



The mission of Salt River Project is to be the best water and power organization, dedicated to improving service, lowering costs, resource stewardship, and market focus through involved, change-oriented employees.

Salt River Project is a major multipurpose reclamation project serving more than 1 million electric customers and water shareholders. SRP comprises two principal operating entities: the Salt River Project Agricultural Improvement and Power District, a political subdivision of the state of Arizona; and the Salt River Valley Water Users' Association, a private corporation.

Salt River Project Agricultural Improvement and Power District

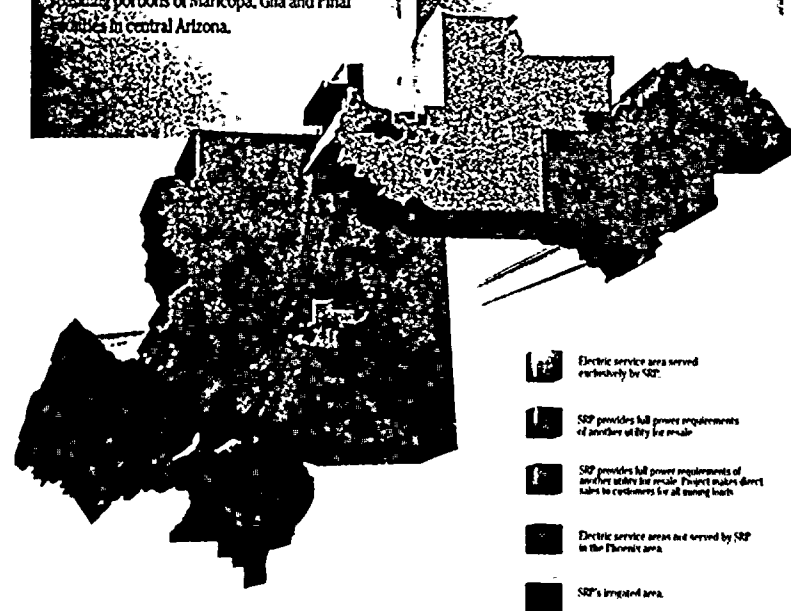
The District provides electricity to more than 600,000 customers in the Phoenix area, commonly described as the "Valley." SRP operates or participates in seven major power plants and numerous other generating stations in Arizona, including thermal, nuclear and hydroelectric sources.






The District serves a 2,900-square-mile area including portions of Maricopa, Gila and Pinal counties in central Arizona.

Salt River Valley Water Users' Association

The Association delivers nearly 1 million acre-feet of water to a 240,000-acre service area in central Arizona. An extensive water delivery system is maintained and operated by the Association.

SRP reservoirs feed a 131-mile canal system which, along with other smaller waterways, carries water to eight cities as well as agricultural and urban irrigators.



-  Electric service area served exclusively by SRP
-  SRP provides full power requirements of customers at city line service
-  SRP provides full power requirements of service users but resale Project makes direct sales to customers for all timing loads
-  Electric service areas not served by SRP in the Phoenix area
-  SRP's irrigated area



11-Year Financial & Operational Review

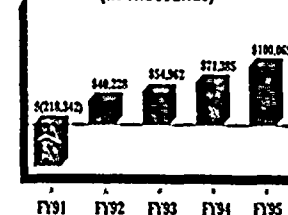
Financial Data (\$000)*	Fiscal Year	1995	1994	1993	1992	1991	1990	1989	1988	1987	1986	1985
Total operating revenues		\$1,451,697	\$1,348,691	\$1,201,429	\$1,183,319	\$1,151,997	\$1,121,935	\$1,063,306	\$959,346	\$888,506	\$848,618	\$785,032
Electric revenues		1,441,442	1,340,691	1,294,271	1,175,379	1,142,494	1,113,184	1,055,042	952,133	881,310	841,936	777,993
Water and irrigation revenues		10,255	8,000	7,158	7,970	9,503	8,751	8,264	7,213	7,166	6,682	7,039
Total operating expenses		1,163,698	1,070,218	1,030,690	933,616	924,787	918,058	832,316	790,972	706,377	642,963	559,504
Total other income, net		28,182	14,568	20,427	36,457	(196,026)	30,044	(123)	19,260	34,009	32,679	58,847
Net financing costs		216,112	221,656	236,204	245,962	249,526	247,113	219,104	171,373	141,377	80,018	68,698
Net revenues for the year		100,069	71,385	54,962	40,228	(218,342)	(13,192)	11,763	16,261	74,761	158,316	215,677
Taxes and tax equivalents		190,039	181,508	172,505	163,745	163,118	138,609	125,171	121,154	103,097	83,864	75,028
Additions to plant, excluding allowances for funds used during construction		248,704	218,922	196,153	173,061	238,844	238,014	341,617	361,881	309,356	352,993	323,682
Utility plant, gross		6,304,600	6,144,158	5,973,092	5,820,751	5,705,685	5,712,380	5,560,160	5,335,784	4,834,055	4,481,667	4,185,919
Long-term debt		3,593,072	3,653,309	3,648,626	3,667,056	3,658,904	3,603,430	3,505,163	3,251,724	2,960,597	2,862,632	2,726,062
Electric-revenue contributions to support water operations		31,791	36,153	26,530	25,053	36,625	29,336	31,634	26,822	13,865	10,609	7,960
Funds available for corporate purposes		255,282	200,948	185,121	182,887	139,091	122,019	132,175	113,002	139,253	115,791	154,296

Selected Data

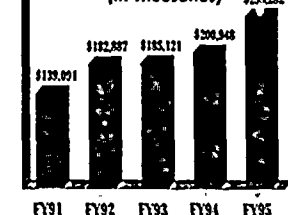
Total energy sources (million kWh)**	24,649	21,177	20,620	19,828	19,011	18,960	19,398	17,739	16,945	15,981	15,526
Total electric sales (million kWh)	23,067	19,721	19,316	18,272	17,427	17,009	17,790	16,335	15,566	14,504	14,131
Total capacity over peak (kW)**	5,085,000	4,439,000	4,378,000	4,472,400	4,470,000	4,460,000	4,204,249	4,270,719	4,144,792	4,256,569	3,782,587
Peak-Project customers (kW)	3,854,000	3,456,000	3,410,000	3,176,000	3,373,000	3,289,000	3,060,000	3,280,000	2,785,000	2,658,000	2,487,000
Peak-overall power system (kW)	4,593,000	3,904,000	3,912,000	3,570,000	3,729,000	3,784,000	3,476,000	3,234,000	3,264,000	2,971,000	2,967,000
Water deliveries (acre-feet)***	-	853,150	985,088	982,691	932,427	767,855	939,921	1,053,717	1,094,601	993,591	1,136,429
Water in storage Dec. 31 (af)	-	1,250,279	1,397,026	1,573,075	1,540,477	833,936	990,838	1,598,989	1,624,272	1,691,741	1,671,535
Runoff (af)	-	733,018	4,150,640	1,771,199	1,711,752	471,282	453,610	1,136,727	1,119,501	1,036,805	1,774,667
Debt service coverage ratio	2.50	2.25	2.11	2.11	1.98	1.85	1.92	1.90	2.00	1.85	2.09
Debt ratio (percent)	70.6	72.4	73.5	74.4	74.9	71.4	70.7	69.3	67.5	67.9	69.5
Employees at year-end	4,256	4,585	4,669	4,681	4,953	5,055	5,599	5,805	5,735	5,468	5,568
Customers at year-end	602,418	582,406	563,846	549,093	538,314	526,333	518,889	505,618	487,321	457,489	422,774
Average annual revenues	-	-	-	-	-	-	-	-	-	-	-
- all accounts (cents/kWh)	6.17	6.69	6.59	6.35	6.52	6.50	5.89	5.79	5.62	5.77	5.50
Average annual kWh use/residential customer	13,490	13,282	13,009	12,628	12,954	13,171	13,184	12,824	12,440	12,175	12,963

* Certain data prior to fiscal year 1991 have been reclassified for conformity
 ** Includes SRP participation in jointly owned projects
 *** Water data is by calendar year

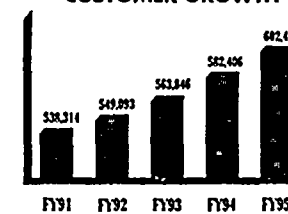
COMBINED NET REVENUES
(In Thousands)



FUNDS AVAILABLE FOR CORPORATE PURPOSES
(In Thousands)



CUSTOMER GROWTH



Business Highlights

- Set a new peak demand record at 3,854 megawatts, exceeding projections for three years ahead, due to record summer heat and new customer growth.
- Continued construction on the 260-mile, 1,300-megawatt electrical transmission system known as the Mead-Phoenix Project, in which SRP is a partner. The 500-kilovolt transmission line is being constructed from northwest of Phoenix to the Lake Mead area in Nevada.
- Opened the first large-scale groundwater recharge project in Arizona, on behalf of SRP and other governmental participants. The Granite Reef Underground Storage Project will help meet "sale yield" mandates and store surplus water for Valley cities.
- Redesigned electric rates for an average 4.5 percent rate reduction for about 100 large commercial and industrial customers, to retain and satisfy those customers, with a total revenue reduction impact to SRP of about \$9.9 million a year.
- Adopted an emergency water delivery program for shareholders that makes use of existing SRP pumping capacity and provides a lifeline for shareholders in unusually dry years.
- Signed 100-year water provision contracts with several Valley cities, preserving historic water rights and securing future domestic water delivery and use arrangements.
- Broke ground on the Navajo Scrubber Project at Navajo Generating Station. When complete, the \$500 million project will help mitigate visibility problems at the Grand Canyon by reducing sulfur dioxide emissions.
- Restructured marketing and customer service functions to improve market focus, increase sales and better reach the customer.
- Conducted two major water releases from Horseshoe and Bartlett dams on the Verde River due to above-normal runoff from heavy rains in February and March 1995.
- Used interest-based bargaining to reach a new three-year contract settlement on issues of wages and benefits between SRP and the International Brotherhood of Electrical Workers Local 266. The contract affects about 2,100 hourly employees.





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Supporting a range of business and community activities that underscore our commitment to the Valley.

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TO OUR Bondholders & Shareholders



President William P. Schroder, left, and Vice President John M. Williams Jr.

Even in a time of rapid change, Salt River Project is showing remarkable success.

Our fiscal year 1995 results certainly bear this out. Last year, we set a new direction for SRP, and this year we demonstrated we're on the right course.

Our success validates our corporate goals and strategies, which are designed to position us well in a newly competitive electric power industry. In fact, a major

bond-rating agency recently said SRP is one of the nation's best-prepared municipal utilities.

Combined net revenues of \$100 million were our best in nine years. Our key financial indicators further reflect our efforts as we reduced our cost of capital, improved our cash flow and increased our Funds Available for Corporate Purposes to \$255 million.

The peak demand on our electric

em this year was well above our expectations because of an unusually hot summer and new housing growth in our service area. These factors, along with high bulk-power sales, contributed to an 8 percent increase in total electric sales revenues.

In water operations, rainfall was normal for calendar year 1994, but as the new year began, rains fell that eventually tripled our average runoff amount. This resulted in two major water-release events, one in the winter and one in the spring.

It was a year for study and projections about the future direction of the electric power industry and the role SRP will play. It was a year to evaluate potential new water opportunities in the West and to plan accordingly.

We also undertook an extensive review of the basic standards upon which SRP has built its success: value, service and commitment. We concluded that our standards of service performance to electric customers and water shareholders can be improved.

As a result, we will spend much time and effort in the year ahead to build a stronger service organization. This effort will engage our employees in a renewed, customer-focused culture. This culture will help ensure that our service is superior and that our prices are competitive.

Cooperative labor-management bargaining efforts will contribute to our success. This year, a new era of "win-win" dialogue between labor and management helped to create a work

force in harmony with the SRP organization. We've built a team that can singularly focus on service.

When we need inspiration, we look to our roots as a turn-of-the-century water organization that helped to bring prosperity to this beautiful Valley. Vision mixed with good-old-fashioned hard work propelled SRP to where it is today – much as it will carry us into the year 2000 and beyond.

William P. Schrader
William P. Schrader
President

John M. Williams Jr.
John M. Williams Jr.
Vice President

ROOSEVELT DAM Where past and future meet

At the heart of SRP is a symbol of the Valley's evolution from dusty territory to thriving commerce center: Theodore Roosevelt Dam.

The dam is the keystone of SRP's water supply for the Valley, storing about 1.6 million acre-feet^{*} of water for use by farms and cities within SRP's service boundaries.

When construction is complete later this year, Roosevelt Dam will have an additional 1.8 million acre-feet of storage space for flood control.

SRP, with other governmental agencies, funded the nearly \$430 million in improvements to the dam and the surrounding recreation area. Work began in 1987. Other changes include new spillways and foundation stabilization for safety.

Now 357 feet high – 77 feet higher than before – this icon in the high desert on the Salt River northeast of Phoenix rises to 2,218 feet above sea level.

A few of the hand-cut stones originally laid at the dam some 90 years ago were removed to make way for



the improvements. Some of the old stone-like facing of the dam is still visible on the upstream side. The downstream-side view is smooth, poured concrete.

Roosevelt Dam entwines the past and future of SRP and the Valley. Built as a result of President Theodore Roosevelt's National Reclamation Act, the dam's original construction (completed in 1911) was funded by a loan secured by the lands owned by shareholders of the Salt River Valley Water Users' Association. The

shareholders were concerned about an adequate and reliable water supply for irrigation.

In 1917, the Association accepted responsibility for the federal government's Salt River reclamation project, which included the dam.

The rest is, as they say, history. Today, the federal government owns the dam and SRP operates and maintains it. Fulfilling its commitment to the Valley, the Association now delivers more than 1 million acre-feet to central Arizona water users and maintains an extensive water delivery system of dams, canals, reservoirs and wells.

* An acre-foot of water supplies a family of four for one year.

WE'LL GO

Beyond

WHAT'S EXPECTED TO SET NEW STANDARDS OF VALUE AND SERVICE

At SRP we are preparing for the time when our electric customers may be permitted to shop around for their energy, when price and service will determine choice.

Our goal for the future will continue to focus on controlling costs, increasing revenues and exceeding the service expectations of electric customers and water shareholders. While other utilities have similar goals, our commitment at SRP is to set new industry standards for value and service.

SRP is among those utilities that have strong value and service positions on which to build, but other utilities are emerging as our competitors. A neighboring utility recently tried to lure two of our large industrial electric customers. I am pleased to report that SRP effectively countered that attempt with new long-term commitments for both of the customers.

We satisfied these customers because we operate from a position of strength in the areas of value and service. And the new long-term contracts help to ensure a stable revenue stream.

This competitive challenge, however, serves as an example of things to come. A number of factors will influence the eventual impacts of competition, including:

- ▶ changes in rules and relationships establishing service area boundaries;
- ▶ the aggressive nature of independent power producers and power marketers;
- ▶ the Federal Energy Regulatory Commission's rule-making on transmission access;
- ▶ action on open access issues by state legislatures and public utility commissions;
- ▶ the outcome of congressional debate over the transfer of federal power marketing administrations.

**"Build value,
deliver service,
deepen the commitment"**



Seated, General Manager Richard H. Silverman; Associate General Managers from left: David G. Areghini, Power, Construction & Engineering Services; D. Michael Rappoport, Public & Communications Services; L.J. "Chip" U'Ren, Operations, Information & Human Resources Services; John F. Sullivan, Water Group; Mark B. Bonsall, Marketing, Customer Service, Finance & Planning

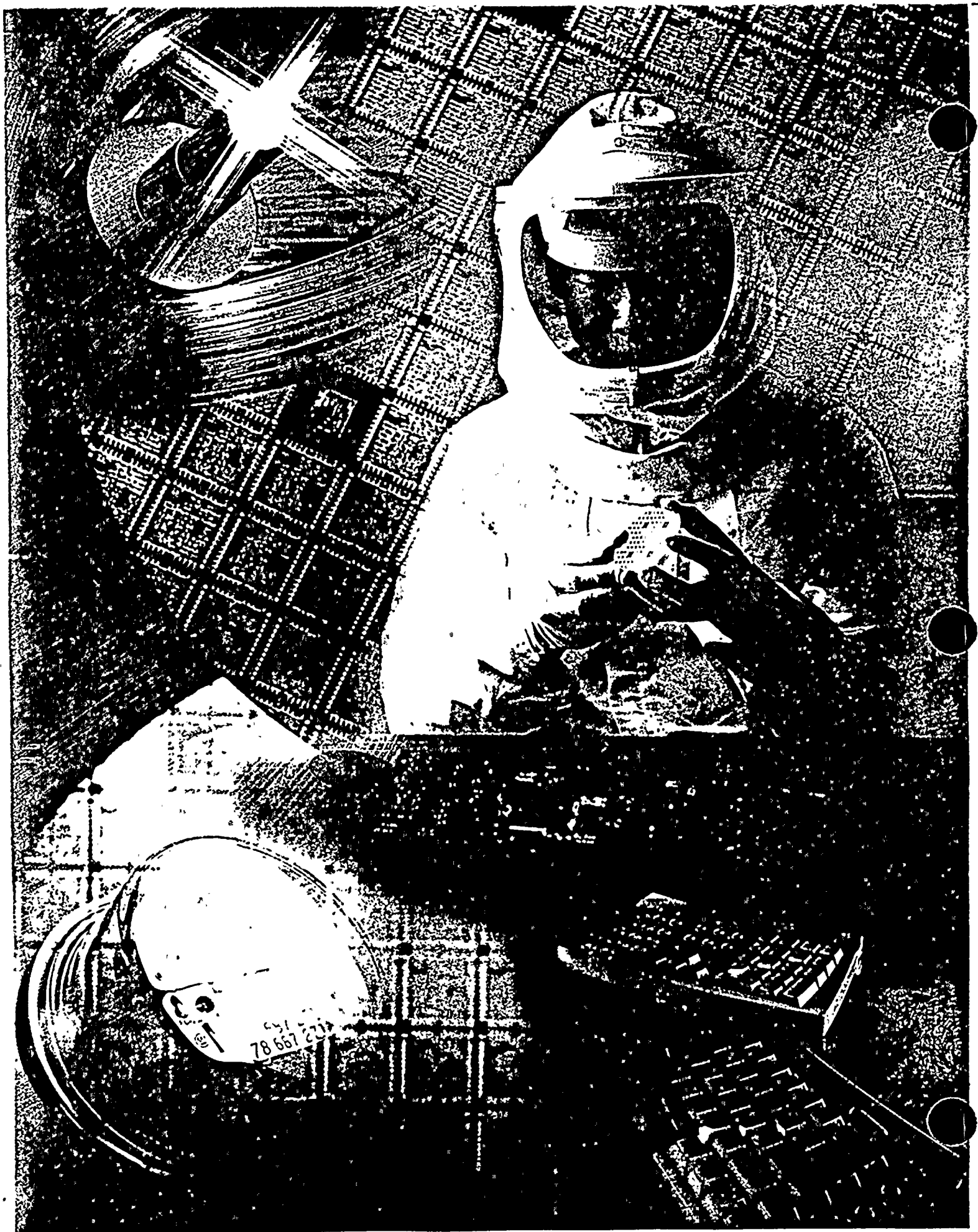
How will entities like Salt River Project look in a more competitive industry? Competition will be an equalizer among utilities. Locally owned utilities, such as SRP, will play an important role in both the marketplace and the industry.

Preparing for the future, we will continue to reduce both our electric and water operating costs, and re-examine rates, while providing consumers with what they want, when they want it, and on

terms that exceed their expectations.

With your support, and the dedication of our highly skilled work force, we will meet the challenges ahead with enthusiasm.

Richard H. Silverman
General Manager



BUILDING GREATER

FOR OUR CUSTOMERS

AND SHAREHOLDERS - BY CUTTING RATES,

BOOSTING SALES AND REDUCING COSTS

The electric bills of more than 100 of our largest commercial and industrial customers are dropping as you read this report.

That's because these customers began to see the benefits of an average percent reduction in their SRP electric rates in June.

We initiated extensive and individualized discussions with these customers regarding all the terms and options for electric service from SRP. Through ongoing, interactive talks, a new package of terms and services was crafted to the benefit of both these customers and SRP.

"SRP continues to manage strong financial operations... (ensuring) that the District can maintain a competitive rate structure."

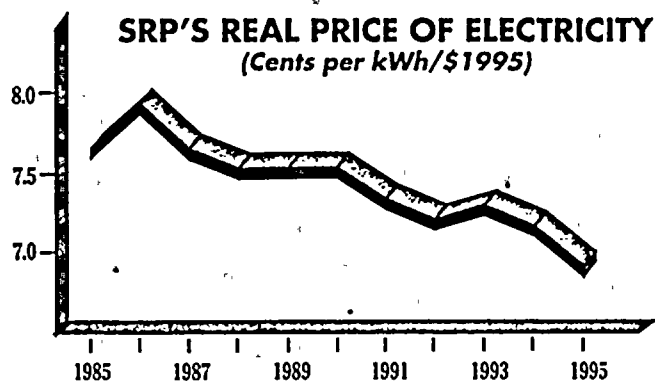
*- Moody's Investors Services
California Energy Markets, April 1995*

The customers emerged with a menu of offerings which they could craft, more than ever before, to their respective needs at a lower cost. We emerged with full-service, multiyear commitments with many of these customers, securing a revenue stream, and enhancing customer relationships.

It's our first rate decrease in more than 30 years. This group of customers accounts for 16 percent of SRP's annual system revenues, or about \$200 million. They'll save as much as \$9.9 million a year under the new rates.

We won't stop there. We are studying other customer classes for rate.

Since fiscal year 1985, the real price of SRP's electricity to our customers has dropped 14 percent.



reductions. And we are committed not to increase rates through the year 2001. Now that commitment goes a step further.

Even without rate decreases, SRP's electricity is a good value. A recent study shows that the cost of SRP's electricity to the consumer is nearly the same as it was almost 50 years ago, minus inflationary effects. This "real price"



of electricity is becoming a competitive pricing measure. Our real price goes down as base rates decrease or

remain stable.

More recently – that is, over the past decade – SRP's real price of electricity has dropped 14 percent. We are projecting it will decline another 18 percent by the year 2001. This will be accomplished through a three-way effort: increase revenues; reduce operating costs; and lessen our reliance on debt.

Let's look at these one at a time.

Increase revenues. SRP is fortunate to do business in a geographic area that is growing steadily. This, in turn, boosts our ability to increase annual revenues at a healthy rate. One of our new corporate goals calls for a 6 percent annual growth in revenues, without base rate increases.

We project continued energy sales increases during the next six years, thanks to a 14 percent increase in system

Maximizing our generating station assets

If you want to talk about maximizing assets, take a look at what's happening at SRP generating stations.

The past year was a powerhouse for SRP generation. Measured in kilowatt-hours produced, five of the six coal-fired plants in which SRP participates beat the national performance average in the 1994 calendar year – and the sixth plant just missed by a hair. The biggest generation headline of the year: Navajo Generating Station set a best-ever record for its 20 years.

As well, Palo Verde Nuclear Generating Station* operated at a higher-than-expected level, beating our estimates and adding to our availability during on- and off-peak times.

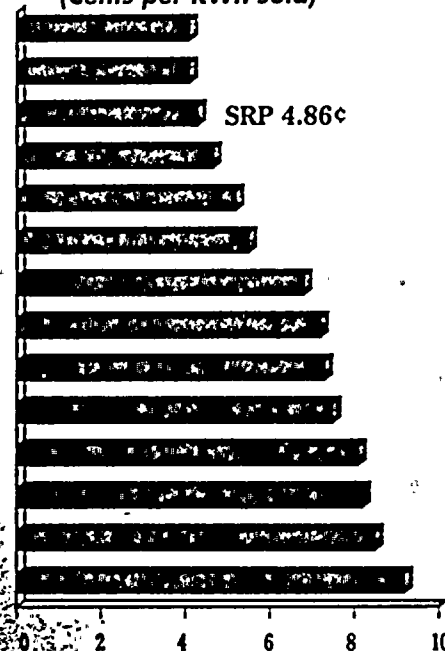
High performance at the plants helps us better meet the electric power demands of customers – and just as importantly, it boosts revenues by giving us more bulk power to sell in the wholesale market.

Plant performance, combined with cost cuts in transmission and distribution, result in lower operating costs per kilowatt-hour sold. This "cost per kWh sold" industry measurement of efficiency – a hot button with competition looming – is part of SRP's focus on operating economics.

We'll be working to further reduce our operating costs to bring us closer to the top of the lowest-cost electric utilities in the Southwest.

OPERATING COSTS OF 14 SOUTHWEST UTILITIES

(Cents per kWh sold)



In a comparison of 14 electric utilities in the Southwest, SRP is moving toward the top of lowest cost providers.

omers. (System customers topped 100 for the first time last year.) New business development planned in our service area, such as Intel's "Fab 12" plant in Chandler, adds to our future revenue projections, as do the expansion plans of several of our large mining and industrial customers.

To further boost revenues, we're stepping up our bulk power sales marketing efforts. We've more than doubled our kilowatt-hour sales in this category in the past five years. In fiscal year 1995, as an excess of bulk power (and competition in the natural gas industry) drove down prices, we set a bulk sales record at SRP with 6,242 gigawatt-hours sold.

We're aiming for aggressive bulk sales targets in the next six years. If this past year is any indication, we must continue to improve these sales to bring a significant revenue return.

Lower operating costs. SRP will continue to reduce operating costs using a management tool we call "operating targets" and detailed as a new corporate goal. This past year, we cut overall operating costs to 4.86 cents per kWh sold, driving us closer to the top of the lowest-cost electric utilities in the Southwest region. By assigning operating targets to each major business function,

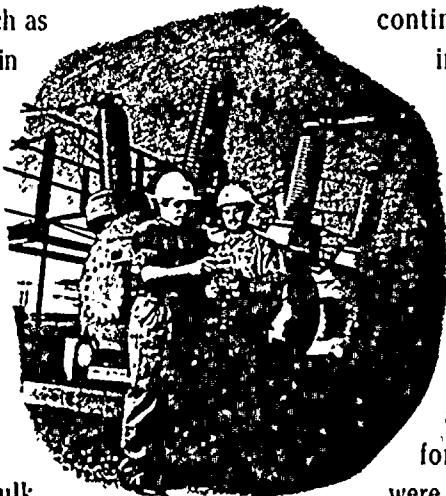
we are able to underscore each group's accountability for costs. We surpassed our target this year, and we'll continue to seek ways to improve our operating economics.

Less debt. We are strengthening SRP's financial posture by reducing debt. We plan no new bond issues through the end of the century, and all capital programs for the past 18 months were funded internally. This is how we'll fund our capital

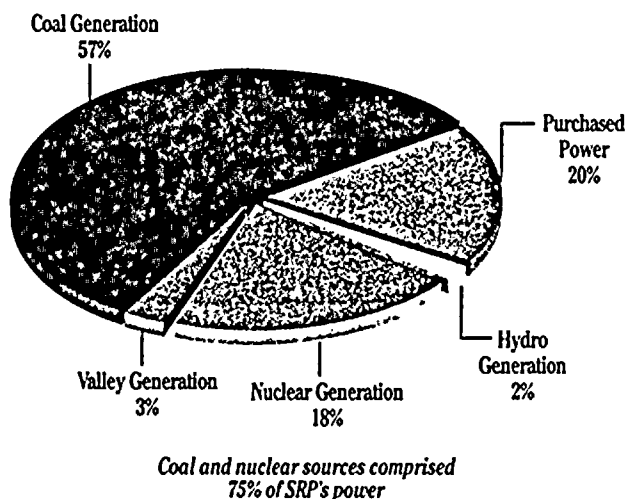
programs for the next six years, as well. For fiscal 1996 alone, we estimate \$65 million will be needed to fund distribution system growth in our service area.

We'll spend our capital dollars to serve growth in our service area, improve reliability where needed, and expand the SRP transmission system.

All of our market-focused actions have the potential of building value to our customers and shareholders. But value is not just driven by rates and costs. Customers care about service features, too.



FUEL MIX
(Fiscal Year 1995)

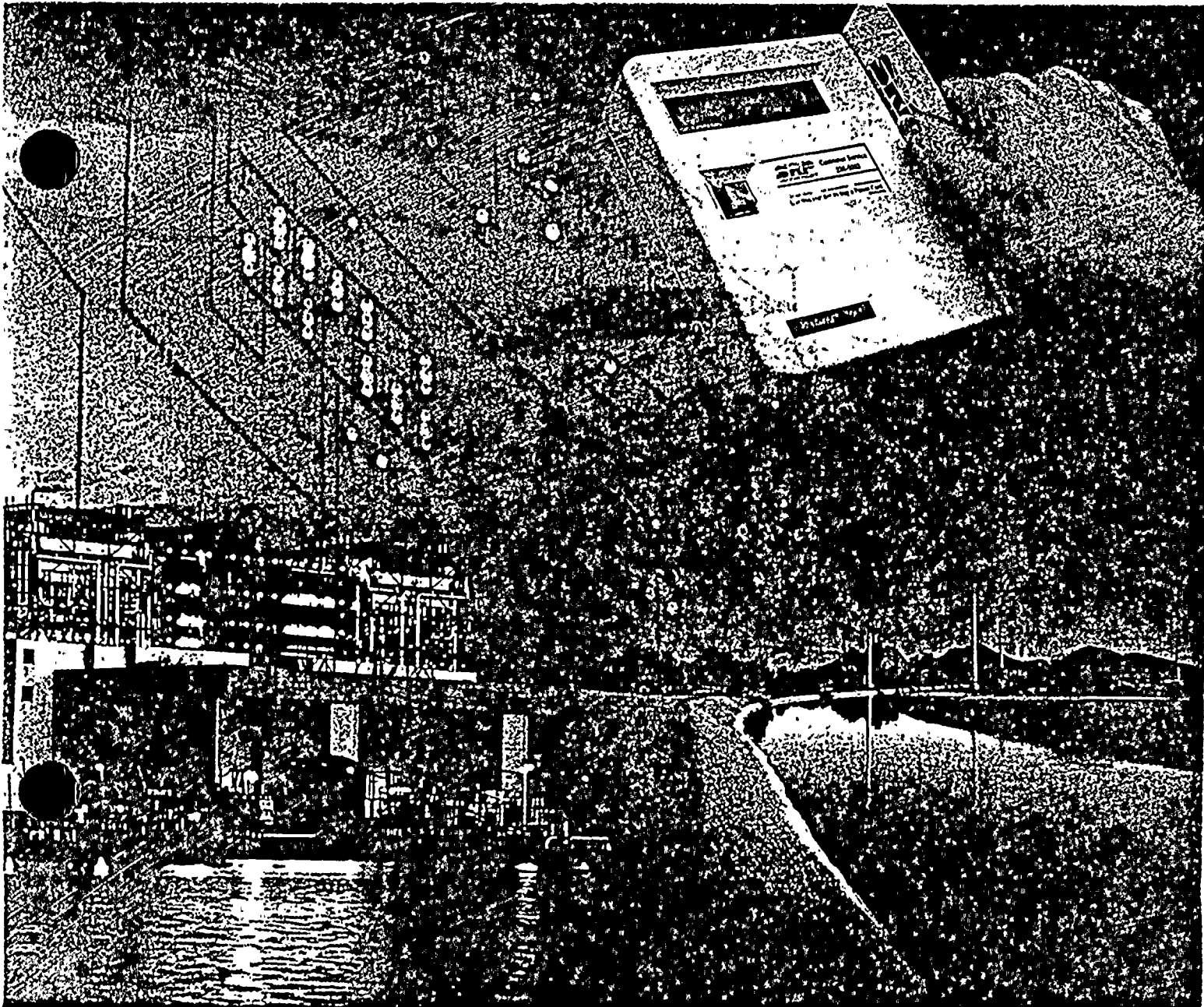




PROVIDING BETTER

Service

CREATES MORE SATISFIED CUSTOMERS, AND WE HAVE THE
EMPLOYEES TO MAKE IT HAPPEN



We're building a new customer-focused culture at SRP. Customer service is not new here. What *is* new is how we *view* customer service.

Creating a more responsive SRP depends upon the strengths, ideas and efforts of our employees. Today, *100 percent* customer and shareholder satisfaction is a new corporate goal. We want our service to please every customer

and shareholder.

Of course, all customers are not alike, and even similar groups of customers may have different service needs. Part of our service effort is to develop subsegments of our residential and business customers, so we can identify their service needs more effectively.

We will work to improve our satisfaction rating, already high enough to

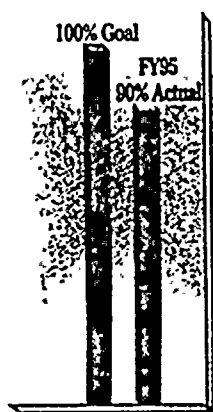
cause envy for some companies. A new mix of services – coupled with low prices – will differentiate SRP for a competitive advantage.

Shaping our new customer service focus are relationships, choices, and promises.

Relationships. Getting close to our customers and shareholders, building relationships, will improve our ability to deliver the services they want.

For the first time in several years, we conducted a formal evaluation of our service to our subdivision water

CUSTOMER SATISFACTION



shareholders. Most are homeowners in the Phoenix metropolitan area using SRP water to irrigate their yards.

While a large percentage of shareholders express satisfaction with our service, we identified two specific areas for improvement: water delivery timing and field service assistance. As a result, we are re-engineering our water delivery process and developing new ways to resolve problems in the field.

We're also improving the ways we communicate with these shareholders, through field contact and telephone calls, to keep them better informed.

Delivering more than power through advances in technology

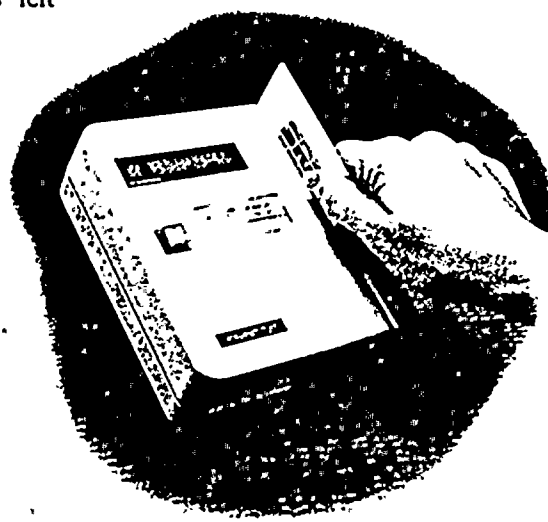
Technology is a key to SRP's future ability to provide better customer service.

Two pilot programs at SRP involve special devices for the electric meter that bring added convenience directly to the customer's home or business.

The first, automated meter reading, may help to keep meter-reading costs down while giving customers new billing options. An SRP computer can turn the special meters on and off, and record the data. The meters are making it easier for SRP to tailor a customer's billing cycle. They also are used with multi-site businesses to combine the electric usage of several meters into one bill.

A second program, Pay As You Go, eliminates the monthly electric bill and allows participating customers to decide how much electricity they will use. A customer buys a power card from SRP, and then pays for the electricity at home by sliding the card through a payment box. At the touch of a button, the customer can see how much power is "left" before the next power purchase.

The program is especially popular with customers who need extra help with their household budget. It gives them more choices about how they use electricity, and more control over their electricity costs.



We're asking our shareholders to let us know how they think we can improve through a new "shareholder input program" with idea cards in the field and a special telephone line.

One-to-one contact makes a difference to our customers. We've created a "key account" philosophy to

serve our shareholders, which mirrors a successful practice with our electric customers. And we're exploring other changes to improve our customer service to shareholders.

Choices. Through new or improved programs and services, we will give customers more choices – and more

ol. Simply put, we want to be able
"Yes!" to the customer more often.

Many new service features are payment and billing options. This past year, we added dozens of bank locations as places where customers can pay their electric bills. And we now can accept a personal check through a simple telephone call with a customer, a feature especially attractive for new-service requests because it eliminates a trip to one of our customer service offices.

We also are expanding the choices we offer in the timing of customers' electric bills. For commercial and industrial customers with multiple meters or locations, we provide summarized electric bills for convenience.

Other pilot billing programs include variable billing, where the customer chooses the monthly timing of their bill. We offer a custom billing cycle that allows customers to pay their electric bills more or less frequently than once a month.

We identified telephone customer service as a high priority, and we took steps to improve how we handle our customers' phone calls. For example, we now have separate commercial and residential call centers. This has proved successful: It speeds our response time to customer

inquiries and provides the customer with SRP staff specifically trained to the

needs of the caller. We boosted call center staffing by 35 percent.

We are supporting our call center employees with state-of-the-art technology, such as call forecasting to identify the highest call-volume periods and automatic call dispatching to deliver a call to the next-available representative. With an annual volume of more than 1.4 million calls, features like these make a big difference in handling customer inquiries more efficiently.

We are working with our water shareholders to find ways to solve their irrigation problems, through innovative exchange agreements, changes to delivery structures and direct connections to our wells.

New features enhance service

- Variable billing
- Summary billing
- Separate business & residential call centers
- Extended service office hours
- Custom meter-read cycles
- Pay As You Go
- Front-line account representatives
- Pay by phone
- Six-month bill averaging



Service promises. We will stand by our word when we say we'll deliver. Our service promises will be defined by the service and performance standards developed to meet the needs and expectations of our customers.

To cultivate a customer-focused work force, we are empowering front-line employees to meet each customer's business needs. We are helping every employee to understand how they can contribute to improved customer satisfaction. And we are building better internal systems for our employees to encourage the right kind of service decisions.

At SRP, we are applying the best practices and new technology to make it easier for customers and shareholders to do business with us. These changes aren't always expensive. In fact, we expect that our operational costs for customer service may decrease over time as we redirect some of our efforts toward what customers want and away from what they don't.

Customer service based upon relationships, choices and promises. Building on a strong foundation, which reaches back 92 years and countless years ahead.

DELIVERING MORE THAN POWER THROUGH

Commitments

THAT MAKE US A BETTER CORPORATE CITIZEN

SRP is one of few organizations in Arizona to successfully reach 92 years of age, and we've done it by taking care of business and people.

