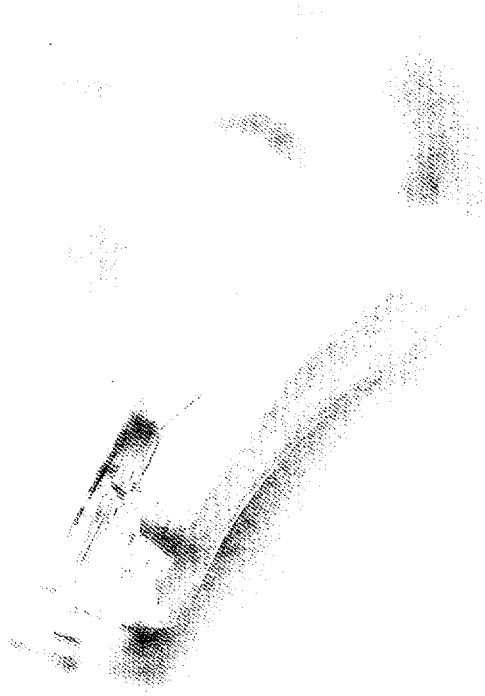


EL PASO ELECTRIC

1999 ANNUAL REPORT

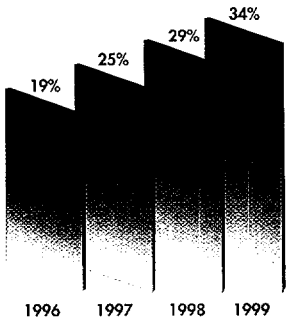
The Rio Grande connects the Southern New Mexico, West Texas, and Northern Mexico communities, served by El Paso Electric for almost 100 years.

Statements in this document, other than statements of historical information, are forward-looking statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements, as well as other oral and written forward-looking statements made by or on behalf of El Paso Electric (EPE) from time to time, including statements contained in EPE's filings with the Securities and Exchange Commission and its reports to shareholders, involve known and unknown risks and other factors which may cause EPE's actual results in future periods to differ materially from those expressed in any forward-looking statements. Please refer to EPE's 10-K for fiscal year ended December 31, 1999, and EPE's other 34 Act filings for a detailed discussion of these risks and uncertainties. EPE cautions that the risks and factors in such filing are not exclusive. EPE does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of EPE.

1999 PERFORMANCE HIGHLIGHTS

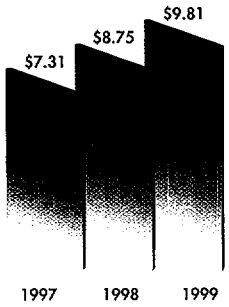
COMMON STOCK EQUITY

(percent of capitalization)



MARKET PRICE PER SHARE

(year end)



Financial ($000)	1997	1998	1999 (1)
EBITDA	$ 264,521	$ 263,389	$ 241,464
Operating Revenue	$ 592,021	$ 601,823	$ 570,469
Net Income	$ 38,649	$ 45,709	$ 28,276
Total Assets	$ 1,812,613	$ 1,891,219	$ 1,625,891
EBITDA Interest Coverage	3.06x	3.22x	2.98x

Common Stock Data			
Earnings Per Share (diluted weighted average)	$ 0.64	$ 0.75	$ 0.47
Free Cash Flow Per Share	$ 2.21	$ 2.24	$ 1.88
Book Value Per Share	$ 6.13	$ 6.92	$ 7.36
Market Price Per Share	$ 7.31	$ 8.75	$ 9.81
Market to Book Ratio	119%	126%	133%
Price Earnings Ratio	11.42x	11.67x	20.87x
Weighted Average Shares Outstanding and Equivalents	60,437,632	60,633,298	59,731,649
Number of Registered Holders	6,675	5,864	5,547

Operational			
Retail GWH	5,784	5,948	5,866
Owned Generating Capacity	1,500	1,500	1,500
Native Peak (MW)	1,122	1,167	1,159
Customers	284,174	290,736	297,982
% Change	1.7	2.3	2.5
Employees	1,076	1,048	1,030
Palo Verde Capacity Factor	88%	91%	91%

(1) 1999 results were affected by a number of unusual, non-recurring items. See detail on page 9.

Palo Verde Performance

Nuclear Regulatory Commission
Plant Performance Review
(PPR)

In 1998, the Nuclear Regulatory Commission (NRC) discontinued the Systematic Assessment of Licensee Performance rating and has, on an interim basis, regulated nuclear power plants under a new PPR process

On August 18, 1999, Palo Verde was rated "Acceptable" by the NRC and did not warrant additional inspection beyond the core inspection program. This is the highest rating available under the PPR process.

A new revised reactor oversight process is scheduled for implementation in April 2000.

Institute of
Nuclear Operations
(INPO)

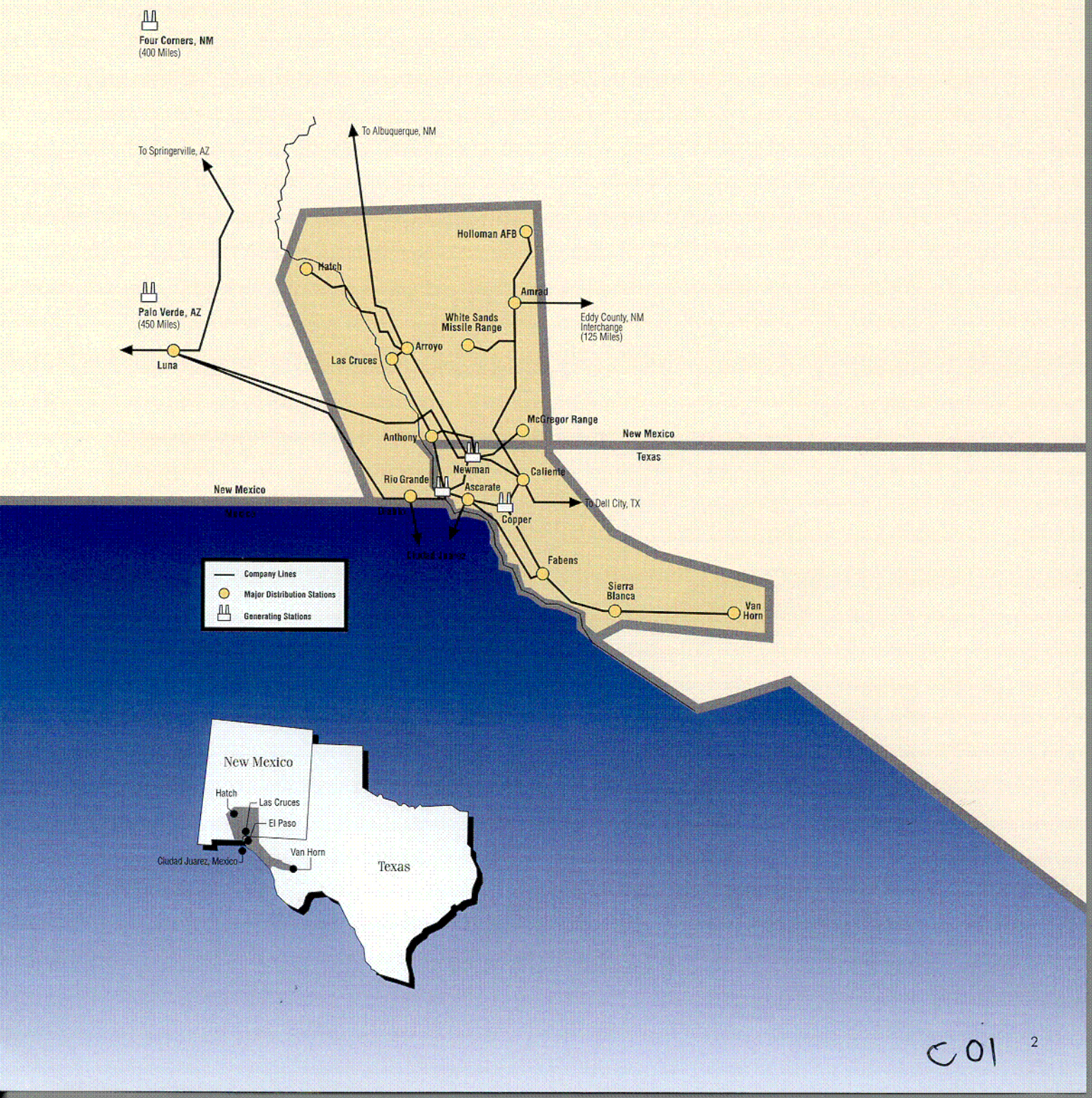
Date	Rating
September 1999	1
October 1997	1
October 1995	1

INPO evaluates seven areas: (1) Organization and Administration, (2) Operations, (3) Maintenance, (4) Engineering, (5) Chemistry, (6) Radiological Protection and (7) Training.

The evaluation range is 1 to 5, with 1 being the highest score. INPO plant evaluations are conducted on a 12- to 18-month cycle.

SERVICE AREA

EPE is an investor-owned utility providing electric energy and energy-related services to more than 298,000 retail customers in an area of the Rio Grande Valley in West Texas and Southern New Mexico, which includes the cities of El Paso, Texas and Las Cruces, New Mexico. EPE serves a population of approximately 870,000. Its service territory covers 10,000 square miles. EPE also serves wholesale customers in New Mexico, Texas, California, and Mexico.



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DEAR SHAREHOLDERS:

We achieved two major goals in 1999 and early 2000. First, we settled our long-running controversy with the City of Las Cruces. Second, all four major credit rating agencies upgraded our first mortgage bonds to investment grade.

Our settlement with Las Cruces will end the City's decade-long effort to condemn our Las Cruces distribution system and create a municipal utility. The settlement will terminate all court and administrative litigation between EPE and the City. Under the settlement, EPE will make a one-time litigation settlement payment to Las Cruces of $16.5 million and will purchase from the City its substation and related facilities at the West Mesa Industrial Park for $4.5 million, bringing the total settlement payment to $21 million. All of the City's electricity customers will be assigned to EPE.

EPE and Las Cruces will enter into a seven-year franchise agreement on terms similar to the previously expired agreement. During the first seven years, the City has agreed that it will not seek to acquire EPE's system. At the end of seven years, the City has a 90-day, non-assignable option to purchase EPE's distribution system at its then book value plus 30 percent. If this option is not exercised, the franchise agreement will remain in effect for two more years. Finally, the City has agreed not to contest any stranded cost claim in any future New Mexico Public Regulatory Commission proceedings as long as the amount claimed does not exceed the amount previously determined by the Federal Energy Regulatory Commission.

This settlement secures our Las Cruces business, provides stability for our employees, reduces legal time and expenses, preserves existing rates, and allows us to direct our efforts toward industry restructuring issues. We are pleased to have achieved a settlement which maintains our almost century-long relationship with our Las Cruces customers.

EPE's return to investment-grade credit quality is an equally significant achievement. Standard & Poor's, Moody's and Duff & Phelps upgraded our first mortgage bonds to investment grade in late 1999, followed by Fitch in January 2000. These upgrades recognize our reduction of fixed obligations by over $503 million since June 1996 and of fixed charges by more than $44 million per year. Our common equity as a percent of capitalization increased from 19 to 34 percent over that same period.

George W. Edwards,
Chairman of the Board,
James Haines,
President & CEO

In a depressed market for utility stocks, EPE's common stock closed the year at $9.81. This represents an increase of 12 percent since year-end 1998. In contrast, the S & P Utilities and S & P Electric Utilities Indices declined 12.5 and 23 percent, respectively, over the same period. In our six million share common stock repurchase program, announced in June 1999, we have already acquired well over five million shares.

We are preparing for competition in our retail electricity markets in both Texas and New Mexico. Laws in both states became effective in 1999 which require the electric industry to restructure and open retail electricity markets to competition. The Texas law explicitly preserves EPE's ten-year rate plan by delaying the start of retail competition in EPE's service area until the plan expires in August 2005. Under that plan, EPE's Texas retail rates will remain frozen through August 2005 to permit EPE the opportunity to fully recover its estimated remaining stranded costs attributable to its Texas operations. The New Mexico law calls for retail electric competition for generation in that state to begin as early as January 2001, and no later than January 1, 2002. The New Mexico law provides for no less than 50 percent recovery of stranded costs. EPE believes this provision will result in treatment similar to that agreed to in a stipulated rate agreement we entered into in late 1998 with the New Mexico Commission.

To meet the challenge of competition and the requirements of the New Mexico restructuring legislation, an important and necessary step will be the restructuring of EPE into a holding company with at least three subsidiaries. Our electric generating business will be in one subsidiary, our transmission and distribution assets in another, and our energy services business in the third. The transmission and distribution business will remain subject to traditional rate and service quality regulation. The other businesses will not be subject to price regulation. We anticipated these changes two years ago when we "functionally" reorganized EPE along these lines. Even though retail competition does not begin in our Texas service area until August 2005, we will complete these structural changes during 2000 so that we will be fully ready for the planned start of competition in New Mexico in 2001.

Another important goal for EPE over the last three years has been the improvement of the quality and reliability of our electric service. Our hard work is paying off. In 1999, EPE ranked high in both measures of system reliability reported by the Public Utility Commission of Texas for major Texas investor-owned electric utilities. These results are reflected in steadily improving levels of customer satisfaction.

Our employees' dedication, commitment, and hard work are recognized and valued, not only in the work place, but also in the communities we serve. EPE employees volunteered more than 13,000 hours of time to various community programs and organizations during 1999. Our commitment to "connect to our community" was publicly recognized when EPE was selected by the United Way of El Paso County to receive its annual Excellence Award, the highest honor bestowed by the United Way of El Paso County. We are understandably proud of our employees' selfless and diligent efforts, which resulted in this outstanding achievement.

During 1999, our stock performed well in what was generally a down market for utilities. We significantly improved our financial fundamentals, improved service reliability, and increased operating efficiencies. Looking forward, we will continue to be exclusively focused on excelling as an electric energy and service-related utility with markets in the U. S. and Northern Mexico. We believe our strong cash flow, above average growth, and unique geographic location, combined with low regulatory risk, provide the basis for continued increases in shareholder value. Thank you for your investment in El Paso Electric.

George W. Edwards, Jr.

James Haines

EPE ranks high [illegible]
reported by the [illegible]

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George W. Edwards, Jr.

James Haines

EPE ranks high on all measures of system reliability reported by the Public Utility Commission of Texas...

RESTRUCTURING LEGISLATION

Electric utility restructuring is creating significant changes in the way utilities operate by opening the marketplace to a variety of energy providers, including generators, marketers, and brokers. The specific details of restructuring plans throughout the country are generally tailored by each state's legislature and utility regulatory agency. Under most current legislative plans, the delivery - that is, transmission and distribution - of electric power will be provided by the local utility and continue to be regulated. However, customers are being given the opportunity to choose their energy provider with rates established by the market, instead of by a state regulatory commission.

El Paso Electric serves a two-state region, Texas and New Mexico, and is subject to two sets of laws and regulations pertaining to utility restructuring.

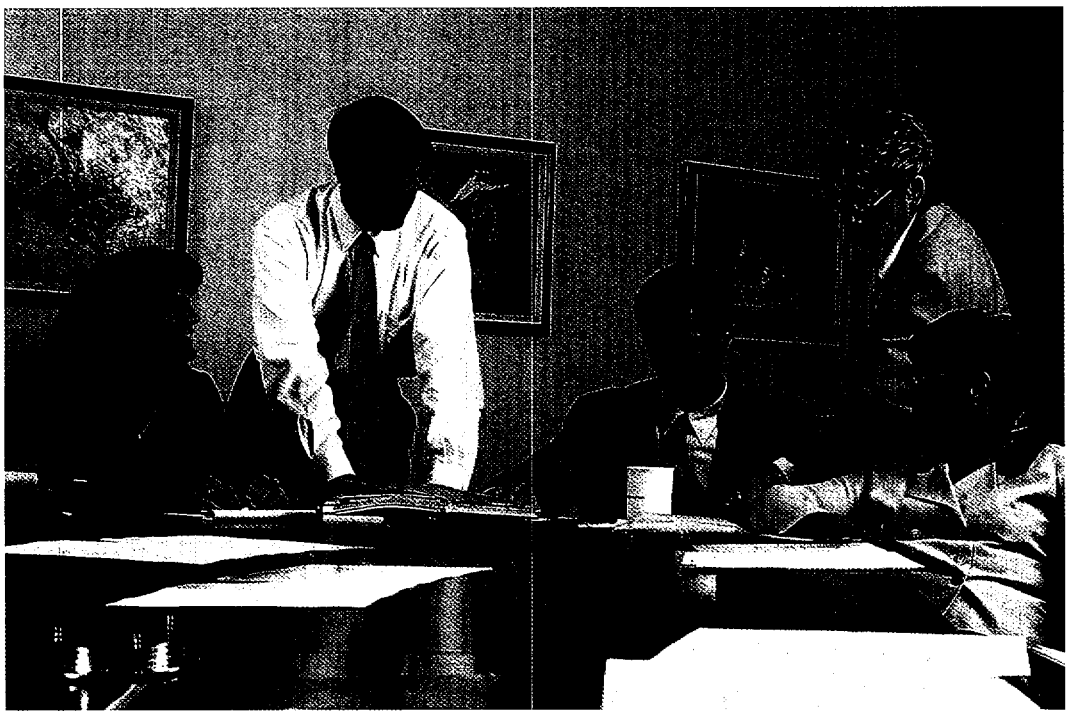
New Mexico Restructuring Legislation

In April 1999, the New Mexico Electric Utility Industry Restructuring Act became law allowing residential and small business customers, and educational institutions in New Mexico a choice in their electric supplier as early as January 2001, with large industrial customers being able to choose by January 2002.

The New Mexico Act requires utilities to separate into at least two corporations by no later than January 1, 2001. One corporation will operate energy-related services and generation operations on a competitive, unregulated basis. The other corporation will consist of transmission and distribution services which will continue to be regulated. Investor-owned utilities are required to file a transition plan by June 1, 2000, detailing their proposals for dealing with competition, including mechanisms for recovery of stranded costs. The restructuring legislation provides for the recovery of no less than 50 percent and, in certain cases, up to 100 percent recovery of stranded costs. Stranded costs are those legitimate, prudent, and verifiable costs which were incurred by a utility to provide service to a customer under prior regulation based on a reasonable expectation of continuing to serve that customer, but which would not otherwise be recovered under competition. EPE believes the New Mexico legislation will provide substantial stranded cost recovery similar to that agreed to by EPE in a rate stipulation entered into in late 1998.

On March 1, 2000, EPE filed with the New Mexico Public Regulatory Commission the first of two phases of its transition plan requesting approval to create a holding company with three subsidiaries: a utility subsidiary to provide regulated transmission and distribution service, an exempt wholesale

New Mexico Transition Team Members: Kerry Lore, Matt Henry, Mathew Benac, Judy Kummrow, and Kathryn Hood

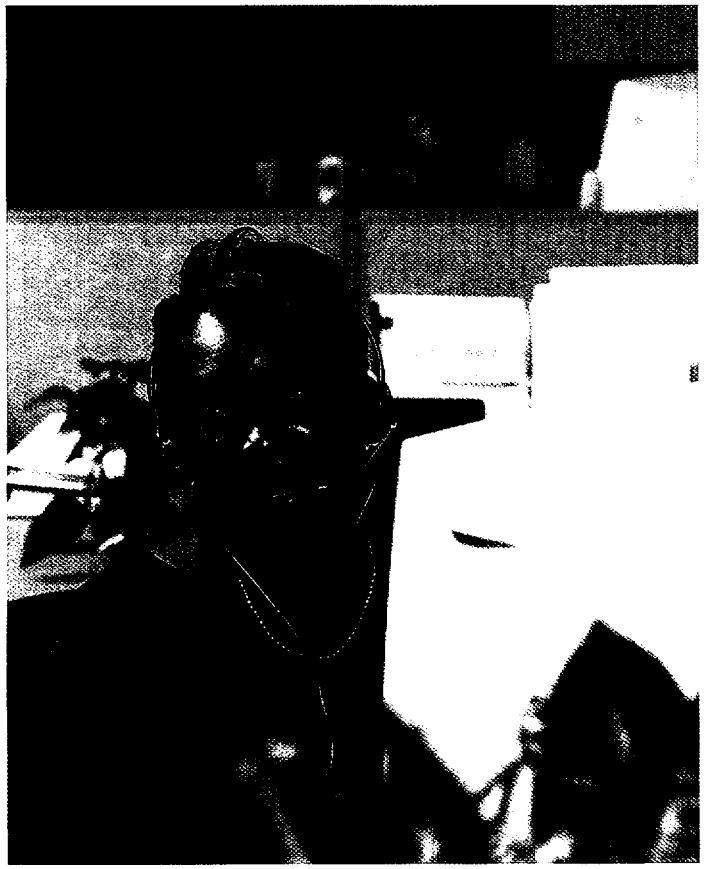


generation company to provide generation services, and an energy services company. Phase II of the Transition Plan is scheduled for filing June 1, 2000. This corporate structure also will enable EPE to be ready for retail competition in Texas in August 2005, after the expiration of EPE's rate freeze.

Texas Restructuring Legislation

In Texas, electric industry restructuring became effective on September 1, 1999. Under specific provisions of the restructuring legislation, EPE is exempt from the competitive provisions of the law until the expiration of its rate freeze agreement in August 2005. This exemption provides EPE with substantial rate stability and the opportunity to achieve a competitive cost structure. Upon the expiration of the rate freeze agreement, EPE will generally be subject to the provisions of the law. The competitive portions of the law, from which EPE is currently considered exempt, require that investor-owned utilities divide business activities into three separate, distinct entities: (i) generation, (ii) transmission and distribution and (iii) a "retail electric provider" before January 1, 2002. On that date, the competitive provisions of the law provide for retail customer choice to begin, coincident with a six percent reduction in rates. Rates will then be frozen at that new lower rate for five years or until 40 percent of the electricity in that market is supplied by at least one other company. Other competitive provisions include a reduction in emissions for grandfathered generating plants by May 2003, the creation of renewable energy options, the establishment of customer education programs, low-income assistance, as well as a detailed affiliate code of conduct to govern relationships between the regulated utility and its affiliates. The law provides for full recovery of stranded costs as determined by the Public Utility Commission of Texas (PUCT). EPE will recover its stranded costs under its rate freeze agreement, and will have no further claim for stranded cost recovery after 2005. Even though EPE is not required to separate its business activities in Texas until 2005, EPE will separate into three subsidiaries owned by a common holding company by early 2001, consistent with New Mexico restructuring requriments.

PREPARATION FOR COMPETITION



In preparation for this new environment of electric utility competition and the challenges and opportunities it will create, we are continuing to explore ways to reduce financial risk, and have initiated programs to improve existing business processes. Following the operating statistics, we have outlined the progress we have made in financial performance, generation, distribution, and energy services – areas we believe will be key in a competitive electric energy market.

Customer Service Representatives: Ida Isles and Lidia Musgrove

OPERATING STATISTICS

	1999	1998	1997	1996 (a)
Operating Revenues (in thousands):				
Retail:				
Residential	$ 164,524	$ 173,215	$ 172,917	$ 163,742
Commercial and Industrial, Small	175,924	174,729	173,318	163,875
Commercial and Industrial, Large	59,497	62,450	64,468	59,041
Sales to Public Authorities	80,393	82,360	82,278	81,185
Total Retail	480,338	492,754	492,981	467,843
Wholesale Sales for Resale	49,441	82,396	83,448	93,737
Total Revenues	529,779	575,150	576,429	561,580
Economy Sales	32,523	20,167	10,612	11,032
Other	8,167	6,506	4,980	3,981
Total Operating Revenues	$ 570,469	$ 601,823	$ 592,021	$ 576,593
Number of Customers (end of year):				
Residential	266,627	260,356	254,348	250,209
Commercial and Industrial, Small	27,274	26,396	25,900	25,304
Commercial and Industrial, Large	124	117	115	102
Other	3,957	3,867	3,811	3,711
Total Customers	297,982	290,736	284,174	279,326
Energy Supplied, Net, MWh:				
Generated	8,392,890	8,586,098	8,186,187	7,920,675
Purchased and Interchanged	328,225	478,396	617,651	711,791
Total Energy Supplied	8,721,115	9,064,494	8,803,838	8,632,466
Energy Sales, MWh:				
Retail:				
Residential	1,653,859	1,621,436	1,587,733	1,545,274
Commercial and Industrial, Small	1,943,120	1,891,703	1,834,953	1,779,986
Commercial and Industrial, Large	1,133,751	1,314,428	1,271,449	1,216,941
Sales to Public Authorities	1,135,438	1,120,654	1,090,312	1,110,706
Total Retail	5,866,168	5,948,221	5,784,447	5,652,907
Wholesale:				
Sales for Resale	905,975	1,757,880	1,897,885	1,753,553
Economy Sales	1,497,880	888,708	640,017	757,999
Total Sales	8,270,023	8,594,809	8,322,349	8,164,459
Losses and Company Use	451,092	469,685	481,489	468,007
Total, Net	8,721,115 (b)	9,064,494 (b)	8,803,838 (b)	8,632,466 (b)
Native System:				
Peak Load, MW	1,159	1,167	1,122	1,105
Net Generating Capacity for Peak, MW	1,500	1,500	1,500	1,500
Load Factor	62.5%	63.1%	64.0%	63.4%
Total System:				
Peak Load, MW	1,287	1,439	1,442	1,387
Net Generating Capacity for Peak, MW	1,500	1,500	1,500	1,500
Load Factor	62.9%	64.3%	64.0%	64.2%

1995	1994	1993	1992	1991	1990
$ 140,799	$ 149,321	$ 144,365	$ 143,150	$ 130,275	$ 126,121
142,981	148,024	143,102	141,039	127,521	121,797
48,643	51,452	47,930	49,742	47,938	44,251
69,149	73,732	72,529	71,496	65,632	64,725
401,572	422,529	407,926	405,427	371,366	356,894
90,246	102,304	126,187	108,985	73,899	71,587
491,818	524,833	534,113	514,412	445,265	428,481
6,681	5,672	3,078	4,982	12,573	12,809
3,744	4,050	4,433	3,575	3,023	2,847
$ 502,243	$ 534,555	$ 541,624	$ 522,969	$ 460,861	$ 444,137
245,245	240,368	235,151	228,688	223,684	218,753
24,615	23,857	23,338	22,883	22,417	22,135
89	80	74	68	68	60
3,674	3,470	3,395	3,251	3,156	2,788
273,623	267,775	261,958	254,890	249,325	243,736
7,439,404	7,018,423	6,625.162	7,330,004	6,128,171	5,277,127
584,853	1,051,251	1,416,172	589,288	1,273,440	1,726,525
8,024,257	8,069,674	8,041,334	7,919,292	7,401,611	7,003,652
1,473,349	1,500,426	1,424,935	1,395,387	1,342,830	1,318,471
1,754,176	1,721,736	1,616,434	1,555,047	1,511,550	1,484,207
1,121,329	1,092,028	872,477	911,750	864,025	784,177
1,068,048	1,081,850	1,034,231	997,483	956,691	954,441
5,416,902	5,396,040	4,948,077	4,859,667	4,675,096	4,541,296
1,646,357	1,925,671	2,484,128	2,361,204	1,717,850	1,442,799
538,102	320,026	164,559	264,654	637,425	640,399
7,601,361	7,641,737	7,596,764	7,485,525	7,030,371	6,624,494
422,896	427,937	444,570	433,767	371,240	379,158
8,024,257 (b)	8,069,674 (b)	8,041,334	7,919,292	7,401,611	7,003,652
1,088	1,093	997	974	929	920
1,500	1,497	1,497	1,497	1,497	1,497
61.6%	61.1%	62.1%	62.3%	62.6%	61.6%
1,374	1,365	1,335	1,302	1,142	1,098
1,500	1,497	1,497	1,497	1,497	1,497
62.0%	63.7%	66.4%	66.4%	67.9%	66.7%

(a) Financial data is based on the results for the Predecessor Company for periods prior to February 11, 1996 and the Reorganized Company thereafter.
(b) Includes unbilled MWh.

