization only if "any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval." Applications have been or will be filed with various regulatory bodies to seek approvals or determinations necessary to consummate the Merger and otherwise satisfy the conditions to the effectiveness of the Plan (see Note A). To date, the Company has reserved arguments in the regulatory proceedings that the provisions of the Bankruptcy Code, together with applicable provisions of other federal statutes, grant the Bankruptcy Court the authority to preempt otherwise applicable regulatory jurisdiction, and it is uncertain whether the Company would prevail on such arguments, if asserted. The Company, however, has asserted that the Texas Commission, the New Mexico Commission, the Texas Office of Public Utility Counsel ("OPC") and the City of El Paso, which are parties to the Bankruptcy Case, are collaterally estopped from challenging certain of the Bankruptcy Court's findings in confirming the Plan and that the Supremacy Clause of the United States Constitution preempts such parties from relitigating the reasonableness of the purchase price offered by CSW. See "Texas Rate Matters – Bankruptcy Court Adversary Proceeding," below. The discussion of the applications filed or to be filed before the regulatory bodies pursuant to the Plan and the pending regulatory appeals discussed below in "Texas Rate Matters" and "New Mexico Rate Matters" should be read in the context of the preemption issue discussed above.

Pursuant to orders entered by the Bankruptcy Court, the automatic stay imposed by the Bankruptcy Code, if and to the extent applicable, has been lifted with respect to all pending appeals of regulatory decisions of the Texas Commission. Accordingly, such appeals are being prosecuted through the applicable courts.

Texas. The rates and services of the Company in Texas municipalities are regulated by those municipalities and in unincorporated areas by the Texas Commission. The largest municipality in the Company's service area in Texas is the City of El Paso. The Texas Commission has exclusive *de novo* appellate jurisdiction to review municipal orders and ordinances regarding rates and services, and its decisions are subject to judicial review.

The Texas Commission has jurisdiction to grant and amend CCNs for service territory and certain facilities, including generation and transmission facilities. Although the Texas Commission does not have the authority to approve transfers of utility assets, it is required to evaluate certain transfers of utility assets and mergers and consolidations of regulated utility companies to determine if those transactions are consistent with the public interest. Upon a finding that such a transaction is not in the public interest, the Texas Commission is required to consider the effects of the transaction in future ratemaking proceedings and is required to disallow the effects of the transaction if it will unreasonably affect rates or service.

New Mexico. The New Mexico Commission has jurisdiction over the Company's rates and services in New Mexico. The New Mexico Commission must grant prior approval of the issuance, assumption or guarantee of securities; the creation of liens on property located within the state; the consolidation, merger or acquisition of some or all of the stock of another utility; and the sale, lease, rental, purchase or acquisition of any public utility plant or property constituting all or part of an operating unit or system. The New Mexico Commission also has jurisdiction as to the valuation of utility property and business; certain extensions, improvements and additions; Class I and II transactions (as defined by the New Mexico Public Utility Act); abandonment of facilities and the certification and decertification of utility plant. The New Mexico Commission's decisions are subject to judicial review.

FERC. The Company is subject to regulation by the FERC in certain matters, including rates for wholesale power sales and the issuance of securities. In 1992, the Congress enacted the Energy Policy Act, which, among other things, removes certain restrictions on utility participation in the competitive wholesale generation market. In addition, subject to certain limitations, the legislation provides that the FERC also may order electric utilities, including the Company, to provide certain transmission services. The legislation also expands the authority of state utility commissions to examine the books and records of electric utilities.

NRC. Palo Verde is subject to the jurisdiction of the NRC, which has authority to issue permits and licenses, to regulate nuclear facilities in order to protect the health and safety of the public from radiation hazards and to conduct environmental reviews pursuant to the National Environmental Policy Act. (See Note E.)

Accounting for the Effects of Regulation. Prior to December 31, 1991, the financial statements of the Company were prepared pursuant to the provisions of Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation," as amended, which provides for the recognition of the economic effects of regulation. In early 1992, the Company determined that there existed substantial doubt concerning whether the criteria for reflecting the economic effects of regulation continued to be met as a result of continuing cash flow problems arising from inadequate rate relief and the uncertainty surrounding regulation during the reorganization process. The Company concluded that it was not reasonable to assume that its rates were, or will be, without giving consideration to possible outcomes of the reorganization process, designed to recover its costs on a timely basis. Because of the uncertainty of the nature of any reorganization plan ultimately consummated and the assessment of the nature of regulation, the Company concluded that it did not then and does not currently have sufficient assurance to reflect the economic effects of regulation in its general purpose financial statements. Therefore, as required by generally accepted accounting principles, the Company eliminated from its

1991 balance sheet the aggregate effects of regulation, which resulted in a $311 million extraordinary charge to results of operations for the year ended December 31, 1991. This amount included approximately $200 million of operating expenses and carrying costs, primarily related to Palo Verde, and approximately $80 million of income taxes related to the Palo Verde sale/leaseback transactions which had been deferred by the Company's regulators for recovery in future periods. Furthermore, the Company did not record the letters of credit draws amounting to $288.4 million as an asset and has not recorded any new assets reflecting the economic effects of regulation since 1991 in its general purpose financial statements.

Although the outcome of the reorganization process cannot presently be determined, the Company believes that the rates established in conjunction with any reorganization plan will be designed to recover the Company's costs, including a return on equity, after the establishment of an appropriate capital structure, as well as to reflect other changes that may result from the reorganization. The Company expects that, upon effectiveness of any plan of reorganization, its regulated operations will meet the SFAS No. 71 criteria necessary to reflect the effects of regulation in its general purpose financial statements. Such rates may include the recovery of some or all items that, at that time, are not reflected as regulatory assets on the Company's general purpose financial statements. However, in the absence of application of purchase accounting applied in the event of a change in control occurring as part of the reorganization, there does not appear to be any applicable accounting precedent for the restoration of such amounts as assets created prior to the re-adoption of SFAS No. 71. Restoration of such amounts as assets will depend upon a number of factors, including intervening developments in accounting standards and other accounting literature, the outcome of which cannot currently be determined. In March 1993, the Financial Accounting Standards Board's Emerging Issues Task Force reached a consensus that if a rate-regulated enterprise initially fails to meet the regulatory asset recognition requirements of SFAS No. 71, but meets those requirements in a subsequent period, then regulatory assets should be recognized in the period the requirements are met. Although the Emerging Issues Task Force's consensus applied to rate-regulated enterprises currently meeting the requirements of SFAS No. 71, the Company believes that this consensus supports the Company's position regarding restoring previous net regulatory assets in its general purpose financial statements. In the event it is concluded that such restoration is not appropriate under generally accepted accounting principles, the Company would be precluded from recognizing historical amounts as regulatory assets in its general purpose financial statements. If it is determined that such restoration is appropriate, regulatory assets would be recorded to the extent items allowed to be recovered in the rate making process have not been reflected as assets in the Company's general purpose financial statements.

Texas Rate Matters

On January 10, 1994, the Company and CSW filed a Joint Report and Application (the "Texas Merger Application") with the Texas Commission requesting (i) a determination that the acquisition by CSW of one hundred percent (100%) of the Company's common stock is consistent with the public interest and (ii) certain determinations regarding the regulatory treatment of the Company's proposed reacquisition of the portions of Palo Verde that it previously sold and leased back. The filing is proceeding as part of Docket 12700.

In addition to the Texas Merger Application filed by CSW and EPE, the Company filed for a base rate increase (the "Texas Rate Filing") incorporating, among other things, the Company's fifth increase under the terms of the Rate Moderation Plan ordered by the Texas Commission in Docket 7460 and a base rate increase under the inventory plan established for Palo Verde Unit 3 in Docket 9945. The Texas Rate Filing was consolidated with the Texas Merger Application under Docket 12700. The Company filed its rate request with both the Texas Commission and the various municipalities retaining original jurisdiction over the Company's rates. See "Texas Rate Filing." In Docket 12700, the Company further proposed to reconcile its Texas fuel costs and revenues for the

period from April 1989 through June 1993 and to decrease its current fixed fuel factors (the "Texas Fuel Filing").

As part of the Texas Merger Application and as a basis of settlement, CSW has proposed rates for Texas jurisdictional customers of the Company that are substantially less than those reflected in the Company's rate case filing. The CSW settlement offer is contingent on the determination by the Texas Commission that CSW's acquisition of the Company is consistent with the public interest and the other regulatory determinations and approvals requested in the Texas Merger Application. The proposed settlement offers (i) to limit the non-fuel base rate increase for Texas jurisdictional customers to $25 million; (ii) a proposed $12.8 million annual reduction in future fuel revenues from the Company's fixed fuel factors; (iii) a refund of $16.4 million over a 12-month period of over-recovered fuel costs and other fuel-related items; and (iv) a rate case expense surcharge of $4.1 million related to previous rate cases to be collected over a 12-month period. Taking into account the annual reduction in fuel costs and the proposed fuel refund, the Company's revenues from Texas jurisdictional customers would not increase during the first year after the rate change goes into effect. The settlement rate plan proposed by CSW also provides for (i) no additional base rate increase until 1997; (ii) a limitation in the frequency of base rate increases following the rate freeze period through 2001 to not more than once every other year (i.e., 1997, 1999 and 2001); and (iii) a limitation on the amount of the 1997, 1999 and 2001 base rate increases, such that each increase would not exceed eight percent of total revenues. CSW's efforts to settle the case, however, have been unsuccessful to date.

During the preliminary stages of Docket 12700, the Company and CSW entered into a stipulation with the City of El Paso, the General Counsel of the Texas Commission, and the OPC whereby the parties agreed that, if at the time the Texas Commission's statutory deadline to enter a rate order would expire all other regulatory approvals or authorizations required by the Merger Agreement have not been issued and CSW is not in a position to state that it is ready to consummate the Merger, the Texas Commission could (i) issue an interim order in Docket 12700 pending the receipt of notification from CSW of the receipt or waiver of such other regulatory orders from other governmental bodies and (ii) remand the proceeding to its hearings division for the limited purpose of receiving such notice from CSW and considering the comments of all parties regarding the effect, if any, of the orders from other governmental bodies on the Interim Order issued by the Texas Commission.

Docket 12700 proceeded to hearing, and on January 3, 1995, a Proposal for Interim Decision was issued. The Texas Commission considered the Proposal for Interim Decision in hearings conducted in February 1995. On March 3, 1995, the Texas Commission issued the Interim Order concerning both the Texas Merger Application and the Texas Rate Filing. The Interim Order was issued after the two Commissioners sitting in deliberation had reached an impasse concerning certain issues. The third Texas Commission seat was vacant pending the confirmation of a new Commissioner. During deliberations on February 22, 1995, and in a separate concurring opinion issued March 3, 1995, the Chairman of the Texas Commission reserved his option to reconsider his vote on certain issues after receipt of motions for reconsideration from the parties to Docket 12700. The significant issues on which the Chairman specifically reserved his option included the following and are described more particularly below: (i) the conditional nature of the finding that the Merger is in the public interest; (ii) whether to modify the level and amortization period of the acquisition adjustment; (iii) whether to authorize rate treatment of the accounting deferrals for Palo Verde Unit 3 and, if so, the magnitude of such authorization; and (iv) whether to modify the treatment of the tax benefit arising from payment of the Palo Verde lease rejection damages. Motions for reconsideration of these issues were filed March 23, 1995, and replies are due April 3, 1995. The Company anticipates that the Texas Commission will hold a hearing on the motions for reconsideration, and that a Second Interim Order will be issued within the next 60 days. It is also expected that the new third Commissioner, who was confirmed by the Texas Senate on February 22, 1995, will take part in the deliberations and vote on the Second Interim Order.

In light of the stipulation concerning the Interim Order and the uncertainty as to when other federal and state governmental bodies will act on the merger-related filings before them, the Company cannot predict when any order of the Texas Commission in Docket 12700 will become final. The Company also cannot predict whether and to what extent parties to Docket 12700 might appeal any final order to the Texas District Court.

The Texas Commission severed the Texas Fuel Filing from Docket 12700 and issued a separate final order in the Texas Fuel Filing on March 3, 1995, under Docket 13966. The Texas Commission's rulings in the Texas Merger Application, the Texas Rate Filing and the Texas Fuel Filing are described below.

Texas Merger Application. In its Interim Order, the Texas Commission determined that the acquisition of the Company's stock by CSW and the reacquisition of the leased portions of the Palo Verde assets are consistent with the public interest pursuant to section 63 of the Public Utility Regulatory Act. The Texas Commission, however, issued a finding of fact and conclusion of law to the effect that the acquisition by CSW of the Company's stock is at a reasonable price and is in the public interest subject to successful resolution of certain matters relating to Palo Verde and the City of Las Cruces. (See Notes E and M.)

With respect to the previously leased portions of the Palo Verde assets, the Interim Order adopts the Company's and CSW's proposal to include the assets in rate base at their original cost less depreciation through December 31, 1994. The Interim Order also concludes that synergy cost savings will accrue to the merged companies in the range of approximately $309 million to $379 million over the first ten years of the Merger. The Interim Order rejects CSW's primary request that it retain the tax benefits arising from the damages resulting from the Company's rejection of the Palo Verde Leases, and instead utilizes the tax benefits to reduce the Company's rate base by approximately $133 million. At the same time, the Interim Order provides for the Company to recover from ratepayers a $151 million acquisition adjustment to be amortized to cost of service over 33 years, without inclusion of the unamortized balance in rate base. CSW has stated that the alternative $151 million acquisition adjustment does not provide CSW with the economic equivalence of CSW's primary request that it retain the tax benefits of the lease rejection damages.

Texas Rate Filing. The total amount of the Company's requested cash base rate increase, exclusive of fuel, is approximately $41.4 million. The total cash base rate increase consists of (i) a base rate increase of $8.3 million, constituting the proposed 3.5 percent increase contemplated under the Rate Moderation Plan established in Docket 7460 for costs other than those associated with Palo Verde Unit 3 and (ii) a base rate increase of $33.1 million, constituting the proposed increase under the inventory plan for Palo Verde Unit 3. The Company also requested the addition of approximately $10.9 million to its Docket 7460 Rate Moderation Plan deferral balance. As discussed above, CSW made a contemporaneous settlement offer that proposed rates lower than those reflected in the Company's rate filing, but that settlement offer has not been accepted.

The Company did not include in the Texas Rate Filing a request to recover the costs of bankruptcy reorganization or the $288.4 million from the draws on the letters of credit related to the Company's sales and leasebacks of portions of its interest in Palo Verde, which draws occurred in late December 1991 and early January 1992. The Company has reserved the ability to seek recovery of such costs if the Plan does not become effective.

By ordinance signed on June 22, 1994, the El Paso City Council denied the Company's requested rate increase and adopted a recommendation from the City of El Paso's Public Utility Regulation Board that base rates for residents in the City of El Paso be reduced by $15.7 million annually. The Company appealed this order to the Texas Commission where it was consolidated with the current rate case in Docket 12700 and is being reviewed de novo by the Texas Commission.

Effective July 16, 1994, the Company implemented a cash base rate increase of approximately $25 million annually, under bond and subject to refund depending on the outcome of the rate case, for its Texas jurisdictional customers. The Company deposited approximately $4.7 million of United States Treasury securities in escrow to provide security for the bonded rates. The bonded rate increase was authorized by applicable statute and regulation. Because of the current uncertainty as to the final outcome of the proceeding, the Company has deferred recognition of the revenue resulting from the increased rates aggregating approximately $11.5 million as of December 31, 1994.

In the Interim Order issued March 3, 1995, the Texas Commission approved a total annual increase in Texas base revenues of approximately $24.9 million. The Texas Commission also approved a rate case expense surcharge of $9.7 million to be recovered over twelve months. The Company expenses rate case costs as incurred on its general purpose financial statements. The order, however, was not immediately placed in effect, due to the Texas Commission's decision to entertain motions for reconsideration. While these motions are pending, the Company's bonded rate increase of approximately $25 million will remain in place.

With respect to the rate treatment of Unit 3, the Texas Commission approved the Company's request to include eighty-five percent (85%) of the cost of the unit in rate base in accordance with the inventory plan established by the Texas Commission in Docket 9945. The Texas Commission disallowed the Company's request to include in rate base approximately $43.3 million at June 30, 1993, net of deferred taxes, of costs deferred on Palo Verde Unit 3 between the unit's in-service date and the date of its inclusion in Texas rates. In addition, the Texas Commission disallowed related depreciation of approximately $12 million. These deferred costs and the depreciation disallowance are subject, however, to reconsideration pursuant to the Interim Order. See "Deferred Accounting Cases" below.

With respect to the rate treatment of Units 1 and 2, the Interim Order discontinues the Rate Moderation Plan established in Docket 7460. In Docket 7460, the Texas Commission established a Rate Moderation Plan, pursuant to which the Texas jurisdictional portion of the Company's cost of service, excluding Palo Verde Unit 3 capital costs, were to be phased-in to rates in four steps. All approved cost of service amounts not phased-in to rates were deferred for future recovery pursuant to the terms and conditions of the Rate Moderation Plan. In lieu of the Rate Moderation Plan, the Interim Order places in rate base all amounts deferred in connection with the Rate Moderation Plan through February 1993 and eliminates from recovery all amounts that would have been deferred thereafter. The Interim Order would remove approximately $16.0 million, net of deferred taxes, in Rate Moderation Plan deferrals as of December 31, 1994.

As a result of the Company's elimination of net regulatory assets from its balance sheet as of December 31, 1991, and subsequent non-recording of any new assets reflecting the economic effects of regulation since 1991, the denial of rate base recognition of the Palo Verde Unit 3 deferred costs and the removal of deferred amounts associated with the Rate Moderation Plan after February 1993 will have no effect on the Company's general purpose financial statements.

Texas Fuel Filing. As a result of the fuel reconciliation and treatment of other fuel-related items, the Company proposed in the Texas Fuel Filing to refund to Texas jurisdictional customers (as a credit to fuel revenue collections) approximately $16.4 million over a 12-month period. The Company also proposed in the Texas Fuel Filing a decrease in its fixed fuel factors that was anticipated to reduce future fuel revenues by approximately $14.3 million annually. Although the Texas Fuel Filing was considered by the Texas Commission as part of the Texas Rate Filing in Docket 12700, the Texas Commission severed the fuel-related proceedings from the rate proceeding and issued a separate final order in the Texas Fuel Filing on March 3, 1995, under Docket 13966. The Texas Commission ordered a fuel cost refund to Texas customers of approximately $13.7 million. The Texas Commission also

ordered, consistent with the Company's request, a reduction in the Company's fixed fuel factors that will result in a reduction in fuel cost recovery on a prospective basis of approximately $14.3 million annually.

For the fuel reconciliation period, the Company was allowed to retain all margins on off-system sales to CFE, consistent with the Texas Commission's order in Docket 9945. For reconciliation period off-system sales of contingent capacity to the Imperial Irrigation District ("IID"), the Texas Commission decided to split the margins, with seventy-five percent (75%) going to ratepayers and twenty-five percent (25%) going to Company shareholders. The Commission adopted the same 75/25 split, but adjusted for incremental costs, for all off-system sales on a prospective basis including CFE, IID-Contingent and economy energy sales.

Based on the Texas Commission's rulings on fuel reconciliation matters and off-system sales, the Company has recorded a provision representing an overrecovery of Texas jurisdictional fuel costs for the period from the end of the last fuel reconciliation period (June 1993) through December 1994. The total overrecovery from July 1993 to December 1994 is approximately $19.6 million. Under a new fuel rule adopted in January 1993 by the Texas Commission, the Company may petition the Commission to refund this overrecovery. The Company may consider the remand of Docket 8588 in its calculation of any refund. See "Recovery of Fuel Expenses." The Company would propose to make any refund over a 12-month period.

Motions for rehearing of the Texas Commission's final order in Docket 13966 were filed on March 23, 1995. Replies to the motions are due April 3, 1995. The Texas Commission will be required to act on the motions by April 18, 1995, or the motions will be overruled by operation of law.

Bankruptcy Court Adversary Proceeding. The Company and CSW filed a joint motion with the Bankruptcy Court on July 21, 1994, seeking an order that would prohibit relitigation in the Texas Merger Application and Texas Rate Filing of issues that were resolved by the Bankruptcy Court in connection with the confirmation of the Plan. The matters at issue were converted to an adversary proceeding by the Company and CSW filing a complaint for declaratory judgment on August 19, 1994. The complaint identifies the following issues and requests that the Bankruptcy Court enter an order declaring that no party before the Texas Commission, including OPC, the City of El Paso or the General Counsel of the Texas Commission, may relitigate any of the following issues: (i) whether the litigation related to the Palo Verde Leases between the Company and the lease bondholders, the lessors and other persons asserting a claim or interest related to the Palo Verde Leases should have been settled and if so on what terms, (ii) whether liquidation should have been considered or pursued as a viable option to reorganization, (iii) whether the Plan is feasible, and (iv) whether the enterprise value for the Company and the consideration to be provided to creditors and equity holders established by the Plan is excessive. On September 14, 1994 CSW filed a notice of dismissal from the adversary proceeding, stating that "while it supports a timely resolution to the preemption issues, its participation is not necessary to a full and complete adjudication of the matters."

On August 30, 1994, the Company filed a motion for summary judgment, which has not yet been ruled upon by the Bankruptcy Court. On December 29, 1994, the Bankruptcy Court issued an order denying motions to dismiss filed by the City of El Paso, the New Mexico Commission, the Texas Commission and OPC. In a memorandum opinion accompanying its order, the Bankruptcy Court stated that, to the extent the ratemaking authorities (the City of El Paso, the Texas Commission and the New Mexico Commission) participated as parties-in-interest in the confirmation of the Plan, the Bankruptcy Court has jurisdiction over those parties to determine if they are attempting to relitigate findings of fact the Bankruptcy Court made in confirming the Plan or if the factual issues ripe for determination in the regulatory process are different from those which the Bankruptcy Court decided in the confirmation process. On January 20, 1995, the Company filed its Second Motion for Summary Judgment asserting that the Bankruptcy Court's finding in the confirmation order that the price to be paid by CSW to acquire the stock of the Company is reasonable precludes the Texas Commission from

concluding otherwise in Docket 12700. See "Texas Merger Application." On March 1, 1995, the Company filed a motion to continue the Bankruptcy Court's March 6, 1995 docket call on the Company's Second Motion for Summary Judgment and March 8, 1995 hearing on certain motions for abstention and for more definite statement filed by the defendants. In its motion to continue, the Company cited the Texas Commission's decision in its Interim Order in Docket 12700 to allow motions for reconsideration of its conditional conclusion that the Merger is in the public interest, subject to successful resolution of the City of Las Cruces and Palo Verde matters. See "Texas Rate Filing." On March 3, 1995, the Bankruptcy Court entered an order continuing the March 6, 1995 docket call and the March 8, 1995 hearing. The ultimate outcome of the adversary proceeding in the Bankruptcy Court and any possible appeals thereof cannot be predicted at this time.

Docket 9945. The Texas Commission issued its final order in Docket 9945 on November 12, 1991, approving a total increase in Texas base revenues of approximately $47 million, consisting of $37 million in cash and $10 million of phase-in deferrals. The increase did not include any current return of or return on the owned portion of Unit 3 or recovery of the lease expenses related to Unit 3. Recovery of these costs has been held in abeyance to be included subsequently in Texas rates over a scheduled period of time. See "Texas Rate Filing" and "Deferred Accounting Cases."

With respect to the rate treatment of Unit 3, the Texas Commission disallowed approximately $32 million of Unit 3 capitalized costs, on a total Company basis, as imprudently incurred. The Texas Commission also adopted an inventory plan, pursuant to which the Company's investment in Unit 3 was neither included in rates nor expressly disallowed, but instead held in abeyance to be included subsequently in Texas rates over a scheduled period of time. In justifying the inventory plan, the Texas Commission found (i) the Company was imprudent in not attempting to sell a portion of its interest in Palo Verde between 1978 and 1981; (ii) the Company failed to demonstrate that it would not have been able to sell such interest if it had attempted to do so; and (iii) as a result of such imprudent action, the addition of Unit 3 to the Company's system would result in excess capacity. However, the Texas Commission further found that Unit 3 would become "used and useful" to the Texas jurisdiction in the following percentages: 0% (in Docket 9945), and 40%, 65%, 85% and 100% thereafter. It is the Company's position that the successive phases of the inventory plan were to be implemented on an annual basis. In the Texas Rate Filing, some parties have contested whether the inventory plan constituted a proper determination by the Texas Commission of when Unit 3 would become used and useful. These parties further contest whether the inventory plan requires implementation of a five year schedule for inclusion of the investment. The Commission's current Interim Order in Docket 12700 adopts the Company's position concerning the inventory plan. See "Texas Rate Filing."