Through the years, SRP has made long-term commitments to efforts that improve the environment, support education, improve safety, help people in need, and improve arts and culture. SRP is, after all, a composite of people: people who work at SRP, people who are our customers and shareholders, our neighbors, friends and families.

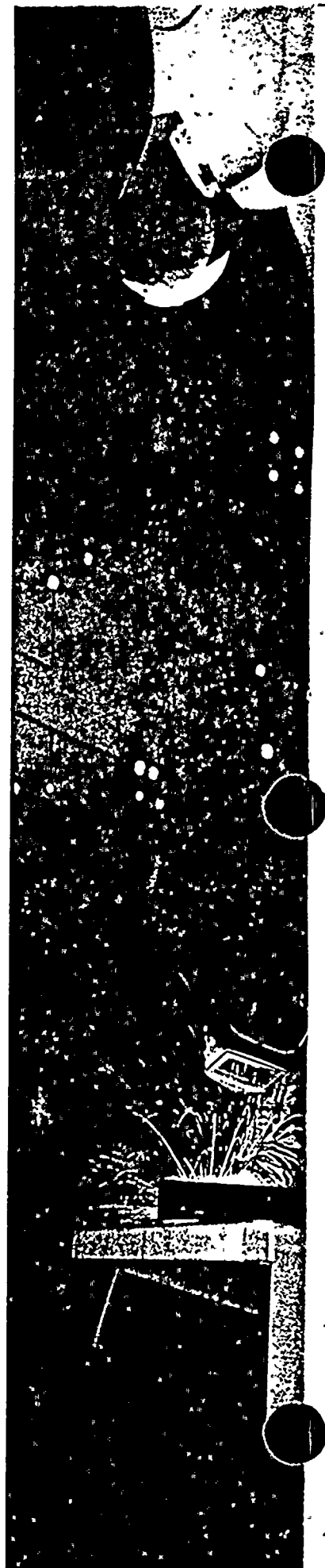
This year we adopted two corporate goals which call on SRP to deepen its commitment as a

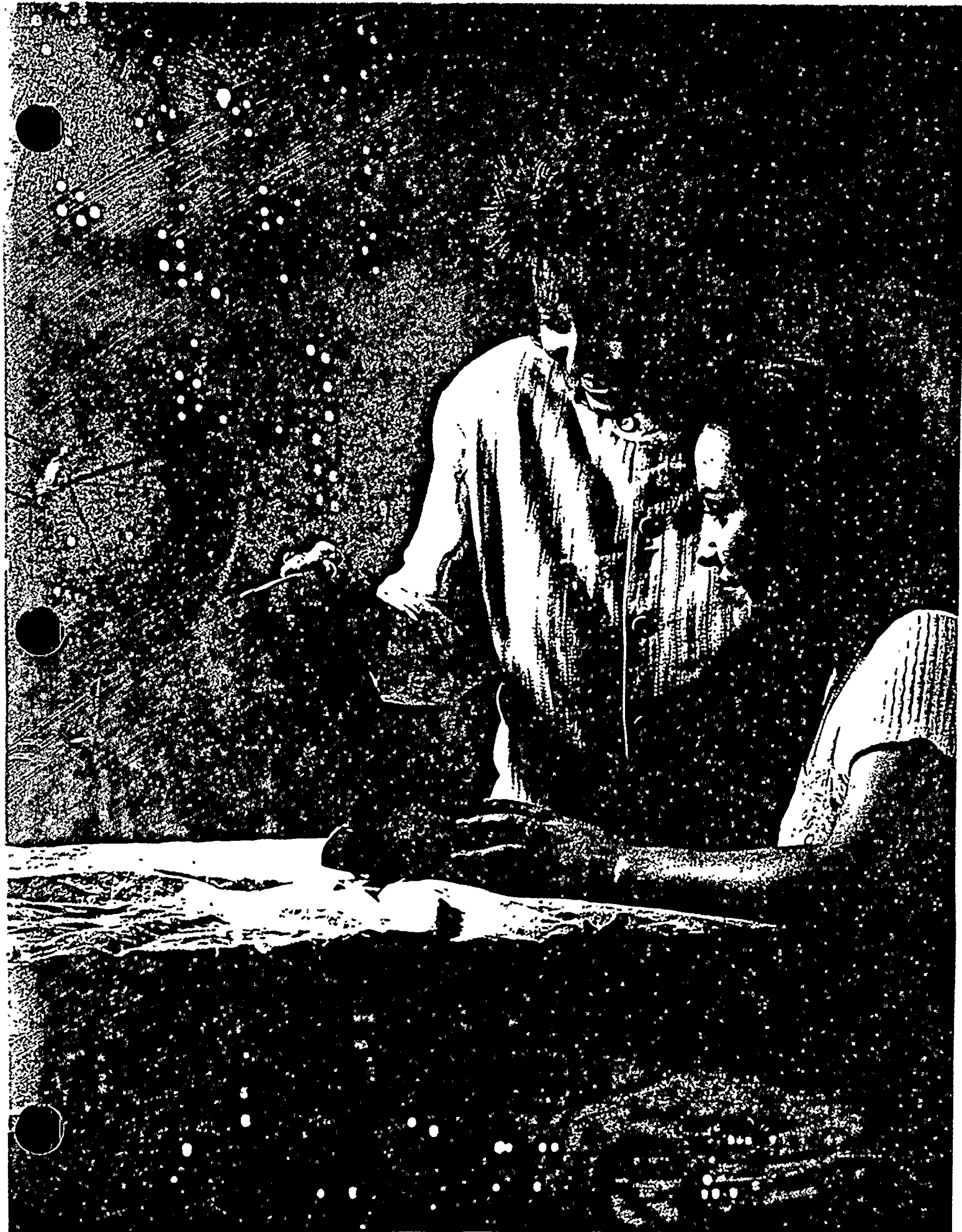
community and industry leader, and to reach superior levels of safety and environmental performance.

Through employees' dedication of time and effort, as well as through financial assistance and in-kind services, we are meeting our commitments.

Safety. SRP is a safe place to work because we give safety equal priority to value, service and cost. This year, our safety numbers in lost-time accidents and preventable vehicular accidents were exceptional. On-the-job personal injuries were among the lowest we've ever recorded. For each

- ▶ **We will achieve the best safety and environmental records in our industries.**
- ▶ **We will be the most respected institution in our communities and industries.**





of the past 15 years, the public power industry recognized us nationally for our superior safety record.

Volunteerism and contributions. SRP's employee volunteer program promotes community involvement and provides scores of opportunities for employees to contribute their time to worthwhile efforts.

This year, SRP volunteers contributed more than 5,000 hours of their own time — planting trees, cleaning parks, building a house for a needy family, staffing fund-raising events for charitable groups, and conducting food and clothing drives.

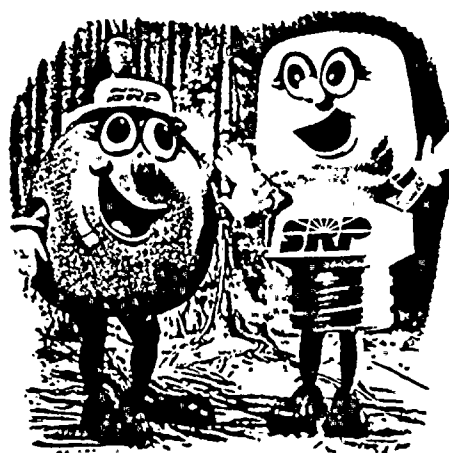
SRP also provides direct contributions and sponsorships to non-profit organizations that support health and human services, arts and

culture, environmental and historical preservation, education, and other community needs important to SRP and its customers. This past year, SRP contributed more than \$1.4 million. SRP employees throughout the state, in an annual fund-raising campaign, contributed another \$510,000.

Education. SRP's support of education in the Valley is extensive. We reach out to students and teachers to enhance the educational experience.

Our efforts this year included a student mentoring program, teacher training, and environmental camps.

We provide a water and electric power education program to schoolchildren, with the addition this year of two mascots — Dewey and Wattson — that help us educate kids



about water and electric safety. Our financial contributions help schools in our communities to buy needed supplies and fund special programs that otherwise might not be possible.

Consumerism. We lend a hand to people with financial difficulties that make it hard for them to pay for

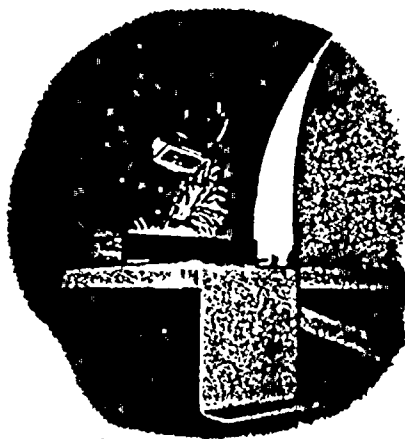
Labor-skills training for scrubber project brings opportunities to Navajo Reservation

Skill, hard work and enthusiasm: three ingredients that are making a success story from an idea to put more people to work on the Navajo Indian Reservation in northern Arizona.

Three years ago, SRP began discussing with Navajo leaders how we could provide opportunities for training and employment of Navajos for the then-planned scrubber project at Navajo Generating Station near Page. Our goal, as manager of the plant and the scrubber project, was to tap into the Navajo Nation labor force and to give the area an economic boost through increased

jobs and wages.

Today, with construction of the half-billion-dollar scrubber project underway, contractors are filling



most of the skilled-labor positions with Navajos. That's a direct result of identifying the labor pool and the people who have received labor-skills training from SRP.

As many as 500 people will be hired during the peak of construction of the scrubbers, which will remove sulfur dioxide emissions from the plant to mitigate visibility impairment in the Grand Canyon.

The Navajo Skills Training Program is one more way SRP demonstrates its commitment to the communities and the people it serves.

electricity at their homes. We also provide assistance, through Project Safe Home and other means, to inspect homes for electrical and safety hazards.

Because we want to do as much as we can to help our customers, our consumer ombudsman's office also is available to resolve service-related issues. Our public involvement group works in the community to help identify service and delivery issues that may be causing undue problems for customers.

Environment. We provide water and electric energy conservation education to our communities, encouraging xeriscaping methods and energy-saving techniques for our customers. In the past year, SRP received two national arborist awards for our outstanding tree projects.

An industry leader in environmental issues, SRP is working with the U.S. Environmental Protection Agency and state regulatory agencies to improve environmental management programs for commercial and industrial businesses.

Our support of electric vehicle technology is directly linked to the Valley's air quality. We believe electric vehicles can contribute to clean air efforts (and reduce traffic noise).

SRP's future success as a leading utility depends to a great extent on our continued dedication to our commitments.

SRP canals gaining appeal as commercial waterfront features

As beautification and commercialization of SRP's canal banks in the Valley become more popular, exciting opportunities emerge for SRP that impact business growth and quality of life.

The Scottsdale Downtown Waterfront Project — which envisions a half-mile section of the Arizona Canal as a lively business district in the heart of Scottsdale near Camelback Road — is a good example.

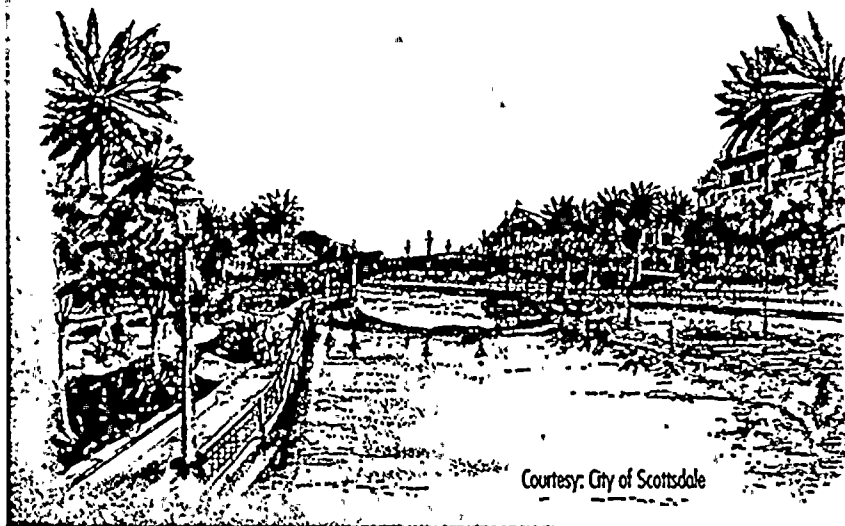
As planned, the Scottsdale project would offer shopping and dining with special features such as pedestrian bridges across the 100-year-old canal.

SRP's role today in the waterfront project is to strengthen the canal's concrete structure so that it will support the development proposed for its banks and allow people to more closely approach the water's edge.

The Arizona Canal, originally built to carry water to homestead farmlands, now makes its deliveries to cities, subdivisions and a dwindling number of farms.

SRP canals, many dating back to the days of the ancient Hohokam, already serve as recreational outlets for running and cycling.

The Scottsdale project is a clear signal that SRP canals could be a vital part of future multiple-use developments. In fact, other Valley cities are pursuing canal bank development opportunities. We are interested in working to enhance the canal areas while preserving our duty to operate and maintain them.



GROWTH, SALES AND

Financial

PERFORMANCE RESULT IN RECORD YEAR

Best-ever system sales combined with outstanding generation plant performance contributed to a banner financial year for SRP in fiscal year 1995.

Credit for the exceptional year-end results goes to employees who worked to control costs and increase sales, an unusually hot

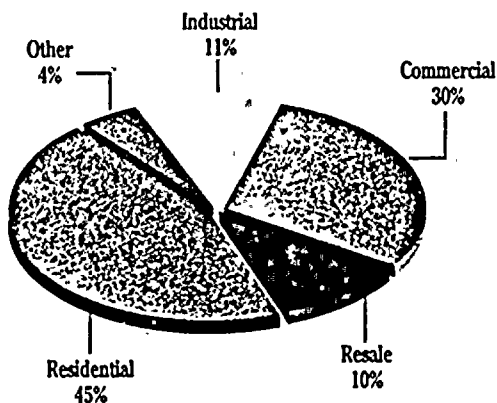
summer, greater-than-expected customer growth, and a vibrant local economy.

Combined net revenues were \$100 million on sales of \$1.45 billion. Gigawatt-hours sold surpassed 23,000, up 17 percent from the previous year, and exceeded all previous sales records. A gigawatt is 1 million kilowatts.

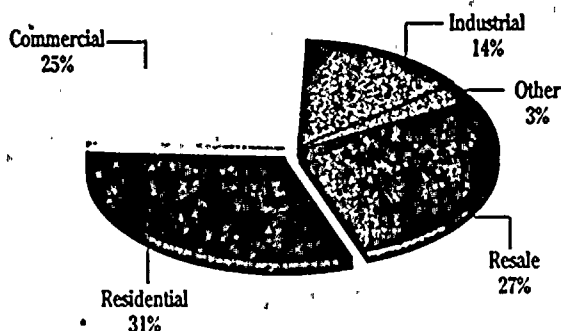
In addition, SRP's primary measures of financial performance all showed significant improvement.

Electric revenues and expenses. For the SRP electric system, residential kWh sales increased 5 percent from the previous year, and commercial sales rose nearly 6 percent. Revenue growth in these two categories alone exceeded \$51 million.

ELECTRIC SALES REVENUES (Fiscal Year 1995)



ELECTRIC SALES kWh (Fiscal Year 1995)



Resale revenues, boosted by an aggressive marketing effort, also saw substantial improvement, growing to about \$150 million from \$103 million. Similarly, kWh sales posted a big jump, up 71 percent. Bulk power revenues increased substantially from the previous year, even though prices softened in the bulk power market especially in the latter part of the year.

Total electric expenses were up about 9 percent. This was due mostly to increased fuel-related costs required to meet customer demand. Maintenance expenses decreased \$15 million, or about 14 percent; production maintenance costs dropped the most in this category. Costs in all areas of electric production, operations and maintenance (gas, coal, nuclear and hydroelectric) were below the previous year.

Water revenues and expenses. Water delivery revenues increased to \$10.3 million, up 28 percent from the previous year, primarily because of increased supplemental water sales. Water expenses increased less than 3 percent.

Key financial indicators. SRP's effective use of resources has resulted in efficiencies in

Healthy growth in SRP service area expected to continue

Metropolitan Phoenix, as the governmental and economic center of Arizona, attracts the largest share of the state's new residents and businesses.

As a result, the Phoenix area is one of the nation's fastest-growing, registering a 2.8 percent population increase in 1994. These new residents were the primary reason SRP showed a 3.4 percent increase in customers in fiscal year 1995.

We closed the year with 602,418 customers, and expect customer growth to average 16,000 per year, or about 3 percent, over each of the next six years.

The economic news for the Phoenix area remains quite good. New jobs grew by more than 6 percent in 1994, boosted by a housing boom for the construction industry. Growth in the manufacturing and government sectors continued at a healthy pace, and population growth helped the services and retail trade.

SRP serves a majority of the electronics industry in the Phoenix area. Plant expansions and increased plant loads are expected. Business growth will contribute to SRP projections for a 2.6 percent annual increase in electric system sales through fiscal year 2001.

all areas of the company. We are realizing the benefits of efforts initiated several years ago to improve our competitive position.

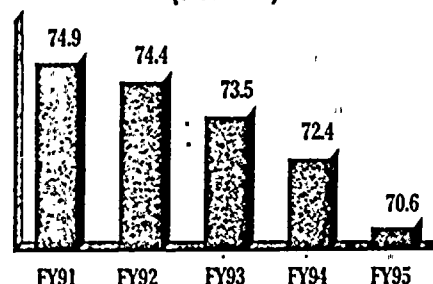
Funds Available for Corporate Purposes (FACP), which represents the cash available after paying operating expenses and debt service, was at its highest level in SRP history, at \$255 million.

Combined net revenues were SRP's highest in nine years.

A debt service coverage ratio of 2.50 for fiscal year 1995 also showed improvement, and was the best in the last 25 years. The debt ratio dropped to 70.6 percent from last year's 72.4 percent.

Through the year 2001. All financial indicators for the next six years are projected to continue to improve, and SRP management is committed to no new base rate increases through 2001.

DEBT RATIO IMPROVES (Percent)



SRP's debt ratio continued to improve in fiscal year 1995. We financed all construction with internally generated funds and issued no new debt.

Rate redesign signals shift in how we view our customers

SRP customer rates are being redesigned as we rethink the way we charge for electricity.

Beginning in fiscal year 1996, our largest commercial and industrial customers will see the returns of an average 4.5 percent rate cut. This translates to an estimated \$9.9 million annual savings in their electricity costs.

Yet the significance goes beyond the savings: We used a new rate-setting process that from the start included dialogue with customers, so that we would better meet their needs.

We "unbundled" our services so in the event of competition, customers can choose the services they want and so that we can recover service-specific costs.

In a move that benefits both the customer and SRP, most of the customers to whom we offered long-term electric power contracts accepted. This arrangement adds to SRP's long-term stability and ensures reduced costs to the customer for an identifiable period.

The redesigned rates clearly are market-driven: they are the result of what our customers wanted and what the marketplace would support.

Over the next year, we will review rates and services for commercial and residential customers, engaging them in dialogue to help ensure we meet their needs.

Combined Balance Sheets

(Thousands of Dollars)

For the Years Ended April 30, 1995 and 1994

	1995	1994
ASSETS		
Utility Plant, at historical cost		
Plant in service —		
Electric	\$ 5,360,230	\$ 5,230,132
Irrigation	157,941	147,828
Common	376,808	390,159
Total plant in service	5,894,979	5,768,119
Less — Accumulated depreciation on plant in service	(1,951,957)	(1,804,293)
	3,943,022	3,963,826
Plant held for future use	90,961	94,200
Construction work in progress	272,241	230,945
Nuclear fuel, net	46,419	50,894
	4,352,643	4,339,865
Other Property and Investments		
Non-utility property and other investments	140,755	94,180
Segregated funds, net of current portion	169,639	161,848
	310,394	256,028
Current Assets		
Cash and cash equivalents, at cost	150,229	101,064
Temporary investments	189,818	177,657
Current portion segregated funds	84,897	85,476
Receivables, including unbilled revenue, net	113,227	96,538
Fuel stocks, at last-in, first-out cost	40,579	40,981
Materials and supplies, at average cost	79,427	80,037
Other current assets	17,467	14,720
	675,644	596,473
Deferred Charges and Other Assets		
	330,152	358,161
	\$ 5,668,833	\$ 5,550,527

The accompanying notes are an integral part of these combined balance sheets.

Combined Balance Sheets

(Thousands of Dollars)

For the Years Ended April 30, 1995 and 1994

1995

1994

CAPITALIZATION AND LIABILITIES

Long-Term Debt

Electric system revenue bonds, net of current portion	\$ 3,218,072	\$ 3,278,309
Commercial paper and other	375,000	375,000
	3,593,072	3,653,309

Accumulated Net Revenues

Balance, beginning of year	1,389,729	1,318,344
Current year net revenues	100,069	71,385
Net accumulated unrealized gain (loss) on available for sale securities	3,291	—
Balance, end of year	1,493,089	1,389,729
Total Capitalization	5,086,161	5,043,038

Current Liabilities

Current portion of long-term debt	70,091	68,295
Accounts payable	117,485	67,050
Accrued taxes and tax equivalents	77,604	73,681
Accrued interest	64,336	64,850
Customers' deposits	42,553	42,451
Other current liabilities	77,945	76,832
	450,014	393,159

Deferred Credits and Other Non-Current Liabilities	132,658	114,330
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Commitments and Contingencies (Notes 5, 6, 9 and 10)

	\$ 5,668,833	\$ 5,550,527
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The accompanying notes are an integral part of these combined balance sheets

Combined Statements of Net Revenues

(Thousands of Dollars)

For the Years Ended April 30, 1995 and 1994

	1995	1994
Operating Revenues	\$ 1,451,697	\$ 1,348,691
Operating Expenses		
Power purchased	151,701	94,332
Fuel used in electric generation	242,749	241,356
Other operating expenses	280,328	269,067
Maintenance	95,281	109,686
Depreciation and amortization	203,600	174,269
Taxes and tax equivalents	190,039	181,508
Total operating expenses	1,163,698	1,070,218
Net operating revenues	287,999	278,473
Other Income (Expense)		
Interest income	34,218	22,445
Other income (expense), net	(6,036)	(7,877)
Total other income (expense), net	28,182	14,568
Net revenues before financing costs	316,181	293,041
Financing Costs		
Interest on bonds, net of capitalized interest	185,450	195,731
Amortization of bond discount, issuance and refinancing expenses	15,776	14,513
Interest on other obligations	14,886	11,411
Net financing costs	216,112	221,656
Net Revenues	\$ 100,069	\$ 71,385

The accompanying notes are an integral part of these combined statements

Combined Statements of Cash Flows

(Thousands of Dollars)

For the Years Ended April 30, 1995 and 1994

	1995	1994
Net Cash Flows from Operating Activities		
Net revenues	\$ 100,069	\$ 71,385
Non-cash items included in income:		
Depreciation and amortization	203,600	174,269
Postretirement benefits expense	19,637	21,491
Amortization of bond related expenses	15,776	14,513
(Gain) loss on sale of property	(3,471)	3,225
Decrease (increase) in —		
Fuel stocks and materials & supplies	1,012	7,924
Other assets	(13,071)	(89,365)
Increase (decrease) in —		
Accounts payable	50,435	11,326
Accrued taxes and tax equivalents	3,923	5,934
Accrued interest	(514)	(3,893)
Other liabilities, net	483	46,246
Net cash flow provided by operating activities	377,879	263,055
Cash Flows from Investing Activities		
Additions to utility plant	(255,723)	(227,074)
Additions to non-utility plant	(4,575)	(11,533)
Increase in other investments	(42,000)	(1,000)
Proceeds from sale of plant	8,382	1,123
Net cash used for investing activities	(293,916)	(238,484)
Cash Flows from Financing Activities		
Proceeds of bond issues, net of offering costs	—	1,335,519
Contributions in Aid of Construction	33,858	20,814
Repayment of long-term debt	(64,735)	(62,991)
(Increase) decrease in segregated funds	(3,921)	(33,593)
Deposits into escrow for bond defeasance	—	(1,298,941)
Net cash used for financing activities	(34,798)	(39,192)
Net Increase (Decrease) in Cash and Cash Equivalents	49,165	(14,621)
Balance at Beginning of Year in Cash and Cash Equivalents	101,064	115,685
Balance at End of Year in Cash and Cash Equivalents	\$ 150,229	\$ 101,064
Supplemental Information		
Cash Paid for Interest	\$ 207,869	\$ 219,188

The accompanying notes are an integral part of these combined statements

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

(1) BASIS OF PRESENTATION

Δ The Company

The Salt River Project Agricultural Improvement and Power District (the District) is an agricultural improvement district, organized under the laws of the State of Arizona, which provides electric service in parts of Maricopa, Gila and Pinal Counties in Arizona. The Salt River Valley Water Users' Association (the Association), predecessor of the District, was incorporated under the laws of the territory of Arizona in February 1903 as a result of the passage of the National Reclamation Act. In 1937, the Association transferred all of its rights, title and interest in the Salt River Project (the Project) to the District. In 1949, the original agreement was amended so that the District would assume construction, operation and maintenance responsibilities for both the electric and irrigation systems. The District then delegated to the Association operation and maintenance of the irrigation and water supply system of the Project.

Δ Principles of Combination

The combined financial statements include the consolidated accounts of the Association and of the District and its wholly owned subsidiary. The District and the Association are collectively referred to as Salt River Project (SRP). The District's subsidiary is Papago Park Center, Inc., a real estate management company. All significant intercompany transactions have been eliminated.

Δ Regulation and Electric Rates

Under Arizona law, the District's Board of Directors (the Board) serves as its regulatory and rate setting agency and has the exclusive authority to establish electric rates. The District is required to follow certain procedures, including public notice requirements and holding a special Board meeting, before implementing changes in standard electric rate schedules.

(2) SIGNIFICANT ACCOUNTING POLICIES

Δ Basis of Accounting

The accompanying combined financial statements are presented in accordance with generally accepted accounting principles and reflect the rate-making policies of the Board.

Δ Utility Plant, Depreciation and Maintenance

Utility plant is stated at the historical cost of construction. Construction costs include labor, materials, services purchased under contract, and allocations of indirect charges for engineering, supervision, transportation and administrative expenses.

Interest on funds used to finance construction work in progress is capitalized as a part of the electric and general plant. Composite rates of 5.71 percent and 6.20 percent were used in 1995 and 1994, respectively.

Depreciation expense is computed on the straight-line basis over the estimated useful lives of the various classes of plant. The following table reflects SRP's average depreciation rates on the average cost of depreciable assets, for the fiscal years ended April 30:

	1995	1994
Average Electric Depreciation Rate	3.28%	2.94%
Average Irrigation Depreciation Rate	1.97%	2.36%
Average Common Depreciation Rate	5.62%	6.46%

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

For fiscal 1995 the depreciation rates were changed due to a comprehensive depreciation study. The cost of property that is replaced, removed or abandoned, together with removal costs, less salvage, is charged to accumulated depreciation.

SRP charges to maintenance expense the cost of labor, materials and other expenses incurred in the repair and replacement of minor items of property.

Δ Regulatory Accounting

Pursuant to SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," which requires cost-based rate-regulated utilities to include the impacts of regulatory decisions in their financial statements, the District has accumulated approximately \$274.0 million in regulatory assets as of April 30, 1995. Regulatory assets represent probable future revenue to the District associated with certain costs which are currently being recovered from electric customers through rates. The District has two regulatory assets, unamortized losses on bond defeasances (see below under "Bond Expense") and the termination costs associated with the Kaiser coal contract (see Note 9 "Fuel Supply").

Δ Bond Expense

Bond discount, issuance and refinancing expenses are being amortized over the terms of the related bond issues. Losses associated with bond defeasance transactions are deferred and amortized over the lives of the defeased debt in accordance with the rate-making policies of the Board. Included in deferred charges and other assets are unamortized losses associated with bond defeasances of \$239.5 million and \$255.2 million as of April 30, 1995 and 1994, respectively.

Δ Nuclear Fuel

Under the provisions of the Nuclear Waste Act of 1982, the District is charged up to one mill per kilowatt-hour on its share of net energy generation at the Palo Verde Nuclear Generating Station (PVNGS) for the cost to dispose of the fuel. The District amortizes the cost of nuclear fuel, including its disposal, to fuel expense using the unit of production method.

Δ Decommissioning

The total estimated cost to decommission the District's share of PVNGS is \$234.0 million in 1992 dollars. This estimate contemplates that decommissioning will begin in 2024 and is based on the prompt removal method authorized by the Nuclear Regulatory Commission (NRC). Estimated decommissioning costs are accrued over the estimated useful life of PVNGS. The liability associated with decommissioning is included in other noncurrent liabilities. Decommissioning expense net of earnings on trust assets of \$5.0 million and \$4.7 million were provided for in fiscal 1995 and 1994, respectively.

The District contributes to an external trust set up in accordance with NRC requirements. Decommissioning funds of approximately \$38.6 million, stated at market, as of April 30, 1995, are held in the trust and are classified as segregated funds in the accompanying combined balance sheet.

The Financial Accounting Standards Board is reviewing current accounting practices for removal costs, including decommissioning of nuclear power plants, to determine the proper accounting classification and measurement criteria for these costs. If current industry accounting practices are changed, the District could be required to record its entire estimated decommissioning cost as a liability, rather than recognize these costs over the term of each facility's operating license. Management does not believe that such changes, if any, would have an adverse effect on the results of operations due to the District's current and expected future ability to recover these costs through electric rates.

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

Δ Fuel Costs

The District maintains a fuel adjustment clause balancing account to adjust operating revenues for variations between the recorded cost of fuel and purchased power and revenue designated for recovery of such costs. At April 30, 1995, overrecovered fuel costs of \$2.4 million were recorded as accounts payable and at April 30, 1994, underrecovered fuel costs of \$6.0 million were recorded as accounts receivable.

Δ Income Taxes

The District is exempt from federal and state income taxes.

Δ Cash Equivalents

The District treats short-term temporary cash investments with original maturities of three months or less as cash equivalents.

Δ Recognition of Unbilled Revenues

The District estimates and accrues revenue for electricity delivered to customers that have not yet been billed.

(3) POSSESSION AND USE OF UTILITY PLANT

The United States of America retains a paramount right or claim in the Project which arises from the original construction and operation of certain facilities as a federal reclamation project. Rights to the possession and use of, and to all revenues produced by these facilities are evidenced by contractual arrangements with the United States.

(4) REALIZATION OF UTILITY PLANT

In fiscal 1991, as a result of a re-examination of its long-range resource plans, the District canceled construction of a third unit at the Coronado Generating Station. The District wrote down its investment, at that time, to its estimated net realizable value. During fiscal 1995, the District entered into an agreement which provides the counterparty exclusive rights, for a period of time, to negotiate with the District for the purchase of these assets. Management continues to review the value of the assets and has done so in relation to the sale prices that are currently under discussion. Management believes that the assets are recorded at their net realizable value at April 30, 1995.

The District has installed certain underground cable for use in its distribution system, and has experienced a higher failure rate than originally anticipated for this cable. As a result, there has been a reduction in the value of this cable by approximately \$27.5 million. In 1995 the District determined not to seek recovery of this loss in future rates. Accordingly, an impairment loss of \$27.5 million is included in fiscal 1995 depreciation expense.

(5) INTERESTS IN JOINTLY OWNED ELECTRIC UTILITY PLANTS

The District has entered into various agreements with other electric utilities for the joint ownership of electric generating and transmission facilities. Each participating owner in these facilities must provide for the cost of its ownership share. The District's share of expenses of the jointly owned plants is included in operating expenses in the combined statements of net revenues.

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

The following table reflects the District's ownership interest in jointly owned electric utility plants as of April 30, 1995:

(Thousands)				
Plant Name	Ownership Share	Plant in Service	Accumulated Depreciation	Construction Work in Progress
Four Corners (NM) (Units 4 & 5)	10.00%	\$ 89,763	\$ (43,745)	\$ 10,854
Mohave (NV) (Units 1 & 2)	10.00%	51,030	(27,384)	6,849
Navajo (AZ) (Units 1, 2 & 3)	21.70%	234,867	(127,064)	25,876
Hayden (CO) (Unit 2)	50.00%	69,699	(39,312)	1,312
Craig (CO) (Units 1 & 2)	29.00%	229,438	(100,675)	3,937
Palo Verde Nuclear Generating Station (AZ) (Units 1, 2 & 3)	17.49%	1,671,853	(372,963)	17,265
		\$ 2,346,650	\$ (711,143)	\$ 66,093

The District acts as the operating agent for the participants in the Navajo Generating Station.

The District retains an option to repurchase up to an additional 5.7 percent interest in PVNGS which was previously sold to another participant. The repurchase price would be based on reproduction cost new, less depreciation, and can occur no sooner than 2001.

(6) LONG-TERM DEBT

Long-term debt consists of the following:

(Thousands)			
	Interest Rate	1995	1994
Revenue bonds (mature through 2031)	3.4-9.3%	\$ 3,399,367	\$ 3,464,101
Unamortized bond discount		(111,204)	(117,497)
Total revenue bonds outstanding		3,288,163	3,346,604
Commercial paper	3.75-4.3%	375,000	375,000
Total long-term debt		3,663,163	3,721,604
Less: current portion		(70,091)	(68,295)
Total long-term debt, net of current portion		\$ 3,593,072	\$ 3,653,309

The annual maturities of long-term debt (excluding commercial paper and unamortized bond discount) as of April 30, 1995, due in the fiscal years ending April 30, are as follows:

(Thousands)	
1996	\$ 70,091
1997	76,653
1998	80,576
1999	87,740
2000	90,739
Thereafter	2,993,568
	\$ 3,399,367

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

Δ Revenue Bonds

Revenue bonds are secured by a pledge of, and a lien on, the revenues of the electric system after deducting operating expenses, as defined in the bond resolution. Under the terms of the bond resolution, the District is required to maintain a debt service fund for the payment of future principal and interest. Included in segregated funds is approximately \$176.4 million and \$177.0 million of debt service related funds as of April 30, 1995 and 1994, respectively.

The District has \$291.0 million of mini-revenue bonds outstanding which can be redeemed at the option of the bondholder under certain circumstances. The District has a \$50.0 million revolving credit agreement available to refinance these bonds in the event significant redemption requests occur. In addition, the District has a \$25.0 million revolving credit agreement available for any corporate purpose including, but not limited to, liquidity support for the mini-revenue bonds. Based on historical redemptions made on these bonds, management is confident that these credit agreements are sufficient.

The debt service coverage ratio, as defined in the bond resolution, is used by bond rating agencies to help evaluate the financial viability of the District. For the years ended April 30, 1995 and 1994, the debt service coverage ratio was 2.50 and 2.25, respectively.

Interest and the amortization of discount on the various issues results in an effective rate of approximately 6.08 percent over the remaining terms of the bonds. The effective rate including amortization of bond issuance expenses and amortization of losses on defeasances is 7.05 percent over the remaining terms of the bonds.

At April 30, 1995, the District has authority to issue additional electric system revenue bonds totaling \$72.8 million principal amount and electric system refunding revenue bonds totaling \$3.2 billion principal amount.

In fiscal 1994, the District defeased \$1.3 billion of electric system revenue bonds resulting in lower future debt service requirements as well as a loss of \$91.1 million. Consistent with the rate-making policies of the Board, the loss has been deferred and is being amortized over the life of the defeased debt. No bond defeasances occurred during fiscal 1995.

Δ Commercial Paper

The District has issued \$375 million of tax-exempt commercial paper at an average interest rate to the District of 4.07 percent. The commercial paper matures not more than 365 days from the date of issuance. The commercial paper has been classified as long-term in connection with refinancing terms under three revolving credit agreements (the Agreements) which support the commercial paper. Under the terms of the Agreements, the District may borrow up to \$100 million through March 19, 1997, up to \$175 million through July 13, 1997 and up to \$100 million through April 29, 1996. Under the terms of the agreement that expires April 29, 1996, the District has the option to initiate a term loan of up to \$100 million upon its expiration.

While the revolving credit agreements contain covenants which could prohibit borrowing under certain conditions, management is confident that financing will be available. The District has never borrowed under the Agreements and does not expect to do so in the future. Alternative sources of funds to support the commercial paper program include existing funds on hand or the issuance of alternative debt, such as revenue bonds.

The commercial paper is an unsecured obligation of the District.

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

Δ General Obligation Bonds

In 1984, the District refunded its then outstanding general obligation bonds. Although the refunding constituted an in-substance defeasance of the prior lien on revenues which secured the bonds, the general obligation bonds continue to be general obligations of the District, secured by a lien upon the real property of the District, a guarantee by the Association, and the District's taxing authority. As of April 30, 1995, the amount of defeased general obligation bonds outstanding was \$37.7 million.

(7) EMPLOYEE BENEFIT PLANS AND INCENTIVE PROGRAMS

Δ Defined Benefit Pension Plan

SRP's Employees' Retirement Plan (the Plan) covers substantially all employees. The Plan is funded entirely from SRP contributions and the income earned on invested plan assets. No contributions were required to be made to the Plan in fiscal years 1995 and 1994. Plan assets consist primarily of stocks, U.S. Government Obligations, corporate bonds and real estate funds.