FINANCIAL PERFORMANCE

El Paso Electric received an investment-grade credit rating from Standard & Poor's, Moody's, and Duff & Phelps in 1999, followed by Fitch in early 2000. Aggressive debt reduction, cost containment efforts, and increased operating efficiencies significantly improved EPE's financial fundamentals. EPE's strong cash flow has allowed it to reduce fixed obligations by approximately $503.4 million since June 1996, including the early redemption of approximately $139.6 million Series A Preferred Stock in March 1999 and the redemption of approximately $36 million of the Series A First Mortgage Bonds in February 1999. This reduction in fixed obligations has reduced fixed charges by more than $44.8 million per year. During 1999, our free cash flow per share was $1.88. Maintaining our strong cash flow and maximizing the return achieved, either through our debt and stock repurchase programs or other alternative uses of cash, will remain a high priority as we continue to improve our competitive profile.

We remain committed to an aggressive deleveraging program designed to achieve a capitalization of 50 to 55 percent debt over time. We believe this will allow us greater financial flexibility in a competitive market. Common equity as a percentage of capitalization has increased from approximately 19 percent on June 30, 1996, to approximately 34 percent as of December 31, 1999, primarily as a result of this program.

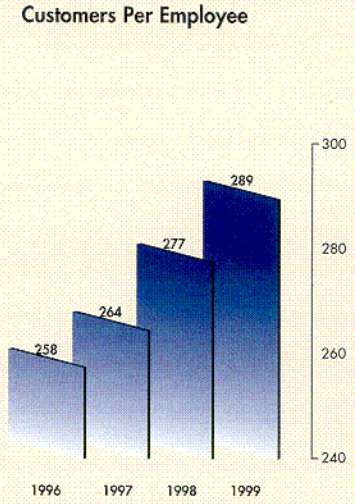
The Board of Directors approved a stock repurchase plan in late May of 1999, for up to six million shares of common stock, consistent with EPE's commitment to enhancing shareholder value. As of March 6, 2000, EPE had repurchased 5.7 million shares of common stock at a total cost of approximately $51.9 million, including commissions. Future repurchases of common stock and reductions in fixed obligations will depend on market conditions and the comparative economic value of alternative uses of cash.

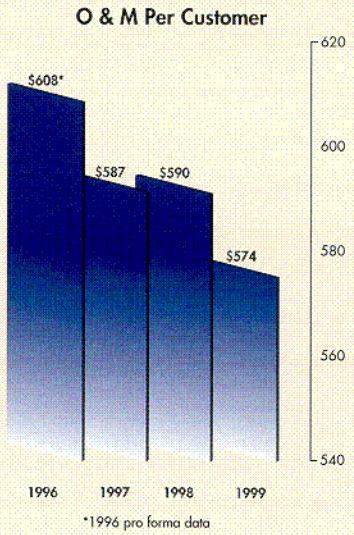
1999 diluted earnings per common share before extraordinary and nonrecurring items were $0.78 compared to $0.75 in 1998. Diluted earnings were affected by the recognition of certain non-recurring items arising from the Las Cruces settlement agreement, the rate settlement entered into in EPE's Texas jurisdiction, a change in estimated fuel cost reserves, a coal reclamation liability adjustment, the write-off of nuclear fuel postload interest capitalized prior to 1999, and the costs associated with the repurchase of the 11.4 percent Series A Preferred Stock, as follows on a per share basis:

	1999	1998
Diluted earnings before the effects of rate settlements, change in estimated fuel cost reserves, coal reclamation, nuclear fuel postload interest capitalized, preferred stock repurchase, and the Las Cruces litigation settlement	$ 0.784	$ 0.753
Texas settlement agreement, net of tax:		
Palo Verde performance reward	0.035	–
Retroactive base rate decrease	(0.024)	–
Change in estimated fuel cost reserves, net of tax	0.038	0.009
Coal reclamation adjustment, net of tax	0.067	–
Write-off of interest capitalized on nuclear fuel, net of tax	(0.042)	–
New Mexico settlement charge, net of tax	–	(0.063)
Preferred stock repurchase	(0.160)	–
Las Cruces litigation settlement	(0.169)	–
Extraordinary item	(0.056)	0.055
Diluted earnings per share	$ 0.473	$ 0.754

Other factors affecting earnings were the discontinuance of the Comisión Federal de Electricidad (CFE) contract, the full impact of the Texas and New Mexico rate reductions, decreased investment income, increased maintenance expense at local plants, and mild weather. These reductions were partially offset by decreased interest charges on long-term debt, increased economy sales at higher margins, and reduced preferred stock dividend requirements.

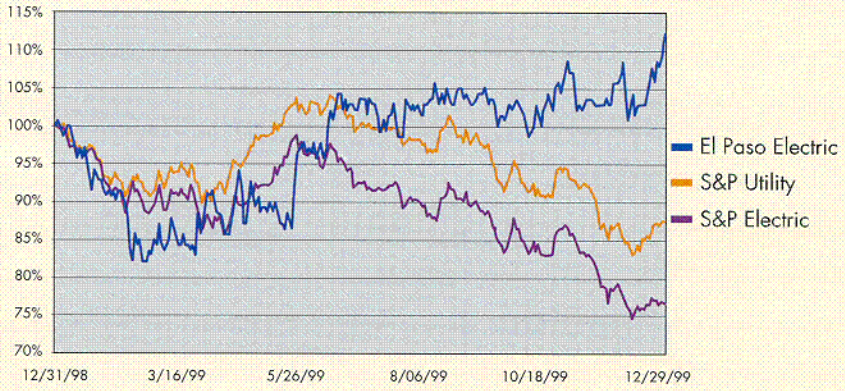
Operating efficiencies at EPE have continued to increase as measured by the number of customers per employee and operations and maintenance (O & M) expense per customer. Our customer base has increased 6.7 percent since 1996, while the number of employees serving this growing customer base has *declined* by 4.8 percent, from 1,082 employees in 1996, to 1030 employees at year-end 1999. O & M expense on a per customer basis decreased 2.7 percent during 1999 and 5.6 percent since 1996.





EPE's market price per share outperformed major utility indices during 1999. At year-end, EPE's common stock closed at $9.81 per share, registering a holding period return of over 12 percent for the year. By comparison, the S & P Utilities and S & P Electric Utilities Indices declined by some 12.5 and 23 percent, respectively, over the same time period.

EPE Relative Price Performance versus S & P Utilities and S & P Electric Utilities Indices 12/31/98 through 12/31/99



Our preparation for competition stretches well beyond improving financial health. In 1999, we also made significant strides in developing and enhancing core business processes in the areas of generation, distribution, and energy services to better prepare EPE for the coming competitive environment.

EPE's strong cash flow allowed it to reduce fixed obligations by $503.4 million since June 1996. . .

C02

GENERATION

As a vital component in a competitive electric utility environment, EPE's power generation group has recognized the need for assessing and improving its business processes. To that end, under the direction of a national firm, a re-engineering process was begun in late 1998 to assure "best practices" in power generation operations at EPE's fossil generation plants. This ongoing process consists of examining and, where appropriate, changing approaches to current work processes and procedures in our power plants. Efficiencies in scheduling planned maintenance outages and best uses of preventive maintenance processes are currently being implemented under this program. By instituting these changes, the generation portion of our business will be better positioned as an efficient, reliable, and competitive entity. EPE believes that, with appropriate application of these best practices and technology improvements, its fossil plants should be able to effectively compete with newly constructed generation. The nature of this market and access to Mexico are significant opportunities for EPE as customer demand for reliable power continues to increase.

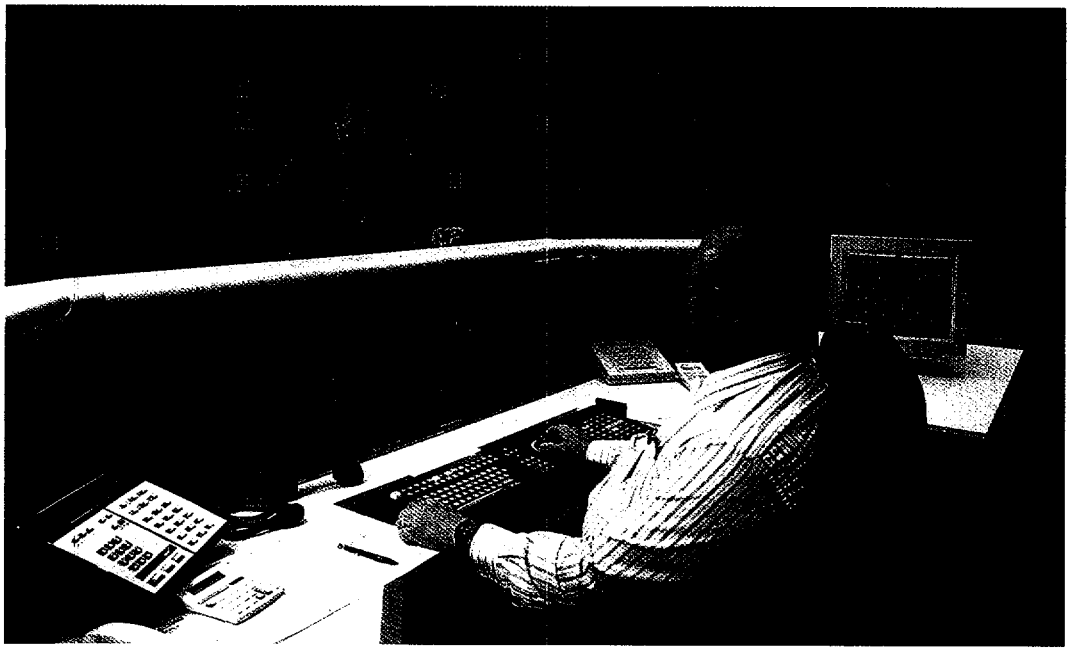
In addition to its fossil plants, EPE has significant nuclear capacity to meet growing base load requirements. The Palo Verde Nuclear Generating Station (PVNGS) represented 40 percent of EPE's net installed generating capacity and provided 55 percent of EPE's energy during 1999. EPE's interest in PVNGS entitles it to approximately 600 MW of power. PVNGS' distinction as the most productive power generation facility in the United States was reaffirmed for a second year in a row with production output that exceeded 30.4 billion kilowatt hours while operating at a robust 91 percent capacity factor.

PVNGS has operated at an exceptional level for several years while earning high marks on performance evaluations. In September 1999, PVNGS earned its third consecutive "one" rating, the highest rating bestowed by the Institute of Nuclear Power Operations (INPO). INPO is an international organization of nuclear power plant operators which, among other services, performs confidential peer reviews on a twelve- to eighteen-month cycle.

In 1998, the Nuclear Regulatory Commission (NRC) discontinued the Systematic Assessment of Licensee Performance (SALP) rating, and has, on an interim basis, instituted a new NRC Plant Performance Review (PPR) to determine the level of regulatory oversight required from the NRC. Palo Verde's most recent SALP rating had placed it in the top ten percent of operating nuclear plants. In August 1999, the PVNGS plant performance was rated "acceptable, warranting routine oversight focus," which is the highest available rating earned under the new PPR.

Palo Verde's strong safety record and high capacity factors should provide a very competitive, base load generation source for the emerging competitive marketplace.

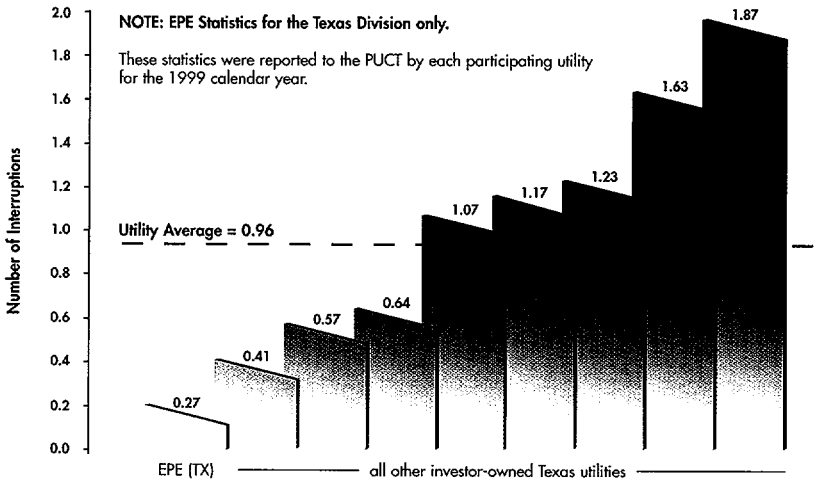
John Whitacre and Richard Seeber at EPE's System Operations Facility



DISTRIBUTION

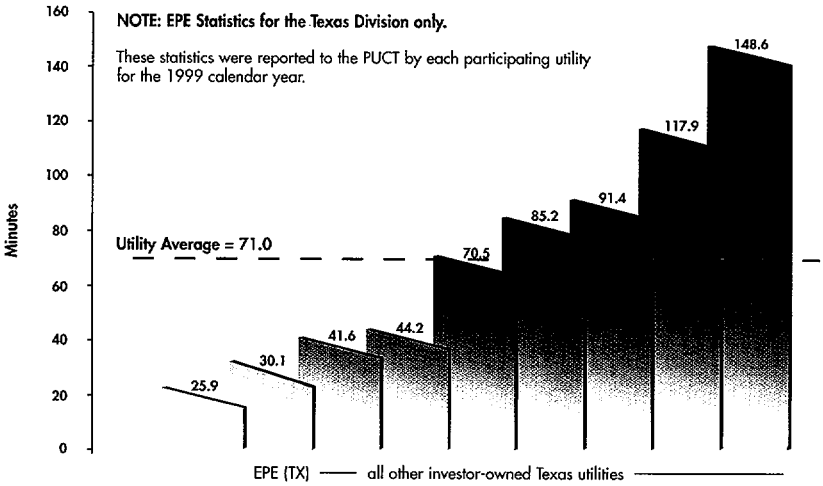
Our Customer Reliability Information System (CRIS) reports, records, and tracks the incidence of electric distribution system outages at the substation and feeder levels enhancing our ability to identify problem areas in our distribution system. This allows us to concentrate on conducting preventive maintenance or repairing equipment in problem areas in a timely manner. The success of our continuing efforts to improve system reliability is reflected in state system reliability measures. In measures of system reliability and service quality established by the PUCT and reported by all major Texas investor-owned utilities, EPE has demonstrated continuous improvement. These system quality measures, depicted graphically below, are the System Average Interruption Frequency Index (SAIFI) and the System Average Interruption Duration Index (SAIDI).

System Average Interruption Frequency Index (SAIFI)
Reporting Period: 1999 Calendar Year



SAIFI – The average number of sustained interruptions (5 minutes or more) that each customer on the system could expect to experience over a one-year period. On average, EPE customers could have expected 0.27 interruptions over one year.

System Average Interruption Duration Index (SAIDI)
Reporting Period: 1999 Calendar Year



SAIDI – The average duration of sustained interruptions (5 minutes or more) that each customer on the system could expect to experience over a one-year period. As a complement to SAIFI, customers on EPE's system could expect 0.27 interruptions over one year, and that interruption would last 30.1 minutes.

The outstanding results shown through these system reliability measures demonstrate that EPE's service quality has been and will continue to be one of its greatest assets.

ENERGY SERVICES

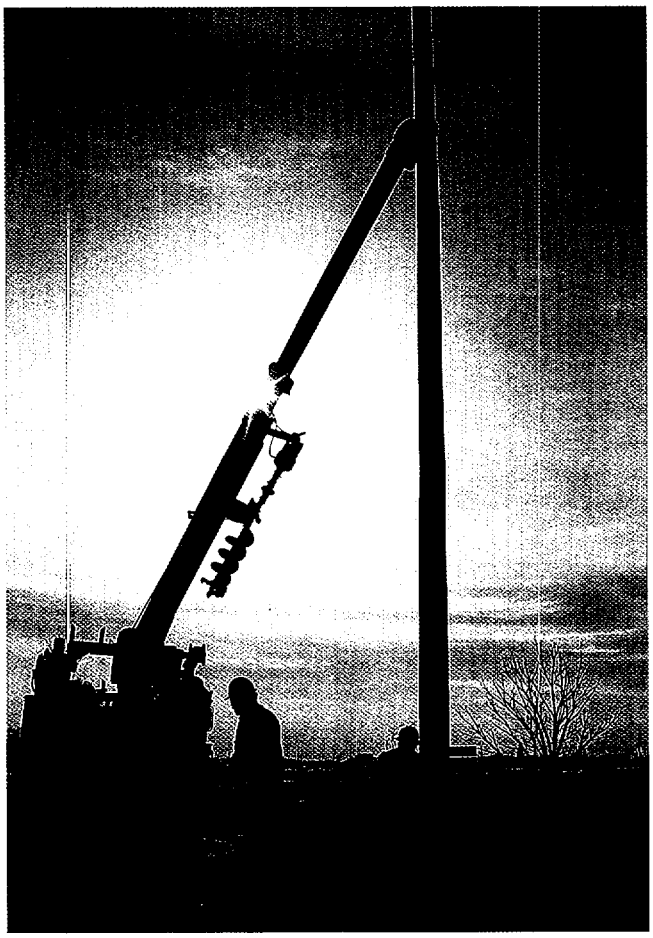
Our Energy Services Business Group (ESBG) completed its second full year of operation with revenues of $2.1 million, a 46 percent increase over 1998. EPE offers energy-related assistance through the ESBG to large and small commercial customers in the areas of lighting, power quality, and distributed generation.

EPE's strategic location on the U.S.-Mexico border presents significant opportunities for developing future energy services markets in its sister city of Ciudad Juarez, Mexico. An International Business Unit (IBU) was created in 1999 to explore these opportunities. The IBU is currently developing energy service projects for maquiladoras (twin plants) in Ciudad Juarez. Over 268 maquiladoras are now in operation in Ciudad Juarez, employing more than 217,000 people. The IBU is also responsible for reestablishing and augmenting contracts for sales of wholesale electricity to Mexico's national electric utility, the Comisión Federal de Electricidad. EPE and the IBU have established relationships with a number of key governmental, business, and professional associations in Ciudad Juarez, the State of Chihuahua, and at the national level in Mexico City.

As in previous years, the growth in electric demand in Mexico was dramatic during 1999, measuring 4.4 percent in Mexico and 7.7 percent in Ciudad Juarez. In early 1999, Mexican President Ernesto Zedillo introduced legislation for a reorganization of the electricity sector. At that time, Mexico's immediate future energy needs were estimated to be 13,000 MW requiring an investment of $25 billion. EPE's ownership of a strategically located interconnection between the U.S. and Mexico and its 100-year history of selling energy to Mexico, establishes EPE as a strong candidate to assist Northern Mexico and Ciudad Juarez in meeting their electric energy needs.

POSITIONING FOR THE NEW ERA

Line Crewmen:
Jimmy Gonzalez
Ernesto Hinojos



As we move into the competitive era, we will continue to focus on maximizing the value of our existing operations, recognizing that in this environment EPE may become the target of a merger or acquisition. While we believe we have the opportunity to create significant value as a stand-alone utility through our short- and long-term strategies, a combination with another company which creates greater value for our shareholders, customers, and employees would be aggressively pursued. In the interim, we will remain focused on our debt and common equity repurchase programs and on improving operating efficiencies in a manner designed to maximize our shareholders' investment and effectively position EPE for competition.

As we look to the future, we believe that EPE's immediate growth potential and long-term success lie within our own region, both on the U.S. and Mexico sides of the border, and we will continue to focus our efforts and energy in that direction.

OFFICERS

James Haines
President and
Chief Executive Officer

Eduardo A. Rodriguez
Senior Vice President
Energy Services

Terry Bassham
Vice President and
General Counsel

J. Frank Bates
Vice President
Transmission & Distribution

Michael L. Blough
Vice President
Administration

Gary R. Hedrick
Vice President, Treasurer
and Chief Financial Officer

John C. Horne
Vice President
Power Generation

Helen Williams Knopp
Vice President
Customer and Public Affairs

Earnest A. Lehman
Vice President
Energy Services Business Group

Robert C. McNiel
Vice President
New Mexico Affairs

Guillermo Silva, Jr.
Secretary

BOARD OF DIRECTORS

George W. Edwards, Jr.
Chairman of the Board
Retired in 1995. Prior to retirement, President, CEO and Director of Kansas City Southern Railway Company, Kansas City, MO

Wilson K. Cadman
Retired in 1992. Prior to retirement, Chairman of the Board, President and CEO, Kansas Gas and Electric Company, Wichita, KS and Vice Chairman of the Board of Western Resources Inc., Topeka, KS

James A. Cardwell
Chairman of the Board and CEO
Petro Stopping Centers, LP, El Paso, TX

James W. Cicconi
General Counsel and
Executive Vice President
Law and Government Affairs,
AT&T, Washington, D.C.

Ramiro Guzman
Owner
Ramiro Guzman & Associates
El Paso, TX

James Haines
President and CEO
El Paso Electric, El Paso, TX

James W. Harris
Founder and President
Seneca Financial Group, Inc.
Greenwich, CT

Kenneth A. Heitz
Partner
Irell & Manella, Los Angeles, CA

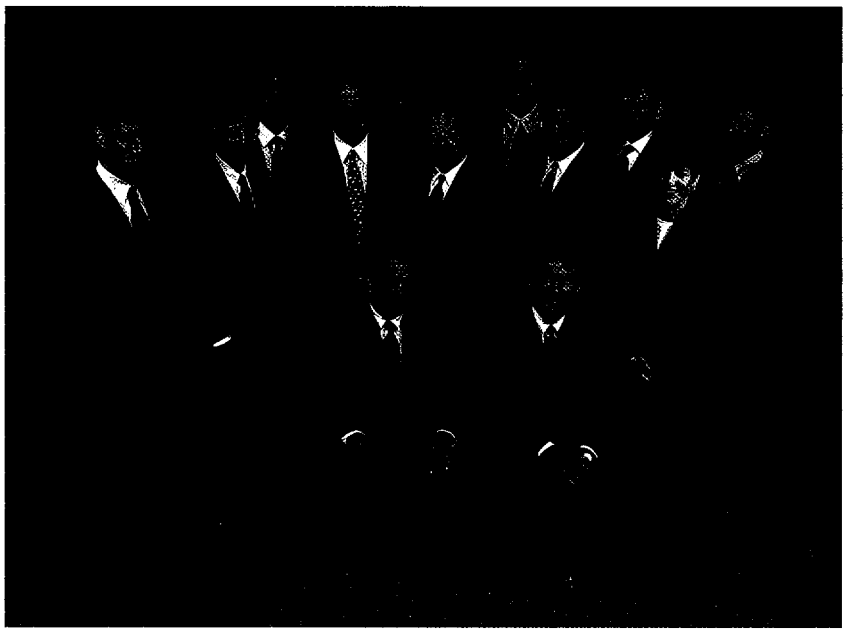
Patricia Z. Holland-Branch
President, CEO and Owner
HB/PZH Commercial Environments, Inc.
El Paso, TX

Michael K. Parks
President and Chief Investment Officer
Aurora National Life Assurance Co.
Los Angeles, CA

Eric B. Siegel
Independent Investor and
Business Consultant
Retired Limited Partner of Apollo Advisors, LP and Lion Advisors, LP,
Los Angeles, CA

Stephen N. Wertheimer
Managing Director
Credit Research & Trading
Greenwich, CT

Charles A. Yamarone
Executive Vice President
U.S. Bancorp Libra
Los Angeles, CA



Seated left to right:
James Haines
George Edwards
Standing left to right:
Michael Parks
James Cicconi
James Cardwell
James Harris
Kenneth Heitz
Wilson Cadman
Eric Siegel
Ramiro Guzman
Stephen Wertheimer
Patricia Holland-Branch
Charles Yamarone

SHAREHOLDER INFORMATION

Securities and Records

The common stock of El Paso Electric is traded on the American Stock Exchange. The ticker symbol is EE.

EPE and The Bank of New York (BONY) act as co-transfer agents and co-registrars for EPE's common stock. BONY maintains all shareholder records of EPE.

