

# OFFICIAL STATEMENT

DATED: October 28, 2010

Fitch AA+  
Moody's Aa2  
S&P AA-

## NEW ISSUES – BOOK-ENTRY-ONLY SYSTEM

RATINGS: See "RATINGS" herein

Interest on the Bonds (defined below) is not excludable from gross income under section 103 of the Code (defined herein) for federal income tax purposes. See "FEDERAL TAX TREATMENT OF BONDS" herein.



**\$300,000,000**  
**CITY OF SAN ANTONIO, TEXAS**  
**ELECTRIC AND GAS SYSTEMS**  
**JUNIOR LIEN REVENUE BONDS,**  
**TAXABLE SERIES 2010A**  
**(DIRECT SUBSIDY - BUILD AMERICA BONDS)**

AND

**\$200,000,000**  
**CITY OF SAN ANTONIO, TEXAS**  
**ELECTRIC AND GAS SYSTEMS**  
**JUNIOR LIEN REVENUE REFUNDING BONDS,**  
**TAXABLE SERIES 2010B**  
**(DIRECT SUBSIDY - BUILD AMERICA BONDS)**

Dated: October 1, 2010 (Interest to accrue from the Closing Date)

Due: February 1, as shown herein

The \$300,000,000 City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Bonds, Taxable Series 2010A (Direct Subsidy - Build America Bonds) ("Series 2010A Bonds") and the \$200,000,000 City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Refunding Bonds, Taxable Series 2010B Bonds (Direct Subsidy - Build America Bonds) ("Series 2010B Bonds" and, together with the Series 2010A Bonds, "Bonds") will be issued under and in conformity with the Constitution and laws of the State of Texas, including, with respect to the Series 2010A Bonds, Chapters 1371 and 1502, Texas Government Code, as amended, and, with respect to the Series 2010B Bonds, Chapter 1207, Texas Government Code, as amended, and pursuant to two separate ordinances (together, "Ordinances") adopted by the City Council ("City Council") of the City of San Antonio, Texas ("City") on October 21, 2010. The City, in the Ordinances, authorizes the City Public Service Board of San Antonio, Texas ("CPS", "Board" or "CPS Energy") to manage, operate, and maintain the City's electric and gas systems ("Systems"). In the Ordinances, the City Council delegated to certain City representatives the authority to execute approval certificates establishing final terms of the sale for the Bonds. These approval certificates were executed by a duly-authorized representative of the City on October 28, 2010.

The Bonds are issuable only as fully registered obligations in denominations of \$5,000 or any integral multiple thereof. Interest on the Bonds will accrue from the date of their initial delivery to the initial purchasers thereof, respectively, named below ("Underwriters") (expected to occur on or about November 4, 2010) ("Closing Date") and will be payable on February 1 and August 1 of each year, commencing February 1, 2011. The Bonds will be issued in book-entry-only form and when issued will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC") acting as securities depository ("Securities Depository"). The City reserves the right to discontinue the use of the Securities Depository, but so long as DTC or its nominee is the registered owner of the Bonds, purchasers of the Bonds ("Beneficial Owners") will not receive physical delivery of certificates representing their interest in the Bonds purchased. The principal of, premium, if any, and interest on the Bonds will be payable by The Bank of New York Mellon Trust Company, National Association, Dallas, Texas, as Paying Agent/Registrar, to the Securities Depository, which will in turn remit such principal, premium, if any, and interest to the Beneficial Owners. See "THE BONDS – Book-Entry-Only System" herein.

The Bonds are subject to redemption prior to stated maturity at the prices, in the amounts, and at the times described herein. See "THE BONDS – Redemption of Bonds" herein.

The Series 2010A Bonds are being issued to: (i) finance costs associated with constructing capital improvements of the Systems and (ii) pay costs and expenses relating to their issuance. The Series 2010B Bonds are being issued to refund certain outstanding commercial paper notes ("Refunded Obligations") as disclosed on Appendix F hereto to lock-in current long term interest rates. The Bonds are special obligations of the City. Principal of and interest on the Bonds are payable solely from and to the extent of and are secured, together with the currently outstanding Junior Lien Obligations, by a junior lien on and pledge of the Net Revenues of the Systems, being remaining Net Revenues after monthly payments or transfers to provide for the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations outstanding from time to time, but prior to the payment of the currently outstanding Commercial Paper Obligations and Inferior Lien Obligations.

**The Ordinances do not create a mortgage or other security interest on the property of the Systems. The Bonds are special obligations of the City, payable from a junior lien on the pledge of the Net Revenues of the Systems, and the taxing power of none of the City, any other political subdivision of the State of Texas, nor the State of Texas is pledged for the payment thereof.**

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### SEE INSIDE COVER PAGE FOR MATURITIES, INTEREST RATES AND PRICING SCHEDULE

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The Series 2010A Bonds are offered when, as, and if issued and received by the Underwriters and subject to the approval of the Attorney General of the State of Texas and the approval of certain legal matters by Fulbright & Jaworski L.L.P. and West & Associates, L.L.P. Co-Bond Counsel, both of San Antonio, Texas. The Series 2010B Bonds are offered when, as, and if issued and received by the Underwriters and subject to the approval of the Attorney General of the State of Texas and the approval of certain legal matters by Fulbright & Jaworski L.L.P. and Shelton & Valadez, P.C., Co-Bond Counsel, both of San Antonio, Texas. Certain legal matters will be passed upon for the City by the City Attorney, by Carolyn E. Shellman, Esq., General Counsel for the City Public Service Board, and for the Underwriters by McCall, Parkhurst & Horton L.L.P. and Law Offices of William T. Avila, P.C., Co-Underwriters' Counsel, both of San Antonio, Texas. The Bonds are expected to be available for initial delivery to the Underwriters and credited through DTC on or about November 4, 2010.

**J.P. MORGAN** (Senior Managing Underwriter for the Series 2010A Bonds)

**BofA MERRILL LYNCH** (Senior Managing Underwriter for the Series 2010B Bonds)

**COASTAL SECURITIES, INC.**  
**LOOP CAPITAL MARKETS, LLC**  
**RAMIREZ & CO., INC.**  
**SAMCO CAPITAL MARKETS, INC.**  
**STERNE, AGEE & LEACH, INC.**

**JEFFERIES & COMPANY**  
**MORGAN KEEGAN & CO., INC.**  
**RBC CAPITAL MARKETS**  
**SOUTHWESTERN CAPITAL MARKETS, INC.**

# **MATURITIES, INTEREST RATES AND PRICING SCHEDULE**

**\$300,000,000**  
**CITY OF SAN ANTONIO, TEXAS**  
**ELECTRIC AND GAS SYSTEMS**  
**JUNIOR LIEN REVENUE BONDS,**  
**TAXABLE SERIES 2010A**  
**(DIRECT SUBSIDY - BUILD AMERICA BONDS)**

**\$300,000,000 5.808% Term Bond due February 1, 2041; Yield 5.808%; CUSIP No.<sup>1</sup> 796253Y30**

Dated October 1, 2010 (Interest to accrue from Closing on November 4, 2010)

**\$200,000,000**  
**CITY OF SAN ANTONIO, TEXAS**  
**ELECTRIC AND GAS SYSTEMS**  
**JUNIOR LIEN REVENUE REFUNDING BONDS,**  
**TAXABLE SERIES 2010B**  
**(DIRECT SUBSIDY - BUILD AMERICA BONDS)**

**\$200,000,000 6.308% Term Bond due February 1, 2037; Yield 6.308%; CUSIP No.<sup>1</sup> 796253Y48**

Dated October 1, 2010 (Interest to accrue from Closing on November 4, 2010)

## **Redemption of Bonds**

The Bonds are subject to redemption prior to stated maturity at the times, in the amounts, and at the prices and under the conditions described herein under the subcaption "THE BONDS – Redemption of Bonds".

(1) CUSIP numbers are included solely for the convenience of owners of the Bonds. CUSIP is a registered trademark of the American Bankers Association. CUSIP data herein is provided by CUSIP Global Services, managed by Standard & Poor's Financial Services LLC on behalf of The American Bankers Association. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP Services. None of the City, the Co-Financial Advisors, nor the Underwriters is responsible for the selection or correctness of the CUSIP numbers set forth herein.

# **CITY OF SAN ANTONIO, TEXAS**

## **CITY COUNCIL**

Julián Castro, Mayor

Elisa Chan  
Mary Alice P. Cisneros  
John G. Clamp

Philip A. Cortez  
Ray Lopez  
David Medina  
Jennifer V. Ramos

Justin Rodriguez  
Ivy Taylor  
Reed Williams

Sheryl Sculley – City Manager  
Ben Gorzell, Jr. – Chief Financial Officer  
Leticia M. Vacek – City Clerk  
Michael D. Bernard – City Attorney

## **CITY PUBLIC SERVICE BOARD OF SAN ANTONIO**

Charles E. Foster, Chairman<sup>1</sup>  
Stephen S. Hennigan, Trustee<sup>1</sup>

Homer Guevara, Jr., Trustee

Derrick Howard, Vice Chairman  
Julián Castro, Mayor

Doyle N. Beneby – President & CEO  
Paula Y. Gold-Williams – Treasurer, Executive Vice President and Chief Financial Officer  
Carolyn E. Shellman, Esq. – Secretary, Executive Vice President and General Counsel

## **CONSULTANTS**

Fulbright & Jaworski L.L.P.,  
West & Associates, L.L.P. and  
Shelton & Valadez, P.C.  
Co-Bond Counsel

Public Financial Management, Inc. and  
Estrada Hinojosa & Company, Inc.  
Co-Financial Advisors

1) See “DESCRIPTION OF PHYSICAL PROPERTY – Electric System – Nuclear Cost Issue and CPS Energy Internal Investigation” herein.

## USE OF INFORMATION

No dealer, broker, salesman, or other person has been authorized by the City to give any information or to make any representation with respect to the Bonds, other than as contained in this Official Statement, and if given or made, such other information or representations must not be relied upon as having been authorized by the City. This Official Statement does not constitute an offer to sell or a solicitation of an offer to buy, nor shall there be any sale of the Bonds by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation, or sale. The information and expressions of opinions herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made shall under any circumstances create any implication that there has been no change in the information or opinions set forth herein after the date of this Official Statement. See “CONTINUING DISCLOSURE OF INFORMATION” for a description of the undertaking of the City and the Board to provide certain information on a continuing basis.

THE BONDS ARE EXEMPT FROM REGISTRATION WITH THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION AND CONSEQUENTLY HAVE NOT BEEN REGISTERED THEREWITH. THE REGISTRATION, QUALIFICATION, OR EXEMPTION OF THE BONDS IN ACCORDANCE WITH APPLICABLE SECURITIES LAW PROVISIONS OF THE JURISDICTIONS IN WHICH THESE BONDS HAVE BEEN REGISTERED, QUALIFIED, OR EXEMPTED SHOULD NOT BE REGARDED AS A RECOMMENDATION FOR THE PURCHASE THEREOF.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with and as part of their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

The Co-Financial Advisors have provided the following sentence for inclusion in this Official Statement. The Co-Financial Advisors have reviewed the information in this Official Statement in accordance with and as part of their responsibilities to the Board and, as applicable, to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Co-Financial Advisors do not guarantee the accuracy or completeness of such information.

None of the City, the Co-Financial Advisors, nor the Underwriters make any representation or warranty with respect to the information contained in this Official Statement regarding The Depository Trust Company or its Book-Entry-Only System.

**The agreements of the City and others related to the Bonds are contained solely in the contracts described herein. Neither this Official Statement nor any other statement made in connection with the offer or sale of the Bonds is to be construed as constituting an agreement with the purchasers of the Bonds.**

THE COVER PAGE CONTAINS CERTAIN INFORMATION FOR GENERAL REFERENCE ONLY AND IS NOT INTENDED AS A SUMMARY OF THIS OFFERING. INVESTORS SHOULD READ THE ENTIRE OFFICIAL STATEMENT, INCLUDING ALL APPENDICES ATTACHED HERETO, TO OBTAIN INFORMATION ESSENTIAL TO MAKING AN INFORMED INVESTMENT DECISION.

NEITHER THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THE BONDS OR PASSED UPON THE ADEQUACY OR ACCURACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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The cover page, subsequent pages hereof, and Appendices attached hereto, are part of this Official Statement.

# OFFICIAL STATEMENT

## Relating To

**\$300,000,000**  
**CITY OF SAN ANTONIO, TEXAS**  
**ELECTRIC AND GAS SYSTEMS**  
**JUNIOR LIEN REVENUE BONDS,**  
**TAXABLE SERIES 2010A**  
**(DIRECT SUBSIDY - BUILD AMERICA BONDS)**

AND

**\$200,000,000**  
**CITY OF SAN ANTONIO, TEXAS**  
**ELECTRIC AND GAS SYSTEMS**  
**JUNIOR LIEN REVENUE REFUNDING BONDS,**  
**TAXABLE SERIES 2010B**  
**(DIRECT SUBSIDY - BUILD AMERICA BONDS)**

## INTRODUCTORY STATEMENT

This Official Statement, including the cover page and the Appendices hereto, of the City of San Antonio, Texas (“City”), is provided to furnish information with respect to the City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Bonds, Taxable Series 2010A (Direct Subsidy - Build America Bonds) (“Series 2010A Bonds”) and the City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Refunding Bonds, Taxable Series 2010B (Direct Subsidy - Build America Bonds) (“Series 2010B Bonds” and, collectively with the Series 2010A Bonds, “Bonds”). Certain terms not defined herein will have the meanings ascribed thereto in the applicable Ordinance (hereinafter defined).

The Series 2010A Bonds are being issued to: (i) finance costs associated with constructing capital improvements of the Systems and (ii) pay costs and expenses relating to their issuance. The Series 2010B Bonds are being issued to refund certain outstanding commercial paper notes (“Refunded Obligations”) as disclosed on Appendix F hereto to lock-in current long term interest rates. See “PLAN OF FINANCE” herein.

The Bonds are special obligations of the City. Principal of and interest on the Bonds are payable solely from and are secured, together with the currently outstanding Junior Lien Obligations, by a junior lien on and pledge of the Net Revenues of the Systems, being remaining Net Revenues after monthly payments or transfers to provide for the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations outstanding from time to time, but prior to the payment of the currently outstanding Commercial Paper Obligations and Inferior Lien Obligations. The City has previously issued and there remain outstanding as of October 28, 2010, \$4,100,135,000 aggregate principal amount of Senior Lien Obligations and \$897,615,000 in Junior Lien Obligations (inclusive of the Bonds). The City has reserved the right to issue Additional Senior Lien Obligations secured by liens on Net Revenues of the Systems that are senior to the liens thereon securing the Bonds and other Junior Lien Obligations, as well as Additional Junior Lien Obligations secured by liens on and pledges of Net Revenues of the System on parity with the Bonds and the currently outstanding Junior Lien Obligations, from time to time in accordance with the provisions of the Ordinances described herein. The City may also issue obligations secured by inferior liens on Net Revenues of the Systems without limitation, including \$450,000,000 currently authorized commercial paper notes (“Notes”), of which \$330,000,000 was outstanding as of October 28, 2010 (but \$200,000,000 of which is being refunded by the Series 2010B Bonds), and \$100,000,000 in flexible rate revolving notes (“Flex Rate Notes”), of which there are currently \$25,200,000 outstanding as of October 28, 2010. See “COMMERCIAL PAPER PROGRAM” and “FLEXIBLE RATE REVOLVING NOTE PRIVATE PLACEMENT PROGRAM” herein.

In the Ordinances, as permitted by Chapter 1371, Texas Government Code, as amended with respect to the Series 2010A Bonds and Chapter 1207, Texas Government Code, as amended, with respect to the Series 2010B Bonds, the City Council delegated to certain authorized officials of the City, each a Designated Financial Officer, the authority to establish the final terms of sale for the Bonds, to be evidenced in separate Approval Certificates relating to each series of Bonds. The Approval Certificates were executed by a Designated Financial Officer on October 28, 2010 in conjunction with the sale of the Bonds.

There follows in this Official Statement a description of the City, the City Public Service Board of San Antonio, Texas (“Board” or “CPS Energy”), and the Systems; certain information relating to the City and the State of Texas (“State”); certain information relating to the sources of payment for the Bonds, together with summaries of certain provisions of the Ordinances and the Bonds; and a discussion of factors affecting the electric and gas industries generally. All references herein to agreements and documents are qualified in their entirety by reference to the definitive forms thereof, and all references to the Bonds are further qualified by reference to the information with respect thereto contained in the Ordinances. Copies of such documents may be obtained from the City or the Co-Financial Advisors upon request by electronic mail or upon payment of reasonable copying, handling and delivery charges.

This Official Statement speaks only as to its date and the information contained herein is subject to change. A copy of the Final Official Statement relating to the Bonds will be available from the Municipal Securities Rulemaking Board (“MSRB”) through its Electronic Municipal Market Access (“EMMA”) system. See “CONTINUING DISCLOSURE OF INFORMATION”, herein, for a description of the City’s and the Board’s undertaking to provide certain information on a continuing basis.

## **PLAN OF FINANCE**

The Series 2010A Bonds are being issued to: (i) finance costs associated with constructing capital improvements of the Systems and (ii) pay costs and expenses relating to their issuance. The Series 2010B Bonds are being issued to refund certain outstanding commercial paper notes (“Refunded Obligations”) as disclosed on Appendix F hereto to lock-in current long term interest rates.

### ***The Refunded Obligations***

The Refunded Obligations, and interest due thereon, are to be paid on the scheduled maturity dates from funds to be deposited with The Bank of New York Mellon Trust Company, National Association, Dallas, Texas (“Escrow Agent”) pursuant to an Escrow and Trust Agreement dated as of October 21, 2010 (“Escrow Agreement”) between the City and the Escrow Agent. The refunding of the Refunded Obligations will result in fixing the long-term rate on such obligations (and not produce gross or present value savings for the Systems) and will restore \$200,000,000 of the City’s \$450,000,000 authorized borrowing capacity under the Commercial Paper Program. CPS Energy currently anticipates a gross cash defeasance of the Refunded Obligations.

The Series 2010B Ordinance (defined herein) provides that the City will deposit certain proceeds of the sale of the Series 2010B Bonds, along with other lawfully available funds of the City, if any, with the Escrow Agent in the amount necessary to effectuate a gross cash defeasance of the Refunded Obligations and to accomplish the discharge and final payment of the Refunded Obligations. Such funds will be held by the Escrow Agent in an escrow fund (“Escrow Fund”) irrevocably pledged to the payment of principal of and interest on the Refunded Obligations and may be used to purchase certain obligations of the United States of America and obligations of agencies or instrumentalities of the United States, including obligations that are unconditionally guaranteed by the agency or instrumentality that are noncallable and that were, on the date the Ordinance was adopted, rated as to investment quality by a nationally recognized rating firm not less than “AAA” (“Federal Securities”). Under the laws of the State, particularly Section 1207.062(b), as amended, Texas Government Code, “AAA” rated obligations of agencies or instrumentalities of the United States may be deposited with the Escrow Agent under the terms of the Escrow Agreement for the payment and defeasance of the Refunded Obligations. Such maturing principal of and interest on the Federal Securities, if any, will not be available to pay the debt service requirements on the Bonds.

Issuance of the Series 2010B Bonds will be subject to delivery by Grant Thornton LLP, Minneapolis, Minnesota (“Verification Agents”) of a report of the mathematical accuracy of certain computations. The Verification Agents will verify from the information provided to them the mathematical accuracy as of the date of the closing on the Series 2010B Bonds of the computations contained in the provided schedules to determine that the amounts deposited to the Escrow Fund at Closing, will be sufficient to pay, when due, the principal and interest requirements of the Refunded Obligations. The Verification Agents will express no opinion on the assumptions provided to them. See “VERIFICATION OF MATHEMATICAL COMPUTATIONS” herein.

By the deposit of the proceeds of the Series 2010B Bonds and cash, with the Escrow Agent pursuant to the Escrow Agreement, the City will have effected the defeasance of the Refunded Obligations pursuant to the terms of the ordinance authorizing the issuance of the Refunded Obligations. It is the opinion of Fulbright & Jaworski L.L.P. and Shelton & Valadez, P.C., Co-Bond Counsel with respect to the Series 2010B Bonds that, as a result of such defeasance, the Refunded Obligations will no longer be payable from the Net Revenues but will be payable solely from the principal of and interest on the Federal Securities and cash, if any, on deposit in the Escrow Fund and held for such purpose by the Escrow Agent, and that the Refunded Obligations will be defeased and are not to be included in or considered to be indebtedness of the City for the purpose of a limitation of indebtedness or for any other purpose. See “APPENDIX E - FORMS OF OPINIONS OF CO-BOND COUNSELS” herein.

The City has covenanted in the Series 2010B Ordinance and the Escrow Agreement to make timely deposits to the Escrow Fund, from lawfully available funds, of any additional amounts required to pay the principal of, premium, if any, and interest on the Refunded Obligations if for any reason the cash balance on deposit or scheduled to be on deposit in the Escrow Fund should be insufficient to make such payment.

## THE BONDS

### *Security for the Bonds; General Terms*

The Bonds are issued as Additional Junior Lien Obligations, which are special obligations of the City the principal of and interest on which is payable solely from and to the extent of Net Revenues of the Systems remaining after monthly payments on and transfers to provide for the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations of the Systems as set forth in the Ordinances and on parity with any Additional Junior Lien Obligations hereafter issued, if certain historical earnings tests and other conditions are satisfied. See “THE BONDS – Additional Bonds” herein for a description of the conditions under which Additional Senior Lien Obligations and Additional Junior Lien Obligations can be issued. The pledge of and lien on Net Revenues securing the payment of the Bonds is superior to the pledge thereof and lien thereon securing the currently outstanding Commercial Paper Obligations, as well as notes issued from time to time under the City’s Flexible Rate Revolving Note Private Placement Program (defined herein).

**The Ordinances do not create a mortgage or other security interest on the property of the Systems. The Bonds are special obligations of the City, payable, together with the currently outstanding Junior Lien Obligations and any Additional Junior Lien Obligations hereafter issued by the City, from a junior lien on the pledge of the Net Revenues of the Systems. The taxing power of neither the City nor the State of Texas is pledged for the payment thereof.**

The Bonds will bear interest at the rates and are scheduled to mature on the dates and in the amounts set forth in the applicable table appearing on the inside cover page of this Official Statement. Interest on the Bonds will accrue from the date of their initial delivery to the Underwriters (expected to occur on or about November 4, 2010) (“Closing Date”) and will be payable on February 1 and August 1 of each year, commencing February 1, 2011. Registered owners of the Bonds are those shown on the registration books kept by the Paying Agent/Registrar at the close of business on the 15th day of the month next preceding each interest payment date (“Record Date”). The Bonds are issued as fully registered obligations in denominations of \$5,000 or any integral multiple thereof. The Bonds are initially issuable only to Cede & Co., the nominee of The Depository Trust Company, New York, New York (“DTC”), pursuant to the Book-Entry-Only System described herein. For such time as the Book-Entry-Only System is utilized, no physical delivery of the Bonds will be made to the purchasers thereof and the principal of and interest on the Bonds will be payable by the Paying Agent/Registrar to Cede & Co., which will make distribution of the amounts so paid to the Beneficial Owners of the Bonds. For such time as the Bonds are issuable in Book-Entry-Only form, references herein and in the Bonds and the Ordinances to “registered owners” will include only Cede & Co., as the nominee of DTC, the sole registered owner of the Bonds. See “THE BONDS – Book-Entry-Only System” herein. The City reserves the right to discontinue the Book-Entry-Only System, whereupon interest on the Bonds will be payable (i) by check mailed by the Paying Agent/Registrar, initially The Bank of New York Mellon Trust Company, National Association, Dallas, Texas, on the interest payment date to the registered owners thereof as shown on the records of the Paying Agent/Registrar, at the close of business on the Record Date, or (ii) by such other method, acceptable to the Paying Agent/Registrar, at the written request of and at the risk and expense of the registered owner.

### *Refundable Tax Credit Bonds*

Under and pursuant to recently-enacted federal legislation, being the American Recovery and Reinvestment Act of 2009, effective February 17, 2009 (“Stimulus Act”), and in accordance with guidance released from time to time by the Internal Revenue Service (“IRS”) concerning the same, the Bonds have been designated as “build America bonds” within the meaning of section 54AA of the Internal Revenue Code of 1986, as amended (“Code”) and as “qualified bonds” under section 54AA(g)(2) of the Code. Because of their qualification as “qualified bonds” under the Code, the City is entitled to receive directly from the United States Department of the Treasury (“Treasury”) with respect to each series of Bonds a refundable tax credit in an amount equal to 35% of the taxable interest paid on the Bonds by the City to the holders thereof (“Refundable Tax Credit”). **As a result of the City’s designation and election entitling it to the receipt of the Refundable Tax Credit, no owner of Bonds will be entitled to a tax credit as a result of such ownership.** See “FEDERAL TAX TREATMENT OF TAXABLE BONDS” herein for a description of the effects upon the owners thereof resulting from the City’s issuance of the Bonds as obligations, the interest on which is not excludable under section 103 of the Code for federal income tax purposes, permitting their designation as “build America bonds”.

The Refundable Tax Credits are not directly pledged to the payment of the series of Bonds to which such Refundable Tax Credit relates; however, the City, in the appropriate form or forms to be filed with the IRS on the Delivery Date and from time to time thereafter notifying the Treasury of its elections with respect to the Bonds described above, and the request for receipt of the Refundable Tax Credits, the City will provide for the Refundable Tax Credits to be delivered from the Treasury directly to the Paying Agent/Registrar, for further deposit and allocation to a separate special interest and sinking subaccount of each Bond Fund (as the same relates to each series of Bonds) created on the books and records of the Paying Agent/Registrar relating solely to the series of Bonds to which such Refundable Tax Credit relates. The respective agreements between the City and the Paying Agent/Registrar relating to each series of Bonds provides that the amount held

in each such special interest and sinking subaccount shall be used to reduce the interest payment amount of the regularly scheduled debt service payments on the applicable series of Bonds that the City is required to make under the applicable Ordinance by remitting the same to the Paying Agent/Registrar.

The City has concluded in the Ordinances, which conclusion was confirmed as reasonable by the Systems' external auditors, that the Refundable Tax Credit, is not considered to be gross revenues of the Systems and, therefore, is not included in the definition of, and does not constitute, Net Revenues. Accordingly, the Refundable Tax Credit is not included in the calculation of gross revenues of the Systems (which are included in the Systems' financial statements that are presented in accordance with generally accepted accounting principles), is not directly pledged to the payment of the Bonds, and (therefore) is not required to be deposited to the General Account or to flow through the flow of funds described herein under the "THE BONDS – Flow of Funds" and does not become Net Revenues pledged to the payment of the Bonds or the City's other outstanding obligations secured by and payable from Net Revenues. Because of the foregoing, the City anticipates that the entirety of the Refundable Tax Credit will be available as an offset to the scheduled debt service payment requirements attributable solely to the Bonds.

The City's continued receipt of the Refundable Tax Credits is subject to various requirements. No assurances are provided that the City will receive each of the Refundable Tax Credits. Refundable Tax Credits will only be paid by the Treasury if the applicable series of Bonds remains qualified in accordance with applicable Code provisions under which the original "build America bond" and "qualified bond" designations were made. For the Bonds to be, and remain, designated as "qualified bonds" for which the Refundable Tax Credits will be received, the City must comply with certain covenants with respect to the Bonds regarding the use and investment of proceeds thereof, the use of property financed therewith, making timely and proper filings with the IRS, and satisfying certain other requirements of the Code. Failure on the part of the City to comply with the conditions imposed by the Code and future guidance to be provided by the Treasury and the IRS, may cause the City to fail to receive one or both of the Refundable Tax Credits for the remaining term of the affected series of Bonds and it could subject the City to a claim for refund of previously received Refundable Tax Credits. Moreover, Refundable Tax Credits are subject to automatic offsets against certain amounts that may, for unrelated reasons, be owed by the City to the United States of America or an agency thereof. In addition, see "THE BONDS - Redemption of Bonds" herein for information concerning optional redemption of the Bonds upon the occurrence of an extraordinary event (generally being the occurrence of an event that results in the loss of the right or opportunity of the City to receive all or part of a Refundable Tax Credit).

#### ***Authority for Issuance***

***Series 2010A Bonds.*** The Series 2010A Bonds are issued under the provisions of applicable laws of the State, including Chapters 1371 and 1502, Texas Government Code, as amended, the Home Rule Charter of the City, and an ordinance adopted by the City Council on October 21, 2010 ("Series 2010A Ordinance").

***Series 2010B Bonds.*** The Series 2010B Bonds are issued under the provisions of applicable laws of the State, including Chapters 1207, Texas Government Code, as amended, the Home Rule Charter of the City, and an ordinance adopted by the City Council on October 21, 2010 ("Series 2010B Ordinance" and, together with the Series 2010A Ordinance, the "Ordinances"; such Ordinances, individually, an "Ordinance").

***Delegated Sale Authority.*** As permitted by Chapter 1371, Texas Government Code, as amended, with respect to the Series 2010A Bonds, and Chapter 1207, Texas Government Code, as amended, with respect to the Series 2010B Bonds, the City has, in the Ordinances, delegated to certain authorized officials of the City the authority to establish final terms of sale of the Bonds, which final sales terms of each series of Bonds shall be evidenced in a separate "Approval Certificate" relating thereto. The Approval Certificates relating to the Bonds were executed by a Designated Financial Officer on October 28, 2010 in conjunction with the sale thereof.

**Sources and Uses of the Series 2010A Bond Proceeds**

The proceeds from the sale of the Series 2010A Bonds will be applied approximately as follows:

Sources of Funds	
Principal Amount of the Series 2010A Bonds .....	\$300,000,000.00
Total Sources of Funds .....	<u>\$300,000,000.00</u>
Uses of Funds	
Project Fund Deposit .....	\$297,731,457.00
Underwriters' Discount .....	1,620,083.00
Costs of Issuance .....	648,460.00
Total Uses of Funds .....	<u>\$300,000,000.00</u>

**Sources and Uses of the Series 2010B Bond Proceeds**

The proceeds from the sale of the Series 2010B Bonds, along with the Board's cash contribution, will be applied approximately as follows:

Sources of Funds	
Principal Amount of the Series 2010B Bonds .....	\$200,000,000.00
Board's Cash Contribution .....	1,569,013.07
Total Sources of Funds .....	<u>\$201,569,013.07</u>
Uses of Funds	
Escrow Fund Deposit.....	\$200,016,592.01
Underwriters' Discount .....	1,077,768.56
Costs of Issuance .....	474,652.50
Total Uses of Funds.....	<u>\$201,569,013.07</u>

**Flow of Funds**

The Ordinances provide that the gross revenues of the Systems are to be deposited in CPS Energy's General Account, and further provide that such gross revenues are pledged and appropriated, in the following priority, to: (i) the payment of reasonable and proper maintenance and operating expenses of the Systems; (ii) the payment of Senior Lien Obligations or Additional Senior Lien Obligations, including the establishment and maintenance of the reserve therefor; (iii) the payment of any Prior Lien Bonds, which include the currently outstanding Junior Lien Obligations, including the City's obligations under the Liquidity Facilities (as defined in the ordinances authorizing such outstanding Junior Lien Obligations), the Bonds, and any Additional Junior Lien Obligations, and for establishment and maintenance of a reserve therefor, if any; (iv) the payment and security of the Commercial Paper Obligations and the Agreement (as defined in the ordinances authorizing the issuance of the Commercial Paper Obligations); (v) the payment and security of obligations hereafter issued that are inferior in lien to the Senior Lien Obligations, Additional Senior Lien Obligations, Prior Lien Bonds, Junior Lien Obligations, Additional Junior Lien Obligations, the Commercial Paper Obligations and the Inferior Lien Obligations, which includes notes issued from time to time under the City's Flexible Rate Revolving Note Private Placement Program; (vi) the payment of an annual amount equal to six percent (6%) of the gross revenues of the Systems to be deposited in the Repair and Replacement Account provided for in the Ordinance; (vii) the payment of the annual amount due the General Fund of the City, as provided in the Ordinances; and (viii) the extent of any remaining Net Revenues of the Systems in the General Account, to the Repair and Replacement Account in accordance with the ordinances of the City authorizing the issuance of the Senior Lien Obligations and Ordinances.

**Rate Covenant**

The City has covenanted in the Ordinances that it will at all times maintain rates and charges for the sale of electric energy, gas, or other services furnished, provided and supplied by the Systems to the residents of the City and all other consumers that will be reasonable and nondiscriminatory and which will be reasonably expected to produce gross revenues sufficient to pay all maintenance and operating expenses of the Systems, and to produce Net Revenues sufficient, together with other lawfully available funds, to pay debt service requirements on all revenue debt of the Systems, including the Senior Lien Obligations (recognizing as an offset to the debt service owed on those outstanding Senior Lien Obligations designated as "build America bonds" the refundable tax credit attributable to such obligations), any Additional Senior Lien Obligations, the currently outstanding Junior Lien Obligations, the Bonds (recognizing as an offset to the debt service owed on the Bonds

the Refundable Tax Credits attributable to such Bonds), Liquidity Facility obligations, any Additional Junior Lien Obligations, the Commercial Paper Obligations, the Inferior Lien Obligations, and any Additional Inferior Lien Obligations. The CPS Energy rate covenant is consistent with and supported by the relevant State statute concerning rate setting for municipally-owned utilities (“Municipal Utilities”) such as CPS Energy. Section 1502.057, as amended, Texas Government Code, provides that the charges for services provided by encumbered municipal systems, such as CPS Energy, must be “at least sufficient to pay: all operating, maintenance, depreciation, replacement, improvement and interest charges in connection with the utility system; for an interest and sinking fund sufficient to pay any public securities issued or obligations incurred for any purpose relating to the utility system; and any outstanding debt against the system”. See “APPENDIX D – CERTAIN PROVISIONS OF THE JUNIOR LIEN ORDINANCE” herein. Also, see “SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Retail Service Rates” and “Transmission Access and Rate Regulation” regarding rate regulation herein.

### ***Additional Bonds***

The City may issue Additional Senior Lien Obligations on a parity with the currently outstanding Senior Lien Obligations if, among other things, it has obtained a certificate from an independent certified public accountant to the effect that the Net Revenues of the Systems during the previous fiscal year, or any 12 consecutive months out of the 15 months immediately preceding the month in which the ordinance authorizing the Additional Senior Lien Obligations is passed, were (i) at least 1.50 times the maximum annual debt service requirements in any future fiscal year on all outstanding Senior Lien Obligations and the proposed Additional Senior Lien Obligations, and (ii) at least 1.00 times the maximum annual debt service requirements for any future fiscal year for Senior Lien Obligations, Additional Senior Lien Obligations, Junior Lien Obligations, and Additional Junior Lien Obligations to be outstanding, assuming that adjustable rate interest accrues at *The Bond Buyer’s* Revenue Bond Index with respect to the Junior Lien Obligations and adding or subtracting net payments due on or receivable under interest rate hedge agreements, if any.

The City may issue Additional Junior Lien Obligations upon obtaining a certificate from a Designated Financial Officer to the effect that the Net Revenues of the Systems during the previous fiscal year, or any 12 consecutive months out of the 18 months immediately preceding the month in which the ordinance authorizing such obligations is passed, were at least 1.00 times the maximum annual debt service requirements for any future fiscal year for Senior Lien Obligations, Additional Senior Lien Obligations, Junior Lien Obligations, and Additional Junior Lien Obligations (including Liquidity Facility obligations) to be outstanding, assuming that adjustable rate interest accrues at *The Bond Buyer’s* Revenue Bond Index with respect to the Junior Lien Obligations and adding or subtracting net payments due on or receivable under interest rate hedge agreements, if any.

The refundable tax credits to be received by the City in relation to the Bonds, including the Refundable Tax Credits, and outstanding Senior Lien Obligations, as well as any future issue of City debt secured by and payable from a lien on and pledge of Net Revenues, designated as “build America bonds” and elected to be treated as “qualified bonds” under the Code will be considered as an offset to debt service for the purpose of satisfying any debt service coverage requirements serving as a prerequisite to the issuance of additional indebtedness. See “THE BONDS – Refundable Tax Credit Bonds” herein.

### ***Perfection of Security for the Bonds***

Chapter 1208, as amended, Texas Government Code, applies to the issuance of the Bonds and the pledge of the Net Revenues and such pledge is therefore valid, effective, and perfected. Should State law be amended while the Bonds are outstanding and unpaid, the result of such amendment being that the pledge of the Net Revenues is to be subject to the filing requirements of Chapter 9, Texas Business and Commerce Code, in order to preserve to the registered owners of the Bonds a security interest in such pledge, the City agrees to take such measures as it determines are reasonable and necessary to enable a filing of a security interest in said pledge to occur.

### ***Redemption of Bonds***

***Optional Redemption of the Series 2010A Bonds.*** The Series 2010A Bonds are subject to redemption prior to stated maturity, at the option of the City, on any date, as a whole or in part, in principal amounts of \$5,000 or any integral multiple thereof, at the Series 2010A Bonds Make-Whole Redemption Price or, upon the occurrence of an Extraordinary Event, at the Extraordinary Redemption Price.

***Optional Redemption of the Series 2010B Bonds.*** The Series 2010B Bonds are subject to redemption prior to stated maturity, at the option of the City, on any date from the Closing Date through January 31, 2020, as a whole or in part, in principal amounts of \$5,000 or any integral multiple thereof, at the Series 2010B Bonds Make-Whole Redemption Price or,

upon the occurrence of an Extraordinary Event, at the Extraordinary Redemption Price. In addition, the Series 2010B Bonds are subject to redemption prior to Stated Maturity, at the option of the City, on February 1, 2020, or on any date thereafter, as a whole or in part in principal amounts of \$5,000 or any integral multiple thereof (and if within a Stated Maturity at random and by lot by the Paying Agent/Registrar), at the redemption price of par plus accrued interest to the date of redemption.

**Definition of Terms.** For purposes of this section, capitalized terms used herein have the following meanings:

*“Extraordinary Event”* means the occurrence of a change to sections 54AA or 6431 of the Code (as such sections were added by Section 1531 of the Stimulus Act, pertaining to “build America bonds”) or if there is any guidance published by the IRS or the Treasury with respect to such sections or any other determination by the IRS or the Treasury, which determination is not the result of an act or omission by the City to satisfy the requirements to receive the Refundable Tax Credits from the Treasury, pursuant to which the City’s 35% Refundable Tax Credits from the Treasury are reduced or eliminated.

*“Extraordinary Redemption Price”* means an amount equal to the greater of (i) the issue price of the Bonds set forth in the Ordinance (but not less than 100% of the principal amount) of the Bonds to be redeemed or (ii) the sum of the present value of the remaining scheduled payments of principal and interest on the Bonds to be redeemed to the maturity date of such Bonds, not including any portion of those payments of interest accrued and unpaid as of the date on which the Bonds are to be redeemed, discounted to the date on which the Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year containing twelve 30-day months, at the Treasury Rate plus 100 basis points, plus accrued interest on the Bonds to be redeemed to the redemption date.

*“Series 2010A Bonds Make-Whole Redemption Price”* means an amount equal to the greater of (i) the issue price of the Bonds set forth in the Ordinance (but not less than 100% of the principal amount) of the Bonds to be redeemed or (ii) the sum of the present value of the remaining scheduled payments of principal and interest on the Bonds to be redeemed to the maturity date of such Bonds, not including any portion of those payments of interest accrued and unpaid as of the date on which the Bonds are to be redeemed, discounted to the date on which the Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year containing twelve 30-day months, at the Treasury Rate plus 30 basis points, plus accrued interest on the Bonds to be redeemed to the redemption date.

*“Series 2010B Bonds Make-Whole Redemption Price”* means an amount equal to the greater of (i) the issue price of the Bonds set forth in the Ordinance (but not less than 100% of the principal amount) of the Bonds to be redeemed or (ii) the sum of the present value of the remaining scheduled payments of principal and interest on the Bonds to be redeemed to the maturity date of such Bonds, not including any portion of those payments of interest accrued and unpaid as of the date on which the Bonds are to be redeemed, discounted to the date on which the Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year containing twelve 30-day months, at the Treasury Rate plus 35 basis points, plus accrued interest on the Bonds, to be redeemed to the redemption date.

*“Treasury Rate”* means, with respect to any redemption date for a particular Bond, the yield to maturity as of such redemption date of Treasury securities with a constant maturity (as compiled and published in the most recent Federal Reserve Statistical Release H.15 (519) that has become publicly available at least five business days prior to the redemption date (excluding inflation indexed securities) (or, if such Statistical Release is no longer published, any publicly available source of similar market data)) most nearly equal to the period from the redemption date to the maturity date or first date of optional call at par (if applicable) of the Bond to be redeemed; provided, however, that if the period from the redemption date to such maturity date is less than one year, the weekly average yield on actually traded Treasury securities adjusted to a constant maturity of one year will be used.

**Mandatory Sinking Fund Redemption of Bonds.** The Bonds of each series are subject to mandatory sinking fund redemption prior to their Stated Maturity from money required to be deposited in the applicable Bond Fund for such purpose and shall be redeemed in part through Pro Rata Pass-Through Distribution of Principal in accordance with the formulaic methodology evidenced in the Principal Paydown Factor Table attached hereto as Appendix G (if administratively permitted by the Paying Agent/Registrar or the administrator of the securities depository system in which such mandatorily-redeemed Bonds are then enrolled) or (if pro rata selection methodology is administratively unavailable) by lot or other customary method, at the principal amount thereof plus accrued interest to the date of redemption in the following principal amounts on February 1 in each of the years as set forth on the following page:

## Series 2010A Bonds

## Series 2010B Bonds

<u>Year (2/1)</u>	<u>Principal Amount (\$)</u>	<u>Year (2/1)</u>	<u>Principal Amount (\$)</u>
2038	52,475,000	2034	50,045,000
2039	53,550,000	2035	48,750,000
2040	95,685,000	2036	49,985,000
2041	98,290,000*	2037	51,220,000*

\*Payable at stated maturity

The principal amount of a Bond required to be redeemed pursuant to the operation of such mandatory redemption provisions shall be reduced, at the option of the City, by the principal amount of any Bonds of such stated maturity which, at least 50 days prior to the mandatory redemption date (1) shall have been defeased or acquired by the City and delivered to the Paying Agent/Registrar for cancellation, (2) shall have been purchased and canceled by the Paying Agent/Registrar at the request of the City with money in the applicable Bond Fund, or (3) shall have been redeemed pursuant to the optional redemption provisions set forth below and not theretofore credited against a mandatory redemption requirement.

### ***Notice of Redemption for the Bonds***

All notices of redemption shall (i) specify the date of redemption for the Bonds, (ii) identify the Bonds to be redeemed and, in the case of a portion of the principal amount to be redeemed, the principal amount thereof to be redeemed, (iii) state the redemption price, (iv) state that the Bonds, or the portion of the principal amount thereof to be redeemed, shall become due and payable on the redemption date specified as well as the interest thereon, or on the portion of the principal amount thereof to be redeemed, shall cease to accrue from and after the redemption date, and (v) specify that payment of the redemption price for the Bonds, or the principal amount thereof to be redeemed, shall be made at the designated corporate trust office of the Paying Agent/Registrar only upon presentation and surrender thereof by the registered owner. If a Bond is subject by its terms to redemption and has been called for redemption and notice of redemption thereof has been duly given or waived as provided in the applicable Ordinance, Bonds (or the principal amount thereof to be redeemed) so called for redemption shall become due and payable and on the redemption date designated in such notice. Interest on said Bonds (or the principal amount thereof to be redeemed) called for redemption shall cease to accrue and such Bonds shall not be deemed to be outstanding.

The Paying Agent/Registrar and the City, so long as a Book-Entry-Only System is used for the Bonds, will send any notice of redemption, notice of proposed amendment to the Ordinances or other notices with respect to the Bonds only to DTC. Any failure by DTC to advise any DTC participant, or of any DTC participant or indirect participant to notify the Beneficial Owner, shall not affect the validity of the redemption of the Bonds called for redemption or any other action premised on any such notice. Redemption of portions of the Bonds by the City will reduce the outstanding principal amount of such Bonds held by DTC. In such event, DTC may implement, through its Book-Entry-Only System, a redemption of such Bonds held for the account of DTC participants in accordance with its rules or other agreements with DTC participants and then DTC participants and indirect participants may implement a redemption of such Bonds from the Beneficial Owners. Any such selection of Bonds to be redeemed will not be governed by the Ordinances and will not be conducted by the City or the Paying Agent/Registrar. Neither the City nor the Paying Agent/Registrar will have any responsibility to DTC participants, indirect participants or the persons for whom DTC participants act as nominees, with respect to the payments on the Bonds or the providing of notice to DTC participants, indirect participants, or Beneficial Owners of the selection of portions of the Bonds for redemption. See “THE BONDS – Book-Entry-Only System” herein.

### ***Amendments***

The City may amend the Ordinances without the consent of or notice to any registered owners in any manner not detrimental to the interests of the registered owners, including the curing of any ambiguity, inconsistency, or formal defect or omission therein. Without the consent of the holders of the Bonds the provisions of the Ordinances may be amended at any time to ensure that the Bonds continue to qualify as “build America bonds” and “qualified bonds”, pursuant to the provisions of the Ordinances, the Code, and the tax credit and representation agreement authorized in each of the Ordinances. In addition, the City may, with the written consent of the holders holding a majority in aggregate principal amount of the Bonds then Outstanding affected thereby, amend, add to, or rescind any of the provisions of the Ordinance; provided that, without the consent of the holders, no such amendment, addition, or rescission shall (i) extend the time or times of payment of the principal of and interest on the Bonds, reduce the principal amount thereof or the rate of interest thereon, or in any other way modify the terms of payment of the principal of or interest on the Bonds, (ii) without the

consent of the holders give any preference to any Bond over any other Bond, or (iii) reduce the aggregate principal amount of Bonds required for consent to any such amendment, addition, or rescission.