Net periodic pension cost (income) is made up of the components listed below and was determined using the projected unit credit actuarial cost method:

	(Thousands)	
	1995	1994
Service cost	\$ 11,382	\$ 11,718
Interest cost	28,013	25,622
Actual return on assets	(10,655)	(52,145)
Net amortization and deferral	(27,026)	13,805
Net periodic pension cost (income)	\$ 1,714	\$ (1,000)

The following schedule reconciles the funded status of the Plan (based on January 31 actuarial valuation dates) with amounts reported in SRP's combined financial statements as of April 30:

	(Thousands)	
Measurement Date	1995	1994
Actuarial present value of projected benefit obligation:		
Vested benefit obligation	\$(310,680)	\$(295,066)
Nonvested benefit obligation	(11,382)	(9,734)
Accumulated benefit obligation	(322,062)	(304,800)
Effect of projected future compensation levels	(69,768)	(65,527)
Projected benefit obligation	(391,830)	(370,327)
Plan assets at fair value	372,875	401,737
Funded status	(18,955)	31,410
Unrecognized transition asset	(28,100)	(32,117)
Unrecognized net loss (gain)	65,393	20,595
Unrecognized prior service cost	4,267	4,431
Prepaid pension costs	\$ 22,605	\$ 24,319

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

As the result of special termination benefits incurred in connection with the 1994 Retirement Incentive Program (see next page), prepaid pension cost was reduced by \$8.7 million in fiscal 1994.

For the fiscal years ending April 30, 1995 and 1994, the discount rate used in determining the actuarial present value of the projected benefit obligation was 7.75 percent, the rate of increase used to determine future compensation levels was 5.0 percent, and the expected long-term rate of return on assets used was 9.25 percent.

Δ Defined Contribution Plans

Effective January 1, 1995, SRP merged the SRP Hourly 401k Plan (the "Hourly Plan") into the Salt River Salaried Employees Thrift Plan (the "SETP") and renamed the SETP the Salt River Project Employees' 401k Plan (the "401k Plan"). Employer matching contributions to the Hourly Plan, the SETP and the 401k Plan were \$3.9 million for the fiscal year ended April 30, 1995. SRP contributed \$3.7 million to the Hourly Plan and the SETP during the fiscal year ended April 30, 1994.

Δ Other Postretirement Benefits

SRP provides certain health care and life insurance benefits for retired employees. Employees are eligible for coverage if they retire at age 65 or older with at least five years of vesting service, or any time after age 55 with a minimum of ten years of vested service. Prior to fiscal 1994, the cost of these benefits was recognized as expense as the premiums and/or deposits to the trust were paid.

Effective May 1, 1993, SRP adopted SFAS No. 106, "Employers Accounting for Postretirement Benefits Other than Pensions," which requires that postretirement benefits be determined based on the projected credit actuarial cost method and attributed over employment periods of plan participants to the date of eligibility for postretirement benefits. The effect of the adoption of this standard was to reduce Net Revenues for fiscal 1994 by approximately \$15.7 million. The transition obligation is being amortized over 20 years.

The components of the postretirement benefit cost (a portion of which has been capitalized as a component of construction costs) are as follows:

	(Thousands)	
	1995	1994
Service cost	\$ 4,056	\$ 4,843
Interest cost	10,069	10,310
Actual return on assets	(327)	(349)
Amortization of transition obligation	5,850	6,081
Unrecognized (gain) loss	(11)	—
Postretirement benefit cost	\$ 19,637	\$ 20,885

The following schedule reconciles the funded status of postretirement benefits (based on January 31, actuarial valuation dates) with amounts reported in SRP's combined financial statements as of April 30:

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

	(Thousands)	
	1995	1994
Plan assets at fair value	\$ 4,988	\$ 4,971
Actuarial present value of accumulated postretirement benefit obligations:		
Retirees	(69,661)	(66,287)
Fully eligible active employees	(6,779)	(13,223)
Other active employees	(46,457)	(53,489)
Accumulated benefit obligations	(122,897)	(132,999)
Accumulated benefit obligations in excess of plan assets:	(117,909)	(128,028)
Unrecognized transition obligations	105,316	111,166
Unrecognized net gain	(25,971)	(6,721)
Benefits paid — February to April	1,259	886
Accrued postretirement benefit obligation	\$ (37,305)	\$ (22,697)

As the result of the 1994 Retirement Incentive Program (see below), SRP recognized additional postretirement benefits expense in fiscal 1994, related to special termination benefits and curtailment losses of approximately \$6.0 million.

For fiscal 1995, different health care cost trends are used for pre-Medicare and post-Medicare expenses. Pre-Medicare trend rates are 11.5 percent for 1995 grading down to 5.25 percent. Post-Medicare trend rates are 8.5 percent for 1995 grading down to 5.25 percent. The effect of a one percent increase in the assumed health care cost trend rates for each future year would have increased the accumulated postretirement health care obligation at January 31, 1994, by approximately \$24.3 million and increased the aggregate of the service and interest cost components by approximately \$3.0 million for fiscal 1995. The annual discount rate used in both the January 31, 1995, and the January 31, 1994, valuations was 7.75 percent. The expected long-term rate of return on plan assets is 7.0 percent.

Δ 1995 Employee Incentive Compensation Program

During fiscal 1995 SRP implemented an incentive compensation program that covered essentially all regular employees. The incentive compensation amount is based on achievement of pre-established cost and safety targets. An accrual for the fiscal 1995 payment of \$31.9 million is included in current liabilities in the accompanying financial statements.

Δ SRP's Retirement Incentive Program

In fiscal 1994, SRP offered a retirement incentive program to certain eligible employees. The incentive, which had a total fiscal 1994 cost of \$31 million, was accepted by 323 of the eligible employees. The cost included direct termination benefits paid by SRP as well as termination benefits and curtailment losses to SRP's employee benefit plans.

(8) FINANCIAL INSTRUMENTS

Δ Fair Value

The following methods and assumptions were used to estimate the fair value of each class of financial instruments identified in the following items on the balance sheet.

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

Investments in Marketable Securities

SRP invests in U.S. Government Obligations, Certificates of Deposit and other marketable investments. Such investments are classified as Other Investments, Segregated Funds, Cash and Cash Equivalents or Temporary Investments depending on the purpose and duration of the investment. The fair value of marketable securities with original maturities greater than one year is based on published market data. The carrying amount of marketable securities with original maturities of one year or less approximates their fair value based on the short maturity period.

Long-Term Debt

The fair value of the District's revenue bonds, including current portion, was estimated by using pricing scales from independent sources. The fair value of commercial paper approximates the carrying amount, because of its short term to maturity.

Other Current Assets and Liabilities

The carrying amounts of receivables, accounts payable, customer deposits and other current liabilities approximate fair value because of the short maturity period.

The estimated fair values of SRP's financial instruments, excluding those instruments where the carrying amount approximates fair value, are as follows:

	(Thousands)			
	April 30, 1995		April 30, 1994	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investments in marketable securities:				
Other investments	\$ 66,858	\$ 66,777	\$ 25,248	\$ 24,796
Segregated funds	91,535	88,662	91,535	88,756
Temporary investments	13,070	12,942	6,016	6,023
Long-term debt	3,288,163	3,331,258	3,346,604	3,294,750

Accounting for Debt and Equity Securities

SRP adopted SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" effective May 1, 1994. Under the Statement, SRP's investments in debt securities are reported at amortized cost if the intent is to hold the security to maturity. Other debt securities and equity securities are reported at market, with unrealized gains or losses included as a separate component of accumulated net revenues. SRP holds no investments that qualify as "trading" securities (as defined by SFAS No. 115) as of April 30, 1995. The cumulative effect of adopting this Statement was not material.

Interest Rate Swaps

During fiscal 1994 the District entered into two interest rate swap transactions with a financial services firm, in a total notional amount of \$25 million. During fiscal 1995 the District terminated these swap transactions at a net gain of approximately \$55 thousand.

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

(9) COMMITMENTS

Δ Construction Program

The construction program represents SRP's six-year plan for major construction projects and ongoing improvements to existing generation, transmission, distribution and irrigation assets. For the 1996-2001 period, SRP estimates capital expenditures of approximately \$1.9 billion. Planned major construction projects include the addition of scrubbers at the Navajo Generating Station and the completion of the Mead-Phoenix Transmission Line and other key strategic transmission projects.

Δ Navajo Generating Station Purchase Power Contracts

The District has entered into three contracts with the United States Bureau of Reclamation (United States), the Western Area Power Administration (WAPA), and the Central Arizona Water Conservation District (CAWCD). The contracts, among other things, provide for the long-term sale to the District of Navajo Surplus through September 2011. The amount of Navajo Surplus available to the District will vary annually and is expected to decline over the life of the contract. The District has the right to use and to schedule power and energy associated with the United States' entitlement to NGS. The District has agreed to pay a fixed amount for these benefits, to pay the cost of NGS generation and other related costs, and to supply energy to CAWCD for Central Arizona Project facilities at cost. The fixed portion of the District's payment obligations under the three contracts totals \$47.0 million annually, of which \$25.2 million annually is unconditionally payable regardless of the availability of power. Payments under these contracts totaled \$43.2 million in fiscal 1995, and \$20.7 million in fiscal 1994 (under the two contracts effective in fiscal 1994).

Long-Term Power Contracts

The District has entered into two additional long-term power purchase agreements to obtain a portion of its projected load requirements through 2011. Minimum payments under these contracts are approximately \$40 million per year. Total payments, including the minimum payments, under these two contracts were \$44.1 million and \$50.3 million in fiscal 1995 and 1994, respectively.

Δ Fuel Supply

At April 30, 1995, minimum long-term commitments of approximately \$1.89 billion exist under coal supply contracts. During 1989, the District paid approximately \$59 million to terminate a contract with Kaiser Coal Company. In accordance with the rate-making policies of the Board, the remaining termination costs of \$34.3 million and \$38.3 million at April 30, 1995 and 1994, respectively, are included in deferred charges and other assets, and are being amortized to fuel expense over the remaining life of the original contract.

Δ Papago Park Center

The District is currently developing a 350 acre (net) mixed-use commercial park called Papago Park Center in Tempe and Phoenix, Arizona. In connection with the infrastructure development, the District and the City of Tempe have entered into an agreement whereby the District will pay an annual assessment of approximately \$1.75 million per year through 2010 to the City of Tempe to pay for its share of street and infrastructure improvements and right of way acquisitions. The obligation of the District to make assessment payments is an unsecured obligation payable from District general funds. The present value of this obligation has been recorded as a noncurrent liability.

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

The District's wholly owned subsidiary, Papago Park Center, Inc., serves as the real estate management company in accordance with the terms of a long-term lease on the property. As of April 30, 1995, approximately 60 acres of the property is under lease to non-SRP users.

(10) CONTINGENCIES

Δ Nuclear Insurance

Under existing law, public liability claims that could arise from a single nuclear incident are limited to \$8.9 billion. PVNGS participants currently insure for this potential liability through commercial insurance carriers to the maximum amount available (\$200 million) with the balance covered by an industrywide retrospective assessment program which is required by the Price-Anderson Act. The maximum assessment per reactor per nuclear incident under the retrospective program is \$75.5 million subject to a 5 percent surcharge which could be applicable in certain circumstances, but not more than \$10 million per reactor may be charged in any one year for each incident.

Based on the District's ownership share in PVNGS, the maximum potential assessment would be \$41.6 million including the 5 percent surcharge, but would be limited to \$5.2 million per incident in any one year.

Δ Environmental

SRP is subject to numerous legislative, administrative and regulatory requirements relative to air quality, water quality, hazardous waste disposal, and other environmental matters. Such requirements have and will continue to result in increased costs associated with the operation of existing properties.

SRP has been named as a Potentially Responsible Party (PRP) at one site by the Environmental Protection Agency (EPA); however, a settlement has been negotiated for SRP's obligation. SRP has not been identified as a PRP at any other EPA or Arizona Department of Environmental Quality (ADEQ) identified sites, but the District is working with ADEQ and the other owners/operators regarding potential petroleum hydrocarbon contamination at one state site. SRP conducts ongoing environmental reviews of its properties to identify those which it believes will potentially require remediation. SRP works with the EPA and ADEQ, as applicable, to determine the appropriate remediation actions necessary, if any. In addition, the District and the other co-owners of the Hayden Generating Station units have been named as defendants in a lawsuit alleging, among other things, violations of opacity standards by Hayden Unit 2. The defendants believe that the allegations are unfounded and are contesting the suit. SRP has recorded environmental reserves of approximately \$19.5 million which represent management's best estimate of SRP's potential liability related to these environmental matters at April 30, 1995.

SRP is pursuing insurance and third-party cost sharing for the remediation costs with regard to the foregoing liabilities. The amount of shared costs, if any, cannot be reasonably determined at this time, and therefore has not been recorded. The estimated reserves are subject to continuing review; however, management believes that the costs incurred by SRP for environmental liabilities will not have a material adverse impact on its financial position or results of operations.

The federal Clean Air Act, as amended in 1990 (CAA), among other things, requires reductions in sulfur dioxide and nitrogen oxide emissions from electric generating stations and may also regulate emissions of hazardous air pollutants by generating stations. Three generating stations in which the District has an interest (Mohave, Craig, and Hayden) have been identified as possible sources of visibility impairment under

Notes to Combined Financial Statements

For the Years Ended April 30, 1995 and 1994

the CAA and visibility studies are underway in these areas. The District estimates its costs to comply with the CAA at these sites to be approximately \$72.1 million and has included this amount in the 1996-2001 construction program.

In addition, the Navajo Generating Station participants are installing scrubbers at the Navajo Generating Station; capital expenditures of \$90.6 million for the District's share of the cost of this project are included in SRP's 1996-2001 construction program.

Δ Indian Matters

From time to time, the District and the Association are involved in litigation and disputes with various Indian tribes on issues concerning royalty payments, taxes and water rights, among others. Resolution of these matters may result in increased operating expenses which may be passed on to customers.

Δ Other Litigation

In the normal course of business, SRP is a defendant in various litigation matters. In management's opinion, the ultimate resolution of these matters will not have a material adverse effect on SRP's financial position or results of operations.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors
Salt River Project Agricultural Improvement
Water District,
Board of Governors,
Salt River Valley Water Users' Association:

We have audited the accompanying combined balance sheets of SALT RIVER PROJECT as of April 30, 1995 and 1994, and the related combined statements of net revenues and cash flows for the years then ended. 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 Salt River Project as of April 30, 1995 and 1994, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As explained in Note 7 to the combined financial statements, effective May 1, 1993, Salt River Project changed its method of accounting for postretirement benefits other than pensions. As explained in Note 8 to the combined financial statements, effective May 1, 1994, Salt River Project changed its method of accounting for investments in debt and equity securities.

Phoenix, Arizona
June 19, 1995

Arthur Andersen LLP

SRP BOARDS

The two Boards of Salt River Project work with management to establish policies to further the business affairs of the Project.

The 10 members of the Salt River Valley Water Users' Association Board of Governors serve two-year terms and are elected by the landowners of the water service territory. The Association is a private corporation that administers the water rights of SRP's 240,000-acre area, and operates and maintains the irrigation and delivery system.

The 14 members of the Salt River Project Agricultural Improvement and Power District Board of Directors serve staggered four-year terms. Ten District Board members are elected from SRP voting divisions and four are elected at-large.

The District is a public utility and a political subdivision of Arizona, providing electricity to more than 600,000 customers in a 2,900-square-mile service area.

Most often, candidates seek election to both Boards.



Martin Kempton
District/Division 8
Association & District



Howard W. Lydic
District/Division 1,
Association & District



Clarence C. Pendergast Jr.
District/Division 2,
Association & District



Bruce B. Brooks
District/Division 3,
Association & District



Gilbert R. Rogers
District/Division 4,
Association & District



Carl E. Weiler
District/Division 5,
Association & District



James L. Diller
*District/Division 6,
Association & District*



Ann M. Burton
*District/Division 7,
Association & District*



Robert E. Hurley
*District/Division 9,
Association & District*



Dwayne E. Dobson
*District/Division 10,
Association & District*



Eldon Rudd
Director-At-Large, Seat No. 11



William W. Arnett
Director-At-Large, Seat No. 12



Fred J. Ash
Director-At-Large, Seat No. 13



James R. Marshall
Director-At-Large, Seat No. 14



Robert L. Cook
District/Division 1,
Association & District



Kevin J. Johnson
District/Division 1,
Association & District



Byron G. Williams
District/Division 4,
Association & District



Lloyd L. Banning
District/Division 4,
Association & District



Roy W. Cheatham
District/Division 5,
Association & District



Edmund Navarro
District/Division 5,
Association & District



Wayne A. Weller
District/Division 5,
Association & District



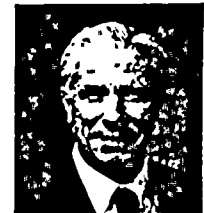
Emil M. Rovey
District/Division 1,
Association & District



Wayne A. Hart
District/Division 2,
Association & District



David Rousseau
Council Chairman
District/Division 6,
Association & District



Ben A. Butler
Division 6, District



Larry D. Rovey
Council Vice Chairman
District/Division 2,
Association & District



Elvin E. Fleming
District/Division 3,
Association & District



John A. Vanderwey
District/Division 2,
Association & District



Clarence J. Duncan
District/Division 6,
Association & District



Robert W. Warren
District 6, Association



John E. Anderson
District/Division 3,
Association & District



Mario J. Herrera
District/Division 3,
Association & District



Wayne A. Marietta
Division 7, District
Deceased 11/30/94



Charles D. Copplinger
District/Division 4,
Association & District



Dan C. McKinney Jr.
*District/Division 7,
Association & District*



W. Curtis Dana
*District/Division 9,
Association & District*



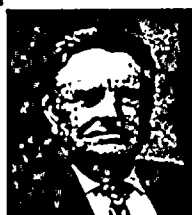
Lester Mowry
*District/Division 7,
Association & District*



Lawrence P. Schrader
*District/Division 10,
Association & District*



Mark A. Lewis
*District/Division 7,
Association & District*



C. Dale Willis
*District/Division 10,
Association & District*



Robert G. Kempton
*District/Division 8,
Association & District*



Michael K. Gantzel
*District/Division 8,
Association & District*



Orland R. Hatch
*District/Division 10,
Association & District*



Mark V. Pace
*District/Division 8,
Association & District*



Dale C. Riggins Jr.
*District/Division 9,
Association & District*



Lee L. Tregaskes
*District/Division 9,
Association & District*

SRP COUNCILS

The two Councils of Salt River Project enact and amend bylaws relating to business affairs of SRP and also serve as liaisons to landowners. As with the SRP Boards, there is one Council for the Association and one for the District.

The 30 Association Council members are elected to two-year terms from the 10 districts within the Association.

The 30 District Council members are elected to staggered four-year terms in each of the 10 divisions.

Most often, candidates seek election to both Councils.

Corporate Officers

<i>President</i>	William P. Schrader
<i>Vice President</i>	John M. Williams Jr.
<i>Secretary</i>	William K. O'Neal
<i>Treasurer</i>	Dean K. Yee

Consultants

Legal Adviser
Jennings, Strouss & Salmon

Independent Public Accountants
Arthur Andersen LLP

Bond Counsel
Mudge Rose Guthrie Alexander and Ferdon

Financial Consultant
Lazard Frères and Co.

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, 1995

OR

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

For the transition period from ____ to ____

Commission file number 0-296

El Paso Electric Company
(Exact name of registrant as specified in its charter)

Texas
(State or other jurisdiction of
incorporation or organization)

74-0607870
(I.R.S. Employer
Identification No.)

303 North Oregon Street, El Paso, Texas
(Address of principal executive offices)

79901
(Zip Code)

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

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

Title of each class
Common Stock, No Par Value

Name of each exchange
on which registered
American Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:
None

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 whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. 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. [X]

As of March 15, 1996, the aggregate market value of the voting stock held by non-affiliates of the registrant was \$268,181,025.

As of March 15, 1996, there were outstanding 59,999,981 shares of common stock, no par value.

DEFINITIONS

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

<u>Abbreviations, Acronyms or Defined Terms</u>	<u>Terms</u>
Agreed Order	Agreed Order of the Texas Commission entered August 30, 1995 implementing certain provisions of the Rate Stipulation
ANPP Participation Agreement	Arizona Nuclear Power Project Participation Agreement dated August 23, 1973, as amended
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 Code	United States Bankruptcy Code, 11 U. S. C. §101 et seq.
Bankruptcy Court	United States Bankruptcy Court for the Western District of Texas, Austin Division
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
Common Stock	Common stock, no par value, issued by the Company in the Reorganization
Company	El Paso Electric Company
CSW	Central and South West Corporation
DOE	United States Department of Energy
Effective Date	February 12, 1996; the date the Reorganization became effective
EPE	El Paso Electric Company
FERC	Federal Energy Regulatory Commission
Four Corners	Four Corners Project
FPA	Federal Power Act
Freeze Period	Ten-year period beginning August 2, 1995 during which rates for most Texas retail customers will remain frozen pursuant to the Rate Stipulation
IID	Imperial Irrigation District, an irrigation district in Southern California
KV	Kilovolt(s)
KW	Kilowatt(s)
KWH	Kilowatt-hour(s)
Merger	Proposed merger pursuant to which the Company would have become a wholly-owned subsidiary of CSW
Merger Agreement	Agreement and Plan of Merger dated as of May 3, 1993 among the Company, CSW and CSW Sub, as amended
Merger Plan	Modified Third Amended Plan of Reorganization
MW	Megawatt(s)
MWH	Megawatt-hour(s)
New Mexico Commission	New Mexico Public Utility Commission
NRC	Nuclear Regulatory Commission
OPC	Texas Office of Public Utility Counsel
Palo Verde	Palo Verde Nuclear Generating Station
Palo Verde Leases	Leases and other documents entered into in connection with a series of sale and leaseback transactions in 1986 and 1987 involving a portion of the Company's interest in Palo Verde
Palo Verde Participants	Those utilities who share in power and energy entitlements, and bear certain allocated costs, with respect to Palo Verde pursuant to the ANPP Participation Agreement

Abbreviations,
Acronyms or Defined Terms

Plan
PNM
Rate Stipulation

Reorganization

Reorganized Company
SFAS
Texas Commission
TNP

Terms

Fourth Amended Plan of Reorganization
Public Service Company of New Mexico
Stipulation and Settlement Agreement dated
as of July 27, 1995 between the Company, the
City of El Paso, OPC and most other parties
to the Company's rate proceedings before the
Texas Commission providing for a ten-year rate
freeze and other matters

Reorganization and emergence from bankruptcy
of the Company pursuant to the Plan
The Company following the Reorganization
Statement of Financial Accounting Standards
Public Utility Commission of Texas
Texas-New Mexico Power Company



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PART I

Item 1. Business

General

The Company is a public utility engaged in the generation, transmission and distribution of electricity in an area of approximately 10,000 square miles in west Texas and southern New Mexico. The Company also serves wholesale customers in Texas, New Mexico, California and Mexico. The Company owns or has significant ownership interests in five electrical generating facilities providing it with a total capacity of approximately 1,500 megawatts. For the twelve months ended December 31, 1995, the Company's energy sources consisted of approximately 53% nuclear fuel, 30% natural gas, 9% coal and 8% purchased power.

The Company serves approximately 274,000 residential, commercial, industrial and wholesale customers. The Company distributes electricity to retail customers principally in El Paso, Texas and Las Cruces, New Mexico (representing approximately 54% and 7%, respectively, of the Company's revenues for the twelve months ended December 31, 1995). In addition, the Company sells electricity to wholesale customers, including Texas-New Mexico Power Company, the Imperial Irrigation District, a southern California electric power agency, and the Comision Federal de Electricidad de Mexico, the national electric utility of Mexico. Principal industrial and other large customers of the Company include steel milling, copper refining, oil refining, garment manufacturing and cattle production concerns and United States military installations including the United States Army Air Defense Center at Fort Bliss in Texas and White Sands Missile Range and Holloman Air Force Base in New Mexico.

The Company's principal offices are located at 303 North Oregon Street, El Paso, Texas 79901 (telephone 915-543-5711). The Company was incorporated in Texas in 1901. As of March 1, 1996, the Company had approximately 1,100 employees, approximately 30% of whom are covered by a collective bargaining agreement that expires in June 1997.

Reorganization Under Chapter 11 of the Bankruptcy Code

Plan of Reorganization

On February 12, 1996, the Company's Fourth Amended Plan of Reorganization (the "Plan"), which was confirmed by the Bankruptcy Court on January 9, 1996, became effective (the "Reorganization"). This permitted the Company to emerge from a bankruptcy proceeding that began in January 1992.

As a result of the Reorganization, the Company has significantly reduced its total debt and simplified its capital structure. The Company's total obligations subject to compromise (excluding obligations related to the Palo Verde Leases, which represented \$700 million of allowed claims in the Bankruptcy Case) prior to its Reorganization was \$1,608 million. Under the Plan, this debt and the Palo Verde Lease obligations were extinguished and the creditors received a combination of cash and newly issued debt and equity



securities of the Reorganized Company. The capital structure of the Reorganized Company consists of approximately \$1,189 million of debt, \$100 million of redeemable preferred stock and approximately \$300 million of common stock equity. The Company has a \$100 million revolving credit facility to finance nuclear fuel purchases and to provide working capital. Approximately \$43.3 million of this revolving credit facility was drawn to finance nuclear fuel and is included in the debt described above. Under the Plan, all of the Company's former common and preferred stock was canceled and the holders of such securities received approximately 15% of the Reorganized Company's Common Stock and the right to receive certain litigation recoveries, if any.

In addition, in connection with the extinguishment of lease obligations, on the Effective Date arrangements pursuant to which the Company sold and leased back portions of its interest in Palo Verde were terminated and the Company reacquired such interests. The Company has agreed to indemnify certain parties to the sale-leaseback transactions against certain possible tax liabilities.

The Company's Common Stock is listed for trading on the American Stock Exchange under the symbol "EE" and began trading on February 16, 1996.

Rate Stipulation

The Agreed Order entered on August 30, 1995 by the Texas Commission became effective on the Effective Date. The Agreed Order implemented certain provisions of a settlement (the "Rate Stipulation") dated July 27, 1995 among the Company and substantially all of the other parties to a rate proceeding in Texas. Among other things, under the Rate Stipulation, (i) the Company received a one-time annual increase in Texas retail base rates of approximately \$24.9 million; (ii) the Company's base rates for most customers in Texas will be fixed at this increased level for ten years beginning August 2, 1995 (the "Freeze Period"); (iii) the City of El Paso granted the Company a new franchise that extends through the Freeze Period; (iv) the Company will retain 75% during the first five years of the Freeze Period and 50% during the remainder of the Freeze Period of (A) the revenues generated by providing third-party transmission services and (B) profit margins from certain off-system power sales; (v) no refunds or surcharges will be made to customers with respect to fuel costs and revenues for the period from July 1993 through June 1995; and (vi) all appeals of Texas Commission orders concerning the Company and all outstanding Texas Commission dockets concerning the Company's rates have been or will be resolved.

Accounting Treatment

The Company's financial statements following its emergence from bankruptcy will not be comparable to the historical financial statements presented herein, which do not reflect the Reorganization. The Company has set forth below unaudited pro forma financial statements that reflect the Reorganization as if it had occurred on the dates specified therein.

The Company's unaudited pro forma financial statements have been prepared in accordance with the requirements of Statement of Position 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code" ("SOP 90-7"). Following its emergence from bankruptcy, the Reorganized Company



will apply fresh-start reporting in accordance with SOP 90-7. SOP 90-7 requires a determination of the Company's reorganization value, which represents the going concern value of all of the Company's assets (excluding liabilities), and an allocation of such value to the Company's assets based on their relative fair values. The application of SOP 90-7 results in the creation of a new reporting entity having no retained earnings or accumulated deficit. Management's estimate of the reorganization value of the Company on a pro forma basis as of December 31, 1995 is approximately \$1,875 million reflecting the application of fresh-start reporting as if the Company had emerged from bankruptcy on that date.

Pro Forma Condensed Financial Statements (Unaudited)

The following unaudited Pro Forma Condensed Balance Sheet and unaudited Pro Forma Condensed Statement of Operations are based on the historical financial statements of the Company, as adjusted to give effect to the Company's Reorganization and consummation of the related transactions, including the application of fresh-start reporting. The unaudited Pro Forma Condensed Balance Sheet has been prepared assuming the Reorganization had occurred on December 31, 1995. The unaudited Pro Forma Condensed Statement of Operations has been prepared as if the Reorganization had occurred immediately prior to January 1, 1995.

The unaudited pro forma condensed financial information and accompanying notes should be read in conjunction with the Company's historical financial statements and the notes thereto appearing elsewhere herein. The unaudited pro forma condensed financial statements are presented for informational purposes only and do not purport to represent what the Reorganized Company's financial position or results of operations would actually have been if the consummation of the Reorganization had occurred on such dates, or to project the Reorganized Company's financial position or results of operations at any future date or for any future period. In addition, due to the seasonality of the Company's business, the results of operations for an annual period are not indicative of interim periods. However, the unaudited pro forma condensed financial statements contain, in the opinion of management, all adjustments necessary for a fair presentation thereof.

The Company has concluded it does not meet the criteria of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS No. 71"), necessary to reflect the effects of regulation in its financial statements upon effectiveness of the Reorganization and therefore SFAS No. 71 is not applied in the unaudited pro forma condensed financial statements. The accounting policies utilized in the preparation of the unaudited Pro Forma Condensed Balance Sheet and the unaudited Pro Forma Condensed Statement of Operations are generally consistent with those applied in the preparation of historical financial statements (See Part II, Item 8, "Financial Statements and Supplementary Data-Note D of Notes to Financial Statements") except as described herein and reflected in the pro forma adjustments. The Company will apply fresh-start reporting upon emergence from bankruptcy as described below and in Part II, Item 8, "Financial Statements and Supplementary Data-Note A of Notes to Financial Statements."

The Company determined its reorganization value by determining the estimated value of its pro forma capital structure, exclusive of operational liabilities, based on management's estimates of future operating results. Debt securities and preferred stock are reflected at face value and common stockholders' equity is valued at \$300 million (an aggregate of \$1,589 million). Such amount plus pro forma operational liabilities equals reorganization value. Reorganization value necessarily assumes that the Reorganized Company will achieve its estimated future operating results in all material respects. If such results are not achieved, the value of the Reorganized Company could be materially different. For purposes of determining reorganization value, management's estimate of future operating results reflect the impacts of the Rate Stipulation and the effects of the Reorganization, as well as other anticipated revenues and expenses.

Reorganization value was allocated first to assets, such as cash, receivables, inventories, and investments, which have readily determinable fair values, and which generally approximate their historic values. The remaining balance represents the value attributable to the Company's integrated utility system because the Company determined that no value is attributable to identifiable intangible assets, such as franchises. Such intangible assets do not allow the Company to receive values in excess of what would otherwise be obtained. Therefore, the entire remaining balance was allocated to net utility plant in service.

This process resulted in a determination of reorganization value as of December 31, 1995 in the amount of \$1,875 million of which \$1,474 million was allocated to net utility plant in service. The determination of reorganization value and allocations under fresh-start reporting are for financial reporting purposes only and are not intended to reflect the aggregate or individual value of assets for any other purpose. See Note 2 of Notes to Pro Forma Condensed Balance Sheet (Unaudited).

The pro forma information reflects certain additional estimated adjustments resulting from the Reorganization and the associated fresh-start reporting. These significant fresh-start reporting adjustments and impacts of implementation of the Reorganization include (1) the reacquisition of assets at Palo Verde subject to sale and leasebacks and the termination of those leases; (2) the discharge of obligations subject to compromise, which will be reflected in the statement of operations for the period prior to emergence from bankruptcy as an extraordinary item; (3) the cancellation of existing preferred and common equity; (4) the issuance of first mortgage bonds, preferred stock and new common stock, as well as payment of cash, to satisfy the claims of creditors and equity holders; (5) the adjustment of the accrual for decommissioning Palo Verde to represent the present value of estimated future expenditures for decommissioning; and (6) the adjustment of deferred tax assets and liabilities to the amounts calculated under SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109"), based upon temporary differences between the income tax and fresh-start reporting bases of the Company's assets and liabilities.

In applying fresh-start reporting, the Company will determine, as of the Effective Date, the actual reorganization value which will be allocated to the Company's assets, and the Company's liabilities will be recorded at their fair values. Accordingly, the estimated effects of fresh-start reporting reflected in the pro forma information are subject to change.

Pro Forma Condensed Balance Sheet
As of December 31, 1995
(Unaudited)

	December 31, 1995	Pro Forma Adjustments		December 31, 1995
	Historical	Debit	Credit	Pro Forma
ASSETS		(In thousands)		
Utility plant:				
Net plant in service	\$ 1,279,157	\$ 515,020 (1)	\$ 319,937 (2)	\$ 1,474,240
Construction work in progress	61,274			61,274
Net nuclear fuel	39,305			39,305
Net utility plant	1,379,736	515,020	319,937	1,574,819
Current assets:				
Cash and temporary investments	262,507	918,930 (3)	1,159,127 (4) 4,000 (5)	18,310
Accounts receivable	59,233			59,233
Inventories	32,737			32,737
Prepayments and other	8,877			8,877
Total current assets	363,354	918,930	1,163,127	119,157
Long-term contract receivable	33,683			33,683
Deferred charges and other assets	33,118	16,490 (6) 11,000 (7)		60,608
Accumulated deferred income tax assets	-	86,311 (8)		86,311
Total assets	\$ 1,809,891	\$ 1,547,751	\$ 1,483,064	\$ 1,874,578

See accompanying Notes to Pro Forma Condensed Balance Sheet (Unaudited).



Pro Forma Condensed Balance Sheet
As of December 31, 1995
(Unaudited)

	December 31, 1995 Historical	Pro Forma Adjustments (In thousands)		December 31, 1995 Pro Forma
		Debit	Credit	
CAPITALIZATION AND LIABILITIES				
Capitalization:				
Common stock	\$ 339,097	\$ 339,097 (9)	\$ 300,000 (10)	\$ 300,000
Accumulated deficit	(758,032)		758,032 (11)	-
Net unrealized gain on marketable securities, net of tax	172	172 (12)		-
Common stock equity (deficit)	(418,763)	339,269	1,058,032	300,000
Preferred stock	81,464	81,464 (13)	100,000 (14)	100,000
Obligations subject to compromise	1,608,091	1,608,091 (15)		-
Long-term debt and capital lease obligation	-		1,189,335 (16)	1,189,335
Total capitalization	1,270,792	2,028,824	2,347,367	1,589,335
Current liabilities:				
Accounts payable	34,900	10,475 (17)		24,425
Taxes accrued other than federal income taxes	24,629			24,629
Net overcollection of fuel revenues	53,788	42,292 (18)		11,496
Revenues subject to refund	35,582	35,582 (19)		-
Other	14,266			14,266
Total current liabilities	163,165	88,349	-	74,816
Deferred credits and other liabilities:				
Accumulated deferred income taxes	70,010	70,010 (8)		-
Accumulated deferred investment tax credits	78,275	78,275 (20)		-
Deferred gain on sales and leasebacks	128,478	128,478 (21)		-
Decommissioning	47,245		37,231 (22)	84,476
Other	51,926		74,025 (23)	125,951
Total deferred credits and other liabilities	375,934	276,763	111,256	210,427
Total capitalization and liabilities	\$ 1,809,891	\$ 2,393,936	\$ 2,458,623	\$ 1,874,578

See accompanying Notes to Pro Forma Condensed Balance Sheet (Unaudited).

Notes to Pro Forma Condensed Balance Sheet (Unaudited)

The following notes set forth the explanation of the assumptions used and adjustments made in preparing the unaudited Pro Forma Condensed Balance Sheet as of December 31, 1995. The unaudited Pro Forma Condensed Balance Sheet should be read in conjunction with the historical financial statements and the notes thereto appearing elsewhere herein.

The adjustments described below are based on the assumptions and preliminary estimates described therein and are subject to change. This statement does not purport to be indicative of the financial position of the Company as of such date, nor is it indicative of future results. Furthermore, the unaudited Pro Forma Condensed Balance Sheet does not reflect anticipated changes, other than the consummation of the Reorganization, which occurred as the result of operating activities before and after the Effective Date and other matters. For the purposes of the unaudited Pro Forma Condensed Balance Sheet, the consummation of the Reorganization is assumed to be as of December 31, 1995.

The unaudited Pro Forma Condensed Balance Sheet includes the following pro forma adjustments based on the assumptions described below:

1. To reflect the reacquisition of the Palo Verde assets that had been subject to sale-leaseback transactions and that were reacquired pursuant to the Reorganization. The amount of the addition to net utility plant is the original cost to the Company of the leased assets subject to the sale and leaseback transactions, less depreciation which would have been recorded if the Company had retained ownership of the assets. In conjunction with the reacquisition of the Palo Verde assets, the owner/lessors of the leased assets retained approximately \$288 million previously received by them from draws on letters of credit supporting the Company's obligations under the leases. In addition, the holders of bonds issued by funding corporations formed by the owner/lessors to finance the leases were allowed a \$700 million unsecured claim under the Reorganization, which claim was settled pro rata with other unsecured claims as outlined in Notes 10, 14 and 16 of Notes to Pro Forma Condensed Balance Sheet (Unaudited).

2. To reflect net plant in service at the amount determined in accordance with fresh-start reporting pursuant to SOP 90-7. Of the amount allocated to net plant in service, as described above, which the Company believes is supported by the Company's estimated future cash flows, the Company allocated amounts to sub-categories within net plant in service primarily based on the Company's estimates of their replacement cost less depreciation ("RCLD"). RCLD of generation assets was calculated based on estimates of the current cost of gas-fired combined-cycle and combustion turbine power plants adjusted for (a) differences in fuel and operating costs between the existing plants and those plants used in the RCLD computations and (b) economic depreciation of the existing plants, but without adjustment for differences in the risks associated with gas-fired plants compared to nuclear or coal-fired plants. RCLD of transmission, distribution and general assets was calculated by escalating the original cost less depreciation ("OCLD") of such assets by vintage year of acquisition to the current year using standard utility indices. Due to their nature, the RCLD of nuclear fuel and construction work in process was determined to be equal to their OCLD. Because the total RCLD of the Company's assets exceeds the amount allocable to utility plant, the excess was allocated pro rata to reduce the RCLD values to amounts that total the amount allocated to utility plant. Portions of the Company's net plant in service will be depreciated more rapidly than their remaining physical lives. See Note 4 of Notes to Pro Forma Condensed Statement of Operations (Unaudited).