The Company disputes there was any imprudence in retaining its full investment in Palo Verde. The Company challenged the Texas Commission's ruling in the Company's Motions for Rehearing and has continued such challenge on appeal to the Texas District Court. The City of El Paso and two intervenors also appealed certain other issues. On October 27, 1993, the Texas District Court affirmed the final order of the Texas Commission except in two respects. The Texas District Court held the Texas Commission erred (i) by refusing to include certain disallowed and below-the-line utility expenses as deductions when computing federal income tax expense for ratemaking purposes, further discussed below under "Ratemaking Treatment of Federal Income Taxes," and (ii) by granting rate base treatment for post-in-service deferred carrying costs associated with Units 1 and 2 of Palo Verde. The District Court affirmed the Commission's decision regarding Palo Verde Unit 3 deferrals, whereby the Commission had postponed the determination of the appropriate regulatory treatment of the deferrals to future cases. The District Court's holding regarding Unit 1 and 2 accounting deferrals is now inconsistent with the subsequent decision of the Texas Supreme Court in the appeal of Docket 7460, discussed below under "Deferred Accounting Cases." The Company appealed the decision to the Court of Appeals, as did the City of El Paso and two other intervenors. The Court of Appeals heard

oral argument in the case on November 9, 1994 and has not yet issued its decision. The ultimate outcome of the appeals and their results or the materiality thereof cannot be predicted at this time.

Recovery of Fuel Expenses. The Company's prior reconciliation of fuel expenses, Docket 8588, was for the period August 1, 1985 through March 31, 1989. The Company and the City of El Paso appealed the Texas Commission's order in Docket 8588 to the Texas District Court. On November 25, 1991, the Texas District Court entered judgment on the appeals, upholding the Texas Commission's order on all points except the Company's appeal of the treatment of certain purchased power capacity costs incurred during 1985 and 1986. With regard to those costs, totaling approximately $4.2 million, the Texas District Court held that the Texas Commission erred in failing to justify adequately its decision not to allow the Company to recover such costs through its reconcilable fuel account. The Texas District Court remanded the case to the Texas Commission with instructions to reconsider the allowance of such costs. Both the Texas Commission and the City of El Paso appealed the Texas District Court's decision to the Court of Appeals. On March 10, 1993, the Court of Appeals affirmed the decision of the Texas District Court. On February 2, 1994, the Texas Supreme Court denied the applications for writ of error filed by the City of El Paso and the Texas Commission. The case has been remanded to the Texas Commission for a new hearing to address whether the Company should be allowed to include the purchased power capacity charges as reconcilable fuel costs and recover such costs. The ultimate outcome of this remand cannot be predicted at this time.

Deferred Accounting Cases. The Company has received a series of orders authorizing the deferral of operating costs incurred, and carrying charges accrued, on each unit of Palo Verde between the unit's in-service date and the date of its inclusion in Texas rates. Certain rate orders have also permitted the Company to include in rate base and amortize into rates the deferred costs associated with Units 1 and 2 (approximately 40 years for ratemaking purposes).

The Company's first order allowing the recovery of accounting deferrals (in Docket 7460 regarding Units 1 and 2) has been finally resolved by the Texas Supreme Court. On June 22, 1994, the Texas Supreme Court reversed the decision of the Court of Appeals and upheld the Texas Commission's authority to include both the Company's deferred operating costs and deferred carrying costs in rate base in City of El Paso v. Public Utility Commission, 883 S.W.2d 179 (Tex.1994) ("City v. PUCT"). On October 6, 1994, the Texas Supreme Court overruled motions for rehearing of the matters. As a result of the Texas Supreme Court's ruling, the Company expects to be able to continue to include in rate base and to amortize into rates the deferred carrying and operating costs associated with Palo Verde Units 1 and 2.

In Docket 9069, the Texas Commission granted the Company a deferred accounting order authorizing it to defer operating and carrying costs associated with Palo Verde Unit 3 between the plant's in-service date and the date its costs were included in rates. The City of El Paso and the State of Texas appealed this order to the Texas District Court. The City of El Paso, however, dismissed its appeal. The State of Texas' appeal remains pending, with a hearing expected in June of 1995. Subsequent to the filing of these appeals, the Texas Supreme Court issued its decision in the appeal of Docket 7460 upholding the legality of deferred accounting orders. The Company believes that the deferred accounting order in Docket 9069 complies in all respects with the Texas Supreme Court's decision, but the ultimate outcome of the appeal and its result or the materiality thereof cannot be predicted at this time. For further discussion of Unit 3 deferrals, see "Docket 9945" and " Texas Rate Filing."

The recovery of the Palo Verde Unit 3 accounting deferrals is currently an issue in the Texas Rate Filing. In City v. PUCT, the Texas Supreme Court established a new requirement that, in the first rate case in which deferrals are included in rates, a utility must demonstrate that the deferrals are needed to protect the utility's financial integrity. The Company initially requested inclusion of the Palo Verde Unit 3 deferrals in rates in Docket 9945. The Texas Commission, however, postponed the

review of those deferrals until the Company's next rate case. See "Docket 9945." Consequently, the Company once again requested recovery of the Palo Verde Unit 3 deferrals in rates in Docket 12700. See "Texas Rate Filing." Because the Texas Supreme Court's opinion in City v. PUCT was issued after the Company had filed its testimony in Docket 12700, the Company filed supplemental testimony demonstrating that all of the Palo Verde Unit 3 deferrals were needed to protect the Company's financial integrity during the deferral period. The Texas Commission Staff filed supplemental testimony which concurred with the Company's position.

Certain of the intervenors in Docket 12700 have taken the position that the Texas Supreme Court's opinion in City v. PUCT requires proof that recovery of the accounting deferrals must be necessary to protect the financial integrity of the utility at the time of the subsequent rate case. It is the Company's position that it must demonstrate that recovery of the accounting deferrals is instead necessary to preserve financial integrity during the deferral period. However, the Texas Commission has not conclusively reached a decision on this issue. The ultimate outcome of the Texas Commission's decision and any possible appeals of the Commission's decision cannot be predicted at this time.

Rate Case Expenses Incurred in Docket 7460. The issue of recovery of expenses incurred by the Company and the City of El Paso in connection with Docket 7460 was severed from the issues ruled upon by the Texas Commission in that docket and was assigned to a new Docket 8018 for consideration. On September 20, 1991, the Texas Commission issued its final order in the case and approved the reimbursement of approximately $10.8 million for expenses incurred by the Company and approximately $1.1 million for expenses incurred by the City of El Paso. The Texas Commission further directed that such amounts be surcharged to the Company's Texas customers over a one-year period, which the Company completed in November 1992. The City of El Paso filed an appeal of the Texas Commission's order in Docket 8018 with the Texas District Court. The Texas District Court affirmed the Texas Commission's decision on March 18, 1994. On April 15, 1994, the City of El Paso filed notice of intent to appeal to the Court of Appeals the decision of the Texas District Court. Briefs have been filed by the parties in the Court of Appeals, and the parties presented oral arguments to the Court of Appeals on February 15, 1995. The ultimate outcome of the appeal and its result or the materiality thereof cannot be predicted at this time.

Texas Recognition of Palo Verde Sales and Leasebacks. The Texas Commission found the Company's sales and leasebacks involving Units 2 and 3 of Palo Verde to be in the public interest in two different cases. The City of El Paso's appeal of the Texas Commission's decision related to the Unit 2 sales and leasebacks (Docket 8363) is pending before the Texas District Court. The Texas District Court affirmed the Texas Commission's order with respect to Unit 3 (Docket 8078) in all respects in August 1994 and the City of El Paso's appeal of such decision is pending before the Court of Appeals. The Company cannot predict the outcomes of the appeals of Dockets 8363 and 8078 or the materiality thereof.

Performance Standards for Palo Verde. In 1991, the Texas Commission established performance standards in Docket 8892 for the operation of the Palo Verde units. Each Palo Verde unit included in Texas rates is evaluated annually to determine if its three-year rolling average capacity factor entitles the Company to a reward or a penalty. There are five performance bands based around a target capacity factor of 70%. Neither a penalty nor a reward would result from capacity factors from 62.5% to 77.5%. Capacity factors are calculated as the ratio of actual generation to maximum possible generation. If the capacity factor for any unit is 35% or less, the Texas Commission is required to initiate a proceeding to determine whether such unit should continue to be included in rate base. The performance standards are effective as of the date each unit is included in Texas rates, which was April 22, 1988 for Units 1 and 2 and December 16, 1991 based on the inventory percentages, as discussed above, for Unit 3. The Company has previously accrued performance penalties of approximately $5.1 million for the performance periods of April 1988 through April 1992, which the Texas Commission included in ordering a refund in Docket 13966. See "Texas Fuel Filing."

In June 1994, the Company filed its annual performance report with the Texas Commission for Units 1 and 2. In February 1995, the Company filed its initial performance report on Unit 3 reflecting 0% in rates for 1992, 40% in rates for 1993 and 65% in 1994, all based on the inventory percentages ordered in Docket 9945. The Company incurred neither a penalty nor a reward for either report. The three-year capacity factor was 73.5% for Unit 1, 62.8% for Unit 2 and 74.5% for Unit 3. The Company expects the report to be filed for Units 1 and 2 with the Texas Commission in 1995 to reflect performance for Unit 1 resulting in neither a reward nor a penalty and for Unit 2 resulting in a penalty of approximately $162,000. Based on historical performance and projected performance, including planned outages and a provision for unplanned outages, and the three-year rolling average for capacity measurement, current projections are that Unit 2 will incur an additional penalty for the period ending in April 1996 of approximately $369,000. The Company has made provisions for these possible penalties in its financial statements. Projections for Unit 1 and Unit 3, using the methodology discussed above, reflect no penalty for the next reporting period.

Ratemaking Treatment of Federal Income Taxes. In a 1987 case, Public Utility Commission of Texas v. Houston Lighting & Power Co., 748 S.W.2d 439 (Tex. 1987), the Texas Supreme Court stated that, under certain circumstances, it is appropriate to allow only "actual taxes incurred" for ratemaking purposes. The Court of Appeals has applied the Texas Supreme Court decision to several other utilities, most notably Public Utility Commission of Texas v. GTE-Southwest, 833 S.W.2d 153 (Tex. App. - Austin 1992, writ granted). The Texas Supreme Court heard oral argument in the GTE-Southwest case in September 1993 but has not yet issued its decision.

There is significant uncertainty as to the application of the "actual taxes incurred" methodology by the Texas Commission. Prior to 1992, the Texas Commission historically granted rates that included an income tax component based on a "stand alone" basis and on the utility's allowed return on equity. The Texas Commission has altered this policy and applied various forms of the "actual taxes incurred" methodology in recent rate proceedings involving other utilities. The application of that methodology is currently at issue in the Texas Rate Filing. In its Interim Order, the Texas Commission has applied a form of the actual taxes methodology. See "Texas Rate Filing."

The appeals related to Dockets 8363 and 9945 include claims that the Texas Commission failed to adhere to the "actual taxes incurred" methodology in setting the federal income tax expense component of the Company's rates. As a result, any remand of Dockets 8363 or 9945 to the Texas Commission could include a reconsideration of the respective federal income tax components, which were based on the "stand alone" methodology previously used by the Commission.

Depending on the outcome of any such remand, the Company may be required to refund certain amounts collected in rates during the period the Docket 8363 and 9945 rates were in effect. The likelihood and amount of any refunds are uncertain at this time because the ultimate outcome of the pending appeals is unknown, and the Company cannot predict the result of any remand.

New Mexico Rate Matters

Rate Moderation Plan - Palo Verde. In 1987, the New Mexico Commission approved a Stipulation in Case No. 2009 establishing a rate moderation plan, pursuant to which the New Mexico jurisdictional portion of the Company's interest in Palo Verde Unit 1 and one-third of Common Plant and approximately 83% of the lease payments on Unit 2 and the related Common Plant were phased-in to rates in three steps. After the third step of the phase-in, the rate moderation plan required the Company to freeze New Mexico rates through December 31, 1994. CSW has agreed to keep this rate freeze in effect for an additional three years if the Merger becomes effective. The rate moderation plan also required the Company to file a cost of service report every two years through the end of 1996 to enable the New Mexico Commission to determine whether the Company was overearning. See

"Annual Filing Requirements" below. The Case No. 2009 Stipulation also required, that in lieu of a prudence review of the Company's participation in the Palo Verde project, all costs associated with Unit 3, and the associated Common Plant, would be permanently excluded from New Mexico rates.

The Company must recover the New Mexico jurisdictional portion of the Company's investment in Unit 3 through off-system sales in the economy energy market. For several years, market prices for economy energy sales have not been at levels sufficient to recover the New Mexico portion of the Company's current operating expenses related to Unit 3, including decommissioning costs and lease payments. The Company expects these market prices to remain at such levels in the near term. The Company projects, but cannot assure, that the market prices of economy energy ultimately will rise to a level sufficient to recover the New Mexico jurisdictional portion of the Company's investment in Unit 3 over the remaining life of the asset.

Performance Standards for Palo Verde. In 1986, the New Mexico Commission established performance standards in Case No. 1833 for the operation of Palo Verde. The entire station is evaluated annually to determine if its achieved capacity factor entitles the Company to a reward or a penalty. There are five performance bands based around a target capacity factor of 67.5%. Neither a penalty nor a reward would result from capacity factors from 60% to 75%. The capacity factor is calculated as the ratio of actual generation to maximum possible generation. Since Unit 3 is not in rate base for purpose of New Mexico rates, any penalty or reward calculated on a total station basis is limited to two-thirds of such penalty or reward. If the annual capacity factor is 35% or less, the New Mexico Commission is required to initiate a proceeding to reconsider the rate base treatment of Palo Verde. See "Annual Filing Requirements" below.

Annual Filing Requirements. Pursuant to the New Mexico Commission's order in Case 1833 the Company must make annual filings, at least through the term of the rate moderation plan, to reconcile fuel costs and establish the fixed fuel factor for New Mexico customers. An annual performance standards report is included in the fuel reconciliation and any resulting rewards or penalties are included in the establishment of a new fixed fuel factor, if a new fuel factor is warranted. The Company has received an extension through April 3, 1995 to file its annual fuel reconciliation report for 1994. The Company anticipates that the fuel report will show a moderate decrease in its current fuel factor. The Company expects the annual performance standards report to show a Palo Verde capacity factor of approximately 69.5%. As a result, neither a reward nor a penalty will be incurred due to the 1994 Palo Verde operations. The new fuel factor should be included in bills rendered on or after May 1, 1995, unless otherwise ordered by the Commission.

As noted above, the rate moderation plan also requires the Company to file a cost of service report every two years through the end of 1996 to enable the New Mexico Commission to determine whether the Company is overearning. The last such report was filed on June 17, 1994. This report indicated the Company, on a stand-alone basis, was not overearning, and in fact had a non-fuel revenue deficiency of $12.6 million for the New Mexico service territory if the letter of credit draws on the Unit 2 portion of the Company's sale and leaseback transactions and administrative costs of the Bankruptcy Case were factored into the calculation. The Company cannot assure that these costs would be recognized for ratemaking purposes by the New Mexico Commission, or that the New Mexico Commission would grant the Company a rate increase based upon the information in this compliance filing. If the Merger becomes effective, CSW has agreed to freeze base rates at current levels for the New Mexico jurisdiction following the Effective Date.

FERC Regulatory Matters

The majority of the Company's rates for wholesale power and transmission services are subject to regulation by FERC. Sales of wholesale power subject to FERC regulation make up a significant portion, approximately 12% in 1994, of the Company's operating revenues. Although rates to

wholesale customers require FERC approval, the Company and its wholesale customers generally have established such rates through negotiation, based on certain cost of service assumptions, subject to FERC acceptance of the negotiated rates.

The Company has a long-term firm power sales agreement with IID providing for the sale of 100 MW of firm capacity to IID through April 2002. The Company also provides contingent capacity of 50 MW to IID. The agreement generally provides for level sales prices over the life of the agreement, which were intended to recover fully the Company's projected costs, as well as a return. Because of the levelized rate, such costs and return were anticipated to exceed revenues for a number of the early years of the agreement with a reciprocal effect in the later years of the agreement. The Company has accrued revenues under the terms of the agreement in the amounts of $1.2 million, $2.4 million, and $2.9 million in 1994, 1993 and 1992, respectively. Such accrued amounts, which since the inception of the agreement aggregate $34 million as of December 31, 1994, are recorded as a long-term contract receivable on the Company's balance sheets. Based on the contractual payments, recovery of the unbilled amounts should begin in 1995. The agreement also provides that the Company may seek increases in the sales price if sufficient evidence exists to determine that certain operating costs have increased above those used in determining the original sales price.

The Company has a firm power sales agreement with Texas-New Mexico Power Company ("TNP"), providing for sales to TNP in the amount of 75 MW through 2002, subject to provisions in the agreement that allow a reduction to a minimum of 25 MW in the amount of demand on a yearly basis. TNP has provided the Company notice that it would take advantage of the provisions to reduce the contract demand to 25 MW for 1994, 1995 and 1996, while preserving its option to maintain or increase its contract demand in subsequent years. Sales prices, which decline over the life of the agreement, are based on substantially the same scheduled and projected costs and return as the IID agreement discussed above.

Rate tariffs currently applicable to IID and TNP contain fuel and purchased power cost adjustment provisions designed to recover the Company's fuel and purchased power costs.

Additionally, the Company supplies Rio Grande Electric Cooperative, Inc. with the full electric requirements for its Van Horn and Dell City, Texas, service areas.

Other Wholesale Customers

The Company has a sales agreement with CFE to provide capacity and associated energy to CFE over a base term that began May 1, 1991 and ends December 31, 1996. The agreement may be extended monthly after that date upon the agreement of the parties. The power sales will be 150 MW during the summer months and 120 MW at other times of the year through the remaining term of the agreement. To support the requirements of the agreement with CFE, the Company entered into a firm power purchase agreement with SPS for at least 50 MW during the base term of the CFE contract. The obligations of CFE under the agreement are subject to continued budgetary authorization by the Ministry of Programming and Budgeting of Mexico for each calendar year. Pricing for the power sales includes an escalating capacity charge and recovery of energy costs at system-average costs plus third party energy charges. The agreement provides for payments to be made by CFE in United States dollars.

D. Summary of Significant Accounting Policies

General. The Company maintains its accounts in accordance with the Uniform System of Accounts prescribed for electric utilities by the FERC. The Company, prior to December 31, 1991, reported its regulated utility operations pursuant to SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," as amended. As more fully discussed in Note C, the Company

discontinued the application of SFAS No. 71 as of December 31, 1991 and accounted for such discontinuation in accordance with SFAS No. 101, "Regulated Enterprises — Accounting for the Discontinuation of Application of SFAS No. 71."

The Company has accounted for all transactions related to the reorganization proceedings in accordance with Statement of Position 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code" ("SOP 90-7"), issued by the American Institute of Certified Public Accountants in November 1990. Accordingly, all prepetition liabilities of the Company that are expected to be impaired under the Plan are reported separately in the Company's balance sheet as obligations subject to compromise (See Note H for a description of such obligations). Pursuant to SOP 90-7, the Company accrues interest on its secured obligations as well as, to the extent allowed by the Plan, on its unsecured and undersecured obligations. Expenses and interest income resulting directly from the reorganization proceedings are reported separately in the Statements of Operations as reorganization items.

The confirmation of the Plan (Note A) did not result in changes in the carrying amounts of the Company's assets or liabilities or the accounting bases used by the Company. Any changes resulting from the emergence from bankruptcy would be reflected at the Effective Date. In addition, the effects of the Merger have not been reflected because of uncertainties regarding whether the Merger will be consummated. In the event the Merger is consummated, it is anticipated that it would be recorded using the purchase method of accounting whereby the Company's assets and liabilities would be adjusted to market value on the Effective Date.

Utility Plant. Utility plant is stated at original cost, less regulatory disallowances. Costs include labor, material, construction overheads, and allowance for funds used during construction ("AFUDC") or capitalized interest (see Capitalized Interest below). Depreciation is provided on a straight-line basis at annual rates which will amortize the undepreciated cost of depreciable property over the estimated remaining service lives which range from 3 years to 49 years. Palo Verde is being amortized on a straight-line basis over approximately 40 years.

The Company charges the cost of repairs and minor replacements to the appropriate operating expense accounts and capitalizes the cost of renewals and betterments. 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.

Decommissioning cost for the Company's interest in Palo Verde is charged to depreciation expense. The Company amortizes decommissioning costs over the estimated service life for the portion of its owned interest and over the term of the related leases for the portions sold and leased back.

The cost of nuclear fuel is amortized to fuel expense on a unit-of-production basis. A provision for spent fuel disposal costs is charged to expense based on requirements of DOE for disposal cost of one-tenth of one cent on each kilowatt hour generated.

Capitalized Interest. As a result of discontinuation of the application of SFAS No. 71, the Company discontinued accruing AFUDC in 1992. In place of AFUDC, the Company capitalizes to construction work in progress ("CWIP") and nuclear fuel in process interest cost calculated in accordance with SFAS No. 34, "Capitalization of Interest Cost," and SOP 90-7.

Cash and Cash Equivalents. All temporary cash investments with an original maturity of three months or less are considered cash equivalents.

Investments. The Company adopted SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," at January 1, 1994, which requires marketable securities to be valued at

market value. The Company's marketable securities, included in deferred charges and other assets in the balance sheets, consist primarily of municipal bonds in trust funds established for decommissioning of its interest in Palo Verde which have a fair market value of approximately $20.2 million at December 31, 1994. Such marketable securities are classified as "available-for-sale" securities as defined by SFAS No. 115 with the difference between cost and market value shown as a separate component of capitalization. The adoption of SFAS No. 115 resulted in a net unrealized gain of $308,000, net of income taxes of $166,000, at January 1, 1994 and a net unrealized loss of $350,000, net of income tax benefits of $189,000, at December 31, 1994.

Inventories. Inventories, primarily parts, materials and supplies, are stated at average cost.

Operating Revenues. Operating revenues are accrued for sales of electricity subsequent to monthly billing cycle dates but prior to the end of the accounting month.

Fuel Cost Adjustment Provisions. Fuel revenues and expense are stated at actual cost incurred. The Company's Texas and New Mexico retail customers are presently being billed under fixed fuel factors approved by the Texas Commission and the New Mexico Commission. Rate tariffs currently applicable to certain FERC jurisdictional customers contain appropriate fuel and purchased power cost adjustment provisions designed to recover the Company's fuel and purchased power costs. Any difference in fuel cost versus cash recovery from the Company's ratepayers is reflected as over/under-recovered fuel in the balance sheet.

Federal Income Taxes and Investment Tax Credits. Effective January 1, 1993, the Company began accounting for federal income taxes under SFAS No. 109, "Accounting for Income Taxes," which requires the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred income taxes are recognized for the estimated future tax consequences of "temporary differences" by applying enacted statutory tax rates for each taxable jurisdiction applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. SFAS No. 109 requires the Company to record a valuation allowance to reduce its deferred tax assets to the extent it is more likely than not that such deferred tax assets will not be realized. SFAS No. 109 recognizes the effect on deferred tax assets and liabilities of a change in tax rate in income in the period that includes the enactment date. Prior to 1993, in accordance with Accounting Principles Board Opinion No. 11 ("APB Opinion No. 11"), the Company used the deferred method of accounting for income taxes. Under the deferred method, deferred income taxes are provided on timing differences between reporting income and expense items for financial statement and income tax purposes. The Company recognized the effect of a change in accounting principle for the adoption of SFAS No. 109 in 1993 by a $96 million charge to results of operations.