Form 10-K Report and Shareholder Inquiries

A complete copy of EPE's Annual Report on Form 10-K for the year ended December 31, 1999, which has been filed with the Securities and Exchange Commission, including Financial Statements and Financial Statement Schedules, is available without charge upon written request to:

Investor Relations
El Paso Electric
P.O. Box 982
El Paso, TX 79960

Or Call 1-800-592-1634
E-mail: investor_relations@epelectric.com

Shareholder Services

Shareholders may obtain information relating to their share position, transfer requirements, lost certificates, and other related matters by telephoning BONY Shareholder Services at 800-524-4458. This service is available to all shareholders Monday through Friday, 8 a.m. to 6 p.m., ET.

Address Shareholder Inquiries to:
The Bank of New York
Shareholder Relations Department
Church Street Station
P.O. Box 11258
New York, NY 10286-1258

Send Certificates for Transfer and Address Changes to:
The Bank of New York
Receive and Deliver Dept.
Church Street Station
P.O. Box 11002
New York, NY 10286-1002

Annual Meeting of Shareholders

The annual meeting of El Paso Electric's shareholders will be held at 10 a.m., Mountain Daylight Time on Thursday, May 4, 2000 in the Paul Kayser Center, 100 N. Stanton, El Paso, TX 79901. In connection with the meeting, proxies will be solicited by the Board of Directors of EPE. A notice of meeting, together with a proxy statement, a form of proxy, and the Annual Report to Shareholders for 1999, were mailed on or about March 31, 2000 to shareholders of record as of March 13, 2000.

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Or Call 1-800-592-1634
E-mail: investor_relations@epelectric.com

Shareholder Services

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Address Shareholder Inquiries to:
The Bank of New York
Shareholder Relations Department
Church Street Station
P.O. Box 11258
New York, NY 10286-1258

Send Certificates for Transfer and Address Changes to:
The Bank of New York
Receive and Deliver Dept.
Church Street Station
P.O. Box 11002
New York, NY 10286-1002

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We will continue to focus on maximizing the value of our existing operations . . .

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**
For the fiscal year ended December 31, 1999

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ____ to ____

Commission file number 0-296

El Paso Electric Company

(Exact name of registrant as specified in its charter)

Texas	**74-0607870**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Kayser Center, 100 North Stanton, El Paso, Texas	**79901**
(Address of principal executive offices)	(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	Name of each exchange on which registered
Common Stock, No Par Value	**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. [ ]

As of March 10, 2000, the aggregate market value of the voting stock held by non-affiliates of the registrant was $522,578,682.

As of March 10, 2000, there were 54,778,810 shares of the Company's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2000 annual meeting of its shareholders are incorporated by reference into Part III of this report.

DEFINITIONS

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

Abbreviations, Acronyms or Defined Terms	Terms
Agreed Order	Agreed Order of the Texas Commission entered August 30, 1995 implementing certain provisions of the Texas Rate Stipulation
ANPP Participation Agreement	Arizona Nuclear Power Project Participation Agreement dated August 23, 1973, as amended
APS	Arizona Public Service Company
CFE	Comision Federal de Electricidad de Mexico, the national electric utility of Mexico
Common Plant or Common Facilities	Facilities at or related to Palo Verde that are common to all three Palo Verde Units
Company	El Paso Electric Company
DOE	United States Department of Energy
DSM	Demand-Side Management
ESBG	The Company's Energy Services Business Group
FERC	Federal Energy Regulatory Commission
Four Corners	Four Corners Generating Station
Freeze Period	Ten-year period beginning August 2, 1995, during which base rates for most Texas retail customers are expected to remain frozen pursuant to the Texas Rate Stipulation
IID	Imperial Irrigation District, an irrigation district in southern California
IRP	Integrated Resource Plan
kV	Kilovolt(s)
kW	Kilowatt(s)
kWh	Kilowatt-hour(s)
Las Cruces	City of Las Cruces, New Mexico
MW	Megawatt(s)
MWh	Megawatt-hour(s)
New Mexico Commission	New Mexico Public Utility Commission or its successor, New Mexico Public Regulation Commission
New Mexico Restructuring Law	New Mexico Electric Utility Industry Restructuring Act of 1999
New Mexico Settlement Agreement	Stipulation and Settlement Agreement in Case No. 2722, between the Company, the New Mexico Attorney General, the New Mexico Commission staff and most other parties to the Company's rate proceedings, excluding Las Cruces, before the New Mexico Commission providing for a 30-month moratorium on rate increases or decreases and other matters
NRC	Nuclear Regulatory Commission
OPC	Texas Office of Public Utility Counsel
Palo Verde	Palo Verde Nuclear Generating Station
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
PNM	Public Service Company of New Mexico
SFAS	Statement of Financial Accounting Standards
SPS	Southwestern Public Service Company
TEP	Tucson Electric Power Company
Texas Commission	Public Utility Commission of Texas
Texas Rate Stipulation	Stipulation and Settlement Agreement in Texas Docket 12700, between the Company, the City of El Paso, the 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
Texas Restructuring Law	Texas Public Utility Regulatory Act Chapter 39, Restructuring of the Electric Utility Industry
Texas Settlement Agreement	Settlement Agreement in Texas Docket 20450, between the Company, the City of El Paso and various parties providing for a reduction of the Company's jurisdictional base revenue and other matters
TNP	Texas-New Mexico Power Company

TABLE OF CONTENTS

PART I

Item 1. Business

General

El Paso Electric 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 MW. For the year ended December 31, 1999, the Company's energy sources consisted of approximately 55% nuclear fuel, 33% natural gas, 8% coal and 4% purchased power.

The Company serves approximately 298,000 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 58% and 8%, respectively, of the Company's revenues for the year ended December 31, 1999). In addition, the Company sells electricity to wholesale customers, including Texas-New Mexico Power Company and the Imperial Irrigation District. Through 1998, the Company also made wholesale sales to the Comision Federal de Electricidad de Mexico. Principal industrial and other large customers of the Company include steel production, copper and oil refining, garment manufacturing 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 Energy Services Business Group began developing energy efficient products and services in 1997. The ESBG offers customers value-added products and services that give them greater value for the kWh purchased from the Company.

The Company's principal offices are located at Kayser Center, 100 North Stanton, El Paso, Texas 79901 (telephone 915-543-5711). The Company was incorporated in Texas in 1901. As of February 25, 2000, the Company had approximately 1,000 employees, 30% of whom are covered by a collective bargaining agreement. The collective bargaining agreement between the Company and the International Brotherhood of Electrical Workers Local 960 ("Local 960") expires on June 15, 2000. Local 960 represents approximately 300 of the Company's employees working primarily in the power plants, substations and line crews. The parties will exchange proposals as early as April 15, 2000 and will begin contract negotiations in May 2000. The Company cannot predict the outcome of these negotiations.

Facilities

The Company's net installed generating capacity of approximately 1,500 MW consists of approximately 600 MW from Palo Verde Units 1, 2 and 3, 482 MW from its Newman Power Station, 246 MW from its Rio Grande Power Station, 104 MW from Four Corners Units 4 and 5, and 68 MW from its Copper Power Station.

Palo Verde Station

The Company owns a 15.8% interest in each of the three nuclear generating units and Common Facilities at Palo Verde, located west of Phoenix, Arizona. The Palo Verde Participants include the Company and six other utilities: APS, Southern California Edison Company, PNM, Southern California Public Power Authority, Salt River Project Agricultural Improvement and Power District and the Los Angeles Department of Water and Power. APS serves as operating agent for Palo Verde.

The NRC has granted facility operating licenses and full power operating licenses for Palo Verde Units 1, 2 and 3, which expire in 2024, 2025 and 2027, respectively. 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 participant is required to fund its proportionate share of fuel, other operations, maintenance and capital costs. The Company's total monthly share of these costs was approximately $6.9 million in 1999. 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 and federal law, the Company must fund its share of the estimated costs to decommission Palo Verde Units 1, 2 and 3, including the Common Facilities, over their estimated useful lives of 40 years (to 2024, 2025 and 2027, respectively). The Company's funding requirements are determined periodically based upon engineering cost estimates performed by outside engineers retained by APS.

In December 1998, the Palo Verde Participants approved an updated decommissioning study. The 1998 study determined that the Company will have to fund approximately $280.5 million (stated in 1998 dollars) to cover its share of decommissioning costs. Cost estimates for decommissioning have increased with each study. The previous cost estimate from a 1995 study determined that the Company would have to fund approximately $229 million (stated in 1995 dollars). The 1998 estimate reflects a 22% increase from the 1995 estimate primarily due to increases in estimated costs for spent fuel storage after operations have ceased. See "Spent Fuel Storage" below.

Although the 1998 study was based on the latest available information, there can be no assurance that decommissioning cost estimates will not continue to increase in the future or that 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 are subject to significant uncertainty. The decommissioning study is updated every three years and a new study is expected to be completed in 2001. See "Disposal of Low-Level Radioactive Waste" below.

The Company will recover its current decommissioning cost estimates through its existing rates during the Freeze Period, and thereafter under the provisions of the Texas Restructuring Law. The rate freeze under the Texas Rate Stipulation and the rate reduction under the Texas Settlement Agreement preclude the Company from seeking a rate increase in Texas to recover increases in decommissioning cost estimates during the Freeze Period. See "Regulation – Texas Regulatory Matters – Deregulation" for further discussion.

Prior to the start of competition in New Mexico, the Company will continue to collect 100% of its decommissioning cost estimates under the New Mexico Settlement Agreement. Under the New Mexico Restructuring Law, however, the New Mexico Commission could effectively reduce the Company's recovery of its decommissioning costs. See "Regulation – New Mexico Regulatory Matters – Deregulation" for further discussion.

Steam Generators. Palo Verde has experienced degradation in the steam generator tubes of each unit. 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.

The projected service lives of the units' steam generators are reassessed by APS periodically in conjunction with inspections made during scheduled outages of the Palo Verde units. In 1997, the Palo Verde Participants unanimously approved the purchase of one set of spare steam generators for delivery in September 2002. In December 1999, the Palo Verde Participants unanimously approved installation of the new steam generators in Unit 2. The Company's portion of total costs associated with construction and installation of new steam generators in Unit 2, including replacement power costs, is currently estimated not to exceed $44 million. APS has also stated that, based on the latest available data, it estimates that the steam generators in Units 1 and 3 should operate for their designated lives of 40 years. However, APS is reassessing whether it is economically desirable to replace the steam generators in Units 1 and 3. Such replacements would also require the unanimous approval of the Palo Verde Participants.

The Texas Rate Stipulation precludes the Company from seeking a rate increase during the Freeze Period to recover additional capital costs associated with the replacement of steam generators. The Company cannot recover these costs through regulated rates in New Mexico since generation and power supply are currently scheduled to become a competitive function in January 2001 under the New Mexico Restructuring Law. Finally, the Company cannot assure that it will be able to recover these capital costs through its wholesale power rates or its competitive retail rates that become applicable after the start of competition. See also Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Overview."

Spent Fuel Storage. In June 1999, APS requested approval from the NRC to use more of the space in the existing spent fuel storage facilities at Palo Verde. The NRC approved this request on March 2, 2000. As a result, the spent fuel storage facilities will have sufficient capacity to store all fuel expected to be discharged from normal operation of all three Palo Verde units through 2003. Alternative on-site storage facilities are currently being constructed to supplement existing facilities. Spent fuel will be removed from the original facilities as necessary and placed in special storage casks which will be stored at the new facilities until accepted by the DOE for permanent disposal. The alternative facilities will be built in stages to accommodate casks on an as needed basis and are expected to be available for use by the end of 2002.

Pursuant to the Nuclear Waste Policy Act of 1982, as amended in 1987 (the "Waste Act"), the DOE is legally obligated to accept and dispose of all spent nuclear fuel and other high-level radioactive wastes generated by all domestic power reactors. In accordance with the Waste Act, the DOE entered into a spent nuclear fuel contract with the Company and all other Palo Verde Participants. In

November 1989, the DOE reported that its spent nuclear fuel disposal facilities would not be in operation until 2010. Subsequent judicial decisions required the DOE to start accepting spent nuclear fuel by January 31, 1998. The DOE did not meet that deadline, and the Company cannot currently predict when spent fuel shipments to the DOE's permanent disposal site will commence. The 1998 decommissioning study assumes that only 14 of 333 spent fuel casks will have been removed from Palo Verde by 2037 when title to the remaining spent fuel is assumed to be transferred to the DOE. In January 1997, the Texas Commission established a project to evaluate what, if any, action it should take with regard to payments made to the DOE for funding of the DOE's obligation to start accepting spent nuclear fuel by January 31, 1998. After receiving initial comments, no further action has been taken on the project.

In July 1998, APS filed, on behalf of all Palo Verde Participants, a petition for review with the United States Court of Appeals for the District of Columbia Circuit seeking confirmation that findings by the Circuit Court in a prior case brought by Northern States Power regarding the DOE's failure to comply with its obligation to begin accepting spent nuclear fuel would apply to all spent nuclear fuel contract holders. The Circuit Court held APS' petition in abeyance pending the United States Supreme Court's decision to review the Northern States Power case. In November 1998, the Supreme Court denied review of this case. The Circuit Court subsequently dismissed APS' petition after the Circuit Court issued clarifying orders essentially granting the relief sought by APS. APS is monitoring pending litigation between the DOE and other nuclear operators before initiating further legal proceedings or other procedural measures on behalf of the Palo Verde Participants to enforce the DOE's statutory and contractual obligations. The Company is unable to predict the outcome of these matters at this time.

The Company expects to incur significant spent fuel storage costs during the life of Palo Verde that it believes are the responsibility of the DOE. These costs will be expensed as incurred until an agreement is reached with the DOE for recovery of these costs. However, the Company cannot predict when, if ever, these additional costs will be recovered from the DOE.

Disposal of Low-Level Radioactive Waste. Congress has established requirements for the disposal by each state of low-level 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, and 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 extensive public hearings, disputes over environmental issues and review of technical issues related to the proposed site. Palo Verde is projected to undergo decommissioning during the period in which Arizona will act as host for the Southwestern Compact. However, the opposition, delays, uncertainty and costs experienced in California demonstrate possible roadblocks that may be encountered 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. The insurance consists of $200 million of primary liability insurance provided by commercial insurance carriers, 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. Effective August 1998, the maximum assessment per reactor for each nuclear incident is approximately $90.7 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 $43.0 million for all three units with an annual payment limitation of approximately $4.7 million.

The Palo Verde Participants maintain "all risk" (including nuclear hazards) insurance for damage to, and decontamination of, property at Palo Verde in the aggregate amount of $2.75 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 an accidental outage of any of the three Palo Verde units if the outage exceeds 12 weeks.

Newman Power Station

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

Four Corners Station

The Company owns 7% of 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 (the Four Corners operating agent) and the other participants.

Four Corners is located on land held on 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 can also operate on fuel oil. The Company leases the combustion turbine and other generation equipment at the station under a lease that expires in July 2005, with an extension option for two additional years.

Transmission and Distribution Lines and Agreements

The Company owns or has significant ownership interests in four major 345 kV transmission lines, three 500 kV lines in Arizona, 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 sources at Palo Verde and Four Corners. Pursuant to standards established by the North American Electric Reliability Council, the Company operates its transmission system in a way that allows it to maintain complete system integrity in the event of any one of these transmission lines being out of service.

Springerville-Diablo Line. The Company owns a 310-mile, 345 kV transmission line from TEP's 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 primary delivery point for the Company's generation entitlement from Four Corners, which is transmitted to the West Mesa Substation over approximately 150 miles of transmission lines owned by PNM.

Greenlee-Newman Line. As a participant in the Southwest New Mexico Transmission Project Participation Agreement, the Company owns 40% of a 60-mile, 345 kV transmission line from TEP's Greenlee Substation in Arizona to the Hidalgo Substation near Lordsburg, New Mexico, 57.2% of a 50-mile, 345 kV transmission line between the Hidalgo Substation and the Luna Substation near Deming, New Mexico, and 100% of an 86-mile, 345 kV transmission line between the Luna Substation and the Newman Power Station. These lines provide 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 66.7% of 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 SPS, providing the Company with access to emergency power from SPS and power markets to the east.

Palo Verde Transmission. The Company owns 18.7% of two 45-mile, 500 kV lines from Palo Verde to the Westwing Substation and a 75-mile, 500 kV line from Palo Verde to the Kyrene Substation. These lines provide the Company with a transmission path for delivery of power from Palo Verde.

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. Substantial expenditures may be required to comply with these regulations. The Company analyzes the costs of its obligations arising from environmental matters on an ongoing basis, and management believes it has made adequate provision in its financial statements to meet such obligations. However, unforeseen expenses associated with compliance could have a material adverse effect on the future operations and financial condition of the Company.

Construction Program

The Company has no current plans to construct any new generating facilities to serve retail customers through at least 2004. Utility construction expenditures reflected in the following table consist primarily of expanding and updating the electric transmission and distribution systems, and the cost of improvements at and the purchase and installation of new steam generators for Palo Verde. The Company's estimated cash construction costs for 2000 through 2003 are approximately $252 million. Actual costs may vary from the construction program estimates shown. Such estimates are reviewed and updated periodically to reflect changed conditions.

By Year (1) (In millions)		By Function (In millions)	
2000	$ 60	Production (1)	$ 90
2001	63	Transmission	16
2002	64	Distribution	101
2003	65	General	45
Total	$ 252	Total	$ 252

(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 fuel, natural gas, coal and purchased power to the total kWh energy mix of the Company:

Power Source	Years Ended December 31, 1999	1998	1997
Nuclear fuel	55%	52%	53%
Natural gas	33	35	34
Coal	8	7	6
Purchased power	4	6	7
Total	100%	100%	100%

Allocated fuel and purchased power costs are generally passed through directly to customers in Texas pursuant to applicable regulations. Historical fuel costs and revenues are reconciled periodically in proceedings before the Texas Commission to determine whether a refund or surcharge based on such historical costs and revenues is necessary. Prior to the New Mexico Settlement Agreement, the Company was required to make annual filings reconciling the revenues collected under its New Mexico fixed fuel factor with its New Mexico fuel and purchased power expenses. As a result of the New Mexico Settlement Agreement, the fixed fuel factor has been incorporated into base rates. See "Regulation – Texas Regulatory Matters" and "– New Mexico Regulatory Matters."

Nuclear Fuel

The Company has contracts for uranium concentrates which should be sufficient to meet the Company's share of Palo Verde's operational requirements through 2002. The Palo Verde Participants have contracted for sufficient conversion services to provide for plant needs through 2000, but need to contract for additional conversion services for 2001 and beyond. APS, as operating agent for Palo Verde, expects that these services will be available on the spot market or, alternatively, through long-term contract arrangements. The Palo Verde Participants have an enrichment services contract which runs through 2002, with an option for five additional years.

Nuclear Fuel Financing. Pursuant to the ANPP Participation Agreement, the Company owns an undivided interest in nuclear fuel purchased in connection with Palo Verde. The Company has available a total of $100 million under a revolving credit facility that provides for both working capital and up to $70 million for the financing of nuclear fuel. At December 31, 1999, approximately $48.3 million had been drawn to finance nuclear fuel. This financing is accomplished through a trust that borrows under the facility to acquire and process the nuclear fuel. The Company is obligated to repay the trust's borrowings with interest and has secured this obligation with First Mortgage Collateral Series Bonds. In the Company's financial statements, the assets and liabilities of the trust are reported as assets and liabilities of the Company.

Natural Gas

In 1999, the Company's natural gas requirements at the Rio Grande Power Station were met with both short-term and long-term natural gas purchases from various suppliers. Interstate gas is delivered under a firm ten-year transportation agreement, which expires in 2001 with extension provisions through 2005. Based on the current availability of economical and reliable market natural gas supplies, the Company anticipates it will continue to purchase natural gas at market prices on a monthly basis for a portion of the fuel needs for the Rio Grande Power Station for the near term. To complement these monthly purchases in 2000, the Company has entered into a one-year fixed-price gas supply contract. The Company will continue to evaluate the availability of short-term natural gas supplies versus long-term supplies to maintain a reliable and economical supply for the Rio Grande Power Station.

In 1999, natural gas for the Newman and Copper Power Stations was supplied primarily pursuant to a five-year intrastate natural gas contract which became effective January 1, 1997 and expires December 31, 2001. Natural gas was also provided to the Newman and Copper Power Stations pursuant to a similar long-term interstate natural gas contract which supplements the intrastate contract and also expires on December 31, 2001. To complement these long-term contracts, the Company also evaluates and procures short-term natural gas supplies at market prices to maintain a reliable and economical supply 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. Based upon information from APS, the Company believes that Four Corners has sufficient reserves of coal to meet the plant's operational requirements for its useful life.

In 1999, upon final review of a study conducted by an outside engineering firm, the Company reduced its estimated final reclamation and coal mine closure liability related to the Company's interest in Four Corners from $14.8 million to $8.2 million. The $6.6 million adjustment was recorded as a reduction of energy expenses in the fourth quarter of 1999.

Purchased Power

To supplement its own generation and operating reserves, the Company engages in firm and non-firm power purchase arrangements which may vary in duration and amount based on evaluation of the Company's resource needs and economics of the transactions.

Operating Statistics

	Years Ended December 31,		
	1999	1998	1997
Operating revenues (In thousands):			
Retail:			
Residential	$ 164,524	$ 173,215	$ 172,917
Commercial and industrial, small	175,924	174,729	173,318
Commercial and industrial, large	59,497	62,450	64,468
Sales to public authorities	80,393	82,360	82,278
Total retail	480,338	492,754	492,981
Wholesale:			
Sales for resale	49,441	82,396	83,448
Economy sales	32,523	20,167	10,612
Total wholesale	81,964	102,563	94,060
Other	8,167	6,506	4,980
Total operating revenues	$ 570,469	$ 601,823	$ 592,021
Number of customers (End of year):			
Residential	266,627	260,356	254,348
Commercial and industrial, small	27,274	26,396	25,900
Commercial and industrial, large	124	117	115
Other	3,957	3,867	3,811
Total	297,982	290,736	284,174
Average annual kWh use per residential customer	6,268	6,291	6,285
Energy supplied, net, kWh (In thousands):			
Generated	8,392,890	8,586,098	8,186,187
Purchased and interchanged	328,225	478,396	617,651
Total	8,721,115	9,064,494	8,803,838
Energy sales, kWh (In thousands):			
Retail:			
Residential	1,653,859	1,621,436	1,587,733
Commercial and industrial, small	1,943,120	1,891,703	1,834,953
Commercial and industrial, large	1,133,751	1,314,428	1,271,449
Sales to public authorities	1,135,438	1,120,654	1,090,312
Total retail	5,866,168	5,948,221	5,784,447
Wholesale:			
Sales for resale	905,975	1,757,880	1,897,885
Economy sales	1,497,880	888,708	640,017
Total wholesale	2,403,855	2,646,588	2,537,902
Total energy sales	8,270,023	8,594,809	8,322,349
Losses and Company use	451,092	469,685	481,489
Total	8,721,115	9,064,494	8,803,838
Native system:			
Peak load, kW	1,159,000	1,167,000	1,122,000
Net generating capacity for peak, kW	1,500,000	1,500,000	1,500,000
Load factor	62.5%	63.1%	64.0%
Total system:			
Peak load, kW	1,287,000	1,439,000	1,442,000
Net generating capacity for peak, kW	1,500,000	1,500,000	1,500,000
Load factor	62.9%	64.3%	64.0%

Regulation

General

In 1999, both Texas and New Mexico enacted electric utility industry restructuring laws requiring competition in certain functions of the industry and ultimately in the Company's service area. The New Mexico Restructuring Law currently requires competition to begin on January 1, 2001. The Company believes the New Mexico Commission may delay the start of competition, but cannot predict the length of such delay, if any. Under the Texas Restructuring Law, the Company's Texas service area is exempt from competition until the expiration of the Freeze Period, currently scheduled to terminate in August 2005.

The Company is working to become more competitive in response to these new restructuring laws as well as other regulatory, economic and technological changes occurring throughout the industry. Deregulation of the production of electricity and related services and increasing customer demand for lower priced electricity and other energy services have accelerated the industry's movement toward more competitive pricing and cost structures. These competitive pressures could result in the loss of customers and diminish the ability of the Company to fully recover its investment in generation assets. This issue is particularly important to the Company because its rates are significantly higher than national and regional averages. As a result of the initiation of deregulation in New Mexico and other portions of Texas, the Company may face increasing pressure on its retail rates and its rate freeze under the Texas Rate Stipulation. The Company's results of operations and cash flows may be adversely affected if it cannot maintain its current retail rates.

The Company is particularly concerned with the ultimate recoverability of "stranded costs," or costs previously found by regulatory authorities to be reasonable and prudent, but which are higher than would be recovered under immediate, full competition. At the federal level, the FERC has announced, through a formal rulemaking, its intention to allow 100% recovery of all legitimate verifiable stranded costs attributable to FERC jurisdictional customers. The Texas Restructuring Law exempts the Company's Texas service area from retail competition, and preserves rates at their current levels, until the end of its Freeze Period. The Company is prohibited from recovering stranded costs or costs of transition to competition beyond the Freeze Period.

Under the New Mexico Restructuring Law, the New Mexico Commission may limit the Company's recovery of its stranded costs. The New Mexico Restructuring Law also allows for recovery of prudent costs related to transition to competition. See "New Mexico Regulatory Matters – Deregulation" below.

Texas Regulatory 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 other activities of the Company. The decisions of the Texas Commission are subject to judicial review.

Deregulation. The Texas Restructuring Law requires an electric utility to separate its business activities into a power generation company, a retail electric provider, and a transmission and distribution utility by January 1, 2002. The Texas Restructuring Law also requires a utility to separate its customer energy services business from its regulated utility activities by September 1, 2000. A utility may accomplish this separation through creation of nonaffiliated companies, separate affiliated companies owned by a common holding company, or through the sale of assets to third parties. Although the Company is not subject to the Texas restructuring requirements until the expiration of the Freeze Period, the Company is subject to the restructuring requirements of the New Mexico Restructuring Law. See "New Mexico Regulatory Matters – Deregulation" below.