The following summarizes the OCLD, RCLD pro forma and fresh-start values of the Company's net utility plant in service as of December 31, 1995:

<u>Classification</u>	<u>OCLD</u>	<u>RCLD</u> (Dollars in millions)	<u>Fresh-Start Value</u>
Generation-Nuclear	\$ 1,313	\$ 582	\$ 577
-Gas	52	91	90
-Coal	38	104	103
Transmission, distribution and general	391	710	704
Total	<u>\$ 1,794</u>	<u>\$ 1,487</u>	<u>\$ 1,474</u>

3. To reflect the net cash proceeds to the Company from the sale of the first mortgage bonds and preferred stock in an underwritten offering and draws pursuant to a revolving credit facility.

4. To reflect amounts paid to creditors and bankruptcy professionals pursuant to the Reorganization and other amounts expended prior to the Reorganization. This amount is net of approximately \$6.4 million of underwriter discounts and commissions which was borne by the creditors.

5. To reflect the payment of the other costs and expenses incurred in the underwritten offering and related to the revolving credit facility.

6. To reflect the Company's portion of the underwriter discounts and commissions and other costs and expenses of the underwritten offering.

7. To record the estimated fair value of a warrant to purchase an equity interest in a non-affiliated company (this warrant had been carried at zero in the historical balance sheet) in accordance with fresh-start reporting.

8. To adjust deferred income taxes to reflect taxes applicable to the differences between the fresh-start reporting bases of assets and liabilities and the corresponding income tax bases in accordance with SFAS No. 109. The Company anticipates that if it had emerged from bankruptcy on December 31, 1995 it would have had a net operating loss carryforward for federal income tax purposes (including anticipated future deductions attributable to retirement of first mortgage bonds issued directly to creditors in the Reorganization) of approximately \$840 million. The Company anticipates that limitations under the Internal Revenue Code on the utilization of net operating loss carryforwards following a change of control would limit the utilization with respect to approximately \$103 million of the net operating loss to approximately \$22 million per year. The remainder of the net operating loss will not be subject to limitation. In addition, the Company has net operating losses for state income tax purposes which result in deferred income tax assets of approximately \$54 million, an alternative minimum tax credit carryforward of approximately \$36 million and an investment tax credit carryforward of approximately \$12 million. Based on the anticipated levels of future taxable income, the Company believes it is more likely than not that the federal net operating loss will be fully realized within the fifteen-year carryforward period. Therefore, the tax benefit of the federal net operating loss has been fully recognized in the unaudited Pro Forma Condensed Balance Sheet and no valuation allowance has been recorded against the deferred tax asset. However, the Company has established valuation allowances for approximately \$26 million of the deferred state income tax assets (due to net operating loss carryforwards generally being available for only a five-year period for state purposes as compared to fifteen years for federal purposes) and the full amount of the investment tax credit carryforward to reflect the net amounts the Company concludes are more likely than

not will be realized. These items and the temporary differences between the income tax and financial reporting bases of the Company's assets and liabilities upon emergence from bankruptcy would result in a deferred tax asset of approximately \$86 million in accordance with SFAS No. 109.

9. To reflect the cancellation of existing common stock in the Reorganization.

10. To reflect the issuance of new common stock in the Reorganization. As described above, the Company determined the reorganization value of the Company upon emergence from bankruptcy in accordance with SOP 90-7. The Company also determined the fair value of all of its liabilities (including the new first mortgage bonds) and the new preferred stock. The difference between the amount of the Company's total assets and the sum of its liabilities and preferred stock is the amount assigned to common stock.

11. To reflect the elimination of the accumulated deficit in accordance with fresh-start reporting.

12. To reflect the elimination of the net unrealized gain on marketable securities in accordance with fresh-start reporting.

13. To reflect the cancellation of the existing preferred stock in the Reorganization.

14. To reflect the issuance of the new preferred stock. There are no sinking fund requirements for the preferred stock, but it is subject to mandatory redemption in 2008.

15. To reflect the elimination of obligations subject to compromise in the Reorganization.

16. To reflect the long-term debt and capital lease obligation that existed upon consummation of the Reorganization. The amount includes \$945.8 million of first mortgage bonds issued under the Reorganization, \$43.3 million under a revolving credit facility with Chemical Bank, \$193.1 million of obligations relating to pollution control revenue bonds assumed under the Reorganization, and a \$7.1 million capitalized lease obligation. The pollution control revenue bonds bear interest at a variable rate which is reset on a weekly basis. The capital lease obligation was recorded using an interest rate which approximates the current rate. Accordingly, these liabilities are reflected in the unaudited Pro Forma Condensed Balance Sheet at their historical amounts, which equal their fair values. Contractual maturities of long-term debt and capital lease obligation aggregate: \$2.0 million in 1996; \$1.3 million in 1997; \$1.4 million in 1998; \$169.8 million in 1999; \$0.8 million in 2000; \$150.0 million in 2001; \$149.0 million in 2003; \$236.0 million in 2006; \$285.9 million in 2011; \$33.3 million in 2013; \$100.6 million in 2014; and \$59.2 million in 2015.

17. To reflect the payment of professional fees and expenses that were accrued as of December 31, 1995.

18. To record the effects of the Rate Stipulation on net overcollection of fuel revenues. The Rate Stipulation provides that (i) no refunds or surcharges will be made to customers with respect to fuel costs and revenues for the period July 1993 through June 1995; and (ii) the Company will retain third-party transmission revenues and margins from certain off-systems sales in accordance with the Rate Stipulation from July 1, 1995 through the end of the Freeze Period.

19. To record the effects of revenues collected subject to refund in Texas. The Rate Stipulation provides that the Company will retain all revenues collected since July 16, 1994 under its bonded rate increase.

20. To reflect the elimination of accumulated deferred investment tax credits in accordance with fresh-start reporting.

21. To reflect the elimination of the deferred gain on sales and leasebacks associated with the reacquired Palo Verde leased assets of \$128.0 million and the deferred gain associated with a capitalized lease obligation of \$0.5 million.

22. In accordance with fresh-start reporting, the Company will reflect its liability for the decommissioning of Palo Verde based on the net present value of estimated future expenditures for decommissioning. Based on a 1995 study for Palo Verde prepared by an independent consultant, the total future decommissioning expenditures through 2037 are estimated to be approximately \$1.4 billion based on estimated costs of approximately \$229 million (in 1995 dollars) and an assumed average annual inflation rate of 3.0%. The amount of decommissioning liability reflected in the unaudited Pro Forma Condensed Balance Sheet is the present value of the estimated future decommissioning expenditures calculated by discounting such future expenditures using a rate of 6.0%. See Part II, Item 8, "Financial Statements and Supplementary Data--Note E of Notes to Financial Statements."

23. To reflect various adjustments related to other liabilities. This amount includes an approximate \$3.8 million reduction of the non-current portion of net overcollection of fuel revenues, which results from the Rate Stipulation as discussed in Note 18 of Notes to Pro Forma Condensed Balance Sheet (Unaudited) above; an increase of approximately \$72.0 million associated with the recording of unrecognized transition obligations, gains or losses, and past service costs for the Company's employee benefit plans in accordance with fresh-start reporting and an additional liability for estimated costs related to personnel severance benefits; and an approximate \$5.8 million increase related to a reclassification of certain liabilities currently classified as obligations subject to compromise which will be assumed by the Company under the Reorganization.



Pro Forma Condensed Statements of Operations
For the Year Ended December 31, 1995
(Unaudited)

	Year Ended December 31, 1995	Pro Forma Adjustments		Year Ended December 31, 1995
	Historical	Debit	Credit	Pro Forma
(In thousands except share and per share data)				
Operating revenues	<u>\$ 504,617</u>	<u>\$</u>	<u>\$ 40,420 (1)</u>	<u>\$ 545,037</u>
Operating expenses:				
Operation:				
Fuel	76,005			76,005
Purchased and interchanged power	<u>16,568</u>			<u>16,568</u>
	92,573			92,573
Other	208,445		75,976 (2)	129,654
			2,815 (3)	
Maintenance	43,412			43,412
Depreciation and amortization	56,762	28,260 (4)		85,022
Taxes:				
Federal income tax expense (benefit)	(11,248)	24,507 (5)		13,259
Other	<u>48,527</u>	<u>7,684 (5)</u>		<u>56,211</u>
	<u>438,471</u>	<u>60,451</u>	<u>78,791</u>	<u>420,131</u>
Operating income	<u>66,146</u>	<u>60,451</u>	<u>119,211</u>	<u>124,906</u>
Other income (deductions):				
Interest income	-		1,047 (6)	1,047
Other, net	(910)			(910)
Federal income tax expense applicable to other income	<u>(474)</u>	<u>366 (5)</u>		<u>(840)</u>
	<u>(1,384)</u>	<u>366</u>	<u>1,047</u>	<u>(703)</u>
Income before interest charges	<u>64,762</u>	<u>60,817</u>	<u>120,258</u>	<u>124,203</u>
Interest charges (credits):				
Interest	91,923	99,133 (7)	91,923 (9)	104,202
		5,069 (8)		
Other interest capitalized and deferred	<u>(3,820)</u>			<u>(3,820)</u>
	<u>88,103</u>	<u>104,202</u>	<u>91,923</u>	<u>100,382</u>
Income (loss) before reorganization items	<u>(23,341)</u>	<u>165,019</u>	<u>212,181</u>	<u>23,821</u>
Reorganization items (expense):				
Professional fees and other	(19,776)		19,776 (10)	-
Interest earned on accumulated cash resulting from				
Bankruptcy Case	13,237	13,237 (6)		-
Federal income tax expense applicable to reorganization items ...	<u>(3,439)</u>		<u>3,439 (5)</u>	<u>-</u>
	<u>(9,978)</u>	<u>13,237</u>	<u>23,215</u>	<u>-</u>
Net income (loss)	<u>(33,319)</u>	<u>178,256</u>	<u>235,396</u>	<u>23,821</u>
Preferred stock dividend requirements	<u>-</u>	<u>11,897 (11)</u>		<u>11,897</u>
Net income (loss) applicable to common stock	<u>\$ (33,319)</u>	<u>\$ 190,153</u>	<u>\$ 235,396</u>	<u>\$ 11,924</u>
Weighted average number of				
common shares outstanding	<u>35,544,330</u>			<u>59,999,981 (1)</u>
Net income (loss) per share of common stock	<u>\$ (0.94)</u>			<u>\$ 0.20</u>

See accompanying Notes to Pro Forma Condensed Statements of Operations (Unaudited).



Notes to Pro Forma Condensed Statement of Operations (Unaudited)

The following notes set forth the explanations and assumptions used and adjustments made in preparing the unaudited Pro Forma Condensed Statement of Operations for the year ended December 31, 1995. The unaudited Pro Forma Condensed Statement of Operations should be read in conjunction with the historical financial statements and the notes thereto appearing elsewhere herein.

The adjustments described below are based on the assumptions and preliminary estimates described therein and are subject to change. This statement does not purport to be indicative of the results of operations of the Company for such period, nor is it indicative of future results or results of interim periods. Furthermore, the unaudited Pro Forma Condensed Statement of Operations does not reflect anticipated changes, other than the consummation of the Reorganization, which occurred as the result of operating activities before and after the Effective Date and other matters. For the purposes of the unaudited Pro Forma Condensed Statement of Operations, the consummation of the Reorganization is assumed to be immediately prior to January 1, 1995.

The unaudited Pro Forma Condensed Statement of Operations includes the following pro forma adjustments based on the assumptions described below:

1. To record the effects of the Rate Stipulation, assuming that rates specified in the Rate Stipulation were implemented as of January 1, 1995. The Rate Stipulation provides that the Company will receive an approximate \$24.9 million annual base rate increase (above the rates being charged prior to the filing of the rate case in Texas for which the Agreed Order was entered), which would have increased operating revenues approximately \$24.1 million. Further, the Rate Stipulation provides that revenues from third-party transmission services and profit margins on off-system sales (other than those off-system sales allocated a full share of system costs) will initially be divided such that the Company retains 75% of such revenues and profit margins and 25% is credited to customers. This would have had the effect of increasing fuel related revenues by approximately \$16.3 million.

2. To eliminate the lease expense associated with the reacquired Palo Verde leases of approximately \$83.1 million. Further, the adjustment eliminates the amortization of the deferred gain on sales and leasebacks associated with the reacquired Palo Verde leased assets of approximately \$7.2 million.

3. To reflect the elimination of the amortization of the transition obligations related to the Company's employee benefit plans, which obligations were recorded on the unaudited Pro Forma Condensed Balance Sheet in accordance with fresh-start reporting.

4. To adjust depreciation and amortization to reflect the pro forma balance sheet amounts. The Company believes it will face a more competitive electric utility industry structure in the future, although the Company's estimate of the timing of such competition and its impact on asset recoveries is subject to change. The Company intends to perform a depreciation study to determine the depreciation methodology it will utilize for financial reporting purposes upon emergence from bankruptcy to reflect this competitive environment. For purposes of the unaudited Pro Forma Condensed Statement of Operations, depreciation and amortization is provided on a straight-line basis over the estimated remaining lives of the assets, except for approximately \$400 million of reorganization value allocated to net plant in service which is being depreciated over the ten-year period of the Rate Stipulation, which provides a transition period to increased competition. The Company believes the depreciation study will result in a methodology under which depreciation and amortization expense would not exceed the amount shown in the unaudited Pro Forma



Condensed Statement of Operations. Accordingly, depreciation expense is subject to change based upon the results of the depreciation study. See Note 2 of Notes to Pro Forma Condensed Balance Sheet (Unaudited). The range of depreciable lives is as follows:

Classification	Lives
Generation	10-31 years
Transmission	10-44 years
Distribution	10-39 years
General	3-38 years

5. To adjust income tax expense to reflect the expense calculated on pro forma pre-tax income at the statutory federal tax rate of 35% and the applicable statutory state tax rates. See Note 8 of Notes to Pro Forma Condensed Balance Sheet (Unaudited).

6. To reduce interest earned on accumulated cash resulting from the Bankruptcy Case included in Reorganization items in the historical financial statements to an amount reflecting interest income on an estimated cash and temporary investments balance of \$18.3 million had the Reorganization been consummated at January 1, 1995.

7. To reflect estimated interest charges. Such amounts were calculated at the stated rates for each series of first mortgage bonds (a weighted average rate of 8.55%); 9% for the capital lease obligation; an average interest rate of 6.31%, including letter of credit fees, on the pollution control revenue bonds; and an assumed rate of 7.88% on \$43.3 million estimated to be outstanding under a revolving credit facility and a commitment fee of 0.5% on the remainder of such facility. This would result in interest charges of approximately \$99.1 million. Additionally, the amount includes debt issuance cost amortization of approximately \$1.8 million. Debt issuance costs will be amortized over the life of the first mortgage bonds using the interest method.

8. To reflect the accrual of interest costs of approximately \$5.1 million, on the liability for estimated future expenditures to decommission Palo Verde.

9. To eliminate recorded historical interest expense related to obligations that existed prior to the Reorganization.

10. To eliminate amounts shown as professional fees and other included in Reorganization items.

11. To record the Preferred Stock dividend requirement at an annual rate of 11.40%, compounded for the payment of dividends in additional shares of preferred stock.

12. To reflect the actual shares of common stock issued in the Reorganization.

Facilities

As described below, the Company currently has a net installed generating capacity of approximately 1,500 MW, consisting of an entitlement of 600 MW from Palo Verde Units 1, 2 and 3, 482 MW at its Newman Power Station, 246 MW at its Rio Grande Power Station, an entitlement of 104 MW from Four Corners Units 4 and 5, and 68 MW at its Copper Power Station.

Palo Verde Station

The Company owns a 15.8% interest in each of the three 1,270 MW nuclear generating units and Common Plant at Palo Verde, which is located west of Phoenix, Arizona. The Palo Verde Participants include the Company and six other utilities: APS, Southern California Edison Company ("SCE"), 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.

The NRC has granted facility operating licenses and full power operating licenses for Unit 1, Unit 2 and Unit 3 at Palo Verde for terms of forty years each. In addition, the Company is separately licensed by the NRC to own its proportionate share of Palo Verde.

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 \$7.3 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.

Decommissioning. Pursuant to the ANPP Participation Agreement, as well as pursuant to applicable law, the Company is required to fund its share of the estimated costs to decommission Palo Verde over the estimated service life of forty years. The Company's funding requirements are derived from periodic engineering cost estimates.

In December 1995, the Palo Verde Participants approved a study by an outside engineering firm of the cost of decommissioning Palo Verde. The 1995 study determined that the Company will have to fund approximately \$229 million (stated in 1995 dollars) to cover its share of such costs. The 1995 study assumes that (i) maintenance expense for spent fuel storage will be incurred for ten years after the shutdown of the last unit (estimated to be in 2024) rather than the approximately 30 years utilized in a 1993 study; (ii) a national interim spent fuel storage facility will be available; and (iii) as a result of such national spent fuel storage facility, the amount of spent fuel stored on-site is reduced from all spent fuel assemblies to the final core plus fuel assemblies from approximately three refuelings. See "Energy Sources-Nuclear Fuel-Spent Fuel Storage."

Cost estimates for decommissioning have increased with each study conducted. The 1995 cost estimate is comparable to the cost estimate from a 1993 study, which determined that the Company would have to fund approximately \$221 million (stated in 1993 dollars), however, the 1993 study was based on different assumptions, primarily related to the decommissioning of spent fuel. The 1993 cost estimate included an estimated cost to decommission on-site spent fuel storage facilities of approximately \$50 million

while the 1995 study includes an estimated cost of approximately \$13 million related to spent fuel. The 1993 study assumed that (i) decommissioning would take place from 2024 through 2035 for the production units; (ii) maintenance expense for spent fuel storage would be incurred from 2035 through 2067; and (iii) that decommissioning of the spent fuel storage facilities would occur in 2067. The 1993 estimate reflected an 84% increase from the previous estimate made in 1989, primarily due to an increase in the estimated costs associated with the permanent burial of low-level radioactive waste due to the uncertainty surrounding the availability and cost of low-level radioactive waste repositories, as discussed below.

Although the 1995 study is based on the latest available information, there can be no assurance that decommissioning costs will not continue to increase in the future or that applicable regulatory requirements will not change. In addition, until a new low-level radioactive waste repository opens and operates for a number of years, estimates of the cost to dispose of low-level radioactive waste may increase significantly. APS has recently begun to consider the possibility that a water reclamation facility, evaporation ponds and related facilities may have to be decommissioned. This potential requirement was not part of the 1995 study, but will be addressed by the Palo Verde Participants in evaluating the decommissioning funding levels in 1996. The Company cannot currently predict the impact of this assessment, but the liability for decommissioning and future decommissioning expense could both increase as a result.

The rate freeze under the Rate Stipulation would preclude the Company from seeking a rate increase in Texas during the Freeze Period to recover increases in decommissioning costs. Additionally, there can be no assurance that the Company could increase its rates in any of its other jurisdictions to recover such increased costs.

Steam Generators. 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 Units 1 and 3. This form of tube degradation is not common in the nuclear industry. The units also have experienced circumferential cracking at the tube sheet, a more common type of tube cracking. The axial tube cracking was discovered following a steam generator tube rupture in Unit 2 in March 1993. Since that time, APS has undertaken an ongoing investigation and analysis and has performed corrective actions designed to mitigate further degradation. Corrective actions have included changes in operational procedures designed to lower the operating temperatures of the units, chemical cleaning and the implementation of other technical improvements. APS has stated that it believes its remedial actions have slowed the rate of tube degradation.

Each of the Palo Verde units has been inspected periodically during regularly scheduled refueling outages and mid-cycle inspection outages. When the tube cracks are detected during an inspection, the affected tubes are taken out of service by plugging, which impairs the performance of a unit if sufficient numbers of steam generator tubes are affected. The output from the Units have been reduced slightly due to the tube plugging and operating modifications.

The projected service lives of the units' steam generators are reassessed by APS periodically in conjunction with inspections made during outages of the Palo Verde units. In August 1995, APS announced that its ongoing analyses indicate 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. The Company intends to consider this finding in its forthcoming depreciation study. APS further stated that it expects replacement of the steam generators 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



steam generators in Units 1 and 3 should operate for their designated life of 40 years (to 2025 and 2027, respectively). APS will continue to assess these steam generators periodically.

Steam generator replacement could be done through new steam generators manufactured for Palo Verde or through the purchase of existing steam generators that are compatible with Palo Verde's design. Replacement of the steam generators would 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 or other Palo Verde Participants will agree to replace the Unit 2 steam generators. The Company expects that if the steam generators in Unit 2 are replaced, most of such costs would be incurred between 2000 and 2005. The total costs associated with replacement of the Unit 2 steam generators, including replacement power costs, could be significant, the Company's portion of which is currently estimated not to exceed \$30 million.

The rate freeze under the Rate Stipulation would preclude the Company from seeking a rate increase in Texas during the Freeze Period to recover capital costs associated with such replacement. It is uncertain whether the costs associated with replacing the Unit 2 steam generators would be approved by the New Mexico Commission and included in the Company's rate base in New Mexico.

Disposal of Low-Level Radioactive Waste. By legislation, Congress has established requirements for the disposal by each state of the radioactive waste generated within its borders. Arizona, California, North Dakota and South Dakota have entered into a compact (the "Southwestern Compact") for the disposal of low-level radioactive waste. California will act as the first host state of the Southwestern Compact, providing for waste disposal among such states. Arizona will serve as the second host state. The construction and opening of the California low-level radioactive waste disposal site in Ward Valley has been delayed due to disputes over environmental issues related to the proposed site, extensive public hearings and review of technical issues related to the proposed site. Despite being licensed by the State of California, the Department of the Interior has not transferred the land to the State of California. Following a report by the National Academy of Sciences related to the site, the Department of the Interior announced that if certain environmental conditions were implemented prior to the transfer, it was prepared to convey the land. The State of California is attempting to obtain the land through the court system without the imposition of these environmental restrictions. It is possible that additional delays will occur related to the Ward Valley low-level radioactive waste disposal site. In addition, the State of California has imposed several surcharges to be applied on a per-unit basis to the waste buried at Ward Valley and additional surcharges are possible. Although Palo Verde is estimated to undergo decommissioning during the period in which Arizona will act as host for the Southwestern Compact, opposition, delays, uncertainty and costs experienced to date in California demonstrate possible roadblocks that may be encountered in the future when Arizona seeks to open its own waste repository.

Liability and Insurance Matters. The Palo Verde Participants have public liability insurance against nuclear energy hazards up to the full limit of liability under federal law in the form of primary liability insurance provided by commercial insurance carriers in the amount of \$200 million, with the balance being provided by an industry-wide retrospective assessment program, pursuant to which industry participants would be required to pay an assessment to cover any loss in excess of \$200 million. The maximum assessment per reactor 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 Palo Verde, 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 the proceeds of which must first be applied to stabilization and decontamination. Finally, the Company has obtained insurance against a portion of any increased cost of generation or purchased power which may result from the accidental outage of any of the three Palo Verde units if the outage exceeds 21 weeks.

Department of Labor Matter. In May 1993, a Department of Labor ("DOL") Administrative Law Judge issued a Recommended Decision and Order finding that a former contract employee who worked at Palo Verde has been discriminated against because he engaged in protected activities (as defined under federal regulations) related to the reporting of safety concerns. APS has advised the Company that a settlement agreement with the former contract employee was approved by the Secretary of Labor in June 1995. In March 1996, the NRC issued a Notice of Violation and Proposed Imposition of Civil Penalty notifying APS that the NRC proposes to impose a \$100,000 civil penalty for a violation of NRC requirements relating to the circumstances surrounding this matter. APS has stated that it plans to pay the civil penalty. The Company's proportionate share of such civil penalty, based on the Company's generation entitlement share of Palo Verde, is 15.8% thereof.

Newman Power Station

The Company's Newman Power Station is located in El Paso, Texas, and consists of four generating units with an aggregate capacity of 482 MW. The units operate primarily on natural gas, but are also capable of operating on fuel oil.

Rio Grande Power Station

The Company's Rio Grande Power Station, located in Sunland Park, New Mexico, adjacent to El Paso, Texas, consists of three steam-electric generating units with an aggregate capacity of 246 MW when operating entirely on natural gas. The units operate primarily on natural gas, but also are capable of operating on fuel oil.

Four Corners Station

The Company owns an undivided 7% interest in Units 4 and 5 at Four Corners, located in northwestern New Mexico. The two coal-fired generating units each have a generating capacity of 739 MW. The Company shares power entitlements and certain allocated costs of the two units with APS (which is the operating agent) and the other participants.

Four Corners is located on land held under easements from the federal government and a lease from the Navajo Nation that expires in 2016. Certain of the facilities associated with Four Corners, including transmission lines and almost all of the contracted coal sources, are also located on Navajo land. Units 4 and 5 are located adjacent to a surface-mined supply of coal.

Copper Power Station

The Company's Copper Power Station, located in El Paso, Texas, consists of a 68 MW combustion turbine used primarily to meet peak demands. The unit operates primarily on natural gas, but is also capable of operating on fuel oil. 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 for up to a seven-year period.

Transmission and Distribution Lines and Agreements

The Company owns or has significant ownership interests in four major transmission lines and owns the distribution network within its retail service area. The Company is also a party to various transmission and power exchange agreements that, together with its owned transmission lines, enable the Company to obtain its energy entitlements from its remote generation at Palo Verde and Four Corners.

Springerville-Diablo Line. The Company owns a 310-mile, 345 KV transmission line from Tucson Electric Power Company's ("TEP") Springerville Generating Plant near Springerville, Arizona to the Luna Substation near Deming, New Mexico, and to the Diablo Substation near Sunland Park, New Mexico, providing an interconnection with TEP for delivery of the Company's generation entitlements from Palo Verde and, if necessary, Four Corners.

Arroyo-West Mesa Line. The Company owns 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 is the delivery point for the Company's generation entitlement from Four Corners, which power is transmitted to the West Mesa Substation over approximately 150 miles of transmission lines owned by PNM. This transmission line also carries power from the region to the west and north of Four Corners, where the Company has a major interconnection with the other Four Corners Participants.

Greenlee-Newman Line. The Company owns undivided interests in a 196-mile, 345 KV transmission line from the Newman Power Station to TEP's Greenlee Substation in Arizona. This line provides an interconnection with TEP for delivery of the Company's entitlements from Palo Verde and, if necessary, Four Corners.

AMRAD-Eddy County Line. The Company owns an undivided 66.7% interest in a 125-mile, 345 KV transmission line from the AMRAD Substation near Oro Grande, New Mexico to the Company's and TNP's high voltage direct current terminal at the Eddy County substation near Artesia, New Mexico. This terminal enables the Company to connect its transmission system to that of Southwestern Public Service Company ("SPS"), providing the Company with access to power markets to the east.

System Outages

The Company experienced three system outages between September 19, 1995 and October 21, 1995. Each outage occurred through a sequence of events following a fault on the Company's 345 KV transmission line from Springerville, Arizona to Deming, New Mexico (a segment of the Springerville-Diablo Line). The initial fault was followed in each instance by a relay mis-operation causing another major transmission line, the Hidalgo-Luna 345 KV transmission line (a segment of the Greenlee-Newman Line), to go out of service. In response to the outages, the Company has replaced certain relay equipment on the Hidalgo-Luna line, has reconfigured support structures on the Springerville-Deming line, and is implementing two new load-shedding programs to reduce the likelihood that future faults on the Company's transmission lines will cause general system instability and widespread outages.

Recent operating experience indicates that the remedial program has solved the system outage problem. The Springerville-Deming transmission line was recently subjected to extremely high winds during an unusually strong windstorm that lasted several hours and caused five faults on the line. The newly-installed relay equipment on the Hidalgo-Luna line performed as designed during the windstorm, preventing the loss of power on other transmission lines. Accordingly, the Company believes that the important first phase of the remedial program has been successful.

Notwithstanding the foregoing, however, the Company is undertaking additional analysis of its power system, including operating procedures, generation response and load-shedding plans. The Texas Commission, the New Mexico Commission and the Western Systems Coordinating Council ("WSCC") (a regional electric reliability council of which the Company is a member) are monitoring the Company's response to such outages. The WSCC recently completed its investigation of the three outages. The Company believes the conclusions of the WSCC investigation are consistent with the analysis and remedial actions undertaken or planned by the Company. Although the cost of the remedial measures is not material, the Company incurred approximately \$2.3 million of additional fuel and purchased and interchanged power costs in the fourth quarter of 1995 due to operating conditions while the initial remediation actions were completed.

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 rapidly and are difficult to predict. The construction of new facilities is subject to standards imposed by environmental regulation, and substantial expenditures may be required to comply with such regulations. The Company analyzes the costs of its obligations arising from environmental matters on an on-going basis and believes it has made adequate provision in its financial statements to meet such obligations, however, additional expenses associated with compliance could have a material adverse effect on the future operations and financial condition of the Company. See Part II, Item 8, "Financial Statements and Supplementary Data," Note J of Notes to Financial Statements.

PCB Treatment, Inc. In September 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, which had been operated by PCB Treatment, Inc. ("PTI"). 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 the EPA has determined that its abandoned two facilities in Kansas City require prompt remediation. In October 1994, the Company met with the EPA and other similarly situated companies, to discuss PTI's compliance history, the EPA's regulatory oversight of PTI, the condition of the two facilities, the identity of companies that had sent PCBs to PTI, and the EPA's legal authority to initiate voluntary or mandatory cleanup of the two facilities.

Based upon current information, more than 1,400 entities sent PCBs to PTI. The Company is working 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 two facilities. The claims, if any, against the Company related to the two facilities remain in dispute. At this time, the Company is unable to determine the extent to which it may bear legal liability for the remediation of the two facilities, or the amount of any such liability. The Company has made no provision in the accompanying financial statements related to this matter.

Santa Fe Facility. The Company has monitored one of its properties in El Paso, Texas (the "Santa Fe Facility") since 1990 for the presence of PCBs and total petroleum hydrocarbons, an indicator of petroleum product contamination. The periodic monitoring has been done at the request of and in coordination with the Texas Natural Resources Conservation Commission and its predecessor, the Texas Water Commission, following the discovery of oil while capping unused water wells at the Santa Fe Facility. The most recent sampling, in October 1995, indicated the presence of trace quantities of PCBs near the detection level, but well below the EPA PCB-spill clean up threshold. Based on the results of the monitoring, the Company believes but cannot assure that extensive remediation is unlikely to be required. The Company therefore has made no provision for remediation in the accompanying financial statements relating to this matter.

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 improvements at Palo Verde. The Company's estimated cash construction costs for 1996 through 1999 are approximately \$167 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)	
1996	\$ 40	Production (1)	\$ 37
1997	40	Transmission	4
1998	47	Distribution	105
1999	40	General	21
Total	<u>\$ 167</u>	Total	<u>\$ 167</u>

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

Energy Sources

General

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

Power Source	Years Ended December 31,		
	1993	1994	1995
Nuclear	43%	45%	53%
Natural Gas	29	32	30
Coal	10	9	9
Purchased Power	18	14	8
Total	100%	100%	100%

Fuel and purchased power costs are passed through directly to customers in Texas and New Mexico pursuant to applicable regulations. Historical fuel costs and revenues are reconciled periodically in proceedings before the applicable commission to establish the applicable fuel rate to be charged customers and to determine whether a refund or surcharge based on such historical costs and revenues is appropriate. See Part II, Item 8, "Financial Statements and Supplementary Data - Note C of Notes to Financial Statements."

Nuclear Fuel

The Palo Verde Participants have contracts for uranium concentrate which should be sufficient to meet Palo Verde's operational requirements through at least the year 2000. Spot purchases in the uranium market will also be made, as appropriate. The Palo Verde Participants have contracted for up to 95% of conversion services required through 2000. The Palo Verde Participants have an enrichment services contract with the United States Enrichment Corporation ("USEC") which obligates USEC to furnish the enrichment services required for the operation of the three Palo Verde units through 2002, with an option for five additional years. Existing contracts will provide fuel assembly fabrication services for each Palo Verde unit through 2000.

Spent Fuel Storage. Existing spent fuel storage facilities at Palo Verde have sufficient capacity to store all fuel expected to be discharged from normal operation of all of the Palo Verde units through at least the year 2000. Existing spent fuel storage facilities can be modified to extend storage capacity through 2005 or, if more economical, alternative interim storage facilities can be constructed on-site for storage of spent fuel. Pursuant to the Nuclear Waste Policy Act of 1982, as amended in 1987, the DOE is obligated to accept and dispose of all spent nuclear fuel and other high-level radioactive wastes generated by all domestic power reactors. In November 1989, the DOE reported that such permanent disposal facility will not be in operation until 2010. As a result, under the DOE's current criteria for shipping allocation rights, it is estimated that Palo Verde could not ship spent fuel to the DOE permanent disposal facility until approximately 2025. APS 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 and to store spent fuel safely until shipments to the DOE's permanent disposal facility begin.



Nuclear Fuel Financing. Pursuant to the ANPP Participation Agreement, the Company has an undivided interest in nuclear fuel purchased in connection with Palo Verde. On the Effective Date, the Company and Texas Commerce Bank National Association, as trustee, entered into a \$100 million credit facility with Chemical Bank that includes a portion for working capital requirements and up to \$60 million for the financing of nuclear fuel. On the Effective Date, approximately \$43.3 million was drawn to finance nuclear fuel. The Company also entered into a purchase contract with an independent trust established by the Company related to the financing of nuclear fuel purchases. Under the terms of the documents related to the nuclear fuel financing, the trust borrows under the credit facility amounts sufficient to purchase and prepare nuclear fuel for use. The Company is required to make quarterly payments to the trust for the heat energy produced by the nuclear fuel and used by the Company.

Natural Gas

In 1995, the Company's natural gas requirements at the Rio Grande Power Station were met solely with spot natural gas purchases from various suppliers. Interstate gas is delivered under a firm ten year transportation agreement, which 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 availability of spot natural gas versus other supplies in obtaining a reliable and economical supply for the Rio Grande Power Station.

The natural gas requirements for the Newman and Copper Power Stations are currently supplied and transported pursuant to an intrastate natural gas contract which expires December 31, 1996. The Company is evaluating this contractual relationship to ensure the continued supply of reliable and economic natural gas for the Newman and Copper Power Stations.

Coal

APS, as operating agent for Four Corners, purchases Four Corners' coal requirements from a supplier with a long-term lease of coal reserves owned by the Navajo Nation. Management believes that Four Corners has sufficient reserves of coal to meet the plant's operational requirements for its useful life.

Purchased Power

The Company has a firm power purchase agreement with SPS for at least 75 MW for 1996 to support the requirements of the agreement with CFE.

In December 1995, the transformer for a 150 MW unit at the Rio Grande Power Station was damaged and is not expected to return to service prior to the Company's summer peak requirements. As a result, the Company may need to purchase replacement power to meet its capacity requirements, the cost of which is currently estimated to be approximately \$2 million.

Operating Statistics

	December 31,		
	1993	1994	1995
Operating revenues (In thousands):			
Base revenues:			
Retail:			
Residential	\$ 123,706	\$ 129,869	\$ 128,295
Commercial and industrial, small	120,084	126,450	128,715
Commercial and industrial, large	36,440	39,754	40,870
Sales to public authorities	<u>57,063</u>	<u>59,811</u>	<u>59,613</u>
Total retail	337,293	355,884	357,493
Wholesale sales for resale	<u>89,863</u>	<u>75,750</u>	<u>74,557</u>
Total base revenues	427,156	431,634	432,050
Fuel revenues and economy sales	112,005	101,076	68,823
Other	<u>4,433</u>	<u>4,050</u>	<u>3,744</u>
Total operating revenues	<u>\$ 543,594</u>	<u>\$ 536,760</u>	<u>\$ 504,617</u>
Fuel and purchased and interchanged power expense	<u>\$ 133,004</u>	<u>\$ 119,822</u>	<u>\$ 92,573</u>
Number of customers (End of year):			
Residential	235,151	240,368	245,245
Commercial and industrial, small	23,338	23,857	24,615
Commercial and industrial, large	74	80	89
Other	<u>3,395</u>	<u>3,470</u>	<u>3,674</u>
Total	<u>261,958</u>	<u>267,775</u>	<u>273,623</u>
Average annual use and revenue per residential customer:			
KWH	6,142	6,299	6,055
Revenue	<u>\$ 637.68</u>	<u>\$ 644.82</u>	<u>\$ 595.89</u>
Average revenue per KWH:			
Residential	10.38¢	10.24¢	9.84¢
Commercial and industrial, small	9.12	8.91	8.46
Commercial and industrial, large	<u>5.79</u>	<u>5.02</u>	<u>4.74</u>
Energy supplied, net, KWH (In thousands):			
Generated	6,625,162	7,018,423	7,439,404
Purchased and interchanged	<u>1,416,172</u>	<u>1,051,251</u>	<u>584,853</u>
Total	<u>8,041,334</u>	<u>8,069,674</u>	<u>8,024,257</u>
Energy sales, KWH (In thousands):			
Retail:			
Residential	1,424,935	1,497,094	1,472,771
Commercial and industrial, small	1,616,434	1,715,409	1,750,973
Commercial and industrial, large	872,477	1,089,695	1,119,463
Sales to public authorities	<u>1,034,231</u>	<u>1,078,800</u>	<u>1,067,263</u>
	4,948,077	5,380,998	5,410,470
Wholesale:			
Sales for resale	2,484,128	1,925,668	1,645,897
Economy sales	<u>164,559</u>	<u>320,026</u>	<u>538,102</u>
Total sales	7,596,764	7,626,692	7,594,469
Losses and company use	<u>444,570</u>	<u>442,982</u>	<u>429,788</u>
Total	<u>8,041,334</u>	<u>8,069,674</u>	<u>8,024,257</u>
Native system:			
Peak load, KW	997,000	1,093,000	1,088,000
Net generating capacity for peak, KW	1,497,000	1,497,000	1,500,000
Load factor	<u>62.1%</u>	<u>61.1%</u>	<u>61.6%</u>
Total system:			
Peak load, KW	1,335,000	1,365,000	1,374,000
Net generating capacity for peak, KW	1,497,000	1,497,000	1,500,000
Load factor	<u>66.4%</u>	<u>63.7%</u>	<u>62.0%</u>



Regulation

Texas Rate Matters

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 is the City of El Paso. The Texas Commission has exclusive appellate jurisdiction to review municipal orders and ordinances regarding rates and services in Texas and jurisdiction over certain activities of the Company. The decisions of the Texas Commission are subject to judicial review.