Investment tax credit ("ITC") generated by the Company is deferred and amortized to income over the estimated remaining useful lives of the property that generated the credit.

Benefit Plans. See Note L for accounting policies regarding the Company's retirement plans and postretirement benefits.

Reclassifications. Certain amounts in the financial statements for 1993 and 1992 have been reclassified to conform with the 1994 presentation.

E. Palo Verde and Other Jointly Owned Utility Plant

The Company has a 15.8% undivided interest in the three 1,270 MW nuclear generating units at Palo Verde in which six other utilities (collectively, the "Palo Verde Participants") have interests, including Arizona Public Service Company ("APS"), who is the operating agent of Palo Verde. The operation of Palo Verde and the relationship among the Palo Verde Participants is governed by the ANPP Participation Agreement. Other jointly owned utility plant includes a 7% undivided interest in Units 4 and 5 of the Four Corners Project and certain other transmission facilities. A summary of the Company's investment in jointly owned utility plant, excluding fuel, is as follows:

	Electric Plant in Service	Accumulated Depreciation	Construction Work in Progress
		(In thousands)	
December 31, 1994:			
Palo Verde Station	$ 940,279	$ (131,737)	$ 12,121
Other	135,178	(54,307)	1,050
December 31, 1993:			
Palo Verde Station	$ 928,351	$ (112,296)	$ 19,881
Other	133,561	(49,628)	1,833

The Company's investment, at cost, in Palo Verde in the amount of approximately $952.4 million at December 31, 1994, excludes amounts related to the Company's investment in Palo Verde which was sold and leased back during 1986 and 1987 and for which the related leases are accounted for as operating leases. See Note B of Notes to Financial Statements for information regarding such transactions and the Company's lease obligations relating thereto. The Company's share of direct expenses of operating jointly owned plant is included in the corresponding operating expense captions on the statement of operations.

Steam Generator Tubes. Palo Verde has experienced degradation in the steam generator tubes of each unit. The degradation includes axial tube cracking in the upper regions of the two steam generators in Unit 2 and, to a lesser degree, in Unit 3. This form of tube degradation is uncommon in the nuclear industry. The units also have experienced a more common type of tube cracking. The tube degradation was discovered following a steam generator tube rupture in Unit 2 in March 1993 and, since that time, APS has undertaken an ongoing investigation and analysis and has performed corrective actions designed to mitigate further degradation.

The corrective actions have included changes in operational procedures designed to lower the operating temperatures of the units, chemical cleaning and implementation of other technical improvements. From September 1993 through mid-summer1994, the units were operated at reduced power levels of approximately 86% to reduce the operating temperatures. The units were returned to full power with operational modifications that enabled the units to be operated at lower temperatures.

Since the discovery of the tube degradation, each of the units has been removed from service periodically for inspections. The inspections have been performed during regularly scheduled refueling outages and mid-cycle inspection outages. During 1994, Unit 2 was removed from service for two mid-cycle inspection outages and Unit 3 was removed from service for one mid-cycle inspection outage; an inspection also was made during the Spring 1994 Unit 3 refueling outage. When tube cracks are detected during an inspection, the affected tubes are taken out of service by plugging. That has occurred in a number of tubes in all three units, particularly in Unit 2, which has the most tubes affected by cracking and plugging. APS has stated that it expects that the remedial actions undertaken will slow the rate of plugging to an acceptable level. APS also has stated that it currently

believes that the Palo Verde steam generators are capable of operating for their designed life of forty years, although, at some point in the future, long-term economic considerations may make steam generator replacement a desirable option.

Liability and Insurance Matters. The Palo Verde Participants have insurance for public liability payments resulting from nuclear energy hazards to the full limit of liability under federal law. This potential liability is covered by primary liability insurance provided by commercial insurance carriers in the amount of $200 million and the balance by an industry-wide retrospective assessment program. The maximum assessment per reactor under the retrospective rating program for each nuclear incident is approximately $79.2 million, subject to an annual limit of $10 million per incident. Based upon the Company's 15.8% interest in the three Palo Verde units, the Company's maximum potential assessment per incident is approximately $37.6 million, with an annual payment limitation of approximately $4.7 million.

The Palo Verde Participants maintain "all risk" (including nuclear hazards) insurance for property damage to, and decontamination of, property at Palo Verde in the aggregate amount of $2.7 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 the accidental outage of any of the three units if the outage exceeds 21 weeks.

Decommissioning. The Company's depreciation expense includes approximately $7.5 million, $7.5 million and $5.2 million in 1994, 1993 and 1992, respectively, for the estimated future decommissioning costs for the owned and leased portions of Palo Verde based on decommissioning studies performed for the Company. The above amounts reflect updated studies implemented in July 1992 and September 1993. The Company is accruing its decommissioning obligation over the estimated service life (approximately 40 years) for the portion of its owned interest in Palo Verde and over the term of the related leases (27 to 29) years for the portions of Palo Verde that were sold and leased back. As of December 31, 1994, the Company has accrued approximately $38.5 million of decommissioning costs, including interest, which is reflected in the Company's balance sheets in deferred credits and other liabilities.

The Company is utilizing a site specific study for Palo Verde, dated December 1993, prepared for the Company by an independent consultant, that estimates the cost to decommission the Company's share of Palo Verde to be approximately $221 million (stated in 1993 dollars). Such amount includes an estimated cost to decommission on-site spent fuel storage facilities of approximately $50 million. The study assumes the prompt removal/dismantlement method of decommissioning will be used to decommission Palo Verde. The study also assumes (i) that decommissioning will take place from 2024 through 2035 for the production units; (ii) that maintenance expense for spent fuel storage will be incurred from 2035 through 2067; and (iii) that decommissioning of the spent fuel storage facilities will occur in 2067. Although the study is based on the latest available information, there can be no assurance that decommissioning costs will not continue to increase in the future.

The Company has established external trusts with independent trustees, which enable the Company to record a current deduction for federal income tax purposes of a portion of amounts funded. As of December 31, 1994, the aggregate balance of the trust funds was approximately $20.8 million, which is reflected in the Company's balance sheets in deferred charges and other assets. Earnings on the trusts' funds of approximately $1.0 million, $0.6 million and $0.5 million in 1994, 1993 and 1992, respectively, are reflected on the statements of operations as interest income. The Company is currently collecting a portion of decommissioning funding obligation for Palo Verde Units 1 and 2 in all three of its ratemaking jurisdictions and for Unit 3 in its Texas and FERC jurisdictions. The Company must fund the decommissioning requirements for the New Mexico jurisdictional portion of Unit 3 through off-system sales of economy energy as Unit 3 is excluded from New Mexico

jurisdictional rate base. Because the Company is under fixed-price long term contracts with its FERC customers, increases in decommissioning costs must be absorbed through reduced margins on these contracts.

Currently, the Company is funding decommissioning costs over the estimated service life for its owned portion of Palo Verde and, prior to filing the bankruptcy petition, over the term of the related leases for the leased portion of Palo Verde. Subsequent to the filing of the bankruptcy petition, the Company has made contributions to the decommissioning trusts pursuant to funding requirements of the NRC, the ANPP Participation Agreement and orders of the Texas Commission, the New Mexico Commission and the FERC. These funded amounts are slightly less than what would have been required pursuant to provisions under applicable agreements related to the Company's sale/leaseback transactions for Units 2 and 3. Under the proposed terms of the Plan, the Company would reacquire all portions of Palo Verde sold and leased back. If this occurs, the Company anticipates it would accrue for and fund all portions of the Palo Verde decommissioning costs over the operating license terms. This funding method has been incorporated in the rate request in the Company's rate filing currently pending before the Texas Commission.

The Energy Policy Act includes an assessment for decontamination of the DOE's enrichment facilities. The total amount of this assessment has not yet been finalized; however, based on preliminary indications, APS estimates that the annual assessment for Palo Verde will be approximately $3.0 million, plus increases for inflation, for the next fifteen years. The Company recorded a charge to results of operations in 1992 in the amount of approximately $7.1 million which represents its portion of the estimated assessment.

The FASB has a current project addressing the accounting for obligations related to the decommissioning of nuclear power plants. One alternative, if adopted, would change the current practice of accruing the decommissioning liability over the plant's useful life and require that estimated total decommissioning costs be recorded as a liability in the financial statements. If the FASB were to require such a change in 1995, the Company would be required to record an additional liability of approximately $182.5 million based on the current cost estimates discussed above. At the present time, the Company cannot predict the effects on the financial condition or results of operations if it were required to record the additional liability.

ANPP Participation Agreement. Pursuant to the ANPP Participation Agreement, the Palo Verde Participants share costs and generating entitlements in the same proportion as their percentage interests in the generating units and each Palo Verde Participant is required to fund its proportionate share of operation and maintenance, capital and fuel costs. The Company's total monthly share of these costs is approximately $7 million. The ANPP 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.

F. Common Stock

In May 1989, the Board of Directors eliminated the second quarter 1989 common stock dividend and the Company has not paid dividends on its common stock since then.

Resumption of dividends on common stock will depend on the terms of the Plan that becomes effective in the Company's Bankruptcy Case as well as applicable provisions of state law and the FPA. Under certain provisions of the FPA regarding the payment of dividends on capital stock, as interpreted by the staff of the FERC, the Company is permitted to pay dividends on its capital stock only out of retained earnings.

Employee Stock Purchase Plan. The Company had an employee stock purchase plan under which eligible employees were granted options twice each year to purchase shares of common stock. This employee benefit plan terminated June 30, 1994.

Employee Stock Compensation Plan. The Company has a broad-based employee stock compensation plan under which shares of Company common stock may be issued from time to time to eligible employees. Under the plan, the Board's Compensation/Benefits Committee may direct the issuance from time to time of Company common stock to compensate employees for past services rendered to the Company or to pay for various employee benefits with common stock rather than with cash. Market value of shares issued would be charged to expense. No shares were issued under the plan during 1992 through 1994. Under the Plan, this employee benefit plan would be terminated at the Effective Date.

Employee Stock Option Plan. The Company's Employee Stock Option Plan was approved by the Board of Directors in December 1987 and received shareholder and regulatory approval in 1988. Following amendment in 1990 to approve an increase in the number of shares available, the plan authorizes the issuance of up to 3,000,000 shares of common stock pursuant to options which may be granted at not less than fair market value.

At December 31, 1994, the outstanding common stock options are as follows:

Date of Options	Option Price	Number of Shares
August 23, 1989	$ 8.875	184,300
January 24, 1990	8.625	100,000
March 27, 1990	8.375	145,800
May 21, 1990	7.250	50,000
November 19, 1990	3.875	704,725
May 18, 1992	3.000	397,706
November 17, 1992	2.500	572,100
September 14, 1994	1.375	840,394
Total options outstanding		2,995,025
Total options exercisable at December 31, 1994		2,025,219

Options granted May 18, 1992 and November 17, 1992 are exercisable in installments, with 25% of the options exercisable immediately and an additional 25% exercisable each full year from the date of the award. In addition, the options granted May 18, 1992 and November 17, 1992 are not exercisable, with certain exceptions, until a plan of reorganization becomes effective in the Company's Bankruptcy Case. All other options granted were exercisable immediately. All options granted have a ten-year expiration period from the date of the award, subject to earlier termination in the event of termination of employment, death, total and permanent disability or dissolution or liquidation of the Company. The plan also provides for stock appreciation rights if there is a change in control of the Company, as defined in the Plan. Options are granted at the discretion of the Compensation/Benefits Committee of the Board. During 1992 through 1994, there were no options exercised. Under the Plan and pursuant to the Merger Agreement, options outstanding at the Effective Date would be converted to options to purchase common stock of CSW.

Changes in common stock are as follows:

	Common Stock	
	Shares	Amount (In thousands)
Balance December 31, 1991	35,525,461	$ 339,047
Issuances of Common Stock:		
1992	9,502	31
1993	9,367	19
1994	–	–
Balance December 31, 1994	35,544,330	$ 339,097

Shares of common stock reserved for issuance under the above described stock benefit plans were 3,116,680 at December 31, 1994.

Directors' Stock Compensation Plan. In 1991, the Board of Directors approved a Directors' Stock Compensation Plan, which was submitted to and approved by the shareholders of the Company at the Annual Meeting held May 20, 1991, subject to regulatory approval. However, the Company has not filed the necessary applications with the New Mexico Commission and the FERC to obtain approval of the issuance of up to 300,000 shares of common stock under the plan or filed a registration statement related to the shares to be issued under the plan with the SEC and does not intend to do so at the current time. A total of 300,000 shares of the Company's common stock would be reserved for issuance under the plan if the regulatory approvals are obtained. Issuances at fair market value would be charged to expense. Under the Plan, this benefit plan would be terminated at the Effective Date.

G. Preferred Stock

The Board of Directors voted to suspend payment of dividends and mandatory sinking fund payments on the Company's outstanding cumulative preferred stock commencing with dividends and sinking fund payments due October 1, 1991. The Company cannot predict when the preferred stock dividends and sinking fund payments will be resumed, if ever, but such payments are precluded by the Bankruptcy Code during the Company's Bankruptcy Case. (See Note A for the treatment of preferred stock, including interim payments, under the Plan).

The Company accrued dividends on and increased the balance of preferred stock, redemption required, with an offsetting decrease to retained earnings for the last two quarters of 1991. No such dividends have been accrued on preferred stock, redemption not required. Because of the bankruptcy filing, the Company, beginning with the first quarter of 1992, ceased accruing any dividends on preferred stock and eliminated the deduction of preferred stock dividend requirements from the determination of net loss and net loss per weighted average share of common stock outstanding insofar as the preferred stock is subordinate to unsecured obligations.

Under the Company's articles of incorporation, as of July 1, 1992, the holders of preferred stock have the right (subject to satisfaction of certain procedural requirements) to elect two additional directors to the Board of Directors. This right has accrued because dividends on the outstanding preferred stock have accumulated and remained unpaid in a cumulative amount at least equal to four quarterly dividends. Because preferred stock dividends in an amount equal to twelve full quarterly dividends are unpaid, the holders of the preferred stock also are entitled to elect the smallest number of directors necessary to constitute a majority of the full Board of Directors until all dividends of preferred stock have been fully paid. However, under the Plan, by voting in favor of the Plan, the preferred shareholders have waived any right to elect a majority of the Board of Directors under the Company's articles of incorporation. The Company has not received notice of any preferred shareholder's desire or intent to exercise the right to elect two additional directors and cannot predict whether or when any such action might be taken.

NOTES TO FINANCIAL STATEMENTS

All preferred stock issues (redemption required and redemption not required) are entitled in preference to common stock, to $100 per share plus accrued dividends, upon involuntary liquidation. All issues are entitled to an amount per share equal to the applicable optional redemption price plus accrued dividends, upon voluntary liquidation.

Following is a summary of cumulative per share dividends in arrears and cumulative dividends in arrears of issued and outstanding preferred stock, as of December 31, 1994, calculated according to the terms of the preferred stock:

	Cumulative Per Share Dividends in Arrears	Cumulative Dividends in Arrears (In thousands)
Preferred Stock, Redemption Required:		
$10.75 Dividend	$37.63	$ 1,957
$ 8.44 Dividend	29.54	2,883
$ 8.95 Dividend	31.33	2,820
$10.125 Dividend	35.44	3,544
$11.375 Dividend	39.81	11,943
		$ 23,147
Preferred Stock, Redemption not Required:		
$ 4.50 Dividend	$15.75	$ 236
$ 4.12 Dividend	14.42	216
$ 4.72 Dividend	16.52	330
$ 4.56 Dividend	15.96	638
$ 8.24 Dividend	28.84	1,513
		$ 2,933

Preferred Stock, Redemption Required. Following is a summary of issued and outstanding preferred stock, redemption required:

	Shares	Amount (In thousands)	Optional Redemption Price Per Share at December 31, 1994
$10.75 Dividend	52,000	$ 5,200	$102.50
$ 8.44 Dividend	97,600	9,760	102.11
$ 8.95 Dividend	90,000	9,000	102.24
$10.125 Dividend	100,000	10,000	100.00
$11.375 Dividend	300,000	30,000	100.00
	639,600	63,960	
Accrued dividends in arrears		3,306	
		$ 67,266	

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

Sinking fund requirements for each of the above series are cumulative and, in the event they are not satisfied at any redemption date, the Company is restricted from paying any dividends on its common stock (other than dividends paid in shares of common stock or other class of stock ranking junior to the preferred stock as to dividends or assets). Sinking fund payments in the following amounts have been missed: (i) $750,000 (7,500 shares at $100 per share) due each of October 1, 1991, October 1, 1992, October 1, 1993 and October 1, 1994 on the Company's $8.95 Dividend Preferred Stock; (ii) $600,000 (6,000 shares at $100 per share) due each of October 1, 1991, October 1, 1992, October 1, 1993 and October 1, 1994 on the Company's $8.44 Dividend Preferred Stock; (iii) $400,000 (4,000 shares at $100 per share) due each of January 1, 1992, January 1, 1993, January 1, 1994 and January 1, 1995 on the Company's $10.75 Dividend Preferred Stock; (iv) $10 million (100,000 shares at $100 per share) due each of July 1, 1992, July 1, 1993 and July 1, 1994 on the Company's $11.375 Dividend Preferred Stock and (v) $5 million (50,000 shares at $100 per share) due each of July 1, 1992 and July 1, 1993 on the Company's $10.125 Dividend Preferred Stock. At December 31, 1994 the total arrearage of mandatory sinking fund payments is $46.6 million.

The aggregate contractual amounts of the above preferred stock required to be redeemed for each of the next five years are $1.75 million per year.

Preferred Stock, Redemption not Required. Following is a summary of preferred stock issued and outstanding at December 31, 1994 which is not redeemable except at the option of the Company:

	Shares	Amount (In thousands)	Optional Redemption Price Per Share
$4.50 Dividend	15,000	$ 1,534	$109.00
$4.12 Dividend	15,000	1,506	103.98
$4.72 Dividend	20,000	2,001	104.00
$4.56 Dividend	40,000	4,000	100.00
$8.24 Dividend	52,450	5,157	101.34
	142,450	$ 14,198	

H. Obligations Subject to Compromise

Under the Bankruptcy Code, certain claims against the Company in existence prior to the Petition Date are stayed, subject to their treatment in the Plan (or another plan of reorganization that becomes effective). Additional claims, which may also be subject to compromise, have arisen and may continue to arise subsequent to the Petition Date as a result of rejection of executory contracts, including the leases related to Palo Verde and other leases, and from the determination by the Bankruptcy Court (or as may be agreed to by parties in interest) of allowed claims for contingencies and other disputed amounts. In accordance with the SOP 90-7, these claims are reflected at amounts expected to be allowed by the Bankruptcy Court in the December 31, 1994 and 1993 balance sheets as "Obligations Subject to Compromise," which amounts could differ substantially from the settled amounts. For a description of the treatment of claims under the Plan, see Note A.

The expiration date for filing creditors' claims against the Company with the Bankruptcy Court was June 15, 1992. As of December 31, 1994, unresolved claims approximate $5.0 billion, reflected by approximately 350 proofs of claim on file with the Bankruptcy Court. There also are approximately 50 proofs of claims that do not specify an amount. The Company continues the process of reviewing each proof of claim to reconcile the claimed amount with the Company's books and records and believes the outstanding claimed amounts are grossly overstated primarily due to duplicative claims. The Company's estimates of the allowed claims as presented in the financial statements are therefore subject to change based upon the outcome of the Bankruptcy Case.

NOTES TO FINANCIAL STATEMENTS

In late December 1991, the Company ceased paying principal, interest and fees on portions of its secured and unsecured debt except as described below. As a result, all of the Company's debt is in default and will remain so until a plan of reorganization becomes effective pursuant to the Bankruptcy Case. Ordinarily these defaults generally would entitle the Company's creditors to accelerate the outstanding principal amounts of debt and pursue other remedies available under the applicable agreements. As a result of the automatic stay imposed by the provisions of the Bankruptcy Code, however, such creditors generally are prevented from taking any action to collect such amounts or pursue any remedies against the Company other than through the Bankruptcy Case. The terms and provisions of the Company's financing arrangements, including the maturity dates, are subject to modification pursuant to a plan of reorganization that becomes effective in the Bankruptcy Case.

In accordance with SOP 90-7, through the Confirmation Date, the Company has been accruing interest, at contractual non-default rates, only on debt secured by first or second mortgages to the extent that the value of underlying collateral exceeds the principal amount of First and Second Mortgage Bonds and no interest was accrued on other debt. As described in Note A, the Plan requires the Company to make interim payments representing interest on other debt and such amounts have been recorded since the Confirmation Date.

Since the Petition Date, the Bankruptcy Court has issued various orders authorizing payment of interest accruing since July 1, 1992 to certain secured creditors. The Company paid approximately $67.7 million, $64.7 million and $32.5 million for 1994, 1993 and 1992, respectively, in interest on First and Second Mortgage Bonds of the Company for the period of July 1, 1992 through December 31, 1994, including those bonds held as security for the Company's revolving credit facility, described below, and interest on three series of pollution control bonds. With respect to three series of pollution control bonds, the Company has reserved its right to repayment from the banks issuing letters of credit supporting such bonds of amounts paid to reimburse the banks for interest paid on the bonds through draws on the letters of credit in the event that the Bankruptcy Court determines the payments to the banks were payments of unsecured claims. The Plan does not contemplate seeking such a ruling, however. The contractual obligations of the Company's debt agreements require principal payments to be made during the next year of approximately $41.5 million; these amounts are presented as non-current because of the stay as of the Petition Date. Contractual obligations of the Company's debt agreements required principal payments in 1994, 1993 and 1992 of approximately $29.9 million, $26.1 million and $69.7 million, respectively, of which approximately $1.0 million, $0.9 million and $0.8 million were paid during the same respective periods. Contract non-default interest expense on unsecured and undersecured debt was approximately $45.7 million, $41.8 million and $41.1 million for the years ended December 31, 1994, 1993 and 1992, respectively, which has not been accrued by the Company. As explained in Note A above, interim payments of approximately $24.8 million and $10.2 million were accrued in 1994 and 1993, respectively, and recorded as interest expense.

Future contractual minimum annual principal requirements on secured and unsecured debt at December 31, 1994 are as follows (In thousands):

1995	$ 41,471
1996	37,340
1997	36,316
1998	50,580
1999	52,550

As of December 31, 1994, approximately $123.0 million remained due on contractual minimum annual principal reduction requirements for 1992, 1993 and 1994.