The Texas Restructuring Law specifically recognizes and preserves the substantial benefits the Company bargained for in its Texas Rate Stipulation and Texas Settlement Agreement. The Texas Restructuring Law exempts the Company's Texas service area from retail competition, and preserves rates at their current levels until the end of its Freeze Period. At the end of the Freeze Period, the Company will be subject to retail competition and will have no further claim for recovery of stranded costs or costs of transition to competition. The Company believes that its continued ability to provide bundled electric service at current rates in its Texas service area will allow the Company to collect its Texas jurisdictional stranded costs and costs of transition to competition.

Texas Rate Stipulation and Texas Settlement Agreement. The Company's rates for its Texas customers are governed by a rate order entered by the Texas Commission adopting the Texas Rate Stipulation and Agreed Order. The Agreed Order implemented certain provisions of the Texas Rate Stipulation and set rates consistent with the Texas Rate Stipulation. Among other things, under the Texas Rate Stipulation: (i) the Company's base rates for most customers in Texas were fixed for the ten-year Freeze Period which began in August 1995; (ii) the City of El Paso granted the Company a new franchise that extends through the Freeze Period; (iii) the Company retains 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; (iv) the Company's reacquisition of the Palo Verde leased assets was deemed to be in the public interest; and (v) all appeals of Texas Commission orders concerning the Company and all outstanding Texas Commission dockets concerning the Company's rates were resolved.

Neither the Texas 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 Texas Rate Stipulation (other than the OPC and the State of Texas) agreed to not 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. However, during the Freeze Period, the Company is precluded from seeking rate increases in Texas, even in the event of increased operating or capital costs. In the event of a merger, the parties to the Texas Rate Stipulation retain all rights provided in the Texas Rate Stipulation, the right to participate as a party in any proceeding related to the merger, and the right to pursue a reduction in rates below the freeze level to the extent of post-merger synergy savings.

Following the New Mexico Settlement Agreement (see "New Mexico Regulatory Matters – New Mexico Settlement Agreement" below), the Company offered to enter into a comparable agreement in Texas. Based upon that offer, the Company entered into the Texas Settlement Agreement providing for: (i) a total annual jurisdictional base rate reduction of approximately $15.4 million; (ii) reconciliation of approximately $221.2 million of fuel revenues to fuel expenses for the 42-month period ended December 31, 1998, with no disallowance; and (iii) an agreement to use 50% of all Palo Verde performance rewards related to evaluation periods after 1997, when collected, for low-income assistance and for DSM programs, primarily focused on small business customers, through the end of the Freeze Period. The Texas Settlement Agreement was filed with the Texas Commission, the City of El Paso and all other municipalities having jurisdiction. The Texas Commission approved the Texas Settlement Agreement in June 1999.

Fuel. Pursuant to Texas Commission rules, the Company must periodically make a filing to reconcile the revenues collected from Texas customers under its fixed fuel factor with the actual fuel and purchased power expenses incurred. Differences between revenues collected and expenses incurred during the reconciliation period are subject to a refund (in the case of an overrecovery of fuel costs) or surcharge (in the case of an underrecovery of fuel costs). The Texas Commission staff, local regulatory authorities such as the City of El Paso, and customers are entitled to intervene in a fuel reconciliation proceeding and to challenge the prudence of fuel and purchased power expenses. The Company's fuel expenses for its most recent reconciliation period of July 1995 through December 1998 were approved, with no disallowance, as part of the Texas Settlement Agreement.

Palo Verde Performance Standards. The Texas Commission established performance standards for the operation of Palo Verde, pursuant to which each Palo Verde unit 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-wide basis for any consecutive 24-month period, should fall below 35%, the Texas Commission could reconsider the rate treatment of Palo Verde, regardless of the provisions of the Texas Rate Stipulation and the Texas Settlement Agreement. The removal of Palo Verde from rate base could have a significant negative impact on the Company's revenues and financial condition. Performance rewards and penalties for the evaluation periods ending in 1997, 1996 and 1995, as well as an agreement regarding disposition of half of any future rewards, were resolved in the Texas Settlement Agreement and the IRP stipulation. The Company has calculated significant performance rewards for the three-year periods ended December 31, 1999 and 1998. However, the ultimate disposition of these rewards is subject to Texas Commission review during the periodic fuel reconciliation proceedings discussed above. Performance rewards are not recorded on the Company's books until a final determination has been ordered by the Texas Commission in a fuel reconciliation proceeding. Performance penalties are recorded when assessed as probable by the Company.

Integrated Resource Plan. Under Texas law and regulations of the Texas Commission, the Company was required to file an IRP in June 1998. The Company's IRP was the culmination of a lengthy planning process involving the Company, its customers, the Texas Commission, consumer advocates and various special interest groups. The purpose of integrated resource planning was to ensure acquisition of the lowest cost, adequate resources necessary to meet the varied needs of the Company and its customers, and to ensure the equitable allocation and distribution of the benefits of such resource acquisitions and other system benefits to all customer classes. The Company entered into an agreement with all parties with respect to all IRP issues, and a Texas Commission order adopting the agreement

was issued in January 1999. Pursuant to the agreement, the Company will meet its resource needs through a combination of short-term purchased power and a DSM program. Pursuant to the IRP, the Company expects to incur DSM expenditures annually of approximately $1.0 million through 2001. Additionally, the Company committed a total of approximately $1.0 million to fund a low-income weatherization and energy efficiency program over a three-year period beginning in 1999. Finally, in response to interest expressed by its customers and encouragement from the Texas Commission and environmental advocates, the Company has committed to the development of renewable resources. Pursuant to the stipulation settling the IRP, the Company has pledged $3.6 million of prior Palo Verde performance rewards, including related interest, collected by the Company as a result of the Texas Settlement Agreement as initial financing for the development of renewable resources. The Company does not believe the IRP agreement will cause it to incur net costs materially in excess of those that would have been incurred in the absence of its IRP. Nevertheless, because of the Texas Rate Stipulation and the Texas Settlement Agreement, the Company will not be able to increase its rates to recover any increase in net costs actually experienced as a result of its IRP. Going forward, the Texas Restructuring Law abolished the requirement for utilities to develop IRPs; therefore, the Company will have no further IRP obligation after December 31, 2001.

New Mexico Regulatory Matters

The New Mexico Commission has jurisdiction over the Company's rates and services in New Mexico and over certain other 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. In January 1999, pursuant to a state constitutional amendment passed in 1996, the three-member appointed commission was replaced by an elected commission from five single-member districts, with regulatory responsibility for electricity, gas, water, telecommunications, insurance and securities activities within the state. The Company's New Mexico service area falls entirely within one district. The largest city in the Company's New Mexico service territory is Las Cruces, which in 1999 accounted for approximately 8% of the Company's total revenue.

Deregulation. The New Mexico Restructuring Law requires the Company to reorganize its present corporate structure, separating its power generation and energy services businesses, which will become competitive, from its transmission and distribution business, which will remain regulated. Originally, utilities were required to file transition plans addressing the various restructuring issues, including the recovery of stranded costs, by March 1, 2000, which was subsequently extended to June 1, 2000. On March 1, 2000, the Company filed the first phase of its transition plan ("Transition Plan-Phase I") with the New Mexico Commission, requesting approval of the Company's proposed corporate reorganization under the New Mexico Restructuring Law. The Company filed its Transition Plan-Phase I early to allow the Company to obtain regulatory and other approvals necessary to complete its corporate separation by the January 1, 2001 deadline under the New Mexico Restructuring Law. The Company proposed to separate its current operations into a power generation subsidiary, a transmission and distribution subsidiary, and an energy services subsidiary, all owned and controlled by a common holding company. The Company will file its Transition Plan-Phase II by June 1, 2000, detailing the Company's proposed processes and procedures to implement customer choice in New Mexico.

Under the New Mexico Restructuring Law, retail customer choice is currently scheduled to begin January 1, 2001 for public post-secondary educational institutions, public schools and residential and small business customers. Retail customer choice is currently scheduled to begin January 1, 2002 for all other customers. The New Mexico Restructuring Law allows a utility to recover at least 50% of

its stranded costs with up to 100% recovery allowed if the New Mexico Commission determines that additional recovery (i) is in the public interest, (ii) is necessary to maintain the utility's financial integrity, (iii) is necessary to continue adequate and reliable service, and (iv) will not cause an increase in rates to residential and small business customers. The New Mexico Restructuring Law, however, includes decommissioning costs as part of stranded costs. Because the New Mexico Restructuring Law defines decommissioning costs as a stranded cost, it is possible that the New Mexico Commission may allow only 50% recovery of decommissioning costs. However, the New Mexico Restructuring Law also specifically provides that nothing in the law should be interpreted as requiring the New Mexico Commission to issue an order which would jeopardize the exclusive use of the external sinking fund method for meeting decommissioning obligations pursuant to federal guidelines. The Company believes this provision requires the full recovery of New Mexico decommissioning requirements over the life of the nuclear asset through a separate non-bypassable wires charge. The Company cannot predict how the New Mexico Commission will ultimately treat this matter.

The New Mexico Restructuring Law allows the Company to recover reasonable, prudent and unmitigated costs that the Company would not have incurred but for its compliance with the New Mexico Restructuring Law. These transition costs do not include stranded costs, costs the Company can collect under federally approved rates or rates approved by the New Mexico Commission, or any costs the Company would have incurred regardless of the New Mexico Restructuring Law. The Company cannot predict whether the New Mexico Commission will allow the Company to recover all of its transition costs.

The New Mexico Restructuring Law also allowed the New Mexico Commission to review and either confirm, reject or modify the Company's New Mexico Settlement Agreement. On November 30, 1999, the New Mexico Commission issued a final order finding that the Company's New Mexico Settlement Agreement did not, under the terms of the New Mexico Restructuring Law, constitute a plan or approval for recovery of stranded costs. On December 30, 1999, the Company filed a motion for rehearing requesting the New Mexico Commission to confirm that it would determine the Company's stranded costs by using either (i) the stranded cost recovery formula contained in the New Mexico Restructuring Law, applied to the Company's generation asset values in effect prior to the rate base write-downs contained in the New Mexico Settlement Agreement, or (ii) the Company's stranded costs contained in the New Mexico Settlement Agreement. This would allow the Company to either (i) preserve the stranded cost benefits obtained in the New Mexico Settlement Agreement or (ii) be subject to the same stranded cost provisions of the New Mexico Restructuring Law as every other electric utility in New Mexico. On January 18, 2000, the New Mexico Commission issued an order granting the Company's request.

New Mexico Settlement Agreement. In July 1998, the Company entered into the New Mexico Settlement Agreement with certain parties, including the New Mexico Commission staff and the New Mexico Attorney General, but not Las Cruces. In September 1998, the New Mexico Commission issued an order adopting, with some modification, the New Mexico Settlement Agreement. The New Mexico Settlement Agreement became effective on October 26, 1998 and provides for (i) a total annual jurisdictional base revenue reduction of $4.6 million; (ii) a 30-month moratorium on rate increases or decreases in New Mexico; (iii) the elimination of the need for future fuel reconciliations in New Mexico by incorporating the existing fixed fuel factor into base rates; (iv) an increased degree of ratemaking certainty for the future achieved by an agreement among the signatories reducing the net value of certain assets by approximately $56 million on a New Mexico jurisdictional basis for ratemaking purposes (but with no effect on book values), while establishing the signatories' agreement that the

Company is entitled to 100% recovery of such revalued assets; and (v) the ability to enter into long-term rate contracts with commercial and industrial customers in New Mexico. Additionally, as a result of the New Mexico Settlement Agreement, the Company will contribute $0.4 million annually ($1.0 million over the term of the moratorium period) to a social services agency in Dona Ana County providing assistance to low-income individuals. Although the New Mexico Settlement Agreement was structured to allow recovery of previously underrecovered fuel balances, the order adopting the New Mexico Settlement Agreement does not support the recognition of this asset in the Company's financial statements under existing accounting standards. The Company wrote off the book value of undercollected fuel revenues in its New Mexico jurisdiction as of September 30, 1998, which amounted to $3.8 million, net of tax, although the Company believes that, based on current estimates of future fuel prices and operating costs, it will recover 100% of these amounts.

Fuel. Prior to the New Mexico Settlement Agreement, the Company was required to file annual reports reconciling the revenues collected under its New Mexico fixed fuel factor with its New Mexico fuel and purchased power expenses, along with the results of the application of Palo Verde performance standards. As a result of the New Mexico Settlement Agreement, outstanding fuel issues from filings in 1998 and 1997 were satisfactorily resolved with no disallowance of fuel and purchased power costs or the performance rewards, and the existing fixed fuel factor was incorporated into base rates.

Palo Verde Performance Standards. As a result of the New Mexico Settlement Agreement, the Palo Verde performance standards, which had been in place since 1986, were eliminated. Consequently, the Company is no longer entitled to a reward or exposed to a penalty in New Mexico resulting from the operations of Palo Verde. The performance standards report filed with the New Mexico Commission in January 1998 was the final such report and entitled the Company to a reward of $1.1 million.

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.

On December 15, 1999, the FERC approved its final rule ("Order 2000") on Regional Transmission Organizations ("RTOs"). Order 2000 strongly encourages, but does not require, public utilities to form and join RTOs. Order 2000 establishes (i) the minimum characteristics and functions an RTO must satisfy to obtain FERC acceptance; (ii) a collaborative process allowing public utilities and non-public utilities that own, operate or control interstate transmission facilities, consulting with state officials as appropriate, to consider and develop RTOs; (iii) a proposal to consider transmission ratemaking returns on a case-specific basis; (iv) opportunities for non-monetary regulatory benefits for RTOs, including deference in dispute resolution and streamlined filing and approval procedures; and (v) a time line for public utilities to make appropriate filings with the FERC to initiate operation of RTOs. All public utilities that own, operate or control interstate transmission facilities must file, by October 15, 2000, either a proposal to participate in an RTO or an alternative filing describing efforts and plans to participate in an RTO. Order 2000 also proposes RTO startup by December 15, 2001.

The Company is an active participant in the development of the Desert Southwest Transmission and Reliability Operator ("Desert Star"). The Company believes Desert Star will qualify as an RTO under Order 2000. The Company intends, subject to the resolution of outstanding issues, to participate in Desert Star. As a participating transmission owner, the Company will transfer operations of its

transmission system to Desert Star. The Company believes the Desert Star proposal will be submitted to the FERC by October 15, 2000. Desert Star is currently scheduled to become operational by January 1, 2002. If Desert Star fails to become operational, the Company intends to participate in another RTO similar to Desert Star.

In April 1996, the FERC issued its Order No. 888, requiring all public utilities owning, operating or controlling facilities used for transmitting electricity in interstate commerce to allow access to their transmission facilities under minimum terms and conditions of non-discriminatory service, including transmission service for their own new wholesale sales and purchases of electric energy. Additionally, Order No. 888 permits public utilities to seek recovery of legitimate, prudent and verifiable stranded costs and provides a mechanism for the recovery of such costs.

In April 1996, the FERC also issued Order No. 889, which requires all public utilities owning, operating or controlling facilities used for transmitting electricity in interstate commerce to develop and maintain an Open Access Same-Time Information System that will give existing and potential transmission users access to transmission-related information on a basis consistent with that available to a utility's employees engaged in the buying and selling of power. Order No. 889 further requires public utilities to separate their transmission and generation marketing functions and adopt standards of conduct ensuring that all open access transmission customers are treated in a non-discriminatory manner.

Pursuant to Order No. 888, the Company filed its non-discriminatory open access transmission tariffs with the FERC in July 1996. The Company reached a settlement with the various parties regarding rates for transmission and ancillary services under these tariffs. However, the settlement, which was filed with the FERC in March 1997 and approved by the FERC in June 1998, did not resolve issues that had been raised with respect to the manner in which the Company will determine the amount of transmission capacity that is available for use by third parties desiring to use its transmission system.

In May 1999, the FERC issued its opinion in a proceeding brought by SPS regarding the use of the Company's transmission system to serve Las Cruces, holding that once the Company's calculation of available transmission capacity was adjusted to reflect the assumed discontinuation of service to Las Cruces and CFE, the Company would have sufficient transmission capacity over the Eddy County tie to meet SPS' request for firm transmission service. Although the Company has filed a compliance filing as required by the FERC's order, the filing reflects that the Company does not have sufficient transmission capacity over the Eddy County tie to meet SPS' request for firm transmission service. The Company filed a motion for rehearing of the FERC's decision. The FERC has extended its time limit for ruling on this motion. The Company does not expect a material financial impact from this FERC ruling. However, the Company is concerned that of an adverse FERC ruling would result in impaired the reliability of service to the Company's retail customers and increased costs. This case will not be automatically dismissed under the settlement agreement with Las Cruces because SPS, not Las Cruces, was the original complainant. Although the SPS complaint was based upon the creation of a Las Cruces municipal utility, the Company cannot predict whether the case will be dismissed as a result of its settlement with Las Cruces.

On February 24, 2000, the Company and Las Cruces entered into a settlement agreement ending Las Cruces' efforts to municipalize the Company's distribution system in Las Cruces. Under the terms of the settlement agreement, all existing litigation between the Company and Las Cruces,

including all litigation pending before the FERC, will be dismissed. For a discussion of this settlement agreement, see Item 3, "Legal Proceedings – Litigation with Las Cruces."

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. The DOE has determined that all such exports over international transmission lines shall be made in accordance with Order No. 888. The DOE is authorized to assess operators of nuclear generating facilities for a share of the costs of decommissioning the DOE's uranium enrichment facilities and for the ultimate costs of disposal of spent nuclear fuel. See "Facilities – Palo Verde Station – Spent Fuel Storage" for discussion of spent fuel storage and disposal costs.

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. The NRC also has the authority to conduct environmental reviews pursuant to the National Environmental Policy Act.

Wholesale Customers

The Company provides IID with 100 MW of firm capacity and associated energy and 50 MW of system contingent capacity and associated energy pursuant to a 17-year agreement which expires April 30, 2002. The Company also provides TNP with up to 75 MW of firm power and associated energy pursuant to an agreement which expires December 31, 2002. The contract allows TNP to specify a maximum annual amount with one year's notice. TNP elected to receive up to 25 MW for 2000.

Executive Officers of the Company

Name	Age	Current Position and Business Experience
James Haines	53	Chief Executive Officer, President and Director since May 1996; Executive Vice President and Chief Operating Officer of Western Resources, Inc. from June 1995 to May 1996; Executive Vice President and Chief Administrative Officer of Western Resources, Inc. from April 1992 to June 1995.
Eduardo A. Rodriguez	44	Senior Vice President – Energy Services since January 1999; Senior Vice President – Customer and Corporate Services from August 1996 to January 1999; Senior Vice President since January 1994; General Counsel from 1988 to August 1996.
Terry Bassham	39	Vice President and General Counsel since January 1999; General Counsel since August 1996; Shareholder with Clark, Thomas & Winters, P.C. from May 1993 to August 1996.
J. Frank Bates	49	Vice President – Transmission and Distribution since August 1996; Vice President – Operations from May 1994 to August 1996.
Michael L. Blough	44	Vice President – Administration since August 1996; Vice President since May 1995; Controller and Chief Accounting Officer from November 1994 to August 1996.
Gary R. Hedrick	45	Vice President, Chief Financial Officer and Treasurer since August 1996; Treasurer since March 1996; Vice President – Financial Planning and Rate Administration from September 1990 to August 1996.
John C. Horne	51	Vice President – Power Generation since August 1996; Vice President – Power Supply from May 1994 to August 1996.
Helen Knopp	57	Vice President – Customer and Public Affairs since April 1999; Executive Director of the Rio Grande Girl Scout Council from September 1991 to April 1999.
Earnest A. Lehman	47	Vice President – Energy Services Business Group since January 1999; Director of Rates of Western Resources, Inc. from January 1998 to January 1999; Director of Wholesale Rates of Western Resources, Inc. from January 1997 to January 1998; Vice President – Consumer Sales of Westar Consumer Services from March 1996 to January 1997; Executive Director of Marketing of Western Resources, Inc. from December 1994 to March 1996.
Robert C. McNiel	53	Vice President – New Mexico Affairs since December 1997; Vice President – Public Affairs and Marketing from August 1996 to December 1997; Vice President – New Mexico Division from December 1989 to August 1996.
Guillermo Silva, Jr.	46	Secretary since January 1994.

The executive officers of the Company are elected annually and serve at the discretion of the Board of Directors.

Item 2. Properties

The principal properties of the Company are described in Item 1, "Business," and such descriptions are incorporated herein by reference. 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 F of Notes to Financial Statements" for information regarding encumbrances against the principal properties of the Company.

Item 3. Legal Proceedings

Litigation with Las Cruces

On February 24, 2000, the Company and Las Cruces entered into a settlement agreement ending Las Cruces' efforts to municipalize the Company's distribution assets and other facilities used to provide electric service to customers in Las Cruces. Under the settlement agreement the Company will pay Las Cruces a one-time lump sum payment of up to $21 million, $16.5 million of which was expensed in the fourth quarter of 1999. The remaining $4.5 million relates to the transfer of Las Cruces' West Mesa Substation and related facilities to the Company. Las Cruces must substantiate the costs of building the West Mesa Substation and related transmission and distribution facilities, subject to a dollar for dollar offset against the $4.5 million purchase price for any amounts not substantiated.

The settlement agreement also provides for Las Cruces and the Company to enter into a seven-year franchise agreement with a 2% annual franchise fee (approximately $0.8 million per year currently) for the provision of electric distribution service. Las Cruces is prohibited during this seven-year period from taking any action to condemn or otherwise attempt to acquire the Company's distribution system, or attempt to operate or build its own electric distribution system. Las Cruces will have a 90-day non-assignable option at the end of the Company's seven-year franchise agreement to purchase the portion of the Company's distribution system that serves Las Cruces at a purchase price of 130% of the Company's book value at that time. If Las Cruces exercises this option, it is prohibited from reselling the distribution assets for two years. If Las Cruces fails to exercise this option, the franchise and standstill agreements will be extended for an additional two years.

Las Cruces also agreed that it will not contest the calculation of the Company's stranded costs in New Mexico, provided the stranded costs charged to Las Cruces customers do not exceed $52.9 million declining over time, which is the amount initially ordered by the FERC in the Las Cruces stranded cost proceeding. Las Cruces also agreed to assign all of its existing customer contracts to the Company.

Under the terms of the settlement agreement, all existing litigation between the Company and Las Cruces, including all litigation pending before the FERC and the Federal District Court of New Mexico, will be dismissed. The Company and Las Cruces are finalizing the written settlement agreement and obtaining final approvals. The Company anticipates signing a definitive agreement by the end of the first quarter of 2000.

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. In October 1995, the Navajo Nation and the Four Corners participants agreed to stay the proceedings indefinitely so the parties may attempt to resolve the dispute without litigation. This matter remains inactive and the Company is unable to predict the outcome of this case.

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. An agreement reached with the Navajo Nation in 1985 provides that if Four Corners loses a portion of its water rights in the adjudication, the tribe will provide sufficient water from its allocation to offset the loss. The case has been inactive for many years and the Company is unable to predict the outcome of this case.

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 this action. APS, as operating agent, filed claims that dispute the Court's jurisdiction over the Palo Verde Participants' groundwater rights and their contractual rights to effluent relating to Palo Verde and, alternatively, seek confirmation of such rights. In November 1999, the Arizona Supreme Court issued a decision confirming that certain groundwater rights may be available to the federal government and Indian tribes. APS and other parties have petitioned the United States Supreme Court for review of this decision. The Company is unable to predict the outcome of this case.

Other Legal Proceedings

The Company is a party to various other claims, legal actions and complaints. In many of these matters, the Company has excess casualty liability insurance which is applicable. Based upon a review of these claims and applicable insurance coverage, the Company believes that none of these claims will have a material adverse effect on the financial position, results of operations and cash flows of the Company.

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

Not applicable.

PART II

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

The Company's common stock trades on the American Stock Exchange under the symbol "EE." The high and low sales prices for the Company's common stock, as reported in the consolidated reporting system of the American Stock Exchange, for the periods indicated below, were as follows:

	Sales Price	
	High	Low
1999		
First Quarter	$ 8 15/16	$ 7
Second Quarter	9 3/16	7 5/16
Third Quarter	9 3/8	8 1/2
Fourth Quarter	9 13/16	8 9/16
1998		
First Quarter	$ 8 13/16	$ 6 3/8
Second Quarter	10 3/8	8 9/16
Third Quarter	9 15/16	7 9/16
Fourth Quarter	9 3/4	8

As of March 13, 2000, there were 5,505 holders of record of the Company's common stock.

Prior to September 1999, the Company's First and Second Supplemental Indentures restricted the Company's ability to pay dividends on its common stock. So long as the Company's First Mortgage Bonds are outstanding and the series with the longest maturity was not rated "investment grade" by either Standard & Poor's Rating Service ("S&P") or Moody's Investors Service, Inc. ("Moody's"), the Company was significantly limited in its ability to declare any dividend on the common stock, other than in additional shares of common stock. The Company's First Mortgage Bonds were upgraded to investment grade by S&P in September 1999 and by Moody's in November 1999. While the First and Second Supplemental Indentures do not currently restrict the Company's ability to pay dividends on its common stock, the Company does not currently anticipate paying dividends on its common stock in the near-term. The Company intends to continue its deleveraging and stock repurchase programs with the goals of improving its capital structure and using free cash flow to its highest economic advantage.

In May 1999, the Company's Board of Directors approved a stock repurchase program allowing the Company to purchase outstanding shares of its common stock from time to time, up to a total of six million shares. The Company will make purchases primarily in the open market at prevailing prices and will also engage in private transactions, if appropriate. The shares that the Company acquires will be available for issuance under employee benefit and stock option plans or may be retired. As of March 10, 2000, the Company had repurchased 5,747,995 shares of common stock at a cost of approximately $51.9 million, including commissions.