Rate Stipulation and Agreed Order. The Company's rates for its Texas jurisdictional customers are governed by the Agreed Order, which became effective on the Effective Date. The Agreed Order implemented certain provisions of the Rate Stipulation and set rates consistent with the Rate Stipulation. Among other things, under the Rate Stipulation: (1) the Company received a one-time annual increase in Texas retail base rates of approximately \$24.9 million; (2) the Company's base rates for most customers in Texas will be fixed at this increased level for the Freeze Period; (3) the City of El Paso granted the Company a new franchise that extends through the Freeze Period; (4) the Company will retain 75% during the first five years of the Freeze Period and 50% during the remainder of the Freeze Period of (a) the revenues generated by providing third-party transmission services and (b) profit margins from certain off-system power sales; (5) the Company's reacquisition of the Palo Verde leased assets is in the public interest; (6) no refunds or surcharges will be made to customers with respect to fuel costs and revenues for the period from July 1993 through June 1995; and (7) all appeals of Texas Commission orders concerning the Company and all outstanding Texas Commission dockets concerning the Company's rates have been or will be resolved.

Neither the Rate Stipulation nor the Agreed Order deprives the Texas regulatory authorities of their jurisdiction over the Company during the Freeze Period. However, the Texas Commission determined in the Agreed Order that the rate freeze is in the public interest and results in just and reasonable rates. Further, the signatories to the Rate Stipulation (other than the General Counsel, OPC and the State of Texas) have agreed not to seek to initiate an inquiry into the reasonableness of the Company's rates during the Freeze Period and to support the Company's entitlement to rates at the freeze level throughout the Freeze Period. The Company believes, but cannot assure, that its cost of service will support rates at or above the freeze level throughout the Freeze Period and therefore does not believe any attempt to reduce the Company's rates would be successful. In the event of a merger, the parties to the Rate Stipulation retain all rights provided in the Rate Stipulation, their rights to participate as a party in any proceeding related to the merger, as well as the right to pursue a reduction in rates below the freeze level. However, such rights shall be limited to urging rate reductions based on post-merger synergy savings.

Palo Verde Performance Standards. The Texas Commission has established performance standards for the operation of Palo Verde, pursuant to which Palo Verde is evaluated annually to determine whether its three-year rolling average capacity factor entitles the Company to a reward or subjects it to a penalty. There are five performance bands based around a target capacity factor of 70%. The capacity factor is calculated as the ratio of actual generation to maximum possible generation. If the capacity factor, as measured on a station basis for any consecutive 24-month period, should fall below 35%, the Texas Commission could reconsider the rate treatment of Palo Verde. The Company expects any reward or penalty for the year ended December 31, 1995, to be minimal. The removal of Palo Verde from rate base could have a significant negative impact on the Company's revenues and financial condition.

New Mexico Rate Matters

The New Mexico Commission has jurisdiction over the Company's rates and services in New Mexico and jurisdiction of certain activities of the Company, including prior approval of the issuance, assumption or guarantee of securities. The New Mexico Commission's decisions are subject to judicial review. Current base rates in New Mexico were established in prior proceedings and have not increased since February 1990. The Company does not currently have any agreement with New Mexico regulatory authorities or parties to New Mexico regulatory proceedings comparable to the Rate Stipulation. Pursuant to New Mexico law, certain interested parties may challenge the Company's rates in New Mexico and, in such a proceeding, such parties might assert that Palo Verde Unit 2 should be revalued downward for rate making purposes as a result of the Reorganization. In addition, the New Mexico Commission might assert that it is within its discretion to value the Company's property for rate making purposes utilizing a methodology that results in decreased rates for New Mexico retail customers. Consequently, there can be no assurance that the Company will continue to be able to charge its current rates in New Mexico.

Palo Verde Performance Standards. The New Mexico Commission has established performance standards for the operation of Palo Verde, pursuant to which the entire Palo Verde station is evaluated annually to determine if its achieved capacity factor entitles the Company to a reward or subject it to a penalty. There are five performance bands based around a target capacity factor of 67.5%. The capacity factor is calculated as the ratio of actual generation to maximum possible generation. Because Unit 3 is not included in the Company's New Mexico rate base, 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. The removal of Palo Verde from rate base could have a significant negative impact on the Company's revenues and financial condition.

Federal Regulatory Matters

Federal Energy Regulatory Commission. The Company is subject to regulation by the FERC in certain matters, including rates for wholesale power sales, transmission of electric power and the issuance of securities.

The Company has a long-term firm power sales agreement with IID providing for the sale of 100 MW of firm capacity and 50 MW of contingent capacity through April 2002. The agreement generally provides for level sales prices over the life of the agreement. The Company has a firm power sales agreement with TNP, providing for sales to TNP in the minimum amount of 25 MW through 2002. Sales prices decline over the life of the agreement. 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.

Department of Energy. The DOE regulates the Company's exports of power to CFE in Mexico pursuant to a license granted by the DOE and a presidential permit. In addition, the DOE is authorized to assess operators of nuclear generating facilities for a share of the costs of decommissioning the DOE uranium enrichment facilities.

Nuclear Regulatory Commission. The NRC has jurisdiction over the Company's licenses for Palo Verde and regulates the operation of nuclear generating stations to protect the health and safety of the public from

radiation hazards and has authority to conduct environmental reviews pursuant to the National Environmental Policy Act.

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 are up to 150 MW during May through September and up to 120 MW at other times of the year. The obligations of CFE under the agreement are subject to continued budgetary authorization by the appropriate Mexican authorities 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.

In addition to the sales agreement that the Company has with CFE, the Company has an agreement to sell CFE an incremental block of 50 MW of energy on an "as requested" basis from June 1, 1996 through September 30, 1996, which date can be extended on a month-to-month basis.

Recent Changes in Utility Regulation

The electric utility industry faces increasing pressure to become more competitive as legislative, regulatory, economic and technological changes occur. Federal legislation, as well as initiatives in various states, encourage competition in electricity generation among electric utility and non-utility power producers. Together with increasing customer demand for lower-priced electricity and other energy services, these measures have accelerated the industry's movement toward more competitive pricing and cost structures. Such competitive pressures could result in the loss of customers and diminish the ability of an electric utility to fully recover from customers its investment in generation assets.

In March 1995, the FERC issued a Notice of Proposed Rulemaking (the "NOPR"), which would require utilities to file open access transmission tariffs and further refined its proposals regarding stranded investment. The NOPR generally would require that a transmitting utility provide third parties with transmission service comparable to the service the transmitting utility provides to itself and would apply to a full range of transmission services. In the NOPR, the FERC also announced that it intends to allow utilities to recover stranded investments resulting from the open access transmission tariffs from former power customers who have elected to become transmission-only customers. Under the NOPR, to recover such stranded investments, the utility may have to demonstrate an expectation of recovery of costs through continued provision of service as well as other factors. In the NOPR, the FERC also has indicated it would assume jurisdiction over stranded investment resulting from municipalization. The period for comment on the NOPR ended in August 1995. The FERC will consider the comments submitted and may issue final rules as proposed, issue revised rules based on the comments received or issue no rules. Although it is not possible to predict the ultimate form of any resulting regulations, management believes that the FERC will continue to take action to increase competition in the wholesale power markets.

In addition, in February 1996 the Texas Commission adopted a rule governing wholesale transmission access, as required by recent Texas legislation. The Texas Commission does not have jurisdiction over the Company's wholesale transactions, however, the rule would require the Company to file its FERC-approved open access transmission tariffs with the Texas Commission to certify compliance with the Texas legislation. The Texas Commission is also considering the extent to which utilities in Texas

could incur stranded investment and the extent to which the Texas Commission has jurisdiction to require the Company to separate its costs and rates based on the costs associated with its generation, transmission and distribution operations.

Various state commissions and legislatures are examining methods to increase competition in retail power markets, including the potential for "retail wheeling" (the required delivery of electric service for other providers to customers on a distribution system) and allowing customers to select a power provider from a pool of producers. The Texas Legislature considered, but did not enact, proposals to permit limited retail wheeling during its recent legislative session. However, the Texas Legislature directed the Texas Commission to prepare reports to the Texas Legislature concerning (i) the scope of competition in electric markets, the impacts of industry restructuring, and recommendations for legislation related thereto; and (ii) the scope of potential stranded investment and procedures for allocating and recovering stranded costs. The Texas Commission is currently conducting investigations and soliciting comments concerning such reports.

In New Mexico, the state legislature considered retail wheeling as early as 1992 and established committees to review the industry structure, integrated resource planning and other issues. In its session ending in February 1996, the New Mexico Legislature concluded that neither retail wheeling nor the restructuring of the electric power industry is in the best interests of the state or its residents at this time, but that the industry may change in the future sufficiently to justify further consideration of these alternatives. The Legislature directed the New Mexico Commission to monitor and evaluate industry restructuring but to take no action without a prior report to the state legislature. The New Mexico Commission has issued a notice of inquiry regarding competition and restructuring of the electric utility industry and a proceeding is pending before the New Mexico Commission.

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

Litigation with Central and South West Corporation

In May 1993, the Company entered into the Merger Agreement with CSW, pursuant to which the Company would have been acquired by CSW. In June 1995, CSW terminated the Merger Agreement. In response, the Company filed a complaint against CSW in the 205th Judicial District Court of El Paso County, Texas, alleging 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 is seeking an unspecified amount of damages, punitive damages, attorneys' fees and costs. As part of the Reorganization, the first \$20 million in proceeds, if any, to the Company from this litigation will be distributed to the holders of preferred stock and common stock of the Company prior to the Reorganization. On June 15, 1995, CSW filed an adversary proceeding against the Company in the Bankruptcy Court seeking to recover termination fees of \$25 million and approximately \$3.7 million in attorneys' fees and expenses that CSW claims it advanced on behalf of the Company in certain regulatory proceedings. All of

the actions are pending before the Bankruptcy Court. The Company is seeking to transfer the case out of the Bankruptcy Court to ensure its right to a jury trial. The parties have commenced discovery, and the Company expects the trial to begin in late 1996 if it remains in the Bankruptcy Court. The Company cannot predict the outcome of this litigation.

Litigation with the City of Las Cruces

The City of Las Cruces ("Las Cruces") has stated that it intends to attempt to replace the Company as its electric service provider by acquiring, through condemnation or otherwise, the distribution assets and other facilities used to provide electric service to customers in Las Cruces. Sales to customers in Las Cruces represented approximately 7% of the Company's operating revenues in 1995. Las Cruces has two actions pending against the Company in federal district court in New Mexico, one seeking to recover franchise fees despite the expiration of the Company's Las Cruces franchise in March 1994 and one seeking a declaratory judgment that Las Cruces can proceed with a condemnation action against the Company.

The franchise fee claim is pending as *City of Las Cruces v. El Paso Electric Co.*, pursuant to which Las Cruces is seeking to enforce what it claims are the Company's continued payment obligations under an allegedly implied continuation of the municipal franchise ordinance that expired by its own terms in March 1994. Alternatively, Las Cruces is seeking the reasonable value of the Company's use, occupation and rental of Las Cruces' rights-of-way or damages for trespass. Las Cruces is also seeking an unspecified amount of punitive damages. In August 1995, the court denied the Company's motion to dismiss the complaint. The Company intends to vigorously defend against the lawsuit.

In April 1995, Las Cruces filed a Complaint for Declaratory Judgment against the Company in the District Court for Dona Ana County, New Mexico, seeking a declaratory judgment that Las Cruces has a right of eminent domain to condemn the electric distribution system and related facilities owned and operated by the Company within the city limits that provide or assist in the provision of electricity within the municipal boundaries of Las Cruces. In May 1995, the Company removed the case to the United States District Court for the District of New Mexico, where it is pending as *City of Las Cruces, New Mexico v. El Paso Electric Co.* (the "Declaratory Judgment Suit"). In October 1995, the Company's motion for summary judgment was denied and the court ruled that although Las Cruces lacks express statutory authority to condemn the Company's assets, such express statutory authority is required only if the proposed condemnation would substantially impair, obliterate or destroy the use of the remaining property. In November 1995, the Board of Commissioners of Dona Ana County, New Mexico, filed a motion to intervene in the Declaratory Judgment Suit to ensure that the concerns of non-municipal county customers and residents are fully developed.

Las Cruces has taken several actions to position itself to acquire portions of the Company's distribution system and certain related facilities in the event it is successful in the Declaratory Judgment Suit and can proceed with condemnation. In June 1994, the Las Cruces City Council approved a resolution selecting SPS to provide operation and maintenance services for the proposed Las Cruces electric distribution system, substations and associated transmission facilities and authorizing the staff of Las Cruces to negotiate a contract with SPS related to such services. In August 1994, SPS and Las Cruces entered into a fifteen-year contract granting SPS the right to provide all of the electric power and energy required by Las Cruces during the term of the contract. Las Cruces also has offered to purchase the Company's assets serving Las Cruces for \$43 million. In addition, Las Cruces announced that, in October 1995, it sold approximately \$73 million in revenue bonds to provide funding to finance the acquisition by condemnation or negotiated purchase of the Company's electrical distribution assets within and adjacent to the Las Cruces



city limits. The Company has filed a lawsuit in the Dona Ana County District Court and is pursuing a complaint simultaneously before the New Mexico Commission challenging the legality of the sale of the revenue bonds. The New Mexico Commission is also investigating an agreement between SPS and Las Cruces that would grant, in certain circumstances, Las Cruces an option to sell electric utility assets acquired through condemnation to SPS.

The Company will continue to contest Las Cruces' efforts to acquire the Company's property and/or to replace the Company as the provider of electric service in Las Cruces. The Company believes that New Mexico law does not authorize condemnation of the Company's facilities by Las Cruces. If Las Cruces succeeds in its efforts, the Company could lose its Las Cruces customer base, although the Company would receive "just compensation" as established by the court. The Declaratory Judgment Suit is at a preliminary stage and is only to determine whether Las Cruces has a right of eminent domain over portions of the Company's system. Accordingly, the Company is unable to predict the outcome of Las Cruces' efforts.

Water Cases

San Juan River System. The Four Corners Participants are among the defendants in a suit filed by the State of New Mexico in 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. The case has been inactive for many years. 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.

Gila River System. 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 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*. 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. In December 1992, the Arizona Supreme Court heard oral argument on certain issues in this matter that are pending on interlocutory appeal. Issues important to 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. In September 1994, the Arizona Supreme Court granted review of the June 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

In July 1995, the Navajo Nation enacted the Navajo Nation Air Pollution Prevention and Control Act, the Navajo Nation Safe Drinking Water Act and the Navajo Nation Pesticide Act (collectively, the



"Acts"). In October 1995, the Four Corners Participants requested that the United States Secretary of the Interior resolve their dispute with the Navajo Nation regarding whether the Acts apply to operation of Four Corners. The Four Corners Participants subsequently filed a lawsuit in the District Court of the Navajo Nation, Window Rock District, seeking, among other things, a declaratory judgment that (i) the Four Corners leases and federal easements preclude the application of the Acts to the operation of Four Corners; and (ii) the Navajo Nation and its agencies and courts lack adjudicatory jurisdiction to determine the enforceability of the Acts as applied to Four Corners. On October 18, 1995, the Navajo Nation and the Four Corners Participants agreed to indefinitely stay the proceedings referenced above so that the parties may attempt to resolve the dispute without litigation. The Company is unable to predict the outcome of this matter.

Other Legal Proceedings

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

The Plan was approved by the holders of the Company's former common stock pursuant to ballots cast in the Bankruptcy Case in the last quarter of 1995. See Item 1, "Business-Reorganization Under Chapter 11 of the Bankruptcy Code."



PART II

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

The Company's Common Stock is listed on the American Stock Exchange under the symbol "EE" and began trading on February 16, 1996. For the period from February 16, 1996 to March 15, 1996, the high sales price was \$6.25 and the low sales price was \$4.75, as reported in the consolidated reporting system of the American Stock Exchange.

The Company did not pay any dividends on the former common stock after March 1989. The former common stock of the Company was canceled effective February 12, 1996 as part of the Reorganization. The holders of the former common stock received 3% or approximately 1.8 million shares of the Common Stock in the Reorganization. The remaining shares of Common Stock issued in the Reorganization were issued to creditors and holders of the Company's former preferred stock. See Part I, Item 1, "Business-Reorganization Under Chapter 11 of the Bankruptcy Code."

The Company's ability to pay dividends on the Common Stock for the next several years will be limited by the terms of applicable laws and financing arrangements entered into in connection with the Reorganization. All distributions with respect to the Common Stock, including the declaration or payment of dividends, are subject to the provisions of the Texas Business Corporation Act, including provisions that prohibit any distribution that exceeds the surplus of the Company. In addition, under Section 305 of the Federal Power Act, it is unlawful for a director or officer of the Company to participate in the making or payment of dividends from "any funds properly included in capital account" (which is not further defined).

Pursuant to the terms of the resolutions creating the Series A Preferred Stock, no dividends can be paid on the Common Stock if there are dividends in arrears on the Series A Preferred Stock. So long as the Company's First Mortgage Bonds, Series A through H, are outstanding and the series with the longest maturity is not rated "investment grade" by either Standard & Poor's Rating Service or Moody's Investors Service, Inc., the Company may not declare any dividend on the Common Stock, other than in additional shares of Common Stock, or make any other distribution on, or acquire for value any shares of Common Stock (with certain limited exceptions) unless, after giving effect thereto, the aggregate of all such dividends, distributions and certain other payments made by the Company since February 12, 1996 would be less than the sum of (i) 50% of the consolidated net income (as defined in the mortgage indenture) of the Company minus dividends paid in respect of the Series A Preferred Stock for the period from February 13, 1996 to the most recently ended fiscal quarter for which quarterly financial statements are available (or, if such consolidated net income is a deficit, less 100% of such deficit), plus (ii) 100% of the aggregate net proceeds received by the Company from the issuance or sale since February 12, 1996 of equity securities or debt securities that have been converted into equity securities, plus (iii) \$10.0 million.

Pursuant to the terms of the reimbursement agreements related to four letters of credit issued in respect of the four series of pollution control revenue bonds, so long as a drawing is available under any of the letters of credit, the same limitation on the declaration of dividends would apply to the Company. In addition to the restriction contained in the mortgage indenture, the reimbursement agreements limit the aggregate amount of dividends that can be paid on the Common Stock during the three years after its initial issuance, i.e., to February 12, 1999, to \$15.0 million. The credit agreement for the working capital and fuel financing facility contains the same limitations on the payment of dividends on the Common Stock as the reimbursement agreements related to the letters of credit on the pollution control revenue bonds.



Item 6. Selected Financial Data

As of and for the years ended December 31:

	Predecessor					Pro Forma 1995 (7)
	1991	1992	1993	1994	1995	
	(In thousands except per share data)					
Operating revenues	\$ 462,405	\$ 524,760	\$ 543,594	\$ 536,760 (1)	\$ 504,617 (1)	\$ 545,037
Operating income	50,722	67,036	64,971	73,011	66,146	124,906
Income (loss) before extraordinary item and cumulative effect of a change in accounting principle	(266,912) (2)	(28,180)	(41,855)	(28,153)	(33,319)	23,821
Extraordinary item	(289,102) (3)	-	-	-	-	-
Cumulative effect of a change in accounting principle	-	-	(96,044) (4)	-	-	-
Net income (loss) applicable to common stock	(564,288)	(28,180)	(137,899)	(28,153)	(33,319)	11,924
Net income (loss) per weighted average share of common stock:						
Income (loss) before extraordinary item and cumulative effect of a change in accounting principle	(7.75) (2)	(0.79)	(1.18)	(0.79)	(0.94)	0.20
Extraordinary item	(8.14) (3)	-	-	-	-	-
Cumulative effect of a change in accounting principle	-	-	(2.70) (4)	-	-	-
Net income (loss)	(15.89)	(0.79)	(3.88)	(0.79)	(0.94)	0.20
Total assets	1,566,281	1,702,778 (5)	1,715,406	1,730,851	1,809,891 (5)	1,874,578
Additions to utility plant	63,394	60,570	58,215	60,113	88,267	88,267
Debt and obligations subject to compromise	1,286,703	1,440,968	1,495,315	1,537,303	1,608,091	1,189,335
Preferred stock - redemption required	67,266 (6)	67,266 (6)	67,266 (6)	67,266 (6)	67,266 (6)	100,000
Common stock equity (deficit)	(191,434)	(220,508)	(357,463)	(385,966)	(418,763)	300,000

- (1) Reflects a decrease in fuel revenues due to a change in the calculation of Texas jurisdictional fuel costs. 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 for previous regulatory disallowances in Texas.
- (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 primarily is due to increase in cash and temporary investments which results from the nonpayment of interest and Palo Verde lease costs in 1992 and the nonpayment of interim payments in 1995.
- (6) Includes approximately \$3.3 million of dividends in arrears.
- (7) The pro forma data is not on a comparable basis to the historical data presented. See Pro Forma Condensed Financial Statements (Unaudited).

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

The Company's principal liquidity requirements through 1998 are expected to consist of the payment of interest on the Company's indebtedness and capital expenditures related to the Company's generating facilities and transmission and distribution systems. The Company expects that cash flows from operations will be sufficient for such purposes.

Long-term capital requirements of the Company will consist primarily of maintenance and construction of electric utility plant, payment of interest on and retirement of debt and payment of dividends on and redemption of preferred stock. The Company has no current plans to construct any new generating capacity through the end of this decade. Utility construction expenditures will consist primarily of expanding and updating the transmission and distribution systems and the cost of betterments and improvements to Palo Verde.

The Company anticipates that internally generated funds will be sufficient to meet its construction requirements, provide for the retirement of debt at maturity, and enable the Company to meet other contingencies that may exist, such as compliance with environmental regulation, pending litigation and any claims for indemnification. At March 8, 1996, the Company had approximately \$68 million in cash, out of which approximately \$20 million of reorganization expenses is expected to be paid during the first half of 1996. The Company also has access to a revolving credit facility, which provides up to \$50 million (depending on the amount of borrowings for nuclear fuel purchases) for seasonal liquidity needs.

The Company has substantial leverage and significant debt service obligations and, due to the Rate Stipulation, does not expect to be able to raise its rates in order to recover increases in future costs or to replace any lost revenues. As of the Effective Date, the Company had total long-term indebtedness of approximately \$1,189 million and redeemable preferred stock of \$100 million. Long-term indebtedness as a percentage of total capitalization totaled approximately 75%.

The degree to which the Company is leveraged could have important consequences to the Company's liquidity, including: (i) the Company's ability to obtain additional financing for working capital, capital expenditures, acquisitions, general corporate purposes or other purposes will be limited in the future; (ii) a substantial portion of the Company's cash flow from operations will be dedicated to the payment of principal and interest on its indebtedness, thereby reducing the funds available to the Company for other purposes; and (iii) the Company's substantial leverage may place the Company at a competitive disadvantage, hinder its ability to adjust rapidly to changing market conditions and make it more vulnerable in the event of a downturn in general economic conditions or its business. As a result, any significant reduction in revenues and/or significant increase in costs or expenditures could materially adversely affect the Company's liquidity.



Operational Overview

Pro Forma Results of Operations

On a pro forma basis after giving effect to the consummation of the Reorganization and the related transactions, the Company's results of operations would improve as compared to historical results of operations. As a result of the Rate Stipulation, as implemented by the Agreed Order, on a pro forma basis the Company would recognize an approximate \$24.9 million rate increase in its Texas jurisdiction. The Company also would recognize additional fuel revenues to reflect the change in the sharing of the revenues from third-party transmission services and profit margins on off-system sales. The historical results of operations reflect the benefits to the Company of retaining 25% of such revenues and margins, while pro forma results would reflect the benefits of 75% of such revenues and margins as a result of the Rate Stipulation. The substantial reduction in the Company's fixed charge obligations resulting from the Reorganization and the decrease in historical contractual interest expense resulting from the new capital structure would improve the Company's results of operations. The reacquisition of the Palo Verde leased assets would contribute to the reduction in fixed obligations due to the elimination of the lease expense, offset in part by an increase in interest expense due to the direct obligations that replace the leases. Results of operations on a pro forma basis also would improve as compared to historical results because the fees and expenses related to reorganization would not be incurred. The improved results of operations on a pro forma basis would be offset, in part, by increased depreciation expense as a result of (i) the reacquisition of the leased portion of Palo Verde; and (ii) the depreciation of a portion of the Company's net plant in service on an accelerated basis following the Reorganization. See Part I, Item 1, "Business-Pro Forma Condensed Financial Statements (Unaudited)."

Operational Prospects and Challenges

The Rate Stipulation provides a level of certainty in the rates that the Company currently charges the majority of its customers. The Company intends to enhance its position during the Freeze Period by (i) serving the growing need for electricity within its retail service territory; (ii) continuing to focus on its strategic location on the border with Mexico; (iii) executing long term contracts to provide electricity to its largest retail customers; (iv) implementing operating cost reduction programs; and (v) utilizing free cash flow to reduce its fixed obligations.

The Company faces a number of challenges which could negatively impact its operations during the Freeze Period. The primary challenge is the risk of increased costs, including the risk of additional or unanticipated costs at Palo Verde resulting from: (i) increases in operation and maintenance expenses; (ii) the potential replacement of steam generators; (iii) an extended outage of any of the Palo Verde units; (iv) increases in estimates of decommissioning costs; (v) the storage of radioactive materials; and (vi) compliance with the regulations governing nuclear generating stations. There can be no assurance that the Company's revenues will be sufficient to recover any increased costs incurred during the Freeze Period, including any such increased costs in connection with Palo Verde or increases in other non-fuel costs of operation, whether as a result of higher than anticipated levels of inflation, changes in tax laws or regulatory requirements, or other causes.

Another risk to the Company's operations is the potential loss of customers. Las Cruces has instituted litigation seeking the ability to condemn the Company's distribution system and related assets located within its city limits. If Las Cruces succeeds in its efforts, the Company could lose its Las Cruces customer base, although the Company would receive "just compensation" as established by the court. In addition, if

Las Cruces succeeds in its efforts, additional areas of the Company's New Mexico service territory may join the Las Cruces system or establish their own system. In recent years, the United States has closed a large number of military bases and there can be no assurance that Holloman, White Sands or Ft. Bliss will not be closed in the future. If the Company loses a significant portion of its retail customer base or wholesale sales, the Company may not be able to replace such revenues through either the addition of new customers or an increase in rates to remaining customers.

The Company does not currently have an agreement with New Mexico regulatory authorities or parties to New Mexico regulatory proceedings comparable to the Rate Stipulation. Pursuant to New Mexico law, certain interested parties may challenge the Company's rates in New Mexico and, in such a proceeding, such parties may assert that Palo Verde Unit 2 should be revalued for rate making purposes. In addition, the New Mexico Commission may assert that it is within the New Mexico Commission's discretion to value the Company's property for rate making purposes utilizing a methodology that results in decreased rates for New Mexico retail customers. Consequently, there can be no assurance that the Company will continue to be able to charge its current rates in New Mexico.

Finally, the electric utility industry in general is facing significant challenges and increased competition as a result of changes in federal provisions relating to third-party transmission services and independent power production, as well as potential changes in state regulatory provisions relating to wholesale and retail service. The Company's wholesale and large retail customers currently have, in varying degrees, and, in the future may have, additional alternate sources of economical power, including co-generation of electric power. In the face of increased competition there can be no assurance that such competition will not adversely affect the future operations and financial condition of the Company.

Historical Results of Operations

General

The Company derives revenue principally from the sale of power to retail and wholesale customers, which accounted for 78.7% and 20.5%, respectively, of the Company's revenues for the year ended December 31, 1994 and 79.6% and 19.7%, respectively, of the Company's revenues, for the year ended December 31, 1995. Revenues from the sale of electricity include fuel costs, which are passed through directly to customers, and base revenues. Base revenues refers to the Company's revenues from the sale of electricity excluding such fuel costs.

The Company's retail customers consist of residential customers, small commercial and industrial customers, large commercial and industrial customers and public authorities, which accounted for 36%, 36%, 11% and 17%, respectively, of the Company's retail base revenues for the year ended December 31, 1994, and 36%, 36%, 11% and 17%, respectively, of the Company's retail base revenues for the year ended December 31, 1995. Wholesale revenues consist of sales pursuant to long-term power contracts, sales to CFE, and spot market sales, which accounted for 57%, 36% and 7%, respectively, of the Company's wholesale base revenues for the year ended December 31, 1994, and 56%, 36% and 8%, respectively, of the Company's wholesale base revenues for the year ended December 31, 1995. Sales to the Company's largest wholesale customer, IID, accounted for 9.2% and 8.8% of the Company's base revenues for the years ended December 31, 1994 and 1995, respectively. No retail customer accounted for more than 3% of the Company's base revenues during such periods.



The Company's business is seasonal, with higher revenues during the summer season. The following table sets forth the percentage of the Company's revenues derived during each quarter of the periods presented.

	<u>Years Ended December 31,</u>		
	<u>1993</u>	<u>1994</u>	<u>1995</u>
January 1 to March 31	22%	23%	22%
April 1 to June 30	25	26	25
July 1 to September 30	28	29	29
October 1 to December 31	<u>25</u>	<u>22</u>	<u>24</u>
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

Palo Verde, which represents approximately 40.0% of the Company's available net generating capacity and represented approximately 57.3% of the Company's available energy for the year ended December 31, 1995, is subject to performance standards in New Mexico and Texas. If such performance standards are not met, the Company is subject to a penalty. See Part I, Item 1, "Business-Regulation - New Mexico Rate Matters - Palo Verde Performance Standards" and "-Regulation - Texas Rate Matters - Palo Verde Performance Standards."

Year Ended December 31, 1995 Compared to Year Ended December 31, 1994

Operating Revenues

Operating revenues decreased 6.0% to \$504.6 million in 1995 compared to \$536.8 million in 1994 primarily due to a decrease in fuel revenues. Despite such decrease in revenues, the Company achieved record total system peak demand of 1,374 MW in 1995, representing a 0.7% increase over 1994's record peak of 1,365 MW.

Base Revenues. Base revenues remained relatively unchanged at \$432.0 million in 1995 compared to \$431.6 million in 1994.

Total system firm energy sales decreased from 7,306,666 MWH in 1994 to 7,056,367 in 1995. Retail firm energy sales increased 29,472 MWH over the same time period.

The Company implemented an increase in base rates for Texas retail customers which began in July 1994 subject to refund and bond. The Company therefore deferred recognition of such revenues and such revenues are not included in reported results. Revenues deferred for 1995 and 1994 were \$24.1 million and \$11.5 million, respectively, and total revenues subject to refund aggregated \$35.6 million at December 31, 1995.

Fuel Revenues. Regulations of the Texas Commission and the New Mexico Commission allow substantially all changes in fuel and purchased and interchanged power costs to be passed through directly to customers in the applicable jurisdiction. As a result, fuel revenues fluctuate in relation to fuel and purchased and interchanged power costs. Fuel revenues decreased 31.9% to \$68.8 million in 1995 compared to \$101.1 million in 1994 primarily due to reduced cost of fuel for Company owned generation and changes in generation supply from higher cost purchased power to Company owned generation. During the fourth quarter of 1995, the Company reserved \$2.3 million against fuel revenues to reflect

additional fuel and purchased and interchanged power costs incurred related to operating conditions during the initial remediation following the system outages.

If the provisions of the Rate Stipulation concerning fuel issues had been implemented for 1995, fuel revenues would have been \$16.3 million greater. Under the Agreed Order, the Company will retain fuel revenues in the amount of \$46.1 million that have been accrued as a provision for refund in the financial statements.

Fuel and Purchased and Interchanged Power Expense

Fuel and purchased and interchanged power expense decreased 22.7% to \$92.6 million in 1995 compared to \$119.8 million in 1994. Such decrease was primarily attributable to the reduced cost of fuel for Company owned generation and changes in the fuel mix from higher cost purchased power to nuclear fuel.

Other Operation and Maintenance Expense

Other operation and maintenance expense decreased 0.8% to \$251.9 million in 1995 compared to \$253.8 million in 1994 as a result of (i) decreased Palo Verde costs of \$3.7 million; (ii) decreased rents of \$1.2 million primarily related to lease expenses for the Company's computer system; (iii) decreased general maintenance costs at a Company operated generation plant of \$1.0 million; (iv) decreased pension and benefit costs of \$0.9 million primarily due to a change in actuarial assumptions; and (v) decreased transmission costs of \$0.8 million primarily related to the installation of transmission equipment which eliminated fees for transmission services. Such decreases were partially offset by (i) increased outside service costs of \$3.3 million primarily related to condemnation and franchise issues for Las Cruces; and (ii) increased maintenance costs of \$2.2 million at a Company operated generating plant.

Depreciation and Amortization Expense

Depreciation and amortization expense increased \$2.9 million to \$56.8 million in 1995 compared to \$53.8 million in 1994 primarily due to increases in depreciable plant balances and a \$0.6 million inflation adjustment to the DOE's assessment on Palo Verde related to a Decontamination and Decommissioning Fund established by the Energy Policy Act.

Federal Income Taxes

Federal income tax benefits decreased \$9.5 million to \$7.3 million in 1995 compared to \$16.8 million in 1994. Federal income taxes fluctuate primarily due to changes in pretax income and differences in book and taxable income.

Other Taxes

Taxes other than federal income taxes decreased \$6.0 million to \$48.5 million in 1995 compared to \$54.5 million in 1994 due to (i) decreased state income taxes resulting from an accrual in 1994 for prior years taxes with no corresponding accrual in 1995; and (ii) a decrease in Arizona sales tax due to an accrual in 1994 for prior years taxes with no corresponding accrual in 1995.

Other Income, Net

Other income, net decreased \$4.3 million to a net deduction of \$0.9 million in 1995 compared to other income, net of \$3.4 million in 1994 primarily due to (i) a gain on the sale of the Company's interest in Triangle Electric Supply Company in 1994 of \$2.4 million with no comparable amount in 1995 and (ii) the recording of \$0.9 million of expense in 1995 compared to \$0.5 million of income in 1994 related to Company owned life insurance policies.

Interest Charges

Interest charges decreased \$6.9 million to \$88.1 million in 1995 compared to \$95.0 million in 1994 primarily due to the Company's discontinuance of interest accruals on unsecured debt pursuant to Bankruptcy Court order which was offset partially by increased interest rates on interim payments to certain secured and unsecured creditors.

Reorganization Items

Reorganization items expense increased 11.0% to \$10.0 million in 1995 compared to \$9.0 million in 1994. Such increase of reorganization items expense was due to increased professional fees and other costs in 1995 partially offset by increased interest earned on accumulated cash in 1995 due to higher cash balances and investment interest rates.

Net Loss

Net loss increased \$5.2 million to \$33.3 million in 1995 compared to \$28.2 million in 1994. The principal factors giving rise to the loss in 1995 were (i) that revenues were not sufficient to recover fully the Company's costs of service and debt service; and (ii) reorganization expenses.

Year Ended December 31, 1994 Compared to Year Ended December 31, 1993

Operating Revenues

Operating revenues decreased 1.3% to \$536.8 million in 1994 compared to \$543.6 million in 1993 primarily due to a decrease in fuel revenues. Despite such decrease in revenues, the Company achieved record total system peak demand of 1,365 MW in 1994, a 2.2% increase over the previous record of 1,335 MW recorded in 1993. The Company also achieved record native system peak demand of 1,093 MW in 1994, a 9.6% increase from the record of 997 MW set in 1993. Such new records were the result of an increase in the number of customers and higher than normal temperatures during the summer months.

Base Revenues. Base revenues increased 1.0% to \$431.6 million in 1994 compared to \$427.2 million in 1993. Such increase was primarily attributable to (i) a 2.2% increase in the average number of customers served; (ii) record high summer temperatures; (iii) changes in the Company's customer sales mix in 1994 compared to 1993; 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. Such increases were offset partially by a reduction in sales for resale due to lower contract demand revenues from TNP.

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

The Company implemented an increase in base rates for Texas retail customers effective July 16, 1994; however, because the revenues collected under that increase were subject to refund and bond, the Company deferred recognition of such revenues and, therefore, they are not included in reported results for 1994.

Fuel Revenues. Fuel revenues decreased 9.7% to \$101.1 million in 1994 compared to \$112.0 million in 1993 due to (i) decreased fuel costs that are passed through directly to customers; and (ii) a change of \$7.5 million in the method of calculating Texas jurisdictional fuel costs based on the final order in a regulatory proceeding. Such decrease was offset partially by a \$2.6 million increase in economy energy sales.

Fuel and Purchased and Interchanged Power Expense

Fuel and purchased and interchanged power expense decreased 9.9% to \$119.8 million in 1994 compared to \$133.0 million in 1993. Such decrease was primarily attributable to changes in the fuel mix from higher cost purchased power to gas and nuclear fuel, which decrease was partially offset by increased power production at Palo Verde and at local gas generating facilities.

Other Operation and Maintenance Expense

Other operation and maintenance expense increased 3.2% to \$253.8 million in 1994 compared to \$246.0 million in 1993 as a result of (i) increased pension and benefit expenses of \$3.2 million related to increased costs of postretirement benefits, pensions and other employee benefit plans; (ii) increased Palo Verde costs of \$2.2 million; (iii) increased regulatory expenses of \$2.1 million resulting from the rate case filing in Texas; (iv) increased outside services of \$1.9 million primarily due to the reissuance and the remarketing of several pollution control revenue bonds; (v) an additional provision for increased environmental costs of \$1.7 million related to remediation projects at the Company's local generating facilities; and (vi) increased maintenance costs of \$1.5 million relating to a non-recurring expense at one of the Company's local generating plants. Such increases were offset in part by (i) decreased pensions and benefits due to the recording of \$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 \$1.9 million recorded in 1993 for the settlement of certain transmission disputes; and (iii) provision of \$1.0 million recorded in the first quarter of 1993 for uncollectible amounts.