### ***Defeasance***

The Ordinances provide for the defeasance of the Bonds when payment of the principal of and premium, if any, on the Bonds plus interest thereon to the due date thereof (whether such due date be by reason of maturity, redemption or otherwise) is provided by irrevocably depositing with a paying agent in trust (i) money in an amount sufficient to make such payment and/or (ii) Government Securities certified by an independent public accounting firm of national reputation to mature as to principal and interest in such amounts and at such times to insure the availability, without reinvestment, of sufficient money to make such payment, and all necessary and proper fees, compensation, and expenses of the paying agent for the Bonds. The Ordinances provide that “Government Securities” means (i) direct, noncallable obligations of the United States of America, including obligations that are unconditionally guaranteed by the United States of America, (ii) non-callable obligations of an agency or instrumentality of the United States of America, including obligations that are unconditionally guaranteed or insured by the agency or instrumentality and that are rated as to investment quality by a nationally recognized investment rating firm not less than “AAA” or its equivalent, and (iii) noncallable obligations of a state or an agency or a county, municipality, or other political subdivision of a state that have been refunded and that are rated as to investment quality by a nationally recognized investment rating firm not less than “AAA” or its equivalent.

Upon such deposit as described above, such Bonds will no longer be regarded to be outstanding obligations for any purpose, including the application of any limitation on indebtedness. After firm banking and financial arrangements for the discharge and final payment of the Bonds have been made as described above, all rights of the City to initiate proceedings to call the Bonds for redemption or take any other action amending the terms of the Bonds are extinguished; provided, however, that, in addition to the City’s continuing obligation to fund, from lawfully available funds, any shortfall in amounts held in trust for the defeasance of the Bonds as described above, which continuing obligation is memorialized in each of the Ordinances, the City’s right to redeem Bonds defeased to stated maturity is not extinguished if the City has reserved the option, to be exercised at the time of the defeasance of the Bonds, to call for redemption, at an earlier date, those Bonds which have been defeased to their stated maturity date, if the City: (i) in the proceedings providing for the firm banking and financial arrangements, expressly reserves the right to call the Bonds for redemption; (ii) gives notice of the reservation of that right to the owners of the Bonds immediately following the making of the firm banking and financial arrangements; and (iii) directs that notice of the reservation be included in any redemption notices that it authorizes.

### ***Registered Owners’ Remedies***

If the City defaults in the payment of principal, interest, or redemption price on the Bonds when due, or if it fails to make payments into any fund or funds created in the Ordinances, or defaults in the observation or performance of any other covenants, conditions, or obligations set forth in the Ordinances, the registered owners may seek a writ of mandamus to compel City officials to carry out their legally imposed duties with respect to the Bonds, if there is no other available remedy at law to compel performance of the Bonds or the Ordinances and the City’s obligations are not uncertain or disputed. The issuance of a writ of mandamus is controlled by equitable principles, so rests with the discretion of the court, but may not be arbitrarily refused. There is no acceleration of maturity of the Bonds in the event of default and, consequently, the remedy of mandamus may have to be relied upon from year to year. The Ordinances do not provide for the appointment of a trustee to represent the interest of the bondholders upon any failure of the City to perform in accordance with the terms of the Ordinances, or upon any other condition and accordingly all legal actions to enforce such remedies would have to be undertaken at the initiative of, and be financed by, the registered owners. On June 30, 2006, the Texas Supreme Court ruled in *Tooke v. City of Mexia*, 197 S.W.3d 325 (Tex. 2006) that a waiver of sovereign immunity in a contractual dispute must be provided for by statute in “clear and unambiguous” language. Even if a judgment against the City could be obtained, it could not be enforced by direct levy and execution against the City’s property. Chapter 1371, as amended, Texas Government Code (“Chapter 1371”), which pertains to the issuance of public securities by issuers such as the City, permits the City to waive sovereign immunity in the proceedings authorizing the issuance of the Bonds. Notwithstanding its reliance upon the provisions of Chapter 1371 in connection with its issuance of the Series 2010A Bonds (as further described in “THE BONDS – Authority for Issuance” herein), the City has not waived the defense of sovereign immunity with respect thereto. Because it is unclear whether the Texas legislature has effectively waived the City’s sovereign immunity from a suit for money damages outside of Chapter 1371, bondholders may not be able to bring such a suit against the City for breach of the Bonds or the Ordinances. Further, the registered owners cannot themselves foreclose on property within the City or sell property within the City to enforce the tax lien on taxable property to pay the principal of and interest on the Bonds. Furthermore, the City is eligible to seek relief from its creditors under Chapter 9 of the U.S. Bankruptcy Code (“Chapter 9”). Although Chapter 9 provides for the recognition of a security interest represented by a specifically pledged source of revenues (such as the Net Revenues), such provision is subject to judicial construction. Chapter 9 also includes an automatic stay provision that would prohibit, without Bankruptcy Court approval, the prosecution of any other legal action by creditors

or bondholders of an entity that has sought protection under Chapter 9. Therefore, should the City avail itself of Chapter 9 protection from creditors, the ability to enforce any remedies under either Ordinance would be subject to the approval of the Bankruptcy Court (which could require that the action be heard in Bankruptcy Court instead of other Federal or State courts); and the Bankruptcy Code provides for broad discretionary powers of a Bankruptcy Court in administering any proceeding brought before it. The opinions of Co-Bond Counsel will note that all opinions relative to the enforceability of the Ordinances and the Bonds are qualified with respect to the customary rights of debtors relative to their creditors and by general principles of equity which permit the exercise of judicial discretion.

### ***Paying Agent/Registrar***

The principal of the Bonds will be paid to the registered owner at stated maturity or prior redemption upon presentation of the Bond to the Paying Agent/Registrar, which initially is The Bank of New York Mellon Trust Company, National Association, at its offices located in Dallas, Texas. Interest on the Bonds will be paid to registered owners shown on the records of the Paying Agent/Registrar on the Record Date, and such interest will be paid by check and sent by mail to the address of such registered owner appearing on the registration books of the Paying Agent/Registrar or by such other customary banking arrangements acceptable to the Paying Agent/Registrar requested by, and at the risk and expense of, the registered owner. See “THE BONDS – Record Date” herein.

### ***Successor Paying Agent/Registrar***

The City reserves the right to replace the Paying Agent/Registrar. If the City replaces the Paying Agent/Registrar, the new Paying Agent/Registrar shall accept the previous Paying Agent/Registrar’s records and act in the same capacity as the previous Paying Agent/Registrar. Any successor Paying Agent/Registrar selected by the City shall be a bank, a trust company, financial institution, or other entity duly qualified and legally authorized to serve and perform the duties of Paying Agent/Registrar for the Bonds. Upon a change in the Paying Agent/Registrar for the Bonds, the City shall promptly cause a written notice thereof to be sent to each registered owner of the Bonds by United States mail, first-class postage prepaid, which notice shall give the address of the new Paying Agent/Registrar.

### ***Record Date***

The Record Date for determining the party to whom the interest on the Bonds is payable on any interest payment date is the close of business on the fifteenth day of the month next preceding such interest payment date.

### ***Future Registration***

In the event the Book-Entry-Only System should be discontinued, the Bonds may be transferred, exchanged and assigned on the registration books of the Paying Agent/Registrar, only upon presentation and surrender thereof to the Paying Agent/Registrar and such transfer or exchange of the Bonds shall be without expense or service charge to the owner, except for any tax or other governmental charges required to be paid with respect to such registration and transfer. A Bond may be assigned by the execution of an assignment form on the Bond or by other instrument of transfer and assignment acceptable to the Paying Agent/Registrar. A new Bond or Bonds will be delivered by the Paying Agent/Registrar in lieu of the Bonds being transferred or exchanged at the corporate trust office of the Paying Agent/Registrar, or sent by United States mail, first-class postage prepaid, to the new registered owner or his assignee. To the extent possible, new Bonds issued in an exchange or transfer of Bonds will be delivered to the contracting party or assignee of the owner in not more than three (3) business days after the receipt of the Bonds to be canceled in the exchange or transfer and the written instrument of transfer or request for exchange duly executed by the owner or his duly authorized agent, in form satisfactory to the Paying Agent/Registrar. Bonds registered and delivered in an exchange or transfer shall be in denominations of \$5,000 for any one maturity or any integral multiple thereof and for a like aggregate principal amount of the Bond or Bonds surrendered for exchange or transfer.

### ***Special Record Date for Interest Payment***

In the event of a nonpayment of interest on a scheduled payment date, and for thirty days thereafter, a new record date for such interest payment (“Special Record Date”) will be established by the Paying Agent/Registrar, if and when funds for the payment of such interest have been received from the City. Notice of the Special Record Date and of the scheduled payment date of the past due interest (which shall be fifteen days after the Special Record Date) shall be sent at least five business days prior to the Special Record Date by United States mail, first-class postage prepaid to the address of each

holder appearing on the Security Register at the close of business on the last business day next preceding the date of mailing of such notice.

### ***Replacement Bonds***

The City has agreed to replace mutilated, destroyed, lost, or stolen Bonds upon surrender of the mutilated Bonds to the Paying Agent/Registrar, or receipt of satisfactory evidence of such destruction, loss, or theft, and receipt by the City and Paying Agent/Registrar of security or indemnity as may be required by either of them to hold them harmless. The City may require payment of taxes, governmental charges, and other expenses in connection with any such replacement.

### ***Book-Entry-Only System***

This section describes how ownership of the Bonds is to be transferred and how the principal of, premium, if any, and interest on the Bonds are to be paid to and credited by DTC while the Bonds are registered in its nominee name. The information in this section concerning DTC and the Book-Entry-Only System has been provided by DTC for use in disclosure documents such as this Official Statement. The City, the Co-Financial Advisors and the Underwriters believe the source of such information to be reliable, but take no responsibility for the accuracy or completeness thereof.

The City cannot and does not give any assurance that (i) DTC will distribute payments of debt service on the Bonds, or redemption or other notices, to DTC Participants, (ii) DTC Participants or others will distribute debt service payments paid to DTC or its nominee (as the registered owner of the Bonds), or redemption or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or (iii) DTC will serve and act in the manner described in this Official Statement. The current rules applicable to DTC are on file with the United States Securities and Exchange Commission, and the current procedures of DTC to be followed in dealing with DTC Participants are on file with DTC.

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered certificate will be issued for each series of the Bonds in the aggregate principal amount of such issue, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC provides custody and asset servicing for about 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. DTC is a wholly owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation, and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: "AAA". The DTC Rules applicable to its participants are on file with the United States Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

Purchases of Bonds under the DTC system must be made by or through Direct Participants, who will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of the Bonds ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interest in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners, will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as: redemptions, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Paying Agent/Registrar and request that copies of notices are provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the City as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, principal and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detailed information from the City or the Paying Agent/Registrar on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC (nor its nominee), the Paying Agent/Registrar or the City, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, principal and interest payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the City; disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the City. Under such circumstances, in the event that a successor depository is not obtained, Bonds are required to be printed and delivered.

The City may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Bonds will be printed and delivered.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the City believes to be reliable, but the City takes no responsibility for the accuracy thereof.

So long as Cede & Co. is the registered owner of the Bonds, the City will have no obligation or responsibility to the DTC Participants or Indirect Participants, or to the persons for which they act as nominees, with respect to payment to or providing of notice to such Participants, or the persons for which they act as nominees.

#### ***Use of Certain Terms in Other Sections of this Official Statement***

In reading this Official Statement, it should be understood that while the Bonds are in the Book-Entry-Only System, references in other sections of this Official Statement to registered owners should be read to include the person for which the Direct or Indirect Participant acquires an interest in the Bonds, but (i) all rights of ownership must be exercised through DTC and the Book-Entry-Only System, and (ii) except as described above, notices that are to be given to registered owners under the Ordinances will be given only to DTC.

## JUNIOR LIEN OBLIGATIONS

On May 15, 2003, the City issued \$250,000,000 of Junior Lien Obligations (“2003 Junior Lien Obligations”) to fund certain capital infrastructure improvements to the Systems and costs of issuance. The 2003 Junior Lien Obligations currently carry an adjustable rate of interest that resets weekly. The final maturity date on any remaining outstanding principal of and interest on the Junior Lien Obligations issued in May 2003 is February 1, 2033. Effective May 19, 2010, Jefferies & Company, Inc. assumed the role of Remarketing Agent for the 2003 Junior Lien Obligations.

On November 18, 2004, the City issued an additional \$160,000,000 of Junior Lien Obligations (“2004 Junior Lien Obligations”) to acquire an additional 300 megawatts of electric generating capacity in the South Texas Project (“STP”). See “DESCRIPTION OF PHYSICAL PROPERTY – Electric System - South Texas Project” herein. In addition, the 2004 Junior Lien Obligations were issued to make other improvements to the Systems and to pay for costs of issuance. On December 1, 2007, the 2004 Junior Lien Obligations were remarketed in the principal amount of \$152,000,000 in a Term Mode, with a three-year interest rate period and a mandatory tender date of December 1, 2010. On December 1, 2010, \$147,615,000 of the 2004 Junior Lien Obligations will be remarketed in a Term Mode with a two-year interest rate period expiring November 30, 2012; \$4,385,000 will be optionally redeemed from funds heretofore deposited with an authorized escrow agent to effectuate the legal defeasance of these 2004 Junior Lien Obligations. As a result, the 2004 Junior Lien Obligations are subject to mandatory tender on December 1, 2012. The 2004 Junior Lien Obligations have a final maturity date of December 1, 2027. While bearing interest in a Term Mode, the interest on the 2004 Junior Lien Obligations is payable semi-annually on June 1 and December 1. Morgan Stanley & Co. Incorporated, pursuant to the terms of a remarketing agreement dated November 1, 2004 (and as supplemented from time to time), has been appointed as the remarketing agent for the 2004 Junior Lien Obligations.

After issuance of the Bonds described in this Official Statement, there will be \$897,615,000 in aggregate principal amount of Junior Lien Obligations outstanding. The mode for the variable rate Junior Lien Obligations or any portion thereof may be converted to a different mode, or to an auction rate or term rate with an interest rate period of different duration, at the direction of the City. Following such a conversion, the variable rate Junior Lien Obligations or portions thereof, will bear interest at the corresponding daily rate, weekly rate, auction rate, commercial paper rate, term rate, or fixed rate. In connection with the issuance of each series of the 2003 Junior Lien Obligations and the 2004 Junior Lien Obligations, the City enhanced their liquidity by providing for the purchase of the 2003 Junior Lien Obligations and the 2004 Junior Lien Obligations that are not remarketed by the remarketing agents through two separate Standby Bond Purchase Agreements, with two different banks. These banks, with respect to the series of the 2003 Junior Lien Obligations and the 2004 Junior Lien Obligation, are not obligated to pay the principal or redemption price of or interest on the 2003 Junior Lien Obligations or the 2004 Junior Lien Obligations under any circumstances, but are obligated only to purchase tendered 2003 Junior Lien Obligations or tendered 2004 Junior Lien Obligations on and subject to the terms, provisions, and conditions of each bank’s respective Standby Bond Purchase Agreement.

The borrowings from the Junior Lien Obligations are equally and ratably secured by and are payable from the Net Revenues of the Systems, such pledge being subordinate and inferior to the pledge of Net Revenues securing the Senior Lien Obligations, but prior and superior to the lien on and pledge of the Net Revenues securing the payment of the Commercial Paper Obligations or any notes to be issued pursuant to the Flexible Rate Revolving Note Private Placement Program. The obligations of the City under the two Standby Bond Purchase Agreements are secured on a parity basis with the pledge of the Net Revenues that secures all Junior Lien Obligations (including the Bonds). See “RESPONSE TO COMPETITION – Debt and Asset Management Program” and “CONSTRUCTION PROGRAM” herein.

## **COMMERCIAL PAPER PROGRAM**

Pursuant to authorization from the City, CPS Energy maintains a Commercial Paper Program to provide tax-exempt financing for various purposes. The Commercial Paper Program, which has been amended numerous times since its inception, and which was most recently amended and restated on June 26, 1997, currently is authorized to have Notes outstanding thereunder in an aggregate principal amount not to exceed \$450,000,000. A revolving credit agreement, as amended, with a consortium of banks (“Credit Agreement”) permits CPS Energy to borrow up to an aggregate amount not to exceed \$450,000,000 in immediately available funds on a revolving basis, until November 1, 2012, with one-year extensions by mutual agreement of the City, the administrative agent and the lenders, to pay the principal of maturing Notes. As of the date of this Official Statement, \$330,000,000 in aggregate principal amount of Notes was outstanding (\$200,000,000 of which are to be refunded with proceeds of the Series 2010B Bonds).

The purpose of the Commercial Paper Program is to: (i) assist in the financing of capital improvements to the Systems; (ii) provide working capital and funds for fuel acquisition; (iii) pay interest on resold Notes; (iv) refund outstanding Notes on maturity; and (v) redeem other obligations of the Systems which are secured by and payable from a lien on and/or a pledge of Net Revenues of the Systems. Scheduled maturities of the Notes may not extend past November 1, 2028 (the maturity date specified in the ordinance authorizing the Commercial Paper Program). See “RESPONSE TO COMPETITION – Debt and Asset Management Program” and “CONSTRUCTION PROGRAM” herein.

The borrowings under the Commercial Paper Program, including the Notes, are equally and ratably secured by and are payable from (i) the Net Revenues of the Systems, such pledge being subordinate and inferior to the pledge of Net Revenues securing the Senior Lien Obligations, and the currently outstanding Junior Lien Obligations (including the Bonds); (ii) the proceeds from the sale of additional bonds issued for that purpose or borrowings under the Commercial Paper Program; and (iii) borrowings under and pursuant to the Credit Agreement. The obligations of the City under the Credit Agreement are secured on a parity basis with the pledge of the Net Revenues that secures the Notes and constitute the Commercial Paper Obligations.

## **FLEXIBLE RATE REVOLVING NOTE PRIVATE PLACEMENT PROGRAM**

The City has established a flexible rate revolving note program (“Flexible Rate Revolving Note Private Placement Program”) for the benefit of the Systems, under which the City may issue taxable or tax exempt notes, bearing interest at fixed or variable rates and having individual maturities of one year or less, in an aggregate principal amount at any one time outstanding not to exceed \$100,000,000 (“Flex Rate Notes”). This program became effective on April 28, 2009, and now provides additional liquidity in support of the Systems. This program authorizes the issuance of such notes through November 1, 2028. These notes will be secured by an inferior lien pledge of Net Revenues (to be classified as Inferior Lien Obligations pursuant to the Bond Ordinances), funds, deposits, or investments of the Board legally available for such purpose, or any combination of the foregoing, and will be sold, by private placement, to provider banks (anticipated to be the Board’s depository bank) under note purchase agreements entered into by the City from time to time. JPMorgan Chase Bank, N.A. currently serves as the note purchaser under this program by contractual arrangement in effect through December 31, 2010. CPS Energy expects to extend the note purchase agreements, prior to the stated termination date, with JPMorgan Chase Bank, N.A. to December 2011.

On May 10, 2010, CPS Energy issued \$25,200,000 of Flex Rate Notes, the interest on which is not excluded for purposes of federal income taxation, under this program and used the proceeds on May 11, 2010, along with other lawfully-available funds, to effectuate the defeasance of \$25,745,000 of outstanding Senior Lien Obligations and Junior Lien Obligations, the interest on which is excluded for purposes of federal income taxation. This action became necessary upon the transfer of tax exempt bond-financed facilities as a part of its settlement of litigation relating to STP Units 3 and 4. See “DESCRIPTION OF PHYSICAL PROPERTY – Electric System – Nuclear Cost Issue and CPS Energy Internal Investigation” herein. There are \$25,200,000 of outstanding Flex Rate Notes under the Flexible Rate Revolving Note Private Placement Program as of the date of this Official Statement.

## DEBT SERVICE REQUIREMENTS

The following schedule reflects annual principal and interest requirements on all outstanding Senior Lien Obligations and the Junior Lien Obligations, including the annual debt service requirements on the Bonds. Debt service incurred on obligations issued from time to time under the Commercial Paper Program and the Flexible Rate Revolving Note Private Placement Program, respectively, is excluded. See "JUNIOR LIEN OBLIGATIONS", "COMMERCIAL PAPER PROGRAM", and "FLEXIBLE RATE REVOLVING NOTE PRIVATE PLACEMENT PROGRAM" herein.

### *Outstanding Senior Lien Obligations and Junior Lien Obligations*

Year Ending February 1,	Total Senior Lien Obligations <sup>1</sup>	Junior Lien Obligations			Total Senior and Junior Lien Obligations <sup>5,6</sup>
		Junior Lien Obligations Outstanding <sup>2,3</sup>	Series 2010A Bonds Debt Service <sup>4</sup>	Series 2010B Bonds Debt Service <sup>4</sup>	
2011	\$ 357,053,617	\$ 15,351,044	\$ 2,737,020	\$ 1,981,763	\$ 377,123,444
2012	363,533,974	15,351,044	11,325,600	8,200,400	398,411,018
2013	351,137,304	15,351,044	11,325,600	8,200,400	386,014,348
2014	354,532,123	15,904,600	11,325,600	8,200,400	389,962,723
2015	318,240,023	15,904,600	11,325,600	8,200,400	353,670,623
2016	310,847,898	15,904,600	11,325,600	8,200,400	346,278,498
2017	314,093,554	15,904,600	11,325,600	8,200,400	349,524,154
2018	300,659,310	15,904,600	11,325,600	8,200,400	336,089,910
2019	308,658,360	15,904,600	11,325,600	8,200,400	344,088,960
2020	308,652,930	15,904,600	11,325,600	8,200,400	344,083,530
2021	303,776,345	15,904,600	11,325,600	8,200,400	339,206,945
2022	312,781,233	15,904,600	11,325,600	8,200,400	348,211,833
2023	312,780,023	15,904,600	11,325,600	8,200,400	348,210,623
2024	312,779,960	15,904,600	11,325,600	8,200,400	348,210,560
2025	309,783,810	53,904,600	11,325,600	8,200,400	383,214,410
2026	113,980,610	52,384,600	11,325,600	8,200,400	185,891,210
2027	113,977,810	50,864,600	11,325,600	8,200,400	184,368,410
2028	113,974,272	44,959,600	11,325,600	8,200,400	178,459,872
2029	113,977,460	60,000,000	11,325,600	8,200,400	193,503,460
2030	113,981,772	58,000,000	11,325,600	8,200,400	191,507,772
2031	113,973,772	56,000,000	11,325,600	8,200,400	189,499,772
2032	112,896,348	54,000,000	11,325,600	8,200,400	186,422,348
2033	120,990,898	52,000,000	11,325,600	8,200,400	192,516,898
2034	119,163,004	-	11,325,600	58,245,400	188,734,004
2035	122,511,827	-	11,325,600	54,898,455	188,735,882
2036	123,271,827	-	11,325,600	54,134,607	188,732,034
2037	124,085,462	-	11,325,600	53,320,122	188,731,184
2038	124,934,980	-	63,800,600	-	188,735,580
2039	125,837,978	-	62,894,564	-	188,732,542
2040	53,393,042	-	103,007,944	-	156,400,986
2041	54,403,912	-	102,000,644	-	156,404,556
Totals	<u>\$ 6,604,665,438</u>	<u>\$ 703,117,132</u>	<u>\$ 628,906,372</u>	<u>\$ 402,989,147</u>	<u>\$ 8,339,678,089</u>

(1) Excludes regularly scheduled interest due on the Taxable New Series 2009C Bonds and the Taxable New Series 2010A Bonds anticipated to be off-set by the refundable tax credit to be received from the Treasury as a result of such obligations being designated as the refundable tax credit relating to the Taxable New Series 2009C Bonds and the Taxable New Series 2010A Bonds.

(2) Assumes redemption in accordance with mandatory sinking fund requirements, but no redemption of the 2003 Junior Lien Obligations purchased by the liquidity bank. If the 2003 Junior Lien Obligations purchased by the liquidity bank are not remarketed by the end of the bank's commitment period, they must be redeemed in ten semiannual installments. Also assumes interest rate expense at 4% per annum. Actual interest rates are set weekly, as long as the 2003 Junior Lien Obligations remain in a weekly rate mode, and will differ.

(3) Assumes redemption in accordance with mandatory sinking fund requirements, but no redemption of the 2004 Junior Lien Obligations purchased by the liquidity bank. If the 2004 Junior Lien Obligations purchased by the liquidity bank are not remarketed by the end of the bank's commitment period, they must be redeemed in eight semiannual installments. Interest on the 2004 Junior Lien Obligations is calculated at the current three-year term expiring November 30, 2010, at 3.625% which is the expected interest rate for a new two-year Term Rate period commencing December 1, 2010 and extending to November 30, 2012, and at 4% per annum thereafter for purposes of illustration. Actual interest rates will be variable after the current interest rate period and will differ.

(4) Excludes regularly scheduled interest due on these obligations anticipated to be off-set by the Refundable Tax Credit. See "THE BONDS - Refundable Tax Credit Bonds".

(5) Includes debt service on the Bonds. Senior Lien Obligations outstanding and Junior Lien Obligations outstanding represent the debt service requirements for the total outstanding debt payable from and secured by the Net Revenues of the Systems, excluding debt service in respect of the Commercial Paper Program and the Flexible Rate Revolving Note Placement Program. See "COMMERCIAL PAPER PROGRAM" and "FLEXIBLE RATE REVOLVING NOTE PRIVATE PLACEMENT PROGRAM".

(6) If the 2003 Junior Lien Obligations and the 2004 Junior Lien Obligations were to bear interest at the rate of 10% per annum (which is the maximum interest rate unless the supporting liquidity facilities are amended), maximum total annual debt service requirements would increase from \$398,411,018 to \$411,495,874, in the fiscal year ending February 1, 2012.

## Historical Net Revenues and Coverage

(Dollars in thousands)

Fiscal Years Ended January 31,

	2006	2007	2008	2009	2010	2010 <sup>1</sup>
Gross Revenues <sup>2</sup> .....	\$ 1,754,927	\$ 1,822,230	\$ 1,943,313	\$ 2,191,323	\$ 1,981,103	\$ 2,052,344
Maintenance & Operating Expenses ...	1,057,035	1,104,037 <sup>3</sup>	1,177,337	1,408,353 <sup>3</sup>	1,205,189	1,218,909
Available For Debt Service .....	\$ 697,892	\$ 718,193	\$ 765,976	\$ 782,970	\$ 775,914	\$ 833,435
Actual Principal and Interest Requirements:						
Senior Lien Obligations <sup>4</sup> .....	\$ 256,442	\$ 271,931	\$ 290,954	\$ 309,855	\$ 332,540 <sup>5</sup>	\$ 347,916 <sup>5</sup>
Junior Lien Obligations .....	\$ 10,964	\$ 15,006	\$ 15,179	\$ 11,190	\$ 6,987	\$ 6,742
ACTUAL COVERAGE - Senior Lien <sup>6</sup> ..	2.72x	2.64x	2.63x	2.53x	2.33x	2.40x
ACTUAL COVERAGE - Senior and Junior Liens .....	2.61x	2.50x	2.50x	2.44x	2.29x	2.35x
PRO FORMA MADS COVERAGE						
Senior Lien <sup>7</sup> .....	1.92x	1.98x	2.11x	2.15x	2.13x	2.29x
Senior and Junior Liens <sup>8</sup> .....	1.75x	1.80x	1.92x	1.97x	1.95x	2.09x

(1) Twelve months ended July 31, 2010.

(2) Calculated in accordance with the Bond Ordinances.

(3) Certain amounts in prior years have been reclassified to conform to the current-year presentation.

(4) Net of accrued interest where applicable.

(5) Includes a reduction in debt service of \$5.0 million and \$10.6 million for the year ending January 31, 2010, and twelve months ended July, 31, 2010, respectively on the Taxable New Series 2009C Bonds and Taxable New Series 2010A Bonds as a result of such obligations' designation as "build America Bonds" and "qualified bonds" under the Code and the City's receipt of the refundable tax credits as a result thereof.

(6) Calculation differs from "FIVE-YEAR STATEMENT OF NET REVENUES AND DEBT SERVICE COVERAGE" herein, by the inclusion of nonoperating expenses in the above schedule.

(7) Maximum annual debt service on Senior Lien Obligations.

(8) Maximum annual debt service on Senior Lien Obligations, the Bonds, and the Junior Lien Obligations is based upon the footnoted assumptions under "Outstanding Senior Lien Obligations and Junior Lien Obligations," footnote 3, on the previous page.

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## SAN ANTONIO ELECTRIC AND GAS SYSTEMS

### *History and Management*

The City acquired its electric and gas utilities in 1942 from the American Light and Traction Company, which had been ordered by the federal government to sell properties under provisions of the Holding Company Act of 1935. The bond ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations, Junior Lien Obligations, Commercial Paper Notes and Inferior Lien Obligations establish management requirements and provide that the complete management and control of the Systems is vested in the Board. The Mayor of the City is a voting member of the Board, represents the City Council, and is charged with the duty and responsibility of keeping the City Council fully advised and informed at all times of any actions, deliberations, and decisions of the Board and its conduct of the management of the Systems. The present members of the Board are:

<u>Name</u>	<u>Profession</u>	<u>Originally Appointed to the Board</u>	<u>Present Term Expires<sup>1</sup></u>
Charles E. Foster, Chairman	AT&T, Retired Prodigy Internet, Retired	January 14, 2010	January 31, 2012
Derrick Howard, Vice Chairman	Executive Director, Freeman Coliseum	February 1, 2008	January 31, 2013
Stephen S. Hennigan, Trustee	Executive Vice President, San Antonio Federal Credit Union	June 1, 2001	January 31, 2011
Homer Guevara, Jr., Trustee	Professor, Academic Chair - Business & Government, Northwest Vista College	March 19, 2009	January 31, 2014
Julián Castro, Ex-Officio Member	Mayor, City of San Antonio	June 1, 2009	May 31, 2011

(1) Stephen S. Hennigan is currently serving his second term. Derrick Howard and Homer Guevara, Jr. are serving their first terms. Julián Castro assumed his Board position upon becoming Mayor on June 1, 2009. Charles E. Foster was selected to serve for Aurora Geis's remaining term. See "DESCRIPTION OF PHYSICAL PROPERTY – Electric System - Nuclear Cost Issue and CPS Energy Internal Investigation" herein for a discussion of recent developments affecting the Board and its members.

Vacancies in membership on the Board are filled by majority vote of the remaining members. New Board appointees must be approved by a majority vote of the City Council. A vacancy in certain cases may be filled by authorization from the City Council. The members of the Board are eligible for re-appointment by other Board members at the expiration of their first five-year term of office to one additional term. Reappointments require approval by the City Council. In 1997, the City Council ordained that Board membership should be representative of the geographic quadrants established by the City Council. New Board members considered for approval by the City Council will be those whose residence is in a quadrant that provides such geographic representation.

The Board is vested with all of the powers of the City with respect to the management and operation of the Systems and the expenditure and application of the revenues, including all powers necessary or appropriate for the performance of all covenants, undertakings, and agreements of the City contained in the bond ordinances, except regarding rates, condemnation proceedings, and issuance of bonds, notes, or commercial paper. The Board has full power and authority to make rules and regulations governing the furnishing of electric and gas service and full authority with reference to making extensions, improvements and additions to the Systems, and to adopt rules for the orderly handling of CPS Energy's affairs. It is empowered to appoint and employ all officers and employees and must obtain and keep in force a "blanket" type employees' fidelity and indemnity bond covering losses in the amount of not less than \$100,000.

The management provisions of the bond ordinances also grant the City Council authority to review Board action with respect to policies adopted relating to research, development, and planning.

### *Citizens Advisory Committee*

In 1997, CPS Energy established a 15-member Citizens Advisory Committee ("CAC") to enhance its relationship with the community and to address the City Council's goals regarding broader community involvement with CPS Energy. The CAC meets monthly and the primary goal of the CAC is to provide recommendations from the community on the operations of CPS Energy for use by the Board and CPS Energy staff. Representing the various sectors of CPS Energy's service area, the CAC encompasses a broad range of customer groups in order to identify their concerns and understand their issues.

City of San Antonio City Council members nominate ten of the 15 members, one representing each district. The other five members are at-large candidates interviewed and nominated by the CPS Energy Citizens Advisory Committee from those submitting applications and resumes. The CPS Energy Board of Trustees appoints all members to the committee. Members can serve up to three two-year terms.

### ***Administration and Operating Personnel***

CPS Energy had 3,659 employees as of July 31, 2010. The average tenure of a CPS Energy employee is over 13 years. The vast majority of all executive and supervisory personnel have been schooled and trained in the utility industry. CPS Energy employees have a broad range of benefits, including a defined benefit pension plan, group life insurance, hospitalization, major medical and other benefits. Generally good working conditions have produced a stable, well-qualified, highly motivated work force which, between August 1, 2009 and July 31, 2010, recorded an average turnover rate of 2.77%. There are approximately 1,686 wage scale (hourly) employees in the CPS Energy work force.

CPS Energy links an employee incentive compensation plan to employee participation in controlling expenses, promoting safety, maintaining low utility bills, and enhancing customer satisfaction. The Executive Incentive Plan, established in 1997, provides links between CPS Energy's competitiveness and each executive's compensation. Incentive plans were implemented for the entire salaried work force (including exempt and non-exempt employees) in 1998 and for the entire wage-scale (hourly) workforce in 2003.

CPS Energy continues to enhance its Performance Management system. This system supports a process that develops and emphasizes performance against an established set of workforce attributes (behavioral factors) and engages all employees in actively working toward key performance goals that align to organizational and business unit/area strategies and objectives. The process is designed to provide for continual monitoring and a high level of coaching and feedback to reach performance expectations, to provide meaningful developmental opportunities, to emphasize how results are achieved, and to reward and recognize contributions toward business goals. The traditional employee annual review process and cost-of-living driven pay system have been replaced with an enhanced performance assessment process, market-based salaries, and incentive awards based on CPS Energy's overall performance. In addition, CPS Energy is actively engaged in comprehensive workforce development and succession planning processes to promote wider development opportunity for employees to learn and grow. These processes are based on the foundational ideas that all employees are expected to develop to their maximum capabilities and that succession planning must focus on ensuring that key positions in the organization are always staffed by employees who have the capacity to keep the company operating at its highest level of productivity.

In the fall of 2006, CPS Energy announced plans for a major organizational redesign of CPS Energy's management. This redesign focused on preparing CPS Energy for the competitive deregulated market that it may be required to enter in the future. By developing an optimal management structure, CPS Energy wants to ensure its continued success either in or out of the competitive deregulated environment. The first phase of the organizational redesign plan began on November 21, 2006, when CPS Energy announced the creation of a senior management "Strategy Development Team". The goal of this management team is to concentrate on corporate strategies for CPS Energy's continued success. Reporting directly to the Strategy Development Team is a management team that focuses on strategy implementation. The "Strategy Implementation and Innovation Team" concentrates on transforming strategic plans into operational processes and actions. Phase one of the redesign was completed with the selection of the members to the Strategy Implementation and Innovation Team on February 7, 2007. Phase two of the organizational redesign focused on the development of CPS Energy's next level management positions and this team is called the "Continuous Quality Improvement Team". This team is responsible for improving efficiencies and effectiveness of processes throughout the organization. The Continuous Quality Improvement Team was established on November 7, 2007. The Organizational Development Division of Corporate Shared Services ("OD") business area continues to monitor CPS Energy's organizational design, reviewing accountabilities of managers in these tiers of the organization.

CPS Energy's principal executives and members of the Strategy Development Team include: Doyle N. Beneby, President & CEO; Paula Gold-Williams, Treasurer, Executive Vice President and Chief Financial Officer; Jelynn LeBlanc-Burley, Executive Vice President of Corporate Support Services & Chief Administrative Officer; John B. Moore, Executive Vice President of Energy Delivery Services; Cristopher C. Eugster, Executive Vice President and Chief Sustainability Officer; Carolyn E. Shellman, Secretary, Executive Vice President and General Counsel; Richard M. Peña, Senior Vice President of Energy Development; Michael K. Kotara, Senior Vice President of Fossil Generation; John Saenz, Jr., Senior Vice President of Retail Energy; Lloyd D. (L.D.) Hollingsworth, Chief Risk Officer; Helen F. Madison, Chief Audit & Ethics Officer; Jim Campbell, Senior Director of Governmental Relations and Communications; and Eduardo J. Belmares, Chief of Staff.

Mr. Beneby joined CPS Energy on August 1, 2010 as President & CEO. A veteran of the electric industry with over 25 years of experience, Mr. Beneby held several leadership positions with Exelon Power and PECO (Philadelphia Electric Company) after joining PECO in 2003. Most recently, he served as President of Exelon Power and Senior Vice President of Exelon Generation where he was responsible for the operations of approximately 8,000 megawatts of natural gas, coal, hydroelectric and solar generation in five states. Mr. Beneby previously held the positions of Senior Vice President, Vice President of Operations and Vice President of Construction and Maintenance with Exelon Power. He has also held positions with Consumers Energy in Michigan and Florida Power & Light. Mr. Beneby earned a bachelor's degree in engineering from Montana Technical College and a master of business administration degree from the University of Miami.

Ms. Gold-Williams joined CPS Energy in October 2004, and served as Controller & Assistant Treasurer, as well as Vice President & Chief Administrative Officer before being appointed Executive Vice President for Financial Services and Chief Financial Officer. Ms. Gold-Williams is responsible for the major areas of budgeting, finance, accounting, and the financial operations of CPS Energy and also serves as Treasurer of the Board. Prior to joining CPS Energy, she held several senior management positions at other companies, including serving as the Vice President of Finance for a publicly traded food service company from 2000 – 2004 with responsibilities over SEC reporting, debt management, financial planning and budgeting, tax and various accounting functions. From 1998 to 2000, Ms. Gold-Williams initially served as the Controller for the same publicly traded company and directly before that period she served as a Regional Controller for Time Warner Cable from 1990 – 1998. At Time Warner Cable, Ms. Gold-Williams was responsible for all accounting functions and intermittently led other functions including IT, purchasing and front counter customer service. Ms. Gold-Williams is a CPA and also holds a master of business administration degree with a concentration in finance and accounting.

Ms. LeBlanc-Burley joined CPS Energy on April 7, 2008, as Vice President & Chief Administrative Officer for Organizational Excellence & Shared Services after serving local municipal government for 24 years. She was appointed by the Board of Trustees to serve as Acting General Manager on November 30, 2009. Ms. LeBlanc-Burley served in this role through August 1, 2010 when she became Executive Vice President of Corporate Shared Services & Chief Administrative Officer. Before leaving the City of San Antonio, she served as Deputy City Manager for Planning and Development. In her current role, Ms. LeBlanc-Burley is responsible for all aspects of Human Resources Management, Supply Chain, Facilities and Information Services. Ms. LeBlanc Burley holds a master's degree in urban studies from Trinity University.

Mr. Moore joined CPS Energy on April 13, 2009, and serves as Executive Vice President of Energy Delivery Services (“EDS”). Mr. Moore most recently served as Vice President of Transmission and Interconnection for E.ON Climate and Renewables, a large developer and operator of wind generation. He previously worked as an independent consultant focused on electric and telecommunications utilities, and he helped with the start-up of Grande Communications as Vice President and General Manager for the Austin region. From 1997 to 2000, Mr. Moore was the Lower Colorado River Authority's Executive Manager of Business Development and Regulatory Affairs for Transmission, and he was General Manager of the City of Austin Electric Utility from 1984 to 1997. A graduate of the University of Texas at Austin, Mr. Moore holds a master of business administration degree.

Dr. Eugster became CPS Energy's first Chief Sustainability Officer (“CSO”) on May 4, 2009. Dr. Eugster most recently served as the City of Houston's Officer for Sustainable Growth. Dr. Eugster initially worked for a consulting firm, served as an officer of an energy hedge fund and ran his own consulting business before joining the City of Houston in 2007. Dr. Eugster received a Ph. D. in electrical engineering from the Massachusetts Institute of Technology. Dr. Eugster holds two patents dealing with nano-transmitter design and he has published more than 30 scientific papers. In his role as CSO, Dr. Eugster is responsible for CPS Energy's generation research and planning, environmental planning and compliance, and energy research and technology initiatives.

Ms. Shellman joined CPS Energy in July 2006. She previously served as General Counsel and Secretary for the Electric Reliability Council of Texas (“ERCOT”). Prior to that, she served as a partner in the utility sections of two separate Texas law firms. Ms. Shellman has also served as the Director for the Hearings Division of the Public Utility Commission of Texas (“PUCT”) and as a hearing officer with the PUCT. In addition to serving as CPS Energy's General Counsel, she also serves as Chief Compliance Officer and Secretary to the Board. Ms. Shellman has an undergraduate degree from Vassar College and a law degree from the University of Oklahoma.

Mr. Peña has been an employee of CPS Energy since 1983 and has previously served as Superintendent of Plant Betterment, Maintenance and Betterment Services, Director of Engineering, Technical Services, and Human Resource Development. Mr. Peña was promoted to Vice President of Gas Systems in January 2002 and named Vice President of Fossil Generation in 2007. He became Senior Vice President of Energy Development in December 2009. In his current role, he is responsible for Fuels Procurement Marketing; Energy Market Operations; JKS 2 Construction Project; and for STP Nuclear Ownership. Mr. Peña holds a master of business administration degree from Our Lady of the Lake University.

Mr. Kotara has been an employee of CPS Energy since 1985, and has held several leadership positions including Director of Gas Engineering, Director of Marketing, Director of Generation Control & Marketing, Director of Fuels, Vice President of the Gas Business Unit, Vice President of Wholesale Energy Markets and Executive Vice President of Energy Development. In his current role as Senior Vice President of Fossil Generation, Mr. Kotara is responsible for management of CPS Energy's fossil generation portfolio.

Mr. Saenz joined CPS Energy in January 2006, as Director of Retail Energy. He currently serves as Senior Vice President of Retail Energy and heads the company's retail functions, which include customer services; customer relationships and sales; strategic marketing; and economic development. Prior to joining CPS Energy, Mr. Saenz helped found Grande Communications Inc., a Central Texas-based bundled telecommunications firm. He also served as president and CEO of ExecuMark Inc., an executive consulting firm focused on sales and marketing strategies. Mr. Saenz also held executive positions with Central and South West Energy Services and Central Power & Light Company.

Mr. Hollingsworth serves as Chief Risk Officer. Mr. Hollingsworth is responsible for CPS Energy's Enterprise Risk Management Program that includes risk management policies and controls, management reporting and on-going company-wide risk assessments. In addition, Mr. Hollingsworth is responsible for credit risk management, insurance services, business continuity management and corporate security services. Mr. Hollingsworth is Co-Chair of CPS Energy's Enterprise Risk Management Committee, and a member of the Corporate Compliance Committee, Enterprise Financial Analysis Committee, and the Enterprise Technology Architecture Council. Mr. Hollingsworth's previous roles include: Senior Director, Enterprise Risk Management for R.W. Beck, Vice President of Finance for Cinergy Marketing and Trading, and Vice President and Chief Risk Officer for The Energy Authority. Mr. Hollingsworth was also employed by Goldman Sachs as Vice President in their commodity trading division, J. Aron and Company, and was a key person in the start-up of Arthur Andersen's Enterprise Risk Management Practice at their world headquarters in Chicago, IL.

Ms. Madison has been an employee of CPS Energy since 1976, and has held various positions in the financial and audit areas of the company. She has headed the internal audit function for CPS Energy since May 1988. In 2005, she was given the additional responsibility for the newly-established Ethics function for CPS Energy. In her role as the Chief Audit & Ethics Officer, Ms. Madison is responsible for leading a comprehensive program of internal audits and reviews for CPS Energy, as well as a comprehensive ethics program, and as such, has a direct reporting relationship to the Audit Committee of the Board of Trustees. Ms. Madison also serves as Chair of the STP Audit Group, which is responsible for conducting independent audits on behalf of the owners of STP. Ms. Madison holds a bachelor of business administration degree in accounting from The University of Texas at Austin. In addition, she is a CPA and a Certified Internal Auditor.

Mr. Campbell joined CPS Energy in August of 2004. As Senior Director of Governmental Relations and Communications for CPS Energy, Mr. Campbell is responsible for CPS Energy's federal, state and local government activities, as well as internal and external communications. Mr. Campbell served in a similar position with the City of San Antonio from 1997-2004. Prior to his appointments in municipal government, Mr. Campbell was Chief of Staff to Texas State Representative Tom Ramsay and Legislative Assistant and District Director to U.S. Congressman Jim Chapman. Mr. Campbell's private-sector experience includes employment with Houston Oil & Minerals Corporation and the Association of American Medical Colleges. He holds a bachelor's degree in political science, summa cum laude, from Texas A&M University.

Mr. Belmares joined CPS Energy in 2008, as Senior Director of Human Resources. He was appointed Acting Chief Administrative Officer prior to holding his current position as Chief of Staff. In this role, Mr. Belmares is responsible for supporting the President & CEO in providing leadership in the development, implementation, and execution of strategies, directing the management and resolution of issues, ensuring complete and appropriate information is provided to the President & CEO and the Board, and providing oversight and direction related to project management and performance measurements. Previously, Mr. Belmares served more than nine years in various positions with the City of San Antonio, including Director of the Human Resources Department and Director of the Office of Innovation and Reform. While with the City he also oversaw the Office of Municipal Integrity and worked five years in the budget office, including two years as Budget Manager. Mr. Belmares holds a master's degree in urban administration from Trinity University.

### ***Service Area***

The CPS Energy electric system serves a territory consisting of substantially all of Bexar County and small portions of the adjacent counties of Comal, Guadalupe, Atascosa, Medina, Bandera, Wilson and Kendall. Certification of this service area was granted by the PUCT.