The table above does not reflect any of the potential effects upon future contractual debt requirements that would result from the Plan becoming effective.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992)

NOTES TO FINANCIAL STATEMENTS

The following is a summary of obligations subject to compromise:

	December 31, 1994	December 31, 1993
	(In thousands)	
Secured Debt:		
First Mortgage Bonds (1):		
4 5/8% Series, issued 1962, due 1992	$ 10,385	$ 10,385
6 3/4% Series, issued 1968, due 1998	24,800	24,800
7 3/4% Series, issued 1971, due 2001	15,838	15,838
9% Series, issued 1974, due 2004	20,000	20,000
10 1/2% Series, issued 1975, due 2005	15,000	15,000
8 1/2% Series, issued 1977, due 2007	25,000	25,000
9.95% Series, issued 1979, due 2004	17,559	17,559
13 1/4% Series, issued 1984, due 1994	17,700	17,700
11.10% Series, issued 1990, due 2001	153,000	153,000
	299,282	299,282
Second Mortgage Bonds (2):		
11.58% Series, issued 1990, due 1997	35,000	35,000
12.63% Series, issued 1990, due 2005	105,000	105,000
12.02% Series, issued 1991, due 1999	25,000	25,000
	165,000	165,000
Revolving credit facility secured by First and Second Mortgage Bonds, due 1992 (3)	150,000	150,000
Pollution Control Bonds (4):		
Secured by Second Mortgage Bonds:		
Variable rate bonds, due 2014, net of $1,781,000 on deposit with trustee	61,719	–
Variable rate bonds, redeemed July 1, 1994, net of $1,740,000 on deposit with trustee	–	61,760
Variable rate refunding bonds, due 2014	37,100	37,100
Variable rate refunding bonds, due 2015	59,235	59,235
	158,054	158,095
Nuclear fuel financing (5)	60,620	60,620
Accrued interest (6)	46,300	45,654
Other	13,287	14,654
Total secured debt	892,543	893,305
Unsecured Debt:		
Notes payable to banks (7)	288,416	288,416
Pollution control bonds, variable rate, refunding bonds, due 2013 (4)	33,300	–
Pollution control bonds, variable rate, refunding bonds, redeemed November 1, 1994, net of $4,041,000 on deposit with trustee (4)	–	31,764
Promissory note due 1992 (8)	25,000	25,000
Financing obligation Palo Verde Unit 2 (9)	79,186	79,186
Accrued operating lease cost, Palo Verde Units 2 and 3 (Note B)	177,613	137,734
Capitalized lease obligation, Copper Turbine (10)	8,106	9,061
Prepetition accrued interest	4,837	4,837
Other	28,302	26,012
Total unsecured debt	644,760	602,010
	$ 1,537,303	$ 1,495,315

(1) First Mortgage Bonds

The First Mortgage Indenture is secured by substantially all of the Company's utility plant. Under the First Mortgage Indenture the Company may issue bonds to the extent of 60% of the value of unfunded (as defined in the Indenture) net additions to the Company's utility property, provided that earnings available for interest are at least equal to twice the annual interest requirements on all bonds to be outstanding and on all prior lien debt.

The First Mortgage Indenture provides for sinking and improvement funds, except as otherwise noted, equivalent to 1%, (approximately $1 million at December 31, 1994), of the greatest aggregate principal amount of such series outstanding prior to a specified date. The Company has generally satisfied the 1% requirements for such series by relinquishing the right to use a net amount of additional property for the issuance of the bonds or by purchasing bonds in the open market. However, this requirement was not met in 1992, 1993 or 1994. With respect to the 9.95% series, the agreement provides for annual cash payments to the trustee equivalent to 4.25% of the greatest aggregate principal amount of such series outstanding at any one time prior to a specified date, approximately $1.1 million as of December 31, 1994. With respect to 11.10% series, commencing in June and December 1995, the agreement provides for semiannual cash payments to the trustee equivalent to 7.14% of the greatest aggregate principal amount of such series outstanding at any one time prior to a specified date. The following amounts are contractually due as follows: 1992 – $18.4 million; 1993 – $8 million; 1994 – $8 million; 1995 – $23.9 million; 1996 – $23.9 million; 1997 – $23.9 million; 1998 – $47 million; 1999 – $23.7 million.

(2) Second Mortgage Bonds

The Second Mortgage Indenture is secured by substantially all of the Company's utility plant. Under the Second Mortgage Indenture the Company may issue bonds on the basis of 40% of the value of unfunded (as defined in the Indenture) net additions to the Company's utility property, or to the extent of the principal amount of retired bonds.

The Second Mortgage Indenture provides for sinking funds. With respect to the 11.58% series, the agreement provides for annual cash payments to the trustee commencing in December 1994, equivalent to 25% of the greatest aggregate principal amount of such series outstanding at any one time prior to a specified date. With respect to the 12.63% series, the agreement provides for annual cash payments to the trustee commencing in December 2001, of a specified amount. The following approximate amounts are contractually due as follows: 1994 – $8.8 million; 1995 – $8.8 million; 1996 – $8.8 million; 1997 – $8.8 million; 1999 – $25 million.

(3) Revolving Credit Facility

The Company currently has a total of $150 million of debt outstanding under a revolving credit facility (the "RCF"). The RCF, which originally involved a syndicate of money center banks, provided for substantially all of the Company's short-term borrowing prior to the filing of the bankruptcy petition. The RCF became due and payable on January 9, 1992. The RCF is secured by $50 million of First Mortgage Bonds and $100 million of Second Mortgage Bonds. Interest on the RCF is calculated at the non-default contract rate, which is the administrating bank's current quoted prime rate plus 1%. Interest rate at December 31, 1994 was 9.5%.

(4) Pollution Control Bonds

The Company has approximately $193.1 million of tax exempt Pollution Control Bonds outstanding consisting of four issues, of which three issues aggregating $159.8 million are secured by Second Mortgage Bonds. Each of the tax exempt issues is credit enhanced by a letter of credit. Prior to the Petition Date, interest and other payments on the Pollution Control Bonds were made through draws on the letters of credit, and the Company reimbursed the letter of credit banks for such draws. Subsequent to the petition filing, interest on all the bonds has continued to be paid by draws on the letters of credit. The Company has paid a portion of the resulting reimbursement obligations to the issuing banks on three Pollution Control Bond issues through interest payments authorized by applicable orders of the Bankruptcy Court.

In May 1992, one series of the secured Pollution Control Bonds was accelerated and the letter of credit supporting such series was drawn upon for the principal and accrued interest, aggregating approximately $37.9 million. In May 1994, the acceleration was rescinded and amendments were made to the governing documents related to this series of Pollution Control Bonds to allow the Bonds to be remarketed during the Company's Bankruptcy Case, at the option of the letter of credit issuer. The amendments also provide for more flexibility in interest rate features, and a letter of credit issuing bank repurchase option that would be effective at the Effective Date. The Bonds were remarketed in May 1994. The letter of credit bank received a total of approximately $37.1 million in proceeds from the remarketing as reimbursement for the letter of credit draw upon acceleration. The series of Pollution Control Bonds currently bears interest at a rate that is repriced weekly.

With respect to another series of Pollution Control Bonds, the letter of credit issuer purchased all of the outstanding bonds of that series. The governing documents related to this series of Pollution Control Bonds also were amended in May 1994 to allow the Bonds to be remarketed during the Company's Bankruptcy Case, at the option of the letter of credit issuer. The amendments also provide for more flexibility in interest rate features and a letter of credit issuing bank repurchase option that would be effective at the Effective Date. The Bonds continue to be held by the letter of credit issuer. The series of Pollution Control Bonds currently bears interest at a rate that is repriced weekly.

A third series of Pollution Control Bonds had been remarketed annually in June of each year. Changes to the governing documents were made effective July 1, 1994, including additional interest term options and a repurchase option for the letter of credit bank that would be effective at the Effective Date. The changes were made by redeeming the outstanding Bonds in the series and issuing a new series of Pollution Control Bonds with governing documents containing the new provisions, but otherwise substantially equivalent to the former series. The new series of Pollution Control Bonds currently bears interest at a rate that is repriced weekly.

The final series of Pollution Control Bonds has been remarketed annually in November of each year. On November 1, 1994, the outstanding bonds were redeemed and a new series of Pollution Control Bonds were issued, with modifications similar to the other series of Pollution Control Bonds. This series also now provides for shorter interest rate periods, which eliminates the need for annual remarketings, and a repurchase option for the letter of credit bank that would be effective at the Effective Date. The aggregate principal amount of the bonds issued in the series was reduced by approximately $2.5 million through the application of proceeds held by the trustee from the original issuance of the bonds. The new series of Pollution Control Bonds currently bears interest at a rate that is repriced weekly.

Because of the pendency of the Company's Bankruptcy Case as well as other defaults, including the failure of the Company to reimburse the letter of credit issuing banks as described above,

the bonds are subject to acceleration at any time. In the event that the bonds are accelerated and redeemed, the tax-advantaged interest rate of the bonds may no longer be available to the Company.

(5) Nuclear Fuel Financing

The Company entered into a nuclear fuel purchase contract with a third party grantor trust, Rio Grande Resources Trust ("RGRT"), established for the sole purpose of financing the purchase and enrichment of nuclear fuel for use by the Company at Palo Verde. The aggregate investment of RGRT is reflected on the Company's books at December 31, 1994. Prior to the filing of the Company's bankruptcy petition, the trust generally financed nuclear fuel and all costs in connection with the acquisition of the Company's share of nuclear fuel for use at Palo Verde up to $125 million pursuant to a borrowing facility (contractual interest rate of 9.52% at December 31, 1994) that is supported by a letter of credit facility. The Company had the option of either paying for the fuel from the trust at the time the fuel was loaded into the reactor or paying for the fuel at the time heat was generated by the fuel. Prior to the petition date of the Bankruptcy Case, the Company elected to pay for the fuel as the heat was produced from the fuel; however, no principal payments of any kind are currently being made to the trust because of the Company's Bankruptcy Case. Since the Company filed its bankruptcy petition, the Company has not sought to finance its fuel costs from the trust, but has instead paid for nuclear fuel with its own funds. The trust contends that it has an enforceable property interest in Palo Verde nuclear fuel, power, energy and revenues, which the Company is disputing in the Bankruptcy Case. The trust and the Company have entered into an interim adequate protection order in the Bankruptcy Case, which essentially preserves the rights, positions and arguments of each party, but does not resolve disputes as to the trust's claims and interests in property.

(6) Accrued Interest

The amount of accrued interest includes approximately $11.3 million of prepetition interest. The remaining amount represents unpaid postpetition interest, primarily from January 9, 1992 through June 30, 1992.

(7) Notes Payable to Banks

The amount represents the aggregate amount of draws on letters of credit supporting the sales and leasebacks of Palo Verde Units 2 and 3. See discussion of letters of credit draws at Note B.

(8) Promissory Note

The unsecured note due 1992 has floating rate which was 8.50% at December 31, 1994.

(9) Financing Obligation, Palo Verde Unit 2

In December 1986, the Company entered into a financing obligation related to one sale and leaseback transaction involving Palo Verde Unit 2 (see Note B). Semiannual payments including interest (using an assumed interest rate of 9.01%), which began in July 1987, are approximately $4.2 million, with the last payment of approximately $2.1 million due in July 2013.

(10) Capitalized Lease Obligation, Copper Turbine

In 1980, the Company sold and leased back a turbine and certain other related equipment from the trust-lessor for a twenty-year period, with renewal options for up to seven more years.

Semiannual lease payments, including interest, which began in January 1982, were approximately $0.7 million through January 1991, and approximately $0.9 million thereafter to July 2000. The effective annual interest rate implicit in this lease is calculated to be 9.6%. A gain to the Company related to the sale of the turbine to the trust in the amount of approximately $2.3 million is being amortized to income over the term of the lease. The Company has paid and currently intends to continue to pay all postpetition lease payments on the Copper Lease.

I. Federal Income Taxes

Effective January 1, 1993, the Company adopted SFAS No. 109 and reported the cumulative effect of that change, approximately $96 million, separately in the December 31, 1993 Statement of Operations. The charge to operations consisted of the recognition of additional tax benefits and valuation allowances as follows:

	Federal	State	Total
		(In thousands)	
Additional net tax benefits	$ (153,232)	$ (12,230)	$ (165,462)
Valuation allowance	219,246	42,260	261,506
Charge to operations	$ 66,014	$ 30,030	$ 96,044

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1994 and 1993, are presented below:

	December 31,	
	1994	1993
	(In thousands)	
Deferred tax assets:		
Letters of credit draws	$ 100,946	$ 100,946
Gain on sale and leaseback transactions	48,920	51,430
Accrued lease expense, net of interim payments (Note A)	62,004	49,929
Accumulated deferred investment tax credits	26,825	24,147
Capital leases	24,815	24,496
Benefits of tax loss carryforwards	33,670	33,300
Investment tax credit carryforward	16,444	28,047
Alternative minimum tax credit carryforward	18,120	15,796
Other	80,525	71,666
Total gross deferred tax assets	412,269	399,757
Less valuation allowance:		
Federal	(221,970)	(223,897)
State	(39,808)	(42,318)
Total valuation allowance	(261,778)	(266,215)
Net deferred tax assets	150,491	133,542
Deferred tax liabilities:		
Plant, principally due to differences in depreciation and basis differences	(232,000)	(234,783)
Other	(16,597)	(22,694)
Total gross deferred tax liabilities	(248,597)	(257,477)
Net accumulated deferred income taxes	$ (98,106)	$ (123,935)

Upon adoption of SFAS No. 109, a valuation allowance was recorded for deferred tax assets which may not be realized, including tax carryforwards that the Company may not utilize before their expiration. In making such computations, the Company has not assumed the occurrence of future taxable income. The valuation allowance decreased by approximately $4.4 million in 1994 and increased by approximately $4.7 million in 1993.

As discussed in Note D, the Company's income tax provision was calculated under APB Opinion No. 11 prior to January 1, 1993 and under SFAS No. 109 since that date. The Company recognized income taxes as follows:

	Years Ended December 31,		
	1994	1993	1992
	(In thousands)		
Income tax expense (benefit):			
Federal:			
Current	$ 6,320	$ 15,253	$ 31
Deferred	(20,304)	(20,345)	(1,119)
Investment tax credit amortization	(2,838)	(2,841)	(2,920)
Total	$ (16,822)	$ (7,933)	$ (4,008)
State:			
Current	$ –	$ 3,316	$ 81
Deferred	(364)	(892)	224
Total	$ (364)	$ 2,424	$ 305

The 1994 and 1993 current federal income expense results primarily from the payment of alternative minimum tax ("AMT"). The deferred federal income tax benefit recorded in 1994 and 1993 includes AMT credits of approximately $8.4 and $15.3 million, respectively. The deferred federal income tax benefit in 1992 pursuant to APB Opinion No. 11 arises primarily from differences in depreciation methods and lives with an associated deferred tax expense of approximately $10.5 million, a deferred fuel revenue tax benefit of approximately $5.2 million and a net operating loss ("NOL") carryforward tax benefit of approximately $5.8 million. For the year 1994, investment tax credits ("ITC") of approximately $2.1 million utilized were recorded as a reduction to current tax and included as a deferred tax expense. The 1993 current state income tax expense results from the settlement of Arizona income tax claims.

Federal income tax provisions differ from amounts computed by applying the statutory rate of 35% in 1994 and 1993 and 34% in 1992 to the book loss before federal income tax as follows:

	Years Ended December 31,		
	1994	1993	1992
	(In thousands)		
Tax benefit computed on loss before cumulative effect of a change in accounting principle at statutory rate	$ (15,741)	$ (17,426)	$ (10,944)
(Increases) decreases in benefits due to:			
Amortization of equity funds used during construction	–	–	1,629
ITC amortization (net of deferred taxes thereon in 1994 and 1993)	(1,845)	(1,846)	(2,920)
Nondeductible reorganization costs	3,915	11,745	6,889
Increase in income tax rate	–	3,403	–
Other	(3,151)	(3,809)	1,338
Total federal income tax benefit	$ (16,822)	$ (7,933)	$ (4,008)
Effective federal income tax benefit rate	37.4%	15.9%	12.5%

The Company has approximately $96 million of tax NOL carryforwards, approximately $16 million of ITC carryforwards and approximately $18 million of AMT credit carryforwards as of December 31, 1994. The NOL carryforward has been reduced by approximately $19 million of estimated taxable income for the year ended December 31, 1994. These carryforwards could be reduced or eliminated, or the amounts that can be utilized in any year could be limited, if certain events occur as a part of the Company's reorganization. Such events include, but are not limited to, debt forgiveness, the conversion of debt to equity or change in control of the Company. The occurrence of such events cannot be predicted and their effects on the Company's tax attributes, if any, cannot be estimated until a reorganization plan is consummated. If unused, the NOL carryforwards would expire at the end of the years 2005 through 2008, the ITC carryforwards would expire in the years 2001 through 2005 and the AMT credit carryforwards have an unlimited life.

On August 10, 1993, President Clinton signed tax legislation which, among other provisions, increases the corporate income tax rate to 35% retroactive to January 1, 1993. SFAS No. 109 requires that deferred tax liabilities and assets be adjusted in the period of enactment for the effect of an enacted change in tax laws or rates. The Company recognized a charge to earnings of approximately $3.4 million in the third quarter of 1993 to reflect the impact on net accumulated deferred income taxes related to such increase in the tax rate.

The Bankruptcy Court entered an order on May 10, 1994 approving the terms of a settlement with the Internal Revenue Service ("IRS") covering tax periods prior to 1992, pursuant to which the Company paid approximately $6.2 million, which primarily represents interest.

J. Commitments and Contingencies

Cash construction commitments for the Company subsequent to December 31, 1994 are primarily related to Palo Verde which approximate $39.2 million.

Sale/Leaseback Indemnification Obligations

Pursuant to the participation agreements and leases entered into in the sale/leaseback transactions, if the lessors incur additional tax liability or other loss as a result of federal or state tax assessments related to the sale/leaseback transaction, the lessors may have claims against the Company for indemnification. The lessors have filed proofs of claim alleging unliquidated amounts owed pursuant to the participation agreements and leases, which may encompass claims for indemnification. Pursuant to settlement agreements entered into between the Company and the lessors in connection with the Plan, the Company's indemnity obligations related to tax matters generally would continue in effect following the Effective Date. (See Note A.)

Arizona Transaction Privilege ("Sales") Tax Indemnification. The Arizona Department of Revenue ("ADR") conducted an audit of the sales taxes paid on lease payments under the Palo Verde Leases during the audit period of August 1, 1988 through July 31, 1990. On March 10, 1992, the Company received copies of Notices of Proposed Assessment issued by the ADR to each of the lessors. On February 22, 1993, the ADR filed Notices of Jeopardy Assessment totaling approximately $7.8 million, including interest thereon through February 28, 1993, to convert the proposed deficiencies for the audit period into jeopardy assessments, which are immediately collectible. On February 23, 1993, the ADR filed Notices of Tax Lien in the Maricopa County Recorder's Office and with the Secretary of State of Arizona against the lessors' interests in Palo Verde. Although the ADR can take action immediately to collect the alleged deficiency from the lessors, the ADR has taken no action in that regard. The ADR also may assert additional tax deficiencies for the period from August 1, 1990 through 1991, when the last lease payments were received by the lessors. The lessors can contest both the jeopardy assessment and the underlying assessment. The Company and the lessors have engaged in settlement discussions with the ADR and, based on these discussions, the ADR has postponed further action on the assessments. The Company believes it has made adequate provision in its financial statements for any indemnification obligations resulting from the claim.

Federal Tax Indemnification. One of the lessors in the sale/leaseback transactions related to Unit 2 of Palo Verde has notified the Company that the IRS has raised issues, primarily related to investment tax credit claims by the lessor, regarding the income tax treatment of the sale/leaseback transactions. The Company estimates that the total amount of potential claims for indemnification from all lessors related to the issues raised by the IRS could approximate $10 million, exclusive of any applicable interest, if the IRS prevails. This matter is at a preliminary stage and, although the Company believes the lessor has meritorious defenses to the IRS' position, the Company cannot predict the outcome of the matter or the Company's liability for any resulting claim for indemnification. The Company has made no provision in the accompanying financial statements related to this matter.

Environmental Matters

The Company is subject to regulation with respect to air, soil and water quality, solid waste disposal and other environmental matters by federal, state and local authorities. These authorities govern current facility operations and exercise continuing jurisdiction over facility modifications. Environmental regulations can change at a rapid pace and cannot be predicted with certainty. The construction of new facilities is subject to standards imposed by environmental regulation and substantial expenditures may be required to comply with such regulations. Recognition in rates of the capital expenditures and operating costs incurred in response to environmental considerations will be subject to normal regulatory review and standards. The Company analyzes the costs of its obligations arising from environmental matters on an ongoing basis and believes it has made adequate provision in its financial statements to meet such obligations.

Clean Air Act. The Clean Air Act Amendments of 1990 (the "Clean Air Act") established new regulatory and permitting programs administered by United States Environmental Protection Agency

("EPA") or delegated to state agencies. Many provisions of the Clean Air Act will affect operations by electric utilities, including the Company. In particular, the following sections may have a significant impact on the Company: Title I dealing with nonattainment of national air ambient quality standards, Title IV dealing with acid rain, and Title V covering operating permits. In addition, provisions addressing mobile sources of pollutants and hazardous air pollutants may have a lesser impact on the Company's operations.

The Company has completed an evaluation of the impact of the Clean Air Act on the Company's operations and has instituted a five-year plan in 1993 to implement Clean Air Act requirements on existing facilities. As part of the plan, the Company will make modifications to existing facilities at the Newman Power Station and the Rio Grande Power Station, including modifications to the steam generators and combustion turbines and the installation of continuous emissions monitoring equipment. The projected costs of these capital improvements are approximately $5 million over the five-year period of the plan.

Rio Grande Power Station. The Company notified the New Mexico Environment Department ("NMED") of a spill of approximately 510 barrels of fuel oil which occurred at the Rio Grande Power Station in August 1986. The remedial action plan has been approved, and remediation is progressing. Clean-up costs are currently estimated to be less than $500,000 to be incurred over the next two to three years. The New Mexico Water Quality Act provides for a potential penalty of $1,000 for each day of violation, which for a five-year period could result in a penalty of approximately $2 million. The Company has been in close communication with the NMED and does not believe that a penalty of such magnitude will be assessed. The NMED has filed a proof of claim in the Bankruptcy Case reflecting an alleged obligation in an unspecified sum based on alleged ground water or soil contamination at the Rio Grande Power Station. The Company has recorded the estimated clean-up costs, but has made no provision for any penalty in the accompanying financial statements.

Col-Tex Refinery Site. In November 1991, the Company was notified by the Texas Natural Resources Conservation Commission ("TNRCC") that the Company had been identified as a potentially responsible party ("PRP") at the Col-Tex Refinery Texas Superfund Site in Colorado City, Mitchell County, Texas (the "Col-Tex Site"). The State of Texas, on behalf of TNRCC, filed a proof of claim in the Bankruptcy Case for remediation and oversight costs as administrative expenses. In addition, the following entities filed proofs of claim in the Bankruptcy Case related to potential claims for contribution in the event any of such entities has liability for remediation and oversight costs of the Col-Tex Site: ASARCO, Inc., Tesoro Petroleum Company, Fina Oil & Chemical Company and Missouri Pacific Railroad Company. The Bankruptcy Court has approved a Joint Motion for Order Approving the Withdrawal of Proofs of Claim filed by the State of Texas over the objection of Fina Oil. Fina Oil appealed the Bankruptcy Court's order. On January 9, 1995, the Bankruptcy Court approved a settlement agreement between the Company and Fina Oil pursuant to which the Company paid Fina $50,000 and Fina (i) withdrew its proof of claim related to the Col-Tex Site, (ii) released all claims it may have against the Company related to the Col-Tex Site, and (iii) withdrew its appeal of the District Court's order affirming the withdrawal of the State of Texas' Proof of Claim. On March 13, 1995, ASARCO, Inc. filed a notice of withdrawal of its proof of claim. While the protective proofs of claim by the two other entities remain, the Company believes these parties have incurred minimal response costs.

PCB Treatment, Inc. On or about September 26, 1994, the Company received a request from the EPA to participate in the remediation of polychlorinated biphenyls ("PCBs") at two facilities in Kansas City, Missouri (the "Facilities"), which had been operated by PCB Treatment, Inc. ("PTI"). Company manifests indicate that between 1982 and 1986 the Company sent 23 shipments of PCBs or PCB-containing electrical equipment ("PCB Equipment") to PTI, accounting for approximately 3%, by weight, of the PCBs and PCB Equipment received by PTI.

PTI has since discontinued operations and EPA has determined that its abandoned Facilities require prompt remediation. In response to EPA's request, the Company and other similarly situated companies met with EPA on October 21, 1994 to discuss PTI's compliance history, EPA's regulatory oversight of PTI, the condition of the Facilities, the identity of companies that had sent PCBs to PTI, and EPA's legal authority to initiate voluntary or mandatory cleanup.

Based upon current information, it is apparent that more than 1,400 entities sent PCBs to PTI. The Company is working informally with other attendees of the October 21 meeting to: (i) investigate the relationship between PTI, its affiliates and other entities that performed PCB treatment services in association with PTI; (ii) identify all financially-viable entities that sent PCBs to PTI; (iii) calculate by volume the quantities of PCBs contributed by the respective entities; and (iv) identify the most efficient framework for remediating the Facilities. The Company also is evaluating the impact of the bankruptcy filing on its responsibilities with respect to the Facilities. At this early stage, the Company is unable to determine the extent to which it may bear legal liability for the remediation of the Facilities, or the amount of any such liability. The Company has made no provision in the accompanying financial statements related to this matter.