Depreciation and Amortization Expense

Depreciation and amortization expense remained relatively unchanged at \$53.8 million for 1994 compared to \$53.1 million for 1993.

Federal Income Taxes

Federal income tax benefits increased \$8.9 million to \$16.8 million in 1994 compared to tax benefits of \$7.9 million in 1993. Such increase in tax benefits resulted primarily from a decline in nondeductible bankruptcy costs which were partially offset by a decrease in pretax losses.



Other Taxes

Taxes other than federal income taxes decreased \$2.4 million to \$54.5 million in 1994 compared to \$56.9 million in 1993 primarily attributable to the accrual of \$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.

Other Income, Net

Other income, net increased \$0.5 million to \$3.4 million in 1994 compared to \$2.8 million in 1993. Other income, net for 1994 includes a gain of \$2.4 million recognized on the sale of the Company's interest in Triangle Electric Supply Company.

Interest Charges

Interest charges increased 21.5% to \$95.0 million in 1994 compared to \$78.2 million in 1993 primarily due to payments to unsecured and undersecured creditors pursuant to Bankruptcy Court order. Such interim payments, which are recorded as interest expense, totaled \$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 interest expense for a full year in 1994 versus approximately half a year in 1993.

Reorganization Items

Reorganization items expense decreased 70.6% to \$9.0 million in 1994 compared to \$30.6 million in 1993. Such reduction of reorganization items expense was due to decreased professional fees and other costs in 1994 compared to 1993 as a result of additional payments in 1993 pursuant to Bankruptcy Court order, and increased interest earned on accumulated cash in 1994 partially offset by increased periodic payments to preferred stockholders pursuant to Bankruptcy Court order.

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 deferral method. The Company recognized a charge to operations in January 1993 of approximately \$96.0 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.

Net Loss

Net loss decreased \$109.7 million to \$28.2 million in 1994 compared to \$137.9 million in 1993. The principal factors giving rise to the loss in 1994 were (i) insufficient revenues to recover fully the Company's costs of service and debt service; (ii) increased interest costs resulting from a Bankruptcy Court order; and (iii) reorganization expenses.

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 has not been significant.

Effect of Recently Issued 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 must 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 will apply fresh-start reporting upon the emergence from bankruptcy, which will encompass the adoption of SFAS No. 121. The Company does not expect any significant impact on its financial statements from adoption of SFAS No. 121.

SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") defines the fair value based method of accounting for an employee stock option or similar equity instrument and encourages all entities to adopt that method of accounting for all of their employee stock compensation plans. However, it also allows an entity to continue to measure compensation costs for those plans using the intrinsic value based method of accounting. The statement also requires that an employer's financial statements include certain disclosures about stock-based employee compensation arrangements regardless of the method used to account for them. The effective date of SFAS No. 123 is for fiscal years beginning after December 15, 1995. Upon emergence from bankruptcy, all of the Company's stock plans were terminated and no new plans have become effective. The Company does not believe the adoption of SFAS No. 123 will have any significant impact on its financial statements on its financial statements.

Item 8. Financial Statements and Supplementary Data

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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) (the "Company") 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.

As discussed in Note A of Notes to Financial Statements, the Company filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code on January 8, 1992. On February 12, 1996, the Company's Fourth Amended Plan of Reorganization (the "Reorganization") was declared to be effective by the Bankruptcy Court. The Reorganization significantly altered, compromised or modified the Company's historical capital structure as reflected in the accompanying balance sheet as of December 31, 1995. The Company will account for the Reorganization on February 12, 1996 and will, at that date, adopt fresh-start reporting. No effects of accounting for the Reorganization are reflected in the accompanying financial statements.

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, 1995 and 1994, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 1995 in conformity with generally accepted accounting principles.

KPMG Peat Marwick LLP

El Paso, Texas
March 18, 1996

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992 - Note A)

BALANCE SHEETS

ASSETS

	<u>December 31,</u>	
	<u>1994</u>	<u>1995</u>
	(In thousands)	
Utility plant (Notes C, D and E):		
Electric plant in service	\$ 1,694,553	\$ 1,744,468
Less accumulated depreciation and amortization	<u>419,212</u>	<u>465,311</u>
Net plant in service	1,275,341	1,279,157
Construction work in progress	43,712	61,274
Nuclear fuel; includes fuel in process of \$10,066,000 and \$6,071,000, respectively	92,720	82,904
Less accumulated amortization	<u>50,273</u>	<u>43,599</u>
Net nuclear fuel	<u>42,447</u>	<u>39,305</u>
Net utility plant	<u>1,361,500</u>	<u>1,379,736</u>
Current assets:		
Cash and temporary investments (Note C)	208,584	262,507
Accounts receivable, principally trade, net of allowance for doubtful accounts of \$5,923,000 and \$6,031,000, respectively ..	54,367	59,233
Inventories, at cost	34,327	32,737
Prepayments and other	<u>11,091</u>	<u>8,877</u>
Total current assets	308,369	363,354
Long-term contract receivable (Note C)	33,603	33,683
Deferred charges and other assets (Note E)	<u>27,379</u>	<u>33,118</u>
Total assets	<u>\$ 1,730,851</u>	<u>\$ 1,809,891</u>

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992 - Note A)

BALANCE SHEETS

CAPITALIZATION AND LIABILITIES

	<u>December 31,</u>	
	<u>1994</u>	<u>1995</u>
	<u>(In thousands)</u>	
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)	(758,032)
Net unrealized (loss) gain on marketable securities, less		
applicable income tax benefit (expense) of \$189,000 and		
\$(93,000), respectively	<u>(350)</u>	<u>172</u>
Common stock deficit	(385,966)	(418,763)
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	<u>1,537,303</u>	<u>1,608,091</u>
Total capitalization	<u>1,232,801</u>	<u>1,270,792</u>
Current liabilities:		
Accounts payable, principally trade	23,015	34,900
Customer deposits	4,891	3,745
Taxes accrued other than federal income taxes	23,427	24,629
Net overcollection of fuel revenues (Note C)	37,207	53,788
Revenues subject to refund (Note C)	11,475	35,582
Other	<u>9,550</u>	<u>10,521</u>
Total current liabilities	<u>109,565</u>	<u>163,165</u>
Deferred credits and other liabilities:		
Accumulated deferred income taxes (Note I)	98,106	70,010
Accumulated deferred investment tax credits (Note I)	76,642	78,275
Deferred gain on sales and leasebacks (Note B)	135,510	128,478
Decommissioning (Note E)	38,528	47,245
Other (Note L)	<u>39,699</u>	<u>51,926</u>
Total deferred credits and other liabilities	<u>388,485</u>	<u>375,934</u>
Commitments, contingencies and subsequent events		
(Notes A, B, C, E, J, K and L)		
Total capitalization and liabilities	<u>\$ 1,730,851</u>	<u>\$ 1,809,891</u>

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992 - Note A)

STATEMENTS OF OPERATIONS

For the years ended December 31, 1993, 1994 and 1995

	<u>1993</u>	<u>1994</u>	<u>1995</u>
	(In thousands except per share data)		
Operating revenues:			
Base revenues	\$ 427,156	\$ 431,634	\$ 432,050
Fuel revenues and economy sales	112,005	101,076	68,823
Other	<u>4,433</u>	<u>4,050</u>	<u>3,744</u>
	<u>543,594</u>	<u>536,760</u>	<u>504,617</u>
Operating expenses:			
Operation:			
Fuel	93,007	89,893	76,005
Purchased and interchanged power	<u>39,997</u>	<u>29,929</u>	<u>16,568</u>
	133,004	119,822	92,573
Other	206,576	209,814	208,445
Maintenance	39,450	44,022	43,412
Depreciation and amortization	53,050	53,841	56,762
Taxes:			
Federal income tax benefit (Note I)	(10,360)	(18,234)	(11,248)
Other	<u>56,903</u>	<u>54,484</u>	<u>48,527</u>
	<u>478,623</u>	<u>463,749</u>	<u>438,471</u>
Operating income	<u>64,971</u>	<u>73,011</u>	<u>66,146</u>
Other income (deductions):			
Other, net	2,838	3,378	(910)
Federal income tax expense applicable to other income (Note I)	<u>(831)</u>	<u>(516)</u>	<u>(474)</u>
	<u>2,007</u>	<u>2,862</u>	<u>(1,384)</u>
Income before interest charges	<u>66,978</u>	<u>75,873</u>	<u>64,762</u>
Interest charges (credits):			
Interest	82,237	97,616	91,923
Other interest capitalized and deferred	<u>(3,998)</u>	<u>(2,581)</u>	<u>(3,820)</u>
	<u>78,239</u>	<u>95,035</u>	<u>88,103</u>
Loss before reorganization items and cumulative effect of a change in accounting principle	<u>(11,261)</u>	<u>(19,162)</u>	<u>(23,341)</u>
Reorganization items (expense):			
Professional fees and other	(35,150)	(15,866)	(19,776)
Interest earned on accumulated cash resulting from Bankruptcy Case	6,152	7,771	13,237
Federal income tax expense applicable to reorganization items (Note I) ...	<u>(1,596)</u>	<u>(896)</u>	<u>(3,439)</u>
	<u>(30,594)</u>	<u>(8,991)</u>	<u>(9,978)</u>
Loss before cumulative effect of a change in accounting principle ...	(41,855)	(28,153)	(33,319)
Cumulative effect of a change in accounting principle (Note I)	<u>(96,044)</u>	<u>-</u>	<u>-</u>
Net loss	<u>\$ (137,899)</u>	<u>\$ (28,153)</u>	<u>\$ (33,319)</u>
Net loss per weighted average share of common stock:			
Loss before cumulative effect of a change in accounting principle	\$ (1.18)	\$ (0.79)	\$ (0.94)
Cumulative effect of a change in accounting principle	<u>(2.70)</u>	<u>-</u>	<u>-</u>
Net loss	<u>\$ (3.88)</u>	<u>\$ (0.79)</u>	<u>\$ (0.94)</u>

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992 – Note A)

STATEMENTS OF ACCUMULATED DEFICIT

For the years ended December 31, 1993, 1994 and 1995

	<u>1993</u>	<u>1994</u>	<u>1995</u>
	(In thousands except share data)		
Accumulated deficit at beginning of year	\$ (558,661)	\$ (696,560)	\$ (724,713)
Net loss	(137,899)	(28,153)	(33,319)
Accumulated deficit at end of year	<u>\$ (696,560)</u>	<u>\$ (724,713)</u>	<u>\$ (758,032)</u>
 Weighted average number of			
common shares outstanding	<u>35,539,480</u>	<u>35,544,330</u>	<u>35,544,330</u>

See accompanying notes to financial statements.



EL PASO ELECTRIC COMPANY

(DEBTOR IN POSSESSION AS OF JANUARY 8, 1992 - Note A)

STATEMENTS OF CASH FLOWS

For the years ended December 31, 1993, 1994 and 1995

	<u>1993</u>	<u>1994</u>	<u>1995</u>
	(In thousands)		
Cash Flows From Operating Activities:			
Loss before cumulative effect of a change in accounting principle	\$ (41,855)	\$ (28,153)	\$ (33,319)
Adjustments for non-cash items from operating activities:			
Depreciation and amortization	66,901	67,189	69,444
Deferred income taxes and investment tax credit, net	(24,077)	(17,990)	(26,744)
Other operating activities	(1,787)	(5,429)	(6,795)
Change in:			
Accounts receivable	(2,756)	285	(4,866)
Inventories	1,983	268	1,590
Prepayments and other	1,316	(1,056)	2,214
Long-term contract receivable	(2,371)	(1,183)	(80)
Obligations subject to compromise	55,214	42,943	71,839
Accounts payable	10,912	(14,017)	11,885
Net overcollection of fuel revenues	239	23,333	16,581
Revenues subject to refund	-	11,475	24,107
Other current liabilities	(3,152)	1,897	1,027
Deferred charges and credits	16,637	8,867	16,028
Net cash provided by operating activities	<u>77,204</u>	<u>88,429</u>	<u>142,911</u>
Cash Flows From Investing Activities:			
Additions to utility plant	(58,215)	(60,113)	(88,267)
Other investing activities	409	137	330
Net cash used for investing activities	<u>(57,806)</u>	<u>(59,976)</u>	<u>(87,937)</u>
Cash Flows From Financing Activities:			
Redemption of long-term obligations	(867)	(955)	(1,051)
Other financing activities	20	-	-
Net cash used for financing activities	<u>(847)</u>	<u>(955)</u>	<u>(1,051)</u>
Net increase in cash and temporary investments	18,551	27,498	53,923
Cash and temporary investments at beginning of year	162,535	181,086	208,584
Cash and temporary investments at end of year	<u>\$ 181,086</u>	<u>\$ 208,584</u>	<u>\$ 262,507</u>
Supplemental Disclosures of Cash Flow Information:			
Cash paid during the year for:			
Income taxes	\$ 17,064	\$ 4,700	\$ 12,950
Interest	64,712	92,474	80,688
Reorganization items:			
Cash interest received on accumulated cash resulting from			
Bankruptcy Case	6,107	6,802	13,738
Cash paid for professional fees and other	28,531	26,406	15,207

See accompanying notes to financial statements.

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NOTES TO FINANCIAL STATEMENTS

A. Emergence From Bankruptcy

Overview

On January 8, 1992 (the "Petition Date"), El Paso Electric Company (the "Company") filed a voluntary petition for reorganization (the "Bankruptcy Case") under Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Western District of Texas, Austin Division (the "Bankruptcy Court"). The Bankruptcy Court entered an order dated January 9, 1996 confirming the Company's Fourth Amended Plan of Reorganization (the "Plan"). On February 12, 1996, the Plan became effective (the "Effective Date") and the Company emerged from bankruptcy (the "Reorganization") as an independent investor-owned utility (the "Reorganized Company").

The Reorganization has significant impacts on the financial statements of the Reorganized Company, including the creation of a new reporting entity upon emergence from bankruptcy on February 12, 1996 through the application of fresh-start reporting pursuant to Statement of Position 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code" ("SOP 90-7"). See Pro Forma Condensed Financial Statements (Unaudited) elsewhere herein for a discussion of the impacts of fresh-start reporting and implementation of the Reorganization, including an unaudited Pro Forma Condensed Balance Sheet as of December 31, 1995 and an unaudited Pro Forma Condensed Statement of Operations for the year ended December 31, 1995.

The accompanying historical financial statements do not reflect the effects of the Reorganization and are premised on the Company's financial agreements and regulatory structures existing prior to the Effective Date. These financial statements must be read with the understanding that the Reorganization significantly altered, compromised or modified the historical capital structure reflected in the accompanying balance sheet as of December 31, 1995. Accordingly, the financial statements of the Reorganized Company for post bankruptcy periods, which will reflect the application of fresh-start reporting, will not be comparable to the financial statements of the Company while in bankruptcy.

Background

The bankruptcy 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"). During the Bankruptcy, the Company's management continued to manage the operations and affairs of the Company as debtor in possession. Actions to collect prepetition indebtedness or pursue prepetition claims were stayed as of the Petition Date, and contractual obligations incurred prepetition could not be enforced against the Company. Substantially all liabilities as of the Petition Date were modified pursuant to the Reorganization.

In May 1993, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement"), pursuant to which the Company would have been acquired by Central and South West



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Corporation ("CSW") through a merger (the "Merger"). In December 1993, the Bankruptcy Court issued an order confirming the Company's Modified Third Amended Plan of Reorganization (the "Merger Plan"). The Merger Plan would have become effective only upon the satisfaction of numerous conditions, including substantial regulatory approvals and, accordingly, none of the effects of the Merger Plan were reflected in the Company's financial statements. In June 1995, CSW terminated the Merger Agreement and revoked the Merger Plan asserting breach of contract. In response, the Company initiated litigation against CSW asserting breach of the Merger Agreement and other causes of action. CSW countersued and litigation is pending. See Note K.

Rate Stipulation

Following the termination of the Merger Plan, the Company began the development of a plan of reorganization under which it could emerge from bankruptcy as an independent company. The Company, the City of El Paso, the Public Utility Commission of Texas General Counsel (the "General Counsel"), the Texas Office of Public Utility Counsel (the "OPC"), and substantially all other parties to the Company's pending Texas rate case (the "Texas Rate Case" or "Docket 12700") (collectively, the "Signatories") entered into an unopposed Stipulation and Settlement Agreement dated as of July 27, 1995 (the "Rate Stipulation") concerning the Company's rates in Texas. On August 30, 1995, the Public Utility Commission of Texas (the "Texas Commission") entered an order (the "Agreed Order") implementing certain provisions of the Rate Stipulation and acknowledging a ten-year rate freeze thereunder. The Agreed Order became effective on the Effective Date.

Under the Rate Stipulation, the Signatories agreed that the Company would receive a \$24.9 million annual base rate increase (above the rates being charged prior to filing Docket 12700). Generally, during the ten years beginning August 2, 1995 (the "Freeze Period"), the Company's Texas base rates for most customers will not be changed. Risks of increased costs or reduced revenues during the Freeze Period generally will be borne by the Company, including increased costs of Palo Verde. The Rate Stipulation and Agreed Order are more fully described in Note C.

The Reorganization

The Reorganization became effective immediately prior to the consummation of the sale by the Reorganized Company in an underwritten offering of \$794 million of first mortgage bonds and \$100 million of 11.40% preferred stock. The net proceeds of approximately \$875.6 million were distributed to the Company's creditors pursuant to the Reorganization. In addition, the Reorganized Company issued \$151.8 million aggregate principal amount of first mortgage bonds and approximately 60 million shares of common stock, and paid approximately \$150 million of cash (excluding the cash proceeds of the underwritten offering) to holders of allowed claims and interests under the Reorganization. The interest rates on the five series of first mortgage bonds range from 7.25% to 9.40% per annum and maturities range from three to fifteen years.

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In connection with the foregoing, on the Effective Date, arrangements pursuant to which the Company sold and leased back portions of its interest in Palo Verde were terminated and the Reorganized Company reacquired such interests. The Reorganized Company has agreed to indemnify certain parties to the sale/leaseback transactions against certain possible tax liabilities related thereto. See Note J.

Fresh-Start Reporting; Capital Structure

As of its emergence from bankruptcy, the Company will apply fresh-start reporting in accordance with the requirements of SOP 90-7. Under fresh-start reporting, the reorganization value of the Company, which represents the going concern value of all of the Company's assets (excluding liabilities), is determined by the Company and such reorganization value is allocated to the Company's assets based on their relative fair values. In addition, liabilities, other than deferred taxes, are stated at their fair values. Deferred taxes are determined in conformity with the Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). This results in the creation of a new reporting entity having no retained earnings or accumulated deficit. Management's estimate of reorganization value of the Company on a pro forma basis as of December 31, 1995 is approximately \$1,875 million, reflecting the application of fresh-start reporting as if the Company had emerged from bankruptcy on that date.

Pursuant to the Reorganization, all of the common stock and preferred stock of the Company that was outstanding immediately prior to the Effective Date was canceled effective February 12, 1996, and record holders of the former common stock and preferred stock on February 12, 1996, will receive the Reorganized Company's common stock upon the surrender of the certificates representing the former common stock or preferred stock. In addition, such record holders of the former common stock and preferred stock will share in the first \$20 million of proceeds, if any, from certain litigation against CSW. See Note K.

As of February 12, 1996, the Reorganized Company's capital structure consists of approximately \$1,189 million of debt, \$100 million of redeemable preferred stock, and approximately \$300 million of common stock equity. The Reorganized Company's debt includes approximately \$945.9 million of first mortgage bonds described above, \$193.1 million of pollution control bonds, and approximately \$49.6 million in other debt obligations (\$43.3 million debt for nuclear fuel and an approximately \$6.3 million capital lease for generating equipment). The Reorganized Company also has available \$100 million under a revolving credit facility (secured by first mortgage bonds issued as a separate series) to finance the purchase of nuclear fuel and to provide working capital, approximately \$43.3 million of which was drawn on the Effective Date to fund the purchase of nuclear fuel.

Accounting During Bankruptcy

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" ("SFAS No. 71"), as amended. The Company discontinued the application of SFAS No. 71 as of December 31, 1991 and accounted for

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NOTES TO FINANCIAL STATEMENTS

such discontinuation in accordance with SFAS No. 101, "Regulated Enterprises—Accounting for the Discontinuation of Application of SFAS No. 71." The Company has concluded that upon emergence from Bankruptcy it does not meet the criteria of SFAS No. 71 necessary to reflect the effects of regulation in its general purpose financial statements.

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 expected to be impaired are reported separately in the Company's balance sheet as obligations subject to compromise. See Note H. Pursuant to SOP 90-7, the Company accrued 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.

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 (the "Palo Verde Leases") 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 remained 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 were to expire in October 2013, while the leases related to Unit 3 were to expire in January 2017. The Palo Verde Leases also contained 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. See Note J.

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 were accounted for as operating leases; one transaction (sales price of \$87.4 million) was 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.

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



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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 were unsecured prepetition claims of the banks. See Note H. The Company did not make lease payments on the Palo Verde Leases, which constituted events of default under the leases. As a result of the bankruptcy filing, the lessors were 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 filed proofs of claims that collectively assert damages of approximately \$742.7 million, which were not recorded by the Company.

Through the Effective Date, the Company continued to accrue the cost of, but did not pay, the contractual rental rates on the Palo Verde Leases. See Note H. In connection with the confirmation of the Merger Plan, the Bankruptcy Court authorized the Company to make interim payments to the holders of the bonds issued to finance the Palo Verde Leases equivalent to interest on their anticipated allowed claim of \$700 million. Approximately \$15.5 million in 1993, \$42.9 million in 1994, and \$14.4 million in 1995 was paid to such bondholders and has been offset against lease expense accruals. Such payments ceased upon termination of the Merger Plan.

During 1993, 1994 and 1995, contractual lease requirements including amortization of transaction costs under the Palo Verde Leases accounted for as operating leases amounted to approximately \$83 million annually.

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. The Reorganization provides for the termination of the Palo Verde Leases and the reacquisition by the Company of the portions of Palo Verde Units 2 and 3 underlying the leases. The Reorganization allows the lessors to retain the amounts previously drawn under the letters of credit and the holders of bonds issued to finance the lessors' purchase of the interests in Palo Verde were allowed an unsecured claim in the amount of \$700 million in the bankruptcy proceeding. Such claim and the Company's obligations to the banks issuing the letters of credit were settled pro rata with other unsecured claims as described in Note H. All other claims related to the Palo Verde Leases were resolved under the Reorganization without additional payment. The Reorganized Company continues to provide indemnification to the lessors with respect to certain tax matters. See Note J.



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C. Rate Matters

Overview

Effect of Bankruptcy on Regulation. The Bankruptcy Code provides that the Bankruptcy Court shall confirm a 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."

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 appellate jurisdiction to review municipal orders and ordinances regarding rates and services in Texas and jurisdiction over certain activities of the Company. The Texas Commission's decisions are subject to judicial review.

New Mexico. The New Mexico Public Utility Commission (the "New Mexico Commission") has jurisdiction over the Company's rates and services in New Mexico and jurisdiction over certain activities of the Company, including prior approval of the issuance, assumption or guarantee of securities. The New Mexico Commission's decisions are subject to judicial review.

Federal Energy Regulatory Commission. The Company is subject to regulation by the Federal Energy Regulatory Commission (the "FERC") in certain matters, including rates for wholesale power sales, transmission of electric power and the issuance of securities.

Department of Energy. The Department of Energy ("DOE") regulates the Company's export of power to the Comision Federal de Electricidad ("CFE") in Mexico pursuant to a license granted by the DOE and a presidential permit. In addition, the DOE is authorized to assess operators of nuclear generating facilities for a share of the costs of decommissioning the DOE uranium enrichment facilities over a period of fifteen years.

Nuclear Regulatory Commission. The Nuclear Regulatory Commission (the "NRC") has jurisdiction over the Company's licenses for Palo Verde, regulates the operation of nuclear generating stations to protect the health and safety of the public from radiation hazards and conducts environmental reviews.

Texas Rate Matters

In January 1994, the Company filed an application with the Texas Commission requesting approval of a Texas jurisdictional base rate increase and a determination by the Texas Commission that the Company's reacquisition of its leased Palo Verde assets is in the public interest. In its application, 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 fixed fuel factors (the "Texas Fuel Filing"). The various applications and rate request were consolidated by the Texas Commission in Docket No. 12700.

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Effective July 16, 1994, the Company implemented an annual base rate increase of approximately \$25 million, under bond and subject to refund depending on the outcome of Docket No. 12700, for its Texas jurisdiction customers. Because of uncertainty as to the final outcome of Docket No. 12700, the Company deferred recognition of the revenues resulting from the bonded rate increase. These deferred revenues were approximately \$11.5 million in 1994 and \$24.1 million in 1995, aggregating approximately \$35.6 million as of December 31, 1995.

Rate Stipulation. Following the termination of the Merger Agreement, the Company negotiated with the other parties to Docket No. 12700, which resulted in the Rate Stipulation, which became effective on the Effective Date. Among other things, under the Rate Stipulation: (1) the Company will receive a one-time annual increase in Texas retail base rates of approximately \$24.9 million; (2) the Company's base rates for most customers in Texas will be fixed at this increased level for ten years beginning August 2, 1995 (the "Freeze Period"); (3) the City of El Paso has granted the Company a new franchise that will extend through the Freeze Period; (4) no refunds or surcharges will be made to customers with respect to fuel costs and revenues for the period from July 1993 through June 1995; (5) the Company will retain 75% during the first five years of the Freeze Period and 50% during the remainder of the Freeze Period of (a) the revenues generated by providing third-party transmission services and (b) profit margins from certain off-system power sales; (6) the Company's reacquisition of the Palo Verde leased assets is in the public interest; and (7) all appeals of Texas Commission orders concerning the Company and all outstanding Texas Commission dockets concerning the Company's rates will be resolved. In the event of a merger following the Effective Date, the Signatories retain their rights to pursue a reduction in rates below the freeze level. However, such rights are limited to urging rate reductions based on post-merger synergy savings.

The Agreed Order. On August 30, 1995, the Texas Commission entered an Agreed Order that implemented certain provisions of the Rate Stipulation and set rates consistent with the Rate Stipulation. Pursuant to the Agreed Order, the Company is allowed to retain all base rate revenues collected under bond. Neither the Rate Stipulation nor the Agreed Order deprives the Texas regulatory authorities of their jurisdiction over the Company during the Freeze Period. However, the Texas Commission has determined in the Agreed Order that the rate freeze is in the public interest and results in just and reasonable rates. Further, the Signatories (other than the General Counsel, OPC and the State of Texas) have agreed not to seek to initiate an inquiry into the reasonableness of the Company's rates during the Freeze Period and to support the Company's entitlement to rates at the freeze level throughout the Freeze Period. The Company believes, but cannot assure, that its cost of service will support rates at or above the freeze level throughout the Freeze Period and therefore does not believe any attempt to reduce the Company's rates would be successful. By its terms, the Agreed Order became effective upon the Effective Date.

Texas Fuel Filing. The Texas Commission severed the Texas Fuel Filing from Docket No. 12700 and issued a separate final order in the Texas Fuel Filing on March 3, 1995, under Docket No. 13966. In the Texas Fuel Filing, which reconciled fuel costs and revenues from April 1989 through June 1993, the Company had proposed to refund to Texas jurisdictional customers approximately \$16.4 million over a 12-month period (as a credit to fuel revenue collections). The Company had proposed a decrease in its fixed fuel factors that would have reduced future fuel revenues by approximately \$14.3 million annually. The



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Texas Commission ordered a fuel cost refund to Texas customers of approximately \$13.7 million. The Texas Commission also ordered a reduction to the Company's fixed fuel factors consistent with the Company's request.

For the fuel reconciliation period, the Texas Commission's order allowed the Company to retain all margins on off-system sales to CFE. For off-system sales of contingent capacity to the Imperial Irrigation District ("IID") during the fuel reconciliation period, the Texas Commission decided to allocate the margins between the Company and its Texas retail customers, with seventy-five percent (75%) going to customers and twenty-five percent (25%) going to the Company. The Texas Commission adopted the same 75/25 split for all off-system sales on a prospective basis, including CFE, IID contingent capacity and economy energy sales. The Company has recorded fuel costs and revenues through December 31, 1995 consistent with the methodologies of Docket No. 13966. If the provisions of the Rate Stipulation concerning fuel issues had been implemented for 1995, fuel revenues would have been approximately \$16.3 million greater. At December 31, 1995, the total amount accrued by the Company for refund to customers under Docket No. 13966 (which will not be refunded because of the Rate Stipulation) was approximately \$46.1 million.

Palo Verde Performance Standards. Each Palo Verde unit is evaluated annually to determine if its three-year rolling average capacity factor entitles the Company to a reward or subjects it to a penalty under performance standards established by the Texas Commission. There are five performance bands based around a target capacity factor of 70%. The capacity factor is 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 removal of Palo Verde from rate base could have a significant negative impact on the Company's revenues and financial condition.

Appeals of Prior Rate Matters. At December 31, 1995, there were numerous appeals at various stages in the judicial process, some of which potentially have significant adverse outcomes to the Company. Unresolved issues surrounding the Company's rate matters include the prudence of the Company's investment in Palo Verde; the appropriateness of deferral of costs, primarily related to Palo Verde, for recovery in subsequent periods through phase-in and rate moderation arrangements; the treatment of the Palo Verde Leases; the recovery of fuel costs; and the ratemaking treatment of federal income taxes. Pursuant to the Rate Stipulation, all appeals relating to Texas Commission orders concerning the Company and all outstanding dockets concerning the Company's rates either have been or will be resolved without adjustment of rates previously charged.

New Mexico Rate Matters

Base rates in New Mexico were established in prior proceedings and have not increased since February 1990. The Company does not currently have any agreement with New Mexico regulatory authorities or parties to New Mexico regulatory proceedings comparable to the Rate Stipulation. Pursuant to New Mexico law, certain interested parties may challenge the Company's rates in New Mexico and, in such a proceeding, such parties might assert that Palo Verde Unit 2 should be revalued downward for rate

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making purposes as a result of the Reorganization. In addition, the New Mexico Commission might assert that it is within its discretion to value the Company's property for rate making purposes utilizing a methodology that results in decreased rates for New Mexico retail customers. Consequently, there can be no assurance that the Company will continue to be able to charge its current rates in New Mexico.

A 1987 New Mexico rate stipulation required that, in lieu of a prudence review of the Company's participation in the Palo Verde project, all costs associated with Palo Verde 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 primarily 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.

Palo Verde Performance Standards. The entire Palo Verde station is evaluated annually to determine if its achieved capacity factor entitles the Company to a reward or subjects it to a penalty. There are five performance bands based around a target capacity factor of 67.5%. The capacity factor is calculated as the ratio of actual generation to maximum possible generation. Because Unit 3 is not included in the Company's New Mexico rate base, 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. The removal of Palo Verde from rate base could have a significant negative impact on the Company's revenues and financial condition.

Federal Regulatory Matters

FERC. The majority of the Company's rates for wholesale power and transmission services are subject to regulation by the FERC. Sales of wholesale power subject to FERC regulation make up a significant portion, approximately 12% in 1995, 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 and 50 MW of contingent capacity to IID through April 2002. 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, including a return, under the terms of the agreement in the amounts of \$2.4 million, \$1.2 million and \$0.1 million in 1993, 1994 and 1995,

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respectively. Such accrued amounts, which since the inception of the agreement aggregate \$33.7 million as of December 31, 1995, are recorded as a long-term contract receivable on the Company's balance sheets. The Company has a firm power sales agreement with Texas-New Mexico Power Company ("TNP"), providing for sales to TNP in the amount of 25 MW through 2002. 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.

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 May through September and 120 MW at other times of the year through the remaining term of the agreement. The Company also sold CFE an incremental block of 50 MW of energy from June through September 1995. 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.

The Company has an agreement to sell CFE an incremental block of 50 MW of energy on an "as requested" basis from June 1, 1996 through September 30, 1996, which date can be extended on a month-to-month basis.

Recent Changes in Utility Regulation

The electric utility industry faces increasing pressure to become more competitive as legislative, regulatory, economic and technological changes occur. Federal legislation and regulations, as well as initiatives in various states, increasingly encourage competition in electricity generation among electric utility and non-utility power producers. Together with increasing customer demand for lower-priced electricity and other energy services, these measures have accelerated the industry's movement toward more competitive pricing and cost structures. Such competitive pressures could result in the loss of customers and diminish the ability of an electric utility to fully recover from customers its investment in generation assets. The Company is unable to predict the ultimate effects of such changes in the electric utility industry.

In March 1995, the FERC issued a Notice of Proposed Rulemaking (the "NOPR"), which would require utilities to file open access transmission tariffs, increase third-party transmission services and refined its proposals regarding stranded investment. The NOPR generally would require that a transmitting utility provide third parties with transmission service comparable to the service the transmitting utility provides to itself and would apply to a full range of transmission services. In the NOPR, the FERC also announced that it intends to allow utilities to recover stranded investments resulting from the open access transmission tariffs from former power customers who have elected to become transmission-only customers. Although it is not



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possible to predict the ultimate form of any resulting regulations, management believes that the FERC will continue to take action to increase competition in the wholesale power markets.

In addition, the Texas Commission recently adopted a rule governing wholesale transmission access (as required by recent Texas legislation) that would require the Company to file its FERC-approved open access transmission tariffs with the Texas Commission to certify compliance with the Texas legislation. The Texas Commission is also considering the extent to which utilities in Texas could incur stranded investment and the extent to which the Texas Commission has jurisdiction to require the Company to separate its costs and rates based on the costs associated with its generation, transmission and distribution operations. The Company cannot predict the ultimate form or impact of any resulting regulation.

Various state commissions and legislatures are examining methods to increase competition in retail power markets, including the potential for "retail wheeling" (the required delivery of electric service for other providers to customers on a distribution system) and allowing customers to select a power provider from a pool of producers. The Texas Legislature considered, but did not enact, proposals to permit limited retail wheeling during its recent legislative session. However, the Texas Legislature directed the Texas Commission to prepare reports to the Texas Legislature concerning (i) the scope of competition in electric markets, the impacts of industry restructuring, and recommendations for legislation related thereto; and (ii) the scope of potential stranded investment and procedures for allocating and recovering stranded costs. The Texas Commission is currently conducting investigations and soliciting comments concerning such reports.

In New Mexico, the state legislature considered retail wheeling as early as 1992 and established committees to review the industry structure, integrated resource planning and other issues. In its session ending in February 1996, the New Mexico Legislature concluded that neither retail wheeling nor the restructuring of the electric power industry is in the best interests of the state or its residents at this time, but that the industry may change in the future sufficiently to justify further consideration of these alternatives. The Legislature directed the New Mexico Commission to monitor and evaluate industry restructuring but to take no action without a prior report to the state legislature. The New Mexico Commission has issued a notice of inquiry regarding competition and restructuring of the electric utility industry. The proceeding is pending before the New Mexico Commission. The Company cannot predict the ultimate form or impact of any action resulting from the proceeding.

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. Upon emergence from bankruptcy, the Agreed Order became effective and has become a final order. The increase in Texas base rates was implemented and the revenues collected by the Company, under bond and subject to refund, were retained by the Company. The Company's Texas fuel costs and revenues will be deemed reconciled for the period from July 1993 through June 1995 without refund to customers, and changes in the sharing of margins on off-system sales and revenues from third-party transmission services have been implemented, both of which resulted in reductions in liabilities accrued by the Company for such refunds and sharing. The Texas performance standards for Palo Verde were modified to provide that Palo



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Verde rate base will not be reduced unless the capacity factor, as measured on a station basis for any consecutive 24-month period, shall fall below 35%. All appeals of Texas Commission orders concerning the Company and all outstanding dockets concerning the Company's rates either have been or will be resolved without adjustments of rates previously charged.

D. Summary of Significant Accounting Policies

General. The Company is a public utility engaged in the generation, transmission and distribution of electricity in an area of approximately 10,000 square miles in west Texas and southern New Mexico. As of December 31, 1995, the Company served approximately 274,000 residential, commercial, industrial and wholesale customers. The Company distributes electricity to retail customers principally in El Paso, Texas and Las Cruces, New Mexico. The Company also serves wholesale customers in Texas, New Mexico, California and Juarez, Mexico.

The preparation of financial statements in conformity with general accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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. As more fully discussed in Note A, the Company discontinued the application of SFAS No. 71 as of December 31, 1991. The Company has accounted for all transactions related to the reorganization proceedings in accordance with SOP 90-7.

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.

The Company accrues a liability for the estimated decommissioning costs for the Company's interest in Palo Verde 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. Decommissioning costs are charged to depreciation expense in the statement of operations.



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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 the 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 \$26.2 million at December 31, 1995. 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.

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

Operating Revenues. The Company accrues base revenues for services rendered but unbilled.

The regulations of the Texas Commission, New Mexico Commission and FERC and the agreements with individual customers generally provide for fuel and purchased and interchanged power expenses to be recovered from customers. Fuel revenues reflect the Company's estimate of recoverable fuel and purchased and interchanged power expenses net of a percentage of (i) profit margins from certain off-system sales and (ii) revenues from third party transmission services, which are credited to customers. Economy sales relate to spot market sales and are included in fuel revenues. Base revenues refers to the Company's revenues from the sale of electricity excluding such fuel costs.

Federal Income Taxes and Investment Tax Credits. Effective January 1, 1993, the Company began accounting for federal income taxes under SFAS No. 109, 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

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used the deferred method of accounting for income taxes. 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 in 1993.

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 1994 and 1993 have been reclassified to conform with the 1995 presentation.