In March 1999, after obtaining required consents of holders of certain of the Company's outstanding debt securities, the Company redeemed its Series A Preferred Stock. The Company paid the redemption price of approximately $139.6 million, accrued cash dividends of $1.3 million and premium, fees and costs of securing the consents aggregating $9.6 million. See Part II, Item 8, "Financial Statements and Supplementary Data – Note E of Notes to Financial Statements" for additional information regarding preferred stock.

Item 6. Selected Financial Data

As of and for the following periods (In thousands except for share data):

	Years Ended December 31, 1999	1998	1997	Period From February 12 to December 31, 1996	Period From January 1 to February 11, 1996	Year Ended December 31, 1995
Operating revenues	$ 570,469	$ 601,823	$ 592,021	$ 521,921	$ 54,672	$ 502,213
Operating income	157,336	159,717	159,636	142,438	1,362	47,470
Income (loss) before extraordinary items	43,809	57,073	54,568	41,919	118,198	(33,319)
Extraordinary loss on repurchases of debt, net of income tax benefit	(3,336)	–	(2,775)	–	–	–
Extraordinary gain on discharge of debt, net of income tax expense	–	3,343	–	–	264,273	–
Net income (loss) applicable to common stock	28,276	45,709	38,649	31,431	382,471	(33,319)
Basic earnings (loss) per common share:						
Income (loss) before extraordinary items	0.533	0.704	0.689	0.523	3.325	(0.937)
Extraordinary loss on repurchases of debt, net of income tax benefit	(0.057)	–	(0.046)	–	–	–
Extraordinary gain on discharge of debt, net of income tax expense	–	0.056	–	–	7.435	–
Net income (loss)	0.476	0.760	0.643	0.523	10.760	(0.937)
Weighted average number of common shares outstanding	59,349,468	60,168,234	60,128,505	60,073,808	35,544,330	35,544,330
Diluted earnings (loss) per common share:						
Income (loss) before extraordinary items	0.529	0.699	0.685	0.523	3.325	(0.937)
Extraordinary loss on repurchases of debt, net of income tax benefit	(0.056)	–	(0.046)	–	–	–
Extraordinary gain on discharge of debt, net of income tax expense	–	0.055	–	–	7.435	–
Net income (loss)	0.473	0.754	0.639	0.523	10.760	(0.937)
Weighted average number of common shares and dilutive potential common shares outstanding	59,731,649	60,633,298	60,437,632	60,116,709	35,544,330	35,544,330
Cash additions to utility property, plant and equipment	53,705	49,787	46,467	33,926	4,724	68,453
Total assets	1,625,891	1,891,219	1,812,613	1,846,190	1,910,354	1,809,891
Long-term debt and financing and capital lease obligations	811,607	897,062	966,810	1,046,173	1,164,328	–
Debt and obligations subject to compromise	–	–	–	–	–	1,608,091
Preferred stock	–	135,744	121,319	108,426	100,000	81,464
Common stock equity (deficit)	421,258	417,278	369,640	331,257	300,000	(418,763)

On February 12, 1996, the Company emerged from a bankruptcy proceeding which it instituted in January 1992. The Company's financial statements for periods after February 12, 1996 are not comparable to the Company's financial statements for periods before February 12, 1996 due to the application of "fresh-start" reporting at that date. A vertical line is shown in the above selected financial data to separate the respective financial information and indicate that it has not been prepared on a consistent basis of accounting.

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."

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

Statements in this document, other than statements of historical information, are forward-looking statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements, as well as other oral and written forward-looking statements made by or on behalf of the Company from time to time, including statements contained in the Company's filings with the Securities and Exchange Commission and its reports to shareholders, involve known and unknown risks and other factors which may cause the Company's actual results in future periods to differ materially from those expressed in any forward-looking statements. Any such statement is qualified by reference to the risks and factors discussed below under the headings "Overview" and "Liquidity and Capital Resources," as well as in the Company's filings with the Securities and Exchange Commission, which are available from the Securities and Exchange Commission or which may be obtained upon request from the Company. The Company cautions that the risks and factors discussed below and in such filings are not exclusive. The Company does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of the Company.

Overview

El Paso Electric Company is an electric utility that serves retail customers in west Texas and southern New Mexico and wholesale customers in Texas, New Mexico, California and Mexico. The Company owns or has substantial ownership interests in five electrical generating facilities providing it with a total capacity of approximately 1,500 MW. The Company's energy sources consist of nuclear fuel, natural gas, coal and purchased power. The Company owns or has significant ownership interests in four major 345 kV transmission lines and three 500 kV lines to provide power from Palo Verde, and owns the distribution network within its retail service territory. The Company is subject to extensive regulation by the Texas and New Mexico Commissions and, with respect to wholesale power sales, transmission of electric power and the issuance of securities, by the FERC.

The Company faces a number of risks and challenges that could negatively impact its operations and financial results. The most significant of these risks and challenges arise from the deregulation of the electric utility industry, the possibility of increased costs, especially from Palo Verde, and the Company's high level of debt.

The electric utility industry in general and the Company in particular are 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 changes in state laws and regulatory provisions relating to wholesale and retail service. Both Texas and New Mexico recently passed legislation that requires the Company to separate its transmission and distribution functions from its generation business and mandates competition in the Company's retail service territory in the future. The Company faces certain risks inherent in separating the Company into affiliates, including the possible loss of operational and administrative efficiencies. In addition to the operational challenges created by separating functions that have historically operated within a single entity, there is substantial uncertainty as to whether the New Mexico legislation will effectively permit the Company to recover its stranded costs, including the costs of decommissioning, in full. The potential effects of deregulation are particularly important to the Company because its rates are significantly higher than the national and

regional averages. In the face of increased competition, there can be no assurance that this competition will not adversely affect the future operations, cash flows and financial condition of the Company.

The changing regulatory environment and the advent of customer choice have created a substantial risk that the Company will lose important customers. For several years, the Company has been engaged in litigation with Las Cruces, which accounted for approximately 8% of the Company's revenues in 1999, over Las Cruces' attempts to create a municipal utility. The parties have settled the litigation, but the risk of loss of customers remains. The Company's wholesale and large retail customers already have, in varying degrees, additional alternate sources of economical power, including co-generation of electric power. For example, a 504 MW combined-cycle generating plant located in Samalayuca, Chihuahua, Mexico, which became fully operational at the end of 1998, gave CFE the current capacity to supply electricity to portions of northern Chihuahua and allowed CFE to eliminate substantially all purchases of power from the Company in 1999. Additionally, American National Power, Inc., a wholly-owned subsidiary of National Power PLC, has announced it is exploring the possibility of building a generation plant in El Paso, Texas. 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.

Another risk to the Company is potential increased costs, including the risk of additional or unanticipated costs at Palo Verde resulting from (i) increases in operation and maintenance expenses; (ii) the 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 various requirements and regulations governing commercial nuclear generating stations. At the same time, the Company's rates, which have been reduced from previous levels as a result of the New Mexico Settlement Agreement and the Texas Settlement Agreement, are effectively capped through the rate freeze periods. Additionally, upon initiation of competition, there will be competitive pressure on the Company's power generation rates. There can be no assurance that the Company's revenues will be sufficient to recover any increased costs, including any increased costs in connection with Palo Verde or increases in other costs of operation, whether as a result of higher than anticipated levels of inflation, changes in tax laws or regulatory requirements, or other causes.

Liquidity and Capital Resources

The Company's principal liquidity requirements in the near-term are expected to consist of interest and principal payments on the Company's indebtedness, capital expenditures related to the Company's generating facilities and transmission and distribution systems and the $21 million payment required under the settlement agreement with Las Cruces. The Company expects that cash flows from operations will be sufficient for such purposes, except that it may be necessary to finance a portion of the Las Cruces payment in the short-term by drawing on its line of credit.

Long-term capital requirements of the Company will consist primarily of construction of electric utility plant and payment of interest on and retirement of debt. The Company has no current plans to construct any new generating capacity to serve retail load through at least 2004. Utility construction expenditures will consist primarily of expanding and updating the transmission and distribution systems and the cost of capital improvements and replacements at Palo Verde and other generating facilities, including the replacement of the Palo Verde Unit 2 steam generators.

At December 31, 1999, the Company had approximately $37.2 million in cash and cash equivalents. In February 1999, the Company renewed its $100 million revolving credit facility, which now provides up to $70 million for nuclear fuel purchases and up to $50 million (depending on the amount of borrowings outstanding for nuclear fuel purchases) for working capital needs. At December 31, 1999, approximately $48.3 million had been drawn for nuclear fuel purchases. No amounts have been drawn on this facility for working capital needs.

The Company has a high debt to capitalization ratio and significant debt service obligations. Due to the Texas Rate Stipulation, the Texas Settlement Agreement, the New Mexico Settlement Agreement and competitive pressures, the Company does not expect to be able to raise its base rates in the event of increases in non-fuel costs, increases in fuel costs in New Mexico or loss of revenues. Accordingly, as described below, debt reduction continues to be a high priority for the Company in order to gain additional financial flexibility to address the evolving competitive market. In March 1999, the Company used cash on hand to pay for the early redemption of its Series A Preferred Stock, which resulted in the avoidance of additional cash dividends of approximately $2.7 million that would have been payable through May 1, 1999, and $4.0 million quarterly thereafter until mandatory redemption in 2008. The preferred stock had an annual dividend rate of 11.40%, which was paid through the issuance of additional shares of preferred stock for the first three years of the issue.

The Company has significantly reduced its long-term debt since its emergence from bankruptcy in 1996. From June 1, 1996 through March 10, 2000, the Company repurchased approximately $327.8 million of first mortgage bonds as part of an aggressive deleveraging program and repaid the remaining $36.0 million of Series A First Mortgage Bonds at their maturity in February 1999. The foregoing, together with the early redemption of Series A Preferred Stock, have reduced the Company's annual interest expense and annual cash dividend requirements by approximately $28.9 million and $15.9 million, respectively. Common stock equity as a percentage of capitalization, excluding current maturities of long-term debt, has increased from 19% at June 30, 1996 to 34% at December 31, 1999. In addition, the Company's bonds are now rated investment grade by all four major credit rating agencies.

In May 1999, the Company's Board of Directors approved a stock repurchase program allowing the Company to purchase outstanding shares of its common stock from time to time, up to a total of six million shares. The Company will make purchases primarily in the open market at prevailing prices and will also engage in private transactions, if appropriate. The shares that the Company acquires will be available for issuance under employee benefit and stock option plans or may be retired. As of March 10, 2000, the Company had repurchased 5,747,995 shares of common stock at a cost of approximately $51.9 million, including commissions.

The Company continues to believe that the orderly reduction of debt with a goal of achieving a capital structure that is more typical in the electric utility industry is a significant component of long-term shareholder value creation. Accordingly, the Company will regularly evaluate market conditions and, when appropriate, use a portion of its available cash to reduce its fixed obligations through open market purchases of first mortgage bonds.

The degree to which the Company is leveraged could have important consequences on the Company's liquidity, including (i) the Company's ability to obtain additional financing for working capital, capital expenditures, acquisitions, general corporate or other purposes could be limited in the

future and (ii) the Company's higher than average leverage may place the Company at a competitive disadvantage by limiting its financial flexibility to respond to the demands of the competitive market and make it more vulnerable to adverse economic or business changes.

Historical Results of Operations

	Years Ended December 31,		
	1999	1998	1997
Net income applicable to common stock before extraordinary items (In thousands)	$ 31,612	$ 42,366	$ 41,424
Diluted earnings per common share before extraordinary items	0.529	0.699	0.685

Results of operations for the year ended December 31, 1999 were affected by unusual or infrequent items including (i) the recognition of certain items arising from the Texas Settlement Agreement; (ii) a change in estimated fuel cost reserves; (iii) an adjustment reducing fuel expense based on a reduction of the Company's estimated coal mine reclamation liability; (iv) a charge to earnings of $10.1 million, net of tax, as a result of the settlement agreement with Las Cruces; (v) a one-time charge to earnings of $2.5 million, net of tax, resulting from the write-off of interest capitalized prior to 1999 on postload nuclear fuel; and (vi) the early redemption of the Company's 11.40% Series A Preferred Stock. Results of operations for 1998 reflect a charge to earnings of $3.8 million, net of tax, as a result of the New Mexico Settlement Agreement, and 1997 results reflect a favorable litigation settlement of $4.6 million, net of legal fees, expenses and tax.

Operating revenues net of energy expenses decreased $11.1 million in 1999, compared to 1998 as follows (In thousands):

Years Ended December 31:	1999	1998	Increase/(Decrease)
Total operating revenues net of energy expenses	$ 460,672	$ 471,763	$ (11,091)
Less:			
Texas Settlement Agreement:			
Palo Verde performance reward	3,453	–	3,453
Retroactive base rate decrease	(2,343)	–	(2,343)
Change in estimated fuel cost reserves	3,754	895	2,859
Coal mine reclamation adjustment	6,601	–	6,601
	$ 449,207	$ 470,868	$ (21,661)

Excluding the effects of the unusual or infrequent items shown above, the decrease of $21.7 million was primarily due to the rate reductions in Texas and New Mexico and the loss of sales to CFE. These decreases were partially offset by increased economy sales.

Operating revenues net of energy expenses increased $13.3 million in 1998 compared to 1997 primarily due to increased economy sales at higher margins and a $1.3 million increase in ESBG revenues.

Operating revenues from retail customers shown below include the effects of the retroactive base rate decrease, the recognition of the Palo Verde performance reward and the changes in estimated fuel cost reserves for the years ended December 31, 1999 and 1998, as applicable. Comparisons of kWh sales and operating revenues are shown below (In thousands):

Years Ended December 31:	1999	1998	Increase/(Decrease) Amount	Increase/(Decrease) Percent
Electric kWh sales:				
Retail	5,866,168	5,948,221	(82,053)	(1.4)%
Sales for resale	905,975	1,757,880	(851,905)	(48.5) (1)
Economy sales	1,497,880	888,708	609,172	68.5
Total	8,270,023	8,594,809	(324,786)	(3.8)
Operating revenues:				
Retail	$ 488,505	$ 499,260	$ (10,755)	(2.2)%
Sales for resale	49,441	82,396	(32,955)	(40.0) (1)
Economy sales	32,523	20,167	12,356	61.3
Total	$ 570,469	$ 601,823	$ (31,354)	(5.2)

(1) The Company's one-year sales agreement for firm capacity and associated energy sales to CFE terminated on December 31, 1998.

Years Ended December 31:	1998	1997	Increase/(Decrease) Amount	Increase/(Decrease) Percent
Electric kWh sales:				
Retail	5,948,221	5,784,447	163,774	2.8%
Sales for resale	1,757,880	1,897,885	(140,005)	(7.4)
Economy sales	888,708	640,017	248,691	38.9
Total	8,594,809	8,322,349	272,460	3.3
Operating revenues:				
Retail	$ 499,260	$ 497,961	$ 1,299	0.3%
Sales for resale	82,396	83,448	(1,052)	(1.3)
Economy sales	20,167	10,612	9,555	90.0
Total	$ 601,823	$ 592,021	$ 9,802	1.7

Other operations and maintenance expense decreased $0.7 million in 1999 compared to 1998 due to decreased other operations expense of $2.1 million partially offset by increased maintenance expense of $1.4 million, as follows (In thousands):

Years Ended December 31:	1999	1998	Increase/(Decrease)
Regulatory expense	$ 1,578	$ 6,043	$ (4,465)
Pensions and benefits expense	15,596	19,940	(4,344)
Customer accounts expense	5,014	3,132	1,882
Outside services expense	9,790	8,008	1,782
Non-nuclear generation expense	5,199	3,672	1,527
Other	97,419	95,879	1,540
Total other operations expense	134,596	136,674	(2,078)
Total maintenance expense	36,307	34,955	1,352
Total other operations and maintenance expense	$ 170,903	$ 171,629	$ (726)

Other operations and maintenance expense increased $4.9 million in 1998 compared to 1997 due to increased other operations expense of $4.7 million and increased maintenance expense of $0.2 million, as follows (In thousands):

Years Ended December 31:	1998	1997	Increase/(Decrease)
All employee bonus plan	$ 5,000	$ 2,200	$ 2,800
Energy Services Business Group expense	2,424	14	2,410
Pensions and benefits expense	19,940	17,774	2,166
Regulatory expense	6,043	3,918	2,125
Outside services expense	8,008	11,814	(3,806)
Injuries and damages expense	2,158	3,632	(1,474)
Other	93,101	92,578	523
Total other operations expense	136,674	131,930	4,744
Total maintenance expense	34,955	34,782	173
Total other operations and maintenance expense	$ 171,629	$ 166,712	$ 4,917

The New Mexico Settlement charge of $6.3 million in 1998 represents the write-off of the book value of undercollected fuel revenues in the Company's New Mexico jurisdiction. See Part I, Item 1, "Business – Regulation – New Mexico Regulatory Matters – New Mexico Settlement Agreement" for further discussion.

Depreciation and amortization expense increased $1.1 million in 1999 compared to 1998 and in 1998 compared to 1997 primarily due to increases in depreciable plant balances.

Taxes other than income taxes decreased $2.8 million in 1999 compared to 1998 primarily due to (i) a $3.1 million reversal of sales tax reserves established in prior years and (ii) a decrease in Arizona property taxes as a result of depreciation and a decrease in the assessment ratio in 1999. The decreases were partially offset by (i) an increase in Texas franchise tax resulting from a refund in 1998 with no comparable amount in 1999 and (ii) a 1999 reclassification of payroll taxes related to the 1998 all

employee cash bonus. The increase of $1.0 million in 1998 compared to 1997 was primarily due to (i) an increase in Texas property taxes and (ii) an increase in revenue related taxes resulting from an increase in revenues in 1998. These increases were partially offset by a decrease in Arizona property taxes due to a decrease in the assessment ratio in 1998.

Other income decreased $20.7 million in 1999 compared to 1998 primarily due to (i) the accrual in 1999 of the $16.5 million to be paid under the settlement agreement with Las Cruces; (ii) a decrease in investment income of $6.4 million resulting from the investment of lower levels of cash and the investment of a portion of decommissioning trust funds in equity securities, the unrealized gains and losses on which are reported as other comprehensive income; and (iii) a favorable settlement of bankruptcy professional fees of $1.3 million in 1998 with no comparable amount in 1999. These decreases were partially offset by (i) an adjustment of $1.7 million to the cash value of Company-owned life insurance policies, which was not previously recognized due to the uncertainty of recoverability from the insurer; and (ii) a gain realized on the disposition of non-utility property of $2.4 million in 1999 compared to $0.7 million in 1998. The decrease of $2.3 million in 1998 compared to 1997 was primarily due to a favorable litigation settlement in 1997 of $7.5 million, net of legal fees and expenses, partially offset by an increase in investment income of $5.1 million resulting from the investment of higher levels of cash.

Interest charges decreased $0.7 million in 1999 compared to 1998 primarily due to a reduction in outstanding debt as a result of open market purchases and redemptions of the Company's first mortgage bonds. This decrease was partially offset by adjustments to postload nuclear fuel to (i) write-off a portion of accumulated interest capitalized prior to 1999 and (ii) discontinue capitalizing interest in 1999. The decrease of $4.7 million in 1998 compared to 1997 was primarily due to a reduction in outstanding debt as a result of open market purchases of the Company's first mortgage bonds.

Income tax expense, excluding the tax effect of extraordinary items, decreased $9.1 million in 1999 compared to 1998 primarily due to changes in pretax income, including the payment under the settlement agreement with Las Cruces, and certain permanent differences including an adjustment to the cash value of Company-owned life insurance policies and tax-exempt income. Income tax expense, excluding the tax effect of extraordinary items, was essentially unchanged for 1998 compared to 1997 primarily due to changes in pretax income which were offset by permanent differences such as bankruptcy fee settlements and tax-exempt income.

Extraordinary loss on repurchases of debt of $3.3 million and $2.8 million in 1999 and 1997, respectively, net of income tax benefit of $2.1 million and $1.5 million, represents the payment of premiums on debt repurchased and the recognition of unamortized issuance expenses on that debt with no comparable amounts in 1998.

Extraordinary gain on discharge of debt of $3.3 million in 1998, net of income tax expense of $2.1 million, represents unclaimed and undistributed funds designated for the payment of preconfirmation bankruptcy claims which reverted to the Company.

For the last several years, inflation has been relatively low and, therefore, has had little impact on the Company's results of operations and financial condition.

There are no new accounting standards pending implementation by the Company which would have a material effect on the Company's financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The following discussion regarding the Company's market-risk sensitive instruments contains forward-looking information involving risks and uncertainties. The statements regarding potential gains and losses are only estimates of what could occur in the future. Actual future results may differ materially from those estimates presented due to the characteristics of the risks and uncertainties involved.

The Company is exposed to market risk due to changes in interest rates, equity prices and commodity prices. Substantially all financial instruments and positions held by the Company described below are held for purposes other than trading.

Interest Rate Risk

The Company's interest rate risk relates primarily to debt financing issued to fund capital and nuclear fuel requirements. Currently, the Company does not have a plan to issue long-term debt within the next five years. The Company's long-term debt obligations are all fixed-rate obligations with varying maturities, except for the pollution control revenue bonds which are variable-rate bonds and nuclear fuel financing which is based on floating rates. The Company's variable-rate pollution control revenue bonds have an aggregate principal amount of $193.1 million. The near-term losses from reasonably possible near-term increases in interest rates would not be material to the Company's financial position, results of operations and cash flows. The interest rate risk related to nuclear fuel financing is substantially mitigated through the operation of the Company's fuel and purchased power cost recovery clauses ("fuel clauses") in its Texas and wholesale rates. Under these fuel clauses, fuel expenses, including interest expense on nuclear fuel financing, are passed through to the customers. Pursuant to the New Mexico Settlement Agreement, fuel costs are recovered through the Company's base rates and are not subject to periodic reconciliation for fluctuations in fuel costs. The near-term losses from reasonably possible near-term increases in interest rates related to nuclear fuel financing for New Mexico fuel costs would not be material to the Company's financial position, results of operations and cash flows.

The Company's decommissioning trust funds consist of municipal bonds and equity securities and are carried at their market value. The Company faces interest rate risk related to the municipal bonds, which were valued at $24.2 million as of December 31, 1999. A hypothetical 10% increase in the rates quoted by the bond market would result in a $2.4 million reduction in fair value.

Equity Price Risk

The Company's decommissioning trust funds include marketable equity securities of approximately $32.9 million at December 31, 1999. A hypothetical 20% decrease in the prices quoted by stock exchanges would result in a $6.6 million reduction in fair value.

Commodity Price Risk

The Company utilizes contracts of various durations for the purchase of natural gas, uranium concentrates and coal to effectively manage its available fuel portfolio. These agreements contain fixed-priced and variable-priced provisions and are settled by physical delivery. The contracts with variable-pricing provisions are exposed to fluctuations in prices due to unpredictable factors, such as weather, which impacts supply and demand. However, the Company's exposure to fuel price risk is substantially mitigated through the operation of its fuel clauses for Texas and wholesale customers as described above. Pursuant to the New Mexico Settlement Agreement, fuel costs are recovered through the Company's base rates and are not subject to periodic reconciliation for fluctuations in fuel costs. The near-term losses from reasonably possible near-term increases in market prices as they relate to the commodity price risk exposure for New Mexico fuel costs would not be material to the Company's financial position, results of operations and cash flows.

In the normal course of business, the Company utilizes contracts of various duration for the forward sale and purchases of electricity to effectively manage its available generating capacity. Such contracts include forward contracts for wholesale sales of generating capacity and energy during periods when the Company's available power resources are expected to exceed the requirements of its native load and wholesale customers. It may also include forward contracts for the purchase of wholesale capacity and energy during periods when the market price of electricity is below the Company's expected incremental power production costs. At December 31, 1999, there were no material open positions in these activities.

Item 8. Financial Statements and Supplementary Data

INDEX TO FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

The Shareholders and Board of Directors
El Paso Electric Company

We have audited the accompanying balance sheets of El Paso Electric Company as of December 31, 1999 and 1998 and the related statements of operations, comprehensive operations, changes in common stock equity, and cash flows for the years ended December 31, 1999, 1998 and 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of El Paso Electric Company as of December 31, 1999 and 1998, and the results of its operations and its cash flows for the years ended December 31, 1999, 1998 and 1997, in conformity with generally accepted accounting principles.