Health Insurance Plan

The Company maintains a self-insurance program for that portion of health care costs not covered by insurance. The Company is liable for claims up to $0.1 million per employee or retiree annually, and aggregate claims up to approximately $7.7 million annually. Self-insurance costs are accrued based upon the aggregate liability for reported claims and an estimated liability for claims incurred but not reported of approximately $0.8 million. See Note L for a discussion of SFAS No. 106.

K. Litigation

Automatic Stay of Litigation Due to Bankruptcy

Upon the filing of the bankruptcy petition, the provisions of the Bankruptcy Code operate as a stay applicable to all entities of, among other things, the commencement or continuation of judicial, administrative, or other actions or proceedings against the Company that were or could have been commenced before the bankruptcy petition. The stay is subject to certain exceptions, including actions by governmental units to enforce police or regulatory powers, and the Bankruptcy Court has the discretion to terminate, annul, modify or condition the stay.

Plains Electric Generation and Transmission Cooperative Litigation

On September 21, 1994, the Company and Plains Electric Generation and Transmission Cooperative, Inc. ("Plains") entered into a Settlement Agreement and Release to resolve the disputes between the two and provide for the dismissal of the lawsuit filed by Plains against the Company in the United States District Court for the District of New Mexico, Cause No. CIV91-1199. On December 5, 1994, the Bankruptcy Court approved the settlement, which provides for the dismissal with prejudice of the lawsuit upon the effective date of the Long Term Transmission Agreement between the parties. Under the Long Term Firm Transmission Agreement, which is subject to FERC approval, Plains will purchase firm transmission service in New Mexico from the Company for a period of thirty years. The transmission services would be based upon an annual schedule established by the parties (with the initial service at 30-35 MW), which can be increased at Plains' election up to 50 MW over time or decreased. The Company filed for approval from the FERC on January 13, 1995, but has not yet received such approval.

The Company is a party to various other claims, legal actions and complaints, the ultimate disposition of which, in the opinion of management, will not have a material adverse effect on the operations or financial position of the Company.

L. Benefit Plans

Pension Plan. The Company's Retirement Income Plan (the "Retirement Plan") covers employees who have completed one year of service with the Company, are 21 years of age and work at least a minimum number of hours each year. The Retirement Plan is a qualified noncontributory defined benefit plan. Upon retirement or death of a vested plan participant, assets of the Retirement Plan are used to pay benefit obligations under the Retirement Plan. Contributions from the Company are based on the minimum funding amounts required by the Department of Labor ("DOL") and IRS under provisions of the Retirement Plan, as actuarially calculated. The assets of the Retirement Plan are invested in equity securities, fixed income instruments and cash equivalents and are managed by professional investment managers appointed by the Company.

The Company's Supplemental Retirement and Survivor Income Plan for Key Employees ("SERP") is a non-qualified, non-funded defined benefit plan which covers certain key employees of the Company. The pension cost for the SERP is based on substantially the same actuarial methods and economic assumptions as those used for the Retirement Plan. Pursuant to an order of the Bankruptcy Court, the Company is authorized to pay and has paid each recipient the lesser of $2,000 per month or the amount he or she otherwise would have received under the SERP from the Petition Date through the end of 1993. Beginning in 1994, the Bankruptcy Court authorized the Company to pay each recipient the lesser of $5,000 per month or the amount he or she otherwise would have received under the SERP. The individuals have an unsecured prepetition claim against the Company for any amounts they would have received in excess of $2,000 per month prior to January 1, 1994 and in excess of $5,000 per month thereafter. Pursuant to the Plan, the SERP would be assumed and the accumulated deficiencies to certain retirees would be paid. In addition, pursuant to the Merger Agreement, CSW would honor the terms of the SERP.

During 1993, the Company entered into early retirement agreements with five senior executives. The cost of these agreements in excess of amounts previously provided through the Retirement Plan and SERP was approximately $4 million which was expensed in 1993 and included in the Non-Qualified Retirement Income Plans below.

Net periodic pension cost for the Retirement Plan and Non-Qualified Retirement Income Plans under SFAS No. 87, "Employers' Accounting for Pensions," is made up of the components listed below as determined using the projected unit credit actuarial cost method:

	Years Ended December 31,		
	1994	1993	1992
	(In thousands)		
Service cost for benefits earned during the period	$ 2,453	$ 6,114	$ 2,165
Interest cost on projected benefit obligation	4,896	4,376	4,235
Actual return on plan assets	378	(1,769)	(1,914)
Net amortization and deferral	(3,383)	(1,245)	(653)
Net periodic pension cost recognized	$ 4,344	$ 7,476	$ 3,833

The assumed annual discount rates used in determining the net periodic pension cost were 7.25%, 8.00% and 7.25% for 1994, 1993 and 1992, respectively.

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

The funded status of the plans and amount recognized in the Company's balance sheets at December 31, 1994 and 1993 are presented below:

	December 31,			
	1994		1993	
	Retirement Income Plan	Non-Qualified Retirement Income Plans	Retirement Income Plan	Non-Qualified Retirement Income Plans
	(In thousands)			
Actuarial present value of benefit obligations:				
Vested benefit obligation	$ (39,205)	$ (7,882)	$ (41,845)	$ (7,545)
Accumulated benefit obligation	$ (41,483)	$ (9,065)	$ (44,315)	$ (8,993)
Projected benefit obligation	$ (51,065)	$ (10,506)	$ (58,289)	$ (10,523)
Plan assets at fair value	43,574	–	43,351	–
Projected benefit obligation in excess of plan assets	(7,491)	(10,506)	(14,938)	(10,523)
Unrecognized net (gain)/loss from past experience	(41)	146	6,414	2,239
Unrecognized prior service cost	242	(471)	816	(2,096)
Unrecognized transition obligation	2,857	304	3,265	348
Accrued pension liability	$ (4,433)	$ (10,527)	$ (4,443)	$ (10,032)

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

	1994	1993
Discount rate	8.50%	7.25%
Rate of increase in compensation levels	5.50%	6.00%
Expected long-term rate of return on plan assets	8.50%	8.50%

The Pension Benefit Guaranty Corporation has filed a proof of claim in the amount of approximately $5.5 million based upon an assumed termination of the Retirement Plan effective June 15, 1992. The Company has not terminated the Retirement Plan, the Company has made all payments necessary to meet funding requirements and has no accumulated funding deficiency.

Other Postretirement Benefits. The Company provides certain health care benefits for retired employees and their eligible dependents and life insurance benefits for retired employees only. Substantially all of the Company's employees may become eligible for those benefits if they reach retirement age while working for the Company.

SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" ("SFAS No. 106"), was issued by the Financial Accounting Standards Board in December 1990. SFAS No. 106 requires a change from the pay-as-you-go accounting method for these postretirement benefits to the accrual accounting method, effective for fiscal years beginning after December 15, 1992. The Company adopted SFAS No. 106 as of January 1, 1993.

The accrual accounting method recognizes the costs of postretirement benefits other than pensions over the years of service of employees, rather than when the benefits are paid out after the employee retires. The Company has elected to amortize the transition obligation at January 1, 1993 of approximately $43.4 million over 20 years.

Net periodic postretirement benefit cost is made up of the components listed below:

	Years Ended December 31, 1994	1993
	(In thousands)	
Service cost for benefits earned during the period	$ 2,064	$ 1,564
Interest cost on accumulated postretirement benefit obligation	3,909	3,425
Amortization of transition obligation	2,172	2,172
Amortization of (gain)/loss	103	–
Net periodic postretirement benefits costs	$ 8,248	$ 7,161

The funded status of the plan and amount recognized in the Company's balance sheet at December 31, 1994 and 1993 are presented below:

	December 31, 1994	1993
	(In thousands)	
Actuarial present value of postretirement benefit obligation:		
Accumulated postretirement benefit obligation:		
Retirees	$ (22,157)	$ (23,358)
Actives	(25,010)	(30,008)
	(47,167)	(53,366)
Plan assets at fair value	–	–
Accumulated postretirement benefit obligation in excess of plan assets	(47,167)	(53,366)
Unrecognized net (gain)/loss from past experience	(5,541)	5,818
Unrecognized transition obligation	39,095	41,267
Accrued postretirement benefit liability	$ (13,613)	$ (6,281)

For measurement purposes, a 12.3 percent annual rate of increase in the per capita cost of covered health care benefits was assumed for 1995; the rate was assumed to decrease gradually to 6 percent for 2004 and remain at that level thereafter. The health care cost trend rate assumption has a significant effect on the amounts reported. To illustrate, increasing the assumed health care cost trend rates by 1 percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1994 by $6.9 million and the aggregate of the service and interest cost components of net periodic postretirement benefit cost for the year ended December 31, 1994 by $1.0 million.

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

	1994	1993
Discount rate	8.50%	7.25%
Rate of increase in compensation levels	5.50%	6.00%

In 1992, the Company expensed postretirement health care costs, under the pay-as-you-go method, of approximately $0.9 million.

M. Franchises and Significant Customers

Franchises. The Company's major franchise is with the City of El Paso, Texas. The franchise agreement provides an arrangement for the Company's utilization of public rights of way necessary to serve its retail customers within the City of El Paso. The franchise with the City of El Paso expires in March 2001 and does not contain renewal provisions. The Company is facing serious near term challenges in connection with certain of its New Mexico customers, including customers within the City of Las Cruces and the military installations of White Sands Missile Range and Holloman Air Force Base.

The Company's franchise with the City of Las Cruces expired in March 1994, and the City of Las Cruces is attempting to acquire the Company's distribution system within the city limits through negotiation or condemnation. CSW has stated that this dispute must be favorably and timely resolved before it will close the Merger. (See Note A.) The Company has continued to provide electric service to customers in the City of Las Cruces, consistent with its view that its right and obligation to serve customers within the City of Las Cruces is derived from the New Mexico Public Utility Act, and other New Mexico law. The City of Las Cruces has acknowledged this obligation in a press release issued March 12, 1994. Sales to customers in the City of Las Cruces represented approximately 7% of the Company's operating revenues in 1994.

The City of Las Cruces has authority from the New Mexico State Board of Finance to issue up to $90 million in revenue bonds to finance a purchase of a distribution system. On August 30, 1994, voters in the City of Las Cruces approved a resolution in a special election allowing the city government to proceed with efforts to acquire the distribution facilities of the Company within the city limits by negotiated purchase or eminent domain. In August of 1994, SPS and the City of Las Cruces entered into a fifteen-year contract for SPS to provide all of the electric power and energy required by the City of Las Cruces during the term of the contract. The contract becomes effective on the completion of the last of the (i) acquisition of a distribution system by the City of Las Cruces; (ii) acquisition of the necessary transmission delivery and back-up agreements by SPS; and (iii) receipt of the required regulatory approvals by the City of Las Cruces and SPS. If the specified events are not completed by July 1, 1998, either SPS or the City of Las Cruces has the right to cancel the contract. On June 6, 1994, the Las Cruces City Council approved a resolution selecting the proposal of SPS for the provision of operation and maintenance services for the proposed City of Las Cruces electric distribution system, substations and associated transmission facilities and authorizing the staff of the City of Las Cruces to negotiate a contract with SPS related to such services.

On June 14, 1994, the City of Las Cruces filed a motion with the Bankruptcy Court to lift the automatic stay imposed by the bankruptcy filing to allow it to (i) commence action against the Company for failure to pay franchise fees after expiration of the franchise in March 1994; (ii) enter the Company's property to conduct an appraisal of the electric distribution system and any suitability studies; (iii) give notice of intent to file a condemnation action; and (iv) commence state court condemnation proceedings against the Company to condemn the Company's distribution system within the Las Cruces city limits. The Bankruptcy Court granted the City of Las Cruces' motion to lift the automatic stay, effective January 1, 1995, to allow the City of Las Cruces to take all legal action and give all notices which the City of Las Cruces deems appropriate and necessary to become the provider of electric power for the City of Las Cruces and its citizens, specifically including eminent domain proceedings, but excluding the authority to seek from any court other than the Bankruptcy Court, immediate, actual, physical, or constructive possession of the assets the City of Las Cruces seeks to condemn. The Bankruptcy Court also ordered that any action to collect franchise fees be brought in the Bankruptcy Court.

The Company believes that New Mexico law does not authorize condemnation of the Company's facilities by the City of Las Cruces. The Las Cruces City Council has authorized the filing of a New Mexico state court declaratory judgment action to "clarify the right of the City to acquire [the

Company's] system." The Company intends to contest the City of Las Cruces' authority to acquire the Company's property and to continue to challenge in all appropriate forums the City of Las Cruces' efforts to replace the Company as the provider of electric service in the City of Las Cruces.

The Company believes, that it will either (i) be successful in preventing condemnation and loss of the City of Las Cruces' load, or (ii) if unsuccessful in that effort, the Company will receive just compensation therefor. Neither of these results would constitute a material loss to the Company. For this and other reasons, the dispute with the City of Las Cruces does not, in the Company's opinion, constitute a Material Adverse Effect under the Merger Agreement. (See Note A.)

On February 21, 1995, the City of Las Cruces filed its Complaint for Breach of Implied Contract, Specific Performance, Unjust Enrichment, and Trespass against the Company in the Bankruptcy Court. The City seeks to enforce what it claims are the Company's continued payment obligations under an allegedly implied continuation of the municipal franchise ordinance which expired by its own terms on March 18, 1994. Alternatively, the City of Las Cruces seeks, the reasonable value of the Company's use, occupation and rental of the rights of way or damages for trespass. On March 24, 1995, the Company filed a motion to dismiss all counts of the City of Las Cruces' complaint. The Company intends to vigorously defend against the lawsuit.

Military Installations. The Company currently provides retail electric service in New Mexico to the Air Force at Holloman Air Force Base and the Army at White Sands Missile Range. The Company's sales to such military bases represented approximately 2% of revenues in 1994. The Company's right to provide this service was authorized by the New Mexico Commission in 1956 by the issuance of a CCN to the Company. The contract with the Army was due to expire on December 31, 1993 but has been extended by unilateral action of the Army for an indefinite period. The contract with the Air Force expired on February 28, 1994. The Company continues to provide the electric service to the Air Force and the Army under state approved tariffs and CCN authority.

On June 15, 1993, the Air Force issued a request for proposal ("RFP") to prospective electric utility service providers to provide electric service to Holloman Air Force Base upon expiration of its service agreement with the Company. The Company submitted its proposal to the Air Force on August 12, 1993 and filed a protest to the issuance and terms of the Air Force's RFP. The protest was upheld, but on technical grounds that have allowed the Air Force to proceed with a delayed competitive bidding process. The Air Force issued a Memorandum requesting that the "best and final offer" of entities participating in the competitive bid process be submitted no later than May 10, 1994. On June 15, 1994 and December 14, 1994, the Company received letters from the Air Force requesting responses to certain questions posed by the Air Force. The Company responded to the requests and anticipates that the Air Force will again request best and final offers prior to awarding the bid.

On January 4, 1994, the Company filed an action against the Air Force and related parties in the United States District Court for the District of New Mexico challenging the authority of the Air Force to conduct a competitive bidding procedure to determine the provider of electric service to Holloman Air Force Base. The New Mexico Attorney General intervened in the case on August 15, 1994. The United States District Court has ruled that it has jurisdiction over the case and, in June 1994, entered an order denying the Company's request for a preliminary injunction. The Air Force has not appealed the jurisdictional ruling and has filed an answer in the case. By a joint motion filed January 27, 1995, the parties sought and were granted a stay of proceedings and extension of deadlines on the grounds that the parties are engaged in serious settlement negotiations. Pursuant to the order entered February 7, 1995, the parties must complete discovery by July 17, 1995, unless otherwise extended.

The Army has issued a RFP related to the provision of all of the electric service requirements for White Sands Missile Range. In addition to the Company, three electric cooperatives serve White Sands Missile Range. Responses to the request were due February 28, 1995. The Company submitted its

proposal to the Army on February 28, 1995 and filed a protest to the issuance and terms of the Army's RFP. On March 29, 1995, the Army suspended the RFP indefinitely in response to the Company's protest while the Army reviews the RFP in its entirety. The Army stated that the review could take several months. The Company is of the opinion that the competitive bidding process established by the request for proposal, as it relates to public utility providers, would not be permitted pursuant to New Mexico and federal law and regulations and intends to contest vigorously the use of the competitive bidding process. As in the case of electric service for Holloman Air Force Base, the Company intends to challenge the process through the New Mexico Commission and the federal courts.

The Company believes that the procurement of retail electric service by the United States Department of Defense by competitive bidding procedures is prohibited by federal procurement law and that participation by public utilities in this process in an attempt to obtain the right to provide this retail electric service is contrary to New Mexico law and a violation of the Company's state-authorized right to provide this service. On April 1, 1993, the Company filed a Petition for Declaratory Order with the New Mexico Commission (Case No. 2505) seeking, among other things, a declaration that the Company currently is the only public utility authorized under New Mexico utility regulatory law to offer and provide this particular retail electric service to Holloman Air Force Base and White Sands Missile Range. The hearing examiner in the case has recommended that the New Mexico Commission determine that the case is not ripe for determination. In September 1993, the Attorney General of New Mexico filed exceptions to the hearing examiner's recommended decision. By order issued February 6, 1995, the New Mexico Commission directed that the record in the case be reopened for the limited purposes of determining the current status of the case and updating, to the extent necessary, the record in the case. The hearing examiner has ordered the Company to file a report to update the status of the competitive bidding process at both military bases. The Company filed its response on March 24, 1995.

The Company believes but can give no assurance that it will continue to provide long-term electric service to Holloman Air Force Base and White Sands Missile Range. If the Company is unable to do so, however, the Company will pursue all available regulatory and legal avenues to obtain the appropriate recovery of its investment related to these customers.

Significant Customers. In 1994, 1993 and 1992, IID, a wholesale customer, accounted for approximately $51.1 million, $55.0 million and $48.8 million or 9.5%, 10.1% and 9.3%, respectively, of operating revenue.

During 1994, 1993 and 1992, the Company recorded revenues pursuant to its contract with CFE in the amount of approximately $42.7 million, $41.9 million and $33.3 million, respectively. The obligations of CFE under the agreement are subject to continued budgetary authorization by the Ministry of Programming and Budgeting of Mexico for each calendar year. The amount of capacity in 1992 began at 80 MW and increased to 120-150 MW during 1992 and will continue at that level through the term of the agreement. The agreement provides for payments to be made by CFE in United States dollars.

N. Financial Instruments

Statement of Financial Accounting Standards No. 107, "Disclosure about Fair Value of Financial Instruments" ("SFAS No. 107"), requires the Company to disclose estimated fair values for its financial instruments. The Company has determined that cash and temporary investments, pollution control bonds trust funds, decommissioning trust funds, its secured and unsecured debt which is included in liabilities subject to compromise, see Note H, and its preferred stock meet the definition of financial instruments. Cash and temporary investments and pollution control bonds trust funds carrying amounts approximate their fair value because of the short-term maturities of the investments. Decommissioning trust funds are carried at market value. Based on discussion with its financial advisor in bankruptcy, the fair value of the other financial instruments depends upon the terms and conditions of a consummated plan of reorganization which will resolve certain uncertainties described in Notes A, B, C and H. These uncertainties preclude the Company from determining the fair value of these financial instruments during the pendency of its reorganization proceedings.

Selected Quarterly Financial Data (Unaudited)

	1994 Quarters				1993 Quarters			
	1st	2nd	3rd	4th	1st	2nd	3rd	4th
	(In thousands of dollars except for per share data)							
Operating revenues	$ 125,476	$ 138,447	$ 157,448 [1]	$ 115,389 [1][2]	$ 122,236	$ 134,561	$ 151,441	$ 135,356
Operating income	11,403	17,749	31,347	12,512	4,980	16,499	27,593	15,899
Income (loss) before reorganization items and cumulative effect of a change in accounting principle	(10,699)	(5,044)	9,493	(12,912)	(12,443) [3]	2,835	9,995	(11,648) [4]
Reorganization items	(2,490)	(2,128)	(2,343)	(2,030)	(5,292)	(3,264)	(2,499)	(19,539) [6]
Income (loss) before cumulative effect of a change in accounting principle	(13,189)	(7,172)	7,150	(14,942)	(17,735)	(429)	7,496	(31,187)
Cumulative effect of a change in accounting principle	—	—	—	—	(96,044) [5]	—	—	—
Net income (loss)	(13,189)	(7,172)	7,150	(14,942)	(113,779)	(429)	7,496	(31,187)
Net income (loss) per weighted average share of common stock before cumulative effect of a change in accounting principle	(0.37)	(0.20)	0.20	(0.42)	(0.50)	(0.01)	0.21	(0.88)
Cumulative effect of a change in accounting principle per weighted average share of common stock	—	—	—	—	(2.70)	—	—	—

(1) Base rate increases, effective July 16, 1994, have been deferred and, therefore, they are not included in operating revenues.

(2) Reflects a decrease in fuel revenues of approximately $7.5 million due to a change in the calculation of Texas jurisdictional fuel costs based on the Texas Docket 13966 final order.

(3) Reflects the recognition of approximately $7.8 million for the settlement and anticipated settlement of state income and other tax claims.

(4) Reflects interest payments on unsecured and undersecured debt of approximately $10.2 million.

(5) Reflects the change in accounting for income taxes from the deferred method to the asset and liability method. See Note I.

(6) Reflects the interim payments or accrual of approximately $13.3 million for fees and expenses. In addition, reflects interim payments to holders of the Company's preferred stock of approximately $1.4 million. See Note A.

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

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant

Information regarding directors is incorporated herein by reference from the Company's definitive proxy statement for the 1995 annual meeting of shareholders (the "1995 Proxy Statement"). Information regarding executive officers of the Company, included herein under the caption "Executive Officers of the Registrant" in Part I, Item 1 above, is incorporated herein by reference.

Item 11. Executive Compensation

Incorporated herein by reference from the 1995 Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Incorporated herein by reference from the 1995 Proxy Statement.

Item 13. Certain Relationships and Related Transactions

Incorporated herein by reference from the 1995 Proxy Statement.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) Documents filed as a part of this report:

3. Exhibits:

Certain of the following documents are filed herewith. Certain other of the following exhibits have heretofore been filed with the Securities and Exchange Commission, and, pursuant to Rule 12b-32 and Regulation 201.24, are incorporated herein by reference.

Exhibit 2 – Plan of Acquisition, Reorganization, Arrangement, Liquidation or Succession:

2.01 – Disclosure Statement to Modified Third Amended Plan of Reorganization of El Paso Electric Company Providing for the Acquisition of El Paso Electric Company by Central and South West Corporation, plus exhibits thereto. (Exhibit 2.2 to the Company's Current Report on Form 8-K dated September 23, 1993)

2.02 – Modified Third Amended Plan of Reorganization of the Debtor Providing for the Acquisition of El Paso Electric Company by Central and South West Corporation as corrected December 6, 1993, as confirmed by the Bankruptcy Court. (Exhibit 2.2 to the Company's Current Report on Form 8-K dated December 8, 1993)

2.03 – Order and Judgment Confirming the Debtor's Modified Third Amended Plan of Reorganization, as Modified, Under Chapter 11 of the United States Bankruptcy Code and Granting Related Relief. (Exhibit 2.1 to the Company's Current Report on Form 8-K dated December 8, 1993)

2.04 – Agreement and Plan of Merger Among El Paso Electric Company, Central and South West Corporation and CSW Sub, Inc. dated as of May 3, 1993, As Amended on May 18, 1993. (Exhibit 2.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1993)

2.04-01 – Second Amendment dated as of August 26, 1993 to Exhibit 2.04. (Included in Exhibit 2.2 to the Company's Current Report on Form 8-K dated September 23, 1993)

2.04-02 – Third Amendment dated as of December 1, 1993 to Exhibit 2.04. (Exhibit 2.3 to the Company's Current Report on Form 8-K dated December 8, 1993)

2.04-03 – Letter Amendment dated August 19, 1994 to Exhibit 2.04. (Exhibit 2.1 to the Company's Current Report on Form 8-K dated August 1, 1994)

Exhibit 3 – Articles of Incorporation and Bylaws:

*3.01 – Restated Articles of Incorporation of the Company dated as of August 22, 1988.