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. The Company anticipates that the accounting policies used prior to emergence from bankruptcy will generally continue to be used thereafter. However, certain modifications to the application of the above described accounting policies will be made. Upon emergence from bankruptcy, utility plant will be valued at the amount determined pursuant to fresh-start reporting and will be based upon the Company's estimate of the plant's replacement cost less depreciation. Depreciation will be based on the results of a depreciation study to be conducted by the Company and will be provided over the remaining lives of the assets. In the application of fresh-start reporting, the Company will record its estimated obligation for the decommissioning of its interest in Palo Verde at the present value of estimates of future cash flows for decommissioning expenditures. In addition, interest will be accrued on the estimated decommissioning liability. Deferred ITC will be eliminated in the application of fresh-start reporting and, therefore, will not be amortized. Debt issuance costs will be amortized over the life of the related debt using the interest method.

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



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Corners Project ("Four Corners") and certain other transmission facilities. A summary of the Company's investment in jointly owned utility plant, excluding fuel, is as follows:

	<u>Electric Plant in Service</u>	<u>Accumulated Depreciation</u> (In thousands)	<u>Construction Work in Progress</u>
December 31, 1994:			
Palo Verde Station	\$ 940,279	\$ (131,737)	\$ 12,121
Other	135,178	(54,307)	1,050
December 31, 1995:			
Palo Verde Station	\$ 952,310	\$ (155,749)	\$ 10,653
Other	135,400	(59,398)	1,661

The Company's investment, at cost, in Palo Verde in the amount of approximately \$963 million at December 31, 1995, 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 were accounted for as operating leases. See Note B for information regarding such transactions and the reacquisition of the leased portions. 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.

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 \$7.3 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.

Decommissioning. The Company is accruing its estimated decommissioning obligation over the remaining 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. The Company's depreciation expense includes approximately \$7.5 million per year for the estimated future decommissioning costs of Palo Verde based on decommissioning studies performed for the Company by an outside engineering firm. The above amount reflects studies implemented in September 1993 and December 1995. As of December 31, 1995, the Company has accrued a liability of approximately \$47.2 million for its estimated decommissioning costs.

In December 1995, the Palo Verde Participants approved a study by an outside engineering firm of the cost of decommissioning Palo Verde. The 1995 study determined that the Company will have to fund approximately \$229 million (stated in 1995 dollars) to cover its share of such costs. The 1995 study assumes



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that (i) maintenance expense for spent fuel storage will be incurred for ten years after the shutdown of the last unit (estimated to be in 2024) rather than the approximately 30 years utilized in a 1993 study; (ii) a national interim spent fuel storage facility will be available; and (iii) as a result of such national spent fuel storage facility, the amount of spent fuel stored on-site is reduced from all spent fuel assemblies to the final core plus fuel assemblies from approximately three refuelings.

Cost estimates for decommissioning have increased with each study conducted. The 1995 cost estimate is comparable to the cost estimate from a 1993 study, which determined that the Company would have to fund approximately \$221 million (stated in 1993 dollars), however, the 1993 study was based on different assumptions primarily related to the decommissioning of spent fuel. The 1993 cost estimate included an estimated cost to decommission on-site spent fuel storage facilities of approximately \$50 million while the 1995 study includes an estimated cost of approximately \$13 million related to spent fuel. The 1993 study assumed that (i) decommissioning would take place from 2024 through 2035 for the production units; (ii) maintenance expense for spent fuel storage would be incurred from 2035 through 2067; and (iii) decommissioning of the spent fuel storage facilities would occur in 2067. The 1993 estimate reflected an 84% increase from the previous estimate made in 1989, primarily due to an increase in the estimated costs associated with the permanent burial of low-level radioactive waste due to the uncertainty surrounding the availability and cost of low-level radioactive waste repositories, as discussed below.

Although the 1995 study is based on the latest available information, there can be no assurance that decommissioning costs will not continue to increase in the future or that applicable regulatory requirements will not change. In addition, until a new low-level radioactive waste repository opens and operates for a number of years, estimates of the cost to dispose of low-level radioactive waste may increase significantly. APS has recently begun to consider the possibility that a water reclamation facility, evaporation ponds and related facilities may have to be decommissioned. This potential requirement was not part of the 1995 study, but will be addressed by the Palo Verde Participants in evaluating the decommissioning funding levels in 1996. The Company cannot currently predict the impact of this assessment, but the liability for decommissioning and future decommissioning expense could both increase as a result.

The FASB has issued an exposure draft of a proposed accounting standard entitled "Accounting for Certain Liabilities Related to Closure or Removal of Long-Lived Assets" which would encompass obligations related to the decommissioning of nuclear power plants. The proposed standard, if adopted, would change the current practice of accruing the decommissioning liability over the plant's useful life and require that the present value of the estimated total decommissioning costs be recorded as a liability in the financial statements. As of December 31, 1995, the present value of the estimated future expenditures for decommissioning, based upon the 1995 study, would be approximately \$84.5 million assuming an inflation rate of 3% and a discount rate of 6%. In the application of fresh-start reporting upon the emergence from bankruptcy, the Company anticipates it will reflect the estimated obligation for decommissioning of Palo Verde in a manner which is substantially consistent with the FASB's current position on this project. Changes in the estimate of the cost to decommission Palo Verde, have been, and could continue to be, material. Any subsequent increases in such estimates will be reflected as additional decommissioning liability and expensed over the estimated remaining useful life of Palo Verde.



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The rate freeze under the Rate Stipulation would preclude the Company from seeking a rate increase in Texas during the Freeze Period to recover increases in decommissioning costs. Additionally, there can be no assurance that the Company could increase its rates in any of its other jurisdictions to recover such increased costs.

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, 1995, the aggregate balance of the trust funds was approximately \$26.2 million, which is reflected in the Company's balance sheets in deferred charges and other assets.

An industry-wide assessment has been made for decontamination of the DOE's enrichment facilities. The total amount of this assessment has not yet been finalized; however, 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 has accrued \$7.2 million which represents its portion of the estimated assessment.

Steam Generators. 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 Units 1 and 3. This form of tube degradation is not common in the nuclear industry. The units also have experienced circumferential cracking at the tube sheet, a more common type of tube cracking. The axial tube cracking was discovered following a steam generator tube rupture in Unit 2 in March 1993. Since that time, APS has undertaken an ongoing investigation and analysis and has performed corrective actions designed to mitigate further degradation. Corrective actions have included changes in operational procedures designed to lower the operating temperatures of the units, chemical cleaning and the implementation of other technical improvements. APS has stated that it believes its remedial actions have slowed the rate of tube degradation.

Each of the Palo Verde units has been inspected periodically during regularly scheduled refueling outages and mid-cycle inspection outages. When tube cracks are detected during an inspection, the affected tubes are taken out of service by plugging, which impairs the performance of a unit if sufficient numbers of steam generator tubes are affected. The output from the Units have been reduced slightly due to the tube plugging and operating modifications.

The projected service lives of the Units' steam generators are reassessed by APS periodically in conjunction with inspections made during outages of the Palo Verde units. In August 1995, APS announced that its ongoing analyses indicate 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 replacement of the steam generators 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 steam generators in Units 1 and 3 should operate for their designated life of 40 years (to 2025 and 2027, respectively). APS will continue to assess these steam generators periodically.



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Steam generator replacement could be done through new steam generators manufactured for Palo Verde or through the purchase of existing steam generators that are compatible with Palo Verde's design. Replacement of the steam generators would 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 or other Palo Verde Participants will agree to replace the Unit 2 steam generators. The Company expects that if the steam generators in Unit 2 are replaced, most of such costs would be incurred between 2000 and 2005. The total costs associated with replacement of the Unit 2 steam generators, including replacement power costs, could be significant, the Company's portion of which is currently estimated not to exceed \$30 million.

The rate freeze under the Rate Stipulation would preclude the Company from seeking a rate increase in Texas during the Freeze Period to recover capital costs associated with such replacement. It is uncertain whether the costs associated with replacing the Unit 2 steam generators would be approved by the New Mexico Commission and included in the Company's rate base in New Mexico.

Liability and Insurance Matters. The Palo Verde Participants have public liability insurance against nuclear energy hazards to the full limit of liability under federal law in the form of primary liability insurance provided by commercial insurance carriers in the amount of \$200 million, with the balance being provided by an industry-wide retrospective assessment program, pursuant to which industry participants would be required to pay an assessment to cover any loss in excess of \$200 million. The maximum assessment per reactor 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 Palo Verde, 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. Finally, the Company has obtained insurance against a portion of any increased cost of generation or purchased power which may result from the accidental outage of any of the three Palo Verde Units if the outage exceeds 21 weeks.

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. Upon emergence the Reorganized Company reacquired the portions of Palo Verde which were subject to the Palo Verde Leases and the leases were terminated. Under fresh-start reporting, all of the Company's interest in Palo Verde, including the reacquired portion, will be valued at an amount based on the replacement cost less depreciation of such interest. The reacquisition has no effect on the Company's obligations with respect to Palo Verde operating costs. In the application of fresh-start reporting, the Company anticipates recording

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its obligation for the decommissioning of its interest in Palo Verde at the present value of estimated future cash flows for decommissioning expenditures.

F. Common Stock

The Company has not paid dividends on its common stock since March 1989. Resumption of dividends on common stock will depend on authorization by the Company's Board of Directors and the availability of sufficient earnings or retained earnings as defined in applicable provisions of state law and the Federal Power Act.

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's employee stock compensation plan is a broad-based plan under which shares of Company common stock were issued from time to time to eligible employees. Under the plan, the Board's Compensation/Benefits Committee could 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 1993 through 1995.

Employee Stock Option Plan. The Company's Employee Stock Option Plan authorized 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, 1995, options were outstanding for the purchase of 2,058,881 shares of common stock at exercise prices ranging from \$2.50 to \$8.88 per share, of which options for 1,089,075 were exercisable. No options were exercised in 1993 through 1995.

Shares of common stock reserved for issuance under described stock benefit plans were 3,116,680 at December 31, 1995.

Changes in common stock are as follows:

	Common Stock	
	Shares	Amount
	(In thousands)	
Balance December 31, 1992	35,534,963	\$ 339,078
Issuances of Common Stock:		
1993	9,367	19
1994	—	—
1995	—	—
Balance December 31, 1995	<u>35,544,330</u>	<u>\$ 339,097</u>

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Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. Upon emergence from bankruptcy, all of the Company's existing common stock was canceled. The holders of the existing common stock received 3% of the common stock (approximately 1.8 million shares) of the Reorganized Company in satisfaction of their claims. In addition, such record holders of the common stock will share with holders of the former preferred stock in the first \$20 million of proceeds, if any, from certain litigation against CSW. See Note K. All of the outstanding stock options were canceled and the Company's existing stock plans were terminated. Under the Reorganization approximately 60 million shares of new common stock were issued. The financing documents executed upon emergence from bankruptcy provide that (i) unless the bonds of the longest maturity have received a rating of "investment grade", the Reorganized Company may only pay cash dividends on its common stock to the extent of (a) \$10 million plus (b) 50% of the amount of its net income less dividends on preferred stock; and (ii) the aggregate of dividends on common stock through February 12, 1999 cannot exceed \$15 million.

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 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. However, in connection with the confirmation of the Merger Plan, the Bankruptcy Court authorized the Company to make interim payments to preferred stockholders. Approximately \$1.4 million, \$4.4 million and \$1.5 million of such payments were made in 1993, 1994 and 1995, respectively. Such payments ceased upon termination of the Merger Plan.

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Preferred Stock, Redemption Required. Following is a summary of issued and outstanding preferred stock, redemption required and a summary of cumulative per share dividends in arrears and cumulative dividends in arrears of issued and outstanding preferred stock, as of December 31, 1995, calculated according to the terms of the preferred stock:

	<u>Shares</u>	<u>Amount</u>	<u>Cumulative Per Share Dividends</u>	<u>Cumulative Dividends in Arrears</u>
		(In thousands)		(In thousands)
\$ 10.75 Dividend	52,000	\$ 5,200	\$ 48.38	\$ 2,516
\$ 8.44 Dividend	97,600	9,760	37.98	3,707
\$ 8.95 Dividend	90,000	9,000	40.28	3,625
\$ 10.125 Dividend	100,000	10,000	45.56	4,556
\$ 11.375 Dividend	<u>300,000</u>	<u>30,000</u>	51.19	<u>15,356</u>
	<u>639,600</u>	<u>63,960</u>		<u>\$ 29,760</u>
Accrued dividends in arrears		<u>3,306</u>		
		<u>\$ 67,266</u>		

At December 31, 1995 the total arrearage of mandatory sinking fund payments on preferred stock, redemption required is \$48.4 million.

Preferred Stock, Redemption not Required. Following is a summary of preferred stock issued and outstanding at December 31, 1995 which is not redeemable except at the option of the Company:

	<u>Shares</u>	<u>Amount</u>
		(In thousands)
\$ 4.50 Dividend	15,000	\$ 1,534
\$ 4.12 Dividend	15,000	1,506
\$ 4.72 Dividend	20,000	2,001
\$ 4.56 Dividend	40,000	4,000
\$ 8.24 Dividend	<u>52,450</u>	<u>5,157</u>
	<u>142,450</u>	<u>\$ 14,198</u>

Total cumulative dividends in arrears on preferred stock, redemption not required is approximately \$3.8 million.

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. Upon emergence from bankruptcy, all of the Company's existing preferred stock and obligations with respect to

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dividends thereon were canceled. The holders of the existing preferred stock received 12% of the common stock (approximately 7.2 million shares) of the Reorganized Company in satisfaction of their claims. In addition, such record holders of the preferred stock will share with holders of the former common stock in the first \$20 million of proceeds, if any, from certain litigation against CSW. See Note K.

In connection with the emergence from bankruptcy, the Reorganized Company issued \$100 million of new preferred stock. The new preferred stock has a liquidation preference of \$100 per share, has no sinking fund requirements and must be redeemed by the Reorganized Company in 2008. The new preferred stock has an annual dividend rate of 11.40%, which is to be paid through the issuance of additional shares of preferred stock for the first three years and in cash thereafter.

H. Obligations Subject to Compromise

Under the Bankruptcy Code, certain claims against the Company in existence prior to the Petition Date were stayed, subject to their treatment in reorganization. Additional claims, also subject to compromise, arose 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, claims are reflected at amounts expected to be allowed by the Bankruptcy Court in the December 31, 1994 and 1995 balance sheets as "Obligations Subject to Compromise," which amounts differ substantially from the settled amounts. See Note B with respect to treatment of obligations under the Palo Verde Leases.

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 went into default. As a result of the automatic stay imposed by the provisions of the Bankruptcy Code, such creditors generally were prevented from taking any action to collect such amounts or pursue any remedies against the Company other than through the Bankruptcy Case.

In accordance with SOP 90-7, the Company accrued interest, at contractual non-default rates, 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. 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 \$32.5 million, \$64.7 million, \$67.7 million and \$72.4 million for 1992, 1993, 1994 and 1995, respectively, in interest on first and second mortgage bonds of the Company for the period of July 1, 1992 through December 31, 1995, including those bonds held as security for the Company's revolving credit facility, described below, and interest on three series of pollution control bonds.

Contractual non-default interest expense on unsecured and undersecured debt was approximately \$41.1 million, \$41.8 million, \$45.7 million and \$52.0 million for the years ended December 31, 1992, 1993, 1994 and 1995, respectively, and was not accrued by the Company. However, in connection with the confirmation of the Merger Plan, the Bankruptcy Court authorized the Company to make interim payments



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to unsecured and undersecured creditors equivalent to interest on their claims. Approximately \$10.2 million in 1993, \$24.8 million in 1994, and \$14.5 million in 1995 was paid and charged to interest expense applicable to such creditors. Such interim payments ceased upon termination of the Merger Plan.

As of December 31, 1995, approximately \$163.5 million remained due on contractual minimum annual principal reduction requirements for 1992, 1993, 1994 and 1995.

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The following is a summary of obligations subject to compromise:

	December 31,	
	1994	1995
	(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
	<u>299,282</u>	<u>299,282</u>
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
	<u>165,000</u>	<u>165,000</u>
Revolving credit facility secured by First and Second Mortgage Bonds, due 1992 (3)	<u>150,000</u>	<u>150,000</u>
Pollution Control Bonds (4):		
Secured by Second Mortgage Bonds:		
Variable rate bonds, due 2014, net of \$1,781,000 and \$1,844,000, respectively, on deposit with trustee	61,719	61,656
Variable rate refunding bonds, due 2014	37,100	37,100
Variable rate refunding bonds, due 2015	59,235	59,235
	<u>158,054</u>	<u>157,991</u>
Nuclear fuel financing (5)	60,620	60,620
Accrued interest (6)	46,300	47,372
Other	9,757	9,757
Total secured debt	<u>889,013</u>	<u>890,022</u>
Unsecured Debt:		
Notes payable to banks (7)	288,416	288,416
Pollution control bonds, variable rate, refunding bonds, due 2013 (4)	33,300	33,300
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 Unit 2 and 3 (Note B)	177,613	246,006
Capitalized lease obligation, Copper Turbine (10)	8,106	7,056
Prepetition accrued interest	4,837	4,837
Other	31,832	34,268
Total unsecured debt	<u>648,290</u>	<u>718,069</u>
	<u>\$ 1,537,303</u>	<u>\$ 1,608,091</u>

EL PASO ELECTRIC COMPANY

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NOTES TO FINANCIAL STATEMENTS

(1) First Mortgage Bonds

The First Mortgage Bonds are secured by substantially all of the Company's utility plant. The First Mortgage Indenture provides for sinking and improvement funds, which were not met since the Petition Date.

(2) Second Mortgage Bonds

The Second Mortgage Bonds are secured by substantially all of the Company's utility plant. The Second Mortgage Indenture provides for sinking funds which have not been met since the Petition Date.

(3) Revolving Credit Facility

The Company 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 Petition Date. 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 administering bank's current quoted prime rate plus 1%. Such interest rate at December 31, 1995 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.

(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, 1995. Prior to the Petition Date, 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

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NOTES TO FINANCIAL STATEMENTS

facility (contractual interest rate of 9.52% at December 31, 1995) that is supported by a letter of credit facility. No principal payments have been made to the trust because of the Company's Bankruptcy Case. Since the Petition Date, the Company has not sought to finance its fuel costs from the trust, but has instead paid for nuclear fuel with its own funds.

(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 a floating rate which was 8.50% at December 31, 1995.

(9) Financing Obligation, Palo Verde Unit 2

In December 1986, the Company entered into a financing obligation pursuant to one of the sale and leaseback transactions 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.

(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%. The Company has paid and intends to continue to pay all postpetition lease payments on the Copper Lease.

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. Pursuant to the Plan, the pollution control bonds, the Copper Turbine capitalized lease obligation and certain other minor amounts were carried forward to the Reorganized Company. The remainder of the obligations subject to compromise were satisfied under the Plan through the payment of cash and the issuance of the securities described in Note A. Secured creditors received the full amount of their claims and unsecured and undersecured creditors received approximately 75% (assuming a value of \$5 per share for the common stock)

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NOTES TO FINANCIAL STATEMENTS

of their allowed claims. While certain litigation and environmental claims carry forward to the Reorganized Company (see Notes J and K) and the claims of the holders of the bonds related to the Palo Verde Leases were allowed a \$700 million claim as unsecured creditors (see Note B), all other claims were resolved in the bankruptcy process at amounts substantially equivalent to the amounts recorded in the Company's financial statements.

On February 12, 1996, the Reorganized Company entered into a \$100 million credit facility with Chemical Bank that includes a portion for working capital requirements and up to \$60 million for the financing of nuclear fuel. The credit facility bears interest at a floating rate on outstanding amounts with a commitment fee of 0.5% on the remainder of the facility and expires on February 12, 1999.

Future contractual minimum annual principal requirements on the debt of the Reorganized Company are as follows (In thousands):

<u>Year Ending December 31,</u>		
1996	\$	2,017
1997		1,272
1998		1,400
1999		169,842
2000		827

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 Statement of Operations for the year ended December 31, 1993. The charge to operations consisted of the recognition of additional tax benefits and valuation allowances as follows:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
	(In thousands)		
Additional net tax benefits	\$ (153,232)	\$ (12,230)	\$ (165,462)
Valuation allowance	219,246	42,260	261,506
Charge to operations	<u>\$ 66,014</u>	<u>\$ 30,030</u>	<u>\$ 96,044</u>



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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 1995, are presented below:

	<u>December 31.</u>	
	<u>1994</u>	<u>1995</u>
	(In thousands)	
Deferred tax assets:		
Letters of credit draws	\$ 100,946	\$ 100,946
Gain on sale and leaseback transactions	48,920	46,410
Accrued lease expense, net of interim payments (Note B)	62,004	85,942
Accumulated deferred investment tax credits	26,825	27,396
Capital leases	24,815	25,100
Benefits of tax loss carryforwards	33,670	3,582
Investment tax credit carryforward	16,444	11,984
Alternative minimum tax credit carryforward	18,120	35,964
Other	<u>80,525</u>	<u>100,900</u>
Total gross deferred tax assets	<u>412,269</u>	<u>438,224</u>
Less valuation allowance:		
Federal	(221,970)	(217,509)
State	<u>(39,808)</u>	<u>(39,808)</u>
Total valuation allowance	<u>(261,778)</u>	<u>(257,317)</u>
Net deferred tax assets	<u>150,491</u>	<u>180,907</u>
Deferred tax liabilities:		
Plant, principally due to differences in depreciation and basis differences	(232,000)	(235,181)
Other	<u>(16,597)</u>	<u>(15,736)</u>
Total gross deferred tax liabilities	<u>(248,597)</u>	<u>(250,917)</u>
Net accumulated deferred income taxes	<u>\$ (98,106)</u>	<u>\$ (70,010)</u>

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 increased by approximately \$4.7 million in 1993 and decreased by approximately \$4.4 million in 1994 and \$4.5 million in 1995.



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NOTES TO FINANCIAL STATEMENTS

As discussed in Note D, the Company's income tax provision has been calculated under SFAS No. 109. The Company recognized income taxes as follows:

	<u>Years Ended December 31.</u>		
	<u>1993</u>	<u>1994</u>	<u>1995</u>
	(In thousands)		
Income tax expense (benefit):			
Federal:			
Current	\$ 15,253	\$ 6,320	\$ 13,757
Deferred	(20,345)	(20,304)	(18,264)
Investment tax credit amortization ..	(2,841)	(2,838)	(2,828)
Total	<u>\$ (7,933)</u>	<u>\$ (16,822)</u>	<u>\$ (7,335)</u>
State:			
Current	\$ 3,316	\$ 584	\$ 935
Deferred	(892)	(364)	(5,959)
Total	<u>\$ 2,424</u>	<u>\$ 220</u>	<u>\$ (5,024)</u>

The current federal income expense results primarily from the accrual of alternative minimum tax ("AMT"). The deferred federal income tax benefit recorded in 1993, 1994 and 1995 includes AMT credits of approximately \$15.3 million, \$8.4 million and \$18.3 million, respectively. ITC utilization was not recorded in 1993. For the years 1994 and 1995, ITC utilized of approximately \$2.1 million and \$4.6 million, respectively, was recorded as a reduction to current tax and included as a deferred tax expense.



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NOTES TO FINANCIAL STATEMENTS

Federal income tax provisions differ from amounts computed by applying the statutory rate of 35% to the book loss before federal income tax as follows:

	<u>Years Ended December 31.</u>		
	<u>1993</u>	<u>1994</u>	<u>1995</u>
	(In thousands)		
Tax benefit computed on loss before cumulative effect of a change in accounting principle at statutory rate	\$ (17,426)	\$ (15,741)	\$ (14,229)
(Increases) decreases in benefits due to:			
ITC amortization (net of deferred taxes)	(1,846)	(1,845)	(1,838)
Nondeductible reorganization costs	11,745	3,915	5,925
Increase in income tax rate	3,403	—	—
Other	(3,809)	(3,151)	2,807
Total federal income tax benefit	<u>\$ (7,933)</u>	<u>\$ (16,822)</u>	<u>\$ (7,335)</u>
Effective federal income tax benefit rate	<u>15.9%</u>	<u>37.4%</u>	<u>18.0%</u>

The Company had approximately \$10 million of tax net operating loss ("NOL") carryforwards, approximately \$12 million of ITC carryforwards and approximately \$36 million of AMT credit carryforwards as of December 31, 1995. The NOL carryforward has been reduced by approximately \$70 million of estimated taxable income for the year ended December 31, 1995. These carryforwards could be reduced or eliminated, or the amounts that can be utilized in any year could be limited, if events occur such as debt forgiveness, the conversion of debt to equity or change in control of the Company. If unused, the NOL carryforwards would expire at the end of the years 2006 through 2009, the ITC carryforwards would expire in the years 2002 through 2005 and the AMT credit carryforwards have an unlimited life.

On August 10, 1993, President Clinton signed tax legislation which, among other provisions, increased 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.

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NOTES TO FINANCIAL STATEMENTS

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. In applying fresh-start reporting upon emergence from bankruptcy, deferred income taxes will be adjusted to reflect the amount calculated, in accordance with SFAS No. 109, on the temporary differences between the tax and fresh-start reporting bases of the Reorganized Company's assets and liabilities. Due to other effects of applying fresh-start reporting, certain temporary differences existing prior to emerging from bankruptcy will be eliminated, the amounts of others will change, and new temporary differences will arise. The Company estimates that upon emergence from bankruptcy it will have an NOL of approximately \$835 million, including anticipated future deductions attributable to retirement of first mortgage bonds issued directly to creditors in the Reorganization. The utilization of approximately \$103 million of such NOL will be limited to approximately \$22 million per year. Based on the anticipated levels of future taxable income, the Company anticipates that no valuation allowance will be required upon emergence from bankruptcy for federal deferred tax assets, other than to the extent of ITC carryforwards. The Company anticipates that a valuation allowance of approximately \$26 million will be required upon emergence from bankruptcy for state deferred tax assets. To the extent that valuation allowances established at emergence from bankruptcy are subsequently reversed, such amounts will not be reflected in the statement of operations.

J. Commitments and Contingencies

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 transactions, the lessors may have claims against the Company for 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 ITC 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 does not believe it is probable that a loss has been incurred and, therefore, 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 rapidly and are difficult to predict. The construction of new facilities is subject to standards

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NOTES TO FINANCIAL STATEMENTS

imposed by environmental regulation, and substantial expenditures may be required to comply with such regulations. 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, however, additional expenses associated with compliance could have a material adverse effect on the future operations and financial condition of the Company.

PCB Treatment, Inc. In September 1994, the Company received a request to participate in the remediation of polychlorinated biphenyls ("PCBs") at two facilities which had been operated by PCB Treatment, Inc. ("PTI"). The Company had sent 23 shipments of PCBs or PCB-containing electrical equipment to PTI, accounting for approximately 3%, by weight, of the PCBs received by PTI. PTI has since discontinued operations and the Environmental Protection Agency (the "EPA") has determined that its abandoned facilities require prompt remediation. Based upon current information, it is apparent that more than 1,400 entities sent PCBs to PTI. The Company is working with other parties to identify the most efficient framework for remediating the facilities. At this time, 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 does not believe it is probable that a loss has been incurred and, therefore, has made no provision in the accompanying financial statements related to this matter.

Santa Fe Facility. The Company is monitoring the ground water at the Santa Fe facility for the presence of PCBs. The Company does not expect to incur any material remediation costs and therefore has made no provision for such costs in the accompanying financial statements.

Purchased Power

To support the requirements of the agreement with CFE, the Company entered into a firm power purchase agreement with Southwestern Public Service Company ("SPS") for at least 75 MW for 1996. See Note C. In December 1995, the transformer for a 150 MW unit at the Rio Grande Power Station was damaged and is not expected to return to service prior to the Company's summer peak requirements. As a result, the Company may need to purchase replacement power to meet its capacity requirements, the cost of which is currently estimated to be approximately \$2 million.

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. Pursuant to settlement agreements entered into between the Company and the lessors under the Palo Verde Leases, certain of the Company's indemnity obligations related to tax matters will continue after the Effective Date. Claims for certain environmental matters are unimpaired under the Reorganization.



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NOTES TO FINANCIAL STATEMENTS

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.

Central and South West Corporation Litigation

In response to CSW's termination of the Merger Agreement and revocation of the Merger Plan (See Note A), on June 9, 1995, the Company filed a lawsuit against CSW, alleging, 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 is seeking an unspecified amount of damages, punitive damages, attorneys' fees and costs. On June 15, 1995, CSW filed a complaint against the Company in the Bankruptcy Court. 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 Docket 12700. 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. Discovery has commenced in the litigation. The Company is unable to predict the ultimate outcome of this matter, but does not believe it is probable that a loss has been incurred and, therefore, has made no provision in the accompanying financial statements related to the litigation between the Company and CSW.

Litigation with the City of Las Cruces

The City of Las Cruces ("Las Cruces") has stated that it intends to attempt to replace the Company as its electric service provider by acquiring through condemnation or otherwise, the distribution assets and other facilities used to provide electric service to customers in Las Cruces. Sales to customers in Las Cruces represented approximately 7% of the Company's operating revenues in 1995. Las Cruces has two actions pending against the Company, one seeking to recover franchise fees despite the expiration of the Company's Las Cruces franchise in March 1994 and one seeking a declaratory judgment that Las Cruces can proceed with a condemnation action against the Company.

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In October 1995, the Company's motion for summary judgment in the declaratory judgment suit was denied and the Court ruled that although Las Cruces lacks express statutory authority to condemn the Company's assets such express statutory authority is required only if the proposed condemnation would substantially impair, obliterate or destroy the use of the remaining property. The Board of Commissioners of Dona Ana County, New Mexico, filed a motion to intervene in the declaratory judgment suit to ensure that the concerns of non-municipal county customers and residents are fully developed.

Las Cruces has taken steps to obtain a supply of power and an operator for its municipal utility in the event it is successful in its condemnation efforts. In June 1994, the Las Cruces City Council approved a resolution selecting SPS to provide operation and maintenance services for the proposed Las Cruces electric distribution system, substations and associated transmission facilities and authorizing the staff of Las Cruces to negotiate a contract with SPS related to such services. In August 1994, SPS and Las Cruces entered into a fifteen-year contract granting SPS the right to provide all of the electric power and energy required by Las Cruces during the term of the contract. Las Cruces also has offered to purchase the Company's assets serving Las Cruces for \$43 million. In addition, Las Cruces announced that, in October 1995, it sold approximately \$73 million in revenue bonds to provide funding to finance the acquisition by condemnation or negotiated purchase of the Company's electrical distribution assets within and adjacent to the Las Cruces city limits. The Company has filed a lawsuit in the Dona Ana County District Court and a complaint before the New Mexico Commission challenging the legality of the sale of the revenue bonds. The New Mexico Commission is also investigating an agreement between SPS and Las Cruces that would grant, in certain circumstances, Las Cruces an option to sell electric utility assets acquired through condemnation to SPS.

The Company believes that New Mexico law does not authorize condemnation of the Company's facilities by Las Cruces. If Las Cruces succeeds in its efforts, the Company could lose its Las Cruces customer base, although the Company would receive "just compensation" as established by the court. Although the Company is unable to predict the outcome of this litigation, the Company does not believe it is probable that a loss has been incurred and, therefore, has made no provision in the accompanying financial statements for this matter. However, the Company has continued to reserve amounts equivalent to the franchise fee.

Water Cases

San Juan River System. 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 seeking adjudication of the water rights of the San Juan River Stream System in New Mexico, which supplies the water used at Four Corners. No trial date has been set in this matter and the case has been inactive for several years. 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. Although the ultimate outcome of this case and the materiality thereof cannot be determined at this time, the Company does not believe it is probable that a loss has been incurred and, therefore, has made no provision in the accompanying financial statements for this matter.

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NOTES TO FINANCIAL STATEMENTS

Gila River System. 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 within that geographic area. The rights of the Palo Verde Participants to the use of groundwater and effluent at Palo Verde are potentially at issue. No trial date has been set in this matter. Although the ultimate outcome of this case and the materiality thereof cannot be determined at this time, the Company does not believe it is probable that a loss has been incurred and, therefore, has made no provision in the accompanying financial statements for this matter.

Four Corners

In July 1995, the Navajo Nation enacted the Navajo Nation Air Pollution Prevention and Control Act, the Navajo Nation Safe Drinking Water Act and the Navajo Nation Pesticide Act (collectively, the "Acts"). By letter dated October 12, 1995, the participants in Four Corners requested that the United States Secretary of the Interior resolve their dispute with the Navajo Nation regarding whether the Acts apply to operation of Four Corners. The participants in Four Corners subsequently filed a declaratory judgment action in the District Court of the Navajo Nation, Window Rock District, seeking such a resolution. On October 18, 1995, the Navajo Nation and the participants in Four Corners agreed to indefinitely stay the lawsuit so that the parties may attempt to resolve the dispute without litigation. The Company is unable to predict the outcome of this matter, but does not believe it is probable that a loss has been incurred and, therefore, has made no provision in the accompanying financial statements for this matter.

Other

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.

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. Claims with respect to the CSW litigation, the Las Cruces litigation, the water cases, the Acts and certain immaterial items of litigation, were not settled in the Bankruptcy Case and carry forward to the Reorganized Company.



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NOTES TO FINANCIAL STATEMENTS

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.

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:

	<u>Years Ended December 31,</u>		
	<u>1993</u>	<u>1994</u>	<u>1995</u>
	(In thousands)		
Service cost for benefits earned during the period	\$ 6,114	\$ 2,453	\$ 2,011
Interest cost on projected benefit obligation ..	4,376	4,896	5,157
Actual return on plan assets	(1,769)	378	(9,267)
Net amortization and deferral	<u>(1,245)</u>	<u>(3,383)</u>	<u>6,008</u>
Net periodic pension cost recognized	<u>\$ 7,476</u>	<u>\$ 4,344</u>	<u>\$ 3,909</u>

The assumed annual discount rates used in determining the net periodic pension cost were 8.00%, 7.25% and 8.50% for 1993, 1994 and 1995, respectively.

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NOTES TO FINANCIAL STATEMENTS

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 1995 are presented below:

	December 31,			
	1994		1995	
	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)	\$ (55,591)	\$ (9,559)
Accumulated benefit obligation	\$ (41,483)	\$ (9,065)	\$ (57,844)	\$ (11,570)
Projected benefit obligation	\$ (51,065)	\$ (10,506)	\$ (70,958)	\$ (13,441)
Plan assets at fair value	43,574	—	53,512	—
Projected benefit obligation in excess of plan assets	(7,491)	(10,506)	(17,446)	(13,441)
Unrecognized net (gain) loss from past experience	(41)	146	11,562	2,648
Unrecognized prior service cost	242	(471)	212	(407)
Unrecognized transition obligation	2,857	304	2,449	260
Accrued pension liability	\$ (4,433)	\$ (10,527)	\$ (3,223)	\$ (10,940)

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

	1994	1995
Discount rate	8.50%	7.25%
Rate of increase in compensation levels	5.50%	5.00%
Expected long-term rate of return on plan assets	8.50%	8.50%

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"



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("SFAS No. 106"), which required a change from the pay-as-you-go accounting method for these postretirement benefits to the accrual accounting method, was adopted 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 \$44.6 million over 20 years.

Net periodic postretirement benefit cost is made up of the components listed below:

	<u>Years Ended December 31,</u>		
	<u>1993</u>	<u>1994</u>	<u>1995</u>
	(In thousands)		
Service cost for benefits earned during the period	\$ 1,564	\$ 2,064	\$ 1,603
Interest cost on accumulated postretirement benefit obligation ..	3,425	3,909	4,046
Amortization of transition obligation	2,172	2,172	2,363
Amortization of (gain) loss	—	103	(54)
Net periodic postretirement benefit cost	<u>\$ 7,161</u>	<u>\$ 8,248</u>	<u>\$ 7,958</u>

The funded status of the plan and amount recognized in the Company's balance sheet at December 31, 1994 and 1995 are presented below:

	<u>December 31,</u>	
	<u>1994</u>	<u>1995</u>
	(In thousands)	
Actuarial present value of postretirement benefit obligation:		
Accumulated postretirement benefit obligation:		
Retirees	\$ (22,157)	\$ (32,656)
Actives	(25,010)	(40,831)
	(47,167)	(73,487)
Plan assets at fair value	—	—
Accumulated postretirement benefit obligation in excess of plan assets ..	(47,167)	(73,487)
Unrecognized net (gain) loss from past experience	(5,541)	15,182
Unrecognized transition obligation	39,095	38,007
Accrued postretirement benefit liability	<u>\$ (13,613)</u>	<u>\$ (20,298)</u>

For measurement purposes, an 11.6 % annual rate of increase in the per capita cost of covered health care benefits was assumed for 1996; the rate was assumed to decrease gradually to 6 % 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



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year would increase the accumulated postretirement benefit obligation as of December 31, 1995 by \$7.4 million and the aggregate of the service and interest cost components of net periodic postretirement benefit cost for the year ended December 31, 1995 by \$1.0 million.

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

	<u>1994</u>	<u>1995</u>
Discount rate	8.50%	7.25%
Rate of increase in compensation levels	5.50%	5.00%

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. Under the Plan, the Company's obligations under the Retirement Plan and for medical care benefits for retired employees have been assumed by the Reorganized Company. The SERP was terminated on the Effective Date so that no benefits will be payable other than to persons currently eligible for or receiving benefits. In the application of fresh-start reporting, the Company will reflect as liabilities amounts of unrecognized transition obligations, gains or losses, and past service costs on the assumed plans aggregating approximately \$72.0 million. In addition, the liability for the SERP will be adjusted to the present value of amounts estimated to be paid to those currently entitled to receive SERP benefits.

M. Franchises and Significant Customers

City of El Paso Franchise

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. At December 31, 1995, the franchise with the City of El Paso was due to expire March 2001.

Las Cruces Franchise

The Company's franchise with Las Cruces expired in March 1994. The Company has continued to provide electric service to customers within Las Cruces and expects and intends to continue to do so. See Note K.