CPS Energy is currently the exclusive provider of retail electric service within this service area, including the provision of electric service to some Federal military installations located within the service area that own their own distribution facilities. As discussed below under "CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Electric Utility Restructuring in Texas; Senate Bill 7", until and unless the City Council and the Board exercise the option to opt-in to retail

electric competition (called “Texas Electric Choice” by the PUCT), CPS Energy has the sole right to provide retail electric services in its service area. On April 26, 2001, after a thorough feasibility study was conducted and reviewed, the City Council passed a resolution stating that the City did not intend to opt-in to the deregulated electric market beginning January 1, 2002, the date Texas Electric Choice became effective. Senate Bill 7 (“SB 7”), adopted by the Texas Legislature in 1999, provides that electric “opt-in” decisions are to be made by the governing body or the body vested with the power to manage and operate a municipal utility such as CPS Energy. Given the relationship of the Board and the City Council, any decision to opt-in to electric competition would be based upon the adoption of resolutions by both the Board and the City Council. If CPS Energy and the City choose to opt-in, other retail electric energy suppliers would be authorized to offer retail electric energy in the CPS Energy service area and CPS Energy would be authorized to offer retail electric energy in any other service areas open to retail competition in ERCOT. See “CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – ERCOT”, herein. ERCOT is the independent entity that monitors and administers the flow of electricity within the interconnected grid that operates wholly within Texas. See “DESCRIPTION OF PHYSICAL PROPERTY – Electric System - Interconnected System” and “CUSTOMER RATES – Governmentally Imposed Fees, Taxes or Payments” herein. CPS Energy has the option of acting in the role of the “Provider of Last Resort” (hereinafter defined) for its service area in the event it and the City choose to opt-in. See “CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Electric Utility Restructuring in Texas; Senate Bill 7” herein.

In addition to the area served at retail rates, CPS Energy sells wholesale electricity to the Floresville Electric Light & Power System, the City of Hondo, and the City of Castroville. These three wholesale supply agreements have remaining terms ranging from three to five years until expiration. Additionally, CPS Energy has agreements to provide partial supply to various other municipalities and cooperatives through June 2011. To optimize certain times when excess capacity is available, CPS Energy will consider entering into additional long-term wholesale electric power agreements in the future. The requirements under the existing wholesale agreements are firm energy obligations of CPS Energy.

The CPS Energy gas system serves the City and its environs, although there is no certificated CPS Energy gas service area. In Texas, no legislative provision or regulatory procedure exists for certification of natural gas service areas. As a result, CPS Energy competes against other gas supplying entities on the periphery of its service area. Pursuant to the authority provided by Section 181.026, Texas Utilities Code, among other applicable laws, the City has executed a license agreement (“License Agreement”) with the City of Grey Forest, Texas (“Licensee”), dated as July 28, 2003, for a term through May 31, 2028. Pursuant to this License Agreement, the City permits the Licensee to provide, construct, operate and maintain certain natural gas lines within the boundaries of the City which it originally established in 1967 to provide extensions and other improvements thereto upon compliance with the provisions of the License Agreement and upon the payment to the City of a quarterly license fee of 3% of the gross revenues received by the Licensee from the sale of natural gas within the Licensed Area (as defined in the License Agreement). Thus, in the Licensed Area, CPS Energy is in direct competition with Grey Forest Utilities as a supplier of natural gas.

CPS Energy also has 20-year Franchise Agreements with 30 incorporated communities in the San Antonio area. These Franchise Agreements permit CPS Energy to operate its facilities in the cities’ streets and public ways in exchange for a franchise fee of 3% on electric and natural gas revenues earned within their respective municipal boundaries. Of these 30 agreements, 24 expire in 2010. Of those 24, seventeen (17) passed renewal ordinances as of October 31, 2010. The remaining seven (7) were automatically renewed for one year, per the terms of the agreements. The others expire in 2011, 2017, 2023, 2024 and 2029. In 2008, CPS Energy and the City of Castroville, a current wholesale power customer, reached an agreement whereby CPS Energy would operate and maintain the Castroville gas system. A similar two-year agreement was reached with the City of Lytle to operate and maintain the Lytle natural gas system commencing January 1, 2010.

**Customer Base<sup>1</sup> as of July 31, 2010**

Electric			Gas		
	Number	Percent		Number	Percent
Residential	626,597	88%	Residential	302,753	93%
Commercial & Industrial	65,916	9%	Commercial	17,990	6%
All Night Security Lighting	11,646	2%	Industrial & Public	2,776	1%
Street Lighting, Public Authorities & Other Utilities <sup>2</sup>	9,789	1%			
<b>Total</b>	<b>713,948</b>	<b>100%</b>	<b>Total</b>	<b>323,519</b>	<b>100%</b>

(1) See "FIVE-YEAR ELECTRIC AND GAS SALES BY CUSTOMER CATEGORY" and "FIVE-YEAR STATEMENT OF NET REVENUES AND DEBT SERVICE COVERAGE" herein for information regarding consumption of energy and contribution of revenues to the Systems by the average customers for these categories as of July 31, 2010.

(2) Also includes off-system sales customers.

**Retail Service Rates**

Under the Texas Public Utility Regulatory Act ("PURA"), significant original jurisdiction over the rates, services, and operations of "electric utilities" is vested in the PUCT. In this context, "electric utility" means an electric investor-owned utility. Since the electric deregulation aspects of SB 7 became effective on January 1, 2002, the PUCT's jurisdiction over electric investor-owned utility ("IOU") companies primarily encompasses only the transmission and distribution functions. PURA generally excludes municipally-owned utilities ("Municipal Utilities"), such as CPS Energy, from PUCT jurisdiction, although the PUCT has jurisdiction over electric wholesale transmission rates. See "Transmission Access and Rate Regulation" herein. Under the PURA, a municipal governing body or the body vested with the power to manage and operate a Municipal Utility such as CPS Energy has exclusive jurisdiction to set rates applicable to all services provided by the Municipal Utility with the exception of electric wholesale transmission activities and rates. Unless and until the City Council and Board choose to opt-in to electric retail competition, CPS Energy retail service electric rates are subject to appellate, but not original rate regulatory jurisdiction by the PUCT in areas that CPS Energy serves outside the San Antonio City limits. To date, no such appeal to the PUCT of CPS Energy retail electric rates has ever been filed. CPS Energy is not subject to the annual PUCT gross receipts fee payable by electric utilities. See "CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Electric Utility Restructuring in Texas; Senate Bill 7" herein.

The Texas Railroad Commission ("TRC") has significant original jurisdiction over the rates, services and operations of all natural gas utilities in the State. Municipal Utilities such as CPS Energy are generally excluded from regulation by the TRC, except in matters related to natural gas safety. CPS Energy retail gas service rates applicable to rate payers outside San Antonio are subject to appellate, but not original rate regulatory jurisdiction, by the TRC in areas that CPS Energy serves outside the City limits. To date, no such appeal to the TRC of CPS Energy retail gas rates has ever been filed. In the absence of a contract for service, the TRC also has jurisdiction to establish gas transportation rates for service to Texas State Agencies by a Municipal Utility. A Municipal Utility is also required to sell gas to and transport State-owned gas for "public retail customers," including State agencies, State institutions of higher education, public school districts, United States military installations, and United States Veterans Affairs facilities, at rates provided by written contract between the Municipal Utility and the buyer entity. If agreement to such a contract cannot be reached, a rate would be set by the legal and relevant regulatory body.

The City has covenanted and is obligated under the Bond Ordinances, as provided under the rate covenant, to establish and maintain rates and collect charges in an amount sufficient to pay all maintenance and operating expenses of the Systems and to pay the debt service requirements on all revenue debt of the Systems, including the outstanding Senior Lien Obligations, any Additional Senior Lien Obligations, the currently outstanding Junior Lien Obligations, Liquidity Facility obligations, the Bonds, any Additional Junior Lien Obligations, the Notes and Inferior Lien Obligations, and to make all other payments prescribed in the Bond Ordinances.

Base rate changes over the past 18 years have consisted of a 4% combined electric and gas base rate increase effective January 31, 1991; a 3.5% electric base rate adjustment effective May 19, 2005 that was more than offset by a reduction in fuel costs, resulting from the purchase of an increased interest in STP Units 1 and 2 (defined herein); a 12.1% gas base rate adjustment effective June 26, 2006; 3.5% system average electric and gas base rate increase that became effective on September 1, 2008; and a 7.5% electric base rate increase and an 8.5% gas base rate increase that became effective on March 1, 2010. This most recent base rate increase is described in greater detail on the following page.

The 2005 electric rate adjustment was intended to cover the incremental costs to be incurred due to acquiring an additional 12% share in the STP. While base rates increase because of the acquisition of additional nuclear generation (the ownership interest in Units 1 and 2 was raised from 28% to 40%), the benefit from the lower priced nuclear power reduced customer bills overall. This acquisition was completed in May 2005. See “DESCRIPTION OF PHYSICAL PROPERTY – Electric System - South Texas Project” herein. CPS Energy also offers a monthly contract for renewable energy service (currently this is wind-generated electricity) under Rider E15. The rate for Rider E15 was reduced to its current level effective on September 30, 2002. A rider to the SLP rate, the Economic Incentive Rider E16, became effective March 10, 2003, and offers discounts off the SLP demand charge for a period up to four years for new or added load of at least 10 megawatts (“MW”). Under certain conditions, the discount may be extended an additional three years. Customers that choose Economic Incentive Rider E16 must also meet City employment targets and targets for purchases of goods or services from local businesses in order to qualify. CPS Energy also has rates that permit recovery of certain miscellaneous customer charges and for extending lines to provide gas and electric service to its customers. In May 2005, the Board adopted a change to its policies for both miscellaneous customer charges and line extensions, which became effective January 1, 2006, increasing charges that had not been raised since 1986. The City Council approved certain price changes in the CPS Energy Board-approved policy; however, the City ordinances prevented recovery of increased line extension charges from developers of affordable housing and the City delayed implementation of certain miscellaneous customer charges until April 1, 2006 (fees for disconnection, reconnection and field notification).

In June of 2007, the City Council passed an ordinance authorizing the creation of a five-year pilot program to develop electric and gas value-added premium based optional services. The initial optional services are limited to a specified number of qualified customers and include a: (1) Fixed Bill Program, (2) Flat Rate Program, (3) Windtricity Rider, and (4) Load Factor Rate Program.

In May 2009, the City Council passed a mechanism to fund CPS Energy’s Save for Tomorrow Energy Plan (“STEP”) energy efficiency and conservation program, which will largely be funded through changes in the electric fuel adjustment fee. Each of CPS Energy’s retail and wholesale rates contains an electric fuel adjustment or gas cost adjustment clause, which provides for current recovery of fuel costs. The fuel cost recovery adjustments are set at the beginning of each CPS Energy billing cycle month. See “CUSTOMER RATES – Fuel and Gas Cost Adjustment” herein.

On February 18, 2010, the City Council unanimously approved CPS Energy’s request for a 7.5% electric base rate increase and an 8.5% gas base rate increase, which is expected to result in a 4.2% bill impact per customer. The electric base rate increase was requested primarily as a result of increases in debt service resulting from the CPS Energy’s capital plan that includes J.K. Spruce 2 (“JKS 2”), LM6000 Gas Combustion Turbine Peakers and environmental upgrades to CPS Energy’s coal plants, which include fuel gas desulfurization (“FGD”) scrubbers and selective catalytic reduction (“SCR”) equipment. The 4.2% bill impact includes a reduction in fuel costs resulting from the JKS 2 plant that was previously placed into service on May 28, 2010. See “DESCRIPTION OF PHYSICAL PROPERTY – Electric System – Generating Station Events” herein. CPS Energy expects to continue to periodically seek electric and gas base rate increases that are intended to maintain debt coverage, debt to equity and liquidity ratios.

### ***Transmission Access and Rate Regulation***

Pursuant to amendments made by the Texas Legislature in 1995 to the PURA (“PURA95”), Municipal Utilities, including CPS Energy, became subject to the regulatory jurisdiction of the PUCT for transmission of wholesale energy. PURA95 requires the PUCT to establish open access transmission on the interconnected Texas grid for all utilities, co-generators, power marketers, independent power producers and other transmission customers.

The 1999 Texas Legislature amended the PURA95 to expressly authorize rate authority over Municipal Utilities for wholesale transmission and to require that the postage stamp method be used exclusively for pricing wholesale transmission transactions. The PUCT in late 1999 amended its transmission rule to incorporate fully the postage stamp pricing method which sets the price for transmission at the system average for ERCOT. CPS Energy’s wholesale open access transmission charges are set out in tariffs filed at the PUCT, and are based on its transmission cost of service approved by the PUCT, representing CPS Energy’s input to the calculation of the statewide postage stamp pricing method. The PUCT’s rule, consistent with provisions in PURA §35.005(b), also provides that the PUCT may require construction or enlargement of transmission facilities in order to facilitate wholesale transmission service. Additional information on recovery of ERCOT transmission fees is discussed in “CUSTOMER RATES – Governmentally Imposed Fees, Taxes or Payments” and with respect to the transition to the nodal market is discussed in “CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Post Senate Bill 7 Wholesale Market Design Developments” herein.

## CUSTOMER RATES

CPS Energy's electric and gas monthly rate schedules list the currently effective monthly charges payable by CPS Energy customers. Each rate schedule briefly describes the types of service CPS Energy renders to customers billed in accordance with that rate schedule, plus customer eligibility criteria. Customers with similar load and usage characteristics are grouped into rate classes and are billed in accordance with the same rate schedule. The different electric rate classes include rate schedules for residential, commercial, and industrial customers. There are also rate schedules for street lighting, other utilities and all night security lights. The gas rate schedules are categorized into general, commercial and industrial.

### ***Fuel and Gas Cost Adjustment***

The rates feature a fuel cost adjustment provision in the electric rates and a gas adjustment provision in the gas rates which allow CPS Energy to reconcile fuel and gas cost variances above or below fuel levels included in base rates. CPS Energy's electric rates are subject to a positive or negative monthly adjustment equal to the variance in the price of fuel above or below a base cost of \$0.01416 per kWh ("kilowatt-hour"). Similarly, CPS Energy's base gas rates are subject to an adjustment equal to the variance in the price of fuel above or below a base cost of \$0.220 per CCF (100 cubic feet).

On May 21, 2009, the City Council approved a funding mechanism for the STEP program. The total cost of the STEP program during the 2009 to 2020 time period is estimated at \$849 million with annual cost ranging from \$12.3 million to over \$77 million. While approximately \$8 million a year is recovered through existing base rates annually, the additional costs for the STEP program will be recovered through a STEP surcharge applied to the electric fuel adjustment. If energy use is reduced to levels predicted, the benefits of this program should exceed the implementation costs. CPS Energy will reassess the STEP program in calendar year 2019 to determine if continuing the program beyond 2020 is a viable option based on projected annual reductions in energy consumption going forward and the costs that would be incurred to achieve such reductions. For additional information on CPS Energy's STEP energy efficiency and conservation program, see "ENERGY CONSERVATION AND PUBLIC SAFETY PROGRAMS", herein.

### ***Governmentally Imposed Fees, Taxes or Payments***

The rates, as previously approved by various rate ordinances adopted by the City Council, may be adjusted without further action by the City Council to reflect the increase or decrease in fees, taxes or other required payments to governmental entities or for governmental or municipal purposes which may be hereafter assessed, imposed, or otherwise required and which are payable out of or are based upon net revenues of the Systems.

In March 2000, two new governmental assessments resulting from regulatory changes in the Texas electric utility industry, including the open access wholesale transmission charges, were added to CPS Energy's electric billings as regulatory adjustments and are updated annually or as needed. The first assessment recovers additional ERCOT-related transmission expenditures not recovered through CPS Energy's current base rates. For residential CPS Energy customer rates, this adjustment (effective January 2010) currently adds an additional \$0.00286 per kWh sold. The second assessment relates to CPS Energy's share of the cost to fund the staffing and operation of the Independent System Operator ("ISO") for ERCOT, the implementation of the nodal market within ERCOT, as well as other market-related costs due to congestion and voltage reliability issues. The PUCT retains oversight authority over ERCOT. For residential CPS Energy customers, this charge increases bills by an additional \$0.00132 per kWh sold.

In March 2005, the TRC began imposing a regulatory fee to cover the cost of regulation by the TRC. The fee is based upon the number of active gas customers and is recovered from CPS Energy gas customers through the payment of an annual fee assessed one time during the year.

**TEN-YEAR ELECTRIC CUSTOMER STATISTICS**

	Fiscal Years Ended January 31,										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2010 <sup>1,2</sup>
<b>RESIDENTIAL</b>											
Average Monthly KWh/ Customer	1,190	1,141	1,154	1,174	1,159	1,217	1,247	1,164	1,187	1,233	1,205
Average Monthly Bill/ Customer	\$85.55	\$77.53	\$81.54	\$94.06	\$87.39	\$99.59	\$98.27	\$91.98	\$107.60	\$107.00	\$106.23
Average Monthly Revenue/KWh	\$0.0719	\$0.0679	\$0.0707	\$0.0801	\$0.0754	\$0.0818	\$0.0788	\$0.0790	\$0.0906	\$0.0868	\$0.0881
<b>COMMERCIAL AND INDUSTRIAL</b>											
Average Monthly KWh/ Customer	11,145	11,116	11,334	12,174	11,345	11,187	11,036	10,887	10,856	10,685	10,722
Average Monthly Bill/ Customer	\$629.98	\$594.33	\$631.54	\$790.31	\$691.48	\$754.65	\$710.85	\$722.94	\$828.72	\$801.81	\$808.34
Average Monthly Revenue/KWh	\$0.0565	\$0.0535	\$0.0557	\$0.0649	\$0.0609	\$0.0675	\$0.0644	\$0.0664	\$0.0763	\$0.0750	\$0.0754
<b>ALL CUSTOMERS</b>											
Average Monthly KWh/ Customer	2,475	2,404	2,434	2,440	2,401	2,471	2,499	2,392	2,419	2,427	2,409
Average Monthly Bill/ Customer	\$154.65	\$142.08	\$151.31	\$173.82	\$159.88	\$180.27	\$174.92	\$170.01	\$197.33	\$192.98	\$192.83
Average Monthly Revenue/KWh	\$0.0625	\$0.0591	\$0.0622	\$0.0712	\$0.0666	\$0.0730	\$0.0700	\$0.0711	\$0.0816	\$0.0795	\$0.0800

(1) Excludes unbilled revenues and off-system sales.

(2) Twelve months ended July 31, 2010.

**HISTORICAL RECORD OF CITY OF SAN ANTONIO GENERAL FUND  
BENEFITS FROM CITY'S ELECTRIC AND GAS UTILITY SYSTEMS**

(Dollars in thousands)

	Fiscal Years Ended January 31,										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2010 <sup>1</sup>
Payments To City <sup>2,3</sup>	\$ 185,006	\$ 168,135	\$ 172,235	\$ 206,057	\$ 194,901	\$ 227,178	\$ 235,898	\$ 247,854	\$ 282,140	\$ 260,636	\$ 268,447

(1) Twelve months ended July 31, 2010.

(2) Payments to the City, by ordinance, are not to exceed 14% of CPS Energy's gross revenue (includes wholesale revenues), and includes cash payments and refund of charges for furnishing the City electricity and gas services, and for a street light replacement program.

(3) Excludes additional payments to the City. See "CONSTRUCTION PROGRAM" herein.

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## FIVE-YEAR ELECTRIC AND GAS SALES BY CUSTOMER CATEGORY

	Fiscal Years Ended January 31,					
	2006	2007	2008	2009	2010	2010 <sup>1</sup>
<b>ELECTRIC SYSTEM</b>						
<b>SALES IN KWH<sup>2</sup></b>						
Residential	8,052,142,783	8,546,981,548	8,247,226,694	8,608,618,534	9,104,633,143	8,989,235,953
Commercial & industrial	8,074,456,666	8,264,544,798	8,345,090,126	8,479,360,921	8,392,016,225	8,472,189,653
Street lighting	81,014,821	91,350,091	90,270,267	91,489,154	91,614,934	91,708,189
Public authorities	1,965,844,597	2,218,197,824	2,236,166,801	2,395,159,428	2,394,638,258	2,476,416,735
Other utilities	1,849,949,855	2,958,437,090	3,930,778,217	3,526,629,066	3,041,256,493	3,996,545,090
ANSL <sup>3</sup>	20,850,505	21,199,115	21,410,010	23,514,275	23,417,810	23,498,050
Total sales in KWH	<u>20,044,259,227</u>	<u>22,100,710,466</u>	<u>22,870,942,115</u>	<u>23,124,771,378</u>	<u>23,047,576,863</u>	<u>24,049,593,670</u>
<b>AVERAGE NUMBER OF CUSTOMERS</b>						
Residential	551,355	571,148	590,560	604,275	615,496	621,416
Commercial & industrial	60,145	62,407	63,875	65,090	65,448	65,846
Street lighting	422	2,320	2,299	2,310	2,319	2,321
Public authorities	6,293	5,628	6,033	6,255	6,621	6,893
Other utilities	20	18	19	23	24	29
ANSL <sup>3</sup>	10,725	10,953	11,212	11,407	11,556	11,594
Total customers	<u>628,960</u>	<u>652,474</u>	<u>673,998</u>	<u>689,360</u>	<u>701,464</u>	<u>708,099</u>
<b>KWH SALES PER CUSTOMER</b>						
Residential	14,604	14,965	13,965	14,246	14,792	14,466
Commercial & industrial	134,250	132,430	130,647	130,271	128,224	128,667
<b>GAS SYSTEM</b>						
<b>SALES IN MCF<sup>2</sup></b>						
Residential	9,794,730	9,474,163	10,742,076	9,415,723	10,497,562	12,182,152
Commercial	8,420,965	8,719,182	9,026,441	8,916,308	9,330,700	10,182,557
Industrial	1,184,875	1,095,727	973,020	815,360	848,333	745,830
Public authorities	2,258,826	2,081,997	2,138,054	2,040,126	2,149,677	2,382,026
Total sales in MCF	<u>21,659,396</u>	<u>21,371,069</u>	<u>22,879,591</u>	<u>21,187,517</u>	<u>22,826,272</u>	<u>25,492,565</u>
<b>AVERAGE NUMBER OF CUSTOMERS</b>						
Residential	288,898	292,083	296,173	298,996	300,646	301,538
Commercial	18,411	18,237	18,260	18,164	18,124	18,061
Industrial	80	76	67	63	60	54
Public authorities	2,373	2,540	2,729	2,765	2,771	2,749
Total customers	<u>309,762</u>	<u>312,936</u>	<u>317,229</u>	<u>319,988</u>	<u>321,601</u>	<u>322,402</u>
<b>MCF SALES PER CUSTOMER</b>						
Residential	34	32	36	31	35	40
Commercial	457	478	494	491	515	564
Industrial	14,811	14,417	14,523	12,942	14,139	13,812

(1) Twelve months ended July 31, 2010.

(2) Excludes unbilled revenues.

(3) All Night Security Lighting.

**FIVE-YEAR STATEMENT OF NET REVENUES AND DEBT SERVICE COVERAGE**

	Fiscal Years Ended January 31,					
	2006	2007	2008 <sup>1</sup>	2009	2010	2010 <sup>2,3</sup>
<b>ELECTRIC SYSTEM</b>						
<b>BILLED REVENUES</b>						
Residential	\$658,916,783	\$673,553,856	\$651,864,884	\$780,252,955	\$790,296,616	\$792,164,102
Commercial & industrial	544,660,000	532,343,750	554,137,294	647,298,754	629,721,617	638,709,266
Street lighting	11,414,666	11,314,041	11,617,586	12,914,300	13,367,606	\$13,910,383
Public authorities	117,661,362	127,237,302	131,412,709	160,622,388	160,157,270	162,746,286
Other utilities	107,656,944	145,115,015	206,176,165	258,311,828	132,204,411	158,351,066
ANSL <sup>4</sup>	3,298,367	3,254,248	3,347,817	3,993,057	4,100,464	4,278,779
Other	15,951,021	13,751,476	30,240,548	17,023,901	10,774,022	5,719,092
Total revenues	<u>1,459,559,143</u>	<u>1,506,569,688</u>	<u>1,588,797,003</u>	<u>1,880,417,183</u>	<u>1,740,622,006</u>	<u>1,775,878,974</u>
<b>OPERATION &amp; MAINTENANCE EXPENSE</b>						
Production	499,098,803	531,000,491	579,840,563	781,103,466	622,600,068	598,209,291
Transmission	12,029,652	16,441,817	13,666,229	16,213,504	44,313,394	36,923,436
Distribution	61,000,014	74,886,837	83,258,140	83,712,446	79,771,716	74,225,394
Regulatory assessments	37,083,246	28,644,959	23,192,383	31,256,674	36,032,960	35,893,660
Customer accounts	18,673,088	22,523,086	24,458,144	25,682,308	28,221,506	24,325,208
Customer information	1,436,331	791,074	730,354	371,983	333,875	386,751
Administrative & general	77,595,068	58,947,387	75,724,322	82,020,830	38,347,373	63,260,577
Payroll taxes	7,496,083	4,651,131	5,243,744	4,854,833	4,690,119	4,578,277
STP decommissioning expense	4,380,000	4,380,000	4,380,000	-	2,219,004	2,217,480
STP operation & maintenance expense	131,601,697	149,100,712	160,391,746	177,527,723	183,478,195	202,575,133
Total expenses	<u>850,393,982</u>	<u>891,367,494</u>	<u>970,885,625</u>	<u>1,202,743,767</u>	<u>1,040,008,210</u>	<u>1,042,595,207</u>
Operating income - electric	<u>609,165,161</u>	<u>615,202,194</u>	<u>617,911,378</u>	<u>677,673,416</u>	<u>700,613,796</u>	<u>733,283,767</u>
<b>GAS SYSTEM</b>						
<b>BILLED REVENUES</b>						
Residential	119,685,785	120,927,007	137,646,461	128,136,627	117,178,502	141,204,090
Commercial & industrial	102,757,554	99,297,749	100,796,578	105,357,182	80,310,178	92,378,514
Public authorities	21,707,539	19,766,696	19,987,023	20,498,684	16,252,552	19,364,806
Other	1,153,715	1,144,716	1,375,480	1,454,758	1,553,615	1,463,464
Total revenues	<u>245,304,593</u>	<u>241,136,168</u>	<u>259,805,542</u>	<u>255,447,251</u>	<u>215,294,847</u>	<u>254,410,874</u>
<b>OPERATION &amp; MAINTENANCE EXPENSE</b>						
Gas purchased	170,893,663	174,793,863	166,763,181	164,422,577	127,097,295	148,027,338
Distribution	16,648,494	18,694,494	16,984,251	17,571,652	16,377,773	14,884,800
Customer accounts	9,197,192	11,093,460	12,046,548	12,649,495	13,900,145	11,981,072
Customer information	478,777	263,691	243,451	123,994	111,292	128,917
Administrative & general	8,302,787	6,219,420	7,623,412	8,334,621	3,916,067	6,445,487
Payroll taxes	1,120,105	694,997	783,548	725,435	700,822	684,110
Total expenses	<u>206,641,018</u>	<u>211,759,925</u>	<u>204,444,391</u>	<u>203,827,774</u>	<u>162,103,394</u>	<u>182,151,724</u>
Operating income - gas	<u>38,663,575</u>	<u>29,376,243</u>	<u>55,361,151</u>	<u>51,619,477</u>	<u>53,191,453</u>	<u>72,259,150</u>
Combined operating income - Electric and gas	647,828,736	644,578,437	673,272,530	729,292,893	753,805,249	805,542,917
Nonoperating income <sup>5</sup>	50,063,264	74,524,014	94,710,771	55,458,451	25,185,995	24,248,826
Net revenues, per ordinances	<u>\$697,892,000</u>	<u>\$719,102,451</u>	<u>\$767,983,301</u>	<u>\$784,751,344</u>	<u>\$778,991,244</u>	<u>\$829,791,743</u>
<b>DEBT SERVICE<sup>6</sup></b>						
Senior lien obligations - Principal and interest	\$256,442,059	\$271,931,037	\$290,953,913	\$309,855,256	\$332,540,132	\$347,915,799
Junior lien obligations - interest	10,964,118	15,005,843	15,179,106	11,190,153	6,987,126	6,742,145
Interest on commercial paper	7,693,133	8,503,062	14,378,366	8,613,289	1,999,500	1,519,532
Total debt service	<u>\$275,099,311</u>	<u>\$295,439,942</u>	<u>\$320,511,385</u>	<u>\$329,658,698</u>	<u>\$341,526,758</u>	<u>\$356,177,476</u>
<b>DEBT SERVICE COVERAGE<sup>6</sup></b>						
Senior & junior lien obligations, commercial paper and FRRN	2.54x	2.43x	2.40x	2.38x	2.28x	2.33x
Senior lien obligations	2.72x	2.64x	2.64x	2.53x	2.34x	2.39x

(1) Excludes component units.

(2) Twelve months ended July 31, 2010.

(3) Includes a reclass between Electric & Gas Administrative & general and STP operation & maintenance expense subsequent to prior publications.

(4) All Night Security Lighting

(5) Excludes Fair Value Adjustments and gain/loss from hedging transactions.

(6) Excludes regularly scheduled interest due on these obligations anticipated to be off-set by the Refundable Tax Credit. See "THE BONDS - Refundable Tax Credit Bonds".

## FORWARD-LOOKING STATEMENTS

This Official Statement, including the Appendices hereto, contains forward-looking statements within the meaning of the federal securities laws. Such statements are based on currently available information, expectations, estimates, assumptions and projections, and management's judgment about the power utility industry and general economic conditions. Such words as "expects", "intends", "plans", "believes", "estimates", "anticipates" or variations of such words or similar expressions are intended to identify forward-looking statements. The forward-looking statements are not guarantees of future performance. Actual results may vary materially from what is contained in a forward-looking statement. Factors which may cause a result different from those expected or anticipated include, among other things, new legislation, increases in suppliers' prices, particularly prices for fuel in connection with the operation of the Systems, changes in environmental compliance requirements, acquisitions, changes in customer power use patterns, natural disasters and the impact of weather on operating results.

Although CPS Energy believes in making any such forward-looking statement, its expectations are based on reasonable assumptions, any such forward-looking statement involves uncertainties and is qualified in its entirety by reference to factors both identified within this Official Statement and from publicly available resources about the electric and gas businesses, regulation and regulatory authorities for that business, and the City that could cause the actual results of CPS Energy to differ materially from those contemplated in such forward-looking statements.

Any forward-looking statement speaks only as of the date on which such statement is made, and CPS Energy undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for CPS Energy to predict all of such factors, nor can it assess the impact of each such factor or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.

## MANAGEMENT DISCUSSION

CPS Energy's audited financial statements for the fiscal years ended January 31, 2010 and 2009, and the Independent Auditors' report thereon are in APPENDIX B. As described herein, CPS Energy adopted Statement No. 34 of the Governmental Accounting Standards Board ("GASB") during its fiscal year ended January 31, 2002, which required the preparation of a Management Discussion and Analysis ("MD&A") in connection with the annual financial report of CPS Energy. Reference is hereby made to APPENDIX B for the MD&A pertaining to the CPS Energy fiscal year ended January 31, 2010. Unaudited financial results for the 12 months ended July 31, 2010 and 2009 are shown in APPENDIX C.

The operating results of the Systems reflect the results of past operations and are not necessarily indicative of results of operations for any future period. Future operations will be affected by factors relating to changes in rates, fuel and other operating costs, utility industry regulation and deregulation, environmental regulation, economic growth of the community, population, weather, and other matters; the nature and effect of which cannot at present be determined. See "FORWARD-LOOKING STATEMENTS" herein.

## IMPLEMENTATION OF NEW ACCOUNTING POLICIES

This section of the Official Statement describes various GASB pronouncements, as assessed and implemented by CPS Energy, where applicable. Any (Note) reference relates to items in CPS Energy's fiscal year 2010 annual report.

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement provides additional guidance for accounting and reporting standards for intangible assets. The objective of this Statement is to reduce inconsistencies in financial reporting by providing further guidance on classification, recognition, measurement, impairment, presentation and disclosures related to intangible assets. There was no impact to the CPS Energy's financial statements as a result of this implementation.
- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This Statement addresses the recognition, measurement and disclosure of information regarding derivative instruments entered into by state and local governments. It generally requires that derivatives be reported on the balance sheet at fair value and realized and unrealized gains/losses be reported on the statement of revenues, expenses and change in fund net assets. As an exception, hedge accounting would be required for potential hedging derivative instruments that are determined to be effective. Under hedge accounting, gains/losses are reported on the balance sheet as deferred credits/charges until expiration of the contract, at which time the deferred credits/charges are reported as an adjustment to the underlying hedged transaction. Disclosure requirements are presented on Note 11 – Other Financial Instruments.

- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The GAAP hierarchy governs what constitutes GAAP for all state and local governmental entities. It lists the order of priority of pronouncements that a governmental entity should look to for accounting and financial reporting guidance. There was no impact to the CPS Energy’s financial statements as a result of this implementation.
- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. The objective of GASB Statement No. 56 is to incorporate three issues that were not previously addressed in the authoritative literature that establishes accounting principles—going concern considerations, related party transactions and subsequent events. These issues are currently addressed in the AICPA Statements on Auditing Standards; however, the GASB staff felt they would be more appropriately included in the accounting and financial reporting standards than in the auditing literature. The purpose of the statement is not to issue new guidance, but to incorporate existing guidance into the GASB standards to improve financial reporting by consolidating all sources of generally accepted accounting principles for state and local governments into one source. There was no impact to the CPS Energy’s financial statements as a result of this implementation.

For the fiscal year ended January 31, 2009, CPS Energy implemented:

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This statement provides guidance that explains when pollution remediation-related obligations should be reported and how pollution remediation costs and liabilities should be determined. Disclosure requirements are presented in Note 16 – Pollution Remediation Obligation.
- GASB Technical Bulletin 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*. This technical bulletin provides guidance that allows the annual required contribution (“ARC”) adjustment for other postemployment benefits (“OPEBs”) to be based on actual amounts associated with the amortization of past contribution deficiencies and excesses included in the ARC in cases in which those amounts are known by the actuary. No impact resulted from the guidance provided under this Technical Bulletin.

In addition to the GASB items described above, CPS Energy changed its method of accounting for the Decommissioning Trusts beginning in fiscal year 2009. Under the new method, a pro rata share of total decommissioning costs (as determined by the most recent cost study) has been recognized as a liability. In subsequent years, annual decommissioning expense and an increase in the liability will reflect the effects of inflation and an additional year of plant usage.

Additionally, due to requirements under the Code of Federal Regulations governing nuclear decommissioning trust funds, guidance under Financial Accounting Standard (“FAS”) 71, *Accounting for the Effects of Certain Types of Regulation*, has been followed. Under this guidance, the zero fund net assets approach to accounting for the Decommissioning Trusts (“Trusts”) has been retained. In accordance with FAS 71, the cumulative effect of activity in the Trusts has been recorded as a regulatory liability reported on the balance sheets as net costs refundable through future rates since any excess funds are payable to customers. Going forward, prolonged unfavorable economic changes could result in the assets of the Trusts being less than the estimated decommissioning liability. In that case, instead of an excess as currently exists, there would be a deficit that would be reported as net costs recoverable through future rates. This amount would be receivable from customers.

Current-year activity in the Trusts has been reported in the nonoperating income (expense) section of the Statements of Revenues, Expenses and Changes in Fund Net Assets as net costs recoverable (refundable) through future rates. There was no impact to fund net assets as a result of this change in accounting method. Prior-year amounts have been reclassified to conform to current-year presentation.

Other than the aforementioned changes, there were no additional significant accounting principles or reporting changes implemented in the fiscal year ending January 31, 2010. Other accounting and reporting changes that occurred during the prior reporting year continued into the fiscal year ending January 31, 2010. These accounting changes and the effects on the financial statements are described in greater detail in the MD&A and in the notes to the audited financial statements included in APPENDIX B.

## PENSION AND OTHER POST EMPLOYMENT BENEFITS

CPS Energy provides Pension and Other Post Employment Benefits (“OPEBs”) for its employees. There are four plans, which include: the Pension Plan, the Group Health Plan, the Group Life Insurance Plan, and the Disability Income Plan (the Group Health Plan, the Group Life Insurance Plan, and the Disability Income Plan, collectively referred to herein as the “Employee Benefit Plans”). All plans are reported on a calendar year basis. While all plans are separately and independently audited, CPS Energy discloses relevant information about them in its Notes or Financial Statements. See “Basic Financial Statements – Note 8 – Employee Pension Plan and Note 9 – Other Postemployment Benefits” in Appendix B (“Notes 8 & 9”).

### *Pension Plan*

The Pension Plan is a self-administered, single-employer, defined-benefit contributory pension plan and provides retirement and ancillary benefits for all CPS Energy employees who complete a minimum period of service and/or otherwise become eligible. The benefits provided by the Pension Plan are paid from a Pension Trust Fund established by CPS Energy that is kept separate from and in addition to the benefits employees are entitled to receive under any other CPS Energy program and under the federal Social Security Act. This Pension Plan and the Pension Trust Fund were established by the Board in accordance with applicable law and are maintained for the exclusive benefit of the eligible employees and their beneficiaries. Consistent with the GASB Statement No. 14 Implementation Guide, the Pension Plan is not categorized as a component unit of CPS Energy.

### *Employee Benefit Plans*

The Employee Benefit Plans are single-employer contributory plans that are funded by employee contributions and annual contributions from CPS Energy as determined by the Board in accordance with applicable law. The assets of the Employee Benefit Plans are stated at fair market value.

The Group Health and the Group Life Insurance plans provide benefits for employees, their spouses, and covered dependents. Additionally, most CPS Energy employees are also eligible for these benefits upon retirement. CPS Energy established each plan as a “risk pool” as that term is defined in the Texas Political Subdivision Employees Uniform Group Benefits Act (“Act”), Chapter 172 Texas Local Government Code. These plans are each operated at all times and in all respects as a risk pool under the Act. CPS Energy’s Disability Income Plan, also established as a risk pool, provides income to eligible employees of CPS Energy who become disabled.

Prior to fiscal year 2008, the Employee Benefit Plans were reported as component units of CPS Energy, and their financial results were blended with those of CPS Energy. In order to properly implement GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension*, the Employee Benefit Plans were removed as component units from the CPS Energy financial statements for fiscal year 2008. Additionally, the fiscal year 2007 financial statements were restated with the removal of these component units for ease of comparability.

## PENSION AND OPEB LIABILITIES

### *Actuarial Value of Plan Assets*

CPS Energy annually retains an actuarial firm to perform actuarial valuations for the Pension Plan and each of the Employee Benefit Plans. Conducted in accordance with generally accepted actuarial principles and practices, the actuarial reports summarize the funding status of each plan for the current and prior year. The reports also provide projected funding contribution requirements for CPS Energy’s next fiscal year. The actuarial value of the assets of each of the plans represents an adjusted value determined by the actuary, in accordance with industry standards, and therefore will not equal the amounts shown in the plans’ balance sheets.

### *Actuarial Accrued Liability*

The Actuarial Accrued Liability (“AAL”) is calculated on a present value basis. Significant actuarial assumptions used in the calculations include, but are not limited to, rates of mortality, rates of retirement, the estimated number of participants expected to withdraw from the program(s), expected base salary increases, overtime rates, disability rates, medical cost increases, and investment returns. The AAL includes liabilities for current retirees and active employees for benefits at retirement.

## Use of Assumptions and Estimates

As set forth herein and in Notes 8 & 9 of Appendix B, the disclosures relating to the Pension Plan and the OPEBs are based upon certain assumptions and estimates that may vary based upon the risk factors. To the extent that these assumptions and estimates do not materialize or are inaccurate, the financial information disclosed herein and in Notes 8 & 9 of Appendix B, including the estimated as compared to the actual values of the assets and liabilities, could change substantially and in a materially adverse manner. The actuarial values determined for benefit plan assets and liabilities include reasonable assumptions, which are estimates based on information available at the time the study was conducted. On June 30, 2006, GASB issued a Technical Bulletin regarding the Medicare Part D subsidy. The Part D subsidy pertains to benefits beginning January 1, 2006. The Technical Bulletin clarified that the Medicare Part D subsidy should be excluded when reporting the AAL. The Group Health Plan AAL, as reported below, therefore excludes any offset in costs resulting from the government subsidizing voluntary prescription drug benefits under Part D of the Social Security Act, established as part of the Medicare Prescription Drug Improvement and Modernization Act of 2003.

## Pension and Employee Benefit/OPEB Funding

The following schedule outlines CPS Energy's Pension and OPEB funding status based on Actuarial Valuation Dates of January 1, 2009, January 1, 2008 projected to February 1, 2009 and January 1, 2007 projected to February 1, 2008<sup>1</sup>. Although CPS Energy is not contractually required to make contributions to fund the future liabilities of the Employee Benefit Plans, it has been voluntarily doing so since 1992.

### PENSION AND EMPLOYEE BENEFIT PLANS

(\$ in millions)

	<b>(A) Actuarial Value of Assets</b>			<b>(B) Actuarial Accrued Liability ("AAL")<sup>2</sup></b>		
	Jan. 1, 2009	Jan. 1, 2008 projected to Feb. 1, 2009	Jan. 1, 2007 projected to Feb. 1, 2008	Jan. 1, 2009	Jan. 1, 2008 projected to Feb. 1, 2009	Jan. 1, 2007 projected to Feb. 1, 2008
Actuarial Valuation Date <sup>1</sup> :						
Pension	\$ 1,067.8	\$ 1,145.0	\$ 1,084.6	\$ 1,184.0	\$ 1,169.3	\$ 1,103.9
OPEBs:						
Group Health	\$ 199.2	\$ 204.3	\$ 194.9	\$ 198.3	\$ 219.4	\$ 247.3
Group Life	46.8	49.6	49.1	36.1	35.5	33.0
Disability	3.6	3.8	3.7	6.9	6.6	5.7
Total OPEBs	\$ 249.6	\$ 257.7	\$ 247.7	\$ 241.3	\$ 261.5	\$ 286.0
	<b>(B) - (A) Unfunded AAL</b>			<b>(A) / (B) Funded Ratio</b>		
Actuarial Valuation Date <sup>1</sup> :						
Pension	\$ 116.1	\$ 24.3	\$ 19.3	90.2%	97.9%	98.3%
OPEBs:						
Group Health	\$ (0.9)	\$ 15.1	\$ 52.4	100.5%	93.1%	78.8%
Group Life	(10.7)	(14.1)	(16.1)	129.7%	139.7%	148.7%
Disability	3.3	2.8	2.0	52.3%	57.2%	65.3%
Total OPEBs	\$ (8.3)	\$ 3.8	\$ 38.3	103.4%	98.5%	86.6%

1) The valuation methodology was changed for the two years reported with February 1 valuation dates, to collect data and asset information as of January 1 of the previous plan year and project to February 1 of the next year based on assumptions. This methodology was discontinued for the period reported with January 1, 2009 valuation date and data was collected and asset information as of January 1, 2009 was used for the valuation for Fiscal Year Beginning February 1, 2010.

2) Includes liabilities for retirees, fully eligible actives, and actives not yet fully eligible. The Group Health Plan does not reflect Medicare Part D Subsidy of approximately \$39.8 million for January 1, 2009, \$47.9 million for February 1, 2009, and \$42.7 million for February 1, 2008.

## CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY

### *The Electric Utility Industry Generally*

The electric utility industry in general has been, and in the future may be, affected by a number of factors which could impact the business affairs, financial condition and competitiveness of an electric utility and the level of utilization of generating facilities, such as those of the Systems. One of the most significant of these factors is the effort on national and local levels to restructure the electric utility industry from a heavily regulated monopoly to an industry in which there is open competition for power supply on both the wholesale and retail level. For a description of the competition in the electric utility industry in Texas and the response of the Systems thereto, see “Electric Utility Restructuring in Texas; Senate Bill 7” herein.

In addition, such factors include, among others, (i) effects of compliance with rapidly changing environmental, safety, licensing, regulatory and legislative requirements, (ii) changes resulting from conservation and demand-side management programs on the timing and use of electric energy, (iii) changes that might result from a national energy policy, (iv) increased competition from independent power producers, (v) “self-generation” by certain industrial and commercial customers, (vi) issues relating to the ability to issue tax-exempt obligations, (vii) severe restrictions on the ability to sell to non-governmental entities electricity from generation projects financed with outstanding tax-exempt obligations, (viii) changes from projected future electricity requirements, (ix) increases in costs, (x) shifts in the availability and relative costs of different fuels, and (xi) effects of the financial difficulties confronting the power marketers. Any of these factors (as well as other factors) could have an effect on the financial condition of any given electric utility and likely will affect individual utilities in different ways. CPS Energy cannot predict what future effects these factors may or will have on its business operations and financial condition, but the effects could be significant. The following is a brief discussion of several factors. This discussion does not purport to be comprehensive or definitive and these matters are subject to change subsequent to the date of this Official Statement. Extensive information on the electric utility industry is available from sources in the public domain, and potential purchasers of the Bonds should obtain and review such information.

### *Federal Energy Legislation*

Federal legislation continues to impose requirements on CPS Energy. In December 2007, the President signed the Energy Independence and Security Act (“EISA”), requiring utilities to consider, for adoption, rejection, or modification by December 19, 2009, the implementation of (1) integrated resource planning; (2) rate design modifications to promote energy efficiency investments; (3) smart grid investments; and (4) smart grid information. CPS Energy has been studying technologies that would allow implementation of the standards, as modified to fit its needs and has completed the regulatory assessment as required under the Act. Municipal Utilities, such as CPS Energy, are designated as “non-regulated” under EISA, as well as the 2005 Energy Act, because those utilities are not regulated by state utility commissions.

The Energy Policy Act of 2005 (“2005 Energy Act”) extended limited Federal Energy Regulatory Commission (“FERC”) jurisdiction, known as “FERC-Lite”, over public power entities within ERCOT such as CPS Energy that own transmission lines, and gave FERC authority to delegate certain transmission reliability standard-setting responsibilities to an Electric Reliability Organization (“ERO”) and, with the ERO, establish mandatory reliability standards for operation of the nation’s transmission system. CPS Energy has operated its electric system under compatible ERCOT reliability standards for many years, so CPS Energy does not anticipate any problems with FERC’s reliability standards. In fact, CPS Energy’s transmission owner (“TO”) and distribution service provider (“DSP”) units underwent an audit by the North American Electric Reliability Corporation and the Texas Regional Entity in spring 2008 and passed the audit without penalty. Its generation owner (“GO”), generation operator (“GOP”), and qualified scheduling entity (“QSE”) units were audited in May 2009 and passed the audit without penalty. Finally, CPS Energy entities submitted certificates regarding their compliance with the NERC Critical Infrastructure Protection (“CIP”) standards by December 31, 2009. Additional information on FERC’s authority over CPS Energy can be found in “FERC Authority” herein.