*3.01-01 – Statement of Change of Registered Agent dated June 12, 1989, amending Exhibit 3.01. (Exhibit 19.5 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990)

*3.01-02 – Articles of Amendment dated May 24, 1990, amending Exhibit 3.01. (Exhibit 19.6 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990)

*3.02 – Bylaws of the Company amended as of January 29, 1992.

Exhibit 4 – Instruments Defining the Rights of Security Holders, including Indentures:

4.01 – Indenture of Mortgage dated as of October 1, 1946. (Exhibit 7-2 to Registration No. 2-6762)

4.01-01 – Seventh Supplemental Indenture, dated as of February 1, 1962, to Exhibit 4.01. (Exhibit 2-f to Registration No. 2-28692)

4.01-02 – Eighth Supplemental Indenture, dated as of December 1, 1957, to Exhibit 4.01. (Exhibit 2-g to Registration No. 2-28692)

4.01-03 – Ninth Supplemental Indenture, dated as of May 1, 1968, to Exhibit 4.01. (Exhibit 2-h to Registration No. 2-39693)

4.01-04 – Tenth Supplemental Indenture, dated as of April 1, 1971, to Exhibit 4.01. (Exhibit 2-j to Registration No. 2-49308)

4.01-05 – Eleventh Supplemental Indenture, dated as of November 1, 1974, to Exhibit 4.01. (Exhibit 2-o to Registration No. 2-52131)

4.01-06 – Twelfth Supplemental Indenture, dated as of November 1, 1975, to Exhibit 4.01. (Exhibit 2-p to Registration No. 2-54772)

4.01-07 – Thirteenth Supplemental Indenture, dated as of August 1, 1976, to Exhibit 4.01. (Exhibit 2-q to Registration No. 2-56666)

4.01-08 – Fourteenth Supplemental Indenture, dated as of April 1, 1977, to Exhibit 4.01. (Exhibit 2-d-14 to Registration No. 2-60485)

4.01-09 – Fifteenth Supplemental Indenture, dated as of July 1, 1978, to Exhibit 4.01. (Exhibit 2-d-13 to Registration No. 2-55174)

4.01-10 – Sixteenth Supplemental Indenture, dated as of May 1, 1979, to Exhibit 4.01. (Exhibit 2-d-16 to Registration No. 2-64865)

4.01-11 – Eighteenth Supplemental Indenture, dated as of August 1, 1982, to Exhibit 4.01. (Exhibit 4.19 to Registration No. 2-78246)

4.01-12 – Nineteenth Supplemental Indenture, dated as of May 1, 1984, to Exhibit 4.01. (Exhibit 4.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1984)

4.01-13 – Twenty Second Supplemental Indenture, dated as of October 1, 1989, to Exhibit 4.01. (Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

4.01-14 – Twenty Third Supplemental Indenture, dated as of January 1, 1990, to Exhibit 4.01. (Exhibit 4.2 to the Company's Current Report on Form 8-K dated January 17, 1990)

4.02 – Bond Purchase Agreement dated as of July 19, 1968, relating to the issuance and sale of 6-3/4% First Mortgage Bonds due 1998. (Exhibit 2-f to Registration No. 2-62090)

4.03 – Bond Purchase Agreement dated as of April 25, 1979, relating to the issuance and sale of $25,000,000 principal amount of First Mortgage Bonds, 9.95% Series due 2004. (Exhibit 2-g to Registration No. 2-64865)

4.04 – Bond Purchase Agreement dated as of May 1, 1984, relating to the issuance and sale by the Company of $22,000,000 principal amount of First Mortgage Bonds, 12-3/4% Series due 1989 and $29,000,000 principal amount of First Mortgage Bonds, 13-1/4% Series due 1994. (Exhibit 4.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1984)

4.05 – Bond Purchase Agreement dated as of January 26, 1990, relating to the issuance and sale by the Company of $153,000,000 principal amount of First Mortgage Bonds, 11.10% Series due 2001. (Exhibit 4.1 to the Company's Current Report on Form 8-K dated January 16, 1990)

4.06 – Credit Agreement dated as of October 26, 1989 among the Company, Chemical Bank, as Agent, and the Banks parties thereto. (Exhibit 4 to the Company's Current Report on Form 8-K dated October 30, 1989)

4.06-01 – First Amendment, dated as of December 21, 1989, to Exhibit 4.06. (Exhibit 4 to the Company's Current Report on Form 8-K dated December 3, 1989)

4.06-02 – Second Amendment, dated as of September 17, 1990, to Exhibit 4.06. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1990)

4.06-03 – Third Amendment, dated as of October 26, 1990, to Exhibit 4.06. (Exhibit 19.7 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990)

4.06-04 – Fourth Amendment, dated as of May 30, 1991, to Exhibit 4.06. (Exhibit 4.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991)

4.06-05 – Fifth Amendment, dated as of August 28, 1991, to Exhibit 4.06. (Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1991)

4.06-06 – Sixth Amendment, dated as of September 27, 1991, to Exhibit 4.06. (Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1991)

4.06-07 – Seventh Amendment, dated as of October 31, 1991, to Exhibit 4.06. (Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1991)

4.06-08 – Eighth Amendment, dated as of November 29, 1991, to Exhibit 4.06. (Exhibit 19.03 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

4.06-09 – Ninth Amendment, dated as of December 13, 1991, to Exhibit 4.06. (Exhibit 19.03-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

4.06-10 – Tenth Amendment, dated as of December 23, 1991, to Exhibit 4.06. (Exhibit 19.03-02 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

4.06-11 – Eleventh Amendment, dated as of December 24, 1991, to Exhibit 4.06. (Exhibit 19.03-03 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

4.06-12 – Twelfth Amendment, dated as of December 30, 1991, to Exhibit 4.06. (Exhibit 19.03-04 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

4.07 – Indenture of Mortgage, dated as of June 1, 1981, between the Company and First City National Bank of El Paso, as Trustee of the Company's Second Mortgage Bonds. (Exhibit 20.30 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

4.07-01 – Fourth Supplemental Indenture, dated as of December 1, 1984, to Exhibit 4.07, relating to an issue of Second Mortgage Bonds, Floating Rate Series E due 2014. (Exhibit 4.10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1984)

4.07-02 – Fifth Supplemental Indenture, dated as of August 1, 1985, to Exhibit 4.07, relating to an issue of Second Mortgage Bonds, Series F Floating Rate due 2015. (Exhibit 4.7 to the Company's Annual Report on Form 10-K for the year ended December 31, 1984)

4.07-03 – Sixth Supplemental Indenture, dated as of October 1, 1985, to Exhibit 4.07, relating to an issue of Second Mortgage Bonds, Series G Floating Rate due 1991. (Exhibit 4.10 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1985)

4.07-04 – Eighth Supplemental Indenture, dated as of November 1, 1987, to Exhibit 4.07, relating to two issues of Second Mortgage Bonds, Series J, 11.58% due 1997 and Series K 12.63% due 2005. (Exhibit 4.07-05 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

4.07-05 – Ninth Supplemental Indenture, dated as of October 1, 1989, to Exhibit 4.07, relating to an issue of Second Mortgage Bonds, 1989 Floating Rate Series I. (Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

4.07-06 – Tenth Supplemental Indenture, dated as of December 1, 1990, to Exhibit 4.07, relating to two issues of Second Mortgage Bonds, 11.58% Series J due 1997 and 12.63% Series K due 2005. (Exhibit 19.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990)

4.07-07 – Eleventh Supplemental Indenture, dated as of June 1, 1991, to Exhibit 4.07, relating to an issue of Second Mortgage Bonds, Series L 12.02% due 1999. (Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991)

4.07-08 – Twelfth Supplemental Indenture, dated as of July 1, 1994, to Exhibit 4.07, relating to an issue of Second Mortgage Bonds, Series M, Floating Rate due 2014. (Exhibit 4.06 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.08 – Bond Purchase Agreement dated as of June 25, 1991, relating to the issuance and sale by the Company of $25,000,000 principal amount of Second Mortgage Bonds, Series L 12.02% due 1999. (Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991)

4.09 – Bond Purchase Agreement dated December 20, 1990, relating to the issuance and sale of $35,000,000 principal amount of Second Mortgage Bonds, Series J 11.58% due 1997 and $105,000,000 principal amount of Second Mortgage Bonds, Series K 12.63% due 2005. (Exhibit 19.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990)

4.10 – Preferred Stock Purchase Agreement dated February 27, 1975, relating to the issuance and sale by the Company of 100,000 shares of $10.75 Dividend Preferred Stock. (Exhibit 2-h to Registration No. 2-65985)

4.11 – Preferred Stock Purchase Agreement dated September 29, 1978, relating to the issuance and sale by the Company of 150,000 shares of $8.44 Dividend Preferred Stock. (Exhibit 2-g to Registration No. 2-63203)

4.12 – Preferred Stock Purchase Agreement dated September 19, 1979, relating to the issuance and sale by the Company of 150,000 shares of $8.95 Dividend Preferred Stock. (Exhibit 2-j to Registration No. 2-65985)

4.13 – Preferred Stock Purchase Agreement dated as of May 16, 1983, relating to the issuance and sale by the Company of 250,000 shares of $10.125 Dividend Preferred Stock. (Exhibit 4.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1983)

4.14 – Participation Agreement dated as of April 15, 1984 among the Company, the Equity Participants listed therein, and United States Trust Company of New York, as Owner Trustee, relating to the Company's Preferred Trust Financing as described therein. (Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1984)

4.14-01 – Extension Letter dated April 15, 1984 from the Company to Prudential Interfunding Corp., as purchaser, and Banker's Trust Company, as Trustee, in connection with the Company's Preferred Trust Financing as described in Exhibit 4.14. (Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1984)

4.15 – Agreement relating to filing of instruments defining the rights of holders of long-term debt not in excess of 10% of the Company's total assets. (Exhibit 4.14 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990)

4.16 – Indenture of Trust dated as of July 1, 1994 between Maricopa County, Arizona Pollution Control Corporation and Texas Commerce Bank National Association, as Trustee, related to $63,500,000 principal amount of Maricopa County, Arizona Pollution Control Corporation Adjustable Tender Pollution Control Revenue Bonds, 1994 Series A (El Paso Electric Company Palo Verde Project). (Exhibit 4.01 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.17 – Loan Agreement dated as of July 1, 1994 between Maricopa County, Arizona Pollution Control Corporation and the Company, related to the Pollution Control Bonds referred to in Exhibit 4.16. (Exhibit 4.02 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.18 – Amended and Restated Letter of Credit and Reimbursement Agreement dated as of July 1, 1994 between the Company and Citibank, N.A., related to the Pollution Control Bonds referred to in Exhibit 4.16. (Exhibit 4.03 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.19 – Remarketing Agreement dated as of July 1, 1994 between the Company and Smith Barney Inc., related to the Pollution Control Bonds referred to in Exhibit 4.16. (Exhibit 4.04 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.20 – Tender Agreement dated as of July 1, 1994 between the Company and Smith Barney Inc., related to the Pollution Control Bonds referred to in Exhibit 4.16. (Exhibit 4.05 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.21 – Ordinance No. 94-1018 adopted by the City Council of the City of Farmington, New Mexico, on October 18, 1994, authorizing and providing for the issuance by the City of Farmington, New Mexico, of $33,300,000 principal amount of its Adjustable Tender Pollution Control Revenue Refunding Bonds, 1994 Series A (El Paso Electric Company Four Corners Project). (Exhibit 4.07 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.22 – Resolution No. 94-798 adopted by the City Council of the City of Farmington, New Mexico, on October 18, 1994, relating to the issuance of the Pollution Control Bonds referred to in Exhibit 4.21. (Exhibit 4.08 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.23 – Amended and Restated Installment Sale Agreement dated as of November 1, 1994, between the Company and the City of Farmington, New Mexico, relating to the Pollution Control Bonds referred to in Exhibit 4.21. (Exhibit 4.09 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.24 – Representation and Indemnity Agreement dated as of October 31, 1994 between the Company, the City of Farmington, New Mexico and Smith Barney Inc., relating to the Pollution Control Bonds referred to in Exhibit 4.21. (Exhibit 4.10 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.25 – Remarketing Agreement dated as of November 1, 1994 between the Company and Smith Barney Inc., relating to the Pollution Control Bonds referred to in Exhibit 4.21. (Exhibit 4.11 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.26 – Tender Agreement dated as of November 1, 1994 between the Company and Smith Barney Inc., relating to the Pollution Control Bonds referred to in Exhibit 4.21. (Exhibit 4.12 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.27 – Amended and Restated Letter of Credit and Reimbursement Agreement dated as of November 1, 1994 between the Company and Citibank, N.A., relating to the Pollution Control Bonds referred to in Exhibit 4.21. (Exhibit 4.13 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)

4.28 – Loan Agreement dated as of December 1, 1984 between Maricopa County, Arizona Pollution Control Corporation and the Company, relating to $37,100,000 principal amount of Maricopa County, Arizona Pollution Control Corporation Adjustable Tender Pollution Control Refunding Revenue Bonds, 1984 Series E (El Paso Electric Company Palo Verde Project). (Exhibit 4.27 to the Company's Annual Report on Form 10-K for the year ended December 31, 1984)

4.28-01 – Supplemental Loan Agreement, dated as of June 1, 1986, to Exhibit 4.28. (Exhibit 4.29-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986)

4.29 – Trust Indenture dated as of December 1, 1984 by and between Maricopa County, Arizona Pollution Control Corporation and MBank El Paso, National Association, as Trustee, securing the Adjustable Tender Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.28. (Exhibit 4.27-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1984)

4.29-01 – Supplemental Trust Indenture No. 2, dated as of June 1, 1986, to Exhibit 4.29. (Exhibit 4.29-03 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986)

4.29-02 – Supplemental Trust Indenture No. 3 dated as of May 6, 1994 to Exhibit 4.29. (Exhibit 4.01 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1994)

4.30 – Letter of Credit and Reimbursement Agreement between the Company and Credit Suisse, dated as of June 1, 1986, securing the Adjustable Tender Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.28. (Exhibit 4.29-04 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986)

4.30-01 – First Amendment Agreement, dated as of December 21, 1988, to Exhibit 4.30. (Exhibit 19.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

4.31 – Indexing Agent's Agreement among Maricopa County, Arizona Pollution Control Corporation, the Company and Smith Barney, Harris Upham & Co., Incorporated, relating to the Adjustable Tender Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.28. (Exhibit 4.27-03 to the Company's Annual Report on Form 10-K for the year ended December 31, 1984)

4.32 – Remarketing Agent's Agreement dated as of May 6, 1994 between Smith Barney Shearson Inc., and the Company, relating to the Adjustable Tender Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.28. (Exhibit 4.02 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1994)

4.33 – Term Loan Agreement dated as of October 1, 1987 among the El Paso Electric Company Leveraged Employee Stock Ownership Plan and Trust, the Company and The Bank of New York. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1987)

4.33-01 – Amendment No. 1, dated as of December 16, 1987, to Exhibit 4.33. (Exhibit 4.30-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1987)

4.33-02 – Amendment No. 2, dated as of December 31, 1987, to Exhibit 4.33. (Exhibit 4.30-02 to the Company's Annual Report on Form 10-K for the year ended December 31, 1987)

4.33-03 – Amendment No. 3, dated as of July 12, 1988, to Exhibit 4.33. (Exhibit 19.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988)

4.33-04 – Amendment No. 4, dated as of September 30, 1988, to Exhibit 4.33. (Exhibit 19.8 to the Company's Annual Report on Form 10-K for the year ended December 31, 1988)

4.33-05 – Amendment No. 5, dated as of December 31, 1988, to Exhibit 4.33. (Exhibit 19.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1989)

4.33-06 – Amendment No. 6, dated as of March 31, 1989, to Exhibit 4.33. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989)

4.33-07 – Amendment No. 7, dated as of June 30, 1989, to Exhibit 4.33. (Exhibit 19.6 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989)

4.33-08 – Amendment No. 8, dated as of October 26, 1989, to Exhibit 4.33. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

4.33-09 – Amendment No. 9, dated as of September 12, 1990, to Exhibit 4.33. (Exhibit 19.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1990)

4.33-10 – Amendment No. 10, dated as of December 10, 1991, to Exhibit 4.33. (Exhibit 19.04 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

4.34 – Loan Agreement dated as of August 1, 1985 between Maricopa County, Arizona Pollution Control Corporation and the Company, relating to $59,235,000 principal amount of Maricopa County, Arizona Pollution Control Corporation Pollution Control Refunding Revenue Bonds, 1985 Series A (El Paso Electric Company Palo Verde Project). (Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1985)

4.35 – Trust Indenture dated as of August 1, 1985 by and between Maricopa County, Arizona Pollution Control Corporation and MBank El Paso, National Association, as Trustee, securing the Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.34. (Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1985)

4.35-01 – Supplemental Trust Indenture No. 3 dated as of May 6, 1994 to Exhibit 4.35. (Exhibit 4.03 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1994)

4.36 – Letter of Credit and Reimbursement Agreement dated as of August 1, 1985 between the Company and Westpac Banking Corporation, Chicago Branch, relating to the Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.34. (Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1985)

4.37 – Pledge Agreement dated as of August 1, 1985 among the Company, Westpac Banking Corporation, Chicago Branch, and MBank El Paso, National Association, as Agent for Westpac Banking Corporation, Chicago Branch relating to the Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.34. (Exhibit 4.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1985)

4.38 – Indexing Agent's Agreement among Maricopa County, Arizona Pollution Control Corporation, the Company, MBank El Paso, National Association, as Trustee, and Smith Barney, Harris Upham & Co., Incorporated, relating to the Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.34. (Exhibit 4.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1985)

4.39 – Remarketing Agent's Agreement dated as of August 1, 1985 between Smith Barney, Harris Upham & Co., Incorporated, and the Company, relating to the Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.34. (Exhibit 4.6 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1985)

Exhibit 10 – Material Contracts:

10.01 – Co-Tenancy Agreement dated July 19, 1966 and Amendment No. 1, dated March 28, 1967, between the Participants of the Four Corners Project, defining the respective ownerships, rights and obligations of the Parties. (Exhibit 4-c to Registration No. 2-28692)

10.01-01 – Amendment No. 2 to Exhibit 10.01. (Exhibit 19.16 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.01-02 – Amendment No. 3 to Exhibit 10.01. (Exhibit 19.17 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.01-03 – Amendment No. 4, dated April 25, 1985, to Exhibit 10.1. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1985)

10.01-04 – Amendment No. 5, dated February 5, 1987, to Exhibit 10.1. (Exhibit 19.7 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1987)

10.02 – Four Corners Fuel Agreement No. 2 dated September 1, 1966 between Utah Construction & Mining Company and the Participants of the Four Corners Project, providing for the supply of fuel and water requirements. (Exhibit 4-d to Registration No. 2-28692)

10.02-01 – First Supplement, dated February 1, 1968, to Exhibit 10.02. (Exhibit 20.01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

10.02-02 – Second Supplement, dated September 1, 1975, to Exhibit 10.02. (Exhibit 20.02 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

10.02-03 – Third Supplement, dated July 1, 1977, to Exhibit 10.02. (Exhibit 20.03 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

10.02-04 – Fourth Supplement, dated January 1, 1981, to Exhibit 10.02. (Exhibit 20.11 to the Company's Annual Report on Form 10-K for the year ended December 31, 1980)

10.02-05 – Fifth Supplement, dated December 14, 1984, to Exhibit 10.02. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1990)

10.02-06 – Sixth Supplement, dated February 1, 1990, to Exhibit 10.02. (Exhibit 19.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1990)

10.02-07 – Seventh Supplement, dated November 1, 1991, and Memorandum of Agreement, dated as of November 1, 1991, to Exhibit 10.02. (Exhibit 19.05 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.03 – Supplemental and Additional Indenture of Lease dated May 27, 1966, including amendments and supplements to original Lease Four Corners Units 1, 2 and 3, between the Navajo Tribe of Indians and Arizona Public Service Company, and including new Lease Four Corners Units 4 and 5, between the Navajo Tribe of Indians and Arizona Public Service Company, the Company, Public Service Company of New Mexico, Salt River Project Agricultural Improvement and Power District, Southern California Edison Company and Tucson Gas & Electric Company. (Exhibit 4-e to Registration No. 2-28692)

10.03-01 – Amendment and Supplement No. 1, dated March 21, 1985, to Exhibit 10.03. (Exhibit 19.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1985)

10.04 – Waste Disposal Agreement dated January 1, 1981 between BHP-Utah International, Inc., and the Participants in the Four Corners project, providing for present and future waste disposal from Units 4 and 5. (Exhibit 20.09 to the Company's Annual Report on Form 10-K for the year ended December 31, 1980)

10.04-01 – First Supplement, dated June 18, 1986, to Exhibit 10.04. (Exhibit 19.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1990)

10.04-02 – Second Supplement, dated February 1, 1990, to Exhibit 10.04. (Exhibit 19.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1990)

10.04-03 – Third Supplement, dated February 1, 1991, to Exhibit 10.04. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1991)

10.05 – Four Corners Project Operating Agreement dated May 15, 1969 between Arizona Public Service Company, the Company, Public Service Company of New Mexico, Salt River Project Agricultural Improvement and Power District, Southern California Edison Company and Tucson Gas & Electric Company. (Exhibit 19.02 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.05-01 – Amendment No. 1, dated August 5, 1974, to Exhibit 10.05. (Exhibit 19.02-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.05-02 – Amendment No. 2, dated September 1, 1975, to Exhibit 10.05. (Exhibit 19.02-02 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.05-03 – Amendment No. 3, dated March 23, 1981, to Exhibit 10.05. (Exhibit 19.02-03 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.05-04 – Amendment No. 4, dated October 21, 1981, to Exhibit 10.05. (Exhibit 19.02-04 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.05-05 – Amendment No. 5, dated January 11, 1982, to Exhibit 10.05. (Exhibit 19.02-05 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.05-06 – Amendment No. 6, dated February 25, 1982, to Exhibit 10.05. (Exhibit 19.02-06 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.05-07 – Amendment No. 7, dated April 25, 1985, to Exhibit 10.05. (Exhibit 19.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1985)

10.05-08 – Amendment No. 8, dated July 5, 1988, to Exhibit 10.05. (Exhibit 19.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1988)

10.05-09 – Amendment No. 9, dated October 6, 1989, to Exhibit 10.05. (Exhibit 19.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

10.05-10 – Amendment No. 10, dated April 16, 1991, to Exhibit 10.05. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991)

10.06 – Four Corners Units 4 & 5 Capital Improvements Design and Construction Agreement dated March 23, 1981. (Exhibit 19.12 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.07 – Four Corners Project Emission Abatement System Operating Power Agreement dated January 19, 1982. (Exhibit 19.31 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.08 – Participation Agreement dated August 23, 1973 between Arizona Public Service Company, Public Service Company of New Mexico, Salt River Project Agricultural Improvement and Power District, Tucson Gas & Electric Company and the Company, describing the respective participation ownerships of the various utilities having undivided interests in the Arizona Nuclear Power Project and in general terms defining the respective ownerships, rights, obligations, major construction and operating arrangements of the Parties. (Exhibit 5-i to Registration No. 2-49308)

10.08-01 – Amendment No. 1, dated as of January 1, 1974, to and Assignment of Interests in, Exhibit 10.08. (Exhibit 5-i to Registration No. 2-52131)

10.08-02 – Amendment No. 2, dated as of August 28, 1975, to Exhibit 10.08. (Exhibit 5-i-7 to Registration No. 2-58366)

10.08-03 – Amendment No. 3, dated as of July 22, 1976, to Exhibit 10.08. (Exhibit 5-c-11 to Registration No. 2-60485)

10.08-04 – Amendment No. 4, dated as of December 15, 1977, to Exhibit 10.08. (Exhibit 5-c-18 to Registration No. 2-62090)

10.08-05 – Amendment No. 5, dated as of December 5, 1979, to Exhibit 10.08. (Exhibit 5-c-5 to Registration No. 2-68414)

10.08-06 – Amendment No. 6, dated as of October 16, 1981, to Exhibit 10.08. (Exhibit 20.25 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

10.08-07 – Amendment No. 7, dated as of April 2, 1982, to Exhibit 10.08. (Exhibit 19.19 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.08-08 – Amendment No. 8, dated as of December 12, 1983, to Exhibit 10.08. (Exhibit 19.04 to the Company's Annual Report on Form 10-K for the year ended December 31, 1983)

10.08-09 – Amendment No. 9, dated as of June 12, 1984, to Exhibit 10.08. (Exhibit 28.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1984)

10.08-10 – Amendment No. 10, dated as of November 21, 1985, to Exhibit 10.08. (Exhibit 10.09-12 to the Company's Annual Report on Form 10-K for the year ended December 31, 1985)

10.08-11 – Amendment No. 11, dated as of September 8, 1986, to Exhibit 10.08. (Exhibit 10.09-13 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986)

10.08-12 – Amendment No. 12, dated as of August 5, 1988, to Exhibit 10.08. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1988)

10.08-13 – Amendment No. 13, dated as of April 22, 1991, to Exhibit 10.08. (Exhibit 19.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1991)

10.09 – Assignment Agreement (Arizona Nuclear Power Project Participation Agreement), dated as of January 4, 1979, between the Company and Newton I. Waldman, Co-trustee. (Exhibit 5-i-5 to Registration No. 2-63203)

10.10 – Arizona Nuclear Power Project Valley Transmission System Participation Agreement, dated August 20, 1981. APS Contract No. 2253-419.00. (Exhibit 20.13 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

10.10-01 – Amendment No. 1, dated May 24, 1982, to Exhibit 10.10. (Exhibit 19.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.10-02 – Amendment No. 2, dated May 9, 1987, to Exhibit 10.10. (Exhibit 19.6 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1987)

10.11 – Arizona Nuclear Power Project High Voltage Switchyard Participation Agreement, dated August 20, 1981. APS Contract No. 2252-419.00. (Exhibit 20.14 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

10.11-01 – Amendment No. 1, dated November 20, 1986, to Exhibit 10.11. (Exhibit 10.11-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986)

10.12 – Assignment, dated August 28, 1975, by Tucson Gas & Electric Company, of its interest in Exhibit 10.08, to Southern California Edison Company. (Exhibit 5-h-7 to Registration No. 2-54773)

10.13 – Firm Palo Verde Nuclear Generating Station Transmission Service Agreement between Salt River Project Agricultural Improvement and Power District and the Company dated October 18, 1983. (Exhibit 19.12 t the Company's Annual Report on Form 10-K for the year ended December 31, 1983)

10.14 – Supplemental Agreement of Settlement dated November 15, 1984 between Arizona Public Service Company and the United States Department of Energy, relating to previous uranium enrichment contracts. (Exhibit 10.17 to the Company's Annual Report on Form 10-K for the year ended December 31, 1984)

10.15 – Contract No. DE-SC05-84UE07536 dated November 15, 1984 between the United States Department of Energy and Arizona Public Service Company, for uranium enrichment services at Palo Verde. (Exhibit 10.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 1984) At the Company's request, confidential treatment has been granted by the Securities and Exchange Commission to portions of this document.