KPMG LLP

El Paso, Texas
February 11, 2000

EL PASO ELECTRIC COMPANY
BALANCE SHEETS

ASSETS (In thousands)	December 31, 1999	December 31, 1998
Utility plant:		
Electric plant in service	$ 1,626,224	$ 1,599,207
Less accumulated depreciation and amortization	329,165	243,405
Net plant in service	1,297,059	1,355,802
Construction work in progress	61,842	54,641
Nuclear fuel; includes fuel in process of $8,994 and $8,031, respectively	78,891	89,784
Less accumulated amortization	39,355	45,691
Net nuclear fuel	39,536	44,093
Net utility plant	1,398,437	1,454,536
Current assets:		
Cash and temporary investments	37,234	229,150
Accounts receivable, principally trade, net of allowance for doubtful accounts of $2,429 and $1,738, respectively	62,036	64,735
Inventories, at cost	25,963	27,537
Prepayments and other	8,832	16,896
Total current assets	134,065	338,318
Long-term contract receivable	17,237	23,139
Deferred charges and other assets:		
Decommissioning trust fund	57,117	46,725
Accumulated deferred income taxes, net	–	10,518
Other	19,035	17,983
Total deferred charges and other assets	76,152	75,226
Total assets	$ 1,625,891	$ 1,891,219

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY
BALANCE SHEETS (Continued)

CAPITALIZATION AND LIABILITIES (In thousands except for share data)	December 31, 1999	December 31, 1998
Capitalization:		
Common stock, stated value $1 per share, 100,000,000 shares authorized, 60,200,921 and 60,122,377 shares issued, and 258,788 and 147,985 restricted shares, respectively	$ 60,460	$ 60,270
Capital in excess of stated value	242,702	241,325
Unearned compensation – restricted stock awards	(1,149)	(611)
Retained earnings	143,724	115,193
Accumulated other comprehensive income (net unrealized gains on marketable securities), net of tax	4,179	1,101
	449,916	417,278
Treasury stock, 3,199,927 shares; at cost	(28,658)	–
Common stock equity	421,258	417,278
Preferred stock, redemption required, cumulative, no par value, 2,000,000 shares authorized, 1,357,444 shares issued and outstanding; at liquidation preference	–	135,744
Long-term debt	788,576	872,213
Financing and capital lease obligations	23,031	24,849
Total capitalization	1,232,865	1,450,084
Current liabilities:		
Current maturities of long-term debt and financing and capital lease obligations	27,042	63,817
Accounts payable, principally trade	22,241	31,135
Litigation settlement payable	16,500	–
Taxes accrued other than federal income taxes	17,617	20,316
Interest accrued	17,022	20,412
Net overcollection of fuel revenues	2,640	2,632
Other	12,946	19,359
Total current liabilities	116,008	157,671
Deferred credits and other liabilities:		
Decommissioning liability	120,875	129,750
Accrued postretirement benefit liability	81,176	80,477
Accrued pension liability	32,476	33,880
Accumulated deferred income taxes, net	12,503	–
Other	29,988	39,357
Total deferred credits and other liabilities	277,018	283,464
Commitments and contingencies		
Total capitalization and liabilities	$ 1,625,891	$ 1,891,219

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY
STATEMENTS OF OPERATIONS
(In thousands except for share data)

	Years Ended December 31,		
	1999	**1998**	**1997**
Operating revenues	$ 570,469	$ 601,823	$ 592,021
Energy expenses:			
Fuel	104,398	109,450	113,457
Coal mine reclamation adjustment	(6,601)	–	–
Purchased and interchanged power	12,000	20,610	20,130
	109,797	130,060	133,587
Operating revenues net of energy expenses	460,672	471,763	458,434
Other operating expenses:			
Other operations	134,596	136,674	131,930
Maintenance	36,307	34,955	34,782
New Mexico Settlement charge	–	6,272	–
Depreciation and amortization	90,934	89,813	88,735
Taxes other than income taxes	41,499	44,332	43,351
	303,336	312,046	298,798
Operating income	157,336	159,717	159,636
Other income (deductions):			
Investment income	6,928	13,334	8,205
Litigation settlement	(16,500)	–	7,500
Settlement of bankruptcy professional fees	–	1,261	362
Other, net	2,766	(736)	83
	(6,806)	13,859	16,150
Income before interest charges	150,530	173,576	175,786
Interest charges (credits):			
Interest on long-term debt	76,634	80,967	86,117
Other interest	7,697	7,198	6,200
Interest capitalized and deferred	(3,242)	(6,400)	(5,875)
	81,089	81,765	86,442
Income before income taxes	69,441	91,811	89,344
Income tax expense	25,632	34,738	34,776
Income before extraordinary items	43,809	57,073	54,568
Extraordinary items:			
Extraordinary loss on repurchases of debt, net of income tax benefit	(3,336)	–	(2,775)
Extraordinary gain on discharge of debt, net of income tax expense	–	3,343	–
Net income	40,473	60,416	51,793
Preferred stock:			
Dividend requirements	2,616	14,707	13,144
Redemption costs	9,581	–	–
Net income applicable to common stock	$ 28,276	$ 45,709	$ 38,649
Basic earnings per common share:			
Income before extraordinary items	$ 0.533	$ 0.704	$ 0.689
Extraordinary loss on repurchases of debt, net of income tax benefit	(0.057)	–	(0.046)
Extraordinary gain on discharge of debt, net of income tax expense	–	0.056	–
Net income	$ 0.476	$ 0.760	$ 0.643
Diluted earnings per common share:			
Income before extraordinary items	$ 0.529	$ 0.699	$ 0.685
Extraordinary loss on repurchases of debt, net of income tax benefit	(0.056)	–	(0.046)
Extraordinary gain on discharge of debt, net of income tax expense	–	0.055	–
Net income	$ 0.473	$ 0.754	$ 0.639
Weighted average number of common shares outstanding	59,349,468	60,168,234	60,128,505
Weighted average number of common shares and dilutive potential common shares outstanding	59,731,649	60,633,298	60,437,632

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY
STATEMENTS OF COMPREHENSIVE OPERATIONS
(In thousands)

	Years Ended December 31,		
	1999	1998	1997
Net income	$ 40,473	$ 60,416	$ 51,793
Other comprehensive income (loss):			
Net unrealized gains (losses) on marketable securities, net of income tax (expense) benefit of $(1,658), $(690) and $223, respectively	3,078	1,285	(416)
Comprehensive income	43,551	61,701	51,377
Preferred stock:			
Dividend requirements	2,616	14,707	13,144
Redemption costs	9,581	–	–
Comprehensive income applicable to common stock	$ 31,354	$ 46,994	$ 38,233

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY
STATEMENTS OF CHANGES IN COMMON STOCK EQUITY
(In thousands except for share data)

	Common Stock Shares	Common Stock Amount	Capital in Excess of Stated Value	Unearned Compensation – Restricted Stock Awards	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Common Stock Equity
Balances at December 31, 1996	60,179,981	$ 60,180	$ 240,768	$ (758)	$ 30,835	$ 232	$ –	$ 331,257
Grants of restricted common stock	84,255	84	491	(575)				–
Amortization of unearned compensation				195				195
Stock awards withheld for taxes	(7,798)	(8)	(37)					(45)
Preferred stock dividends					(13,144)			(13,144)
Net income					51,793			51,793
Other comprehensive loss						(416)		(416)
Balances at December 31, 1997	60,256,438	60,256	241,222	(1,138)	69,484	(184)	–	369,640
Grants of restricted common stock	26,675	27	169	(196)				–
Amortization of unearned compensation				709				709
Stock awards withheld for taxes	(10,843)	(11)	(54)					(65)
Forfeitures of restricted common stock	(1,908)	(2)	(12)	14				–
Preferred stock dividends					(14,707)			(14,707)
Net income					60,416			60,416
Other comprehensive income						1,285		1,285
Balances at December 31, 1998	60,270,362	60,270	241,325	(611)	115,193	1,101	–	417,278
Grants of restricted common stock	210,744	211	1,505	(1,716)				–
Amortization of unearned compensation				1,167				1,167
Stock awards withheld for taxes	(19,965)	(20)	(118)					(138)
Forfeitures of restricted common stock	(1,432)	(1)	(10)	11				–
Preferred stock dividends					(2,616)			(2,616)
Preferred stock redemption					(9,581)			(9,581)
Capital stock adjustment					255			255
Net income					40,473			40,473
Other comprehensive income						3,078		3,078
Treasury stock, 3,199,927 shares; at cost							(28,658)	(28,658)
Balances at December 31, 1999	60,459,709	$ 60,460	$ 242,702	$ (1,149)	$ 143,724	$ 4,179	$ (28,658)	$ 421,258

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY
STATEMENTS OF CASH FLOWS
(In thousands)

	Years Ended December 31,		
	1999	1998	1997
Cash Flows From Operating Activities:			
Net income	$ 40,473	$ 60,416	$ 51,793
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	90,934	89,813	88,735
Amortization of nuclear fuel	17,658	21,804	21,490
Deferred income taxes, net	23,490	29,854	32,394
Coal mine reclamation adjustment	(6,601)	–	–
New Mexico Settlement charge	–	6,272	–
Extraordinary loss on repurchases of debt, net of income tax benefit	3,336	–	2,775
Extraordinary gain on discharge of debt, net of income tax expense	–	(3,343)	–
Other operating activities	9,291	5,561	3,949
Change in:			
Accounts receivable	2,699	(5,775)	(1,373)
Federal income tax receivable	–	–	20,713
Inventories	1,574	(407)	1,192
Prepayments and other	8,064	(4,479)	1,797
Long-term contract receivable	5,902	4,520	3,398
Accounts payable	(8,894)	6,178	(12,258)
Litigation settlement payable	16,500	–	–
Taxes accrued other than federal income taxes	(2,699)	1,024	(2,003)
Interest accrued	(3,390)	(760)	(1,978)
Net under/overcollection of fuel revenues	8	10,230	(11,945)
Other current liabilities	(3,833)	1,882	2,389
Deferred charges and credits	(313)	10,445	5,520
Net cash provided by operating activities	194,199	233,235	206,588
Cash Flows From Investing Activities:			
Cash additions to utility property, plant and equipment	(53,705)	(49,787)	(46,467)
Cash additions to nuclear fuel	(16,593)	(15,409)	(22,539)
Interest capitalized:			
Utility property, plant and equipment	(2,618)	(2,380)	(1,820)
Nuclear fuel	(624)	(4,020)	(4,055)
Investment in decommissioning trust fund	(5,656)	(6,312)	(6,023)
Other investing activities	(935)	(2,623)	(550)
Net cash used for investing activities	(80,131)	(80,531)	(81,454)
Cash Flows From Financing Activities:			
Treasury stock	(28,658)	–	–
Repurchases of and payments on long-term debt	(124,272)	(30,542)	(86,492)
Nuclear fuel financing obligations:			
Proceeds	19,907	19,438	26,585
Payments	(20,930)	(22,121)	(21,216)
Redemption of preferred stock	(148,937)	–	–
Preferred stock dividend payment	(1,328)	–	–
Payments on capital lease obligations	(1,540)	(1,400)	(1,272)
Other financing activities	(226)	(156)	(279)
Net cash used for financing activities	(305,984)	(34,781)	(82,674)
Net (decrease) increase in cash and temporary investments	(191,916)	117,923	42,460
Cash and temporary investments at beginning of period	229,150	111,227	68,767
Cash and temporary investments at end of period	$ 37,234	$ 229,150	$ 111,227

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY

NOTES TO FINANCIAL STATEMENTS

A. Summary of Significant Accounting Policies

General. El Paso Electric Company (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.

Use of Estimates. The preparation of financial statements in conformity with generally 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.

Basis of Presentation. The Company maintains its accounts in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (the "FERC"). The Company determined that it does not meet the criteria for the application of Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation," and accordingly does not report the effects of certain actions of regulators as assets or liabilities unless such actions result in assets or liabilities under generally accepted accounting principles for commercial enterprises in general.

Comprehensive Income. Certain gains and losses that are not recognized currently in the statements of operations are reported as other comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income."

Utility Plant. Effective February 12, 1996, the Company applied "fresh-start" reporting in accordance with Statement of Position 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code" ("SOP 90-7") and revalued its utility plant. Additions to utility plant subsequent to February 12, 1996 are reported at historical cost. Depreciation is provided on a straight-line basis over the estimated remaining lives of the assets (ranging from 5 years to 31 years), except for approximately $384 million of reorganization value allocated to net transmission, distribution and general plant in service. This amount is being depreciated over the ten-year period of a rate settlement (the "Texas Rate Stipulation"). Amortization of intangible plant (software) is provided on a straight-line basis over the estimated useful life of the asset (primarily three 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 recorded a liability for the present value of the estimated decommissioning costs for the Company's interest in Palo Verde using a cost inflation rate of 3% and a discount rate of 6%. Accretion of the decommissioning liability is charged to other interest charges in the statements of operations.

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 Department of Energy (the "DOE") for disposal cost of approximately one-tenth of one cent on each kWh generated. The Company is also expensing its share of costs, as incurred, associated with on site spent fuel storage at Palo Verde. See Note C.

Impairment of Long-Lived Assets. The Company evaluates impairment of its long-lived assets and certain intangible assets whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. An asset is deemed impaired if the sum of the expected future cash flows is less than the carrying amount of the asset.

Capitalized Interest. The Company capitalizes, to construction work in progress and nuclear fuel in process, interest cost calculated in accordance with SFAS No. 34, "Capitalization of Interest Cost."

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

Investments. The Company's marketable securities, included in decommissioning trust funds in the balance sheets, are reported at fair market value and consist primarily of equity securities and municipal bonds in trust funds established for decommissioning of its interest in Palo Verde which had a fair market value of approximately $57.1 million at December 31, 1999. Such marketable securities are classified as "available-for-sale" securities and, as such, unrealized gains and losses are included in accumulated other comprehensive income as a separate component of common stock equity.

Inventories. Inventories, primarily parts, materials and supplies are stated at average cost not to exceed recoverable cost.

Operating Revenues Net of Energy Expenses. The Company accrues revenues for services rendered, including unbilled revenues and revenues generated by the Company's Energy Services Business Group (the "ESBG"). Energy expenses are stated at actual cost incurred. The Company's Texas retail customers are presently being billed under fixed fuel factors approved by the Texas Commission. Rate tariffs currently applicable to certain FERC jurisdictional customers contain appropriate fuel and purchased power cost adjustment provisions designed to recover the Company's fuel and purchased power costs. Any difference between fuel cost and fuel revenues charged to the Company's Texas and FERC jurisdictional customers is reflected as net over/undercollection of fuel revenues in the balance sheets.

Federal Income Taxes. The Company accounts for federal income taxes under the asset and liability method of accounting for income taxes. Under this 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. The Company records 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. The effect on deferred tax assets and liabilities of a change in tax rate is recognized in income in the period that includes the enactment date.

Earnings per Share. In 1997, the Company adopted the provisions of SFAS No. 128, "Earnings per Share," which establishes standards for computing and presenting earnings per share. Basic earnings per common share is computed by dividing net income, after deducting the preferred stock dividend requirements, by the weighted average number of common shares outstanding. Diluted earnings per common share is computed by dividing net income, after deducting the preferred stock dividend requirements, by the weighted average number of common shares and dilutive potential common shares outstanding.

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

Stock Options and Restricted Stock. The Company has a long-term incentive plan which reserves shares of common stock for issuance to officers, key employees and non-employee directors through the award or grant of stock options and restricted stock. The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). Accordingly, compensation expense is recognized for the intrinsic value, if any, of option grants at measurement date ratably over the vesting period of the options. Compensation expense for the restricted stock awards is recognized for the fair value of the shares at the award date ratably over the restriction period. Unearned compensation related to restricted stock awards is shown as a reduction of common stock equity.

Reclassifications. Certain amounts in the financial statements for 1998 and 1997 have been reclassified to conform with the 1999 presentation.

Supplemental Statements of Cash Flows Disclosures (In thousands)

	Years Ended December 31,		
	1999	1998	1997
Cash paid (refunded) for:			
Income taxes paid	$ 1,882	$ 2,900	$ 2,901
Income taxes refunded	–	–	(20,713)
Interest on long-term debt (1)	72,600	74,537	81,293
Other interest	702	436	562
Reorganization items – professional fees and other	–	4,310	3,264
Non-cash investing and financing activities:			
Issuance of preferred stock for pay-in-kind dividends	3,867	14,425	12,893
Grants of restricted shares of common stock	1,716	196	575

(1) Includes interest on bonds, letter of credit fees related to bonds, and postload interest on nuclear fuel financing that was not capitalized.

B. Regulation

General

In 1999, both Texas and New Mexico enacted electric utility industry restructuring laws requiring competition in certain functions of the industry and ultimately in the Company's service area. The New Mexico Restructuring Law currently requires competition to begin on January 1, 2001. The Company believes the New Mexico Commission may delay the start of competition, but cannot predict the length of such delay, if any. Under the Texas Restructuring Law, the Company's Texas service area is exempt from competition until the expiration of the Freeze Period, currently scheduled to terminate in August 2005.

The Company is working to become more competitive in response to these new restructuring laws as well as other regulatory, economic and technological changes occurring throughout the industry. Deregulation of the production of electricity and related services and increasing customer demand for lower priced electricity and other energy services have accelerated the industry's movement toward more competitive pricing and cost structures. These competitive pressures could result in the loss of customers and diminish the ability of the Company to fully recover its investment in generation assets. This issue is particularly important to the Company because its rates are significantly higher than national and regional averages. As a result of the initiation of deregulation in New Mexico and other portions of Texas, the Company may face increasing pressure on its retail rates and its rate freeze under the Texas Rate Stipulation. The Company's results of operations and cash flows may be adversely affected if it cannot maintain its current retail rates.

The Company is particularly concerned with the ultimate recoverability of "stranded costs," or costs previously found by regulatory authorities to be reasonable and prudent, but which are higher than would be recovered under immediate, full competition. At the federal level, the FERC has announced, through a formal rulemaking, its intention to allow 100% recovery of all legitimate verifiable stranded costs attributable to FERC jurisdictional customers. The Texas Restructuring Law exempts the Company's Texas service area from retail competition, and preserves rates at their current levels, until the end of its Freeze Period. The Company is prohibited from recovering stranded costs or costs of transition to competition beyond the Freeze Period.

Under the New Mexico Restructuring Law, the New Mexico Commission may limit the Company's recovery of its stranded costs. The New Mexico Restructuring Law also allows for recovery of prudent costs related to transition to competition. See "New Mexico Regulatory Matters – Deregulation" below.

Texas Regulatory 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 other activities of the Company. The decisions of the Texas Commission are subject to judicial review.

Deregulation. The Texas Restructuring Law requires an electric utility to separate its business activities into a power generation company, a retail electric provider, and a transmission and distribution utility by January 1, 2002. The Texas Restructuring Law also requires a utility to separate its customer energy services business from its regulated utility activities by September 1, 2000. A utility may accomplish this separation through creation of nonaffiliated companies, separate affiliated companies owned by a common holding company, or through the sale of assets to third parties. Although the Company is not subject to the Texas restructuring requirements until the expiration of the Freeze Period, the Company is subject to the restructuring requirements of the New Mexico Restructuring Law. See "New Mexico Regulatory Matters – Deregulation" below.

The Texas Restructuring Law specifically recognizes and preserves the substantial benefits the Company bargained for in its Texas Rate Stipulation and Texas Settlement Agreement. The Texas Restructuring Law exempts the Company's Texas service area from retail competition, and preserves rates at their current levels until the end of its Freeze Period. At the end of the Freeze Period, the Company will be subject to retail competition and will have no further claim for recovery of stranded costs or costs of transition to competition. The Company believes that its continued ability to provide bundled electric service at current rates in its Texas service area will allow the Company to collect its Texas jurisdictional stranded costs and costs of transition to competition.

Texas Rate Stipulation and Texas Settlement Agreement. The Company's rates for its Texas customers are governed by a rate order entered by the Texas Commission adopting the Texas Rate Stipulation and Agreed Order. The Agreed Order implemented certain provisions of the Texas Rate Stipulation and set rates consistent with the Texas Rate Stipulation. Among other things, under the Texas Rate Stipulation: (i) the Company's base rates for most customers in Texas were fixed for the ten-year Freeze Period which began in August 1995; (ii) the City of El Paso granted the Company a new franchise that extends through the Freeze Period; (iii) the Company retains 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; (iv) the Company's reacquisition of the Palo Verde leased assets was deemed to be in the public interest; and (v) all appeals of Texas Commission orders concerning the Company and all outstanding Texas Commission dockets concerning the Company's rates were resolved.

Neither the Texas 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 Texas Rate Stipulation (other than the OPC and the State of Texas) agreed to not 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. However, during the Freeze Period, the Company is precluded from seeking rate increases in Texas, even in the event of increased operating or capital costs. In the event of a merger, the parties to the Texas Rate Stipulation retain all rights provided in the Texas Rate Stipulation, the right to participate as a party in any proceeding related to the merger, and the right to pursue a reduction in rates below the freeze level to the extent of post-merger synergy savings.

Following the New Mexico Settlement Agreement (see "New Mexico Regulatory Matters – New Mexico Settlement Agreement" below), the Company offered to enter into a comparable agreement in Texas. Based upon that offer, the Company entered into the Texas Settlement Agreement providing for: (i) a total annual jurisdictional base rate reduction of approximately $15.4 million; (ii) reconciliation of approximately $221.2 million of fuel revenues to fuel expenses for the 42-month period ended December 31, 1998, with no disallowance; and (iii) an agreement to use 50% of all Palo Verde performance rewards related to evaluation periods after 1997, when collected, for low-income assistance and for DSM programs, primarily focused on small business customers, through the end of the Freeze Period. The Texas Settlement Agreement was filed with the Texas Commission, the City of El Paso and all other municipalities having jurisdiction. The Texas Commission approved the Texas Settlement Agreement in June 1999.

Fuel. Pursuant to Texas Commission rules, the Company must periodically make a filing to reconcile the revenues collected from Texas customers under its fixed fuel factor with the actual fuel and purchased power expenses incurred. Differences between revenues collected and expenses incurred during the reconciliation period are subject to a refund (in the case of an overrecovery of fuel costs) or surcharge (in the case of an underrecovery of fuel costs). The Texas Commission staff, local regulatory authorities such as the City of El Paso, and customers are entitled to intervene in a fuel reconciliation proceeding and to challenge the prudence of fuel and purchased power expenses. The Company's fuel expenses for its most recent reconciliation period of July 1995 through December 1998 were approved, with no disallowance, as part of the Texas Settlement Agreement.

Palo Verde Performance Standards. The Texas Commission established performance standards for the operation of Palo Verde, pursuant to which each Palo Verde unit 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-wide basis for any consecutive 24-month period, should fall below 35%, the Texas Commission could reconsider the rate treatment of Palo Verde, regardless of the provisions of the Texas Rate Stipulation and the Texas Settlement Agreement. The removal of Palo Verde from rate base could have a significant negative impact on the Company's revenues and financial condition. Performance rewards and penalties for the evaluation periods ending in 1997, 1996 and 1995, as well as an agreement regarding disposition of half of any future rewards, were resolved in the Texas Settlement Agreement and the IRP stipulation. The Company has calculated significant performance rewards for the three-year periods ended December 31, 1999 and 1998. However, the ultimate disposition of these rewards is subject to Texas Commission review during the periodic fuel reconciliation proceedings discussed above. Performance rewards are not recorded on the Company's books until a final determination has been ordered by the Texas Commission in a fuel reconciliation proceeding. Performance penalties are recorded when assessed as probable by the Company.

Integrated Resource Plan. Under Texas law and regulations of the Texas Commission, the Company was required to file an IRP in June 1998. The Company's IRP was the culmination of a lengthy planning process involving the Company, its customers, the Texas Commission, consumer advocates and various special interest groups. The purpose of integrated resource planning was to ensure acquisition of the lowest cost, adequate resources necessary to meet the varied needs of the Company

and its customers, and to ensure the equitable allocation and distribution of the benefits of such resource acquisitions and other system benefits to all customer classes. The Company entered into an agreement with all parties with respect to all IRP issues, and a Texas Commission order adopting the agreement was issued in January 1999. Pursuant to the agreement, the Company will meet its resource needs through a combination of short-term purchased power and a DSM program. Pursuant to the IRP, the Company expects to incur DSM expenditures annually of approximately $1.0 million through 2001. Additionally, the Company committed a total of approximately $1.0 million to fund a low-income weatherization and energy efficiency program over a three-year period beginning in 1999. Finally, in response to interest expressed by its customers and encouragement from the Texas Commission and environmental advocates, the Company has committed to the development of renewable resources. Pursuant to the stipulation settling the IRP, the Company has pledged $3.6 million of prior Palo Verde performance rewards, including related interest, collected by the Company as a result of the Texas Settlement Agreement as initial financing for the development of renewable resources. The Company does not believe the IRP agreement will cause it to incur net costs materially in excess of those that would have been incurred in the absence of its IRP. Nevertheless, because of the Texas Rate Stipulation and the Texas Settlement Agreement, the Company will not be able to increase its rates to recover any increase in net costs actually experienced as a result of its IRP. Going forward, the Texas Restructuring Law abolished the requirement for utilities to develop IRPs; therefore, the Company will have no further IRP obligation after December 31, 2001.

New Mexico Regulatory Matters

The New Mexico Commission has jurisdiction over the Company's rates and services in New Mexico and over certain other 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. In January 1999, pursuant to a state constitutional amendment passed in 1996, the three-member appointed commission was replaced by an elected commission from five single-member districts, with regulatory responsibility for electricity, gas, water, telecommunications, insurance and securities activities within the state. The Company's New Mexico service area falls entirely within one district. The largest city in the Company's New Mexico service territory is Las Cruces, which in 1999 accounted for approximately 8% of the Company's total revenue.

Deregulation. The New Mexico Restructuring Law requires the Company to reorganize its present corporate structure, separating its power generation and energy services businesses, which will become competitive, from its transmission and distribution business, which will remain regulated. Originally, utilities were required to file transition plans addressing the various restructuring issues, including the recovery of stranded costs, by March 1, 2000, which was subsequently extended to June 1, 2000. On March 1, 2000, the Company filed the first phase of its transition plan ("Transition Plan-Phase I") with the New Mexico Commission, requesting approval of the Company's proposed corporate reorganization under the New Mexico Restructuring Law. The Company filed its Transition Plan-Phase I early to allow the Company to obtain regulatory and other approvals necessary to complete its corporate separation by the January 1, 2001 deadline under the New Mexico Restructuring Law. The Company proposed to separate its current operations into a power generation subsidiary, a transmission and distribution subsidiary, and an energy services subsidiary, all owned and controlled by a common holding company. The Company will file its Transition Plan-Phase II by June 1, 2000, detailing the Company's proposed processes and procedures to implement customer choice in New Mexico.

Under the New Mexico Restructuring Law, retail customer choice is currently scheduled to begin January 1, 2001 for public post-secondary educational institutions, public schools and residential and small business customers. Retail customer choice is currently scheduled to begin January 1, 2002 for all other customers. The New Mexico Restructuring Law allows a utility to recover at least 50% of its stranded costs with up to 100% recovery allowed if the New Mexico Commission determines that additional recovery (i) is in the public interest, (ii) is necessary to maintain the utility's financial integrity, (iii) is necessary to continue adequate and reliable service, and (iv) will not cause an increase in rates to residential and small business customers. The New Mexico Restructuring Law, however, includes decommissioning costs as part of stranded costs. Because the New Mexico Restructuring Law defines decommissioning costs as a stranded cost, it is possible that the New Mexico Commission may allow only 50% recovery of decommissioning costs. However, the New Mexico Restructuring Law also specifically provides that nothing in the law should be interpreted as requiring the New Mexico Commission to issue an order which would jeopardize the exclusive use of the external sinking fund method for meeting decommissioning obligations pursuant to federal guidelines. The Company believes this provision requires the full recovery of New Mexico decommissioning requirements over the life of the nuclear asset through a separate non-bypassable wires charge. The Company cannot predict how the New Mexico Commission will ultimately treat this matter.