The 2005 Energy Act included several provisions that could affect CPS Energy’s business and continue to be evaluated by management, including:

- repeal of existing Public Utility Holding Company Act of 1935 requirements;
- conditional termination of the mandatory federal purchase and sale requirements for co-generation and small power production;
- expansion of FERC’s merger review authority;
- re-authorization of renewable energy production incentives for solar, wind, geothermal, and biomass and authorization of new incentives for landfill gas;
- incentives for development of new commercial nuclear power plants and other non- or low-carbon emitting technologies;

- establishment of a 7.5% goal for increased renewable energy use by the federal government by 2013, and of a 20% required reduction in energy use by federal buildings by 2015; and
- increased funding for weatherization of low-income homes and for state energy efficiency programs.

The 2005 Energy Act also included provisions affecting existing nuclear generating units, including:

- extension of the Price-Anderson Act to 2025 and increases in the retrospective premiums for which licensees are liable for claims resulting from a nuclear incident;
- expansion of the Nuclear Regulatory Commission (“NRC”) authority to regulate decommissioning trust funds (primarily affecting funds held by former plant licensees);
- direction of the U.S. Department of Energy (“DOE”) to take responsibility for safe disposal of high-level radioactive waste;
- procedural protections for individuals filing claims under federal whistleblower provisions;
- enhanced provisions relating to NRC oversight of the security of licensed facilities; and
- various decommissioning tax-related adjustments beneficial to federal tax-paying licensees.

Furthermore, the Energy Policy Act of 2005 amended the Public Utility Regulatory Policies Act of 1978 (“PURPA”) by adding five new standards that Municipal Utilities must consider and determine whether to implement. These new standards address net metering, diversity of fuel sources, efficiency of fossil-fuel-fired generation, time-based or “smart” metering, and the interconnection of distributed generation. CPS Energy considered the new standards and developed five modified standards that more accurately reflect local conditions and priorities. These new standards were approved by the Board on June 25, 2007.

On June 17, 2009, during the first term of the 111th Congress, the Senate Energy and Natural Resources Committee passed the American Clean Energy Leadership Act (S. 1462) which contained the first-ever federal renewable energy standard for electricity. The bill requires utilities to generate 15% of their electricity with renewable energy by 2021. The bill may be taken up by the full U.S. Senate in 2010.

The 111th Congress is considering a wide range of energy legislation measures addressing climate change policy, carbon dioxide controls, and energy independence. On June 26, 2009, the U.S. House of Representatives passed landmark energy and climate legislation. The legislation, passed as the American Clean Energy and Security Act of 2009 (H.R. 2454) (“ACES”), requires significant reductions in stationary source greenhouse gas (“GHG”) emissions through a cap-and-trade system, mandates regulation of mobile source GHG emissions, and creates a 20% efficiency and renewable electricity standard. The legislation also provides for a \$190 billion investment in clean energy technology between 2012 and 2025. The Environmental Protection Agency (“EPA”) estimates that, in 2005 dollars, the auctioned allowances will cost \$13 per allowance in 2015, and increase to \$26 or \$27 per allowance by 2030. The Congressional Budget Office’s estimate is slightly higher, with allowances costing \$16 in 2015, and increasing to \$36 by 2030. In August 2009, the EPA proposed some significant GHG rules, including a new vehicle emission standard rule, a reporting rule and an endangerment finding. On September 22, 2009, the EPA finalized the nation’s first greenhouse gas reporting system/monitoring regulations which will require large emitters of heat-trapping emissions to collect GHG data. On December 2009, the EPA denied the petitions to reconsider the Endangerment and Cause or Contribute Findings for Greenhouse Gases under Section 202(a) of the Clean Air Act. On May 12, 2010, Senators John Kerry (D-MA) and Joseph Lieberman (I-CT) released the comprehensive climate change and clean energy bill, titled the “American Power Act”. The bill included similar targets to ACES to reduce economy-wide GHG emissions from 2005 levels. See “ENVIRONMENTAL MATTERS – Federal Clean Air Act” herein. CPS Energy continues to monitor these issues closely and will be assessing the impact of proposed legislation (and rulemaking) as the session progresses.

### **FERC Authority**

In 1992, pursuant to the Energy Policy Act of 1992 (“Energy Act”), the FERC required utilities under its jurisdiction to provide access to their electric transmission systems for interstate wholesale transactions on terms and at rates comparable to those available to the owning utility for its own use. Municipal Utilities are subject to FERC orders requiring provision of wholesale transmission service to other utilities, qualifying cogeneration facilities and independent power producers. Under FERC rules promulgated subsequent to the Energy Act, FERC further expanded open access wholesale transmission by requiring public utilities operating in interstate commerce to file open access non-discriminatory transmission tariffs. Because the interconnected ERCOT grid operates outside interstate commerce and because PURA95 and SB 7, State laws discussed below, provide comparable wholesale transmission authority to the PUCT for utilities in ERCOT pursuant to which the PUCT has required open access of transmission facilities in ERCOT, the exercise of FERC authority relating to open access transmission has not been a major factor in the operation of the wholesale market in ERCOT. The 2005 Energy Act authorizes FERC to encourage and approve the voluntary formation of regional transmission organizations in order to promote fair and open access to electric transmission service and facilitate wholesale competition. See “Federal Energy Legislation” herein. The ERCOT open access system is administered by an ISO conducting many of the functions that would be administered by a Regional Transmission Organization. Section 1211 of the 2005 Energy Act amended the Federal Power Act to include a new section, designated as

Section 215, which directed FERC to certify an ERO and develop procedures for establishing, approving and enforcing electric reliability standards. As discussed herein under “DESCRIPTION OF PHYSICAL PROPERTY – Electric System - Interconnected System”, FERC designated the North American Electric Reliability Corporation to serve as the ERO and to set and monitor through Regional Entities (“RE”) implementation of electric reliability standards. A separate group within ERCOT was selected to serve as the RE for the ERCOT service area and CPS Energy has taken a number of steps to comply with the new electric reliability standards. Finally, on September 2, 2009, FERC executed a memorandum of agreement (“MOA”) with the NRC to facilitate interactions between the NRC and the FERC on matters of mutual interest pertaining to the nation’s electric power grid reliability and nuclear power plants. Matters being addressed under this MOA, which may impact developments at STP, include cyber-security requirements, reliability requirements for nuclear power plants, and grid stability issues related to nuclear plant operation. See “DESCRIPTION OF PHYSICAL PROPERTY – Electric System - Interconnected System” herein. CPS Energy and the South Texas Nuclear Operating Company will continue to monitor and evaluate FERC developments with a potential to impact the gas and electric systems; however, it is unclear what changes, if any, will be proposed as a result of the MOA.

## ***ERCOT***

ERCOT is one of 10 Regional Reliability Councils in the North American Electric Reliability Council. The ERCOT bulk electric system is located entirely within the State and serves more than 20 million customers, representing approximately 85% of Texas’ electrical load. The ERCOT service region covers more than 75%, or 200,000 square miles, of the State and contains a total of approximately 38,000 miles of transmission lines, including more than 7,000 miles at 345-kV. ERCOT only has asynchronous ties to other reliability councils, and is only connected through two direct current (“DC”) ties to the eastern interconnect and three small DC ties to Mexico, providing only limited import/export capability.

In response to legislative directive, ERCOT amended its articles of incorporation to establish an ISO in 1996. Under ERCOT’s organizational structure, the ISO reports to the ERCOT Board of Directors, but the PUCT has complete authority to oversee and investigate ERCOT’s finances, budget, and operations as necessary to ensure that ERCOT is accountable. ISO responsibilities include security operations of the bulk system, facilitation and efficient use of the transmission system by all market participants, and coordination of regional transmission planning among transmission owning utilities and providers.

ERCOT’s statutory functions include establishing and enforcing procedures relating to the reliability of the regional electrical network and accounting for the production and delivery of electricity among generators and all other market participants. The procedures are subject to PUCT oversight and review, and the PUCT chairman is an ex-officio member of the ERCOT Board. The PUCT may authorize ERCOT to charge a reasonable and competitively neutral rate to wholesale buyers and sellers to cover the independent organization’s costs. Individual electric utilities own sections or components of the ERCOT transmission grid and are responsible for operating and maintaining their own transmission lines and equipment. The ISO coordinates the operation of the transmission grid to ensure its reliability, and ERCOT coordinates with the various transmission-owning electric utilities to make sure the transmission system will meet the needs of the electric market. SB 7 (described in greater detail below under “Electric Utility Restructuring in Texas; Senate Bill 7”) provides that a retail electric provider, municipally-owned utility, electric cooperative, power marketer, transmission and distribution utility (“TDU”), or Power Generation Company shall observe all scheduling, operating, planning, reliability, and settlement policies, rules, guidelines and procedures established by the ISO.

Under the PUCT’s transmission open access rules, each transmission service provider in ERCOT is required to provide transmission service to transmission customers in ERCOT. As compensation for this service, each transmission service provider annually recovers, through ERCOT-wide transmission charges, its Transmission Cost of Service (“TCOS”), which is set by the PUCT. See “SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Transmission Access and Rate Regulation” herein.

In September 2006, the PUCT selected Potomac Economics (“Potomac”), an energy consulting firm, to serve as the independent market monitor (“IMM”) for ERCOT, a function that was legislated at the request of the PUCT by the 2005 Texas Legislature. The IMM has the authority to conduct monitoring, analysis and reporting activities but has no enforcement authority. A PUCT rule provides that the IMM shall report directly to the PUCT any potential market manipulations, including market power abuse, and any violations of PUCT rules or ERCOT protocols.

The PUCT rule establishes the IMM as an office independent from ERCOT, which is not subject to the supervision of ERCOT with respect to its monitoring and investigative activities. ERCOT funds the operations of the IMM, but the budget and expenditures of the IMM are subject to PUCT supervision and oversight. The ethical standards governing the IMM director and staff are intended to prevent conflicts of interest between the IMM and a market participant or an affiliate of a market participant. The rule took effect in April 2006.

Among other activities undertaken by the IMM was an investigation into relative shortages of energy in the balancing energy market, which is used by ERCOT to ensure that supply and demand match at all times, and usually comprises around 5% of the energy used in the market. Potomac concluded that a significant amount of available energy that could have been offered into the balancing energy market was not, because of barriers and economic risks inherent in the balancing energy market, rather than

physical or economic withholding. Potomac's report expressed the view that such inefficiencies will be addressed when ERCOT implements a nodal market (as opposed to the current "zonal" market) design for the wholesale market, currently projected for 2010 (as described below under "Post Senate Bill 7 Wholesale Market Design Developments"), which will result in better utilization of these resources through pricing of power at the point where generators deliver power to the electric network and through a day-ahead market. In the end, Potomac's report concludes that there is little evidence that "the large amount of unoffered capacity represents strategic withholding".

### ***Electric Utility Restructuring in Texas; Senate Bill 7***

During the 1999 legislative session, the Texas Legislature enacted SB 7, providing for retail electric open competition. This began on January 1, 2002. SB 7 continues Texas electric transmission wholesale open access, which came into effect in 1997 and requires all transmission system owners to make their transmission systems available for use by others at prices and on terms comparable to each respective owner's use of its system for its own wholesale transactions. SB 7 also fundamentally redefined and restructured the Texas electric industry. The following discussion of SB 7 applies primarily to ERCOT.

SB 7 includes provisions that apply directly to Municipal Utilities, such as CPS Energy, as well as other provisions that govern IOUs and electric co-operatives ("Electric Co-ops"). As of January 1, 2002, SB 7 allows retail customers of IOUs to choose their electric energy suppliers. SB 7 also allows retail customers of those Municipal Utilities and Electric Co-ops that elect to opt-in, on or after that date, to choose their electric energy suppliers. Provisions of SB 7 that apply to the CPS Energy electric system, as well as provisions that apply only to IOUs and Electric Co-ops, are described below, the latter for the purpose of providing information concerning the overall restructured electric utility market in which CPS Energy and the City could choose to directly participate in the future.

SB 7 required IOUs to separate their retail energy service activities from regulated utility activities by September 1, 2000, and to unbundle their generation, transmission/distribution and retail electric sales functions into separate units by January 1, 2002. An IOU may choose to sell one or more of its lines of business to independent entities, or it may create separate but affiliated companies and possibly operating divisions. If so, these new entities may be owned by a common holding company, but each must operate largely independent of the others. The services offered by such separate entities must be available to other parties on non-discriminatory bases. Municipal Utilities and Electric Co-ops which open their service territories ("opt-in") to retail electric competition are not required to, but may, unbundle their electric system components. See "SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Service Area" herein.

### ***Entities that have Opted-in to Competition***

The following discussion relates to entities that are currently in electric competition in Texas, and does not apply to CPS Energy, but could apply if CPS Energy and the City opt-in to electric competition. Generation assets of IOUs are owned by Power Generation Companies, which must register with the PUCT and must comply with certain rules that are intended to protect consumers, but they otherwise are unregulated and may sell electricity at market prices. IOU owners of TDUs are fully regulated by the PUCT. Retail sales activities are performed by Retail Electric Providers ("REPs") which are the only entities authorized to sell electricity to retail customers (other than Municipal Utilities and Electric Co-ops within their service areas, or, if they have adopted retail competition, also outside their service areas). REPs must register with the PUCT, demonstrate financial capabilities and comply with certain consumer protection requirements. REPs buy electricity from Power Generation Companies, power marketers, and/or other parties and may resell that electricity to retail customers at any location in Texas (other than within service areas of Municipal Utilities and Electric Co-ops that have not opened their service areas to retail competition). TDUs, Municipal Utilities, and Electric Co-ops that have chosen to participate in competition are obligated to deliver electricity to retail customers and are all also required to transport electricity to wholesale buyers. The PUCT is required to approve the construction of TDUs' new transmission facilities and may order the construction of new facilities in Texas in order to relieve transmission congestion. TDUs are required to provide access to both their transmission and distribution systems on a non-discriminatory basis to all eligible customers. Retail rates for the use of distribution systems of Municipal Utilities and Electric Co-ops are exclusively within the jurisdiction of these entities' governing bodies rather than that of the PUCT.

SB 7 also provides a number of consumer protection provisions. Each service area within Texas that participates in retail competition has a designated Provider of Last Resort; those Providers of Last Resort serving in former service areas of IOUs are selected and approved by the PUCT. The Provider of Last Resort is a REP that must offer to sell electricity to any retail customer in its designated area at a standard rate approved by the PUCT. The Provider of Last Resort must also serve any customer whose REP has failed to provide service. Each Municipal Utility and Electric Co-op that opts-in to retail competition may designate itself or another qualified entity as the Provider of Last Resort for its service territory. In such cases, the respective Municipal Utility or Electric Co-op, not the PUCT, will set the electric rates for such respective Provider of Last Resort.

Under SB 7, IOUs may recover a portion of their “stranded costs” (the net book value of certain “non-economic” assets less market value and certain “above market” purchased-power costs) and “regulatory assets”, which is intended to permit recovery of the difference between the amount necessary to pay for the assets required under prior electric regulation and the amount that can be collected through market-based rates in the open competition market. SB 7 establishes the procedure to determine the amount of IOU stranded costs and regulatory assets. The PUCT has determined the stranded costs, which have been and will be collected through a non-bypassable competitive transition charge collected from the end retail electric users within the IOU’s service territory as it existed on May 1, 1999. The charge is collected primarily as an additional component to the rate for the use of the retail electric distribution system delivering electricity to such end user.

IOUs may recover a certain portion of their respective stranded costs through the issuance of bonds, with a maturity not to exceed 15 years, whereby the principal, interest and reasonable costs of issuing, servicing and refinancing such bonds is secured by a qualified rate order of the PUCT that creates the “competitive transition charge”. Neither the State nor the PUCT may amend the qualified rate order in any manner that would impair the rights of the “securitized” bondholders.

### ***Additional Impacts of Senate Bill 7***

Municipal Utilities and Electric Co-ops are largely exempt from the requirements of SB 7 that apply to IOUs. While IOUs became subject to retail competition beginning on January 1, 2002, the governing bodies of Municipal Utilities and Electric Co-ops have the sole discretion to determine whether and when to opt-in to retail competition. However, if a Municipal Utility or Electric Co-op has not voted to opt-in, it will not be able to compete for retail energy customers at unregulated rates outside its traditional electric service area or territory.

SB 7 preserves the PUCT’s regulatory authority over electric transmission facilities and open access to such transmission facilities. SB 7 provides for an independent transmission system operator (an ISO as previously defined) that is governed by a board comprised of market participants and independent members and is responsible for directing and controlling the operation of the transmission network within ERCOT. The PUCT has designated ERCOT as the ISO for the portion of Texas within the ERCOT area. In addition, SB 7 (as amended by the Texas Legislature after 1999) directs the PUCT to determine electric wholesale transmission open access rates on a 100% “postage stamp” pricing methodology.

The greatest potential impact on CPS Energy’s electric system from SB 7 could result from a decision by the Board and the City Council to participate in a fully competitive market, particularly in light of the fact that CPS Energy is among the lowest cost producers of electric energy in Texas. On April 26, 2001, the City Council passed a resolution stating that the City did not intend to opt-in to the deregulated electric market beginning January 1, 2002. However, CPS Energy currently believes that it is taking all steps necessary to prepare for possible competition in the unregulated energy market, should the Board and the City Council make a decision to opt-in, or future legislation forces Municipal Utilities and Electric Co-ops into retail competition.

Any future decision of the Board and the City Council to participate in full retail competition would permit CPS Energy to offer electric energy service to customers located in areas participating in retail choice that are not presently within the certificated service area of CPS Energy. The Board and the City Council could likewise choose to open the CPS Energy service area to competition from other suppliers while choosing not to have CPS Energy compete for retail customers outside its certified service area.

As discussed above, Municipal Utilities and Electric Co-ops will also determine the rates for use of their distribution systems after they open their territories to retail competition, although the PUCT has established by rule the terms and conditions applicable to have access to those systems. SB 7 also permits Municipal Utilities and Electric Co-ops to recover their stranded costs through collection of a non-bypassable transition charge from their customers if so determined by such entities through procedures that have the effect of procedures available to IOUs under SB 7. Unlike IOUs, the governing body of a Municipal Utility determines the amount of stranded costs to be recovered pursuant to rules and procedures established by such governing body. Municipal Utilities and Electric Co-ops are also permitted to recover their respective stranded costs through the issuance of bonds in a similar fashion to the IOUs. Any decision by CPS Energy as to the magnitude of its stranded costs, if any, would be made in conjunction with the decision as to whether or not to participate in retail competition.

A Municipal Utility that decides to participate in retail competition and to compete for retail customers outside its traditional service area will be subject to a PUCT-approved code of conduct governing affiliate relationships and anti-competitive practices. The PUCT has established by a standard rule the terms and conditions, but has no jurisdiction over the rates, for open access by other suppliers to the distribution facilities of Municipal Utilities electing to compete in the retail market. If a Municipal Utility decides to participate in retail competition, its customers are subject to being charged a PUCT-approved System Benefit Fund fee per megawatt hour beginning six months prior to implementation of customer choice. The fee is a contribution to a statewide fund targeted at property tax replacement, low-income assistance programs and customer education.

Among other provisions, SB 7 provides that nothing in that act or in any rule adopted under it may impair any contracts, covenants, or obligations between municipalities and bondholders of revenue bonds issued by municipalities and that nothing in that act may impair the tax-exempt status of municipalities or compel them to use facilities in a manner that violates any bond covenants or other exemption of interest or tax-exempt status. The bill also improves the competitive position of Municipal Utilities by allowing local governing bodies, whether or not they implement retail choice, to adopt alternative procurement processes under which less restrictive competitive bidding requirements can apply and to implement more liberal policies for the sale and exchange of real estate. Also, matters affecting the competitiveness of Municipal Utilities are made exempt from disclosure under the open meetings and open records acts and the right of Municipal Utilities to enter into risk management and hedging contracts for fuel and energy is clarified. See “FUEL SUPPLY”, “WHOLESALE POWER MARKETING” and “ENTERPRISE RISK MANAGEMENT” herein for discussion of the Energy Price Risk Management Program in use at CPS Energy.

During its 79<sup>th</sup> Legislative Session in 2005, the Texas Legislature reviewed the mission and performance of the PUCT, as required by the Texas Sunset Act. This act provides that the Sunset Commission, composed of legislators and public members, periodically evaluate a state agency to determine if the agency is still needed, and what improvements are needed to ensure that tax dollars are appropriately utilized. Based on recommendations of the Sunset Commission, the Texas Legislature ultimately decides whether an agency continues to operate into the future.

The 79<sup>th</sup> Legislature in its review of the PUCT, reauthorized the agency until 2011. Reforms were enacted to increase the accountability of ERCOT, including added regulatory scrutiny and governance changes that add independence while preserving input from industry experts. An “independent market monitor” selected by and reporting to the PUCT, was institutionalized to help guard against manipulation in the Texas wholesale electric market. No significant, direct impact on CPS Energy is anticipated as a result of this legislation.

#### ***Post Senate Bill 7 Wholesale Market Design Developments***

In the summer of 2003, the PUCT adopted rules requiring that ERCOT transition from a zonal to a nodal wholesale market and requiring that new protocols to accomplish this transition be submitted to the PUCT for review. Implementation of the nodal market will include, among other elements: direct assignment of the costs of local transmission congestion to market participants that cause the congestion; implementation of an integrated, financially binding day-ahead market; and nodal energy prices for resources and zonal energy prices for loads. Consistent with the rule, ERCOT and industry stakeholders have developed and submitted to the PUCT protocols and proposed energy load zones to implement these market design elements, together with an independent cost-benefit analysis (which indicated that the conversion would cost approximately \$260 million, while yielding approximately \$6 billion in benefits). The PUCT in 2005 reaffirmed its intent to implement the nodal market in ERCOT. In December 2005, the PUCT conducted a hearing on the nodal protocols submitted by ERCOT, and in April 2006 it issued an order approving the implementation of the nodal market. ERCOT has completed its process of design specification and is currently in the implementation phase of its nodal systems. Market participants, including CPS Energy, are also in the implementation phase for the upgrade of their systems necessary to operate in accordance with the nodal market protocols. Three municipalities have appealed approval of the protocols to the Travis County District Court, but the appeal has been abated because of the hereinafter described delay of the launch of the nodal market.

Since the PUCT’s action requiring the conversion, the transition by ERCOT from a zonal to a nodal wholesale market has experienced delays and increased cost projections. The original effective date of conversion (October 1, 2006) has twice been delayed (first to the end of 2008/beginning of 2009 and, most recently (as announced on November 26, 2008), to December 1, 2010), and the anticipated cost has increased from approximately \$260 million to \$660 million. To accommodate this projected cost increase, ERCOT petitioned the PUCT on March 31, 2009, for an increase in the nodal surcharge assessed to energy generators. On September 24, 2009, the PUCT approved a Non-Unanimous Stipulation that requires the \$0.169 interim nodal surcharge approved by the Commission to continue through December 31, 2009, and imposed a revised nodal surcharge of \$0.375 per megawatt-hour beginning January 1, 2010. Signatories to the Stipulation Agreement also agreed not to contest the allocation of the nodal surcharge to generators as previously approved by the Commission. These fees are directly applied to customer bills as they become effective. See “SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Transmission Access and Rate Regulation” herein.

These delays and cost increases have drawn criticism from certain Texas legislators, as well as from energy generators that will fund this conversion through payment of the increased nodal surcharge described above. The new cost/benefit analysis for this conversion, delivered in mid-December 2008, found the benefits of the nodal market still outweighed not completing the conversion.

### ***Environmental Restrictions of Senate Bill 7 and Other Related Regulations***

SB 7 contains specified emissions reduction requirements for certain older electric generating units, which would otherwise be exempt from the Texas Commission on Environmental Quality (“TCEQ”) permitting program by virtue of “grandfathered” status. Under SB 7, annual emissions of nitrogen oxides (“NO<sub>x</sub>”) from such units were reduced by 50% from 1997 levels, beginning May 1, 2003. These emissions have been reported on a yearly basis and CPS Energy has met the requirements of its NO<sub>x</sub> cap for the applicable units for the past three compliance years. CPS Energy has final Electric Generating Facility (“EGF”) State permits from the TCEQ for its four older electric generating plant sites, comprising 11 gas-fired units. CPS Energy may require future additional expenditures for emission control technology. See “ENVIRONMENTAL MATTERS – Federal Clean Air Act” and “CONSTRUCTION PROGRAM” herein for discussion of the cumulative economic effect of these requirements together with requirements under Federal Clean Air Act permits.

Although SB 7 instituted many of the changes to environmental emission controls which affect grandfathered electric generating plants, another TCEQ regulation, Chapter 117, is directed at all units in the state, including CPS Energy’s coal plants. These regulations required a 50% reduction in NO<sub>x</sub> emissions statewide beginning May 1, 2005, and system-wide on an annual basis. The first reporting period for CPS Energy’s power plants subject to the Chapter 117 cap was for the compliance period May 1, 2005 to April 2006. CPS Energy has met the Chapter 117 cap for each compliance period. As a result of the J.K. Spruce Plant Unit 2 (“JKS 2”) air permitting process, CPS Energy has committed to tighter NO<sub>x</sub> emission limitations than what is required under Chapter 117 at the Calaveras Power Station once the JKS 2 unit comes on line. The final Clean Air Interstate Rule (“CAIR”) has imposed even more NO<sub>x</sub> restrictions on CPS Energy power plants as described in “ENVIRONMENTAL MATTERS” herein. Changes to environmental emission controls may have the greatest effect on coal plants. See “ENVIRONMENTAL MATTERS – Federal Clean Air Act” herein. Further statutory changes and additional regulations may change existing cost assumptions for electric utilities. Such changes could have a material impact on the cost of power generated at affected electric generating units.

SB 7 established the State’s goal for renewable energy in 1999 but made no special provisions for transmission to interconnect renewable resources. The rapid development of wind power in west Texas since 2001 has shown that wind farms can be built more quickly than traditional transmission facilities. This timing difference poses a dilemma for planning as it is difficult to know whether a new line will be needed if the generation facilities do not yet exist. A wind farm is difficult to finance if there is no certainty that sufficient transmission will be available to deliver generated electricity. Senate Bill 20, enacted by the Texas Legislature in 2005 (“SB 20”), authorized the PUCT to regulate in this area, and specifically authorized the PUCT to identify an area with sufficient renewable energy potential, known as competitive renewable energy zones (“CREZs”) and pre-designate the need for transmission facilities serving the area even if no specific renewable generation projects exist or are under construction. The designation of CREZs in regions with developable renewable resources would be partially based on financial commitments of wind project developers desirous of building in the CREZ. In July 2008, the PUCT voted to create five CREZs in west Texas and the Panhandle. In August 2008, the PUCT further decided that an additional 18,456 MW of wind energy from the five CREZs would be delivered into ERCOT via transmission lines estimated to cost ERCOT rate payers a minimum of \$4.93 billion. The PUCT awarded the construction of those transmission lines to existing transmission service providers (“TSPs”) in whose service areas the lines will be located and new entrants seeking to become TSPs. The PUCT’s decision was appealed by the City of Garland, and a State District Court determined that the PUCT should have given municipally owned utilities consideration in the CREZ award process. In March 2010, the PUCT awarded the City of Garland a CREZ line to construct. CPS Energy does not plan to renew its request for authority to construct any part of the CREZ lines. Under the statewide transmission costs allocation process, CPS Energy will pay approximately 7% of these construction costs.

According to ERCOT, about 8.3% of the electricity generated in Texas during the first half of 2010 came from renewable energy resources, up from 6.4% for all of 2009. The total capacity of renewable facilities in Texas as of June 30, 2010, is approximately 10,073.5 MW which exceeds the 5,000 MW goal specified in the PUCT Substantive Rule 25.173 – Goal for Renewable Energy and it exceeds the January 1, 2025 “target” of 10,000 MW wind generation. At 10:58 pm on June 12, 2010, wind generation in ERCOT produced a new record of 7,016 MW, which represented 15.8% of the system load at that time. The previous record was 6,272 MW on March 5, 2010, which represented 19% of the load at that time.

On February 26, 2008, ERCOT implemented the second stage of its emergency grid procedures (out of 4 stages) following a sudden drop in the system frequency. The drop in system frequency was attributed to a combination of events including a drop in wind energy production at the same time the evening electricity load was increasing, accompanied by multiple power providers, other than CPS Energy, falling below their scheduled energy production. The loss of wind energy also resulted in congestion in certain parts of the ERCOT transmission system. Implementing the stage two emergency procedures stabilized ERCOT system frequency. Other than interruptible loads, no other customers in the ERCOT region lost power due to the event. Because of the challenges associated with scheduling wind energy, ERCOT has chosen to count only 8.6% of nameplate wind capacity toward ERCOT’s reserve margin requirements.

The Legislature increased the State's renewable energy goal in 2005 with the enactment of SB 20. As amended by SB 20, PURA directs that the cumulative installed renewable capacity in the State must total 2,280 MW by January 1, 2007; 3,272 MW by January 1, 2009; 4,264 MW by January 1, 2011; 5,256 MW by January 1, 2013; and 5,880 MW by January 1, 2015. Further, the PUCT is directed to establish a target of 10,000 MW by January 1, 2025. The legislation includes a target of 500 MW from renewable resources other than wind power and requires the PUCT to designate CREZs to expedite transmission planning. In addition, on April 2, 2008, ERCOT filed a report with the PUCT concerning wind power and the transmission facilities that may be necessary to transfer the electric power across the State. No actions taken during the 81<sup>st</sup> Session of the Texas Legislature, which adjourned on June 1, 2009, in this regard impact CPS Energy.

Looking to the future, CPS Energy plans to evolve from a company focused on providing low-cost power from traditional generation sources to a company providing competitively priced power from a variety of sustainable sources. CPS Energy will continue to focus on high levels of reliability to the communities it serves, while working on customer retention and loyalty.

## **RESPONSE TO COMPETITION**

In order to prepare to operate successfully in the new competitive environment created by the enactment of SB 7, CPS Energy developed a marketing plan that focuses on retaining the retail customers in its historic service areas and active participation in wholesale markets. Programs concentrate on not only meeting all customers' traditional needs, but also on providing products and services that provide comfort and convenience for residential customers and improve productivity and reduce costs for commercial and industrial customers. In addition, CPS Energy is improving internal and external communications, promoting participation in a wide variety of community initiatives, staying actively involved with regulatory issues, and focusing on the strategies and objectives at the corporate and business unit levels which have been identified as critical to success.

As a step in diversifying its energy resource plan, CPS Energy is aggressively pursuing renewable energy supplies. CPS Energy is currently receiving renewable energy under several long-term contracts. CPS Energy has a 20-year contract for 160.5 MW of wind-generated electricity from the Desert Sky Wind Project; a 20-year contract for 100.5 MW from the Cottonwood Creek Wind Farm; a 20-year contract for 240.8 MW from an expansion to the Cottonwood Creek Wind Farm; a 15-year contract for 76.8 MW from the Penascal Wind Farm; and a 15 year contract for 130.4 MW from the Papalote Creek Wind Farm. CPS Energy also has a landfill gas-generated energy project totaling 9.6 MW which came on-line in December 2005. See "DESCRIPTION OF PHYSICAL PROPERTY – Electric System – Generating Plants" herein.

To date CPS Energy's renewable energy capacity totals more than 718.6 MW in service with another 191.4 MW under contract. CPS Energy has one of the most aggressive renewable energy programs in Texas with a renewable capacity under contract equivalent to nearly 19.6% of its historic peak power requirement. For discussion of the reliability of wind-powered generation, see "CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY - Environmental Restrictions of Senate Bill 7 and Other Related Regulations" herein.

With respect to state and national legislative action regarding competition, CPS Energy continues to participate actively in the legislative process to voice the interests of Municipal Utilities and play an integral part in shaping the new environment in which it will operate. CPS Energy continues to evaluate the price components of the energy services it provides, recognizing that the price for electricity will be a paramount factor for succeeding in a deregulated environment. Cost containment initiatives coupled with additional phases of debt management strategies will continue in the years ahead.

In conjunction with the onset of deregulation and retail competition, overall merchant plant activity in ERCOT increased significantly in recent years, with more than 48,705 MW of new generation completed since wholesale competition was introduced in September 1995. The result of these capacity additions has been a strong downward pressure on wholesale power prices that, in turn, has led several companies to decommission or "mothball" less efficient power plants. According to information posted at the PUCT website, as of December 28, 2009, 8 ERCOT facilities (2,718 MW) were mothballed since September 1995, and 38 such facilities have been retired (9,824 MW) since 2002. CPS Energy was a net seller of power when excess capacity was available. The market is constantly monitored, and CPS Energy continues to purchase or sell on a daily basis to optimize use of its generation portfolio.

### ***Strategic Planning Initiatives***

CPS Energy has a comprehensive corporate strategic plan that is designed to make CPS Energy more efficient and competitive, while delivering value to its various customer groups and the City. On August 22, 2005, the Board approved a new strategic plan, developed by a cross-functional team. The plan built on the CPS Energy mission, vision, and core values, as well as long-term goals adopted in 2004, as part of the strategic process. The strategic plan has evolved to include components for the wholesale; retail; transmission and distribution; gas; and shared services business units/areas. Each plan is the responsibility of the business unit and will focus on Customer Relationships; Employee Relationships; External Relationships; Operational Excellence;

Renewables, Carbon Constraints and the Environment; Technology & Innovation; Financial Integrity. The senior executive team has accountability for development and delivery of corporate strategy and the related plans. The Board reviews and approves the corporate strategy each year.

Major initiatives and key action plans necessary to accomplish the corporate objectives and meet or exceed the targets are also included in each plan. Status reports on strategies, risks and market changes are provided to the Board and senior management on a regular basis. An oversight team, appointed by senior management, ensures consistency with the corporate vision and directs the resolution of cross-business unit issues. Vision 2020 was completed in 2008, outlining CPS Energy's long term view, focused on the key business drivers for the coming decade: customer relationships, employee relationships, external relationships, carbon constraints and the environment, technology and innovation, and financial integrity. In furtherance of Vision 2020, CPS Energy and the City hosted a Sustainability Workshop in April 2009. CPS Energy continues to work with City and community leaders in the development of sustainability initiatives to improve the overall quality of life in San Antonio. CPS Energy periodically updates Vision 2020 to ensure it properly reflects CPS Energy's perspective and direction.

### ***Debt and Asset Management Program***

CPS Energy has developed a debt and asset management program ("Debt Management Program") for the purposes of lowering the debt component of energy costs, maximizing the effective use of cash and cash equivalent assets and enhancing financial flexibility. An important part of the Debt Management Program is debt restructuring through the prudent employment of variable rate debt. CPS Energy does not currently use interest rate swaps, but continues to assess them as possibilities for the future. The program also focuses on the use of unencumbered cash and available cash flow, when available, to redeem debt ahead of scheduled maturities as a means of reducing outstanding debt. The Debt Management Program is designed to lower interest costs, fund strategic initiatives and increase net cash flow. CPS Energy has a Debt Management Policy ("Policy"), providing guidelines under which financing and debt transactions are managed. These guidelines focus on financial options intended to lower debt service costs on outstanding debt; facilitate alternative financing methods to capitalize on the present market conditions and optimize capital structure; and maintain favorable financial ratios. Under these guidelines, CPS Energy's gross variable rate exposure is limited to 25% of total outstanding debt.

### ***Current Economic Developments***

CPS Energy works independently as well as with local economic development agencies to recruit, retain and encourage the expansion of targeted businesses throughout the service territory. Strategic initiatives include the pro-active recruitment, retention and expansion of the following industries which have the most potential advantage to CPS Energy: advanced manufacturing (including aviation, aerospace, automotive), life sciences/bio-medical, homeland security, information technology (including data centers, financial service centers, insurance and back office operations) and large-scale retail developments.

Even in a recessionary national economy, San Antonio continues to systematically grow its economy, as indicated by recent publications naming San Antonio as one of the nation's best performing and strongest metro areas during the most recent recession (Brookings Institute, Business Week, Forbes).

The City has solidified its position nationally as a location for companies with mission critical information technology, information security and data storage requirements. Microsoft, the 24<sup>th</sup> Air Force (Cyber Command), Affiliated Computer Services ("ACS"), Lowe's Home Improvement, Valero Energy, Christus Healthcare, Frost Bank, Rackspace Managed Hosting, Power Loft, the Texas Cryptologic Center, Corporate Office Properties Trust – all have decided to locate data centers in San Antonio, the seventh-largest city in the United States. All cite CPS Energy, the nation's largest municipally owned energy company providing electric and natural gas service, as one of the primary reasons for those decisions.

Over the past year and one-half, San Antonio has been successful in recruiting 16 new or expanding companies into the CPS Energy service territory with the potential to create almost 7,000 new jobs, including:

- Medtronic Diabetes National Sales and Operations Headquarters will serve as the company's diabetes therapy management and education center. This new 150,000 square foot facility has created 1,400 new jobs;
- Nationwide Mutual Insurance Company based in Columbus, Ohio will create 838 jobs in San Antonio at a new regional corporate campus;
- Transcom North America, Canada's largest privately-held provider of customer relationship and contract center services will create 1,400 jobs;
- Toyota Motor Corporation's decision to move its Tacoma truck production to San Antonio will create 850 new jobs anticipated by the end of 2010;
- Allstate Corp. plans to open a customer information center in San Antonio that will employ 600 full-time employees;
- Kohl's has opened a regional operations center for its credit card program and will employ 1,065;

- Atento will employ 400 in its new back office contact center; and
- BD (Becton, Dickinson Company), a leading global medical technology company, will open a professional services headquarters creating 296 jobs.

New business development is achieved in partnership with the San Antonio Economic Development Foundation and results in development throughout the CPS Energy service territory. For example, the Cole Hersee Company, a manufacturer and distributor of electrical switches, recently located to the City of Schertz adding 30 new jobs.

Work continues on the Texas Cryptologic Center (“TCC”) in San Antonio. The TCC has committed to establish a regional cryptology center to support its communications intelligence – and is projected to retain and create almost 2,000 jobs over the next few years. At full build-out, in 2014, this center will result in an additional load of over 60 MW onto the CPS Energy system. This operation has already been the catalyst for the development of a new office park surrounding the TCC site as two buildings are currently under construction.

In addition, progress continues on other major projects such as the United States Department of Defense’s Base Realignment and Closure (“BRAC”) program.

The San Antonio economy is holding up stronger than what most of the nation is experiencing. The unemployment rate in San Antonio is 7.7% and is lower than the state and national rate of 8.5% and 9.7% respectively. San Antonio is expecting job growth of 2%-2.5% for 2010. Although Bexar County has experienced a decrease in the number of residential housing permits, the 12-month moving average remains positive. As a result, CPS Energy is not predicting net customer losses as a result of the current economic slow-down.

## **CONSTRUCTION PROGRAM**

Comprehensive programs for planning and construction to meet current and future electric and gas systems needs are continually being reviewed and updated, and are aligned with the strategic plan. CPS Energy utilizes computer-based mathematical models for its forecasting processes. CPS Energy bases its near-term construction and operating needs on a five-year forecast. This short-term annual forecast is supported by a 35-year electric resource plan and is integrated in the long-term financial plan. These assumptions are subject to substantial change and are revised as necessary to maintain CPS Energy’s competitive position.

While short-term energy demand projections have been impacted by recent economic developments and while energy efficiency and conservation is expected to reduce usage through STEP, positive customer growth is still expected. CPS Energy expects to see continued growth in its customer base for the electric and gas systems due to projected population growth in the San Antonio area. The current energy sales and peak demand forecast predicts annual increases in sales over the next 25 years of 1.64% and 0.04% in electric and gas sales, respectively, and an average peak demand growth rate over the next 25 years of 1.28% per year. CPS Energy has continued to expand its electric customer extensions, with ongoing construction growth in this area. The capital projects in fiscal year 2010-11 are planned to be funded with transfers from internally generated funds, debt proceeds, and other sources.

A capital improvement plan is made for planning purposes and may identify projects that may be deferred or omitted entirely in future years. In addition, the proposed funding sources for the plan may be modified to meet changing conditions. Likewise, as conditions change, new projects may be added that are not currently identified. CPS Energy continually monitors and updates the capital plan with estimates of expenditures necessary to meet proposed and probable new environmental regulations and regulatory standards. CPS Energy’s current \$3.006 billion, five-year capital improvement plan is forecasted from February 1, 2010 to January 31, 2015, and does not include expenditure for further development of CPS Energy’s existing 7.625% interest in STP Units 3 and 4.

Construction projects include electric transmission, electric generation, electric distribution, general properties, and gas facilities. See also “DESCRIPTION OF PHYSICAL PROPERTY – Electric System” herein. The capital program is primarily driven by the generation function and includes expenditures for completing JKS 2 and additional gas peaking generation, various environmental and production upgrades at existing plants, and CPS Energy’s 40% share of STP Units 1 and 2. The remainder of the capital budget is for electric distribution, electric transmission, gas distribution, and shared services including the deployment of Advanced Metering Infrastructure technology.

Over the five-year period covered by the current capital plan, construction funding from debt proceeds averages approximately \$419.9 million per year, with other significant sources of funding for the plan consisting of internally generated funds.

The Community Infrastructure and Economic Development Fund (“CIED”) was established by Board policy on January 19, 2005, as a successor to the Overhead Conversion Fund (“OCF”). The OCF was originally instituted in 1993 by the Board in response to interest by the citizens and governing bodies of the City and the suburban cities within the CPS Energy service area to enhance the

aesthetic appeal of the public areas by minimizing the visual impact of overhead electric facilities. The OCF amount, set annually, equaled 1% of the electric revenue (less uncollectibles) of the CPS Energy electric system billed during the previous fiscal year to retail electric customers of CPS Energy residing within the City and each of the suburban cities. For several reasons, including the high cost of converting overhead facilities to underground, the City and the suburban cities had difficulty spending the OCF monies on an annual basis. In late 2004, CPS Energy was asked to consider expanding the potential uses of the fund. This request was later approved by the Board.

Going forward, CPS Energy will continue to make all or any part of the monies available for “traditional” OCF projects (re-routing or undergrounding), but will also make the funds available for certain eligible economic development and environmental stewardship/energy efficiency projects. Such projects are evaluated for their ability to improve the environment, create new jobs, and generate new electric and gas revenues. Both of these new allowable uses (economic development and environmental stewardship) require a positive cost-benefit evaluation, meaning that CPS Energy is likely to receive greater economic return as a result of the project being eligible to receive CIED Fund monies and other investments applied toward the project. The CIED Fund allocable to all the beneficiary entities as of July 31, 2010, totaled over \$51 million.

By further policy change effective January 2006, and by City ordinance passed in February 2006, CPS Energy agreed to transfer monies allocable to the City under the CIED Fund Policy to that entity’s General Fund. The transfer is subject to the limitations that the: (1) total annual City transfer from the gross revenue of the Systems, inclusive of the CIED fund transfers, does not exceed 14% of CPS Energy’s total gross revenues (in compliance with the Bond Ordinances), and (2) CIED fund transfer does not exceed 1% of electric base rates paid by residents of the City. Using a portion of the CIED fund’s beginning balance on March 30, 2009, the City sought and obtained consent from CPS Energy for a one-time transfer of previously collected CIED funds allocable to the City in excess of the 1% of electric base rates paid by residents of the City in the prior year. The City stated the intended uses for these funds were to support BRAC-related improvements in the Fort Sam Houston area and other City infrastructure improvements. (See “RESPONSE TO COMPETITION – Current Economic Developments” herein). This special transfer complied with all the Bond Ordinances in that it did not result in transfers in excess of 14% of CPS Energy’s total gross revenues during that Fiscal Year.

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## DESCRIPTION OF PHYSICAL PROPERTY

### ELECTRIC SYSTEM

#### *Generating Plants*

CPS Energy currently operates 16 electric generating units, four of which are coal-fired and 12 of which are gas-fired. This excludes three gas steam units currently in “mothball” status that could be brought back into operation, if needed. Some of the gas-fired generating units may also burn fuel oil, which provides greater fuel flexibility and reliability. CPS Energy also owns a 40% interest in the South Texas Project’s (“STP”) two existing nuclear generating Units 1 and 2. These nuclear units supplied 31.0% of the electric system native load for the six months ending July 31, 2010. See “South Texas Project” herein.

The J.T. Deely, J.K. Spruce, and O.W. Sommers Plants are located at the Calaveras Power Station southeast of the City and share Calaveras Lake’s cooling capacity. The J.T. Deely Plant consists of two units that are equipped to burn coal. Like the Deely Plant units, the J.K. Spruce Plant consists of two units, including the J.K. Spruce Unit 2 (“JKS 2”) that was provisionally commissioned on May 28, 2010. All CPS Energy’s coal units burn low sulfur western coal from the Powder River Basin area of Wyoming. Prior to completion of JKS 2, coal units provided 44.0% of the electric system native load for the six months ending July 31, 2010. The O.W. Sommers Plant comprises two units, which are capable of operating on either natural gas or fuel oil. CPS Energy entered into a financial lease/leaseback transaction with an affiliate of Unicom Corporation involving CPS Energy’s J.K. Spruce Unit 1 (“JKS 1”) in June 2000. Unicom Corporation has subsequently merged into Exelon Corporation. The balance sheets and related notes in Appendix B include items related to this transaction.

CPS Energy owns 1,274 aluminum railroad cars which are used in unit trains to haul coal from mines in Wyoming and other locations to the J.T. Deely Plant and the J.K. Spruce Plant. CPS Energy performs its own railroad car maintenance and servicing at its railroad car maintenance facility located at Calaveras Power Station. Also, CPS Energy is currently leasing an additional 567 aluminum rail cars to meet the increased coal demand due to the commercial operation of JKS 2.