10.15-01 – Supplemental Agreements, Modifications Numbers 1, 2 and 3, dated September 30, 1985, May 27, 1986 and April 7, 1986, respectively, to Exhibit 10.15. (Exhibit 10.17-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986)

10.15-02 – Modifications Numbers 4, 5 and 6, dated September 29, 1986, August 8, 1986 and February 20, 1987, respectively, to Exhibit 10.15. (Exhibit 19.6 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1987)

10.15-03 – Modification No. 7, dated September 29, 1988, to Exhibit 10.15. (Exhibit 19.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 1988)

10.15-04 – Modification No. 8, dated September 18, 1988, to Exhibit 10.15. (Exhibit 19.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 1988)

10.15-05 – Modification No. 9, dated April 12, 1989, to Exhibit 10.15. (Exhibit 19.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989)

10.15-06 – Modification No. 10, dated April 16, 1990, to Exhibit 10.15. (Exhibit 19.06 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.15-07 – Modification No. 11, dated February 20, 1990, to Exhibit 10.15. (Exhibit 19.06-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.15-08 – Modification No. 12, dated August 16, 1991, to Exhibit 10.15. (Exhibit 19.06-02 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.16 – Contract No. DE-CR01-84RW00005 dated July 21, 1984 between the United States Department of Energy and Arizona Public Service Company, for disposal of spent nuclear fuel at Palo Verde. (Exhibit 10.19 to the Company's Annual Report on Form 10-K for the year ended December 31, 1984)

10.17 – Agreement for Fuel and Other Consulting Services dated October 6, 1972 between the S. M. Stoller Corporation and Arizona Nuclear Power Project. (Exhibit 5-c-32 to Registration No. 2-68414)

10.17-01 – Assignment Agreement dated as of January 4, 1979, relating to Exhibit 10.17. (Exhibit 5-i-15 to Registration No. 2-63203)

10.18 – Intercreditor Agreement dated as of June 15, 1977 between National Bank of North America and The State National Bank of El Paso. (Exhibit 5-f-8 to Registration No. 2-60485)

10.19 – Credit Agreement dated as of January 4, 1979 between Security Pacific National Bank and Empire National Bank and Newton I. Waldman, Trustees. (Exhibit 5-i-1 to Registration No. 2-63203)

10.19-01 – First Amendment, dated as of January 8, 1982, to Exhibit 10.19. (Exhibit 19.08 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.19-02 – Second Amendment, dated as of March 23, 1983, to Exhibit 10.19. (Exhibit 19.08-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.19-03 – Third Amendment, dated as of July 5, 1983, to Exhibit 10.19. (Exhibit 19.08-02 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.19-04 – Fourth Amendment, dated as of July 1, 1985, to Exhibit 10.19. (Exhibit 19.08-03 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.19-05 – Fifth Amendment, dated as of June 15, 1987, to Exhibit 10.19. (Exhibit 19.08-04 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.20 – Trust Agreement dated as of December 15, 1978 between M & W Resources, Incorporated, Trustor, and Empire National Bank and Newton I. Waldman, Trustees, forming the Rio Grande Resources Trust. (Exhibit 5-i-2 to Registration No. 2-63203)

10.20-01 – Supplemental Instructions No. 1, dated as of December 18, 1978, to Exhibit 10.20. (Exhibit 19.09 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.20-02 – Supplemental Instructions No. 2, dated as of January 8, 1982, to Exhibit 10.20. (Exhibit 19.09-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.20-03 – Supplemental Instructions No. 3, dated as of March 23, 1983, to Exhibit 10.20. (Exhibit 19.09-02 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.20-04 – Supplemental Instructions No. 4, dated as of March 23, 1983, to Exhibit 10.20. (Exhibit 19.09-03 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.20-05 – Supplemental Instructions No. 5, dated as of July 5, 1983, to Exhibit 10.20. (Exhibit 19.09-04 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.20-06 – Supplemental Instructions No. 6, dated as of July 1, 1985, to Exhibit 10.20. (Exhibit 19.09-05 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.20-07 – Supplemental Instructions No. 7, dated as of June 29, 1987, to Exhibit 10.20. (Exhibit 19.09-06 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.21 – Purchase Contract dated as of January 4, 1979 between Newton I. Waldman, Co-trustee, and the Company. (Exhibit 5-i-3 to Registration No. 2-63203)

10.21-01 – Letter Agreement dated January 8, 1982 between Newton I. Waldman, Esquire, as Co-trustee of the Rio Grande Resources Trust, and the Company amending Exhibit 10.21. (Exhibit 20.33 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

10.21-02 – First Amendment, dated as of July 5, 1983, to Exhibit 10.21. (Exhibit 19.10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.21-03 – Second Amendment, dated as of July 1, 1985, to Exhibit 10.21. (Exhibit 19.10-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.21-04 – Third Amendment, dated as of June 15, 1987, to Exhibit 10.21. (Exhibit 19.10-02 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.22 – Depository Agreement dated as of January 4, 1979 between Empire National Bank and Newton I. Waldman, Trustees, and Security Pacific Bank, Credit Bank, and The Chase Manhattan Bank, N.A., Depository. (Exhibit 5-i-4 to Registration No. 2-63203)

10.23 – Trust Agreement dated as of May 1, 1980 between The Bank of New York, as Beneficiary, and First Security Bank of Utah, N.A., and Robert S. Clark, as Owner Trustees, establishing a trust designated as El Paso Electric Company (1980) Equipment Trust No. 2. (Exhibit 5-p-1 to Registration No. 2-68414)

10.24 – Trust Indenture dated as of May 1, 1980 between The Connecticut Bank and Trust Company, as Indenture Trustee, and First Security Bank of Utah, N.A., and Robert S. Clark, Owner Trustees. (Exhibit 5-p-2 to Registration No. 2-68414)

10.25 – Lease Agreement dated as of May 1, 1980 between First Security Bank of Utah, N.A., and Robert S. Clark, the Owner Trustees, as Lessor, and the Company, as Lessee, providing for the lease of a combustion turbine and related generation equipment. (Exhibit 5-p-3 to Registration No. 2-68414)

10.26 – Participation Agreement dated as of May 1, 1980 among the Company, as Lessee, The Bank of New York, as Beneficiary, First Security Bank of Utah, N.A., and Robert S. Clark, as Owner Trustees, The Connecticut Bank and Trust Company, as Indenture Trustee, Franklin Life Insurance Company, Woodmen of the World Life Insurance Society, Minnesota Mutual Life Insurance Company, MacCabees Mutual Life Insurance Company and Mutual Service Insurance Company, as Lenders, pertaining to Exhibit 10.25. (Exhibit 5-p-4 to Registration No. 2-68414)

10.27 – Assignment Agreement dated June 30, 1981 between the Company and Newton I. Waldman, as Co-trustee under the Trust Agreement dated as of December 15, 1978, concerning Palo Verde uranium venture. (Exhibit 20.34 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

10.28 – Interconnection Agreement, as amended, dated December 8, 1981 between the Company and Southwestern Public Service Company. (Exhibit 20.28 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

10.28-01 – Service Schedule D – Power Exchange Service, dated March 3, 1987, to Exhibit 10.28. (Exhibit 19.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1987)

10.28-02 – Rate Agreement dated April 26, 1990 between the Company and Southwestern Public Service Company, relating to Service Schedule C of Exhibit 10.28. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1990)

10.28-03 – Service Schedule E - Firm Power Service dated June 19, 1992 between the Company and Southwestern Public Service Company, relating to Exhibit 10.28. (Exhibit 19.01 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1992)

10.29 – Amrad to Artesia 345 KV Transmission System and D.C. Terminal Participation Agreement dated December 8, 1981 between the Company and Texas-New Mexico Power Company. (Exhibit 20.08 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

10.30 – D.C. Terminal Construction Agreement dated December 8, 1981 between Texas-New Mexico Power, the Company and Southwestern Public Service Company. (Exhibit 20.06 to the Company's Annual Report on Form 10-K for the year ended December 31, 1981)

10.30-01 – Supplemental Agreement, dated December 8, 1981, to Exhibit 10.30. (Exhibit 19.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1987)

10.30-02 – Second Supplemental Agreement, dated April 29, 1987, to Exhibit 10.30. (Exhibit 19.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1987)

10.31 – Interconnection Agreement and Amendment No. 1, dated July 19, 1966, between the Company and Public Service Company of New Mexico. (Exhibit 19.01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.31-01 – Service Schedule G – Transmission Service for EPE, dated March 18, 1983, to Exhibit 10.31. (Exhibit 19.03 to the Company's Annual Report on Form 10-K for the year ended December 31, 1983)

10.32 – Agreement for the Purchase of Electric Service from the Company and Rio Grande Electric Cooperative, Inc. (at Van Horn, Texas) dated March 2, 1977, and Agreement for the Purchase of Electric Service from the Company and Rio Grande Electric Cooperative, Inc. (at Dell City, Texas) dated November 27, 1967. (Exhibit 19.05 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.32-01 – Amendment, dated January 9, 1987, to Exhibit 10.32. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1987)

10.32-02 – Amendment, dated December 18, 1987, to Exhibit 10.32. (Exhibit 19.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990)

10.32-03 – Addendum, dated September 26, 1991 (Van Horn), to Exhibit 10.32. (Exhibit 19.11 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.32-04 – Addendum, dated September 26, 1991 (Dell City), to Exhibit 10.32. (Exhibit 19.11-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.33 – Southwest New Mexico Transmission Project Participation Agreement dated April 29, 1977. (Exhibit 19.06 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.33-01 – Southwest New Mexico Transmission Project Letter Agreement dated March 18, 1984, and Supplement to same dated June 11, 1984, amending Exhibit 10.33. (Exhibit 28.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1984)

10.33-02 – Amendment No. 3, dated April 29, 1987, to Exhibit 10.33. (Exhibit 19.6 to the Company's Annual Report on Form 10-K for the year ended December 31, 1988)

10.33-03 – Amendment No. 4, dated May 18, 1988, to Exhibit 10.33. (Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988)

10.34 – Tucson-El Paso Power Exchange and Transmission Agreement dated April 19, 1982. (Exhibit 19.26 to the Company's Annual Report on Form 10-K for the year ended December 31, 1982)

10.35 – Utility Service Contract dated as of March 1, 1984 for electric service to Holloman Air Force Base between the Company and the United States of America. (Exhibit 19.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 1983)

10.36 – Revised Inland Power Pool Agreement dated November 23, 1983. (Exhibit 19.11 to the Company's Annual Report on Form 10-K for the year ended December 31, 1983)

10.37 – Utility Service Contract dated as of January 1, 1984 for Electric Service to White Sands Missile Range between the Company and the United States of America. (Exhibit 19.13 to the Company's Annual Report on Form 10-K for the year ended December 31, 1983)

10.38 – Power Sales Agreement No. 2 dated December 2, 1986 between El Paso Electric Company and Imperial Irrigation District. (Exhibit 10.72 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986)

10.38-01 – Amendment No. 1, dated June 20, 1989, to Exhibit 10.38. (Exhibit 19.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989)

†10.39 – Facility Lease dated as of August 1, 1986 between The First National Bank of Boston, Owner Trustee, as Lessor, and El Paso Electric Company, as Lessee. (Exhibit 28.1 to the Company's Current Report on Form 8-K dated August 29, 1986)

†10.39-01 – Amendment No. 1, dated as of October 1, 1986, to Exhibit 10.39. (Exhibit 4.7 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1986)

†10.39-02 – Amendment No. 2, dated as of December 31, 1987, to Exhibit 10.39. (Exhibit 28.9 to Registration No. 33-19656)

†10.39-03 – Amendment No. 3, dated as of May 1, 1988, to Exhibit 10.39. (Exhibit 19.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988)

†10.39-04 – Amendment No. 4, dated as of October 1, 1989, to Exhibit 10.39. (Exhibit 19.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

10.40 – Facility Lease dated as of December 1, 1986 between The First National Bank of Boston, Owner Trustee, as Lessor, and El Paso Electric Company, as Lessee. (Exhibit 28.1 to the Company's Current Report on Form 8-K dated December 23, 1986)

10.40-01 – Amendment No. 1, dated as of December 31, 1987, to Exhibit 10.40. (Exhibit 28.11 to Registration No. 33-19656)

10.40-02 – Amendment No. 2, dated as of May 1, 1988, to Exhibit 10.40. (Exhibit 19.10 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988)

10.40-03 – Amendment No. 3, dated as of October 1, 1989, to Exhibit 10.40. (Exhibit 19.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

10.41 – Facility Lease dated as of December 1, 1986 between The First National Bank of Boston, Owner Trustee, as Lessor and the Company, as Lessee. (Exhibit 28.1.1 to the Company's Current Report on Form 8-K dated December 23, 1986)

10.41-01 – Amendment No. 1, dated as of December 31, 1987, to Exhibit 10.41. (Exhibit 28.10 to Registration No. 33-19656)

10.41-02 – Amendment No. 2, dated as of May 1, 1988, to Exhibit 10.41. (Exhibit 19.11 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 10, 1988)

10.41-03 – Amendment No. 3, dated as of October 1, 1989, to Exhibit 10.41. (Exhibit 19.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

10.42 – Arizona Nuclear Power Project Transmission Project Westwing Switchyard Amended Interconnection Agreement dated August 14, 1986. (Exhibit 10.72 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986)

10.43 – Reload Nuclear Fuel Agreement, as amended, dated November 5, 1986 with Combustion Engineering, Inc. and ANPP. (Exhibit 10.74 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986) At the Company's request, confidential treatment has been granted by the Securities and Exchange Commission to portions of this document.

10.44 – Letter of Credit and Reimbursement Agreement dated as of April 1, 1987, between the Company and Marine Midland Bank, N.A. (Exhibit 10.75 to the Company's Annual Report on Form 10-K for the year ended December 31, 1987)

10.44-01 – Amendment No. 1, dated as of October 26, 1989 to Exhibit 10.44. (Exhibit 19.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

10.44-02 – Amendment No. 2, dated as of September 12, 1990, to Exhibit 10.44. (Exhibit 19.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1990)

10.44-03 – Deferral Agreement, dated as of December 31, 1991, between the Company and Marine Midland Bank, N.A. related to Exhibit 10.44. (Exhibit 19.15 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.45 – Reimbursement Agreement dated as of December 1, 1987 among the Company, The Fuji Bank, Limited, Chemical Bank and other participating banks. (Exhibit 28.11 to the Company's Current Report on Form 8-K dated December 31, 1987)

10.45-01 – First Amendment, dated as of December 31, 1987, to Exhibit 10.45. (Exhibit 10.77 to the Company's Annual Report on Form 10-K for the year ended December 31, 1987)

10.45-02 – Second Amendment, dated as of September 30, 1988, to Exhibit 10.45. (Exhibit 19.4 to the Company's Annual Report on Form 10-K for the year ended December 31, 1988)

10.45-03 – Third Amendment, dated as of March 15, 1989, to Exhibit 10.45. (Exhibit 19.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1989)

10.45-04 – Waiver, dated May 1, 1989, to Exhibit 10.45. (Exhibit 19.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989)

10.45-05 – Fourth Amendment, dated as of October 26, 1989, to Exhibit 10.45. (Exhibit 19.7 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

10.45-06 – Fifth Amendment, dated as of September 17, 1990, to Exhibit 10.45. (Exhibit 19.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1990)

10.45-07 – Deferral Agreement dated as of December 30, 1991 among the Company, Chemical Bank, The Fuji Bank, Limited and other participating banks related to Exhibit 10.45. (Exhibit 19.13 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

††10.46 – Facility Lease dated as of December 1, 1987 between The First National Bank of Boston, Owner Trustee, as Lessor, and the Company, as Lessee. (Exhibit 28.1 to the Company's Current Report on Form 8-K dated December 31, 1987)

††10.46-01 – Amendment No. 1, dated as of February 1, 1988, to Exhibit 10.46. (Exhibit 10.80 to the Company's Annual Report on Form 10-K for the year ended December 31, 1987)

10.47 – Power Sales Agreement dated April 29, 1987 between the Company and Texas-New Mexico Power Company. (Exhibit 19.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1987)

10.47-01 – Amendment No. 1, dated January 14, 1988, to Attachment 1 of Exhibit B to Exhibit 10.47. (Exhibit 19.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1988)

10.48 – Form of Indemnity Agreement between the Company and its directors and officers. (Exhibit 19.7 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1987)

††††10.49 – Reimbursement Agreement dated as of May 1, 1988 among the Company, The Fuji Bank, Limited, Chemical Bank and other participating banks. (Exhibit 19.7 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988)

††††10.49-01 – First Amendment, dated as of September 30, 1988, to Exhibit 10.49. (Exhibit 19.5 to the Company's Annual Report on Form 10-K for the year ended December 31, 1988)

††††10.49-02 – Second Amendment, dated as of March 15, 1989, to Exhibit 10.49. (Exhibit 19.6 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1989)

††††10.49-03 – Waiver, dated May 1, 1989, to Exhibit 10.49. (Exhibit 19.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1989)

††††10.49-04 – Third Amendment, dated as of October 26, 1989, to Exhibit 10.49. (Exhibit 19.6 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

††††10.49-05 – Fourth Amendment dated as of September 17, 1990 to Exhibit 10.49. (Exhibit 19.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1990)

10.49-06 – Deferral Agreement dated as of December 30, 1991 between the Company, Chemical Bank, The Fuji Bank, Limited and other participating banks related to Exhibit 10.49. (Exhibit 19.14 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.50 – Employee Stock Option Plan. (Exhibit 19.4 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

10.51 – Amended and Restated Supplemental Benefit Agreement dated as of December 15, 1989 with David H. Wiggs, Jr. (Exhibit 19.5 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

10.52 – Amended and Restated Severance Compensation Agreement dated as of January 10, 1990 for David H. Wiggs, Jr. (Exhibit 19.6 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

10.53 – Phantom Stock Deferred Compensation Plan. (Exhibit 19.7 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

10.54 – Amended and Restated Supplemental Retirement and Survivor Income Plan for Key Employees dated as of October 24, 1989. (Exhibit 19.8 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

10.55 – Trust Agreement, dated as of October 24, 1989, with respect to Exhibit 10.54. (Exhibit 19.9 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

†††10.56 – Form of Amended and Restated Severance Compensation Agreement between the Company and certain key officers of the Company. (Exhibit 19.10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

10.57 – Director Stock Compensation Plan. (Exhibit 19.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991)

10.58 – Decommissioning Trust Agreement dated as of December 1, 1987 among the Company, The First National Bank of Boston, as Owner Trustee under two separate Trust Agreements, and First City, Texas-El Paso, N.A., as Decommissioning Trustee. (Exhibit 19.12 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

††10.59 – Decommissioning Security Agreement dated as of December 1, 1987 among the Company, The First National Bank of Boston, as Owner Trustee, and First City, Texas-El Paso, N.A., as Decommissioning Trustee. (Exhibit 19.13 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

10.60 – Decommissioning Trust Agreement dated as of August 1, 1986 among the Company, The First National Bank of Boston, as Owner Trustee under eight separate Trust Agreements, and Security Pacific Bank Washington, N.A., as Decommissioning Trustee. (Exhibit 19.14 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

†10.61 – Decommissioning Security Agreement dated as of August 1, 1986 among the Company, The First National Bank of Boston, as Owner Trustee, and Security Pacific Bank Washington, N.A., as Decommissioning Trustee. (Exhibit 19.15 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

††10.62 – Decommissioning Security Agreement dated as of December 1, 1986 among the Company, The First National Bank of Boston, as Owner Trustee, and Security Pacific Bank Washington, N.A., as Decommissioning Trustee. (Exhibit 19.16 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989)

10.63 – Interchange Agreement executed April 14, 1982 between Comision Federal de Electricidad ("CFE") and the Company. (Exhibit 19.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991)

10.63-01 – Interchange Service A Agreement Emergency Assistance, executed April 14, 1982, to Exhibit 10.63. (Exhibit 19.2-01 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991)

10.63-02 – Interchange Service B Agreement Short-Term Firm Capacity, executed April 14, 1982, to Exhibit 10.63. (Exhibit 19.2-02 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991)

10.63-03 – Interchange Service C Agreement Economy Energy, executed April 23, 1987, to Exhibit 10.63. (Exhibit 19.2-03 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991)

10.63-04 – Interchange Service D Agreement Firm Capacity, executed April 3, 1991, to Exhibit 10.63. (Exhibit 19.2-04 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991) At the Company's request, confidential treatment has been granted by the Securities and Exchange Commission to portions of this document.