The New Mexico Restructuring Law allows the Company to recover reasonable, prudent and unmitigated costs that the Company would not have incurred but for its compliance with the New Mexico Restructuring Law. These transition costs do not include stranded costs, costs the Company can collect under federally approved rates or rates approved by the New Mexico Commission, or any costs the Company would have incurred regardless of the New Mexico Restructuring Law. The Company cannot predict whether the New Mexico Commission will allow the Company to recover all of its transition costs.

The New Mexico Restructuring Law also allowed the New Mexico Commission to review and either confirm, reject or modify the Company's New Mexico Settlement Agreement. On November 30, 1999, the New Mexico Commission issued a final order finding that the Company's New Mexico Settlement Agreement did not, under the terms of the New Mexico Restructuring Law, constitute a plan or approval for recovery of stranded costs. On December 30, 1999, the Company filed a motion for rehearing requesting the New Mexico Commission to confirm that it would determine the Company's stranded costs by using either (i) the stranded cost recovery formula contained in the New Mexico Restructuring Law, applied to the Company's generation asset values in effect prior to the rate base write-downs contained in the New Mexico Settlement Agreement, or (ii) the Company's stranded costs contained in the New Mexico Settlement Agreement. This would allow the Company to either (i) preserve the stranded cost benefits obtained in the New Mexico Settlement Agreement or (ii) be subject to the same stranded cost provisions of the New Mexico Restructuring Law as every other electric utility in New Mexico. On January 18, 2000, the New Mexico Commission issued an order granting the Company's request.

New Mexico Settlement Agreement. In July 1998, the Company entered into the New Mexico Settlement Agreement with certain parties, including the New Mexico Commission staff and the New Mexico Attorney General, but not Las Cruces. In September 1998, the New Mexico Commission issued an order adopting, with some modification, the New Mexico Settlement Agreement. The

New Mexico Settlement Agreement became effective on October 26, 1998 and provides for (i) a total annual jurisdictional base revenue reduction of $4.6 million; (ii) a 30-month moratorium on rate increases or decreases in New Mexico; (iii) the elimination of the need for future fuel reconciliations in New Mexico by incorporating the existing fixed fuel factor into base rates; (iv) an increased degree of ratemaking certainty for the future achieved by an agreement among the signatories reducing the net value of certain assets by approximately $56 million on a New Mexico jurisdictional basis for ratemaking purposes (but with no effect on book values), while establishing the signatories' agreement that the Company is entitled to 100% recovery of such revalued assets; and (v) the ability to enter into long-term rate contracts with commercial and industrial customers in New Mexico. Additionally, as a result of the New Mexico Settlement Agreement, the Company will contribute $0.4 million annually ($1.0 million over the term of the moratorium period) to a social services agency in Dona Ana County providing assistance to low-income individuals. Although the New Mexico Settlement Agreement was structured to allow recovery of previously underrecovered fuel balances, the order adopting the New Mexico Settlement Agreement does not support the recognition of this asset in the Company's financial statements under existing accounting standards. The Company wrote off the book value of undercollected fuel revenues in its New Mexico jurisdiction as of September 30, 1998, which amounted to $3.8 million, net of tax, although the Company believes that, based on current estimates of future fuel prices and operating costs, it will recover 100% of these amounts.

Fuel. Prior to the New Mexico Settlement Agreement, the Company was required to file annual reports reconciling the revenues collected under its New Mexico fixed fuel factor with its New Mexico fuel and purchased power expenses, along with the results of the application of Palo Verde performance standards. As a result of the New Mexico Settlement Agreement, outstanding fuel issues from filings in 1998 and 1997 were satisfactorily resolved with no disallowance of fuel and purchased power costs or the performance rewards, and the existing fixed fuel factor was incorporated into base rates.

Palo Verde Performance Standards. As a result of the New Mexico Settlement Agreement, the Palo Verde performance standards, which had been in place since 1986, were eliminated. Consequently, the Company is no longer entitled to a reward or exposed to a penalty in New Mexico resulting from the operations of Palo Verde. The performance standards report filed with the New Mexico Commission in January 1998 was the final such report and entitled the Company to a reward of $1.1 million.

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.

On December 15, 1999, the FERC approved its final rule ("Order 2000") on Regional Transmission Organizations ("RTOs"). Order 2000 strongly encourages, but does not require, public utilities to form and join RTOs. Order 2000 establishes (i) the minimum characteristics and functions an RTO must satisfy to obtain FERC acceptance; (ii) a collaborative process allowing public utilities and non-public utilities that own, operate or control interstate transmission facilities, consulting with state officials as appropriate, to consider and develop RTOs; (iii) a proposal to consider transmission ratemaking returns on a case-specific basis; (iv) opportunities for non-monetary regulatory benefits for RTOs, including deference in dispute resolution and streamlined filing and approval procedures; and

(v) a time line for public utilities to make appropriate filings with the FERC to initiate operation of RTOs. All public utilities that own, operate or control interstate transmission facilities must file, by October 15, 2000, either a proposal to participate in an RTO or an alternative filing describing efforts and plans to participate in an RTO. Order 2000 also proposes RTO startup by December 15, 2001.

The Company is an active participant in the development of the Desert Southwest Transmission and Reliability Operator ("Desert Star"). The Company believes Desert Star will qualify as an RTO under Order 2000. The Company intends, subject to the resolution of outstanding issues, to participate in Desert Star. As a participating transmission owner, the Company will transfer operations of its transmission system to Desert Star. The Company believes the Desert Star proposal will be submitted to the FERC by October 15, 2000. Desert Star is currently scheduled to become operational by January 1, 2002. If Desert Star fails to become operational, the Company intends to participate in another RTO similar to Desert Star.

In April 1996, the FERC issued its Order No. 888, requiring all public utilities owning, operating or controlling facilities used for transmitting electricity in interstate commerce to allow access to their transmission facilities under minimum terms and conditions of non-discriminatory service, including transmission service for their own new wholesale sales and purchases of electric energy. Additionally, Order No. 888 permits public utilities to seek recovery of legitimate, prudent and verifiable stranded costs and provides a mechanism for the recovery of such costs.

In April 1996, the FERC also issued Order No. 889, which requires all public utilities owning, operating or controlling facilities used for transmitting electricity in interstate commerce to develop and maintain an Open Access Same-Time Information System that will give existing and potential transmission users access to transmission-related information on a basis consistent with that available to a utility's employees engaged in the buying and selling of power. Order No. 889 further requires public utilities to separate their transmission and generation marketing functions and adopt standards of conduct ensuring that all open access transmission customers are treated in a non-discriminatory manner.

Pursuant to Order No. 888, the Company filed its non-discriminatory open access transmission tariffs with the FERC in July 1996. The Company reached a settlement with the various parties regarding rates for transmission and ancillary services under these tariffs. However, the settlement, which was filed with the FERC in March 1997 and approved by the FERC in June 1998, did not resolve issues that had been raised with respect to the manner in which the Company will determine the amount of transmission capacity that is available for use by third parties desiring to use its transmission system.

In May 1999, the FERC issued its opinion in a proceeding brought by SPS regarding the use of the Company's transmission system to serve Las Cruces, holding that once the Company's calculation of available transmission capacity was adjusted to reflect the assumed discontinuation of service to Las Cruces and CFE, the Company would have sufficient transmission capacity over the Eddy County tie to meet SPS' request for firm transmission service. Although the Company has filed a compliance filing as required by the FERC's order, the filing reflects that the Company does not have sufficient transmission capacity over the Eddy County tie to meet SPS' request for firm transmission service. The Company filed a motion for rehearing of the FERC's decision. The FERC has extended its time limit for ruling on this motion. The Company does not expect a material financial impact from this FERC

ruling. However, the Company is concerned that an adverse FERC ruling would result in impaired reliability of service to the Company's retail customers and increased costs. This case will not be automatically dismissed under the settlement agreement with Las Cruces because SPS, not Las Cruces, was the original complainant. Although the SPS complaint was based upon the creation of a Las Cruces municipal utility, the Company cannot predict whether the case will be dismissed as a result of its settlement with Las Cruces.

On February 24, 2000, the Company and Las Cruces entered into a settlement agreement ending Las Cruces' efforts to municipalize the Company's distribution system in Las Cruces. Under the terms of the settlement agreement, all existing litigation between the Company and Las Cruces, including all litigation pending before the FERC, will be dismissed. For a discussion of this settlement agreement, see Note I.

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. The DOE has determined that all such exports over international transmission lines shall be made in accordance with Order No. 888. The DOE is authorized to assess operators of nuclear generating facilities for a share of the costs of decommissioning the DOE's uranium enrichment facilities and for the ultimate costs of disposal of spent nuclear fuel. See Note C for discussion of spent fuel storage and disposal costs.

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. The NRC also has the authority to conduct environmental reviews pursuant to the National Environmental Policy Act.

Wholesale Customers

The Company provides IID with 100 MW of firm capacity and associated energy and 50 MW of system contingent capacity and associated energy pursuant to a 17-year agreement which expires April 30, 2002. The Company also provides TNP with up to 75 MW of firm power and associated energy pursuant to an agreement which expires December 31, 2002. The contract allows TNP to specify a maximum annual amount with one year's notice. TNP elected to receive up to 25 MW for 2000.

C. Palo Verde and Other Jointly-Owned Utility Plant

The Company owns a 15.8% interest in each of the three nuclear generating units and common facilities at Palo Verde. The Palo Verde Participants include the Company, five other utilities and Arizona Public Service Company ("APS"), which serves as operating agent for Palo Verde. The operation of Palo Verde and the relationship among the Palo Verde Participants is governed by the Arizona Nuclear Power Project Participation Agreement (the "ANPP Participation Agreement").

Other jointly-owned utility plant includes 7% of Units 4 and 5 at Four Corners Generating Station ("Four Corners") and certain other transmission facilities. A summary of the Company's investment in jointly-owned utility plant, excluding fuel, at December 31, 1999 and 1998 is as follows (In thousands):

	December 31, 1999		December 31, 1998	
	Palo Verde Station	Other	Palo Verde Station	Other
Electric plant in service	$ 594,755	$ 180,196	$ 602,061	$ 180,185
Accumulated depreciation	(88,004)	(55,526)	(64,595)	(40,959)
Construction work in progress	16,502	3,373	14,084	2,710

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 participant is required to fund its proportionate share of fuel, other operations, maintenance and capital costs, which, except capital costs, are included in the corresponding expense captions in the statements of operations. The Company's total monthly share of these costs was approximately $6.9 million in 1999. 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 and federal law, the Company must fund its share of the estimated costs to decommission Palo Verde Units 1, 2 and 3, including the Common Facilities, over their estimated useful lives of 40 years (to 2024, 2025 and 2027, respectively). The Company's funding requirements are determined periodically based upon engineering cost estimates performed by outside engineers retained by APS.

In December 1998, the Palo Verde Participants approved an updated decommissioning study. The 1998 study determined that the Company will have to fund approximately $280.5 million (stated in 1998 dollars) to cover its share of decommissioning costs. Cost estimates for decommissioning have increased with each study. The previous cost estimate from a 1995 study determined that the Company would have to fund approximately $229 million (stated in 1995 dollars). The 1998 estimate reflects a 22% increase from the 1995 estimate primarily due to increases in estimated costs for spent fuel storage after operations have ceased. See "Spent Fuel Storage" below.

Although the 1998 study was based on the latest available information, there can be no assurance that decommissioning cost estimates will not continue to increase in the future or that 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 are subject to significant uncertainty. The decommissioning study is updated every three years and a new study is expected to be completed in 2001. See "Disposal of Low-Level Radioactive Waste" below.

The Company will recover its current decommissioning cost estimates through its existing rates during the Freeze Period, and thereafter under the provisions of the Texas Restructuring Law. The rate freeze under the Texas Rate Stipulation and the rate reduction under the Texas Settlement Agreement

preclude the Company from seeking a rate increase in Texas to recover increases in decommissioning cost estimates during the Freeze Period. See Note B.

Prior to the start of competition in New Mexico, the Company will continue to collect 100% of its decommissioning cost estimates under the New Mexico Settlement Agreement. Under the New Mexico Restructuring Law, however, the New Mexico Commission could effectively reduce the Company's recovery of its decommissioning costs. See Note B.

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, 1999, the fair market value of the trust funds was approximately $57.1 million, which is reflected in the Company's balance sheet in deferred charges and other assets.

Steam Generators. Palo Verde has experienced degradation in the steam generator tubes of each unit. 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.

The projected service lives of the units' steam generators are reassessed by APS periodically in conjunction with inspections made during scheduled outages of the Palo Verde units. In 1997, the Palo Verde Participants unanimously approved the purchase of one set of spare steam generators for delivery in September 2002. In December 1999, the Palo Verde Participants unanimously approved installation of the new steam generators in Unit 2. The Company's portion of total costs associated with construction and installation of new steam generators in Unit 2, including replacement power costs, is currently estimated not to exceed $44 million. APS has also stated that, based on the latest available data, it estimates that the steam generators in Units 1 and 3 should operate for their designated lives of 40 years. However, APS is reassessing whether it is economically desirable to replace the steam generators in Units 1 and 3. Such replacements would also require the unanimous approval of the Palo Verde Participants.

The Texas Rate Stipulation precludes the Company from seeking a rate increase during the Freeze Period to recover additional capital costs associated with the replacement of steam generators. The Company cannot recover these costs through regulated rates in New Mexico since generation and power supply are currently scheduled to become a competitive function in January 2001 under the New Mexico Restructuring Law. Finally, the Company cannot assure that it will be able to recover these capital costs through its wholesale power rates or its competitive retail rates that become applicable after the start of competition. See also Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Overview."

Spent Fuel Storage. In June 1999, APS requested approval from the NRC to use more of the space in the existing spent fuel storage facilities at Palo Verde. The NRC approved this request on March 2, 2000. As a result, the spent fuel storage facilities will have sufficient capacity to store all fuel expected to be discharged from normal operation of all three Palo Verde units through 2003. Alternative on-site storage facilities are currently being constructed to supplement existing facilities. Spent fuel will be

removed from the original facilities as necessary and placed in special storage casks which will be stored at the new facilities until accepted by the DOE for permanent disposal. The alternative facilities will be built in stages to accommodate casks on an as needed basis and are expected to be available for use by the end of 2002.

Pursuant to the Nuclear Waste Policy Act of 1982, as amended in 1987 (the "Waste Act"), the DOE is legally obligated to accept and dispose of all spent nuclear fuel and other high-level radioactive wastes generated by all domestic power reactors. In accordance with the Waste Act, the DOE entered into a spent nuclear fuel contract with the Company and all other Palo Verde Participants. In November 1989, the DOE reported that its spent nuclear fuel disposal facilities would not be in operation until 2010. Subsequent judicial decisions required the DOE to start accepting spent nuclear fuel by January 31, 1998. The DOE did not meet that deadline, and the Company cannot currently predict when spent fuel shipments to the DOE's permanent disposal site will commence. The 1998 decommissioning study assumes that only 14 of 333 spent fuel casks will have been removed from Palo Verde by 2037 when title to the remaining spent fuel is assumed to be transferred to the DOE. In January 1997, the Texas Commission established a project to evaluate what, if any, action it should take with regard to payments made to the DOE for funding of the DOE's obligation to start accepting spent nuclear fuel by January 31, 1998. After receiving initial comments, no further action has been taken on the project.

In July 1998, APS filed, on behalf of all Palo Verde Participants, a petition for review with the United States Court of Appeals for the District of Columbia Circuit seeking confirmation that findings by the Circuit Court in a prior case brought by Northern States Power regarding the DOE's failure to comply with its obligation to begin accepting spent nuclear fuel would apply to all spent nuclear fuel contract holders. The Circuit Court held APS' petition in abeyance pending the United States Supreme Court's decision to review the Northern States Power case. In November 1998, the Supreme Court denied review of this case. The Circuit Court subsequently dismissed APS' petition after the Circuit Court issued clarifying orders essentially granting the relief sought by APS. APS is monitoring pending litigation between the DOE and other nuclear operators before initiating further legal proceedings or other procedural measures on behalf of the Palo Verde Participants to enforce the DOE's statutory and contractual obligations. The Company is unable to predict the outcome of these matters at this time.

The Company expects to incur significant spent fuel storage costs during the life of Palo Verde that it believes are the responsibility of the DOE. These costs will be expensed as incurred until an agreement is reached with the DOE for recovery of these costs. However, the Company cannot predict when, if ever, these additional costs will be recovered from the DOE.

Disposal of Low-Level Radioactive Waste. Congress has established requirements for the disposal by each state of low-level 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, and 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 extensive public hearings, disputes over environmental issues and review of technical issues related to the proposed site. Palo Verde is projected to undergo decommissioning during the period in which Arizona will act as host for the Southwestern Compact. However, the opposition, delays, uncertainty and costs experienced in

California demonstrate possible roadblocks that may be encountered 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. The insurance consists of $200 million of primary liability insurance provided by commercial insurance carriers, 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. Effective August 1998, the maximum assessment per reactor for each nuclear incident is approximately $90.7 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 $43.0 million for all three units with an annual payment limitation of approximately $4.7 million.

The Palo Verde Participants maintain "all risk" (including nuclear hazards) insurance for damage to, and decontamination of, property at Palo Verde in the aggregate amount of $2.75 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 an accidental outage of any of the three Palo Verde units if the outage exceeds 12 weeks.

Coal Reclamation. In 1999, upon final review of a study conducted by an outside engineering firm, the Company reduced its estimated final reclamation and coal mine closure liability related to the Company's interest in Four Corners from $14.8 million to $8.2 million. The $6.6 million adjustment was recorded as a reduction of energy expenses in the fourth quarter of 1999.

D. Common Stock

Overview

The Company's common stock has a stated value of $1 per share, with no cumulative voting rights or preemptive rights. Holders of the common stock have the right to elect the Company's directors and to vote on other matters.

Prior to September 1999, the Company's First and Second Supplemental Indentures restricted the Company's ability to pay dividends on its common stock. So long as the Company's First Mortgage Bonds are outstanding and the series with the longest maturity was not rated "investment grade" by either Standard & Poor's Rating Service ("S&P") or Moody's Investors Service, Inc. ("Moody's"), the Company was significantly limited in its ability to declare any dividend on the common stock, other than in additional shares of common stock. The Company's First Mortgage Bonds were upgraded to investment grade by S&P in September 1999 and by Moody's in November 1999.

1996 and 1999 Long-Term Incentive Plans

The 1996 Long-Term Incentive Plan (the "1996 Plan") authorized the issuance of up to 3,500,000 shares of common stock for the benefit of officers, key employees and non-employee directors

through the award or grant of non-statutory stock options, incentive stock options, stock appreciation rights, restricted stock, bonus stock and performance stock.

In May 1999, the Company's shareholders approved the adoption of a stock-based long-term incentive plan (the "1999 Plan"). Under the 1999 Plan, directors, officers, managers, other employees and consultants are eligible to receive non-statutory stock options, incentive stock options, stock appreciation rights, restricted stock, bonus stock and performance shares covering up to two million shares of common stock. In July 1999, the Company filed its Registration Statement on Form S-8 registering the two million shares of common stock reserved for issuance under the 1999 Plan. In August 1999, the FERC approved the issuance of shares under the 1999 Plan.

Stock Options. Stock options have been granted at prices equal to or greater than the market value of the shares at the date of grant. The options expire ten years from the date of grant unless terminated earlier by the Board of Directors. The following table summarizes the transactions of the Company's stock options for 1999, 1998 and 1997:

	Number of Shares	Weighted Average Exercise Price
Unexercised options outstanding at December 31, 1996 ...	1,900,000	$ 5.69
Options granted	55,000	6.56
Options exercised	–	–
Options forfeited	(5,000)	6.56
Unexercised options outstanding at December 31, 1997 ...	1,950,000	5.71
Options granted	585,000	7.71
Options exercised	–	–
Options forfeited	–	–
Unexercised options outstanding at December 31, 1998 ...	2,535,000	6.17
Options granted	255,644	8.24
Options exercised	–	–
Options forfeited	–	–
Unexercised options outstanding at December 31, 1999 ...	2,790,644	6.16

Stock option awards provide for vesting periods of up to five years. Stock options outstanding at December 31, 1999 are as follows:

Exercise Price	Number Outstanding	Remaining Life, In Years	Number Exercisable
$ 5.32	800,000	6.3	640,000
5.56	800,000	6.4	560,000
6.56	50,000	7.3	50,000
7.00	300,000	6.4	300,000
7.50	525,000	8.0	105,000
9.50	60,000	8.4	60,000
8.75	100,000	9.0	–
7.38	50,000	9.3	50,000
8.13	100,000	9.0	–
8.94	2,703	9.6	2,703
9.00	2,941	9.9	2,941
	2,790,644		1,770,644

The Company has adopted the disclosure-only provisions of SFAS No. 123. Accordingly, because the stock option grants had no intrinsic value at the measurement date, no compensation expense has been recognized. Had compensation expense for the plan been determined based on the fair value at the grant date, consistent with the provisions of SFAS No. 123, the Company's net earnings and earnings per share would have been reduced to the pro forma amounts presented below:

	Years Ended December 31,		
	1999	1998	1997
Net income applicable to common stock (In thousands):			
As reported	$ 28,276	$ 45,709	$ 38,649
Pro forma	27,380	44,913	38,093
Basic earnings per share:			
As reported	0.476	0.760	0.643
Pro forma	0.461	0.746	0.634
Diluted earnings per share:			
As reported	0.473	0.754	0.639
Pro forma	0.458	0.742	0.630

The fair value for these options was estimated at the grant date using the Black-Scholes option pricing model. Weighted average assumptions and grant-date fair value for 1999, 1998 and 1997 are presented below:

	1999	1998	1997
Risk-free interest rate	5.01%	5.82%	6.76%
Expected life, in years	10	10	10
Expected volatility	33.98%	7.47%	10.86%
Expected dividend yield	–	–	–
Fair value	$4.58	$2.97	$3.24

Restricted Stock. The Company has awarded vested and unvested restricted stock awards under the 1996 Plan. Restrictions from resale generally lapse, and unvested awards vest, over periods of four to five years. The market value of the restricted stock at the time of grant is recorded as unearned compensation as a separate component of common stock equity and is amortized to expense over the restriction period. During 1999, 1998 and 1997, approximately $1.2 million, $0.5 million and $0.5 million, respectively, related to restricted stock awards was charged to expense. The following table summarizes the vested and unvested restricted stock awards for 1999, 1998 and 1997:

	Vested	Unvested	Total
Restricted shares outstanding at December 31, 1996	80,000	100,000	180,000
Restricted stock awards	47,440	36,815	84,255
Lapsed restrictions and vesting	(40,488)	(27,363)	(67,851)
Restricted shares outstanding at December 31, 1997	86,952	109,452	196,404
Restricted stock awards	–	26,675	26,675
Lapsed restrictions and vesting	(40,488)	(32,698)	(73,186)
Forfeitures	–	(1,908)	(1,908)
Restricted shares outstanding at December 31, 1998	46,464	101,521	147,985
Restricted stock awards	94,619	116,125	210,744
Lapsed restrictions and vesting	(40,488)	(58,021)	(98,509)
Forfeitures	–	(1,432)	(1,432)
Restricted shares outstanding at December 31, 1999	100,595	158,193	258,788

The holder of a restricted stock award has rights as a shareholder of the Company, including the right to vote and, if applicable, receive cash dividends on restricted stock, except that certain restricted stock awards require any cash dividend on restricted stock to be delivered to the Company in exchange for additional shares of restricted stock of equivalent market value.

Common Stock Repurchase Program

In May 1999, the Company's Board of Directors approved a stock repurchase program allowing the Company to purchase outstanding shares of its common stock from time to time, up to a total of six million shares. The Company will make purchases primarily in the open market at prevailing prices and will also engage in private transactions, if appropriate. The shares that the Company acquires will be available for issuance under employee benefit and stock option plans or may be retired. As of

December 31, 1999, the Company had repurchased 3,169,289 shares of common stock at a cost of approximately $28.7 million, including commissions.

Reconciliation of Basic and Diluted Earnings Per Common Share

The reconciliation of basic and diluted earnings per common share before extraordinary items is presented below:

	Year Ended December 31, 1999		
	Income (In thousands)	Shares	Per Common Share
Income before extraordinary item	$ 43,809		
Less:			
Preferred stock:			
Dividend requirements	2,616		
Redemption costs	9,581		
Basic earnings per common share:			
Net income applicable to common stock	31,612	59,349,468	$ 0.533
Effect of dilutive securities:			
Unvested restricted stock	–	32,729	
Stock options	–	349,452	
Diluted earnings per common share:			
Net income applicable to common stock	$ 31,612	59,731,649	$ 0.529

	Year Ended December 31, 1998		
	Income (In thousands)	Shares	Per Common Share
Income before extraordinary item	$ 57,073		
Less: Preferred stock dividend requirements	14,707		
Basic earnings per common share:			
Net income applicable to common stock	42,366	60,168,234	$ 0.704
Effect of dilutive securities:			
Unvested restricted stock	–	30,309	
Stock options	–	434,755	
Diluted earnings per common share:			
Net income applicable to common stock	$ 42,366	60,633,298	$ 0.699

	Year Ended December 31, 1997		
	Income (In thousands)	Shares	Per Common Share
Income before extraordinary item	$ 54,568		
Less: Preferred stock dividend requirements	13,144		
Basic earnings per common share:			
Net income applicable to common stock	41,424	60,128,505	$ 0.689
Effect of dilutive securities:			
Unvested restricted stock	–	16,041	
Stock options	–	293,086	
Diluted earnings per common share:			
Net income applicable to common stock	$ 41,424	60,437,632	$ 0.685

Options that were excluded from the computation of diluted earnings per common share because the options' exercise price was greater than the average market price of the common shares for the period are listed below:

1) 300,000 options granted June 11, 1996 at an exercise price of $7.00 were excluded for the second through fourth quarters of 1997.
2) 525,000 options granted January 2, 1998 at an exercise price of $7.50 were excluded for the first quarter of 1998.
3) 60,000 options granted May 29, 1998 at an exercise price of $9.50 were excluded for the second through fourth quarters of 1998 and all of 1999.
4) 100,000 options granted January 11, 1999 at an exercise price of $8.75 were excluded for the first and second quarters of 1999.