The Braunig Power Station is located on Braunig Lake, also southeast of the City. It has three units that can operate on either natural gas or fuel oil. The Arthur von Rosenberg Plant, located adjacent to the Braunig Power Station, uses combined cycle technology that is 25 to 30% more fuel efficient than other gas generation technologies.

While STP and the plants at the Calaveras Power Station and Braunig Power Station now provide most of CPS Energy’s generation, CPS Energy has two other sites with power generation assets. Leon Creek Power Station located in southwest San Antonio has two older gas steam units and four natural gas simple cycle combustion turbines that were installed in 2004. The combustion turbines provide quick-start peaking energy for CPS Energy’s generation portfolio, as well as black start service to the grid operator, ERCOT. And finally, the Tuttle Power Station located in northeast San Antonio has four older gas steam units with Unit 2 retired from service in January 2007 and Units 1, 3, and 4 currently in mothball status. See “Generating Capability” table herein for more details on CPS Energy generating units.

Authorization to proceed with the permit application for JKS 2, a new 750 MW coal-fired generating station co-located with the JKS 1 coal-fired generating station, was received from the Board in June 2003. In November 2003, CPS Energy filed with TCEQ an application for permits associated with construction and operation of JKS 2. The TCEQ approved the permit in December 2005. The ground breaking for the new coal-fired unit took place on March 21, 2006. The plant was placed into service on May 28, 2010. JKS 2 incorporates the most-advanced emissions controls currently available, including a wet SO<sub>2</sub> scrubber, selective catalytic reduction (“SCR”) technology, and baghouse. See “ENVIRONMENTAL MATTERS – Other Environmental Issues” herein for further discussion.

CPS Energy is adding four natural gas/fuel oil simple cycle combustion turbines, rated at 47.5 MW each, to the Braunig Power Station. The new units are scheduled to come on line by the end of 2010 and will include blackstart capability. To conserve Edwards Aquifer ground water, the new units will use “once through” cooling water from Braunig Lake to reject heat from the inlet air chilling system. This will add very little heat load to the lake.

Braunig and Calaveras Lakes are CPS Energy-owned man-made lakes that provide cooling for the majority of CPS Energy’s generating units. These lakes utilize treated sewage effluent and runoff waters to maintain operating levels. CPS Energy was a pioneer in the use of non-potable, recycled water from treated sewage effluent for cooling purposes, thereby saving higher quality, potable ground water for other uses. Braunig Lake has additional cooling capability for future generating units.

CPS Energy has contracted with the San Antonio Water System (“SAWS”) to provide a maximum of 50,000 acre-feet of treated sewage effluent per year to CPS Energy. This water is supplied under contract as a firm base volume of 40,000 acre-feet and 10,000 acre-feet from exercise of two Contingent Options of 5,000 acre-feet each. CPS Energy projects that these contract volumes, along with water available under existing permits, will provide sufficient cooling capacity for existing and planned generation units at these lakes.

CPS Energy owns approximately 3,000 acre-feet of Edwards Aquifer ground water to supply process water and some cooling water to power plants in our service territory. CPS Energy projects that this amount of water is sufficient to maintain power plant operations under worst case electric demand conditions, coupled with drought of record assumptions. CPS Energy also purchases about 700 acre-feet per year of potable water from SAWS through standard water delivery rates for power plant process water and miscellaneous plant needs.

CPS Energy continues to manage water-related legal, supply, and conservation issues through participation in the Senate Bill 3 – Edwards Aquifer Recovery Implementation Program, the SAWS/San Antonio River Authority/San Antonio Mayor’s Drought Management groups, and an internal CPS Energy water planning committee. CPS Energy has conserved water by using technologies such as once-through cooling pond (instead of cooling towers), increased power plant efficiency projects, the installation of water-efficient gas turbines (versus gas steam turbines), and new water treatment technologies. CPS Energy is continuing to study other water conservation technologies, such as dry cooling, and is actively planning for increased water usage through the implementation of air emissions technologies such as sulfur dioxide scrubbers and possible future carbon dioxide capture. See “ENVIRONMENTAL MATTERS” herein.

Papalote Creek is the latest wind farm brought on line under contract by CPS Energy. The 130.4 MW farm began operation on September 25, 2009. The Cedro Hill wind farm project is scheduled to bring 150 MW of capacity on line in late 2010. CPS Energy also contracted for two new solar energy projects: Blue Wing Solar for 14.4 MW, located just southeast of the City; and Western Ranch Solar for 27 MW, located in West Texas. Blue Wing Solar is scheduled for commercial operation by December 31, 2010. Western Ranch Solar was scheduled for early 2012; however, the developer terminated the contract effective September 29, 2010, due to its inability to secure sufficient financing for the project. On October 7, 2010, CPS Energy announced a solar partnership with SunEdison that will bring three 10 MW solar installations to the CPS Energy service area. CPS Energy will continue to issue Request for Proposals for renewable energy projects to help meet its goal of 1,500 MW of renewable energy capacity by 2020. Ten MW of solar electricity will be produced by the utility’s new Solartricity producer program. Participants in a two-year pilot program will install roof-mounted solar photovoltaic systems. CPS Energy will purchase power generated from the Solartricity producer program.

A new system peak demand of 4,706 MW was set on August 16, 2010. CPS Energy currently has 5,872.6 MW of fossil fuel and nuclear available and an expected summer availability of 68.9 MW of renewable generation providing a total of 5,941.5 MW to meet its summer peaking needs. For details, see the “Generating Capability” table herein.

### ***Generating Station Events***

On June 15, 2009, V.H. Braunig Plant Unit 3 (with a unit capacity of 420 MW) underwent a controlled plant shutdown related to high vibration from its low pressure turbine. The low pressure turbine was shipped to a repair facility where the affected turbine blades were repaired. Additional inspections confirmed that the damage was limited to the low pressure turbine and the unit was returned to service August 2, 2009. Also, on June 26, 2009, the JKS 1 Plant experienced a plant trip due to a loss of the generator exciter. Within three weeks, the JKS 1 Plant was returned to service using a temporary exciter unit, which allowed the plant to operate at its rated capacity until late September 2009, when permanent repairs were made to the existing exciter. Root cause analyses of both events either have been performed and incorporated into on-going best practices applied at electric power generating facilities. These mechanical failures were unrelated. At this time there is no indication that either event could have been anticipated or avoided.

On February 3, 2010, during routine testing, it was discovered that a control rod was not responding to the rod control system in STP Unit 1. Analyses performed by STP Nuclear Operating Company determined that the control rod was not withdrawing properly and that the most probable cause of the issue was corrosion in the Control Rod Drive Mechanism (“CRDM”). Further analysis identified a total of four control rods that demonstrated similar symptoms. The problem was addressed by flushing the corrosion from the CRDMs of the affected control rods. Extensive testing clearly demonstrated that all affected control rods had been restored back to proper functionality; the testing also verified the functionality of the other 53 control rods. The unit was down for seven days from February 3, 2010 to February 10, 2010, and reached 100% capacity on February 10, 2010.

On September 3, 2010, JKS 2 came off line so an inspection could be performed on the separate Generator Step-Up (“GSU”) transformer that is required to modify energy produced by JKS 2 to be sent to the transmission system. There were indications the transformer was malfunctioning. The transformer is still under warranty, and the transformer manufacturer is working diligently to correct the problem. A visual inspection along with electrical testing performed by the transformer manufacturer did not indicate conclusive evidence that there were internal faults in the transformer. However, low voltage bushings on the transformer were found to be damaged due to overheating. The transformer manufacturer believes the damaged bushings are the most probable cause of the transformer malfunction, and the transformer manufacturer has sent the bushings to the original equipment manufacturer to be rebuilt. CPS Energy is monitoring this work closely, and is developing a contingency plan in the event that the rebuilt low voltage bushings fail to rectify the transformer malfunction.

Depending upon the time of the year and actual customer demand, unplanned outages may or may not result in a need to purchase power from other providers on the market. In all of the cases noted above, the ERCOT market had more than enough reserve capacity for CPS Energy to obtain replacement power while the units were out of service. While replacement power is more expensive to CPS Energy's customers than generation from its own facilities, CPS Energy's existing rate structure allows the costs of replacement power to be funded through its monthly electric fuel adjustment fee. As a result, there was no material adverse effect on the finances of CPS Energy from replacement power associated with these events.

### Generating Capability<sup>1</sup>

Plant	Fuel	Year Installed	Net Max	Total	
			Capability	Capability	
			MW <sup>3,8</sup>	MW <sup>4</sup>	
STP (40% interest)	Unit 1	Nuclear	1988	540	
	Unit 2	Nuclear	1989	540	1,080 Nuclear
J.K. Spruce Plant <sup>2</sup>	Unit 1	Coal	1992	560	
	Unit 2	Coal	2010	775	
J.T. Deely Plant	Unit 1	Coal	1977	435	
	Unit 2	Coal	1978	436	2206 Coal
A. von Rosenberg Plant <sup>3</sup>	Unit 1	Gas	2000	481	
O.W. Sommers Plant <sup>4</sup>	Unit 1	Gas/Oil	1972	445	
	Unit 2	Gas/Oil	1974	435	
V.H. Braunig Plant <sup>4</sup>	Unit 1	Gas/Oil	1966	225	
	Unit 2	Gas/Oil	1968	240	
	Unit 3	Gas/Oil	1970	420	
W.B. Tuttle Plant	Unit 1 <sup>5</sup>	Gas	1954	0	
	Unit 3 <sup>5</sup>	Gas	1961	0	
	Unit 4 <sup>5</sup>	Gas	1963	0	
Leon Creek Plant	Unit 3 <sup>6</sup>	Gas	1953	60	
	Unit 4	Gas	1959	95	
	CT 1 <sup>7</sup>	Gas	2004	46.4	
	CT 2 <sup>7</sup>	Gas	2004	46.4	
	CT 3 <sup>7</sup>	Gas	2004	46.4	
	CT 4 <sup>7</sup>	Gas	2004	<u>46.4</u>	2,586.6 Gas/Oil
Total Capability owned by CPS Energy				<u>5,872.6</u>	<u>5,872.6</u>
Renewable Purchased Power:					
Desert Sky Wind Farm	Wind	2002	160.5		
Cottonwood Creek Wind Farm	Wind	2005	100.5		
Sweetwater 4	Wind	2007	240.8		
Penascal	Wind	2009	76.8		
Papalote Creek	Wind	2009	130.4	709.0 Wind	
Covel Gardens	Landfill Gas	2005	<u>9.6</u>	<u>9.6</u> Landfill Gas	
Total Renewable Purchased Power			<u>718.6</u>	<u>718.6</u>	
Total Capability including Wind and Landfill Gas			<u>6,591.2</u>	<u>6,591.2</u>	

(1) As of July 31, 2010.

(2) JKS 1 net maximum capability reduced from 595 to 560 MW to show net rating instead of gross rating.

(3) Net capability reflects summer rating.

(4) For gas/oil fueled units, the capabilities shown are the gas ratings.

(5) W.B. Tuttle 1, 3 and 4 are currently in mothball status.

(6) Leon Creek Unit 3 has been de-rated (from 65 MW to 60 MW).

(7) Combustion Turbine.

(8) "Net Max Capability" adjusted on applicable units to align with ERCOT reporting.

### New Generation / Conservation

One of CPS Energy's strongest aspects of operational and financial effectiveness has been the benefit it has derived from its diverse and low-cost generation portfolio, which is currently comprised of coal; nuclear; gas; various renewables such as wind, methane and a modest portion of solar; as well as purchased power. Continued diversification is a primary objective of the CPS Energy management team. Accordingly, this team periodically assesses future generation options that would be viable for future decades. This extensive assessment of various options involves projections of customer growth and demand; technological viability; upfront financial investment requirements; annual asset operation and maintenance costs; and environmental impacts.

The rapid cost escalation during the 2006 to 2008 timeframe of all physically constructed infrastructure projects eased through 2009 and 2010. CPS Energy continues to monitor proposed regulatory charges that could raise the costs of operating plants, such as those that have been proposed for units that use carbon-based fuels.

To mitigate the pressure on new generation construction requirements, CPS Energy management is expanding its efforts towards community-wide energy efficiency and conservation. These mitigation efforts are also referred to as the “5<sup>th</sup> Fuel” and are very important to CPS Energy’s strategic energy plans and specifically to its new generation needs. CPS Energy is currently implementing energy efficiency and conservation measures designed to save approximately 771 MW of electrical demand by the year 2020. See “CUSTOMER RATES – Fuel and Gas Cost Adjustment” herein. Additionally, CPS Energy management has explored and continues to cooperatively develop opportunities with its City Council for potential changes in ordinances, codes and administrative regulations focused on encouraging commercial and residential utility customers, builders, contractors and other market participants to implement energy conservation measures. For additional information on CPS Energy’s energy efficiency and conservation program, see “ENERGY CONSERVATION AND PUBLIC SAFETY PROGRAMS” herein.

In July 2010, CPS Energy completed its most recent assessment of generation resource options. This assessment included updated fuel prices, updated wholesale electric market forecasts and updated electric peak demand forecast which incorporated the most recent economic, demographic and historical demand data for the CPS Energy service territory. Additionally, this assessment included updated demand reductions due to the STEP energy efficiency and conservation program. Based on the updated demand forecast and the current CPS Energy generation resource portfolio, it is expected that a new generation resource will be needed by the summer of 2024, to meet the needs of the CPS Energy service territory and maintain a 12.5% reserve margin.

Before a commitment is made to construct the next generation facility, CPS Energy management will pursue several objectives. These objectives include the pursuit of additional stakeholder input; expanded community education about the long-term energy and conservation needs of the San Antonio community; continued option analyses and evaluations, including CPS Energy’s own formalized cost estimates; additional Board approval to move forward; and expanded presentations to the City Council, which governs the related rate increases and bond issuances required to support any generation construction project.

***South Texas Project***

STP is a two-unit nuclear power plant with Unit 1 and Unit 2 (or Units 1 & 2) having a nominal output of approximately 1,350 MW each. STP is located on a 12,220 acre site in Matagorda County, Texas, near the Texas Gulf Coast, approximately 200 miles from San Antonio. CPS Energy currently owns 40% of these units. Participant Ownership (“Participants”) in STP 1 & 2 and their shares therein are as follows:

<u>Participants</u>	<u>Ownership</u>	
	<u>Effective February 2, 2006<sup>1</sup></u>	
	<u>%</u>	<u>MW (approximate)</u>
NRG Energy (“NRG”)	44.0	1,188
CPS Energy	40.0	1,080
City of Austin-Austin Energy	16.0	432
	<u>100.0</u>	<u>2,700</u>

(1) In 2006, Texas Genco, holder of a 44% interest in STP, was acquired by NRG Energy, Inc. NRG Energy Inc. holds its interest in STP Units 1 & 2 in NRG South Texas LP.

STP is maintained and operated by a non-profit Texas corporation (“STP Nuclear Operating Company” or “STPNOC”) financed and controlled by the owners pursuant to an operating agreement among the owners and STPNOC. Currently, a four-member board of directors governs the STPNOC, with each owner appointing one member to serve with the STPNOC’s chief executive officer. All costs and output continue to be shared in proportion to ownership interests.

STP Units 1 & 2 each have a 40-year NRC license that expires in 2027 and 2028, respectively. In August 2006, the Strategic Teaming and Resource Sharing (“STARS”) alliance notified the NRC that a member intended to submit a license renewal application in the fourth quarter of 2010. On June 18, 2008, STPNOC sent a letter to the NRC naming STP as the STARS member who intended to submit an application in the fourth quarter of 2010. Subsequently, in October 2010, STPNOC filed an application to the NRC to extend the operating licenses of STP Units 1 and 2 to 2047 and 2048, respectively.

During the twelve-months ended July 31, 2010, the STP Units 1 and 2 operated at approximately 89.2% and 93.0% of net capacities, respectively. Unit 1 completed a refueling outage in the fall of 2009 that also involved the replacement of the reactor vessel head. On January 6, 2010, Unit 1 encountered a control rod misalignment during Control Rod Operability testing as initially described above and herein. To comply with the Technical Specification action for this condition, reactor power was reduced to less than 75%. The unit was stabilized at 73% power. Grid conditions contributed to a delay in troubleshooting of approximately 3½ days. Unit 1 was returned to 100% power on January 19, 2010. On February 3, 2010, a similar condition on a second control rod resulted in a shutdown of Unit 1. Unit 1 was returned to full power operation on February 10, 2010. On

May 26, 2010, Unit 1 experienced a tube leak in one of the main condenser waterboxes that required a reduction in power to approximately 90%. Following repair of the tube leak, the unit resumed full power operation on May 29, 2010. On August 20, 2010, a human performance error during performance of a surveillance on critical protective equipment resulted in an automatic trip of Unit 1. Unit 1 returned to full power operation on August 23, 2010. Unit 2 was taken offline September 16, 2009, for maintenance of the plant's extraction steam system and successfully returned to full power operation on September 29, 2009. Unit 2 completed a refueling outage in the spring of 2010 that also included the replacement of the reactor vessel head.

**Five-Year South Texas Project Capacity Factor<sup>1</sup>**

	Calendar Years Ended December 31,					2010 <sup>3</sup>
	2005	2006	2007 <sup>2</sup>	2008	2009	
Unit 1	90.0%	92.6%	107.7%	98.3%	92.1%	89.2%
Unit 2	<u>90.6%</u>	<u>102.5%</u>	<u>94.4%</u>	<u>97.8%</u>	<u>103.3%</u>	<u>93.0%</u>
Total	90.3%	97.6%	101.1%	98.1%	97.7%	91.1%

(1) Capacity Factor based on nameplate rating of 1250.6 MW per unit.  
(2) Greater than 100% due to plant upgrades.  
(3) Twelve months ended July 31, 2010.

Recent operational highlights for STP include the following: In 2009, for the sixth year in a row, STP led the nation in nuclear generation from a two-unit site. In total generation, Unit 1 ranked #9 of 104 reactors in the U.S. and #20 of 439 reactors worldwide. This generation performance was accomplished despite a scheduled outage for refueling and maintenance. Unit 2 ranked #2 in the U.S. and #4 in the world. In October 2009, Unit 1 completed a breaker-to-breaker production run by operating continuously between refueling outages which are scheduled 18 months apart. STP set an industry record by completing a fifth consecutive breaker-to-breaker run. In August 2009, STP received a Utility Achievement Award from the American Nuclear Society for demonstrating sustained outstanding performance.

The NRC evaluates plant performance by analyzing two distinct inputs: inspection findings from the NRC's inspection program and performance indicators that are reported by the licensee. Inspection findings and performance indicators are given a color designation based on their safety significance. The current plant assessment for STP can be found at a summary level at [http://www.nrc.gov/NRR/OVERSIGHT/ASSESS/pim\\_summary.html](http://www.nrc.gov/NRR/OVERSIGHT/ASSESS/pim_summary.html), or by writing to U.S. Nuclear Regulatory Commission, Public Document Room, O-1F-13, Washington, D.C. 20555.

The NRC rules require that each holder of a nuclear plant operating license submit to the NRC a decommissioning plan, which contains, among other things, a cost estimate for decommissioning such plant and either a funding plan or a guaranty method for covering decommissioning costs for such plant. Participants in STP have filed a decommissioning plan for the STP in compliance with these rules, which includes representations by each Participant that it has established a trust into which it annually pays, throughout the life of the STP, amounts which, when accumulated with investment income, are projected to provide the funds required by the rules to pay its respective portion of such costs.

CPS Energy maintains decommissioning funds for its 28% interest in STP separate from decommissioning funds associated with its 12% STP interest ("former AEP TCC interest") to meet its decommissioning obligations for its entire 40% interest in STP. See Note 13 to CPS Energy's audited financial statements in APPENDIX B. As of June 30, 2010, the CPS Energy balance in the City Public Service Restated Decommissioning Master Trust for the South Texas Project Decommissioning Trust ("STP Decommissioning Trust") to decommission CPS Energy's 28% interest in STP was \$263.0 million and exceeded estimated NRC requirements by \$155.3 million. With respect to decommissioning funds for the former AEP TCC interest, the acquisition by CPS Energy and Texas Genco of AEP TCC's interest in STP includes, proportionately, the responsibility for decontamination and decommissioning, but also resulted in the transfer of decommissioning funds held in trust by AEP TCC. Under PUCT Substantive Rule 25.303, AEP TCC will continue to collect decommissioning fees from its historical retail customers, which are paid into new trust accounts applicable to the new shares of STP acquired by CPS Energy and Texas Genco. These fees are subject to review and adjustment by the PUCT at its initiative or at the request of an interested person, including CPS Energy or Texas Genco. As of June 30, 2010, the CPS Energy balance in the Decommissioning Master Trust Related to the South Texas Project Interest Acquired from AEP Texas Central Company, "Master Trust (TCC Funded)", was \$88.0 million. As of June 30, 2010, the balance in the Master Trust to decommission CPS Energy's 12% interest in STP exceeded estimated NRC requirements by \$42.0 million. See "INVESTMENTS – STP Decommissioning Funds" and "Master Trust (TCC Funded)" herein for information concerning the value of investments in the decommissioning trusts. Actual decommissioning costs could vary substantially from the estimate of such costs depending on future regulatory requirements, the method used for decommissioning, and other factors, and the amounts in the decommissioning trusts may or may not be adequate to pay these costs.

### ***Used Nuclear Fuel Management***

Under the Nuclear Waste Policy Act, 42 U.S.C. 10101, et seq. (“NWP”), the DOE has an obligation to provide for the permanent disposal of high level radioactive waste, which includes used nuclear fuel at United States commercial nuclear power plants such as STP. To fund that obligation, all owners or operators of commercial nuclear power plants have entered into a standard contract under which the owner(s) pay a fee to the DOE of 1.0 mill per kilowatt hour (1M/kWh) electricity generated and sold from the power plant along with additional assessments. In exchange for collecting this fee and the assessments, the DOE undertook the obligation to develop a high-level waste repository for safe long-term storage of the fuel and, no later than January 31, 1998, to transport, and dispose of the used fuel. That date came and went and no high-level waste repository has been licensed to accept used fuel.

According to the filings in one recent suit brought against the DOE, at least 66 cases have been filed in the Court of Federal Claims against the DOE related to its failure to meet its obligations under the NWP by the existing owners or operators of nuclear facilities seeking damages related to ongoing used nuclear fuel storage costs. On August 31, 2000, in *Maine Yankee Atomic Power Company, et. al. v. U.S.*, the United States Court of Appeals for the Federal Circuit affirmed that the DOE has breached its obligations to commercial nuclear power plant owners for failing to live up to its obligations to dispose of used nuclear fuel. Subsequent to that decision, the DOE has settled with certain commercial nuclear power plant owners and agreed to provide funds to pay for storage costs while the DOE continues to develop a permanent high-level waste repository. STP has recently received a voluntary dismissal of litigation to cover its long-term storage costs and is negotiating to obtain a reasonable settlement that would provide for those costs in light of a decision in related litigation by another utility that had not yet been forced to incur significant damages because of the DOE’s breach. STP Owners will work to develop a strategy to recover any additional spent fuel storage costs from the DOE at the appropriate time.

Until the DOE is able to fulfill its responsibilities under the NWP, the NWP has provisions directing the NRC to create procedures to provide for interim storage of used nuclear fuel at the site of a commercial nuclear reactor. Currently, STP has adequate space in its on-site spent fuel storage pools to provide for storage of all of its used fuel. If the DOE is unable to take the used fuel from STP, sometime late this decade STP management expects to start the process of planning, licensing, and building an on-site independent spent fuel storage installation (“ISFSI”). That ISFSI is expected to have sufficient capacity to provide safe interim storage for used nuclear fuel from the current and future reactors at the STP site.

### ***Additional Nuclear Generation Opportunities***

This section describes some of the initial investigation, study and analysis that CPS Energy management undertook to explore one type of possible generation infrastructure, additional nuclear capacity. CPS Energy received Board approval to participate in the early development phase of two additional nuclear projects, with third-party co-owners; however, recent events hereinafter described superseded this initial approval.

The first possible nuclear project was scoped as the development of two additional reactors at the current STP site. These new units have been referred to preliminarily as STP Units 3 and 4. The second possible nuclear project would be a new two-unit facility tentatively located in Victoria County, which is also located in south Texas. Either or both projects, if fully developed by CPS Energy, would have delivered a portion of its power for use by CPS Energy customers in the ERCOT market.

In June 2009, CPS Energy management provided the Board its formal assessment and recommendations concerning these options compared to other possible new generation types. Management also provided its first public estimate of the cost of the first possible project at \$13 billion, inclusive of financing costs. Reports of higher cost estimates; however, resulted in reconsideration of the advisability of participating in the STP Units 3 and 4 Project and, ultimately, in CPS Energy’s decision to limit participation in further development of STP Units 3 and 4. In a settlement negotiated with NRG and the other participants in the development of STP Units 3 and 4, CPS Energy received a 7.625% ownership interest in the combined STP Units 3 and 4. CPS Energy will not be liable for any STP 3 and 4 Project development costs incurred after January 31, 2010. However, once the new units reach commercial operation, CPS Energy will be responsible for its 7.625% share of ongoing costs to operate and to maintain the units. CPS Energy will also receive two \$40 million installment payments upon award of a DOE loan guarantee to NRG and the NRG-Toshiba Corporation partnership, Nuclear Innovation North America called NINA (“NINA”). NINA also agreed to make a contribution of \$10.0 million over a four-year period to the Residential Energy Assistance Partnership, which provides emergency bill payment assistance to low-income customers in San Antonio and Bexar County. See “DESCRIPTION OF PHYSICAL PROPERTY – Electric System – Nuclear Cost Issue and CPS Energy Internal Investigation” herein. A detailed timeline of events concerning this matter and the recent settlement of the STP Units 3 and 4 lawsuit is provided in the following pages:

- Regarding the STP Units 3 and 4 Project, in June 2007, STPNOC signed a technical services agreement with Toshiba Corporation (“Toshiba”), a major Japanese manufacturer of heavy electrical equipment and developer of advanced boiling water reactors (“ABWR”) in Japan. Under this agreement, Toshiba agreed to perform early engineering and procurement work for STP Units 3 and 4 (“Project”). STPNOC is in the process of reserving the major, long-lead components for the

Project. STPNOC has already made a reservation for the Unit 3 reactor pressure vessel forgings. Rights and obligations in the agreements with GE-Hitachi Nuclear Company (“GE-H”), Toshiba and other vendors for long-lead equipment and services were shared with CPS Energy under the terms of the NRG-CPS Supplemental Agreement.

- On September 20, 2007, NRG and CPS Energy signed the South Texas Project Supplemental Agreement (“Supplemental Agreement”) under which CPS Energy elected to participate in the preliminary development of two new nuclear units at the STP nuclear power station site, STP Units 3 and 4, pursuant to the terms of the current participation agreement among the STP owners. CPS Energy could own up to 50% of the Project. The Supplemental Agreement provides for CPS Energy to reimburse NRG for its pro rata share, based on its ownership percentage, of initial project costs incurred and to pay its pro rata share of future development costs. The Boards of CPS Energy and NRG subsequently approved the Supplement Agreement which was effective on October 29, 2007. The Supplemental Agreement also provided CPS Energy and NRG with preferred rights of first refusal in the event of certain types of transfers of either NRG’s or CPS Energy’s interests in STP.
- On September 24, 2007, CPS Energy, subsidiaries of NRG, and the STPNOC filed a combined construction and operating license application (“COLA”) with the NRC to build and operate the Project. The COLA for the Project was the first complete application for new commercial reactors to be filed with the NRC in nearly thirty years. In the COLA, the owners proposed to use ABWR technology, which has been proven in four operating units in Japan. The total projected rated capacity of STP Units 3 and 4 is expected to be about 2,700 MW. On November 29, 2007, the NRC announced that it had accepted the COLA for review.

In order to develop the COLA and to provide on-going licensing support, STPNOC entered into an interim services agreement with General Electric Company (“GE”). Subsequent to entering into that agreement, GE entered into a joint venture in which it transferred its nuclear business to GE-H. GE assigned its responsibilities under the interim services agreement to GE-H. Despite its obligations in the interim services agreement, GE-H suspended licensing support for the COLA soon after it was filed with the NRC.

- Subsequently, CPS Energy and NRG determined that they would continue the Project with Toshiba Corporation, an experienced developer of ABWR units in Japan. Project development continued under a technical services agreement with Toshiba Corporation’s United States subsidiary Toshiba International Corporation while the parties negotiated a definitive engineering, procurement and construction (“EPC”) contract.
- On September 24, 2008, STPNOC submitted a revised COLA to the NRC reflecting CPS Energy and NRG’s intention to develop STP Units 3 and 4 with Toshiba. The COLA revision also reflected the establishment of a new NRG-Toshiba Corporation partnership, called NINA, which is 88% owned by NRG and 12% owned by Toshiba Corporation. In addition to STP Units 3 and 4, NINA has proposed to develop up to two additional two-unit ABWR projects in the United States. NINA has placed its ownership interest in STP Unit 3 into a wholly-owned subsidiary, NINA STP 3, LLC, and its interest in STP Unit 4 into a wholly-owned subsidiary, NINA STP 4, LLC. In addition, Toshiba Corporation has established a United States subsidiary to develop ABWRs, called Toshiba America Nuclear Energy (“TANE”). The updated COLA reflects the relationships among the developers, CPS Energy and NINA and the new NINA, TANE, NINA STP 3, LLC and NINA STP 4, LLC entities. On February 10, 2009, the NRC issued a schedule for completing its review of the COLA. The NRC projected to issue the final Safety Evaluation Report in September 2011. Currently, the Project expects that the COLA will be received early in calendar year 2012. Receipt of the NRC-approved COLA is a condition precedent to starting significant Project construction.
- On September 29, 2008, CPS Energy filed with the DOE a Phase I application for a loan guarantee related to the development of the Project. Following the DOE’s evaluation of all Phase I applications, the DOE ranked the Project third out of 14 nuclear loan guarantee project applications that were submitted. On December 19, 2008, CPS Energy filed with the DOE a Phase II loan guarantee application. In a letter dated February 9, 2009, the DOE informed CPS Energy that the Project is one of five nuclear projects for which the DOE is conducting due diligence as part of its process for potentially offering loan guarantees. Subsequently, the DOE narrowed the list of nuclear project candidates for the DOE loan guarantees to four projects, including the Project. Under current legislation, should the DOE ultimately approve an applicant’s filing, such a loan guarantee could be used to guarantee financing up to 80% of the debt for the applicable project. The DOE’s ability to issue guarantees is limited by appropriations. Currently, there is \$18.5 billion set aside for loan guarantees associated with new nuclear project development in the United States through federal fiscal year 2011. As part of the settlement with NINA, CPS Energy has withdrawn its DOE loan guarantee application.
- On November 5, 2008, STPNOC and the DOE executed a Standard Contract in which the DOE undertook the obligation to provide for permanent disposal of the used nuclear fuel from the proposed STP Units 3 and 4.

- On January 21, 2009, the Board approved increasing the Project development budget for STP Units 3 and 4 to \$276 million (from \$206 million). On February 24, 2009, CPS Energy and its Project co-owner authorized STPNOC, as their agent, to enter into an Engineering, Procurement and Construction (“EPC”) contract with Toshiba Corporations United States subsidiary, TANE.
- On February 24, 2009, STPNOC, as agent for CPS Energy and NINA, executed an EPC Agreement with TANE that provides terms and conditions under which STP Units 3 and 4 will be designed and constructed. The EPC Agreement has terms and conditions comparable to those for fossil-fired generating plants and has limits of liability and other provisions that are scaled to a project of this size. Toshiba has provided parent company guarantees for TANE’s performance.
- Following notice published on February 21, 2009, three individuals and three groups joined to file one Petition to intervene against the STP Units 3 and 4 COLA on April 21, 2009. This initial petition contained 28 contentions. Interveners subsequently filed seven additional contentions. As a result of NRC Licensing Board decisions, most of the contentions were dismissed. The remaining contentions have been combined into a single contention which has been admitted for further consideration. STPNOC, as agent for owners, plans to file supporting information as required to address any open issues and STPNOC staff believes these contentions can be resolved without hearings. The Project schedule already has time built into it for hearings as part of the COLA process; however, it is unclear whether contentions may result in hearings and whether hearings will affect the timing for issuance of the COLA.
- On August 31, 2009, the Board approved increasing the Project development budget for STP Units 3 and 4 to \$376 million (from \$276 million).
- On October 13, 2009, the Board approved selection of STP Units 3 and 4 as the next baseload generation resource and, in support thereof, approved a request to ask the City to approve \$400 million in bonds to support the Project at the City Council’s October 29, 2009 meeting.
- On October 27, 2009, amid reports CPS Energy had knowledge that costs of the Project might be significantly higher than previously reported; the City Council’s vote on the bonds was postponed. The Board undertook action to investigate the Project cost issue. The results of this investigation were reported to the Board in late 2009 and are described in “DESCRIPTION OF PHYSICAL PROPERTY – Electric System – Nuclear Cost Issue and CPS Energy Internal Investigation”.
- While the Project’s cost issue was being investigated, CPS Energy explored all its options regarding participation in or withdrawal from the Project. On December 6, 2009, CPS Energy filed a petition in Bexar County district court to clarify the roles and obligations of CPS Energy and NINA to define the rights of both parties should either decide to withdraw from the Project. A discussion of the resulting litigation is described below.
- On May 10, 2010, NRG announced that NINA had reached an agreement with The Tokyo Electric Power Company (“TEPCO”) to partner in the STP Units 3 and 4 Project. TEPCO will invest \$155 million for a 10% share of NINA Investments Holdings’ interest in STP Units 3 and 4. This investment will give TEPCO a 9.2375% interest in STP Units 3 and 4. TEPCO’s initial investment is conditioned upon receipt of a conditional commitment for a DOE loan guarantee for the Project. The investment also includes a \$30.0 million option payment that enables TEPCO to purchase an additional 10% share of NINA Investment Holdings for approximately \$125.0 million within one year. If TEPCO were to exercise their option, their interest in STP Units 3 and 4 would be approximately 18%. TEPCO would also be responsible for up to 20% (if the option were exercised) of the capital cost of the Project going forward. The agreement has been approved by the Boards of both companies and is expected to close once NINA secures a conditional commitment for a DOE loan guarantee.
- During the presentation of second quarter earnings results held on August 2, 2010, NRG announced a reduction in spending on the Project. NRG announced that accrued Project costs would be reduced from the current level of approximately \$30.0 million per month to approximately \$20.0 million per month. NRG also announced that its commitment to Project spending would be reduced to \$1.5 million per month. NRG reported that Toshiba had agreed to provide interim funding to cover the NRG gap. The parties are working together to adjust the near-term Project activities to maintain the overall Project schedule. NRG stated that they are confident the STP Units 3 and 4 Project will be awarded a DOE loan guarantee. However, they are not certain of the timing for the loan guarantee.

As briefly mentioned earlier, in addition to the STP Units 3 and 4 Project, CPS Energy has also explored another nuclear project with Exelon. In December 2007, CPS Energy and Exelon signed an agreement granting CPS Energy an option to participate in a possible joint investment in a nuclear-powered electric generation facility in southeast Texas (“Exelon Project”). Preliminary plans indicated that the Exelon Project would be located in Victoria County and would involve the development of two GE-H Economic Simplified Boiling Water Reactors (“ESBWR”), nominally rated at 1,520 megawatts each. Under this agreement,

CPS Energy has the option to acquire between a 25% and a 40% ownership in the Exelon Project. On September 3, 2008, Exelon filed a COLA with the NRC to build and operate Victoria County Station Units 1 and 2. On October 30, 2008, the NRC docketed the COLA for a detailed review. Subsequently Exelon determined that it was unable to reach commercial terms with GE-H. Exelon announced on November 24, 2008, that they intended to select another technology, other than the ESBWR, for the Exelon Project. On December 18, 2008, the NRC placed on hold the review of Exelon's COLA. On March 27, 2009, Exelon announced that it selected Hitachi's ABWR design for the Exelon Project and that it planned to revise the COLA and its DOE Loan Guarantee application accordingly. The Exelon Project failed to qualify for the initial round of DOE loan guarantees. Exelon has filed an Early Site Permit application with the NRC for the Victoria County location. CPS Energy will continue to monitor the Exelon Project.

### ***Nuclear Cost Issue and CPS Energy Internal Investigation***

Following the postponement of the City Council's vote, the Board undertook an investigation to determine whether CPS Energy management had knowledge of an increase in a preliminary cost estimate for STP Units 3 and 4 and why that information was not communicated to the Board. Specifically, the Board asked the CPS Energy Chief Audit & Ethics Officer to investigate and answer the following questions: (1) Who knew what information, by when, and who did they inform?; (2) Was there malicious intent to withhold information?; (3) Was there a failure to exercise prudent judgment and/or a failure to communicate in a timely manner?; and (4) Did the individuals understand their roles and accountabilities?

An outside law firm was hired to assist in the investigation, which took approximately four weeks to complete and involved the reviews of internal documents, interviews of numerous individuals and the preparation of a written report that was publicly disclosed on December 7, 2009. The results of this investigation were reported to the Board in late November and early December 2009 and, based on that report, the Board adopted a resolution finding that there was a failure of communication from certain members of CPS Energy executive management to the Board and the City Council regarding the "revised cost estimate" that was publicly disclosed in October 2009; that the failure of communication resulted in substantial part from a good faith belief that the "revised estimate" was not a formal estimate supported by data but, instead, was communicated as part of the ongoing negotiation process expected to lead to a contractually required formal cost estimate due on or about December 31, 2009, pursuant to the terms of the EPC Agreement; and that there was no malicious intent on the part of any member of the management team in connection with the failure of communication. The investigation report also concluded that no member of management instructed any other employee to conceal or withhold any information from the Board and that lack of information flowing to the Board was, at worst, due to a difference of opinion about what information should be deemed material and deserving of the Board's attention.

During the course of the investigation, several changes occurred in the Board and personnel:

- Shortly after the Board initiated its investigation, two senior CPS Energy staff members involved in the Project were placed on administrative leave pending results of the investigation.
- On November 26, 2009, Interim General Manager Steve Bartley resigned; a severance agreement was reached with Mr. Bartley.
- On November 30, 2009, the Board adopted a resolution accepting the findings and results of the investigation, and reinstating the two senior staff members who had been placed on administrative leave.
- Also on November 30, 2009, Jelynn LeBlanc-Burley was named Acting General Manager (a role in which she served until August 1, 2010) and the Board accelerated its search for a new CEO to replace Milton Lee upon his previously-announced retirement in 2010.
- On December 15, 2009, Deputy General Counsel Robert Temple resigned; a severance agreement was reached with Mr. Temple.
- During the course of the public controversy surrounding the investigation, the Mayor and certain City Council members called for the resignation of Board Chair, Aurora Geis and long-time trustee Stephen Hennigan. Ms. Aurora Geis resigned effective January 14, 2010, and Mr. Charles E. Foster, a retired AT&T executive, was selected to replace her on the Board.
- On January 22, 2010, Mr. Charles E. Foster was elected Chairman of the Board.
- Mr. Hennigan continues to serve on the Board; his term ends in January 2011. The Board is currently seeking applicants to fill this upcoming vacancy.

While the Project's cost controversy was being investigated, CPS Energy explored all of its options regarding participation in or withdrawal from the Project. One of the steps it took to clarify its rights under the existing project agreements, including the EPC Agreement, was to seek judicial clarification regarding the consequences of unilaterally withdrawing. The resulting lawsuits were dismissed, subject to final execution of documents reflecting a settlement reached between CPS Energy and NINA (which were signed on March 1, 2010).

This litigation involved the following causes of action:

- On December 6, 2009, CPS Energy filed a declaratory judgment action in State District Court in Bexar County seeking clarification of its rights under existing contracts with NINA and NRG regarding the parties' development of and participation in the Project.
- In mid-December 2009, CPS Energy and NINA/NRG commenced discussions about a way to achieve a reasonable business solution to the litigation. CPS Energy also continued its previously-initiated effort to sell some or all of its interest in the Project.
- On December 23, 2009, NINA filed an answer to the CPS Energy petition and also filed a counterclaim alleging breach of contract and requesting declaratory relief, a temporary injunction and forfeiture of CPS Energy's interest in the Project.
- On December 23, 2009, CPS Energy responded to NINA's counterclaim by filing an amended petition asserting additional causes of action against NINA, NRG and Toshiba including tortious interference with contract, fraud, negligent misrepresentation, and business disparagement, among others. The amended claim sought exemplary and punitive damages of up to \$32 billion.

Only CPS Energy's declaratory judgment action was pursued in court. The court found that CPS Energy would not forfeit its interest upon withdrawal, but would continue to be a tenant in common even if it ceased funding development of the Project. However, with both sides still interested in a business solution for all remaining matters, a settlement was pursued. CPS Energy and NINA/NRG reached a business agreement to resolve their differences in the Project. By the terms agreed upon with NINA, CPS Energy received a 7.625% ownership interest in the Project, an interest expected to entitle CPS Energy to approximately 200 MW of power, depending on the output of the units, once they reach commercial operation (expected to occur in 2017-2018). Based on the latest load forecast, CPS Energy does not anticipate needing this power or any additional base load generation until 2024. This interest in the Project will satisfy almost 40% of that need and is expected to contribute to meeting whatever carbon requirements may be imposed by federal legislation. CPS Energy will, therefore, not need to make a decision regarding additional base load generation until at least 2015, but at that time will consider natural gas combined cycle units, natural gas peaking units, renewable energy, nuclear generation, and other conventional and nonconventional technologies that may or may not be currently available. The time period between 2015 and 2024, when the power will be needed, will be used for planning and construction.

CPS Energy currently owns a percentage of the common facilities related to its ownership in STP Units 1 and 2, which will also be used by STP Units 3 and 4 when they become operational. One component of the STP Units 3 and 4 settlement was the transfer of a percentage of the ownership in the common facilities from CPS Energy to NINA. Tax-exempt debt was used to acquire and construct these common facilities and a portion of that debt is still outstanding. The IRS private business use regulations prevent state and local governments from transferring the benefits of tax-exempt financing to private business interests. On May 11, 2010, CPS Energy used a combination of cash and taxable debt from its Flexible Rate Revolving Note Program to defease \$25,745,000 in principal amount of the allocable portion of the debt (being both outstanding Senior Lien Obligations and Junior Lien Obligations) associated with the common facilities of STP Units 3 and 4 that are now owned by NINA.

### ***Qualified Scheduling Entity***

CPS Energy operates as an ERCOT Level 4 Qualified Scheduling Entity ("QSE") representing all of CPS Energy's assets and load. The communication with ERCOT and the CPS Energy power plants is monitored and dispatched 24 hours per day/365 days a year. Functions are provided from the Energy Market Center housed within the main office. Backup facilities have also been created. QSE functions include load forecasting, day ahead and real time scheduling of load, generation and bilateral transactions, generator unit commitment and dispatch, communications, invoicing and settlement.

The QSE will update systems and prepare personnel to accommodate the newly designed ERCOT "Nodal" Market design. See "CERTAIN FACTORS AFFECTING THE ELECTRIC UTILITY INDUSTRY – Post Senate Bill 7 Wholesale Market Design Developments" herein. The new market design will vastly change the procedures to dispatch generation and schedule bilateral transactions. CPS Energy is currently designing new processes and systems to continue to operate as a QSE in the new market.

### ***Transmission System***

CPS Energy maintains a transmission network for the movement of large amounts of electric power from generating stations to various parts of the service area and to or from neighboring utilities and for wholesale energy transactions as required. This network is composed of 138 and 345 kilovolt (“kV”) lines with autotransformers to provide the necessary flexibility in the movement of bulk power.

### ***Interconnected System***

The electric system is integrated with more than 100 other utilities, municipalities, independent power producers, power marketers, and co-operatives in Texas to form ERCOT, which covers a large portion of Texas. The ERCOT system is operated entirely within the State and is connected to other reliability councils and Mexico through three direct-current lines, providing only limited import/export capability. CPS Energy and the nine utilities below are the major transmission entities in ERCOT:

American Electric Power Service Corporation	Austin Energy
Brazos Electric Power Co-op	CenterPoint Energy
City of Brownsville Public Utilities Board	LCRA Transmission Services Corp.
South Texas Electric Co-op/Medina Electric Co-op	Texas Municipal Power Agency
ONCOR Electric Delivery	

The transmission facilities of the nine above entities, along with CPS Energy, have been integrated into a single control area, which is operated by ERCOT acting as the ISO. ERCOT operates the transmission grid through each of the transmission-owning entities that maintain direct control and maintenance of their respective portions of the transmission infrastructure.

Pursuant to the PUCT’s open access transmission rule, discussed under “SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Transmission Access and Rate Regulation” herein, ERCOT members and other wholesale market participants jointly established, by a filing with the PUCT in 1996, the ERCOT organization as an ISO and an integrated electronic transmission information network. ERCOT’s responsibilities, which were augmented in 1999 under SB 7 for the pending retail competitive market, include daily administration of the ERCOT transmission tariffs, including alternate dispute resolution procedures; coordination of the scheduling of ERCOT generation and transmission; directing the redispatch of ERCOT generation and transmission transactions for economic purposes; preserving system reliability; and administering the electronic transmission information network. ERCOT also manages commercial operations of the wholesale power market, as well as acts as a single clearinghouse for retail customer switches and metering information. ERCOT does not purchase or sell bulk electricity, nor does it dispatch generation facilities. Beginning July 31, 2001, ERCOT began operating the interconnected system as a single control area, in contrast to the multiple control areas historically in place, as part of the transition to the retail competitive market, which was fully implemented on January 1, 2002. As a participant as a generation entity, load serving entity, and transmission owner in the ERCOT wholesale market, CPS Energy is obligated to comply with all rules established by ERCOT as reflected in its protocols and operating guides, which are subject to change from time to time and subject to oversight and review by the PUCT. ERCOT’s costs of converting to a single control area and of administering system operations for the competitive retail market are recovered through an administrative fee assessed to system participants, including CPS Energy, allocated on a load-ratio share basis. CPS Energy recovers the fee through the billing adjustment discussed above under “CUSTOMER RATES – Governmentally Imposed Fees, Taxes or Payments”.