10.63-05 – Interchange Agreement Operating Procedure No. 1, executed July 2, 1991, to Exhibit 10.63. (Exhibit 19.2-05 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991)

10.64 – Gas Purchase Agreement dated as of January 1, 1990 between the Company and Meridian Oil Transportation Inc. (Exhibit 19.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990)

10.64-01 – Amendment No. 1, dated April 1, 1993, to Exhibit 10.64. (Exhibit 10.75-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1993)

10.65 – Areawide Utilities Contract for Electric Services Contract No. GS-00P-89-BSD-0017 between the United States and El Paso Electric Company dated February 27, 1989. (Exhibit 19.01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.66 – Transportation Service Agreement between the Company and El Paso Natural Gas Company dated August 30, 1991. (Exhibit 19.02 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.67 – Severance Compensation Agreement dated December 16, 1991 between the Company and Curtis Lynn Hoskins. (Exhibit 19.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

10.68 – Supplemental Retirement Benefit Agreement dated December 16, 1991 between the Company and Curtis Lynn Hoskins. (Exhibit 19.19 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991)

Exhibit 23 – Consents of Experts:

*23.01 – Consent of KPMG Peat Marwick LLP (set forth on page 145 of this report).

Exhibit 24 – Power of Attorney:

*24.01 – Power of Attorney (set forth on page 144 of this report).

*24.02 – Certified copy of resolution authorizing signatures pursuant to power of attorney.

Exhibit 99 – Additional Exhibits:

99.01 – Collateral Trust Indenture dated as of August 1, 1986 among El Paso Funding Corporation, the Company and First City National Bank of Houston, as Trustee. (Exhibit 28.9 to the Company's Current Report on Form 8-K dated August 29, 1986)

99.02 – Series 1986 Bond Supplemental Indenture, dated as of October 15, 1986, to Exhibit 99.01. (Exhibit 4.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1986)

99.03 – Series 1986A Bond Supplemental Indenture, dated as of December 1, 1986, to Exhibit 99.01. (Exhibit 28.8 to the Company's Current Report on Form 8-K dated December 23, 1986)

†99.04 – Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of August 1, 1986 between The First National Bank of Boston, as Owner Trustee, and First City National Bank of Houston, as Indenture Trustee. (Exhibit 28.2 to the Company's Current Report on Form 8-K dated August 29, 1986)

†99.04-01 – Supplemental Indenture No. 1, dated as of October 15, 1986, to Exhibit 99.04. (Exhibit 4.9 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1986)

†99.04-02 – Supplemental Indenture No. 2, dated as of May 1, 1988, to Exhibit 99.04. (Exhibit 19.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988)

††99.05 – Trust Indenture, Mortgage, Security Agreement and Assignment of Rents dated as of December 1, 1986 between The First National Bank of Boston, as Owner Trustee, and First City National Bank of Houston, as Indenture Trustee. (Exhibit 28.2 to the Company's Current Report on Form 8-K dated December 23, 1986)

††99.05-01 – Supplemental Indenture No. 1, dated as of May 1, 1988, to Exhibit 99.05. (Exhibit 19.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988)

†99.06 – Participation Agreement dated as of August 1, 1986 among El Paso Funding Corporation, The First National Bank of Boston, in its individual capacity and as Owner Trustee under a Trust Agreement, dated as of August 1, 1986, with the Owner Participant named therein, First City National Bank of Houston, in its individual capacity and as Indenture Trustee under a Trust Indenture, Mortgage, Security Agreement and Assignment of Rents, dated as of August 1, 1986, with the Owner Trustee, El Paso Electric Company and the Owner Participant named therein. (Exhibit 2 to the Company's Current Report on Form 8-K dated August 29, 1986)

†99.06-01 – Amendment No. 1, dated as of October 1, 1986, to Exhibit 99.06. (Exhibit 19.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1986)

†99.06-02 – Amendment No. 2, dated as of May 1, 1988, to Exhibit 99.06. (Exhibit 19.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988)

†99.06-03 – Amendment No. 3, dated as of October 1, 1989, to Exhibit 99.06. (Exhibit 28.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

99.07 – Participation Agreement dated as of December 1, 1986 among El Paso Funding Corporation, The First National Bank of Boston, in its individual capacity and as Owner Trustee under a Trust Agreement, dated as of December 1, 1986, with the Owner Participant named therein, First City National Bank of Houston, in its individual capacity and as Indenture Trustee under a Trust Indenture, Mortgage, Security Agreement and Assignment of Rents, dated as of December 1, 1986, with the Owner Trustee, El Paso Electric Company and the Owner Participant named therein. (Exhibit 2 to the Company's Current Report on Form 8-K dated December 23, 1986)

99.07-01 – Amendment No. 1, dated as of May 1, 1988, to Exhibit 99.07. (Exhibit 19.9 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988)

99.07-02 – Amendment No. 2, dated as of October 1, 1989, to Exhibit 99.07. (Exhibit 28.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

†99.08 – Extension Letter dated October 15, 1986 from the Owner Participant named therein, El Paso Funding Corporation, The First National Bank of Boston, individually and as Owner Trustee, First City National Bank of Houston, as Indenture Trustee, and the Company, severally, to First City National Bank of Houston, as Collateral Trust Trustee. (Exhibit 28.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 1987)

99.09 – Participation Agreement dated as of December 1, 1986 among El Paso Funding Corporation, The First National Bank of Boston, in its individual capacity and as Owner Trustee under a Trust Agreement, dated as of December 1, 1986, with the Owner Participant named therein, First City National Bank of Houston, in its individual capacity and as Indenture Trustee under a Trust Indenture, Mortgage, Security Agreement and Assignment of Rents, dated as of December 1, 1986, with the Owner Trustee, the Company and the Owner Participant named therein. (Exhibit 2.1 to the Company's Current Report on Form 8-K dated December 23, 1986)

99.09-01 – Amendment No. 1, dated as of May 1, 1988, to Exhibit 99.09. (Exhibit 19.10 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988)

99.09-02 – Amendment No. 2, dated as of October 1, 1989, to Exhibit 99.09. (Exhibit 28.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1989)

†99.10 – Assignment, Assumption and Further Agreement dated as of August 22, 1986 between the Company and The First National Bank of Boston, as Owner Trustee. (Exhibit 28.3 to the Company's Current Report on Form 8-K dated August 29, 1986)

†99.10-01 – Amendment No. 1, dated as of October 1, 1986, to Exhibit 99.10. (Exhibit 28.14-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1988)

†99.10-02 – Amendment No. 2, dated as of May 1, 1988, to Exhibit 99.10. (Exhibit 19.6 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1988)

†99.11 – Deed and Bill of Sale dated as of August 22, 1986 between the Company, as Seller and The First National Bank of Boston, Owner Trustee, as Buyer. (Exhibit 28.4 to the Company's Current Report on Form 8-K dated August 29, 1986)

†99.12 – Deed dated as of August 22, 1986 from the Company to The First National Bank of Boston, as Owner Trustee. (Exhibit 28.5 to the Company's Current Report on Form 8-K dated August 29, 1986)

†99.13 – Deed and Assignment of Beneficial Interest dated as of August 22, 1986 between the Company and The First National Bank of Boston, as Owner Trustee. (Exhibit 28.6 to the Company's Current Report on Form 8-K dated August 29, 1986)

††99.14 – Deed and Assignment of Beneficial Interest dated as of December 18, 1986 between the Company and The First National Bank of Boston, as Owner Trustee. (Exhibit 28.6 to the Company's Current Report on Form 8-K dated December 23, 1986)

††99.15 – Assignment, Assumption and Further Agreement dated as of December 1, 1986 between the Company and The First National Bank of Boston, as Owner Trustee. (Exhibit 28.3 to the Company's Current Report on Form 8-K dated December 23, 1986)

††99.16 – Deed and Bill of Sale dated as of December 18, 1986 between the Company as Seller, and The First National Bank of Boston, Owner Trustee, as Buyer. (Exhibit 28.4 to the Company's Current Report on Form 8-K dated December 23, 1986)

††99.17 – Deed dated as of December 18, 1986 from the Company to The First National Bank of Boston, as Owner Trustee. (Exhibit 28.5 to the Company's Current Report on Form 8-K dated December 23, 1986)

††99.18 – Extension Letter dated December 18, 1986 from the Owner Participant named therein, El Paso Funding Corporation, The First National Bank of Boston, individually and as Owner Trustee, First City National Bank of Houston, as Indenture Trustee, and the Company, severally, to First City National Bank of Houston, as Collateral Trust Trustee. (Exhibit 28.7 to the Company's Current Report on Form 8-K dated December 23, 1986)

††99.19 – Participation Agreement dated as of December 1, 1987 among Del Norte Funding Corporation, The First National Bank of Boston, in its individual capacity and as Owner Trustee under a Trust Agreement, dated as of November 1, 1987, with the Owner Participant named therein, Chemical Bank, in its individual capacity and as Indenture Trustee under a Trust Indenture, Mortgage, Security Agreement and Assignment of Facility Lease, dated as of December 1, 1987, with the Owner Trustee, the Company and the Owner Participant named therein. (Exhibit 2 to the Company's Current Report on Form 8-K dated December 31, 1987)

††99.19-01 – Amendment No. 1, dated as of February 1, 1988, to Exhibit 99.19. (Exhibit 28.24-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1987)

††99.20 – Trust Indenture, Mortgage, Security Agreement and Assignment of Facility Lease dated as of December 1, 1987 between The First National Bank of Boston, as Owner Trustee, and Chemical Bank, as Indenture Trustee. (Exhibit 28.2 to the Company's Current Report on Form 8-K dated December 31, 1987)

††99.20-01 – Supplemental Indenture No. 1, dated as of February 1, 1988 to Exhibit 99.20. (Exhibit 28.25-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1987)

††99.21 – Assignment, Assumption and Further Agreement dated as of December 1, 1987 between the Company and The First National Bank of Boston, as Owner Trustee. (Exhibit 28.3 to the Company's Current Report on Form 8-K dated December 31, 1987)

††99.22 – Deed and Bill of Sale dated as of December 31, 1987 between the Company, as Seller, and The First National Bank of Boston, Owner Trustee, as Buyer. (Exhibit 28.4 to the Company's Current Report on Form 8-K dated December 31, 1987)

††99.23 – Deed dated as of December 31, 1987 from the Company to The First National Bank of Boston, as Owner Trustee. (Exhibit 28.5 to the Company's Current Report on Form 8-K dated December 31, 1987)

††99.24 – Extension Letter dated February 22, 1988 from the Owner Participant named therein, Del Norte Funding Corporation, The First National Bank of Boston, individually and as Owner Trustee, Chemical Bank, as Indenture Trustee, and the Company, severally, to Chemical Bank, as Collateral Trust Trustee. (Exhibit 28.29 to the Company's Annual Report on Form 10-K for the year ended December 31, 1987)

99.25 – Collateral Trust Indenture dated as of December 1, 1987 among Del Norte Funding Corporation, the Company and Chemical Bank, as Trustee. (Exhibit 28.8 to the Company's Current Report on Form 8-K dated December 31, 1987)

†99.26 – Agreement dated as of December 31, 1987 among the Company, the Owner Participant named therein and The First National Bank of Boston, as Owner Trustee. (Exhibit 28.12 to Registration No. 33-19656)

99.27 – Agreement dated as of December 31, 1987 among the Company, the Owner Participant named therein and The First National Bank of Boston, as Owner Trustee. (Exhibit 28.13 to Registration No. 33-19656)

99.28 – Agreement, dated as of December 31, 1987, among the Company, the Owner Participant named therein and The First National Bank of Boston, as Owner Trustee. (Exhibit 28.14 to Registration No. 33-19656)

99.29 – Series 1988 Bond Supplemental Indenture, dated as of February 1, 1988, to Exhibit 99.25. (Exhibit 28.34 to the Company's Annual Report on Form 10-K for the year ended December 31, 1987)

99.30 – Warrant to purchase shares of common stock of CAI Corporation, dated December 30, 1989. (Exhibit 19.2 to the Company's Current Report on Form 8-K, dated December 3, 1989)

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* Filed herewith.

† Five additional documents, substantially identical in all material respects to this Exhibit, have been entered into, one relating to each of five additional Owner Participants. Although such additional documents may differ in other respects (such as dollar amounts, percentages,

tax indemnity matters and dates of execution), there are no material details in which such documents differ from this Exhibit.

†† One additional document, substantially identical in all material respects to this Exhibit, has been entered into, relating to another Owner Participant. Although such additional document may differ in other respects (such as dollar amounts and percentages), there are no material details in which such document differs from this Exhibit.

††† Seventeen additional documents, substantially identical in all material respects to this Exhibit, have been entered into with officers of the Company. Although such additional documents may differ in other respects (such as dollar amounts), there are no material details in which such documents differ from this Exhibit.

†††† One additional document, substantially identical in all material respects to this Exhibit, has been entered into with respect to another Reimbursement Agreement, dated as of May 1, 1988, among the same parties.

(b) Reports on Form 8-K:

The following reports on Form 8-K were filed during the last quarter of 1994:

None.

UNDERTAKING

For the purposes of complying with the amendments to the rules governing Form S-8 (effective July 13, 1990) under the Securities Act of 1933, the undersigned registrant hereby undertakes as follows, which undertaking shall be incorporated by reference into registrant's Registration Statements on Form S-8 Nos. 2-91222 (filed May 21, 1984), 33-29066 (filed June 1, 1989), and 33-35753 (filed July 2, 1990):

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act of 1933 and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question of whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each of El Paso Electric Company, a Texas corporation, and the undersigned directors and officers of El Paso Electric Company, hereby constitutes and appoints David H. Wiggs, Jr., Curtis L. Hoskins, Eduardo A. Rodriguez, John Droubay, Michael L. Blough and Guillermo Silva, Jr., its, his or her true and lawful attorneys-in-fact and agents, for it, him or her and its, his or her name, place and stead, in any and all capacities, with full power to act alone, to sign any and all amendments to this report, and to file each such amendment to this report, with all exhibits thereto, and any and all documents in connection therewith, with the Securities and Exchange Commission, hereby granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform any and all acts and things requisite and necessary to be done in and about the premises, as fully to all intents and purposes as it, he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, may lawfully do or cause to be done by virtue hereof.

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, on the 30th day of March 1995.

EL PASO ELECTRIC COMPANY

By: /s/ DAVID H. WIGGS, JR.
David H. Wiggs, Jr.,
Chief Executive Officer
(Principal 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 date indicated.

Signature	Title	
/s/ DAVID H. WIGGS, JR. (David H. Wiggs, Jr.)	Chairman of the Board, and Chief Executive Officer (Principal Executive Officer) and Director	March 30, 1995
/s/ CURTIS L. HOSKINS (Curtis L. Hoskins)	Director, President and Chief Operating Officer (Principal Financial Officer)	
/s/ MICHAEL L. BLOUGH (Michael L. Blough)	Controller (Principal Accounting Officer)	
/s/ JOSEFINA A. SALAS-PORRAS (Josefina A. Salas-Porras)	Director	
/s/ WILFRED E. BINNS (Wilfred E. Binns)	Director	
/s/ THOMAS C. SIMPSON (Thomas C. Simpson)	Director	
/s/ JAMES A. CARDWELL (James A. Cardwell)	Director	
/s/ SIDNEY G. BAUCOM (Sidney G. Baucom)	Vice Chairman of the Board and Director	
/s/ WILSON K. CADMAN (Wilson K. Cadman)	Director	
/s/ GEORGE W. EDWARDS, JR. (George W. Edwards, Jr.)	Director	

EXHIBIT 23.01

CONSENT OF INDEPENDENT AUDITORS

The Shareholders and Board of Directors
El Paso Electric Company:

We consent to incorporation by reference in the Registration Statements numbered 2-91222 on Form S-8, 33-35753 on Form S-8, and 33-29066 on Form S-8 of El Paso Electric Company of our report dated March 30, 1995, relating to the balance sheets of El Paso Electric Company (a debtor-in-possession as of January 8, 1992) as of December 31, 1994 and 1993, and the related statements of operations, accumulated deficit, and cash flows for each of the years in the three-year period ended December 31, 1994, which report appears in the December 31, 1994 annual report on Form 10-K of El Paso Electric Company. Our report refers to changes in the methods of accounting for income taxes and postretirement benefits other than pensions effective January 1, 1993.

Our report referred to above contains an explanatory paragraph which indicates that the financial statements in Form 10-K have been prepared assuming that El Paso Electric Company will continue as a going concern. As discussed in Note A of Notes to Financial Statements in Form 10-K, El Paso Electric Company filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code on January 8, 1992. The Chapter 11 case is administered by the United States Bankruptcy Court for the Western District of Texas. The Company is operating its business as debtor-in-possession which requires certain of its actions to be approved by the Bankruptcy Court. The Bankruptcy Court has confirmed the Company's proposed plan of reorganization which contemplates the Company would be acquired by Central and South West Corporation. Consummation of the plan of reorganization is subject to the satisfaction of certain conditions, including numerous regulatory approvals. Continuation of the Company as a going concern is dependent upon, among other things, the consummation of a plan of reorganization, the Company's ability to generate sufficient cash from operations, most significantly its operations which are subject to regulation of the rates it is allowed to charge as described in Note C of Notes to Financial Statements, and its ability to restructure or obtain financing to meet its obligations. Further, as more fully described in Notes B, H, J, and K of Notes to Financial Statements, significant claims beyond those reflected as liabilities in the financial statements at December 31, 1994 have been or may be asserted against the Company. The validity of these claims, as well as the amount and manner of payment of all valid claims, will ultimately be determined by the Bankruptcy Court. These matters raise substantial doubt about the Company's ability to continue as a going concern. As a result of the reorganization proceedings, the Company may sell or otherwise realize assets and liquidate or settle liabilities for amounts other than those reflected in the financial statements. Further, the consummation of a plan of reorganization could materially change the amounts currently recorded in the financial statements, and if no reorganization plan is consummated, it is possible that the Company's assets could be liquidated. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

KPMG Peat Marwick LLP

El Paso, Texas
March 30, 1995

APPENDIX B

Section 1129(a)(6) of the Bankruptcy Code provides that a plan of reorganization may be confirmed only if any regulatory government authority with jurisdiction over rates of the debtor has approved any rate change provided in the plan, or such plan is expressly conditioned on such approval. In addition to the amendments and consent sought by this Application, it is anticipated that the following federal and state approvals will be sought for consummation of the Plan.

1. Federal Energy Regulatory Commission ("FERC"). Under the Federal Power Act (FPA) the FERC regulates the activities of public utilities which own or operate facilities used to perform transmission in interstate commerce or which own facilities used to make sales of power for resale in interstate commerce. The FPA provides FERC with jurisdiction over the rates and terms for wholesale sales and transmission in interstate commerce, certain securities issuances by jurisdictional utilities, utility mergers or acquisitions and the permissibility of sharing officers and directors between jurisdictional utilities and certain companies dealing in securities. El Paso, being such a public utility will seek approval by FERC of its issuance of new equity and debt pursuant to the Plan, which El Paso does not anticipate will necessitate adjudication.

Also, El Paso's rates for transmission service as well as the terms and conditions of transmission service are subject to FERC jurisdiction and are carried out under tariffs filed with

and approved by the FERC. In addition, all of El Paso's wholesale sales for service to domestic purchasers are subject to FERC jurisdiction and are carried out under tariffs approved by the FERC. El Paso's wholesale customers subject to FERC jurisdiction include the Imperial Irrigation District, Texas-New Mexico Power Company and the Rio Grande Electric Cooperative, Inc.

2. Securities and Exchange Commission ("SEC"). Reorganized El Paso intends to issue Reorganized El Paso First Mortgage Bonds and Reorganized El Paso Common Stock to certain classes of creditors and shareholders, as applicable, pursuant to the Plan and may issue other securities to its creditors and shareholders pursuant to the Plan. Reorganized El Paso also intends to issue Reorganized El Paso First Mortgage Bonds in a public offering at, or shortly after the effective date of the Plan. El Paso believes that, pursuant to Section 1145 of the Bankruptcy Code and applicable provisions of the Securities Act of 1933, as amended (the "Securities Act") and the Trust Indenture Act, the issuance of the Reorganized El Paso First Mortgage Bonds, the common stock and any other securities to creditors and interest holders pursuant to the Plan will be exempt from the registration requirements of the Securities Act and the requirement of qualification under the Trust Indenture Act. El Paso also believes that any resale of such securities, except for any such resales by underwriters or by "affiliates" of

El Paso, are exempt from the registration requirements under the Securities Act.

As noted, El Paso intends to issue additional First Mortgage Bonds in a public offering at or shortly after the effective date of the Plan. El Paso will be required to comply with the requirements of the Securities Act and the Trust Indenture Act (with respect to debt securities) in connection with such an issuance. These requirements include the filing with the SEC of a registration statement under the Securities Act and the qualification of the First Mortgage Indentures under the Trust Indenture Act. The registration statement and any application to qualify indentures under the Trust Indenture Act will be subject to review by the SEC and must be declared effective by the SEC prior to any such public offering.

It is possible that the Plan will result in one or more creditors holding sufficient amounts of voting securities of Reorganized El Paso to be considered a public utility holding company, as defined under the Public Utility Holding Company Act of 1935 ("PUHCA"). A public utility holding company is required to register by filing with the SEC a notification of registration pursuant to PUHCA section 5(a) within 90 days after becoming a holding company. A holding company is required to make periodic reports to the SEC and is subject to the SEC's review and regulation. A creditor may apply with the SEC for an exemption from holding company status under applicable provisions of PUHCA. In addition, the SEC regulates and requires prior approval in

connection with the acquisition of voting securities in certain circumstances, including where a person holds five percent or more of the voting stock of one or more public utility. El Paso may participate in requests by creditors for exemption from holding company status or other approvals from the SEC in connection with the Plan.

3. Public Utility Commission of Texas ("PUCT"). Following termination of the merger plan with CSW, El Paso plans to emerge from bankruptcy as an independent company. El Paso, the City of El Paso, the Public Utility Commission of Texas General Counsel, the Office of Public Utility Counsel, and essentially all other parties to El Paso's pending Texas rate case entered into an unopposed Stipulation and Settlement Agreement dated as of July 27, 1995.

El Paso currently has an application pending with the PUCT requesting approval of a base rate increase under PUCT Docket No. 12700. Following termination of the Merger Agreement, El Paso began negotiations with the other parties to Docket No. 12700 to reach an agreement concerning rates that would support a stand-alone plan of reorganization. As a result of these negotiations, El Paso, the City of El Paso, the PUCT General Counsel, the Texas Office of Public Utility Counsel, and essentially all other parties to Docket No. 12700 entered into an unopposed Stipulation and Settlement Agreement ("Stipulation") dated as of July 27, 1995, concerning El Paso's Texas rates. The Stipulation contemplates, among other things, a $24.946 million annual base

rate increase in Docket No. 12700 and a ten-year rate freeze in Texas effective August 2, 1995.

The Stipulation is conditioned upon a new plan of reorganization becoming effective as contemplated by the Stipulation. The PUCT issued a Second Interim Order in Docket No. 12700 on August 2, 1995 and an Agreed Order on August 30, 1995 implementing the terms of the Stipulation. The effectiveness of the Agreed Order is conditioned upon the effectiveness of El Paso's new plan of reorganization as contemplated by the Stipulation. El Paso believes (but can give no assurance) it will meet the schedule for plan effectiveness.

4. New Mexico Public Utility Commission ("NMPUC"). Because El Paso is a public utility subject to the New Mexico Public Utility Act (the "NMPUA"),10/ anticipates seeking various authorizations from the NMPUC with respect to El Paso's reorganization, notwithstanding the potential ability of the Bankruptcy Court to preempt New Mexico law in this regard. Under New Mexico law, the following three regulatory approvals are implicated with respect to the Plan:

> (i) receipt of a final order from the NMPUC authorizing the issuance by Reorganized El Paso of the securities required for the consummation of the Plan;
>
> (ii) receipt of a final order of the NMPUC approving the reacquisition of the Palo Verde leased assets by El Paso and the related accounting treatment; and
>
> (iii) receipt of a final order from the NMPUC approving Reorganized El Paso's amended general diversification

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10/ See N.M. Stat. Ann. § 62-3-3 (Michie 1993).

plan with respect to the acquisition by certain creditors of Reorganized El Paso securities.

El Paso believes that it will be able to obtain these approvals prior to the confirmation date of the Plan, but can give no assurance at this time.