E. Preferred Stock

In March 1999, after obtaining required consents of holders of certain of the Company's outstanding debt securities, the Company redeemed its Series A Preferred Stock. The Company paid the redemption price of approximately $139.6 million, accrued cash dividends of $1.3 million, and premium, fees and costs of securing the consents aggregating $9.6 million. The preferred stock had an annual dividend rate of 11.40%.

Following is a summary of the changes in the preferred stock for 1999, 1998 and 1997:

	Shares	Amount (In thousands)
Balance at December 31, 1996	1,084,264	$ 108,426
Issuance of dividends	128,924	12,893
Balance at December 31, 1997	1,213,188	121,319
Issuance of dividends	144,256	14,425
Balance at December 31, 1998	1,357,444	135,744
Issuance of dividends	38,670	3,867
Redemption of preferred stock	(1,396,114)	(139,611)
Balance at December 31, 1999	–	$ –

F. Long-Term Debt and Financing and Capital Lease Obligations

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

	December 31, 1999	December 31, 1998
	(In thousands)	
Long-Term Debt:		
First Mortgage Bonds (1):		
7.25% Series A, issued 1996, due 1999	$ –	$ 36,034
7.75% Series B, issued 1996, due 2001	38,571	62,698
8.25% Series C, issued 1996, due 2003	94,505	119,292
8.90% Series D, issued 1996, due 2006	211,402	223,132
9.40% Series E, issued 1996, due 2011	250,498	273,398
Pollution Control Bonds (2):		
Secured by First Mortgage Collateral Series Bonds:		
Variable rate bonds, due 2014	63,500	63,500
Variable rate refunding bonds, due 2013	33,300	33,300
Variable rate refunding bonds, due 2014	37,100	37,100
Variable rate refunding bonds, due 2015	59,235	59,235
Promissory note, due 2007 ($93,000 due in 2000) (3)	558	646
Total long-term debt	788,669	908,335
Financing and Capital Lease Obligations:		
Nuclear fuel ($25,261,000 due in 2000) (4)	48,292	49,316
Turbine lease ($1,688,000 due in 2000) (5)	1,688	3,228
Total financing and capital lease obligations	49,980	52,544
Total long-term debt and financing and capital lease obligations	838,649	960,879
Current maturities (amount due within one year)	(27,042)	(63,817)
	$ 811,607	$ 897,062

(1) First Mortgage Bonds

Substantially all of the Company's utility plant is subject to liens under the First Mortgage Indenture.

The First Mortgage Indenture imposes certain limitations on the ability of the Company to (i) declare or pay dividends on common stock; (ii) incur additional indebtedness or liens on mortgaged property; and (iii) enter into a consolidation, merger or sale of assets.

The Company repaid the remaining $36.0 million of Series A bonds at their maturity on February 1, 1999. The Series B, C and D bonds may not be redeemed by the Company prior to maturity. The Series E bonds may be redeemed at the option of the Company, in whole or in part, on or after February 1, 2006. The Company is not required to make mandatory redemption or sinking fund payments with respect to the bonds prior to maturity.

Repurchases of First Mortgage Bonds made during 1999, 1998 and 1997 are as follows (In thousands):

	Years Ended December 31,		
	1999	1998	1997
7.25% Series A	$ –	$ 30,227	$ 12,005
7.75% Series B	24,127	–	16,073
8.25% Series C	24,787	–	29,697
8.90% Series D	11,730	–	12,825
9.40% Series E	22,900	–	12,502
Total	$ 83,544	$ 30,227	$ 83,102

(2) Pollution Control Bonds

The Company has four series of tax exempt Pollution Control Bonds in an aggregate principal amount of approximately $193.1 million. The average effective annual interest rate on the bonds is calculated to be 6.17% at December 31, 1999. The bonds may be required to be repurchased at the holder's option or are subject to mandatory redemption upon the occurrence of certain events, and are redeemable at the option of the Company under certain circumstances. Each of the tax exempt issues is enhanced by a letter of credit. The Company's obligation to the issuing banks pursuant to the letter of credit reimbursement agreements are secured by First Mortgage Collateral Series Bonds (the "Collateral Series Bonds") issued pursuant to the First Mortgage Indenture in the amount of the letters of credit.

(3) Promissory Note

The note has an annual interest rate of 5.5% and is secured by certain furniture and fixtures.

(4) Nuclear Fuel Financing

The Company has available a $100 million credit facility that provides for up to $70 million for the financing of nuclear fuel and up to $50 million, depending on the balance of nuclear fuel financings, for working capital. This financing is accomplished through a trust that borrows under the facility to acquire and process the nuclear fuel. The Company is obligated to repay the trust's borrowings with interest, and has secured this obligation with the Collateral Series Bonds. In the Company's financial statements, the assets and liabilities of the trust are reported as assets and liabilities of the Company.

(5) Copper Turbine Lease Obligation

The Company leases a turbine and certain other related equipment under a lease which is currently accounted for as a capital lease and expires in July 2000. Semiannual lease payments, including interest, are approximately $0.9 million through July 2000. The effective annual interest rate implicit in this lease is calculated to be 9.6%. The Company has renewed the lease through July 2005, with an extension option for two additional years. The renewal lease will be accounted for as an operating lease as of the effective date of the lease renewal and requires semiannual lease payments of approximately $0.4 million.

The letter of credit reimbursement agreements which enhance the Company's Pollution Control Bonds and the $100 million credit facility require compliance with certain total debt and interest coverage ratios. The Company maintained the required compliance throughout 1999.

As of December 31, 1999, the scheduled maturities for the next five years of long-term debt and financing and capital lease obligations are as follows (In thousands):

2000	$ 27,042
2001	61,701
2002	104
2003	94,615
2004	116

The table above does not reflect future obligations and maturities related to nuclear fuel purchase commitments.

G. Income Taxes

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at December 31, 1999 and 1998 are presented below (In thousands):

	December 31,	
	1999	1998
Deferred tax assets:		
Benefits of tax loss carryforwards	$ 137,752	$ 171,977
Pensions and benefits	45,341	45,380
Decommissioning	29,642	25,800
Investment tax credit carryforward	20,410	20,410
Alternative minimum tax credit carryforward	16,776	14,719
Reorganization expenses financed with bonds	9,247	15,777
Capital leases	2,015	2,349
Other (including state deferred taxes)	17,008	14,898
Total gross deferred tax assets	278,191	311,310
Less valuation allowance:		
Federal	12,661	12,661
State	15,659	16,314
Total valuation allowance	28,320	28,975
Net deferred tax assets	249,871	282,335
Deferred tax liabilities:		
Plant, principally due to depreciation and basis differences	(256,701)	(264,175)
Other	(5,673)	(7,642)
Total gross deferred tax liabilities	(262,374)	(271,817)
Net accumulated deferred income taxes	$ (12,503)	$ 10,518

The deferred tax asset valuation allowance decreased by $0.7 million, $0.8 million and $0.8 million in 1999, 1998 and 1997, respectively. These decreases were due to a reduction of unused state net operating loss ("NOL") carryforward benefits, which had valuation allowances recorded against them. Based on the average annual book income before taxes for the prior three years, excluding the effects of extraordinary and unusual or infrequent items, the Company believes that the net deferred tax assets will be fully realized at current levels of book and taxable income. Approximately $26.8 million of the Company's valuation allowance at December 31, 1999, if subsequently recognized as a tax benefit, would be credited directly to capital in excess of stated value in accordance with SOP 90-7.

The Company recognized income taxes as follows (In thousands):

	Years Ended December 31,		
	1999	1998	1997
Income tax expense:			
Federal:			
Current	$ 2,142	$ 2,884	$ 2,382
Deferred	20,415	27,412	28,087
Total federal income tax from operations	22,557	30,296	30,469
Deferred included in extraordinary items	(1,796)	1,800	(1,494)
Total federal income tax expense	$ 20,761	$ 32,096	$ 28,975
State:			
Deferred	$ 3,075	$ 4,442	$ 4,307
Deferred included in extraordinary items	(331)	344	–
Total state income tax expense	$ 2,744	$ 4,786	$ 4,307

The current federal income tax expense for 1999, 1998 and 1997 results primarily from the accrual of alternative minimum tax ("AMT"). Deferred federal income tax includes an offsetting AMT benefit of $2.1 million, $2.8 million and $2.4 million for 1999, 1998 and 1997, respectively.

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

	Years Ended December 31,		
	1999	1998	1997
Federal income tax expense computed on income at statutory rate	$ 21,432	$ 32,379	$ 28,269
Difference due to:			
Adjustment to cash value of Company-owned life insurance policies	(608)	–	–
Other	(63)	(283)	706
Total federal income tax expense	$ 20,761	$ 32,096	$ 28,975
Effective federal income tax rate	33.9%	34.7%	35.9%

As of December 31, 1999, the Company had $393.6 million of federal tax NOL carryforwards, $20.4 million of investment tax credit ("ITC") carryforwards and $16.8 million of AMT credit carryforwards. If unused, the NOL carryforwards would expire at the end of 2011, the ITC carryforwards would expire in 2001 through 2005, and the AMT credit carryforwards have an unlimited life. The Company had $367.1 million of state NOL carryforwards which, if unused, would expire at the end of 2001. These tax attributes are subject to audit by the Internal Revenue Service ("IRS"). The IRS is in the preliminary stages of its examination of the carryforwards and the 1996 through 1998 federal income tax returns. The differences between book and taxable income were primarily due to depreciation, plant basis differences and deferred fuel costs.

H. Commitments and Contingencies

Sale/Leaseback Indemnification Obligations

Pursuant to the Palo Verde sale/leaseback participation agreements and leases, if the lessors incur additional tax liability or other loss as a result of federal or state tax assessments related to the sale/leaseback transactions, the lessors may have claims against the Company for indemnification.

One of the lessors in the sale/leaseback transactions related to Unit 2 of Palo Verde notified the Company that the IRS raised issues, primarily related to ITC claims by the lessor, regarding the income tax treatment of the sale/leaseback transactions. Although the Company believes the lessor has meritorious defenses to the IRS' position, the Company cannot predict the outcome of this matter. The lessor has advised the Company that it held several meetings with the IRS in 1999 and anticipates a final report from the IRS in which these issues will be favorably resolved.

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 $10.0 million, exclusive of any applicable interest, if the IRS prevails. 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. Substantial expenditures may be required to comply with these regulations. The Company analyzes the costs of its obligations arising from environmental matters on an ongoing basis, and management believes it has made adequate provision in its financial statements to meet such obligations. However, unforeseen expenses associated with compliance could have a material adverse effect on the future operations and financial condition of the Company.

I. Litigation

Litigation with Las Cruces

On February 24, 2000, the Company and Las Cruces entered into a settlement agreement ending Las Cruces' efforts to municipalize the Company's distribution assets and other facilities used to provide electric service to customers in Las Cruces. Under the settlement agreement the Company will pay Las Cruces a one-time lump sum payment of up to $21 million, $16.5 million of which was expensed in the fourth quarter of 1999. The remaining $4.5 million relates to the transfer of Las Cruces' West Mesa Substation and related facilities to the Company. Las Cruces must substantiate the costs of building the West Mesa Substation and related transmission and distribution facilities, subject to a dollar for dollar offset against the $4.5 million purchase price for any amounts not substantiated.

The settlement agreement also provides for Las Cruces and the Company to enter into a seven-year franchise agreement with a 2% annual franchise fee (approximately $0.8 million per year currently) for the provision of electric distribution service. Las Cruces is prohibited during this seven-year period from taking any action to condemn or otherwise attempt to acquire the Company's distribution system, or attempt to operate or build its own electric distribution system. Las Cruces will have a 90-day non-assignable option at the end of the Company's seven-year franchise agreement to purchase the portion of the Company's distribution system that serves Las Cruces at a purchase price of 130% of the Company's book value at that time. If Las Cruces exercises this option, it is prohibited from reselling the distribution assets for two years. If Las Cruces fails to exercise this option, the franchise and standstill agreements will be extended for an additional two years.

Las Cruces also agreed that it will not contest the calculation of the Company's stranded costs in New Mexico, provided the stranded costs charged to Las Cruces customers do not exceed $52.9 million declining over time, which is the amount initially ordered by the FERC in the Las Cruces stranded cost proceeding. Las Cruces also agreed to assign all of its existing customer contracts to the Company.

Under the terms of the settlement agreement, all existing litigation between the Company and Las Cruces, including all litigation pending before the FERC and the Federal District Court of New Mexico, will be dismissed. The Company and Las Cruces are finalizing the written settlement agreement and obtaining final approvals. The Company anticipates signing a definitive agreement by the end of the first quarter of 2000.

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. In October 1995, the Navajo Nation and the Four Corners participants agreed to stay the proceedings indefinitely so the parties may attempt to resolve the dispute without litigation. This matter remains inactive and the Company is unable to predict the outcome of this case.

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. An agreement reached with the Navajo Nation in 1985 provides that if Four Corners loses a portion of its water rights in the adjudication, the tribe will provide sufficient water from its

allocation to offset the loss. The case has been inactive for many years and the Company is unable to predict the outcome of this case.

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 this action. APS, as operating agent, filed claims that dispute the Court's jurisdiction over the Palo Verde Participants' groundwater rights and their contractual rights to effluent relating to Palo Verde and, alternatively, seek confirmation of such rights. In November 1999, the Arizona Supreme Court issued a decision confirming that certain groundwater rights may be available to the federal government and Indian tribes. APS and other parties have petitioned the United States Supreme Court for review of this decision. The Company is unable to predict the outcome of this case.

Other Legal Proceedings

The Company is a party to various other claims, legal actions and complaints. In many of these matters, the Company has excess casualty liability insurance which is applicable. Based upon a review of these claims and applicable insurance coverage, the Company believes that none of these claims will have a material adverse effect on the financial position, results of operations and cash flows of the Company.

J. Employee Benefits

Retirement Plans

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 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 Non-Qualified Retirement Income Plan is a non-funded defined benefit plan which covers certain former employees of the Company. During 1996, as part of the Company's reorganization, the Company terminated the Non-Qualified Retirement Income Plan with respect to all active employees. The benefit cost for the Non-Qualified Retirement Income Plan is based on substantially the same actuarial methods and economic assumptions as those used for the Retirement Plan.

The Company accounts for the Retirement Plan and the Non-Qualified Retirement Income Plan under SFAS No. 87, "Employers' Accounting for Pensions," ("SFAS No. 87"). In accordance with SFAS No. 87, the 2000 net periodic benefit cost will include amortization of the unrecognized net gain which exceeded 10% of the benefit obligation at the beginning of the year. The amortization will reflect the excess divided by the average remaining service period of active employees expected to receive benefits. In 1998, the Company adopted SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," ("SFAS No. 132") which supercedes the disclosure requirements of SFAS No. 87.

The amounts recognized in the Company's balance sheets and the funded status of the plans at December 31, 1999 and 1998 are presented below (In thousands):

	Years Ended December 31,			
	1999		1998	
	Retirement Income Plan	Non-Qualified Retirement Income Plan	Retirement Income Plan	Non-Qualified Retirement Income Plan
Change in benefit obligation:				
Benefit obligation at beginning of year	$ (94,140)	$ (19,495)	$ (83,812)	$ (19,324)
Service cost	(3,155)	–	(2,879)	–
Interest cost	(6,295)	(1,271)	(5,861)	(1,304)
Actuarial gain (loss)	12,517 (1)	1,366	(4,796)	(559)
Benefits paid	3,346	1,687	3,208	1,692
Benefit obligation at end of year	(87,727)	(17,713)	(94,140)	(19,495)
Change in fair value of plan assets:				
Fair value of plan assets at beginning of year	79,629	–	74,114	–
Actual return on plan assets	7,050	–	5,603	–
Employer contribution	3,120	1,687	3,120	1,692
Benefits paid	(3,346)	(1,687)	(3,208)	(1,692)
Fair value of plan assets at end of year	86,453	–	79,629	–
Funded status	(1,274)	(17,713)	(14,511)	(19,495)
Unrecognized net (gain) loss	(12,844)	(645)	126	559
Balance of additional liability	–	–	–	(559)
Accrued benefit liability	$ (14,118)	$ (18,358)	$ (14,385)	$ (19,495)

(1) Represents a change in actuarial assumptions due to revised census data.

Weighted average actuarial assumptions used in determining the actuarial present value of the benefit obligations are as follows:

	1999		1998	
	Retirement Income Plan	Non-Qualified Retirement Income Plan	Retirement Income Plan	Non-Qualified Retirement Income Plan
Discount rate	7.75%	7.75%	6.75%	6.75%
Expected return on plan assets	8.50%	N/A	8.50%	N/A
Rate of compensation increase	5.00%	N/A	5.00%	N/A

Net periodic benefit cost is made up of the components listed below as determined using the projected unit credit actuarial cost method (In thousands):

	Years Ended December 31,		
	1999	1998	1997
Components of net periodic benefit cost:			
Service cost	$ 3,155	$ 2,879	$ 2,402
Interest cost	7,566	7,165	6,737
Expected return on plan assets	(6,597)	(5,820)	(5,094)
Net periodic benefit cost	$ 4,124	$ 4,224	$ 4,045

Weighted average actuarial assumptions used in determining the net periodic benefit costs are as follows:

	1999	1998	1997
Discount rate	6.75%	7.00%	7.50%
Expected return on plan assets	8.50%	8.50%	8.50%
Rate of compensation increase	5.00%	5.00%	5.00%

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. Those benefits are accounted for under SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," ("SFAS No. 106"). In 1998, the Company adopted SFAS No. 132 which supercedes the disclosure requirements of SFAS No. 106. In accordance with SFAS No. 106, the 1999 net periodic benefit cost includes amortization of the unrecognized net gain arising in 1999 which exceeded 10% of the benefit obligation at the beginning of the year. The amortization reflects the excess divided by the average remaining service period of active employees expected to receive benefits. Contributions from the Company are based on the funding amounts required by the Texas Commission in the Texas Rate Stipulation. The assets of the Other Postretirement Benefits Plan are invested in fixed income instruments and cash equivalents and are managed by professional investment managers appointed by the Company.

The amounts recognized in the Company's balance sheets and the funded status of the plan at December 31, 1999 and 1998 are presented below (In thousands):

	December 31,	
	1999	1998
Change in benefit obligation:		
Benefit obligation at beginning of year	$ (94,658)	$ (83,973)
Service cost	(2,226)	(2,818)
Interest cost	(3,994)	(5,822)
Actuarial gain (loss)	45,314 (1)	(3,438)
Retirees' contributions	(215)	(202)
Benefits paid	1,833	1,595
Benefit obligation at end of year	(53,946)	(94,658)
Change in fair value of plan assets:		
Fair value of plan assets at beginning of year	11,254	8,822
Actual return on plan assets	467	403
Employer contribution	3,422	3,422
Retirees' contributions	215	202
Benefits paid	(1,833)	(1,595)
Fair value of plan assets at end of year	13,525	11,254
Funded status	(40,421)	(83,404)
Unrecognized net (gain) loss	(40,755)	2,927
Accrued benefit liability	$ (81,176)	$ (80,477)

(1) Represents a change in actuarial assumptions due to (i) a change in Medicare credits; (ii) revised census data; and (iii) prior experience benefit.

Net periodic benefit cost is made up of the components listed below (In thousands):

	Years Ended December 31,		
	1999	1998	1997
Components of net periodic benefit cost:			
Service cost	$ 2,226	$ 2,818	$ 2,538
Interest cost	3,994	5,822	5,254
Expected return on plan assets	(381)	(271)	(250)
Amortization of unrecognized gain	(1,719)	–	(7)
Net periodic benefit cost	$ 4,120	$ 8,369	$ 7,535

Weighted average assumptions are as follows:

	1999	1998	1997
Discount rate	7.75%	6.75%	7.00%
Expected return on plan assets	4.50%	4.50%	4.50%
Rate of compensation increase	5.00%	5.00%	5.00%

For measurement purposes, a 9.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 1999; the rate was assumed to decrease gradually to 6% for 2004 and remain at that level thereafter. Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. The effect of a 1% change in these assumed health care cost trend rates would increase or decrease the benefit obligation by $6.8 million or $6.0 million, respectively. In addition, such a 1% change would increase or decrease the aggregate service and interest cost components of net periodic benefit cost by $1.0 million or $0.8 million, respectively.

All Employee Cash Bonus Plan

The All Employee Cash Bonus Plan (the "Bonus Plan"), introduced in early 1997, was established to reward employees for their contribution in helping the Company attain its corporate goals. Eligible employees below manager level would receive a cash bonus if the Company attained established levels of safety, customer satisfaction and cash flow during 1999. The cash flow goal had to be met before any bonus amounts would be paid and improvement in cash flow must be greater than any bonus amounts paid. The Company was able to surpass the required minimum levels of improvement in all of the performance measures. As a result of the Company's success, the Company distributed approximately $4.5 million in cash bonuses, which were expensed in 1999, to all eligible employees in March 2000. The Company has renewed the Bonus Plan in 2000 with similar goals.

K. 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. The franchise with the City of El Paso extends through August 1, 2005.

Las Cruces Franchise

The Company's franchise with Las Cruces expired in March 1994. The Company has, however, continued to provide electric service to customers within Las Cruces, pending resolution of a dispute with Las Cruces over its efforts to condemn a portion of the Company's distribution assets and related facilities. On February 24, 2000, the Company entered into a settlement agreement with Las Cruces which, among other things, provides for a new seven-year franchise agreement. See Note I for futher discussion.

Military Installations

The Company currently serves Holloman Air Force Base ("Holloman"), White Sands Missile Range ("White Sands") and the United States Army Air Defense Center at Fort Bliss ("Ft. Bliss"). The Company's sales to the military bases represent approximately 3% of annual operating revenues. The Company currently has long-term contracts with all three military bases that it serves. The Company signed a contract with Ft. Bliss in December 1998, under which Ft. Bliss will take service from the Company through December 2008. The Company has a contract to provide retail electric service to Holloman for a ten-year term which began in December 1995. In May 1999, the Army and the Company entered into a new ten-year contract to provide retail electric service to White Sands.

L. 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, decommissioning trust funds, long-term debt and financing obligations, accounts payable, litigation settlement payable and customer deposits 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.

The fair values of the Company's long-term debt and financing obligations, including the current portion thereof, are based on estimated market prices for similar issues at December 31, 1999 and 1998 and are presented in the table below (In thousands):

	1999		1998	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
First Mortgage Bonds (1)	$ 594,976	$ 607,517	$ 714,554	$ 810,258
Pollution Control Bonds (2)	193,135	193,135	193,135	193,135
Nuclear Fuel Financing(1)(3)	48,292	48,292	49,316	49,316
Total	$ 836,403	$ 848,944	$ 957,005	$ 1,052,709

(1) Includes current maturities.
(2) The interest rate on the Company's pollution control bonds is reset weekly to reflect current market rates. Consequently, the carrying value approximates fair value.
(3) The interest rate on the Company's financing for nuclear fuel purchases is reset every quarter to reflect current market rates. Consequently, the carrying value approximates fair value.

EL PASO ELECTRIC COMPANY

NOTES TO FINANCIAL STATEMENTS

M. Selected Quarterly Financial Data (Unaudited)

	1999 Quarters				1998 Quarters			
	4th[1]	3rd	2nd	1st	4th[2]	3rd	2nd	1st
	(In thousands except for share data)							
Operating revenues	$137,409	$170,341	$133,167	$129,552	$141,769	$177,471	$146,026	$136,557
Operating income	36,426	59,790	28,446	32,674	28,334	58,286	39,780	33,317
Income before extraordinary items	1,075	26,224	7,048	9,462	6,814	26,049	13,695	10,515
Extraordinary loss on repurchases of debt, net of income tax benefit	(85)	(2,068)	(1,183)	–	–	–	–	–
Extraordinary gain on discharge of debt, net of income tax expense	–	–	–	–	3,343	–	–	–
Net income (loss) applicable to common stock	990	24,156	5,855	(2,725)	6,324	22,322	10,071	6,992
Basic earnings (loss) per common share:								
Income (loss) before extraordinary items	0.019	0.443	0.117	(0.045)	0.049	0.371	0.167	0.116
Extraordinary loss on repurchases of debt, net of income tax benefit	(0.002)	(0.035)	(0.020)	–	–	–	–	–
Extraordinary gain on discharge of debt, net of income tax expense	–	–	–	–	0.056	–	–	–
Net income (loss)	0.017	0.408	0.097	(0.045)	0.105	0.371	0.167	0.116
Diluted earnings (loss) per common share:								
Income (loss) before extraordinary items	0.018	0.439	0.116	(0.045)	0.049	0.368	0.166	0.116
Extraordinary loss on repurchases of debt, net of income tax benefit	(0.001)	(0.034)	(0.019)	–	–	–	–	–
Extraordinary gain on discharge of debt, net of income tax expense	–	–	–	–	0.055	–	–	–
Net income (loss)	0.017	0.405	0.097	(0.045)	0.104	0.368	0.166	0.116

(1) Includes an accrued loss pursuant to the settlement agreement with Las Cruces, a coal mine reclamation adjustment, an all employee bonus, the write-off of capitalized interest on postload nuclear fuel and a sales tax liability adjustment, which resulted in an aggregate decrease in net earnings applicable to common stock of approximately $9.3 million, net of income tax benefit, or $0.16 diluted loss per common share.

(2) Includes an all employee bonus of approximately $3.1 million, net of income tax benefit, or $0.05 diluted loss per common share.

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

Not applicable.

PART III and PART IV

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