CPS Energy is also complying with the North American Electric Reliability Corporation’s reliability standards, including the new Critical Infrastructure Protection standards. CPS Energy must comply with these standards as a Transmission Planner, Transmission Owner, Distribution Provider, Generation Owner and Generation Operator. CPS Energy is continually monitoring for proposed new reliability standards and the potential of violations related to the new standards, but does not anticipate any violations of known standards to date that would have a material financial impact.

### ***Distribution System***

The distribution system is supplied by 79 substations strategically located on the high voltage 138 kV transmission system. The central business district of the City is served by nine underground networks, each consisting of four primary feeders operated at 13.8 kV, transformers equipped with network protectors, and both a 4-wire 120/208 volt secondary grid system and a 4-wire 277/480 volt secondary spot system. This system is well designed for both service and reliability.

Approximately 7,610 circuit miles (three-phase equivalent) of overhead distribution lines are included in the distribution system. These overhead lines also carry secondary circuits and street lighting circuits. The underground distribution system consists of 348 miles of three-phase equivalent distribution lines, 83 miles of three-phase Downtown Network distribution lines, and 4,391 miles of single-phase underground residential distribution lines. Many of the residential subdivisions added in recent years are served by underground residential distribution systems. At July 31, 2010, the number of street lights in service was 79,468. The vast majority of the lights are high-pressure, sodium vapor units.

## GAS SYSTEM

### *Transmission System*

The gas transmission system consists of a network of approximately 86 miles of steel mains that range in size from 4 to 30 inches. The entire system is coated and cathodically protected to mitigate corrosion. The gas transmission system operates at pressures between 135 psig and 1,118 psig, and supplies gas to the distribution system. A Supervisory Control and Data Acquisition (“SCADA”) computer system monitors the gas pressure and flow rates at many strategic locations within the transmission system. Additionally, most of the critical pressure regulating stations and isolation valves are remotely controlled by SCADA.

### *Distribution System*

The gas distribution system consists of 293 pressure regulating stations and approximately 5,053 miles of mains. The system consists of 2 to 30-inch steel mains and 1-1/4 to 8-inch high-density polyethylene (plastic). The distribution system operates at pressures between 9 psig and 274 psig. All steel mains are coated and cathodically protected to mitigate corrosion. The vast majority of the gas services are connected to the distribution system, and the gas normally undergoes a final pressure reduction at the gas meter to achieve the required customer service pressure. Critical areas of the distribution system are also remotely monitored by SCADA and designated critical pressure regulating stations and isolation valves are also remotely controlled by SCADA.

### *Proposed Rule Relating to Replacement of Gas Distribution Facilities*

In September 2010, the Texas Railroad Commission (“Commission”) published a proposed rule relating to replacement of gas distribution facilities, primarily those involving steel service lines. The proposed rule requires all gas distribution utilities in Texas to develop and implement a risk-based plan to replace steel distribution facilities and, if steel service lines are determined to be the greatest risk of failure, to establish an accelerated replacement program. CPS Energy has utilized a risk-based plan for facility replacement for a number of years and it has been successful in significantly reducing system leak rates on mains and services as well as lost and unaccounted-for gas. This plan has been shared with the Commission and CPS Energy is working with the Commission as it finalizes its rule to resolve unclear language and to attempt to ensure that any rule the Commission adopts will be compatible with CPS Energy’s plan.

## OTHER ELECTRIC AND GAS SYSTEMS STATISTICS<sup>1</sup>

	Electric System			Gas System	
	Transmission System	Overhead Distribution System	Underground Distr. System & Network	Gas Supply Pipe Line	Distribution System <sup>2</sup>
Substations	16 <sup>3</sup>	79			
Miles of Lines	1,472	7,610	4,391 <sup>4</sup> 83 <sup>5</sup>		
Kilovolts	138/345	13.2/34.5	13.2/34.5		
Miles of Main				86	5,053
Main Sizes (inches)				4 - 30	1 1/4 - 30
Main Pressures (psig)				135 - 1,118	9 - 274 <sup>2</sup>

- (1) As of July 31, 2010.
- (2) Maximum allowable operating pressure.
- (3) Includes switchyards.
- (4) Underground single phase, includes 321 miles three-phase commercial, industrial lines.
- (5) Downtown Network three-phase.

## GENERAL PROPERTIES

### *Operation Control System*

The Energy Management Center (“EMC”) is the facility where system operators use SCADA systems to monitor and control the CPS Energy electric transmission and distribution systems, and the CPS Energy gas supply pressure and distribution systems. All substations, power plants and major gas regulating points are continually monitored and displayed on one-line diagrams on video screens. Abnormalities register an alarm and the system operator can reset certain circuit breakers and valves as required, maintaining delivery of gas or electric service. In addition to the control capability, the system gathers data that are recorded on a computer for various reporting needs. The operation and control function located at the Jones Avenue facility, upgraded and expanded in 1999, serves as the secondary/back-up control center to ensure continued reliability of utility service to CPS Energy’s customers in the event of the loss of the EMC.

### *Support Facilities*

Core business operations are supported by various support facilities used for maintenance of such items as meters, transformers, communication equipment, vehicles, railroad cars and heavy construction equipment. These maintenance facilities, together with warehouses, administrative offices, customer service centers and storage areas, are strategically located throughout the service area to minimize driving time to work locations.

### *General Offices and Customer Service Centers*

The Main Office Complex comprised of the Main Office and Navarro Buildings, makes up CPS Energy’s General Offices, and is located at the intersection of Navarro and Villita Streets in downtown San Antonio. Executive, administrative, financial, information technology and engineering functions are located at the complex. The Main Office Building includes 11 floors of office space with adjacent surface level parking. The Navarro Office Building provides three floors for office space, is connected to the Main Office Complex by an enclosed elevated walkway, and includes a 7 floor parking garage.

CPS Energy’s customer service center staff provides information concerning customer accounts and processes customer payments. Customer service centers and authorized pay agents are geographically located in all sectors of the service area. These centers are convenient to the customers’ homes and in locations readily accessible to freeways. The Northside Customer Service Center serves as a walk-in center, customer call center, and additional general office space for personnel. The facility is an environmentally friendly facility.

### *Construction Centers and Service Centers*

In 2008, CPS Energy began leasing a combined office and industrial building that serves as a construction center. The primary function of this center is to pilot the redesigned new service delivery process, which is limited to new construction. CPS Energy owns four other construction centers, accommodating electric and gas construction, repair and maintenance services, support personnel for administration, planning, training, warehousing functions and garage facilities. The Salado Street Central Garage Service Center serves as the primary central garage for heavy equipment and vehicle repair and maintenance functions, with separate buildings housing a central printing shop, safety and health functions, billing operations, remittance processing, and warehousing.

### *Assembly Building*

The Villita Assembly Building is located in downtown San Antonio near the Main Office Complex. The main hall has a capacity to accommodate 1,840 people as an auditorium or 858 for a dinner function. The building is used for CPS Energy sponsored meetings and events and leased out to local civic, community, and non-profit organizations for major banquets, meetings and social events.

### *Vehicles and Work Equipment*

CPS Energy operates and maintains a fleet of automobiles, trucks, and heavy construction equipment. The garage facilities, located at CPS Energy’s service and construction centers, are staffed with trained mechanics that provide a majority of the maintenance performed on the vehicles and equipment. Major maintenance on heavy construction equipment is performed at the Salado Street Central Garage Service Center.

## SUMMARY OF INSURANCE PROGRAMS

CPS Energy maintains property and liability insurance programs that combine self-insurance with commercial insurance policies to cover major financial risks. The property insurance program provides \$5.7 billion of replacement value for property and boiler, machinery loss coverage including comprehensive automobile coverage, fire damage coverage for construction equipment, and valuable papers coverage. The deductible for the property insurance policy is \$5.0 million per occurrence with a secondary deductible of \$1.0 million per occurrence applicable to non-power plant and non-substation property locations. The liability insurance program includes (1) excess liability coverage with a \$100.0 million policy limit at a \$3.0 million self-insured retention, and (2) excess workers compensation coverage with a \$35.0 million policy limit at a \$3.0 million self-insured retention. Other property and liability insurance coverages include employment practices liability, fiduciary liability, employee travel, event insurance and commercial crime. CPS Energy also maintains insurance reserves, which as of July 31, 2010, totaled \$14.6 million to cover losses under the self-insurance portion of the insurance program.

CPS Energy and the other participants in STP Units 1 and 2 maintain NRC-required nuclear liability, worker liability, and property insurance, each of which includes provisions for retrospective assessments depending on occurrences at STP Units 1 and 2 and other commercial nuclear plants. CPS Energy is liable for 40% of the premiums and any retrospective assessments with respect to STP Units 1 and 2 insurance, and for costs of decontamination and repairs or replacement of damaged property in excess of policy limits; however, under PUCT regulations, AEP TCC's historical customers bear the risk associated with decommissioning that portion of STP Units 1 and 2 previously owned by AEP TCC.

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## ENVIRONMENTAL MATTERS

CPS Energy operations have the potential to affect the environment in a variety of ways, but primarily through discharges to air, land and water. To minimize environmental impact, CPS Energy constructs and operates its facilities according to, and often in excess of, the standards established for the utility industry by Federal, State, and local laws and regulations. CPS Energy's commitment to the environment is evidenced by its official environmental policy, which places the responsibility for regulatory compliance on all CPS Energy employees, regardless of job function or title. A full-time Environmental Department consisting of educated and trained professionals oversees the enforcement of this policy. Since 1996, environmental operating procedures ("EOPs") have been developed to provide guidance to CPS Energy employees as to how to perform their jobs in a way that protects the environment.

### *Federal Clean Air Act*

Congress enacted the Clean Air Act Amendments of 1990 ("Clean Air Act Amendments") with the intent of improving ambient air quality throughout the United States. All of CPS Energy's generating units in Bexar County have been issued Federal Operating (Title V) permits and Federal Acid Rain (Title IV) permits under the Clean Air Act by the TCEQ.

CPS Energy received a Plantwide Applicability Limit ("PAL") permit from the TCEQ for the Calaveras Power Station. This PAL permit sets a cap on emissions at the site based on past emissions. This is a voluntary permit submitted by CPS Energy to provide flexibility to better manage facility-wide emissions. The PAL permit allows CPS Energy to have limited flexibility in maintaining its Calaveras Lake units while enhancing environmental protection. CPS Energy's PAL permit includes a commitment to maintain emission reductions already achieved.

On September 8, 2009, the United States Environmental Protection Agency ("EPA") proposed to disapprove key aspects of the Texas clean-air permitting program that do not meet federal Clean Air Act requirements followed by other states. Final decisions about changing the program will be made under an expedited schedule agreed to under a recent settlement with Texas businesses. The EPA intends to work with the State and interested parties to quickly identify and adopt changes. Standard Permits for Pollution Control Projects are no longer a permitting option.

**Sulfur Dioxide:** One objective of the Clean Air Act Amendments is to reduce emissions of sulfur dioxide ("SO<sub>2</sub>"), a gaseous emission formed during the combustion of coal by coal-burning power plants. The JKS 1, the J.T. Deely Plant Unit 1 and Unit 2 and older gas units (excluding AVR and Leon Creek CTs) are subject to the Clean Air Act Amendments' SO<sub>2</sub> emission allowance system. An allowance is an authorization to emit one ton of SO<sub>2</sub> during or after a specified year. Under the emission allowance system, each affected generating facility is issued annual allowances based upon a variety of factors. No utility may emit more tons of SO<sub>2</sub> in a year than is authorized by its total allowances. Allowances issued to one generating facility may be used by a utility to offset the emissions of another generating facility. Allowances not needed by the recipient utility for its current emissions may be banked for future use, or they may be sold or otherwise transferred. CPS Energy upgraded the JKS 1 scrubber in early 2009 prior to the JKS 2 unit coming on line because of a commitment made in the JKS 2 air permitting process, which required JKS 1 to reduce SO<sub>2</sub> emissions by the amount expected to be emitted by JKS 2.

On July 11, 2008, the District of Columbia Court of Appeals vacated the Clean Air Interstate Rule ("CAIR") in its entirety. In late December 2008, D.C. Circuit Court of Appeals granted the EPA's petition to remand CAIR to the Agency to be "fixed" rather than be vacated. CAIR is back in effect, but the EPA is responsible for replacing the rule consistent with the Court's July 2008 findings. CAIR, published in May of 2005, greatly reduced the value of allowances allocated to each utility starting in 2010 with further reductions by 2015. The rule allowed units to use SO<sub>2</sub> allowances they have saved over the years at various ratios. CPS Energy believes these allowances will cover the operation of the Deely units until scrubbers are installed. On July 6, 2010, the EPA issued a Notice of Proposed Rulemaking, the Air Transport Rule, that would require a significant reduction in SO<sub>2</sub> and nitrogen oxide ("NO<sub>x</sub>") emissions from power plants in 31 states located in the Eastern half of the U.S. Texas is not currently included in the SO<sub>2</sub> requirements. Until the rule is final, the current CAIR requirements are in effect.

**Nitrogen Oxides:** In addition to SB 7 regulations that require NO<sub>x</sub> reductions at CPS Energy's formerly grandfathered gas units, the TCEQ implemented additional rules. Chapter 117 regulations require all fossil fuel power plants to achieve a NO<sub>x</sub> emission level cap. For coal units this cap is based on a NO<sub>x</sub> emission rate of 0.165 lb/MMBtu (pounds per million British thermal units) by mid-2005; for gas units this cap is based on a NO<sub>x</sub> emissions rate of 0.14 lb/MMBtu. However, CPS Energy management chose to comply with a system cap rather than the emission specifications. CPS Energy met the system cap for the calendar year 2009 and is on target to meet the system cap for calendar 2010, with total projected emissions of 9,079 tons. The revised CAIR reduced the NO<sub>x</sub> emission rate to less than 0.15 lb/MMBtu in the first phase and will be accomplished via statewide allocations that are required to be met in 2009 with further reductions by 2015. The new rule is a cap and trade rule which means that specific units are not required to meet any particular emission limit,

only that they have adequate NO<sub>x</sub> allowances for the amount they actually emit. CPS Energy is adding SCR technology to J.T. Deely Unit 2, and is evaluating adding the same technology to J.T. Deely Unit 1 and/or JKS 1. CAIR has a limited provision for allowances for new units.

In July 2010, the EPA proposed a rule that would replace CAIR, called the Air Transport Rule. The proposal includes Texas in an Ozone Season only NO<sub>x</sub> program. Ozone season includes the summer months of May-September. Since the Air Transport rule is just a proposal, it is unclear what the final rule will require.

**Mercury:** In early 2004, the EPA published a proposed rule to reduce mercury to a level of 21 X 10<sup>-6</sup> lb/MWh (pounds per megawatt hour) from new units (about 2.0 lb/trillion Btu) and CPS Energy agreed to this level for the new JKS 2 unit. The final rule published in May 2005, called the Clean Air Mercury Rule, established mercury emission limits on new and existing units and set up a cap and trade system starting in January 1, 2010. The final rule had a less stringent mercury limit for new units; however, CPS Energy agreed to the previously proposed level and the final JKS 2 unit permit has a mercury limit (2.0 X 10<sup>-5</sup> lb/MWh), which is currently being met. The EPA goal is that emissions of mercury from power plants be reduced by 70% from 1999 levels which will result in a 15 ton cap nation-wide in 2018. The final rule also required continuous mercury monitoring to be installed and operational by January 1, 2009.

CPS Energy has been preparing to meet mercury limits on all the coal units according to the JKS 2 permit limit and Clean Air Mercury Rule; however, that may change due to a February 8, 2008, Washington D.C. Circuit court decision to vacate the Clean Air Mercury Rule. On February 25, 2009, the United States Supreme Court declined to hear arguments in the appeal petition filed by the Utility Air Regulatory Group (“UARG”). The Supreme Court’s rejection of the petition to hear the case means that D.C. Circuit Court of Appeals decision to remand the case to the EPA stands. One potential outcome of this litigation is that the EPA will have to regulate mercury using another section of the Clean Air Act and the limits will be more stringent. The EPA issued an Information Collection Request (“ICR”) in order to collect data to promulgate a new rule for mercury. CPS Energy received the ICR for all 4 coal units at the Calaveras Power Station. The EPA is expected to propose a rule in late 2011. CPS Energy has installed mercury monitors on all coal units and will take steps as needed to comply with new regulations once those are issued and made final.

**Ozone (“O<sub>3</sub>”):** On March 12, 2008, the EPA revised national ambient air quality standards (“NAAQS”) for ground-level ozone (the primary component for smog). This revision was part of a required review process mandated by the Clean Air Act, as amended in 1990. Prior to the revision, an area met the ground-level ozone standards if the three-year average of the annual fourth-highest daily maximum eight hour average at every ozone monitor (“eight-hour ozone standard”) was less than or equal to 0.08 parts per million (ppm). Because ozone is measured out to three decimal places, the standard effectively became 0.084 as a result of rounding. For years 2005 – 2007, during which the old standard applied, San Antonio maintained average ozone readings of 0.082 ppm and therefore, has been compliant with historic EPA ground-level ozone standards.

The EPA’s March 2008 revision changed the NAAQS such that an area’s eight-hour ozone standard must not exceed 0.075 ppm rather than the previous 0.084. Thus in 2007, under the new standard, the City would not have complied with the federal requirements regarding ground-level ozone. Since 2007, however, San Antonio’s unofficial eight-hour ozone average has been falling. According to the Texas Commission on Environmental Quality (“TCEQ”), the three-year average in 2008 was 0.078 ppm and as of June 9, 2009, it was 0.074 ppm for 2009.

The Clean Air Act requires the EPA to designate areas as “attainment” (meeting the standards), “nonattainment” (not meeting the standards), or “unclassifiable” (insufficient data to classify). As a result of the revisions to the NAAQS, states were required to make recommendations to the EPA no later than March 12, 2009, for areas to be classified attainment, nonattainment, or unclassifiable. Texas Governor Rick Perry submitted a list of 27 counties in Texas, including Bexar that should be designated as nonattainment. Even if the 2008 data, as recorded above, is certified by the EPA, San Antonio would still be classified as an area of nonattainment under the revised NAAQS.

On January 6, 2010, the EPA formally proposed a regulation that would lower the primary NAAQS for ozone to a level within a range of 0.060 to 0.070 ppm. The EPA plans to sign a final rule revising the ozone NAAQS standards from August 31, 2010 to October 2010. Under the Clean Air Act, the EPA has two years from the time it revises the NAAQS to complete the designation process. Therefore, if the EPA adheres to its published schedule, final designations for all areas must be issued no later than August 31, 2012, unless there is insufficient information to make such designations (in which case designations will be made by the EPA not later than August 31, 2012). If the EPA intends to issue a designation that deviates from a state’s recommendation, it must notify the state at least 120 days prior to promulgating the final designations. Following the issuance of final designations, states are required to submit State Implementation Plans (“SIPs”) outlining how they will reduce pollution to meet the new standards. These SIPs will be due to the EPA by a date that it will establish under separate rule, but in no case will that date be later than three years after the EPA’s final designations (e.g., 2015 if the EPA makes its designations in 2013). In conjunction with the revised NAAQS, the EPA has proposed separate rules to address monitoring the new standard. Generally, the proposal from the EPA would require a

greater number of EPA-approved monitors in both urban and non-urban areas and longer ozone monitoring seasons in many states. For Texas specifically, the proposal calls for year-round monitoring throughout the state. On July 16, 2009, the EPA proposed to revise its monitoring network design requirements for ozone to assist in implementation of the 2008 ozone NAAQS. The comment period closed on September 14, 2009. The EPA has not stated whether its decision to withdraw the 2008 ozone NAAQS will delay the release of the final ozone NAAQS monitoring rule.

Any State plan formulated to reduce ground-level ozone may curtail new industrial, commercial and residential development in San Antonio and adjacent areas (“San Antonio Area”). Examples of past efforts by the EPA and the TCEQ to provide for annual reductions in ozone concentrations in areas of nonattainment under the former NAAQS include imposition of stringent limitations on emissions of volatile organic compounds (“VOCs”) and NO<sub>x</sub> from existing stationary sources of air emissions, as well as specifying that any new source of significant air emissions, such as a new industrial plant, must provide for a net reduction of air emissions by arranging for other industries to reduce their emissions by 1.3 times the amount of pollutants proposed to be emitted by the new source. Studies have shown that standards significantly more stringent than those currently in place in the San Antonio Area and across the State are required to meaningfully impact an area’s ground-level ozone reading, which will be necessary to achieve compliance with the new eight-hour ozone standard. Due to the magnitude of air emissions reductions required as well as the limited availability of economically reasonable control options, the development of a successful air quality compliance plan for areas of nonattainment within the State has proven to be extremely challenging and will inevitably impact a wide cross-section of the business and residential community.

Failure by an area to comply with the eight-hour ozone standards by the requisite time could result in the EPA’s imposing a moratorium on the awarding of federal highway construction grants and other federal grants for certain public works construction projects, as well as severe emissions offset requirements on new major sources of emissions for which construction has not already commenced.

Other constraints on economic growth and development include lawsuits filed under the Clean Air Act by plaintiffs seeking to require emission reduction measures that are even more stringent than those approved by the EPA. From time to time, various plaintiff environmental organizations have filed lawsuits against the TCEQ and the EPA seeking to compel the early adoption of additional emission reduction measures, many of which could make it more difficult for businesses to construct or expand industrial facilities or which could result in travel restrictions or other limitations on the actions of businesses, governmental entities and private citizens. Any successful court challenge to the currently effective air emissions control plan could result in the imposition of even more stringent air emission controls that could threaten continued growth and development in the San Antonio Area.

It remains to be seen exactly what steps will ultimately be required to meet federal air quality standards, how the EPA may respond to developments as they occur, and what impact such steps and any EPA action have upon the economy and the business and residential communities in the San Antonio Area.

**Carbon Dioxide:** The United States Supreme Court has rendered its first major decision in the climate change arena. In *Massachusetts v. EPA*, 549 U.S. 497 (2007), the Supreme Court held that carbon dioxide (“CO<sub>2</sub>”) and other greenhouse gases from motor vehicles are “air pollutants” and are subject to regulation under the Clean Air Act. There have also been several bills introduced in Congress that propose to regulate greenhouse gases (“GHGs”) through a cap and trade and/or quasi-carbon tax program. In July 2008, the EPA issued an Advance Notice of Proposed Rulemaking (“ANPR”) outlining issues and options associated with regulating GHG under the Clean Air Act.

In a noteworthy Clean Air Act decision, in the wake of *Massachusetts v. EPA*, the Environmental Appeals Board (“EAB”) avoided the key question of whether CO<sub>2</sub> is currently “subject to regulation” under the Clean Air Act. In *the Matter of Deseret Power Electric Cooperative*, EAB App. No. PSD 07-03 (November 13, 2008) it appears that the decision is carefully designed to leave open for the Obama Administration the question of whether CO<sub>2</sub> will be regulated under a key EPA permitting program. EAB sided with the EPA, agreeing that EPA is not required to treat CO<sub>2</sub> as “subject to regulation” for purposes of the Prevention of Significant Deterioration (“PSD”) permitting program. However, EAB found that EPA could exercise its discretion to treat CO<sub>2</sub> as “subject to regulation,” and thus require permit limits for CO<sub>2</sub> based on the best available control technology (“BACT”). Based upon guidance from the Bush Administration, EPA made it clear that, for both legal and policy reasons, it did not want to treat CO<sub>2</sub> as “subject to regulation” under the Clean Air Act. This position was confirmed in a memorandum dated December 18, 2008, from Stephen L. Johnson, the Administrator of the EPA, establishing that CO<sub>2</sub> is not “subject to regulation” under the Clean Air Act. The EAB found; however, that the Deseret permitting record was not adequate to support this position. It then remanded the permit back to the EPA with instructions that will make it difficult for the EPA to respond to the remand until the Obama Administration takes a position. In doing so, the EAB has created significant uncertainty for anyone planning to construct virtually any type of commercial building or industrial facility (such as a new power plant). As CPS Energy is not currently seeking a new PSD permit for any of its facilities, CPS Energy is not currently affected by this decision.

In April 2009, the EPA proposed a public health endangerment finding under Section 202. An endangerment finding under Section 202, or any other similar section, is the necessary prerequisite to mandatory regulation. In most instances, once an endangerment finding is made, the Clean Air Act Amendments require the EPA to regulate the subject pollutant. That mandatory duty to regulate, combined with the cascading effect of a single endangerment finding, means that the EPA may face a burden of needing a regulatory regime in place for all emission sources at the time it starts to regulate the first source. Accordingly, the creation of GHG emission standards for new motor vehicles could trigger a duty for the EPA to regulate GHG emissions from stationary sources under other Clean Air Act Amendment sections, such as the development of NAAQS, New Source Performance Standards (“NSPS”), the PSD program, Title V, and National Emission Standards for Hazardous Air Pollutants (“NESHAP”). On May 12, 2010, Senators John Kerry (D-MA) and Joseph Lieberman (I-CT) released the comprehensive climate change and clean energy bill, titled the “American Power Act”. The bill included similar targets to ACES to reduce economy-wide GHG emissions from 2005 levels.

CPS Energy is monitoring and evaluating proposed legislation, and continues to document its climate change activities, particularly its GHG emissions. CPS Energy has included a potential carbon dioxide cost in its assumptions as it evaluates alternatives for meeting the growing demand for electricity in the CPS Energy service territory. In conjunction with the Alamo Area Council of Governments, the City coordinated the development of a regional GHG emission inventory and entity-specific emission inventories for the SAWS, Bexar County, CPS Energy and itself. The baseline year chosen for the inventory is 2005. CPS Energy is also working on its GHG inventory for the years 2006 - 2009. CPS Energy is working with the City and its Mission Verde plan, which addresses a wide range of issues affecting the community.

On September 22, 2009, the EPA finalized the nation’s first greenhouse gas reporting system and monitoring regulations. On January 1, 2010, the EPA, for the first time, required large emitters of heat-trapping emissions to begin collecting GHG data, under a new reporting system. This new program will cover approximately 85 percent of the nation’s GHG emissions and apply to roughly 10,000 facilities. The EPA’s new reporting system will provide a better understanding of where GHGs are coming from and will guide the development of policies and programs to reduce emissions. Fossil fuel and industrial GHG suppliers, motor vehicle and engine manufacturers, and facilities that emit 25,000 metric tons or more of CO<sub>2</sub> equivalents per year will be required to report GHG emissions data to the EPA annually. The first annual reports for the largest emitting facilities, which include CPS Energy plants, covering calendar year 2010, will be submitted to the EPA in 2011. On March 22, 2010, the EPA proposed a rule to include the reporting of GHG from large sources of fluorinated GHG, which includes sulfur hexafluoride (“SF<sub>6</sub>”). Once the rule becomes final, annual reports covering calendar year 2011 will be submitted to the EPA in 2012.

On September 30, 2009, using the power and authority of the Clean Air Act Amendments, the EPA proposed a rule requiring power plants and other large stationary CO<sub>2</sub> emitters to have the BACT installed. The new rule would apply to industrial facilities that emit at least 25,000 tons of GHGs each year. That clashes with a Clean Air Act Amendments provision calling for regulation of facilities that emit over 250 tons per year. The GHGs covered include CO<sub>2</sub>, methane, NO<sub>x</sub>, hydro-fluorocarbons, fluorocarbons and SF<sub>6</sub>. The EPA estimated 400 new sources and modifications would be subject to review each year for GHG emissions and, in total, 14,000 sites would have to get permits under the proposal. The administration has not done any calculations on how much emissions the law would cut or the costs to industry. BACT would be decided somewhat on a case-by-case basis, with EPA staff doing technical work to see what the best options are. The most promising technology for fossil generation is carbon capture and storage, but that is at least a decade away from commercial viability. BACT would change over time. Permitting delays and increased Title V permit fees are projected.

The EPA issued a final endangerment finding on December 7, 2009, that GHGs pose a danger to human health and the environment, clearing the way for a Clean Air Act Amendments’ regulation limiting CO<sub>2</sub> emissions from power plants, vehicles and other major sources. Power plants and other large stationary sources of CO<sub>2</sub> will be required to use BACT to reduce emissions when they modify or construct plants beginning in spring of 2010. Currently, there is no set BACT for power plants; however, the EPA has said it will issue guidance as to what BACT is for GHGs. Once BACT is set, the next time CPS Energy constructs or modifies a plant, our permits will have to include CO<sub>2</sub> limits, and we will have to meet those limits using BACT. Currently, there is no commercially available technology to reduce CO<sub>2</sub> emissions. The EPA may push for BACT determinations for coal and gas fired generation (new and existing fleet) to meet 50-80% reduction in CO<sub>2</sub> through carbon capture and sequestration (“CCS”). As an alternative to reducing CO<sub>2</sub> emissions through a removal technology, offsets could be purchased to meet the limits. On December 2009, the EPA denied the petitions to reconsider the Endangerment and Cause or Contribute Findings for Greenhouse Gases under Section 202(a) of the Clean Air Act Amendments.

## ***Federal Clean Water Act***

The National Pollutant Discharge Elimination System (“NPDES”) program is administered by the EPA under the Federal Clean Water Act Amendments. The NPDES program provides the framework for monitoring and regulating the discharge of pollutants to surface waters of the United States. The EPA has delegated NPDES authority to the State. The TCEQ administers the Texas Pollutant Discharge Elimination System in cooperation with the EPA to improve water quality on a basin-wide permitting basis. CPS Energy has operated all of its generating facilities pursuant to water discharge permits from both the TCEQ and the EPA for many years with no significant compliance issues.

CPS Energy currently has four individual operating permits for the discharge of industrial waste water to “waters of the United States”. The focus of these permits is to reduce discharge of industrial waste and other constituents that could reduce water quality in the San Antonio River basin. The TCEQ and the EPA have developed a list of water quality standards that apply to power plant operations. Although each of CPS Energy’s permits is based on the specific operating parameters of the individual power plant, there are some common threads for all of CPS Energy’s plant sites.

**Water Quality Standards:** The EPA is currently looking at revising water quality standards. Water quality standards were last revised in 1982. The EPA completed a multi-year study of the electric power industry and concluded that water discharges had changed significantly over time and that regulation had not kept up with changes in industry. The EPA is conducting an ICR asking over 750 power plants to complete a lengthy questionnaire designed to better characterize power plant effluent and the impact on industry of changes in water quality standards. CPS Energy is participating in this ICR by completing questionnaires about operations at Calaveras Lake.

The EPA has directed regional offices to use their influence with state agencies to force more strict water quality standards even before the new rules are written. CPS Energy has two TPDES permits undergoing the renewal process. The EPA has formally challenged renewal of the operating permit for the Braunig Lake plants based on water quality concerns.

**Clean Water Act Section 316 (b):** The power plants at Braunig and Calaveras Lakes use the lakes as the source for cooling water. Section 316 (b) of the Clean Water Act Amendments requires damage to the environment be mitigated and the number of aquatic species injured or killed as the result of plant operation be reduced. The EPA developed specific methods for reduction of impingement and entrainment of aquatic organisms at intake structures. Environmental groups have challenged the suite of technologies developed by the EPA as not reducing impingement enough and challenged the EPA’s rulemaking reasoning. Recent court action has invalidated the EPA’s rulemaking and remanded the rule to the EPA for reconsideration. As of the fall 2008, the EPA has directed the TCEQ to have each permit writer require impingement reduction technologies be used at individual facilities based on the best professional judgment of the permit writer. CPS Energy has done extensive studies of the impingement at each of its cooling lakes and is currently in the process of evaluating the data. CPS Energy will be working with the TCEQ and the EPA to determine what if any additional measures will need to be taken to assure compliance with the intent of Section 316 (b).

**Storm Water:** There are numerous storm water outfalls at CPS Energy’s plant sites. Storm water is the primary transport method of sediment and pollutants from upland areas to waters of the United States. CPS Energy works in cooperation with the TCEQ and SAWS to improve industrial processes and reduce transport of pollutants from industrial operations to adjacent lakes and streams. Each storm water outfall has specific requirements. In general, the storm water outfalls must be sampled once each six months within two hours of one-half inch rainfall during normal working hours. The goal of monitoring storm water outfalls is to reduce discharge of sediment and pollutants. The primary method of reducing these discharges is good housekeeping and reducing exposure of industrial processes to weather. In general, there can be no visible discharge from any storm water outfall.

**Industrial Discharges:** Each of the individual permits has numerous parameters that must be monitored for discharges of industrial waste water. Many power plant processes involve water as an active fluid or as a motive fluid. As an active fluid (steam, feed water, condensate water), water is treated with chemicals or comes in contact with power plant equipment that can modify the properties of the water adding dissolved salts and metals. Water can be used for cooling and motive functions. Each step in the process can add impurities to the water. The water must be monitored for impurities and processed to reduce the level of impurities to permitted levels based on the water quality standards established by the EPA and the TCEQ.

### ***Water Conservation***

The production of electricity is one of the top industrial consumptive uses of fresh water in the United States. San Antonio is the largest metropolitan area in the world that depends exclusively on groundwater for fresh water supply. The Edwards Aquifer is unique for its ability to supply all the fresh water needs of almost two million people in the San Antonio region. CPS Energy recognized the importance of preserving this fresh water resource and began planning to reduce consumption of Edwards Aquifer water for power plant cooling shortly after the drought of record in the 1950's. CPS Energy built Braunig and Calaveras Lakes to utilize treated sewage effluent and runoff waters rather than water from the Edwards Aquifer to maintain operating levels at these man-made cooling lakes. Through 2008, CPS Energy has conserved over 270 billion gallons of Edwards Aquifer water. For these water conservation efforts, the Association of Environmental Professionals selected CPS Energy as one of eight 2001 recipients of the National Environmental Excellence Award. As part of CPS Energy's sustainability efforts, on March 30, 2009, the Board approved a resolution supporting a mutually beneficial cooperative relationship between CPS Energy and SAWS that promotes conservation of both energy and water. Additional information on CPS Energy's sustainability programs can be found in "ENERGY CONSERVATION AND PUBLIC SAFETY PROGRAMS" herein.

### ***Other Environmental Issues***

By the early 1990s, CPS Energy completed a program aimed at removing from its system all electrical equipment accessible to the public that was known to contain polychlorinated biphenyls ("PCBs") in concentrations of 500 ppm or greater, as required by the Federal Toxic Substances Control Act. In addition, all oil-filled equipment is tested at the time of servicing as part of an ongoing program at CPS Energy for voluntarily eliminating electrical equipment containing mineral oil with any level of PCBs. Since 1996, in connection with capital improvements being made to many of its substation sites, CPS Energy has identified and remediated areas found to be contaminated by pollutants, such as PCBs. The TCEQ allows the disposal at a local landfill of soil and debris contaminated with 1-49 ppm of PCBs from electrical equipment spills, in lieu of distant disposal sites, resulting in considerable cost savings.

The EPA published an Advance Notice of Proposed Rulemaking ("ANPRM") in the Federal Register, seeking both comments and data regarding EPA's intent to curtail and/or eliminate numerous existing provisions of the PCB regulations found at 40 CFR Part 761 (Title 40 of the Code of Federal Regulations Part 761), specifically regarding use, handling, reuse, and storage. The EPA is soliciting information and data relating to PCB inventories, testing data, PCB management accomplishments, servicing practices, failure rates, weather-related incidents, removal and replacement costs, non-liquid PCBs et al. Some believe a proposed rule will be promulgated by 2012, and the final rule will be promulgated by 2014.

CPS Energy also operates its own Class 1 non-hazardous waste landfill, which is registered with the TCEQ, an initiative that reduces disposal costs and CPS Energy's reliance upon off-site disposal facilities. Since 1990, CPS Energy has significantly reduced the amount of hazardous waste (defined under the Federal Resource Conservation and Recovery Act) generated by its operations. CPS Energy also has an extensive recycling program which includes electronics, wood, paper, cardboard, metals, plastic bottles, aluminum cans, used oil, coal-combustion by-products, concrete and asphalt.

The EPA is considering a proposal to regulate coal ash generated during the combustion of coal to produce electricity (referred to as coal combustion byproducts or "CCBs") and classify it as a hazardous waste. Listing CCBs as hazardous waste could have dramatic adverse logistical and cost consequences due to the increases in costs associated with managing and disposing of CCBs. CPS Energy's CCBs have been analyzed and test non-hazardous for the following constituents: mercury, selenium, chromium, cadmium, silver, arsenic, barium and lead. For the past several years, CPS Energy has recycled 100% of its CCBs.

### ***Recent Events***

On February 3, 2010, a 30% hydrochloric acid spill occurred at the Calaveras Power Station. A failure in the piping on the aboveground storage tank resulted in the release of 4,200 gallons of 30% hydrochloric acid. The acid spilled into the drainage system, which drains into an oil water separator. It is estimated that approximately 100 gallons of acid mixed with process waters, primarily lake water, discharged into Calaveras Lake. Due to the weak concentration of acid entering the lake, there is no evidence of any danger to aquatic life. As required, the spill was reported to the National Response Center and the Texas Emergency Response Center. In addition, written notification was made to the TCEQ on February 11, 2010. No response has been received by CPS Energy as of the date hereof.

### ***Ward Transformer Superfund Site***

CPS Energy has been named as a Potentially Responsible Party (“PRP”) at the Ward Transformer Superfund Site (“Ward Site”) in Raleigh, North Carolina. The EPA is directing remediation efforts under the Comprehensive Environmental Response, Compensation, and Liability Act (“CERCLA”) to address PCB contamination at the Ward Site stemming from Ward Transformer Company’s (“Ward’s”) transformer repair activities at the Ward Site. Documents relating to CPS Energy’s past transactions with Ward suggest that Ward purchased six used three-phase padmount transformers from CPS Energy in 1978, which Ward then rebuilt and sold as refurbished units. CPS Energy is one of nearly 200 entities identified as having sent electrical equipment to Ward for repair or resale; however, based on CPS Energy’s limited commercial history with Ward, CPS Energy believes that, at most, it should be treated as a *de minimis* contributor to the contamination.

The EPA has divided the Ward Site into separate phases investigation and removal activities on the Ward Transformer property itself (“On-site”) and similar activities at areas around the Ward Transformer property (“Off-site”). Five companies are currently performing and funding remediation activities at the On-site property (“Performing Parties”). The Performing Parties developed a draft allocation formula to proportionately allocate the remediation expenses they have incurred to the other parties who sent transformers to Ward. The Performing Parties have indicated that they anticipate incurring at least \$65 million in cleanup costs for the removal activities. According to the draft allocation, which has been challenged, CPS Energy’s share is well under one percent. The Performing Parties offered buyout options to the other parties, which CPS Energy accepted. On July 7, 2009, CPS Energy entered into a Settlement Agreement with the Performing Parties and agreed to pay \$359,296. The Settlement Agreement ended CPS Energy’s involvement with the Performing Parties for any removal activities On-site, unless additional documents are discovered indicating that CPS Energy sent additional equipment to the Ward Site.

Separate from the activities with the Performing Parties, CPS Energy was one of 60 entities who received a Special Notice Letter (“SNL”) from the EPA. The SNL demanded that the recipients provide the EPA with a Good Faith Offer agreeing to reimburse the EPA for its costs and implement the investigation and remediation of the Off-site property. In January 2009, CPS Energy and over 20 other SNL recipients sent the EPA a joint response to the SNL. Negotiations with the EPA concerning the Off-site property are ongoing. CPS Energy has retained legal counsel to assist it in this matter. CPS Energy responded to a CERCLA Section 104(e) Request for Information for the Ward Transformer Superfund Site, Raleigh, North Carolina from the EPA in May 2010. On May 5, 2010, CPS Energy submitted a response to the EPA’s Request for Information Pursuant to Section 104 of CERCLA and Section 3007 of RCRA for the Ward Transformer Superfund Site.

## **ENERGY CONSERVATION AND PUBLIC SAFETY PROGRAMS**

CPS Energy programs and activities to assist customers in understanding energy and ways to reduce electric and gas usage include:

- Comprehensive suite of energy efficiency programs offering rebates and incentives for residential, commercial and industrial customers;
- maintaining a special contact number where customers can obtain conservation and other energy-related information;
- conducting commercial energy audits;
- providing a free comprehensive weatherization and energy efficiency program for low-income customers;
- scheduling consumer information exhibits at high-traffic locations such as area shopping malls, trade shows, and other special events;
- conducting utility-related presentations for schools, community service organizations, and business and professional groups; and
- making available a residential self-energy audit facility on the CPS Energy web site.

In connection with CPS Energy’s development of a Strategic Energy Plan that includes energy efficiency as well as generation, CPS Energy has committed to an aggressive, long-term energy efficiency and conservation plan, referred to as STEP. The City Council has partnered with CPS Energy by enacting a building code ordinance to encourage energy efficiency and conservation. In coordination with the new 2010 building codes, CPS Energy is offering incentives for “whole building performance” starting at a minimum of 15% more energy efficient than code. CPS Energy maintains, develops and implements programs and activities, alone and in collaboration with like-minded community entities, which will help achieve annual electrical demand reduction targets that are indexed to the annual growth of electrical demand within the CPS Energy service area. The goal of the STEP Program is to reduce growth in peak electrical demand by 40% in 2010, 50% in 2011 and 60% for the years 2012 through 2020. Reaching these targets will yield peak electrical demand reductions of 771 MW by the end of 2020, an amount equivalent to the electric generation capacity of an electric power

plant. Energy efficiency and demand response programs include Peak Saver, which cycles residential air conditioner compressors; residential rebates for both central air conditioners and window units; residential rebates for low-e windows, high efficiency appliances, cool roofs and additional insulation, and commercial and industrial rebates for the installation of energy efficient air conditioners, motors, lighting and roof coatings. CPS Energy has plans to evaluate and increase program offerings annually to target the most effective methods for energy reduction. To facilitate program development, CPS Energy has hired a leading consulting firm and established the Green Ribbon Committee – a community stakeholder input group. It is estimated that the programs will cost approximately \$849 million through 2020 and CPS Energy worked with the City of San Antonio to establish a fair and equitable funding mechanism to support these goals. See “CUSTOMER RATES – Fuel and Gas Cost Adjustment” herein.

On January 20, 2009, the Board approved a new Sustainable Energy Policy Statement. While making clear that centralized power plants and the traditional electric utility business model are needed now to bridge the gap to the future, CPS Energy is planning for a future when much of its electricity comes from distributed renewable resources and stored energy, which is distributed on a “smart grid,” to customers empowered with the information to better control their own energy cost and consumption.

CPS Energy management plans to develop strategies, goals and policies that will align with this new policy statement and will coordinate with the City of San Antonio on sustainable energy projects. On May 21, 2009, the City Council approved a funding mechanism for the STEP program. See “CUSTOMER RATES – Fuel and Gas Cost Adjustment” herein.

On June 8, 2010, CPS Energy committed to partner in the Texas Sustainable Energy Research Institute at the University of Texas at San Antonio for sustainable energy research. The agreement calls for CPS Energy to invest up to \$50 million over 10 years in the institute. The first two years’ investment will be \$3.5 million, from funds currently allocated to research and development. Future funding will be developed by the scope of the projects defined by the partnership and subject to annual approval by the Board.

The Public Safety Awareness Section (“PSA”) provides natural gas safety programs to natural gas customers within the CPS Energy service area and surrounding counties. In accordance with the Texas Railroad Commission and the Department of Transportation, Office of Pipeline Safety recommended practice 1162 (RP1162), the PSA works to provide natural gas incident prevention education to affected publics, government officials, emergency responders and excavators along CPS Energy natural gas routes. The PSA works as a liaison with area educational, business, contractors, civic and emergency services organizations to establish strategic alliances that benefit the dissemination of CPS Energy’s natural gas messages and enhance the utility’s reputation as a good corporate citizen.

## **FUEL SUPPLY**

CPS Energy has a diversified generation fuel supply that includes coal, natural gas, nuclear, and fuel oil. CPS Energy purchases natural gas for electric generation and local distribution through its natural gas system on a consolidated basis. Master enabling agreements with natural gas suppliers are reviewed on an ongoing basis to ensure adequate natural gas supplies exist to meet current and future requirements. While coal, natural gas, and nuclear fuel represent the base fuel supply for power generation, certain CPS Energy power plants also have the capability to burn petroleum coke to supplement coal while others can burn fuel oil as an alternate fuel or to supplement natural gas. This dual fuel capability provides greater operational flexibility. Fuel oil can be used for generation, when needed, at the O.W. Sommers and V.H. Braunig Plants and in the new V. H. Braunig Peaking Plants.

Coal is CPS Energy’s base energy option, providing 34% of its net annual generation, prior to completion of JKS 2. CPS Energy’s units including JKS 2, are designed to use Wyoming Powder River Basin (“PRB”) coal. PRB coal is clean, abundant and economical and it is part of CPS Energy’s long-range energy plan. Coal is secured through contracts providing both fixed and variable prices that reflect current market conditions. Delivery of PRB coal to CPS Energy occurs on the Union Pacific (“UP”) railroad with BNSF Railway having access rights to CPS Energy’s coal yard at Calaveras Lake. CPS Energy has favorable long-term contracts with UP. In 2009, CPS Energy resolved outstanding contract issues with UP to assure multi-year coverage of transportation needs for our coal-fired plants. While CPS Energy will take every reasonable step to assure the continuity of its coal supply, CPS Energy cannot predict whether any future coal shipment delays or curtailments could have a material adverse effect on the availability of its coal-fired generating stations.