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Military Installations

The Company currently provides retail electric service in New Mexico to the Air Force at Holloman Air Force Base ("HAFB") and the Army at White Sands Missile Range ("WSMR"). The Company's sales to such military bases represented approximately 2% of revenues in 1995. 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 Army has issued a request for proposal related to the provision of all of the electric service requirements for WSMR but has suspended the proposal process. On December 27, 1995, the Company and the Air Force entered into a contract which provides that the Company will continue to furnish the electrical power needs of HAFB for the next ten years and will not seek any increase in the base rates it charges to HAFB during the ten-year period.

Significant Customers

In 1993, 1994 and 1995, IID, a wholesale customer, accounted for approximately \$55.0 million, \$51.1 million and \$43.3 million or 10.1%, 9.5% and 8.6%, respectively, of operating revenues. During 1993, 1994 and 1995, the Company recorded revenues pursuant to its contract with CFE in the amount of approximately \$41.9 million, \$42.7 million and \$39.4 million, respectively. See Note C.

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. Consistent with the Stipulation, the City of El Paso granted the Company a new franchise that extends through August 1, 2005. The emergence from bankruptcy had no effect on the Las Cruces franchise situation.

N. Financial Instruments

SFAS No. 107, "Disclosure about Fair Value of Financial Instruments", requires the Company to disclose estimated fair values for its financial instruments. The Company has determined that cash and temporary investments, accounts receivable, long-term contract receivable, accounts payable, customer deposits, decommissioning trust funds, obligations subject to compromise, see Note H, and preferred stock meet the definition of financial instruments. The carrying amounts of cash and temporary investments, accounts receivable, accounts payable, and customer deposits approximate fair value because of the short maturity of these items. Based on prevailing interest rates, the fair value of the long-term contract receivable approximates its carrying value. Decommissioning trust funds are carried at market value. Based on discussions with its financial advisor, the fair value of the other financial instruments is not determinable during bankruptcy due to uncertainties surrounding the terms and conditions under which the Company would emerge from bankruptcy.

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NOTES TO FINANCIAL STATEMENTS

Effects of Emergence from Bankruptcy

As discussed in Note A, the Company emerged from bankruptcy on February 12, 1996. In connection with the emergence from bankruptcy, the Reorganized Company issued new first mortgage bonds and new preferred stock in an underwritten offering. The Company's existing secured and unsecured debt was extinguished and existing preferred stock was cancelled. The new first mortgage bonds and new preferred stock were issued at par and therefore their fair value is equal to their face value.

O. Selected Quarterly Financial Data (Unaudited)

	1994 Quarters				1995 Quarters (1) (2)			
	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)	\$112,389	\$124,683	\$148,177	\$119,368
Operating income	11,403	17,749	31,347	12,512	11,950	17,851	31,175	5,170 (3)
Income (loss) before reorganization items	(10,699)	(5,044)	9,493	(12,912)	(14,449)	(7,130)	12,258	(14,020)
Reorganization items	(2,490)	(2,128)	(2,343)	(2,030)	(1,999)	(2,472)	(658)	(4,849)
Net income (loss)	(13,189)	(7,172)	7,150	(14,942)	(16,448)	(9,602)	11,600	(18,869)
Net income (loss) per weighted average share of common stock	(0.37)	(0.20)	0.20	(0.42)	(0.46)	(0.27)	0.33	(0.54)

- (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 due to a change in the calculation of Texas jurisdictional fuel costs based on the Texas Docket 13966 Final Order.
- (3) Reflects a \$2.3 million reserve against fuel revenues and changes in the Company's tax estimates.



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

MANAGEMENT

The following table sets forth certain information with respect to executive officers and directors of the Company as of March 15, 1996.

<u>Name</u>	<u>Age</u>	<u>Current Position and Business Experience</u>
David H. Wiggs, Jr.	48	Chairman of the Board; Chief Executive Officer, President and Director
Eduardo A. Rodriguez	40	Senior Vice President and General Counsel
J. Frank Bates	45	Vice President-Operations
Michael L. Blough	40	Vice President and Controller, Chief Accounting Officer
Gary R. Hedrick	41	Vice President-Financial Planning and Rate Administration and Treasurer
John C. Horne	47	Vice President-Power Supply
Robert C. McNiel	49	Vice President-New Mexico Division
Guillermo Silva, Jr.	42	Secretary
Wilson K. Cadman	68	Director
James A. Cardwell	63	Director
George W. Edwards, Jr.	56	Director
Ramiro Guzman	49	Director
James W. Harris	49	Director
Kenneth R. Heitz	48	Director
Edward C. Houghton, IV	44	Director
Michael K. Parks	36	Director
Eric B. Siegel	37	Director
Stephen Wertheimer	45	Director
Charles A. Yamarone	37	Director

David H. Wiggs, Jr. has been Chairman of the Board of the Company since May 1989, Chief Executive Officer of the Company since March 1989 and a Director of the Company since January 1988. Mr. Wiggs was President of the Company from January 1988 to January 1994 and since February 1996. Mr. Wiggs will retire from the Company as Chief Executive Officer and President effective on the date the new Chief Executive Officer and President takes office. Mr. Wiggs will remain a director of the Company.

Eduardo A. Rodriguez has been a Senior Vice President of the Company since January 1994 and General Counsel of the Company since 1988. Mr. Rodriguez was a Vice President of the Company from April 1992 to January 1994 and Secretary of the Company from January 1989 to January 1994.

J. Frank Bates has been the Vice President-Operations of the Company since May 1994. Mr. Bates was the Vice President-Customer Services for the Texas Division of the Company from June 1989 to May 1994.

Michael L. Blough has been a Vice President of the Company since May 1995 and the Controller and Chief Accounting Officer of the Company since November 1994. Mr. Blough was the Assistant Vice President-Financial Planning of the Company from September 1990 to November 1994.

Gary R. Hedrick has been Treasurer of the Company since March 1996 and Vice President-Financial Planning and Rate Administration of the Company since September 1990.

John C. Horne has been the Vice President-Power Supply of the Company since May 1994. Mr. Horne was the Vice President Transmission Systems Division of the Company from August 1989 to May 1994.

Robert C. McNiel has been the Vice President-New Mexico Division of the Company since December 1989.

Guillermo Silva, Jr. has been Secretary of the Company since January 1994. He was the Assistant Secretary of the Company from June 1989 to January 1994.

Wilson K. Cadman has been a Director of the Company since 1992. Mr. Cadman retired in 1992 after spending more than four years as Chairman of the Board, President, and Chief Executive Officer of Kansas Gas & Electric Company and as Vice Chairman of the Board of Western Resources, Inc., electric utility companies headquartered in Wichita, Kansas. Mr. Cadman is also a director of the Columbia Gas System, Inc., Wilmington, Delaware and Clark/Bardes, Inc., Dallas, Texas.

James A. Cardwell has been a Director of the Company since 1990. Mr. Cardwell is the Chief Executive Officer of Petro Stopping Centers, L.P., El Paso, Texas, a nationwide chain of truck stopping centers. Mr. Cardwell is also a trustee of Security Capital Pacific Trust, a real estate investment trust.

George W. Edwards, Jr. has been a Director of the Company since 1992 and will become the Chairman of the Board upon the retirement of Mr. Wiggs. Mr. Edwards was the President and Chief Executive Officer of the Kansas City Southern Railway Company, Kansas City, Missouri, from April 1991 until his retirement on May 15, 1995. Mr. Edwards also was the Executive Vice President and Director of Kansas City Southern Industries, a multi-business holding company headquartered in Kansas City, Missouri, from April 1991 to May 15, 1995. Mr. Edwards was Chairman of the Board and Chief Executive

Officer of United Illuminating Company, an electric utility located in New Haven, Connecticut, for more than five years prior to April 1991. Mr. Edwards is also a director of Aquarion Company and Hubbell, Inc.

Ramiro Guzman has been a Director of the Company since February 13, 1996. Mr. Guzman has been the President and Chief Executive Officer of Dickshire Distributing, a beer and soft drink distributorship located in El Paso, Texas, for more than five years.

James W. Harris has been a Director of the Company since February 13, 1996. Mr. Harris founded and has been the President of Seneca Financial Group, Inc., a financial services firm specializing in corporate restructurings located in Greenwich, Connecticut, since April 1993. Mr. Harris was a Vice President and subsequently a Managing Director of Lehman Brothers, Inc., New York, New York, from 1982 to March 1993.

Kenneth R. Heitz has been a Director of the Company since February 13, 1996. Mr. Heitz has been a senior partner in the law firm of Irell & Manella, Los Angeles, California, since May 1991 and was a partner of the firm from 1979 to 1988. From April 1988 to March 1990, Mr. Heitz served as Executive Vice President and General Counsel of Columbia Savings and Loan Association, Beverly Hills, California and, from January 1990 to March 1990, as its acting President and Chief Executive Officer.

Edward C. ("Ted") Houghton, IV, has been a Director of the Company since February 13, 1996. Mr. Houghton has been an insurance agent in El Paso, Texas for John Hancock Financial Services for more than ten years. Mr. Houghton serves as a member of the Public Service Board, El Paso Water Utilities.

Michael K. Parks has been a Director of the Company since February 13, 1996. Mr. Parks has been the President and Chief Investment Officer of Aurora National Life Assurance Company, a California life insurance company headquartered in Los Angeles, California, since September 1993. Mr. Parks was a financial consultant from September 1992 to August 1993 in the rehabilitation of Executive Life Insurance Company and was a Director-Leveraged Finance and held various other positions at Salomon Brothers Inc., New York, New York, for more than five years prior to September 1992.

Eric B. Siegel has been a Director of the Company since February 13, 1996. Mr. Siegel has been a principal of Pegasus Insurance Partners since January 1995. Pegasus Insurance Partners was formed to advise the majority investor in Aurora National Life Assurance Company, which acquired the restructured insurance business of Executive Life Insurance Company. Mr. Siegel has also been a limited partner of Apollo Advisors, L.P. and Lion Advisors, L.P. and related entities since 1992 and was Vice President of the General Partners of Apollo Advisors, L.P. and Lion Advisors, L.P. and related entities from June 1990 to June 1995. Apollo Advisors, L.P. acts as managing General Partner of Apollo Investment Fund, L.P. and AIF II, L.P., private investment funds. Lion Advisors, L.P. acts as financial advisor to certain overseas investors. Mr. Siegel practiced as an attorney and served as a financial consultant prior to June 1990. Mr. Siegel also serves as a director of Sun International Hotels, Ltd., Paradise Island, Bahamas.

Stephen Wertheimer has been a Director of the Company since February 13, 1996. Mr. Wertheimer founded and has been president of Water Capital Corporation, a financial services company headquartered in Greenwich, Connecticut, since 1991. Mr. Wertheimer was Managing Director, Head of Investment Banking-Asia, for PaineWebber Incorporated, New York, New York, from 1989 to 1991. Mr. Wertheimer also serves on the board of directors of Greenwich Fine Arts, Inc., Greenwich, Connecticut, and is Chairman of the Board of AMS, Inc., Greenwich, Connecticut.

Charles A. Yamarone has been a Director of the Company since February 13, 1996. Mr. Yamarone has been Executive Vice President and Research Director of Libra Investments, Inc., a broker-dealer located in Los Angeles, California, since July 1994. Mr. Yamarone was Senior Vice President and General Counsel of Libra Investments, Inc. from October 1991 to June 1994. Mr. Yamarone was Senior Vice President-Legal of Columbia Savings and Loan, Beverly Hills, California, from January 1990 to October 1991 and was also Secretary of Columbia Savings and Loan from January 1990 to January 1991. Mr. Yamarone also serves as a director of Continental Airlines, Inc.

As part of the Reorganization, after the Effective Date the Board of Directors of the Company was reconstituted to consist of thirteen members approved by the former Board of Directors. Four members of the new Board of Directors were members of the Board of Directors immediately prior to the Effective Date. Eight of the remaining nine members of the Board of Directors were designated by a committee (the "Board Selection Committee") consisting of two members of the Board of Directors and the three members of the Official Committee of Unsecured Creditors appointed in the Bankruptcy Case.

James S. Haines, Jr. has been elected as the new Chief Executive Officer and President of the Company and will also become a director of the Company. The Company expects Mr. Haines to take office on or about May 1, 1996. Mr. Haines has been the Executive Vice President and Chief Operating Officer of Western Resources, Inc., a diversified energy company based in Kansas, since June 1995 and has been a member of the owners' committee of the Wolf Creek Nuclear Operating Corporation. Upon the consummation of the merger of The Kansas Power and Light Company and Kansas Gas and Electric Company in April 1992, Mr. Haines was elected the Executive Vice President and Chief Administrative Officer of the new company, Western Resources, Inc. Prior to the merger, Mr. Haines had served as Group Vice President of Kansas Gas and Electric Company since September 1985. Mr. Haines also has experience in electric utility regulatory matters as the Vice President, Regulatory Affairs for Kansas Gas and Electric Company and as Deputy General Counsel and Counsel to the Missouri Public Service Commission.



Item 11. Executive Compensation

The following table sets forth certain information concerning the cash and non-cash compensation paid to the Chief Executive Officer and each of the other four most highly compensated officers (the "Named Executive Officers") of the Company for the fiscal years ended December 31, 1995, December 31, 1994 and December 31, 1993. The compensation paid for such periods was paid pursuant to policies, programs and employee benefit plans that were terminated at the Effective Date.

Summary Compensation Table

Name and Principal Position	Year	Annual Compensation		Long-Term Compensation Awards	
		Salary (\$)	Other Annual Compensation(1) (\$)	Securities Underlying Options/SARs (#)	All Other Compensation(2) (\$)
David H. Wiggs Chairman of the Board & Chief Executive Officer	1995	454,796	41,982	0	4,621
	1994	437,512	33,638	259,750	4,948
	1993	397,500	27,519	0	4,506
Curtis L. Hoskins (3) President & Chief Operating Officer	1995	251,690	9,681	0	4,621
	1994	241,366	9,308	143,750	4,981
	1993	220,000	9,308	0	4,505
Eduardo A. Rodriguez Senior Vice President & General Counsel	1995	172,000	9,750	0	1,499
	1994	161,754	5,000	96,500	1,999
	1993	137,500	7,403	0	1,500
John E. Droubay (4) Vice President & Treasurer	1995	127,800	7,200	0	4,621
	1994	120,164	0	40,507	3,912
	1993	113,568	873	0	4,501
Gary R. Hedrick (5) Vice President-Financial Planning and Rate Administration & Treasurer	1995	127,800	9,600	0	1
	1994	120,013	6,923	40,507	1
	1993	109,782	9,711	0	5

- (1) Represents payments for accrued and unused vacation and personal holiday time pursuant to Company policy. Excludes perquisites representing less than ten percent of annual salary.
- (2) Includes matching contributions made by the Company for 1995 under the Company's 401(k) Plan to Messrs. Wiggs, Hoskins, Rodriguez, Droubay and Hedrick in the amounts of \$4,620, \$4,620, \$1,498, \$4,620, and \$0, respectively, and the reallocation of forfeited shares of the Company's old common stock under the Leveraged Employee Stock Ownership Plan and Trust (the "Leveraged ESOP") for the plan year ended December 31, 1995 in an amount having a fair market value of less than \$1.00 for each individual, based on market valuations as of December 29, 1995.
- (3) Mr. Hoskins retired from the Company effective February 12, 1996.
- (4) Mr. Droubay retired from the Company effective February 29, 1996.
- (5) Mr. Hedrick became Treasurer in March 1996.



Aggregate Options Outstanding

Set forth below is information with respect to the aggregate options granted pursuant to the Employee Stock Option Plan that were outstanding at December 31, 1995 for each of the Named Executive Officers. The Employee Stock Option Plan was terminated and all outstanding options were canceled at the Effective Date.

Aggregated Options/SAR Exercises in Last Fiscal Year and FY-End Option/SAR Values

Name	Number of Securities Underlying Unexercised Options/SARs at FY-End (#)	Value of Unexercised In-the-Money Options/SARs at FY-End (\$)
	Exercisable/ Unexercisable	Exercisable/ Unexercisable
David H. Wiggs	405,200/533,561	0.00/0.00
Curtis L. Hoskins	132,600/268,459	0.00/0.00
Eduardo A. Rodriguez	63,600/167,786	0.00/0.00
John E. Droubay	24,400/0	0.00/0.00
Gary R. Hedrick	46,000/0	0.00/0.00

Retirement Income Plan Table

The table set forth below shows estimated annual benefits payable at the normal retirement age of 65 upon retirement under the Company's Retirement Income Plan for the years of service and levels of final average compensation specified.

Compensation	Years of Service				
	15	20	25	30	35
125,000	23,438	31,250	39,062	46,875	54,688
150,000	28,125	37,500	46,875	56,250	65,625
175,000	28,125	37,500	46,875	56,250	65,625
200,000	28,125	37,500	46,875	56,250	65,625
225,000	28,125	37,500	46,875	56,250	65,625
250,000	28,125	37,500	46,875	56,250	65,625
300,000	28,125	37,500	46,875	56,250	65,625
400,000	28,125	37,500	46,875	56,250	65,625
500,000	28,125	37,500	46,875	56,250	65,625



The compensation covered by the Retirement Income Plan is the annual salary paid to the participant, which is reflected in the column titled "Salary" in the Summary Compensation Table. The estimated credited years of service for each of Messrs. Wiggs, Hoskins, Rodriguez, Droubay and Hedrick at December 31, 1995 was 8, 6, 15, 5 and 19, respectively. The benefits are computed based on straight-life annuity amounts and are not subject to any deduction or offset for social security benefits or other amounts. Pursuant to applicable federal regulations, for periods after December 31, 1992 the maximum amount of compensation on which the benefits can be based was reduced to \$150,000 per year, as such amount may be adjusted in \$10,000 increments. Participants in the Retirement Income Plan will receive the greater of the accrued benefit at December 31, 1992 or the benefits accrued using the compensation limitation.

Compensation of Directors

The compensation of the Board of Directors consists of the following, or its economic equivalent: (a) \$20,000 per year, for four meetings of the Board of Directors or committees thereof per year, and an additional \$1,000 per meeting for each such meeting beyond four; and (b) subject to approval by the New Mexico Commission and the FERC and, if the Board of Directors determines that it is appropriate, shareholder approval, (i) an initial stock grant of 5,000 shares of Common Stock of the Company as of the Effective Date and (ii) an additional grant of 1,000 shares on the earlier to occur of the first anniversary of the Effective Date or the date upon which there is a change in control (such date being referred to as the "Additional Grant Date") for every \$1.00 that a share of Common Stock of the Company trades above \$5.00 per share on the Additional Grant Date (based on the trading average for the five business days preceding the Additional Grant Date). The shares of Common Stock awarded to the directors will be subject to restrictions on resale for five years from the date(s) of grant, or such other restrictions or other provisions as the Board of Directors determines are necessary or appropriate; provided, however, that such restrictions shall be removed in the event of a change in control of the Company.

Employment Agreements and Related Matters

The Company has entered into certain employment agreements and special early retirement arrangements with the Named Executive Officers of the Company and has entered into employment agreements with the individuals serving as executive officers, all as approved by the Board of Directors and the Bankruptcy Court. The arrangements (i) provide additional compensation for the unique or extraordinary demands placed on and the contributions of the officers to the Company's reorganization; (ii) in certain instances provide incentive for individuals to remain with the Company after the Effective Date; and (iii) provide for a complete release by the employees of any claims they may have against the Company in connection with their employment, all benefit and compensation plans and termination of employment. The following is a summary of the arrangements for the Named Executive Officers.

Pursuant to an Amended and Restated Executive Services Agreement between the Company and Mr. Wiggs, upon the date a successor Chief Executive Officer is elected by the Board of Directors of the Company and begins his employment, Mr. Wiggs will retire as Chairman of the Board and the Chief Executive Officer. Mr. Wiggs will receive a retirement benefit of \$280,000 per year, payable to him or upon his death, to his designated beneficiary until the expiration of the number of years determined to be the life expectancy of Mr. Wiggs at his retirement. Mr. Wiggs was paid a cash bonus of \$500,000 following the Effective Date and will receive an additional \$500,000 on the first anniversary of the Effective Date. Mr. Wiggs will also have the opportunity to receive up to \$1.0 million more if the value of the Company's Common Stock appreciates in value from its initial trading price to designated levels of 115%, 125%, and 135% of such initial value and sustains such value for five consecutive trading days.



Pursuant to a written agreement between the Company and Mr. Hoskins, Mr. Hoskins retired at the Effective Date and will receive a lifetime retirement benefit of \$151,200 per year, which will be payable to him or to his designated beneficiary upon his death until the expiration of the number of years determined to be the life expectancy of Mr. Hoskins as of the first day of the first month that begins after the end of his employment with the Company. In addition, on the Effective Date, Mr. Hoskins was paid a cash bonus of \$500,000.

The Company has entered into a four-year employment contract with Mr. Rodriguez at an initial base salary of \$200,000 per year. In addition, on the Effective Date, Mr. Rodriguez was paid a cash bonus of \$250,000.

The Company has entered into two-year employment agreement with Mr. Hedrick, effective with the Effective Date. The Company has entered into two-year or eighteen-month employment agreements with the other current executive officers, effective with the Effective Date. The employment agreements provide for a base salary equal to the individual's base salary at January 1, 1996. On February 29, 1996, Mr. Droubay retired pursuant to an early retirement offer and agreement that provides for a lifetime retirement benefit of approximately \$52,000 per year. Each Vice President (including Mr. Droubay) and the Secretary received a cash bonus at the Effective Date from a bonus pool of \$1.0 million, in amounts for each individual determined by the Board of Directors.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth, as of March 15, 1996, certain information regarding the beneficial ownership of Common Stock of the Company by (i) each person known by the Company to beneficially own more than 5% of its Common Stock; (ii) each director and Named Executive Officer of the Company; and (iii) all executive officers and directors as a group.

Beneficial Owner	Number of Shares (1)	Percent of Class
FMR Corp.	13,842,797 (2)	23
Wilson K. Cadman	0	0
James A. Cardwell	51	*
George W. Edwards, Jr.	0	0
Ramiro Guzman	0	0
James W. Harris	0	0
Kenneth R. Heitz	0	0
Edward C. Houghton, IV	0	0
Michael K. Parks	0	0
Eric B. Siegel	0	0
Stephen Wertheimer	6,250	*
Charles A. Yamarone	10,000	*
John E. Droubay	104 (3)	*
Gary R. Hedrick	179 (4)	*
Curtis L. Hoskins	186 (5)	*
Eduardo A. Rodriguez	168 (6)	*
David H. Wiggs, Jr.	974 (7)	*
All directors and executive officers as a group (19 persons)	18,513 (8)	*

* Less than 1%.

- (1) Each individual has sole voting and investment power with respect to his shares (or shares such powers with his spouse, except as noted below). None of the individuals or entities owns any preferred stock of the Company. The stated amounts of shares represent estimates of the number of shares of Common Stock received or that the individual or entity is entitled to receive in the Reorganization.
 - Because the distribution of Common Stock issued pursuant to the Reorganization had not been completed by the distribution agent at March 1, 1996, such amounts are subject to change.
- (2) FMR Corp.'s principal offices are located at 82 Devonshire Street, Boston, MA 02109. The number of shares indicated is an estimate of the number of shares anticipated to be distributed under the Plan in partial exchange for certain of the Company's debt securities and bank debt. The number of shares to be received is subject to adjustment under the Plan. Such shares will be directly owned by various funds and accounts advised by FMR Co. and FMTC (each, as defined below). This number includes approximately 8,435,090 shares beneficially owned by funds managed by Fidelity Management & Research Company ("FMR Co."), an investment adviser registered under Section 203 of the Investment Advisers Act, and 5,407,707 shares beneficially owned by Fidelity Management Trust

Company ("FMTC"), a bank as defined in Section 3(a)(6) of the Securities Exchange Act of 1934. FMR Co. acts as investment adviser to various investment companies registered under Section 8 of the Investment Company Act of 1940, as amended. FMTC acts as trustee or managing agent for various private investment accounts, primarily employee benefit plans. FMR Co. and FMTC are wholly owned subsidiaries of FMR Corp. None of the funds and accounts hold an amount equal to or greater than 10% of the outstanding Common Stock. Prior to the effectiveness of the Plan, the Securities and Exchange Commission entered an order granting FMR Co. and FMTC an exemption from regulation as a public utility holding company under the Public Utility Holding Company Act of 1935 with respect to the funds' and accounts' ownership of the Common Stock.

- (3) Includes (i) 1 share held for the benefit of Mr. Droubay in the Leveraged ESOP, over which Mr. Droubay has voting power but not investment power; and (ii) 1 share held in the 401(k) Plan, over which Mr. Droubay has voting and investment power.
- (4) Includes (i) 159 shares held for the benefit of Mr. Hedrick in the Leveraged ESOP, over which Mr. Hedrick has voting power but not investment power; and (ii) 1 share held in the 401(k) Plan, over which Mr. Hedrick has voting and investment power.
- (5) Includes (i) 58 shares held for the benefit of Mr. Hoskins in the Leveraged ESOP, over which Mr. Hoskins has voting but not investment power; and (ii) 1 share held in the 401(k) Plan, over which Mr. Hoskins has voting and investment power.
- (6) Includes (i) 157 shares held for the benefit of Mr. Rodriguez in the Leveraged ESOP, over which Mr. Rodriguez has voting but not investment power; and (ii) 1 share held in the 401(k) Plan, over which Mr. Rodriguez has voting and investment power.
- (7) Includes (i) 204 shares held for the benefit of Mr. Wiggs in the Leveraged ESOP, over which Mr. Wiggs has voting but not investment power; (ii) 59 shares held in the 401(k) Plan, over which Mr. Wiggs has voting and investment power; and (iii) 229 shares held by Mr. Wiggs in a fiduciary capacity as trustee, over which he has voting and investment power.
- (8) Includes (i) 1,123 shares held for the benefit of the executive officers in the Leveraged ESOP, over which such officers have voting but not investment power; and (ii) 72 shares held for the benefit of executive officers who participate in the 401(k) Plan, over which the participants have voting and investment power. Excludes shares owned by Mr. Droubay and Mr. Hoskins, who retired from the Company prior to March 1, 1996.



Item 13. Certain Relationships and Related Transactions

In 1992, the Company entered into an agreement to purchase its requirements of unleaded gasoline for its fleet of vehicles from C&R Distributing, Inc., a corporation affiliated with Mr. Cardwell, a Director. The Company entered into the agreement following a competitive bid process and evaluation and approval by the disinterested directors. The Company purchased \$356,178 of fuel in 1995 and estimates that it will purchase a similar amount of fuel in 1996 pursuant to the agreement.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) Documents filed as a part of this report:

	<u>Page</u>
1. Financial Statements:	
See Index to Financial Statements	43
2. Financial Statement Schedules:	
All schedules are omitted as the required information is not applicable or is included in the financial statements or related notes thereto.	
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 – Fourth Amended Plan of Reorganization, dated November 7, 1995. (Exhibit 2.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1995)
- 2.02 – Disclosure Statement to Fourth Amended Plan of Reorganization of El Paso Electric Company. (Exhibit 2.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1995)

Exhibit 3 – Articles of Incorporation and Bylaws:

- *3.01 – Restated Articles of Incorporation of the Company, dated February 7, 1996 and effective February 12, 1996.
- *3.01-01 – Statement of Resolution Establishing Series of Preferred Stock, dated February 7, 1996 and effective February 12, 1996, amending Exhibit 3.01.
- *3.02 – Bylaws of the Company dated February 6, 1996.

Exhibit 4 – Instruments Defining the Rights of Security Holders, including Indentures:

- *4.01 – General Mortgage Indenture and Deed of Trust dated as of February 1, 1996, and First Supplemental Indenture dated as of February 1, 1996, including form of Series A through H First Mortgage Bonds.**
- *4.02 – Statement of Resolution Establishing Series of Preferred Stock, dated February 7, 1996 and effective February 12, 1996.**
- 4.03 – 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)**
- *4.03-01 – Supplemental Indenture of Trust No. 1 dated as of December 12, 1995 related to Exhibit 4.03, including form of bond.**
- 4.04 – 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 4.03. (Exhibit 4.02 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)**
- *4.04-01 – Supplemental Loan Agreement No. 1 dated as of February 12, 1996 related to Exhibit 4.04.**
- 4.05 – 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 4.03. (Exhibit 4.04 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)**
- 4.06 – 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 4.03. (Exhibit 4.05 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)**
- 4.07 – 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)**
- *4.07-01 – Ordinance No. 96-1035 adopted by the City Council of the City of Farmington, New Mexico, on January 23, 1996 as Supplemental Ordinance No. 1, related to Exhibit 4.07.**

- 4.08 - 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 4.07. (Exhibit 4.08 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)
- 4.09 - 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 4.07. (Exhibit 4.09 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)
- 4.10 - 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 4.07. (Exhibit 4.10 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)
- 4.11 - 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 4.07. (Exhibit 4.11 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)
- 4.12 - 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 4.07. (Exhibit 4.12 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1994)
- *4.13 - Letter of Credit and Reimbursement Agreement, dated as of February 12, 1996, between the Company and Citibank, N.A., relating to the Pollution Control Bonds referred to in Exhibit 4.07.
- 4.14 - 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 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)
- 4.14-01 - Supplemental Loan Agreement, dated as of June 1, 1986, to Exhibit 4.14. (Exhibit 4.29-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986)
- *4.14-02 - Supplemental Loan Agreement No. 3, dated as of February 12, 1996, to Exhibit 4.14.
- 4.15 - 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 Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.14. (Exhibit 4.27-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1984)

- 4.15-01 - Supplemental Trust Indenture No. 2, dated as of June 1, 1986, to Exhibit 4.15. (Exhibit 4.29-03 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986)
- 4.15-02 - Supplemental Trust Indenture No. 3, dated as of May 6, 1994, to Exhibit 4.15. (Exhibit 4.01 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1994)
- *4.15-03 - Supplemental Trust Indenture No. 4, dated as of November 30, 1995, to Exhibit 4.15, including form of bond.
- 4.16 - Indexing Agent's Agreement among Maricopa County, Arizona Pollution Control Corporation, the Company and Smith Barney, Harris Upham & Co., Incorporated, relating to the Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.14. (Exhibit 4.27-03 to the Company's Annual Report on Form 10-K for the year ended December 31, 1984)
- 4.17 - Remarketing Agent Agreement, dated as of May 6, 1994, between Smith Barney Shearson Inc., and the Company, relating to the Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.14. (Exhibit 4.02 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1994)
- *4.18 - Loan Agreement, dated as of February 12, 1996, 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).
- *4.19 - Indenture of Trust, dated as of February 12, 1996, by and between Maricopa County, Arizona Pollution Control Corporation and Texas Commerce Bank National Association, as Trustee, relating to the Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.18.
- *4.20 - Tender Agent Agreement dated as of February 12, 1996, between the Company and Smith Barney Inc., relating to the Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.18.
- *4.21 - Remarketing Agent Agreement, dated as of February 12, 1996, between the Company and Smith Barney Inc., relating to the Pollution Control Refunding Revenue Bonds referred to in Exhibit 4.18.
- *4.22 - Letter of Credit and Reimbursement Agreement dated as of February 12, 1996, among the Company, Citibank, N.A., as agent for the Creditors named therein related to the pollution control revenue bonds referred to in Exhibits 4.03, 4.14 and 4.18.

Exhibit 10 - Material Contracts:

- *10.01 - Co-Tenancy Agreement, dated July 19, 1966, and Amendments No. 1 through 5 thereto, between the Participants of the Four Corners Project, defining the respective ownerships, rights and obligations of the Parties.



- 10.02 - 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)
- 10.02-01 - Amendment and Supplement No. 1, dated March 21, 1985, to Exhibit 10.02. (Exhibit 19.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1985)
- *10.04 - 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, and Amendments 1 through 10 thereto.
- *10.05 - Arizona Nuclear Power Project 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, and Amendments No. 1 through 13 thereto.
- *10.06 - ANPP Valley Transmission System Participation Agreement, dated August 20, 1981, and Amendments No. 1 and 2 thereto. APS Contract No. 2253-419.00.
- 10.07 - 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)
- 10.07-01 - Amendment No. 1, dated November 20, 1986, to Exhibit 10.07. (Exhibit 10.11-01 to the Company's Annual Report on Form 10-K for the year ended December 31, 1986)
- 10.08 - 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 to the Company's Annual Report on Form 10-K for the year ended December 31, 1983)
- 10.09 - 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)



- 10.10 - 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)
- 10.11 - 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)
- 10.12 - 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 10.17. (Exhibit 5-p-4 to Registration No. 2-68414)
- *10.13 - Interconnection Agreement, as amended, dated December 8, 1981, between the Company and Southwestern Public Service Company, and Service Schedules A through F thereto.
- *10.14 - Amrad to Artesia 345 KV Transmission System and DC Terminal Participation Agreement, dated December 8, 1981, between the Company and Texas-New Mexico Power Company, and the First through Third Supplemental Agreements thereto.
- 10.15 - 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)
- *10.16 - Southwest New Mexico Transmission Project Participation Agreement, dated April 11, 1977, and Amendments 1 through 5 thereto.
- 10.17 - 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)
- 10.18 - 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)
- *10.19 - Power Sales Agreement No. 2, dated December 2, 1986, between El Paso Electric Company and Imperial Irrigation District, and Amendment No. 1 thereto.
- 10.20 - 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)
- *10.21 - Power Sales Agreement, dated April 29, 1987, between the Company and Texas-New Mexico Power Company, and Amendment No. 1 thereto.
- *10.22 - Form of Indemnity Agreement between the Company and its directors and officers.

- 10.23 - 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)
- 10.23-01 - Interchange Service D Agreement Firm Capacity, executed April 3, 1991, to Exhibit 10.23. (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.
- 10.23-02 - Interchange Agreement Operating Procedure No. 1, executed July 2, 1991, to Exhibit 10.23. (Exhibit 19.2-05 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1991)
- *10.24 - Credit Agreement dated as of February 12, 1996 between the Company, Chemical Bank, as agent, and Texas Commerce Bank National Association, as Trustee.
- *10.25 - Amended and Restated Executive Services Agreement for David H. Wiggs, Jr., dated February 27, 1996.
- *10.26 - Retirement Agreement for Curtis L. Hoskins, dated October 26, 1995.
- *10.27 - Retirement Agreement for John E. Droubay, dated February 22, 1996.
- *10.28 - Employment Agreement for Eduardo A. Rodriguez, dated October 26, 1995.
- *10.29 - Employment Agreement for Gary R. Hedrick, dated February 12, 1996.
- *10.30 - Restatement of Decommissioning Trust Agreement dated as of February 12, 1996 between the Company and Boatmen's Trust Company of Texas, as Decommissioning Trustee for Palo Verde Unit 1.
- *10.31 - Restatement of Decommissioning Trust Agreement dated as of February 12, 1996 between the Company and Boatmen's Trust Company of Texas, as Decommissioning Trustee for Palo Verde Unit 2.
- *10.32 - Restatement of Decommissioning Trust Agreement dated as of February 12, 1996 between the Company and Boatmen's Trust Company of Texas, as Decommissioning Trustee for Palo Verde Unit 3.
- *10.33 - Spent Fuel Trust Agreement dated as of February 12, 1996 between the Company and Boatmen's Trust Company of Texas, as Spent Fuel Trustee.
- *10.34 - Trust Agreement, dated as of February 12, 1996, between the Company and Texas Commerce Bank National Association, as Trustee of the Rio Grande Resources Trust II.
- *10.35 - Purchase Contract, dated as of February 12, 1996, between the Company and Texas Commerce Bank National Association, as Trustee of the Rio Grande Resources Trust II.



Exhibit 24 – Power of Attorney:

*24.01 – Powers of Attorney (set forth on page 111 of this report).

*24.02 – Certified copy of resolution authorizing signatures pursuant to power of attorney.

Exhibit 99 – Additional Exhibits:

99.01 – 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)

99.02 – Agreed Order entered August 30, 1995 by the Public Utility Commission of Texas. (Exhibit 99.31 to Registration Statement No. 33-99744)

* Filed herewith.

(b) Reports on Form 8-K:

The following reports on Form 8-K were filed during the last quarter of 1995:

None.

UNDERTAKING

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., Eduardo A. Rodriguez, Michael L. Blough, Gary R. Hedrick 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 20th day of March 1996.

EL PASO ELECTRIC COMPANY

By: /s/ DAVID H. WIGGS, JR.
David H. Wiggs, Jr.,
Chief Executive Officer and President
(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	Date
<u>/s/ DAVID H. WIGGS, JR.</u> (David H. Wiggs, Jr.)	Chairman of the Board, Chief Executive Officer, President (Principal Executive Officer) and Director	
<u>/s/ MICHAEL L. BLOUGH</u> (Michael L. Blough)	Vice President and Controller (Principal Financial Officer and Principal Accounting Officer)	
<u>/s/ WILSON K. CADMAN</u> (Wilson K. Cadman)	Director	
<u>/s/ JAMES A. CARDWELL</u> (James A. Cardwell)	Director	
<u>/s/ GEORGE W. EDWARDS, JR.</u> (George W. Edwards, Jr.)	Director	
<u>/s/ RAMIRO GUZMAN</u> (Ramiro Guzman)	Director	
<u>/s/ JAMES W. HARRIS</u> (James W. Harris)	Director	
<u>/s/ KENNETH R. HEITZ</u> (Kenneth R. Heitz)	Director	
<u>/s/ EDWARD C. HOUGHTON, IV</u> (Edward C. Houghton, IV)	Director	
<u>/s/ MICHAEL K. PARKS</u> (Michael K. Parks)	Director	
<u>/s/ ERIC B. SIEGEL</u> (Eric B. Siegel)	Director	
<u>/s/ STEPHEN WERTHEIMER</u> (Stephen Wertheimer)	Director	
<u>/s/ CHARLES A. YAMARONE</u> (Charles A. Yamarone)	Director	

} March 20, 1996