Nuclear is CPS Energy’s other base energy option, providing about 35% of its net annual generation. Nuclear fuel procurement for STP is managed by the STPNOC staff with oversight and guidance provided by the Participants. STP fuel supply requires uranium oxide, conversion of oxide to hexafluoride, enrichment of fissile uranium 235 isotope from 0.7% to about 4.5%, design and fabrication of fuel assemblies along with disposal of spent fuel assemblies. Uranium conversion and enrichment are obtained under contracts of several years duration with primary producers. Beyond 2010, through

STP's current operating license term, 50% of uranium and conversion requirements are contracted 25% to Areva and 25% to Cameco. Enrichment requirements are contracted with Urenco/LES through STP's current operating license term. Fabrication requirements are contracted with Westinghouse through STP's current operating license term. See "DESCRIPTION OF PHYSICAL PROPERTY – Electric System – Used Nuclear Fuel Management" herein.

CPS Energy also owns and operates natural gas transmission facilities, consisting of two larger systems and some short segments connected to power plants. The North Gate Pipeline and the South Gate Pipeline are the two larger systems. The North Gate Pipeline is a 24-inch steel pipeline, which extends 17.2 miles from southern Comal County into northern Bexar County, Texas. Natural gas can be supplied to the pipeline through Energy Transfer's 36-inch Oasis Pipeline and Enterprise Texas Pipeline's ("Enterprise") 30-inch West Texas Pipeline.

The South Gate Pipeline comprises 60.3 miles of 24 and 30-inch steel pipeline, of which 46.9 miles of 30-inch pipeline extends south into Karnes County. A major delivery station in Karnes County connects to the joint venture pipeline owned by Kinder Morgan and Energy Transfer. CPS Energy also operates numerous taps throughout the system connecting to Enterprise, on the North Gate and South Gate Pipelines, and directly into the supply pressure and distribution systems. CPS Energy utilizes its diverse natural gas supply portfolio and interconnects with these pipelines to meet its power plant and distribution requirements.

CPS Energy manages the combined natural gas supply requirements of the power plants and distribution systems through a diversified portfolio of firm and interruptible services with a variety of suppliers. Most of the major natural gas delivery stations are owned by CPS Energy and remotely monitored by the CPS Energy control center, assuring reliable operation. In accordance with the CPS Energy Fuels Management Procedures Policy, designated CPS Energy staff may enter into natural gas supply transactions using master enabling agreements, which incorporate standard commercial terms. CPS Energy has approximately 70 master enabling contracts with natural gas suppliers under which CPS Energy may purchase natural gas requirements. CPS Energy manages firm transportation and storage contracts with Enterprise and also manages firm transportation with Houston Pipeline.

Periods of prolonged cold weather, during which natural gas supply may fall short of demand, may necessitate the curtailment of gas use for boiler fuel. The Natural Gas Policy Act subjects intrastate gas, including gas intended for boiler fuel uses, to Presidential emergency purchase authority and emergency allocation authority to assist in meeting interstate natural gas requirements for high priority uses. CPS Energy's gas supply has not been curtailed by its major suppliers since 1983. Nevertheless, CPS Energy's gas supply is subject to the ability of its gas suppliers to make available sufficient quantities of supply, as well as fluctuations in market prices.

CPS Energy maintains fuel oil supplies at certain capable generating units. At these plants CPS Energy maintains fuel oil inventory and fuel oil receipt by truck. CPS Energy also maintains receipt capability by pipeline at the V.H. Braunig facility. Inventory and receipt capability at these plants assures continued operation during natural gas supply disruptions or price events.

The Energy Price Risk Management Policy was implemented in 2002 to reduce the effects of energy price volatility consistent with this policy. At times, financial derivative instruments are utilized to hedge natural gas prices. See "WHOLESALE POWER MARKETING" and "ENTERPRISE RISK MANAGEMENT" herein.

On June 21, 2007, CPS Energy entered into a prepaid natural gas transaction with SA Energy Acquisition Public Facility Corporation ("PFC"), a non-profit public facility corporation previously created by the City pursuant to Chapter 303, as amended, Texas Local Government Code. This transaction enabled CPS Energy to purchase a 20-year supply of natural gas to cover approximately 20,000 MMBtu per day. This gas is dedicated for use in CPS Energy's gas distribution system and CPS Energy's obligation in this transaction is limited to a take-and-pay gas purchase agreement, obligating CPS Energy to pay a monthly index-based price less a fixed discount for delivered gas. The PFC prepaid for this gas by issuing \$644,260,000 of tax-exempt fixed rate bonds and used the proceeds to make the payment to the natural gas supplier. This prepaid gas transaction was supported by its own official statement issued by the PFC fully disclosing the transaction and related risks.

Multiple PFC debt credit rating changes resulted as a direct consequence of Goldman Sachs Group, parent of the natural gas supplier J. Aron, having their credit ratings lowered by each rating agency. The PFC debt credit ratings were lowered in December 2008 and January 2009 by Fitch Ratings ("Fitch"), Moody's Investors Service, Inc. ("Moody's"), and Standard & Poor's Ratings Services, a Standard and Poor's Financial Services LLC business ("S&P"). On December 17, 2008, Moody's lowered the PFC debt credit ratings from "Aa3" to "A1" and on December 19, 2008, S&P lowered the PFC debt credit ratings from "AA-" to "A". On December 30, 2008, the authorized representatives of the PFC posted a material event notice through the MAC (defined herein), as required by Rule 15c2-12 of the United States Securities and Exchange Commission ("SEC"), disclosing these two credit rating changes. Subsequently, on January 28, 2009, Fitch lowered the PFC debt credit ratings from "AA-" to "A+" and the authorized representatives of the

PFC posted a second material event notice through the MAC on February 4, 2009. Recently Moody's and Fitch lowered the ratings assigned to DEPPFA BANK, with which the PFC invests funds used to pay debt service, to "Baa3/P-3" and "BBB+/F-2," respectively, and Moody's put the PFC's credit rating on watch for a possible future downgrade. The lowering of the PFC's credit ratings does not change the day-to-day operations of the PFC and has no impact on CPS Energy's credit ratings. CPS Energy continues to purchase and receive natural gas at the discounted price. However, if a party providing funds (or gas to be sold to produce funds) used to pay the PFC's debt were to default, the PFC's debt could be accelerated and its gas supply agreement could be terminated, thereby eliminating future fuel expense savings passed through to CPS Energy customers.

CPS Energy, via the SA Energy Acquisition Public Facility Corporation ("SAEA" or "PFC"), is currently negotiating the purchase of a natural gas volumetric production payment ("VPP") from Wells Fargo Bank, N.A. ("WF"), representing approximately 41 billion cubic feet over a term of 8.5 years. A VPP is a lower risk form of natural gas reserve ownership in a producing asset, which is sold for a specific gas volume with priority interest in a reserve to be produced over a term. Gas produced in Texas and delivered to the PFC under the VPP will be provided to CPS Energy for use for its customers, and will qualify for production tax exemption. The exemption will result in a discounted price to CPS Energy for the life of the VPP, currently estimated at a net present value savings of \$7 million. Savings will be passed on to CPS Energy customers through the monthly fuel adjustment clause. Financing for the VPP acquisition will be provided by a consortium of banks via a non-recourse loan to SAEA and is expected to close in late fall 2010.

## LEASE TRANSACTION

The City is a party to a transaction, entered into in June 2000, involving its JKS 1, pursuant to which such facility is subject to a variety of contractual arrangements, including a lease agreement ("Lease"), with CPS Energy as lessee. This Lease transaction was complex, involved voluminous documentation and numerous parties, and the discussion herein is provided primarily for the purpose of providing information concerning the current potential financial impact on CPS Energy from this Lease transaction as disclosed in the following paragraph. See also "Appendix B – City Public Service – Audited Financial Statements" (page B-63) herein for certain financial disclosure about the Lease transaction. The term of the Lease expires in March 2032. As security for its obligations under the Lease, CPS Energy obtained (a) a payment undertaking agreement guaranteed by American International Group, Inc. which is additionally secured by a pool of United States government securities ("AIG Collateral") and (b) a financial guaranty issued by Financial Security Assurance Inc., since succeeded in legal interest by AGM (defined below). The Lease transaction documents require that, in the event the senior unsecured credit rating of AGM falls below "AA-" from S&P or "Aa3" from Moody's, CPS Energy is required to replace the financial guaranty with a similar collateral instrument issued by a provider having such minimum (or in the case of certain providers, higher) ratings. AGM is currently rated "AA+" (stable outlook) and "Aa3" (negative outlook) by S&P and Moody's, respectively. CPS Energy, working with its financial advisors, is evaluating various options to potentially unwind this transaction and/or find a replacement surety provider in the event of a further downgrade of AGM.

Additional information on the acquisition of FSA by AGM can be found in "LEASE TRANSACTION – Acquisition of FSA by AGM, Recent Developments Concerning AGM, and Company Capitalization" herein. Given current financial market conditions, in the event such a AGM credit downgrade occurs, it could be difficult for CPS Energy to substitute another collateral provider with the required minimum credit ratings. If CPS Energy was able to identify a suitable provider, a significant premium could be payable. Failure to replace this provider as required could ultimately constitute an event of default under the Lease and permit the lessor to terminate the transaction and demand that CPS Energy make a termination payment, which may only partially be covered by the AIG Collateral. See discussion below under the caption "POTENTIAL EXCISE TAX ADVERSELY AFFECTING THE CITY AND CPS ENERGY".

In addition to the foregoing exposure to AGM, AGM is the provider of a debt service reserve fund surety policy satisfying a portion of the reserve requirement attributable to the Senior Lien Obligations and any Additional Senior Lien Obligations. This policy provides coverage in the amount of \$275,000,000 and has a stated expiration date of February 1, 2042.

### ***Acquisition of FSA by AGM, Recent Developments Concerning AGM, and Company Capitalization***

AGM is a New York domiciled financial guaranty insurance company and a wholly owned subsidiary of Assured Guaranty Municipal Holdings Inc. ("Holdings"). Holdings is an indirect subsidiary of Assured Guaranty Ltd. ("AGL"), a Bermuda-based holding company whose shares are publicly traded and are listed on the New York Stock Exchange under the symbol "AGO". AGL, through its operating subsidiaries, provides credit enhancement products to the U.S. and global public finance, infrastructure and structured finance markets. No shareholder of AGL, Holdings or AGM is liable for the obligations of AGM.

Effective November 9, 2009, Financial Security Assurance Inc. changed its name to Assured Guaranty Municipal Corp.

AGM's financial strength is rated "AA+" (stable outlook) by S&P and "Aa3" (negative outlook) by Moody's. On February 24, 2010, Fitch, at the request of AGL, withdrew its "AA" (Negative Outlook) insurer financial strength rating of AGM at the then current rating level. Each rating of AGM should be evaluated independently. An explanation of the significance of the above ratings may be obtained from the applicable rating agency. The above ratings are not recommendations to buy, sell or hold any security, and such ratings are subject to revision or withdrawal at any time by the rating agencies, including withdrawal initiated at the request of AGM in its sole discretion. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of any security guaranteed by AGM. AGM does not guarantee the market price of the securities it insures, nor does it guarantee that the ratings on such securities will not be revised or withdrawn.

#### *Current Financial Strength Ratings*

On October 25, 2010, S&P published a Research Update in which it downgraded AGM's counterparty credit and financial strength rating from "AAA" (negative outlook) to "AA+" (stable outlook). Reference is made to the Research Update, a copy of which is available at [www.standardandpoors.com](http://www.standardandpoors.com), for the complete text of S&P's comments.

In a press release dated February 24, 2010, Fitch announced that, at the request of AGL, it had withdrawn the "AA" (Negative Outlook) insurer financial strength rating of AGM at the then current rating level. Reference is made to the press release, a copy of which is available at [www.fitchratings.com](http://www.fitchratings.com), for the complete text of Fitch's comments.

On December 18, 2009, Moody's issued a press release stating that it had affirmed the "Aa3" insurance financial strength rating of AGM, with a negative outlook. Reference is made to the press release, a copy of which is available at [www.moody.com](http://www.moody.com), for the complete text of Moody's comments.

There can be no assurance as to any further ratings action that Moody's or S&P may take with respect to AGM.

For more information regarding AGM's financial strength ratings and the risks relating thereto, see AGL's Annual Report on Form 10-K for the fiscal year ended December 31, 2009, which was filed by AGL with the Securities and Exchange Commission ("SEC") on March 1, 2010, AGL's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010, which was filed by AGL with the SEC on May 10, 2010, and AGL's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2010, which was filed by AGL with the SEC on August 9, 2010.

#### *Capitalization of AGM*

At June 30, 2010, AGM's consolidated policyholders' surplus and contingency reserves were approximately \$2,264,680,337 and its total net unearned premium reserve was approximately \$2,259,557,420, in each case, in accordance with statutory accounting principles.

#### *Incorporation of Certain Documents by Reference*

Portions of the following documents filed by AGL with the SEC that relate to AGM are incorporated by reference into this Official Statement and shall be deemed to be a part hereof:

- The Annual Report on Form 10-K for the fiscal year ended December 31, 2009 (which was filed by AGL with the SEC on March 1, 2010);
- The Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2010 (which was filed by AGL with the SEC on May 10, 2010); and
- The Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2010 (which was filed by AGL with the SEC on August 9, 2010).

All information relating to AGM included in, or as exhibits to, documents filed by AGL pursuant to Section 13(a), 13(c) or 15(d) of the Securities Exchange Act, as amended, after the filing of the last document referred to above and before the termination of the offering of the Bonds shall be deemed incorporated by reference into this Official Statement and to be a part hereof from the respective dates of filing such documents. Copies of materials incorporated by reference are available over the internet at the SEC's website at <http://www.sec.gov>, at AGL's website at <http://www.assuredguaranty.com>, or will

be provided upon request to Assured Guaranty Municipal Corp. (formerly known as Financial Security Assurance Inc.): 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

Any information regarding AGM included herein under the caption “LEASE TRANSACTION – Acquisition of FSA by AGM, Recent Developments Concerning AGM, and Company Capitalization” or included in a document incorporated by reference herein (collectively, the “AGM Information”) shall be modified or superseded to the extent that any subsequently included AGM Information (either directly or through incorporation by reference) modifies or supersedes such previously included AGM Information. Any AGM Information so modified or superseded shall not constitute a part of this Official Statement.

AGM makes no representation regarding the Bonds or the advisability of investing in the Bonds. In addition, AGM has not independently verified, makes no representation regarding, and does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding AGM supplied by AGM and presented under the heading “LEASE TRANSACTION – Acquisition of FSA by AGM, Recent Developments Concerning AGM, and Company Capitalization”.

## **POTENTIAL EXCISE TAX ADVERSELY AFFECTING THE CITY AND CPS ENERGY**

The Tax Increase Prevention and Reconciliation Act of 2005, enacted on May 17, 2006, added section 4965 (“Section 4965”) to the Internal Revenue Code, as amended (“Code”), which imposes an excise tax with respect to “prohibited tax shelter transactions” on certain “tax-exempt entities”, including a state or political subdivision thereof, such as the City that is a “party to a prohibited tax shelter transaction”. CPS Energy, acting for the benefit of the City, entered into a series of leasing transactions (“Transactions”) in 2000, which may be considered prohibited tax shelter transactions. As a result of guidance issued by the Internal Revenue Service in 2007, CPS Energy has determined that Code rules currently do not retroactively apply to the Transactions. CPS Energy and its advisors will continue to analyze any additional regulations and any future guidance to ensure that the Transactions remain exempt from any new tax liability.

## **LITIGATION**

### ***The City of San Antonio***

This section describes the litigation involving the City that does not directly involve CPS Energy or claims payable out of Systems revenues. Please see “LITIGATION – Systems Litigation and Claims” herein for a description of litigation involving CPS Energy.

The City is a defendant in various lawsuits and is aware of pending claims arising in the ordinary course of its municipal and enterprise activities, certain of which seek substantial damages. That litigation includes lawsuits claiming damages that allege that the City caused personal injuries and wrongful deaths; class actions and promotional practices; various claims from contractors for additional amounts under construction contracts; and property tax assessments and various other liability claims. The amount of damages in most of the pending lawsuits is capped under the Texas Tort Claims Act. Therefore, as of fiscal year ended September 30, 2009, the amount of \$18.497 million is included as a component of the Reserve for claims liability. The estimated liability, including an estimate of incurred but not reported claims, is recorded in the Insurance Reserve Fund. The status of such litigation ranges from early discovery stage to various levels of appeal of judgments both for and against the City. The City intends to defend vigorously against the lawsuits, including the pursuit of all appeals; however, no prediction can be made, as of the date hereof, with respect to the liability of the City for such claims or the outcome of such lawsuits.

In the opinion of the City Attorney, it is improbable that the lawsuits now outstanding against the City could become final in a timely manner so as to have a material adverse financial impact upon the City. The City provides the following updated information related to the lawsuits:

***Brooks Hardee, et al. v. City of San Antonio; Reed Lehman Grain, Ltd. v. City of San Antonio; Farmco Trust et al. v. City of San Antonio, et al.*** These are similar cases brought by the same developer/landowner under different entities. These cases raise complex issues of fact and law and, collectively, challenge the City’s authority to regulate land development; including challenging the City’s vested rights determinations for the landowner’s projects. The City’s legal team is confident that many of the allegations are without merit and the number of resolved cases illustrates the City’s strong positions. The City has coordinated its defense with SAWS.

**CKW, Inc., et al. v. City of San Antonio, et al.** In this case, multiple Plaintiffs claim damages for alleged inverse condemnation, takings, and “constitutional damages” due to a road-widening project. This case is related to several other cases arising out of the same project. The claims aggregate well over \$100,000. This case is not yet set for trial.

**Erin McCutcheon v. Sheryl Sculley, et al.** Plaintiff was arrested by a San Antonio Police Department (“SAPD”) officer for a public disturbance at a night club. Plaintiff has filed suit against the officers, the City and the night club, alleging use of excessive force by the officers. The City has been dismissed from the suit. Damages could exceed \$200,000. The case is stayed by the judge pending Plaintiff’s criminal case.

**Koplow Development, Inc. v. City of San Antonio.** Plaintiff contends that the construction of a regional stormwater detention facility was an inverse condemnation of its property by increasing the flood plain elevation on its property. The City also filed a statutory condemnation to acquire an easement involving Plaintiff’s property to construct and maintain part of the facility. This matter was tried in July 2008, resulting in a judgment against the City of approximately \$2 million and an adverse ruling to the City on Plaintiff’s claim of vested development rights. The City’s motion for new trial was granted. After a retrial, the Court ruled that Plaintiff does not have vested rights with respect to flood plain development, and the jury awarded approximately \$600,000 to Plaintiff for the inverse condemnation and statutory condemnation. The City and Plaintiff have appealed.

**Shawn Rosenbaum, et al. v. City of San Antonio, et al.** Plaintiff’s decedent, Diane Rosenbaum, was operating her motorized wheelchair, crossing a parking area where she allegedly was struck by a City vehicle. Ms. Rosenbaum later died, allegedly as a result of this incident. This case is recently filed and discovery is on-going. Damages in this matter are capped by the Texas Tort Claims Act at \$250,000.

**Daniel Thomas, et al. v. City of San Antonio, et al.** Plaintiffs’ decedent was involved in two vehicle accidents in a short period of time and fled the scene of the second one on foot. After decedent refused commands to stop and drop his weapon, and in fear for their safety, the officers shot and killed the decedent. Plaintiffs filed suit against the City and the officers in their individual capacities. Discovery is on-going. If liability is determined, damages could be in excess of \$250,000.

**Chacon, et al. v. City of San Antonio, et al.** Plaintiffs are land owners who own property in an area that had been part of a limited purpose annexation by the City. The area was deannexed in March 2008 and City South Management Authority (“CSMA”) took over responsibility for planning and zoning pursuant to State statute. Plaintiffs challenge both the City and CSMA’s authority to enact and enforce zoning and planning regulations, alleging that these restrictions have devalued their property by limiting their ability to develop it. Plaintiffs seek damages in excess of \$4 million.

**Galvan, et al. v. City of San Antonio, et al.** Plaintiffs filed suit for wrongful death under State and federal laws related to the death of Sergio Galvan. During the course of an arrest, decedent became violent and, in response, SAPD used taser guns to subdue him. Decedent became unresponsive and was later pronounced dead. The trial court granted summary judgment in favor of all defendants in November 2008. Plaintiffs have appealed the judgment with respect to the defendant officers to the Fifth Circuit Court of Appeals. Briefing and oral argument has been completed. A second lawsuit was filed by different family members of the decedent, in State district court.

**Smith, et al. v. Ybarra, et al.** Plaintiffs’ decedent was killed in a motor vehicle accident. Plaintiffs filed suit against the driver of the vehicle involved, as well as the City. As to the City, plaintiffs contend that paramedics did not render medical aid to decedent based on their mistaken belief that she was already dead. Damages could be up to \$250,000.

**Vargas v. City of San Antonio, et al.** Plaintiff alleges that a police officer improperly used a police vehicle to pin and injure minor plaintiff against a utility pole. Plaintiff filed suit alleging excessive force. A new scheduling order has been filed and parties are awaiting a new trial setting.

**Wissmann v. City of San Antonio.** Plaintiff was involved in a motor vehicle accident with a SAPD cruiser and filed suit for injuries allegedly sustained in the accident. This case is covered by the Texas Tort Claims Act. If liability is determined, damages could be in excess of \$250,000.

**KGME, Incorporated v. City of San Antonio.** Plaintiff entered into a contract with the City to provide construction services. The parties determined that work on portions of the contract had become impracticable and further work would cease. Plaintiff sued for Breach of Contract and Violations of the Prompt Payment Act. Damages could exceed \$250,000.00. The City filed a plea to the jurisdiction, which was denied by the Court. The City has appealed to the Fourth Court of Appeals.

**Vasquez, et al. v. City of San Antonio Police Department.** Plaintiffs were involved in a motor vehicle accident while pursued by SAPD officers. Plaintiff filed suit on her behalf and on behalf of her minor child for injuries allegedly sustained in the accident. This case is covered by the Texas Torts Claims Act. If liability is determined, damages could be in excess of \$250,000. This case has not been set for trial.

**Rosemary Flammia v. City of San Antonio.** Plaintiff initially filed an EEOC complaint alleging discrimination based on gender and race based on not being appointed as an Assistant Chief of the SAPD, and amended her complaint on several occasions. She also asserted claims of retaliation based on her prior EEOC filings. Expenses in this case could exceed \$250,000.

**David Ash v. City of San Antonio.** Plaintiff struck a City vehicle from behind. Plaintiff claims he could not see that the City vehicle was stopping because of the dust cloud kicked up by the truck. This case was tried to a jury in September 2009 and Plaintiff was awarded damages of approximately \$190,000. This case is currently on appeal. If the verdict is upheld, the damages, plus interests and legal expenses to the City, is likely to reach or exceed \$250,000.

**Paez, et al v. City of San Antonio.** Plaintiffs sued under the Texas Torts Claims Act for negligence, gross negligence, and wrongful death alleging that SAPD Sergeant Gabriel Trevino negligently struck and killed Rosita Davila in a motor vehicle accident on Loop 1604 on March 7, 2010. Many depositions have been taken as discovery is still in progress. This case is set for trial on February 7, 2011.

### ***Systems Litigation and Claims***

CPS Energy is involved in various legal proceedings related to alleged personal and property damages, condemnation appeals and discrimination cases. As the operator of San Antonio's gas and electric systems, various claims have been asserted against CPS Energy. Most of those claims, including those in active litigation, do not merit individual disclosure and, in all cases, except where mentioned below, CPS Energy maintains a litigation reserve that is sufficient to satisfy reasonable outcomes concerning these pending claims and litigation. Subject to the foregoing, CPS Energy separately discloses certain pending litigation and potential claims, as follows:

**American Empire Surplus Lines Insurance Co. v. City of San Antonio.** This is a subrogation claim in which Plaintiff is suing CPS Energy and alleging that property and buildings of its subrogor were damaged by an electrical explosion and fire that Plaintiff alleges emanated from CPS Energy's transformer and electric lines. Plaintiff claims damages in excess of \$500,000. CPS Energy denied Plaintiff's allegations and claims. Discovery is on-going and is set for trial on April 18, 2011.

**Casey Industrial, Inc. v. City of San Antonio.** CPS Energy was sued by Casey Industrial, Inc. ("Casey"), relating to Casey's work on the design build contract for CPS Energy's J.T. Deely Baghouse Project, on which Casey and Wheelabrator Air Pollution Control, Inc. ("Wheelabrator") were contractors. Casey alleges that it is due additional compensation because of delays in receiving engineering from Wheelabrator and because of additional work that Casey performed, which, in Casey's view, was not part of the scope in Casey's original bid. Casey has claimed that it is owed approximately \$12,000,000 based on its claims. CPS Energy answered the lawsuit, denying Casey's claim, and asserted a \$1,600,000 counter-claim for work unperformed by Casey. Discovery is on-going and trial is set for May 9, 2011.

**Time Warner Cable San Antonio, L.P. v. City Public Service of San Antonio.** Texas law prohibits discrimination by a municipally owned utility ("MOU") in the rates and terms the MOU charges a certificated telecommunications provider ("CTP") for the attachments the CTP makes to an MOU's poles and, beginning September 1, 2006, requires the MOU charge a single, uniform pole attachment rate to all CTPs. Beginning with its 2007 invoices, CPS Energy has charged all CTPs the same rate. AT&T claims its pole attachment agreement with CPS Energy requiring joint ownership of poles exempts it from the requirement; CPS Energy continues its attempts to collect the outstanding balance and AT&T has continued to pay the significantly lower pole attachment rate provided by its 20-year contract. Time Warner Cable San Antonio, L.P. ("TWC") has brought suit against CPS Energy in State district court in San Antonio, claiming CPS Energy's failure to collect the outstanding balance from AT&T is in violation of the statutory requirement and that CPS Energy has discriminated against TWC by charging TWC and AT&T different pole attachment rates. TWC seeks damages of no less than \$5 million. CPS Energy responded to the lawsuit by asking the court to abate the lawsuit because the PUC has primary jurisdiction over the issues raised by TWC and should be allowed to rule on the issues raised in a PUC docket CPS Energy filed. *Petition of CPS Energy for Enforcement Against AT&T and Time Warner Cable Regarding Pole Attachments*, Docket No. 36633. CPS Energy also counter-sued for TWC's outstanding balance, which has resulted from TWC paying for its pole attachments at the 20-year-old AT&T rate instead of the 2008 rate CPS Energy is uniformly charging all CTPs for pole attachments. By order issued March 17, 2009, the court abated the proceeding pursuant to CPS Energy's request. Consistent with CPS Energy's request, on April 3, 2009, the PUC issued an order assuming

jurisdiction over the case. The State Office of Administrative Hearings will hear CPS Energy's docket on November 15-17, 2010, and the PUC Commissioners are expected to issue an order in early to mid-2011.

**Pedro Gonzalez v. City of San Antonio, et al.** The Plaintiff sued CPS Energy for wrongful termination based on gender discrimination. CPS Energy claimed that it terminated the Plaintiff for legitimate, non-discriminatory reasons. The case was tried to a jury verdict. On August 15, 2008, the court entered a judgment against CPS Energy after the jury returned an adverse verdict and awarded the Plaintiff approximately \$668,000 in damages, fees, and costs against CPS Energy. CPS Energy filed a variety of post-trial motions, as well as an appeal. On appeal, the 4<sup>th</sup> Court of Appeals reversed and rendered overturning the lower court decision and ordered that Plaintiff take nothing from CPS Energy. The Plaintiff then filed a petition for review with the Texas Supreme Court which was denied on October 2, 2010. Unless the Plaintiff files a motion for a rehearing of that decision and the Court grants it, the Court of Appeals decision in CPS Energy's favor will stand. CPS Energy had previously made an appropriate adjustment to its litigation reserve in the event of an unsuccessful outcome in this appellate process.

**Beverly Harvey Lay, Individually and as Personal Representative of the Heirs and Estate of Arthur L. Lay, Jr. v. A. W. Chesterton, et al.** CPS Energy was sued, along with thirty-five other defendants, by Ms. Beverly Lay who alleges that her deceased husband, Arthur L. Lay, a former CPS Energy power plant employee who retired with over twenty-five years of service, was exposed to asbestos containing products, contracted mesothelioma and died shortly thereafter. Each named defendant is alleged to be jointly and severally liable under the doctrines of enterprise liability, market share liability, concert of action, and alternative liability. Mr. Lay, as an employee of CPS Energy, had Worker's Compensation Insurance coverage at the time. As such, Ms. Lay will be required to prove gross negligence in order to attribute any liability to or collect monetary damages from CPS Energy. While exposure could be potentially high if liability were imposed, proving gross negligence against CPS Energy will be extremely difficult. CPS Energy has successfully defended this type of claim in the past. This case will be vigorously defended.

**Ricky Spriggs v CPS Energy and Badeco.** On June 29, 2009, Ricky Lee Spriggs, an employee of Dean Word Company, a contractor working on a project for the Texas Department of Transportation ("TXDOT"), was operating a milling machine about the intersection of NW Military Highway and Huebner Rd. in San Antonio, Texas. As his equipment was cutting the road at that location, it came into contact with an eight-inch pressurized natural gas supply line owned by CPS Energy. This contact resulted in a broken line causing the gas to leak and ignite. Mr. Spriggs sustained burns and required hospitalization. A lawsuit was filed by Mr. Spriggs against CPS Energy and Badeco, Inc., a subcontractor of Mr. Spriggs' employer. CPS Energy filed its answer in June of 2010 and discovery is ongoing. While it is too early to adequately and accurately assess Mr. Spriggs' damages and the liability of the various parties involved, CPS Energy has put its excess insurance carrier on notice as a precautionary measure and will vigorously defend this lawsuit. The initial trial date is set for May 2, 2011.

**Public Utility Commission of Texas v. Constellation Energy Commodities Group, Inc.** On November 14, 2006, Constellation Energy Commodities Group, Inc. ("Constellation") filed a complaint at the Public Utility Commission ("Commission") against ERCOT relating to ERCOT's settlement for replacement reserve service ("RPRS") under-scheduled capacity charges. The Commission denied Constellation's complaint, finding that Protocol §§ 6.6.3.2.1 and 6.9.2.1.1 did not conflict but were in harmony, that ERCOT correctly settled the capacity insufficiency charges for the disputed dates in accordance with the Protocols then in effect, and that no resettlement should occur. The Commission determined that subsection (6) of Protocol § 6.6.3.2.1 addressed capacity insufficiencies and provided a factor for insufficiency that was included in the formula for calculating charges to under-scheduled qualified scheduling entities ("QSEs") on a zonal basis in Protocol § 9.9.2.1.1. The Commission further determined that ERCOT correctly applied the formula as written at that time, that a Protocol Revision Request ("PRR") was later utilized to modify the Protocol to avoid the consequences of applying the zonal factor as the formula previously required, and the decision comported with Protocol § 1.1, the purpose of which is to preclude the retroactive application of a protocol revision to a settlement period that predates the revision. Constellation appealed the Commission's decision to state district court in Travis County. The Commission, ERCOT, and a number of market participants, including CPS Energy, intervened in the appeal in support of the Commission's position. On June 19, 2009, the district court reversed the Commission, finding that there was conflict in the Protocol provisions, and ordered that ERCOT resettle the timeframe at issue. The Commission and the intervenors appealed this decision to the Third Court of Appeals, which heard the Commission's appeal on October 6, 2010. If the district court's finding is upheld, this would not result in a judgment of any kind against CPS Energy but would instead require that ERCOT order a resettlement of the market. CPS Energy and other market participants would have to reimburse Constellation and other under-reporting entities for charges ERCOT collected from them during the relevant timeframe. It is difficult to quantify the impact on CPS Energy if this resettlement were to be required, as it would require a determination by ERCOT of which market participants paid RPRS under-scheduled capacity charges, how much each paid, and how much each will receive from those market participants that were not assessed RPRS under-scheduled capacity charges.

On the date of delivery of the Bonds to the Underwriters, the City will execute and deliver to the Underwriters a certificate to the effect that, except as disclosed herein, no litigation of any nature has been filed or is pending, as of that date, to restrain or enjoin the issuance or delivery of the Bonds or which would affect the provisions made for their payment or security or in any manner question the validity of the Bonds.

## **WHOLESALE POWER MARKETING**

Beginning in 1997, CPS Energy initiated an active program to market its excess generation capacity in the wholesale power market. CPS Energy's power marketing strategy also includes purchasing power if the cost of such power is below what it would cost for CPS Energy to supply the energy from its own generation units. CPS Energy may also purchase power if there is an unanticipated deficit in capacity, to maintain planning reserve margins, to enhance reliability for the electric system, or when economically prudent to reduce overall costs of its obligations in the ERCOT market. CPS Energy buys power only for CPS Energy customer load requirements and does not sell power in excess of its available generation capacity. Certain exceptions exist, such as during times of forced outages, etc. CPS Energy's sales and purchase volumes represent less than 15% of CPS Energy's generation volumes.

Trained, experienced staff in CPS Energy's Wholesale Power Marketing Division, who report to the CPS Energy Senior Vice President for Energy Development, conduct wholesale power transactions in accordance with established procedures. Any deviation from current operating procedures related to purchases or sales of energy must be reported to management and, depending on the deviation, also to the Board.

CPS Energy conducts wholesale power transactions only with approved counterparties with which CPS Energy has established master enabling agreements for such transactions, or with ERCOT itself, in the case of balancing energy and ancillary services. The enabling agreements outline the general payment and delivery terms and conditions of such sales and purchases, and provide for written transaction confirmations to be exchanged between CPS Energy and its counterparts for each transaction.

## **ENTERPRISE RISK MANAGEMENT**

In June 1998, CPS Energy established a Risk Management Department under the direction of the Executive Vice President and Chief Financial Officer. The department's initial focus was on establishing an insurance program to address CPS Energy's internal risks as well as exposures created by third parties, such as vendors and contractors.

In 2002, as part of its risk management and fuel and electricity purchasing policies, CPS Energy obtained the ability to utilize certain financial derivative instruments, such as energy-based futures, options and swap contracts to hedge or mitigate price volatility associated with fuel and energy sales and purchases. The hedge program is operated in accordance with a written policy approved annually by the Board. A program oversight committee composed of CPS Energy corporate officers and senior executives approves operating policies and corporate hedging strategies.

As part of its continued expansion, the Risk Management Department began working closely with the Wholesale Energy Markets staff to provide credit risk assessments and on-going monitoring of existing and potential counterparties. Capabilities in this area continue to expand. In April 2006, a Chief Risk Officer was brought on board to formalize an enterprise-wide approach to monitor CPS Energy's financial and non-financial risk management efforts. The department was renamed Enterprise Risk Management ("ERM"). ERM continuously monitors all counterparties and credit related exposure on a daily basis. In addition, the ERM department now reports to the President & CEO rather than the Chief Financial Officer, to more fully reflect the enterprise-wide focus on risk management.

## INVESTMENTS

### *Operating Funds*

CPS Energy invests its operating funds as authorized by its bond and commercial paper ordinances and by federal and Texas law including, but not limited to, the Public Funds Investment Act, as amended, Chapter 2256, Texas Government Code (“Investment Act”), Chapter 272, as amended, Texas Local Government Code, and in accordance with written investment policies approved by the Board. These ordinances, laws and CPS Energy’s investment policies are subject to change.

Under current Texas law and the investment policies approved by the Board, CPS Energy may invest its funds in (1) obligations of the United States or its agencies and instrumentalities, including letters of credit; (2) direct obligations of the State or its agencies and instrumentalities; (3) collateralized mortgage obligations directly issued and guaranteed by a Federal agency or instrumentality of the United States; (4) other obligations, the principal and interest of which are unconditionally guaranteed or insured by Texas or the United States or their agencies and instrumentalities; (5) obligations of states, agencies, counties, cities, and other political subdivisions of any state rated not less than “A” or its equivalent; (6) a certificate of deposit or share certificate which is fully secured and/or federally insured; (7) securities lending programs that are 100-102% collateralized; (8) fully collateralized repurchase agreements; (9) certain bankers’ acceptances; (10) commercial paper rated not less than “A-1” or “P-1” or equivalent and that have a stated maturity of 270 days or fewer from the date of issuance; (11) no-load money market mutual funds that have a dollar weighted average stated maturity of 90 days or less, and include in their investment objectives the maintenance of a stable net asset value of \$1 for each share; (12) certain no-load mutual funds that are rated at least “AAA” or its equivalent; (13) certain guaranteed investment contracts that are funded by bond proceeds if authorized in the order, ordinance, or resolution authorizing the issuance of the bonds; (14) investment pools that stabilize at a \$1 net asset value to the extent reasonably possible and are rated no lower than “AAA” or “AAA-m” or equivalent; (15) in connection with a transaction authorized by Section 272.004 of the Local Government Code, one or more of the investments, securities, guarantees, and/or insurance contracts or other contracts and agreements described in Section 452.108(d) of the Texas Transportation Code, including, but not limited to the following: payment agreements, financial guarantees or insurance contracts with counterparties having either a corporate credit or debt rating in any form, a claims-paying ability, or a rating for financial strength of “AA” or better and (16) hedging instruments authorized by Section 2256.0201 of the Texas Government Code and in accordance with CPS Energy’s Energy Price Risk Management Policy for the purpose of managing risks of financial uncertainty or loss associated with adverse volatility in the pricing of CPS Energy’s energy and fuel assets, to include energy based futures contracts, option contracts, swap contracts, insurance contracts, and structured contracts composed of combinations of hedging instruments.

CPS Energy is specifically prohibited from investing its funds in: (1) obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal; (2) obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest; (3) collateralized mortgage obligations that have a stated final maturity date of greater than 10 years; and (4) collateralized mortgage obligations, the interest rate of which is determined by an index that adjusts opposite to the change in the market index.

The weighted term to maturity of investments at July 31, 2010, was 1 year 29 days for CPS Energy’s funds. CPS Energy’s funds, as of July 31, 2010, were invested entirely in Government Agency Obligations held in book-entry form by the Federal Reserve, collateralized mortgage obligations directly issued by and guaranteed by a Federal agency, money market mutual funds, fully collateralized or insured certificates of deposit, fully collateralized repurchase agreements, high quality municipal bonds and money market deposit funds. The market value of the investments held totaled approximately \$1.044 billion (unaudited). Based on market value, 68% of the portfolio was invested in United States Government Agency Obligations, 15% in money market mutual funds, 6% in fully collateralized or insured certificates of deposit, 5% in fully collateralized repurchase agreements, 3% in collateralized mortgage obligations backed by Federal agencies, 2% in high-quality municipal bonds and less than 1% in money market deposit funds. CPS Energy determines the market value of such investments by reference to Bloomberg’s financial terminal, published quotations and other comparable information. No CPS Energy funds are invested currently in reverse repurchase agreements or derivative securities, securities whose rate of return is determined by reference to some other instrument, index, or commodity, except for certain natural gas options held under the Energy Price Risk Management Policy. See “WHOLESALE POWER MARKETING”, “ENTERPRISE RISK MANAGEMENT” and “FUEL SUPPLY” herein.

### ***STP Decommissioning Funds***

CPS Energy invests in two specific decommissioning trusts, the STP Decommissioning Trust and the Master Trust (TCC Funded), in accordance with its decommissioning investment policy and as authorized by Texas law, the NRC and, where applicable, the PUCT. The STP Decommissioning Trust is the sinking fund created by CPS Energy for the sole purpose of financing the decommissioning expenses for its original (28%) interest in STP. CPS Energy obtained the Master Trust (TCC Funded) after it purchased from AEP Texas Central Company its additional 12% interest in STP. As part of the acquisition of the additional interest in STP, CPS Energy obtained a proportionate amount of the nuclear decommissioning trust fund originally created by TCC. Responsibility for continuous funding of the Master Trust (TCC Funded) will remain the responsibility of TCC customers through final decommissioning of STP. At acquisition by CPS Energy of the additional interest in STP from TCC, the funds were transferred to CPS Energy by TCC and placed into the Master Trust (TCC Funded), which is entirely separate from the existing decommissioning trust fund held in the STP Decommissioning Trust created and maintained by CPS Energy for its original interest in STP. See “DESCRIPTION OF PHYSICAL PROPERTY – Electric System - South Texas Project” herein for further discussion of CPS Energy’s acquisition of a 12% interest in STP from TCC. CPS Energy’s investments in the STP Decommissioning Trust and in the Master Trust (TCC Funded) are held by an independent trustee and are invested pursuant to a separate investment policy adopted by the Board and to the provisions of the trust agreements of each trust.

Effective September 1, 2005, the Investment Act was amended to allow a Texas municipality which owns a municipal electric utility to invest its decommissioning trust funds in any investment authorized by Subtitle B, Title 9 of the Texas Property Code. The broad investment authority found in the Texas Property Code includes, but is not limited to, the power to invest in equities.

### ***STP Decommissioning Trust***

Under the Texas Property Code, other applicable law and the South Texas Project Decommissioning Trust Investment Policy (“STP Investment Policy”) approved by the Board, the STP Decommissioning Trust may be invested as follows: (1) funds may be invested in investments permissible by law under the guidance and regulations issued by the NRC and under the Texas Property Code; (2) the STP Decommissioning Trust’s investments should be diversified such that (a) no more than 5% of the securities held may be issued by one entity, with the exception of the federal government, its agencies and instrumentalities, and (b) the portfolio shall contain at least 20 different issues of securities with municipal securities and real estate investment trusts diversified as to geographic region; (3) derivative securities are limited to those whose purpose is to enhance returns of the STP Decommissioning Trust without a corresponding increase in risk of the portfolio; (4) securities lending transactions must be collateralized at 100-102%; (5) fixed income securities may not be rated below “BBB-” and “BBB-” by S&P and Fitch, respectively, or “Baa3” by Moody’s, at the time of purchase, and the overall fixed income portfolio must be rated no less than “A” by S&P, Fitch and Moody’s; (6) equity securities are permissible investments (a) limited to a cap of (i) 60% when the weighted average remaining life of the decommissioning liability exceeds 5 years, (ii) 30% when the weighted average remaining life of decommissioning liability ranges between 5 years and 2.5 years and during all years in which expenditures for decommissioning the nuclear units occur, and (iii) 0% when the weighted average remaining life of the decommissioning liability is less than 2.5 years, and (b) when the equities are of a type not considered to be speculative; and (7) commingled funds that include United States equity-indexed funds, actively managed United States equity funds, balanced funds, bond funds, real estate investment trusts, and international funds are permissible investments, if the commingled funds are consistent with the goals stated in the STP Investment Policy. Commingled funds (a) may be focused on specific market sectors or concentrated in a few holdings only as necessary to balance the trust’s overall investment portfolio mix, and (b) may contain some below investment grade bonds; but the overall portfolio of debt instruments shall have a quality level, measured quarterly, not below an “A” rating by S&P, Fitch and Moody’s, respectively.

The STP Decommissioning Trust is specifically prohibited (1) from investing in derivatives if being used to increase the value of the portfolio by any amount greater than the value of the underlying securities; (2) from the use of leverage (borrowing) to purchase securities or the purchase of securities on margin; (3) from investing in corporate or municipal debt securities that have a bond rating below investment grade (below “BBB-” by S&P and Fitch or “Baa3” by Moody’s) at the time that the securities are purchased and the appropriateness of continuing to hold a particular debt security must be reexamined if the debt rating of the company in question falls below investment grade after the debt security has been purchased; and (4) from investing in equity securities that are considered speculative (e.g., stocks of companies with limited operating history or that have low “safety” rankings from ratings agencies).

Investments in the STP Decommissioning Trust consisted of fixed income securities, equity securities and cash equivalents at June 30, 2010. The total market value of all investments was approximately \$263.0 million (unaudited). Fixed income securities totaled approximately \$138.0 million, equity securities had a market value of approximately \$123.0 million and the remaining \$2.0 million was invested in cash and cash equivalents. Based upon market values, 54% of fixed income

securities were invested in United States Government and Government Agency obligations, 41% were invested in corporate bonds and municipal bonds and 5% were invested in foreign bonds.

### ***Master Trust (TCC Funded)***

Under applicable law, including NRC and PUCT regulations, and the STP Investment Policy, the Master Trust (TCC Funded), may be invested in (1) a way that, once the portfolio of securities (including commingled funds) held in the Trust contains securities with an aggregate value in excess of \$20 million, the funds are diversified so that (a) no more than 5% of the Investment Manager's portfolio of securities held are issued by one entity, with the exception of the federal government, its agencies and instrumentalities, (b) the portfolio shall contain at least 20 different issues of securities with municipal securities and real estate investments diversified as to geographic region; (2) derivative securities limited to those whose purpose is to enhance returns of the trust without a corresponding increase in risk of the portfolio; (3) securities lending transactions when collateralized at 100-102%; (4) fixed income securities not rated below "BBB-" or "BBB-" by S&P and Fitch Ratings, respectively, or "Baa3" by Moody's, at the time of purchase; (5) equity securities, (a) limited to a cap of (i) 60% when the weighted average remaining life of the decommissioning liability exceeds 5 years, (ii) 30% when the weighted average remaining life ranges between 5 years and 2.5 years and during all years in which expenditures for decommissioning the nuclear units occur, and (iii) 0% when the weighted average remaining life of the decommissioning liability is less than 2.5 years, and (b) with at least 70% of the aggregate market value of the equity portfolio, including the individual securities in commingled funds, having a quality ranking from a major rating service and the overall portfolio of ranked equities with a weighted average quality rating equivalent to the composite rating of the S&P 500 index assuming equal weighting of each ranked security in the index; and (6) commingled funds that include United States equity-indexed funds, actively managed United States equity funds, balanced funds, bond funds, real estate investment trusts, and international funds that (a) are consistent with the goals stated in the investment policy, (b) are focused on specific market sectors or concentrated in a few holdings only if used as necessary to balance the trust's overall investment portfolio mix, and (c) may contain some below investment grade bonds; however, the overall portfolio of debt instruments shall have a quality level, measured quarterly, not below a "AA" rating by S&P or "Aa2" by Moody's.

The Master Trust (TCC Funded) is specifically prohibited (1) from investing in derivatives if being used to increase the value of the portfolio by any amount greater than the value of the underlying securities; (2) from the use of leverage (borrowing) to purchase securities or the purchase of securities on margin; (3) from investing in corporate or municipal debt securities that have a bond rating below investment grade (below "BBB-" or "BBB-" by S&P and Fitch, respectively, or "Baa3" by Moody's) at the time that the securities are purchased and the appropriateness of continuing to hold a particular debt security must be reexamined if the debt rating of the company in question falls below investment grade at some time after the debt security has been purchased; (4) from investing in equity securities where the issuer has a capitalization of less than \$100 million; and (5) from investing in securities issued by the electric utility collecting the funds or any of its affiliates; however, investments may include commingled funds that contain securities issued by the electric utility if the securities of the utility constitute no more than 5% of the fair market value of the assets of such commingled funds at the time of the investment.

At June 30, 2010, CPS Energy's investments in the Master Trust (TCC Funded) consisted of fixed income securities, equity securities and cash equivalents with a total market value of approximately \$88.0 million (unaudited). Fixed income securities totaled approximately \$41.0 million, equity securities had a market value of approximately \$46.0 million and the remaining \$1.0 million was invested in cash and cash equivalents. Based upon market values, 81% of fixed income securities were invested in United States Government and Government Agency obligations and 19% were invested in corporate, municipal and foreign bonds.

### ***Investment Policies***

Under the Investment Act, CPS Energy is required to invest its funds in accordance with written investment policies that (1) primarily emphasize safety of principal and liquidity; (2) address investment diversification, yield, maturity, and the quality and capability of investment management; (3) include a list of authorized investments for CPS Energy funds and the maximum allowable stated maturity of any individual investment; (4) state the maximum average dollar-weighted maturity allowed for pool fund groups; (5) contain the methods to monitor the market price of investments acquired with public funds; and (6) require the settlement of all transactions, except investment pool funds and mutual funds, on a delivery versus payment basis. All CPS Energy funds must be invested consistent with formally adopted written investment strategies that specifically address each fund's investment. Each strategy describes its objectives concerning (1) suitability of investment type; (2) preservation and safety of principal; (3) liquidity; (4) marketability of each investment; (5) diversification of the portfolio; and (6) yield.

Under the Investment Act, CPS Energy investments under all investment policies must be made “with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person’s own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived”.

Consistent with the requirements of the NRC, Texas Property Code, the Investment Act, and as applicable, the PUCT, the STP Decommissioning Trust, and the Master Trust (TCC Funded) will be invested consistent with the following goals: (1) the funds will be invested with a goal of earning a reasonable return commensurate with the need to preserve the value of the assets; (2) the portfolio of securities will be diversified to the extent reasonably feasible given the size of the trust; (3) asset allocation and the acceptable risk level of the portfolio will take into account market conditions, the time horizon remaining before the commencement and completion of decommissioning, and the funding status of the trust; (4) while maintaining an acceptable risk level, the investment emphasis when the remaining life of the liability exceeds five years will be to maximize net long-term earnings and the investment emphasis in the remaining investment period of the trust will be on current income and asset preservation; and (5) in selecting investments, the impact of the investment on the portfolio’s volatility and expected return net of fees will be considered.

### ***Additional Provisions***

Under the Investment Act for the Operating Funds, STP Decommissioning Trust and the Master Trust (TCC Funded), CPS Energy must: (1) review annually and, if desired, change its adopted written investment policies and strategies; (2) designate investment officers to be responsible for investment of its funds consistent with the investment policies of CPS Energy; (3) require any investment officers with personal business relationships or relatives with firms seeking to sell securities to the entity to disclose the relationship and file a statement with the Texas Ethics Commission and the Board; (4) require the qualified representative of firms seeking to sell securities to CPS Energy to (a) receive and review the CPS Energy investment policies; (b) acknowledge that reasonable controls and procedures have been implemented to preclude investment transactions not authorized by the CPS Energy investment policies; and (c) deliver a written statement attesting to these requirements; (5) perform an annual audit of the management controls on investments and adherence to the CPS Energy investment policies; (6) provide specific investment training for CPS Energy’s investment officers; and (7) review, revise, and adopt on an annual basis a list of qualified brokers that are authorized to engage in investment transactions with CPS Energy.

For the STP Decommissioning Trust and the Master Trust (TCC Funded), CPS Energy is prohibited from being engaged as investment manager for the funds or from giving day-to-day management direction of the funds’ investments. Therefore, the use of one or more professional investment managers is necessary to assure that the trusts are managed in a manner so that the funds are secure and earn a reasonable return. CPS Energy has the following duties concerning the use of one or more investment managers: (1) a duty to determine whether the investment manager’s fee schedule for investment management services is reasonable, when compared to other such managers; (2) a duty to investigate and determine whether the past performance of the investment manager in managing investments has been reasonable; (3) a duty to investigate and determine whether the financial stability and strength of the investment manager is adequate for purposes of liability; (4) a duty to investigate and determine whether the investment manager has complied with the investment management agreement; and (5) a duty to investigate any other factors which may bear on whether the investment manager is suitable.

Some of the proceeds of the financial lease/leaseback transaction with a subsidiary of Unicom Corporation involving CPS Energy’s JKS 1 are invested, as security for certain CPS Energy undertakings in connection with the transaction, in a collateralized payment undertaking agreement among (1) CPS Energy; (2) Spruce Equity Holdings, L.P., a Delaware limited partnership; (3) Spruce Holdings Trust, a Delaware business trust; and (4) a subsidiary of American International Group, Inc. Unicom Corporation, subsequent to this transaction, has merged into Exelon. See “LEASE TRANSACTION” and “POTENTIAL EXCISE TAX ADVERSELY AFFECTING THE CITY AND CPS ENERGY” herein.

## CONTINUING DISCLOSURE OF INFORMATION

In the Ordinances, the City and the Board made the agreement described below for the benefit of the holders and Beneficial Owners of the Bonds. The City and the Board are required to observe the agreement for so long as they remain obligated to advance funds to pay the Bonds. Under the agreement, the City and the Board will be obligated to provide certain updated financial information and operating data annually, and timely notice of specified material events, to the Municipal Securities Rulemaking Board (“MSRB”) through its Electronic Municipal Market Access (“EMMA”) System, where such information will be available to the general public, free of charge, through an internet website at [www.emma.msrb.com](http://www.emma.msrb.com).

### *Annual Reports*

Under Texas law, including, but not limited to, Chapter 103, as amended, Texas Local Government Code, Texas Government Code Sections 1502.66, 1502.67 and 1502.68, as amended, and the City’s Home Rule Charter, the City and the Board must keep their fiscal records in accordance with generally accepted accounting principles, must have their financial accounts and records audited by an independent certified public accountant, and must file each audit report with the City Clerk or the Secretary of the Board, as appropriate, within 180 days after the close of the City’s or Board’s fiscal year. The City’s fiscal records and audit reports are available for public inspection during the regular business hours of the City Clerk. The Board’s financial statements and independent auditors’ reports are available for public inspection to the extent information contained in them is not excepted from disclosure under the Texas Public Information Act, as amended, Texas Government Code, Chapter 552. Persons may obtain copies of the portions of these documents not excepted from disclosure under the Texas Public Information Act upon submission of a written request to the City Clerk or Secretary of the Board, as appropriate, and paying the reasonable copying, handling and delivery charges for providing this information. The Ordinances obligate the Board to provide certain updated financial information and operating data to the MSRB annually. The information to be updated includes all quantitative financial information and operating data with respect to the Board of the general type included in this Official Statement under the headings “SAN ANTONIO ELECTRIC AND GAS SYSTEMS – Customer Base as of July 31, 2010”; “TEN-YEAR ELECTRIC CUSTOMER STATISTICS”; “FIVE-YEAR ELECTRIC AND GAS SALES BY CUSTOMER CATEGORY”; “FIVE-YEAR STATEMENT OF NET REVENUES AND DEBT SERVICE COVERAGE”; “DESCRIPTION OF PHYSICAL PROPERTY – Electric System - Generating Capability”; “DESCRIPTION OF PHYSICAL PROPERTY – Electric System - Five-Year South Texas Project Capacity Factor”; “DESCRIPTION OF PHYSICAL PROPERTY – Other Electric and Gas Systems Statistics”; and APPENDIX B. The Board will update and provide this information within six months after the end of each fiscal year.

The Board may provide annual information in full text or may incorporate by reference certain other publicly available documents, as permitted by the United States Securities and Exchange Commission (“SEC”) Rule 15c2-12 (“Rule”). The annual information will include audited financial statements, if the Board commissions an audit and it is completed by the required time. If audited financial statements are not available by the required time, the Board will provide audited financial statements when the audit report becomes available. Any such financial statements will be prepared in accordance with the accounting principles described in APPENDIX B, or such other accounting principles as the Board may be required to employ from time to time pursuant to Texas law or regulation.

### *Material Event Notices*

The Board will also provide timely notices of certain events to the MSRB. The Board will provide notice of any of the following events with respect to the Bonds, if such event is material to a decision to purchase or sell Bonds: (1) principal and interest payment delinquencies; (2) non-payment related defaults; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions or events affecting the federal income tax status of the Bonds; (7) modifications to rights of holders of the Bonds; (8) Bond calls; (9) Bond defeasances; (10) release, substitution, or sale of property securing repayment of the Bonds; and (11) rating changes. Neither the Bonds nor the Ordinance make any provision for debt service reserves, liquidity enhancement, or credit enhancement. In addition, the Board will provide timely notice of any failure by the Board to provide information, data, or financial statements in accordance with its agreement described above under “Annual Reports”. The Board will provide each notice described in this paragraph to the MSRB.

### ***Availability of Information***

Effective July 1, 2009 (“EMMA Effective Date”), the SEC implemented amendments to the Rule approving the establishment by the MSRB of EMMA, which is now the sole successor to the national municipal securities information repositories with respect to filings made in connection with undertakings made under the Rule after the EMMA Effective Date. Commencing with the EMMA Effective Date, all information and documentation filing required to be made by the Board in accordance with its undertaking made for the Bonds will be made with the MSRB in electronic format in accordance with MSRB guidelines. Access to such filings will be provided, without charge to the general public, by the MSRB.

With respect to debt of the City issued prior to the EMMA Effective Date, the Board remains obligated to make annual required filings, as well as notices of material events, under its continuing disclosure obligations relating to those debt obligations (which includes a continuing obligation to make such filings with the State Information Depository or “SID”). Prior to EMMA Effective Date, the Municipal Advisory Council of Texas (“MAC”) had been designated by the State and approved by the SEC staff as a qualified SID. Subsequent to the EMMA Effective Date, the MAC entered into a Subscription Agreement with the MSRB pursuant to which the MSRB makes available to the MAC, in electronic format, all Texas-issuer continuing disclosure documents and related information posted to EMMA’s website simultaneously with such posting. Until the Board receives notice of a change in this contractual agreement between the MAC and EMMA or of a failure of either party to perform as specified thereunder, the Board has determined, in reliance on guidance from the MAC, that making its continuing disclosure filings solely with the MSRB will satisfy its obligations to make filings with the SID pursuant to its continuing disclosure agreements entered into prior to the EMMA Effective Date.

### ***Limitations and Amendments***

The Board has agreed to update information and to provide notices of material events only as described above. The Board has not agreed to provide other information that may be relevant or material to a complete presentation of its financial results of operations, conditions, or prospects or agreed to update any information that is provided, except as described above. The Board makes no representation or warranty concerning such information or concerning its usefulness to a decision to invest in or sell Bonds at any future date. The Board disclaims any contractual or tort liability for damages resulting in whole or in part from any breach of its continuing disclosure agreement or from any statement made pursuant to its agreement, although holders and Beneficial Owners of Bonds may seek a writ of mandamus to compel the Board to comply with its agreement.

The Board may amend its continuing disclosure agreements to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status, or type of operations of the Board, if the agreements, as amended, would have permitted an underwriter to purchase or sell the Bonds in the offering described herein in compliance with the Rule and either the holders of a majority in aggregate principal amount of the outstanding Bonds consent or any person unaffiliated with the Board (such as nationally recognized bond counsel) determines that the amendment will not materially impair the interests of the Beneficial Owners of the Bonds. The Board may also repeal or amend the provisions of its continuing disclosure agreement if the SEC amends or repeals the applicable provisions of the Rule or any court of final jurisdiction enters judgment that such provisions of the Rule are invalid, and the Board also may amend these provisions in its discretion in any other manner or circumstance, but in either case, only if and to the extent that the provisions of this sentence would not have prevented an underwriter from lawfully purchasing or selling Bonds in the primary offering of bonds, giving effect to (a) such provisions as so amended and (b) any amendments or interpretations of the Rule. If the Board amends its agreements, it must include with the next financial information and operating data provided in accordance with its agreements described above under “Annual Reports” an explanation, in narrative form, of the reasons for the amendment and of the impact of any change in the type of information and data provided.

### ***Compliance with Prior Undertakings***

During the last five years, the City and the Board have complied in all material respects with all continuing disclosure agreements made by them in accordance with the Rule.

On October 20, 2010, the Board filed a material events notice with the MSRB through EMMA concerning its receipt from the Service (defined herein) of notice of the commencement of an audit by the Service of a series of its outstanding bonds to confirm compliance with applicable federal tax law. See “RECEIPT OF NOTICE OF INTERNAL REVENUE SERVICE AUDITS” herein.

## RECEIPT OF NOTICE OF INTERNAL REVENUE SERVICE AUDITS

The Board received a letter dated January 25, 2008, from the Internal Revenue Service (“Service”) that the Service would be conducting a routine audit of the \$350,493,000 City of San Antonio, Texas Electric and Gas Systems Revenue Refunding Bonds, New Series 2003 (Forward Delivery), dated July 1, 2003 (“Obligations”). The Obligations are currently outstanding in the principal amount of \$116,200,000 and mature on February 1 in each of the years 2011 and February 1, 2013. The Board mailed its initial response to the Service on February 15, 2008. By mailing such information, the Board will have complied with all written requests from the Service concerning this matter. On May 20, 2008, CPS Energy, in response to discussions with the Service’s agent concerning the Obligations, sent a letter seeking confirmation that in fact the Service was not conducting a routine audit with respect to the Obligations, but simply was seeking clarifications concerning CPS Energy’s filing of its IRS Form 8038-G with respect to the City’s Commercial Paper Program. On March 3, 2009, during a telephone conference with a representative of the City, the Service requested a copy of the transcript of the City’s Commercial Paper Program. It appears that the Service is not auditing the Obligations. The Service’s agent indicated that she was “looking to close out the audit” with respect to the City’s Commercial Paper Program. Such notice of closure dated April 29, 2009, was subsequently received by CPS Energy.

On October 18, 2010, the Board received a letter, dated October 14, 2010, from the Service that the Service would be conducting an audit of the \$375,000,000 City of San Antonio, Texas Electric and Gas Systems Revenue Bonds, Taxable New Series 2009C (Direct Subsidy – Build America Bonds). These obligations are currently outstanding in the principal amount of \$375,000,000 and have a stated maturity of February 1, 2039. This letter from the Service states that it routinely examines municipal debt issuance to confirm compliance with applicable federal tax law and that it has no reason to believe that the referenced obligations are not compliant therewith. The Board is fully complying with the requests of the Service made in this letter. The Board has filed a material event notice with the MSRB through EMMA concerning its receipt of this letter. See “CONTINUING DISCLOSURE OF INFORMATION – Compliance with Prior Undertakings” herein.

## LEGAL MATTERS

Legal matters incident to the authorization, issuance and sale of the Bonds are subject to the unqualified approval of the Attorney General of the State of Texas and the approval of certain legal matters by Co-Bond Counsel. Though they represent the Co-Financial Advisors and the Underwriters from time to time in matters unrelated to the issuance of the Bonds, Co-Bond Counsel has been engaged by the Board and only represents the Board and the City in connection with the issuance of the Bonds. Co-Bond Counsel were not requested to participate and did not take part in the preparation of this Official Statement except as hereinafter noted, and such firms have not assumed any responsibility with respect thereto or undertaken independently to verify any of the information contained herein, except that, in their capacity as Co-Bond Counsel, such firms have reviewed the information under the captions “THE BONDS” (except under the sub-captions “Sources and Uses of the Series 2010A Bond Proceeds”, “Sources and Uses of the Series 2010B Bond Proceeds”, “Perfection of Security for the Bonds”, the second paragraph under “Additional Bonds”, “Registered Owners’ Remedies”, and “Book-Entry-Only System”, as to which no opinions are expressed) and “CONTINUING DISCLOSURE OF INFORMATION” (except matters discussed under the subcaption “Compliance with Prior Undertakings”, as to which no opinion is expressed), “LEGAL MATTERS” (except for the last sentence of the first paragraph thereof as to which no opinion is expressed), “FEDERAL TAX TREATMENT OF BONDS”, “LEGAL INVESTMENTS IN TEXAS”, “SECURITIES LAWS”, “APPENDIX D – CERTAIN PROVISIONS OF THE JUNIOR LIEN ORDINANCE”, and “APPENDIX E – FORMS OF OPINIONS OF CO-BOND COUNSELS” in this Official Statement, and such firms were of the opinion that the information relating to the Bonds, the Ordinances and the legal issues contained under such captions and sub-captions were an accurate and fair description of the laws and the legal issues addressed therein and, with respect to the Bonds, such information conforms to the Ordinances. The legal fees paid to Co-Bond Counsel in connection with the issuance of the Bonds were contingent on the sale and delivery of the Bonds. Certain legal matters were passed upon for the Underwriters by their Co-Underwriters Counsel, McCall, Parkhurst & Horton L.L.P. and Law Offices of William T. Avila, P.C., both of San Antonio, Texas, whose legal fees were contingent on the sale and delivery of the Bonds, and for CPS Energy by its General Counsel, and for the City by the City Attorney.

The various legal opinions to be delivered concurrently with the delivery of the Bonds express the professional judgment of the attorneys rendering the opinions as to the legal issues explicitly addressed therein. In rendering legal opinions, the attorney does not become an insurer or guarantor of the expression of professional judgment, of the transaction opined upon, or of the future performance of the parties to the transaction, nor does the rendering of opinions guarantee the outcome of any legal dispute that may arise out of the transaction.

## FEDERAL TAX TREATMENT OF BONDS

*General.* The following is a general summary of the United States federal income tax consequences of the purchase and ownership of the Bonds. The discussion is based upon laws, Treasury Regulations, rulings and decisions now in effect, all of which are subject to change or possibly differing interpretations. No assurances can be given that future changes in the law will not alter the conclusions reached herein. The discussion below does not purport to deal with United States federal income tax consequences applicable to all categories of investors. Further, this summary does not discuss all aspects of United States federal income taxation that may be relevant to a particular investor in the Bonds in light of the investor's particular personal investment circumstances or to certain types of investors subject to special treatment under United States federal income tax laws (including insurance companies, tax exempt organizations, financial institutions, brokers-dealers, and persons who have hedged the risk of owning the Bonds). The summary is therefore limited to certain issues relating to initial investors who will hold the Bonds as "capital assets" within the meaning of section 1221 of the Code, and acquire such Bonds for investment and not as a dealer or for resale. Prospective investors should note that no rulings have been or will be sought from the IRS with respect to any of the U.S. federal income tax consequences discussed below, and no assurance can be given that the IRS will not take contrary positions.

INVESTORS SHOULD CONSULT THEIR OWN TAX ADVISORS IN DETERMINING THE FEDERAL, STATE, LOCAL, FOREIGN AND ANY OTHER TAX CONSEQUENCES TO THEM FROM THE PURCHASE, OWNERSHIP AND DISPOSITION OF THE BONDS.

*Internal Revenue Service Circular 230 Notice.* You should be aware that:

- (i) the discussion with respect to United States federal tax matters in this Official Statement was not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer;
- (ii) such discussion was written to support the promotion or marketing (within the meaning of IRS Circular 230) of the transactions or matters addressed by such discussion; and
- (iii) each taxpayer should seek advice based on his or her particular circumstances from an independent tax advisor.

This notice is given solely for purposes of ensuring compliance with IRS Circular 230.

*Payments of Stated Interest on the Bonds.* The stated interest paid on the Bonds will be included in the gross income, as defined in section 61 of the Code, of the beneficial owners thereof and be subject to U.S. federal income taxation when received or accrued, depending on the tax accounting method applicable to the beneficial owners thereof.

*Original Issue Discount.* If a substantial amount of the Bonds are purchased at original issuance for a purchase price (the "Issue Price") that is less than their face amount by more than one quarter of one percent times the number of complete years to maturity, the Bonds will be treated as being issued with "original issue discount". The amount of the original issue discount will equal the excess of the principal amount payable on such Bonds at maturity over its Issue Price, and the amount of the original issue discount on the Bonds will be amortized over the life of the Bonds using the "constant yield method" provided in the Treasury Regulations. As the original issue discount accrues under the constant yield method, the beneficial owners of the Bonds, regardless of their regular method of accounting, will be required to include such accrued amount in their gross income as interest. This can result in taxable income to the beneficial owners of the Bonds that exceeds actual cash distributions to the beneficial owners in a taxable year.

The amount of the original issue discount that accrues on the Bonds each taxable year will be reported annually to the IRS and to the beneficial owners. The portion of the original issue discount included in each beneficial owner's gross income while the beneficial owner holds the Bonds will increase the adjusted tax basis of the Bonds in the hands of such beneficial owner.

*Disposition of Bonds and Market Discount.* A beneficial owner of Bonds will generally recognize gain or loss on the redemption, sale or exchange of the Bonds equal to the difference between the redemption or sales price (exclusive of the amount paid for accrued interest) and the beneficial owner's adjusted tax basis in the Bonds. Generally, the beneficial owner's adjusted tax basis in the Bonds will be the beneficial owner's initial cost, increased by the original issue discount previously included in the beneficial owner's income to the date of disposition. Any gain or loss generally will be capital gain or loss and will be long-term or short-term, depending on the beneficial owner's holding period for the Bonds.

Under current law, a purchaser of Bonds who did not purchase the Bonds in the initial public offering (a "subsequent purchaser") generally will be required, on the disposition of the Bonds, to recognize as ordinary income a portion of the gain, if any, to the extent of the accrued "market discount." Market discount is the amount by which the price paid for the Bonds by a subsequent purchaser is less than the sum of Issue Price and the amount of original issue discount previously

accrued on the Bonds. The Code also limits the deductibility of interest incurred by a subsequent purchaser on funds borrowed to acquire Bonds with market discount. As an alternative to the inclusion of market discount in income upon disposition, a subsequent purchaser may elect to include market discount in income currently as it accrues on all market discount instruments acquired by the subsequent purchaser in that taxable year or thereafter, in which case the interest deferral rule will not apply. The recharacterization of gain as ordinary income on a subsequent disposition of Bonds could have a material effect on the market value of the Bonds.

*Backup Withholding.* Under section 3406 of the Code, a beneficial owner of the Bonds who is a United States person, as defined in section 7701(a)(3) of the Code, may, under certain circumstances, be subject to “backup withholding” on payments of current or accrued interest on the Bonds. This withholding applies if such beneficial owner of Bonds: (i) fails to furnish to payor such beneficial owner’s social security number or other taxpayer identification number (“TIN”); (ii) furnishes the payor an incorrect TIN; (iii) fails to report properly interest, dividends, or other “reportable payments” as defined in the Code; or (iv) under certain circumstances, fails to provide the payor with a certified statement, signed under penalty of perjury, that the TIN provided to the payor is correct and that such beneficial owner is not subject to backup withholding.

Backup withholding will not apply, however, with respect to payments made to certain beneficial owners of the Bonds. Beneficial owners of the Bonds should consult their own tax advisors regarding their qualification for exemption from backup withholding and the procedures for obtaining such exemption.

*Withholding on Payments to Nonresident Alien Individuals and Foreign Corporations.* Under sections 1441 and 1442 of the Code, nonresident alien individuals and foreign corporations are generally subject to withholding at the current rate of 30% (subject to change) on periodic income items arising from sources within the United States, provided such income is not effectively connected with the conduct of a United States trade or business. Assuming the interest received by the beneficial owners of the Bonds is not treated as effectively connected income within the meaning of section 864 of the Code, such interest will be subject to 30% withholding, or any lower rate specified in an income tax treaty, unless such income is treated as portfolio interest. Interest will be treated as portfolio interest if: (i) the beneficial owner provides a statement to the payor certifying, under penalties of perjury, that such beneficial owner is not a United States person and providing the name and address of such beneficial owner; (ii) such interest is treated as not effectively connected with the beneficial owner’s United States trade or business; (iii) interest payments are not made to a person within a foreign country which the IRS has included on a list of countries having provisions inadequate to prevent United States tax evasion; (iv) interest payable with respect to the Bonds is not deemed contingent interest within the meaning of the portfolio debt provision; (v) such beneficial owner is not a controlled foreign corporation, within the meaning of section 957 of the Code; and (vi) such beneficial owner is not a bank receiving interest on the Bonds pursuant to a loan agreement entered into in the ordinary course of the bank’s trade or business.

Assuming payments on the Bonds are treated as portfolio interest within the meaning of sections 871 and 881 of the Code, then no backup withholding under section 1441 and 1442 of the Code and no backup withholding under section 3406 of the Code is required with respect to beneficial owners or intermediaries who have furnished Form W-8 BEN, Form W-8 EXP or Form W-8 IMY, as applicable, provided the payor does not have actual knowledge that such person is a United States person.

*Reporting of Interest Payments.* Subject to certain exceptions, interest payments made to beneficial owners with respect to the Bonds will be reported to the IRS. Such information will be filed each year with the IRS on Form 1099 which will reflect the name, address, and TIN of the beneficial owner. A copy of Form 1099 will be sent by the Paying Agent/Registrar to each beneficial owner of a Taxable Refunding Bond for U.S. federal income tax purposes.

## UNDERWRITING

The Underwriters of the Series 2010A Bonds, for which J.P. Morgan Securities LLC is acting representative, have agreed, subject to certain customary conditions to closing, to purchase the Series 2010A Bonds from the City at the initial prices indicated on the inside front cover hereof, less an Underwriters' discount of \$1,620,083.00, and no accrued interest. The Underwriters of the Series 2010A Bonds, for which J.P. Morgan Securities LLC is acting representative, have agreed, subject to certain customary conditions to closing, to purchase all of the Series 2010A Bonds if any Series 2010A Bonds are purchased. The Series 2010A Bonds may be offered and sold to certain dealers and others at prices lower than the initial public offering prices set forth on the inside cover page of this Official Statement, which may be changed, from time to time, by the Underwriters.

The Underwriters of the Series 2010B Bonds, for which Merrill Lynch, Pierce, Fenner & Smith Incorporated is acting representative, have agreed, subject to certain customary conditions to closing, to purchase the Series 2010B Bonds from the City at the initial prices indicated on the inside front cover hereof, and no accrued interest. The Underwriters' compensation of \$1,077,768.56 will be paid directly by CPS Energy on November 4, 2010. The Underwriters of the Series 2010B Bonds, for which Merrill Lynch, Pierce, Fenner & Smith Incorporated is acting representative, have agreed, subject to certain customary conditions to closing, to purchase all of the Series 2010B Bonds if any Series 2010B Bonds are purchased. The Series 2010B Bonds may be offered and sold to certain dealers and others at prices lower than the initial public offering prices set forth on the inside cover page of this Official Statement, which may be changed, from time to time, by the Underwriters.

J.P. Morgan Securities LLC ("JPMS"), one of the Underwriters of the Bonds, has entered into negotiated dealer agreements (each, a "Dealer Agreement") with each of UBS Financial Services Inc. ("UBSFS") and Charles Schwab & Co., Inc. ("CS&Co.") for the retail distribution of certain securities offerings, including the Bonds, at the original issue prices. Pursuant to each Dealer Agreement, each of UBSFS and CS&Co. will purchase Bonds from JPMS at the original issue price less a negotiated portion of the selling concession applicable to any Bonds that such firm sells.

## LEGAL INVESTMENTS IN TEXAS

Section 1201.041 of the Public Securities Procedures Act (Chapter 1201, as amended, Texas Government Code) provides that the Bonds are negotiable instruments governed by Chapter 8, Texas Business and Commerce Code, and are legal and authorized investments for insurance companies, fiduciaries, and trustees, and for the sinking funds of municipalities or other political subdivisions or public agencies of the State of Texas. With respect to investment in the Bonds by municipalities or other political subdivisions or public agencies of the State of Texas, the Public Funds Investment Act, as amended, Chapter 2256, Texas Government Code, requires that the Bonds be assigned a rating of at least "A" or its equivalent as to investment quality by a national rating agency. See "RATINGS" herein. In addition, various provisions of the Texas Finance Code provide that, subject to a prudent investor standard, the Bonds are legal investments for state banks, savings banks, trust companies with at least one million dollars of capital, and savings and loan associations. The Bonds are eligible to secure deposits of any public funds of the State, its agencies, and its political subdivisions, and are legal security for those deposits to the extent of their market value.

The City has made no investigation of other laws, rules, regulations or investment criteria which might apply to such institutions or entities or which might limit the suitability of the Bonds for any of the foregoing purposes or limit the authority of such institutions or entities to purchase or invest in the Bonds for such purposes. The City has made no review of laws in other states to determine whether the Bonds are legal investments for various institutions in those states.

## SECURITIES LAWS

No registration statement relating to the Bonds has been filed with the SEC under the Securities Act of 1933, as amended, in reliance upon exemptions provided thereunder. The Bonds have not been registered or qualified under the Securities Act of Texas in reliance upon various exemptions contained therein; nor have the Bonds been registered or qualified under the securities laws of any other jurisdiction. The City assumes no responsibility for registration or qualification of the Bonds under the securities laws of any such jurisdiction in which the Bonds may be offered, sold or otherwise transferred. This disclaimer of responsibility for registration or qualification for sale or other disposition of the Bonds must not be construed as an interpretation of any kind with regard to the availability of any exemption from securities registration or qualification provisions in such other jurisdictions.

## **RATINGS**

Fitch Ratings (“Fitch”), Moody’s Investors Service, Inc. (“Moody’s”) and Standard & Poor’s Rating Services, a Standard and Poor’s Financial Services LLC business, (“S&P”) have each assigned long-term ratings of “AA+” “Aa2”, and “AA-”, respectively, to the Bonds. An explanation of the significance of such ratings may be obtained from Fitch, Moody’s and S&P. The rating of the Bonds by Fitch, Moody’s and S&P reflects only the view of said company at the time the rating is given, and the City makes no representations as to the appropriateness of the rating. There is no assurance that the rating will continue for any given period of time, or that the rating will not be revised downward or withdrawn entirely by Fitch, Moody’s and S&P in the judgment of Fitch, Moody’s and S&P as circumstances so warrant. Any such downward revision or withdrawal of the rating may have an adverse effect on the market price of the Bonds.

## **CO-FINANCIAL ADVISORS**

Public Financial Management, Inc. and Estrada Hinojosa & Company, Inc. (“Co-Financial Advisors”) are employed as Co-Financial Advisors to the Board in connection with the issuance of the Bonds. The Co-Financial Advisors’ fee for services rendered with respect to the sale of the Bonds is contingent upon the issuance and delivery of the Bonds. Although the Co-Financial Advisors have read and participated in the preparation of this Official Statement, they have not independently verified any of the information set forth herein. The information contained in this Official Statement has been obtained primarily from the City’s and the Board’s records and other sources which are believed to be reliable, including financial records of the Board and other entities, which may be subject to interpretation. No person, therefore, is entitled to rely upon the participation of the Co-Financial Advisors as implicit or explicit expression of opinions as to the completeness and accuracy of the information contained in this Official Statement. The Co-Financial Advisors have relied on the opinions of Co-Bond Counsel and have not verified and do not assume any responsibility for the information, covenants and representations contained in any of the legal documents with respect to the federal income tax status of the Bonds, or the possible impact of any present, pending or future actions taken by any legislative or judicial bodies.

## **INDEPENDENT AUDITORS**

This Official Statement includes the audited financial statements of CPS Energy for the fiscal years ended January 31, 2010 and 2009. These financial statements included in this Official Statement as APPENDIX B have been audited by Baker Tilly Virchow Krause, LLP, Garza, Preis & Co., L.L.C., and Robert J. Williams, CPA, independent accountants, as stated in their report thereon, which includes a reference to other auditors, which also appears in APPENDIX B hereto.

As part of its external audit procurement process, CPS Energy issued a Request for Proposal for annual financial audits and related services in July 2008. On August 25, 2008, CPS Energy selected Virchow, Krause & Co., LLP, Garza, Preis & Co., LLC and Robert J. Williams, CPA, to serve as its external auditors. The contract extends through the fiscal year ended January 31, 2012, with a one-year extension option. Effective June 1, 2009, Virchow Krause & Company, LLP changed their name to Baker Tilly Virchow Krause, LLP.

## **VERIFICATION OF MATHEMATICAL COMPUTATIONS**

The issuance of the Series 2010B Bonds will be subject to delivery by the Verification Agents of a report of the mathematical accuracy of certain computations. The Verification Agents will verify from the information provided by Estrada Hinojosa & Company, Inc. the mathematical accuracy, as of the Closing Date, of the computations contained in the provided schedules to determine that the anticipated receipts from the Federal Securities and cash deposits, if any, listed in the schedules provided by Estrada Hinojosa & Company, Inc. to be held in escrow, will be sufficient to pay, when due, the principal and interest requirements of the Refunded Obligations contained in the provided schedules used by Co-Bond Counsel in its determination that the Refunded Obligations are legally defeased. The Verification Agents will express no opinion on the assumptions provided to them. Such verification of accuracy of such mathematical computation will be based upon information and assumptions supplied by CPS Energy and Estrada Hinojosa & Company, Inc. and Co-Bond Counsel will rely on such verification, information and assumptions in rendering its opinions described herein.

## USE OF INFORMATION IN OFFICIAL STATEMENT

No person has been authorized to give any information or to make any representations other than those contained in this Official Statement, and if given or made, such other information or representations must not be relied upon as having been authorized by the City or the Board. This Official Statement does not constitute an offer to sell or solicitation of an offer to buy in any state in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such offer of solicitation.

## MISCELLANEOUS

The description of the Bonds contained in this Official Statement does not purport to be complete. All references to the Bonds are qualified by reference to the Ordinance and to the complete form of the Bonds. There is no guarantee that any of the assumptions or estimates contained herein will be realized. All of the summaries of the statutes, documents and resolutions contained in this Official Statement are made subject to all of the provisions of such statutes, documents and resolutions. These summaries do not purport to be complete statements of such provisions and reference is made to such documents for further information. Reference is made to original documents in all respects. So far as any statements made in this document involve budgeted amounts or other estimates or projections, whether or not so expressly stated, they should not be considered statements of fact or representations that the budgeted amount, estimate or projection will approximate actual results.

This Official Statement has been approved by the City Council and the Board.

CITY OF SAN ANTONIO, TEXAS

CITY PUBLIC SERVICE BOARD OF SAN ANTONIO

By /s/ Julián Castro  
Mayor, City of San Antonio, Texas

By /s/ Charles E. Foster  
Chairman, Board of Trustees  
City Public Service Board of San Antonio

## APPENDIX A



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## CITY OF SAN ANTONIO, TEXAS

### GENERAL DEMOGRAPHIC AND ECONOMIC INFORMATION

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## APPENDIX A

### CITY OF SAN ANTONIO, TEXAS GENERAL DEMOGRAPHIC AND ECONOMIC INFORMATION

This Appendix contains a brief discussion of certain economic and demographic characteristics of the City of San Antonio, Texas (the “City” or “San Antonio”) and of the metropolitan area in which the City is located. Although the information in this Appendix has been provided by sources believed to be reliable, no investigation has been made by the City to verify the accuracy or completeness of such information.

#### Population and Location

The Census 2000, prepared by the United States Census Bureau (“U.S. Census Bureau”), found a City population of 1,144,646. The City’s Department of Planning and Community Development estimated the City’s population to be 1,383,072 at December 31, 2009. The U.S. Census Bureau ranks the City as the second largest in the State of Texas and the seventh largest in the United States.

The City is the county seat of Bexar County, which had a population of 1,392,931 according to the Census 2000. The City’s Department of Planning and Development Services estimated Bexar County’s population to be 1,676,847 at December 31, 2009. The City is located in south central Texas approximately 80 miles south of the state capital in Austin, 165 miles northwest of the Gulf of Mexico, and approximately 150 miles from the United States (“U.S.”) / Mexico border cities of Del Rio, Eagle Pass, and Laredo.

The following table provides the population of the City, Bexar County, and the San Antonio Metropolitan Statistical Area (“MSA”)<sup>1</sup> as of April 1 for the years shown:

Year	City of San Antonio	Bexar County	San Antonio MSA
1920	161,379	202,096	238,639
1930	231,543	292,533	333,442
1940	253,854	338,176	376,093
1950	408,442	500,460	542,209
1960	587,718	687,151	736,066
1970	654,153	830,460	888,179
1980	786,023	988,971	1,088,881
1990	935,933	1,185,394	1,324,749
2000	1,144,646	1,392,931	1,711,703 <sup>1</sup>

<sup>1</sup> As of June 2003, the U.S. Office of Management and Budget redefined the MSA by increasing the number of counties from four to eight: Atascosa, Bandera, Kendall, and Medina Counties were added to its mainstays of Bexar, Comal, Guadalupe, and Wilson Counties. (The 2000 figure reflects the new 2003 redefined eight-county area.)

Sources: U.S. Census Bureau; City of San Antonio, Department of Planning and Development Services.

#### Area and Topography

The area of the City has increased through numerous annexations and now contains approximately 467 square miles. The topography of San Antonio is generally hilly with heavy black to thin limestone soils. There are numerous streams fed with underground spring water. The average elevation is 788 feet above mean sea level.

#### Three-Year Annexation Plan Process

Through both full and limited purpose annexations, the City has grown from its original size of 36 square miles to its current area, encompassing 467 square miles, and having a tax year 2009 net taxable value of \$73.2 billion.

By City Charter, City Council has the power to annex territory by passage of an ordinance. As of January 1999, State law mandates that municipalities prepare an annexation plan specifically identifying annexations that may occur beginning on the third anniversary of the date such plan was adopted. The City is required to maintain the annexation plan on the City's web site and notify property owners and public entities.

The City is currently engaged in a sector plan process to help define how the City may grow. This process will help identify areas adjacent to the current City limits and within its extra-territorial jurisdiction ("ETJ"), generally five miles outside the boundary, that are appropriate for annexation. At the present time, the City does not have a three-year annexation plan in place, but plans to start drafting a plan in FY 2010.

## **Governmental Structure**

The City is a "Home Rule Municipality" that operates pursuant to the Charter of the City of San Antonio (the "City Charter"), which was adopted on October 2, 1951 and became effective on January 1, 1952. The City Charter provides for a council-manager form of government, whereby subject only to the limitations imposed by the Texas Constitution and the City Charter, all powers of the City are vested in an elective Council (the "City Council") which enacts legislation, adopts budgets, and determines policies. The City Council is comprised of 11 members, with ten members elected from single-member districts, and the Mayor elected at-large. Each member of the City Council serves two-year terms, and each member is limited to a maximum of four full terms. The office of Mayor is considered a separate office. The terms of all members of the City Council currently sitting in office expire on May 31, 2011. The City Council also appoints a City Manager who executes the laws and administers the government of the City, and serves as the City's chief administrative officer. The City Manager serves at the pleasure of City Council.

## **City Charter**

The City may only hold an election to amend its City Charter every two years. Since its adoption, the City Charter has been amended on seven separate occasions: November 1974, January 1977, May 1991, May 1997, November 2001, May 2004, and November 2008.

The amendments to the City Charter that were adopted in 2001 included, among others, provisions creating the position of an independent City Internal Auditor and granting the City Manager the power to appoint and remove the City Attorney upon the City Council's confirmation.

At the May 2004 City Charter election, voters considered four propositions seeking to amend the City Charter as follows: Proposition 1 was to amend the provisions of the City Charter applicable to the term of office and term limits of members of the City Council; Proposition 2 was to amend the provisions of the City Charter applicable to compensation for members of the City Council and the Mayor; Proposition 3 was to amend the City Charter by establishing an independent Ethics Review Board; and Proposition 4 was to amend the City Charter to permit an individual member of the City Council to hire staff who serve at the will of the Councilmember. Of these four propositions, only Proposition 3 establishing an independent Ethics Review Board was approved by the voters.

At the November 4, 2008 election, an amendment to the City Charter passed, which revised term limits to allow a mayor or member of the City Council to serve four full two-year terms of office, instead of two full two-year terms, but prohibited the current and former mayors and members of the City Council, whether appointed or elected, as of the date of the election, from being elected to more than two full two-year terms.

## **Services**

The full range of services provided to its constituents by the City includes ongoing programs to provide health, welfare, art, cultural, and recreational services; maintenance and construction of streets, highways, drainage, and sanitation systems; public safety through police and fire protection; and urban redevelopment and housing. The City also considers the promotion of convention and tourism and participation in economic development programs high priorities. The funding sources from which these services and capital programs are provided include ad valorem, sales and use, and hotel occupancy tax receipts, grants, user fees, bond proceeds, tax increment financing, and other sources.

In addition to the above described general government services, the City provides services financed by user fees set at levels adequate to provide coverage for operating expenses and the payment of outstanding debt. These services include airport and solid waste management.

Electric and gas services to the San Antonio area are provided by CPS Energy (“CPS”), an electric and gas utility owned by the City that maintains and operates certain utilities infrastructure. This infrastructure includes a 15 generating unit electric system and the gas system that serves the San Antonio area. CPS operations and debt service requirements for capital improvements are paid from revenues received from charges to its customers. CPS is obligated to transfer a portion of its revenues to the City. CPS revenue transfers to the City for the City’s fiscal year ending September 30, 2009 were \$265,459,226. (See “SAN ANTONIO ELECTRIC AND GAS SYSTEMS” herein.)

Water services are provided by the San Antonio Water System (“SAWS”), San Antonio’s municipally-owned water supply, water delivery, and wastewater treatment utility. SAWS is in its 18<sup>th</sup> year of operation as a separate, consolidated entity. SAWS operating and debt service requirements for capital improvements are paid from revenues received from charges to its customers. SAWS is obligated to transfer a portion of its revenues to the City. SAWS revenue transfers to the City for the City’s fiscal year ending September 30, 2009 were \$10,146,195. (See “SAN ANTONIO WATER SYSTEM” herein.)

### **Economic Factors**

The City supports a favorable business environment and economic diversification which is represented by various industries, including domestic and international trade, convention and tourism, medicine and health care, government employment, manufacturing, information security, financial services, telecommunications, telemarketing, insurance, and oil and gas refining. Support for these economic activities is demonstrated by the City’s commitment to its ongoing infrastructure improvements and development, and its dedicated work force. With continuously resilient employment growth, San Antonio fares well when compared to the State and nation. San Antonio’s unemployment rate remained constant at 7.7% for July, when compared to the prior month. The Texas unadjusted (actual) unemployment rate remained constant at 8.5% for July, when compared to the prior month. The nation’s unemployment rate increased to 9.7% in July, up from 9.6% reported in June. Total employment in the San Antonio MSA for July 2010 was 908,900. Education and health services, trade, transportation and utilities, and professional and business services represent the largest employment “super” sectors in the San Antonio MSA. Healthcare, retail trade, leisure and hospitality, and education represent the largest industries in San Antonio.

### ***Finance Industry***

According to a study conducted by the “Finance San Antonio Ad Hoc Committee,” the finance industry is San Antonio’s largest economic generator with an annual economic impact of \$20.5 billion in 2004. The industry employs 50,469 people to whom it pays an average annual wage of \$52,612. Total wages paid in the industry amounted to \$2.66 billion in 2004. As a percent of total employment, the finance industry in San Antonio is the largest of any major metropolitan area in Texas. Compared to the growth in wages and employment in San Antonio overall, the finance industry experienced higher levels of average annual growth in these areas since 2001. Average annual growth in total wages paid by the finance industry for years 2001 through 2004 was 4.5%, compared to 4% for all industries. Average annual growth in employment in the finance industry over this same time period was 2.18%, compared to 0.36% for all other industries.

The largest sector in this industry is insurance. While this sector is led by USAA, San Antonio is home to other insurance headquarters such as Catholic Life and GPM Life, as well as being the home to many regional operations centers for many health care insurers. Insurers with substantial regional operations centers in San Antonio include Caremark, United Health, and PacifiCare.

On October 29, 2009, Nationwide selected San Antonio for its \$92 million consolidation and expansion involving two project phases of their new corporate campus. San Antonio competed with several other communities across the U.S. for a potential consolidation and expansion of Nationwide operations. The City, in partnership with the State and Bexar County, offered a competitive package of business incentives to retain the existing 932 jobs and

compete for 838 new jobs. Nationwide selected San Antonio over Raleigh, North Carolina, Little Rock, Arkansas, and Tulsa, Oklahoma for its consolidation and expansion.

On February 9, 2010, Allstate Insurance Corporation (“Allstate”) announced its decision to locate a customer operations center, invest \$12 million, and create 600 new full-time jobs in San Antonio. The core function of the customer operations center will support direct sales through calls to 1-800-ALLSTATE and sell additional insurance products to existing clients. Allstate is the nation’s largest publicly held personal lines insurer. Allstate employs an estimated 70,000 agents and support staff nationwide. The company was founded in 1931 as part of Sears Roebuck and Co. In 2009, the company ranked number 81 on the list of Fortune 500 Companies with annual revenues exceeding \$29 billion. Allstate’s main lines of insurance include automobiles, property, life, and retirement and investment products. Allstate has two other sales support centers located in Northbrook, Illinois (its headquarters) and Charlotte, North Carolina. In May 2010, Allstate reported it has hired 200 workers and plans to hire an additional 128 for its new customer information center, opening June 2010 in San Antonio. It eventually expects the center will employ 600 employees, who will sell Allstate products and provide service to the company’s customers.

The second largest sector in this industry is banking. Like insurance, San Antonio is also the home of many banking headquarters and regional operation centers such as Frost National Bank, Broadway Bank, and USAA Bank. Companies with large regional operations centers in San Antonio include Wells Fargo, J.P. Morgan, and Citi.

### ***Healthcare and Bioscience Industry***

The healthcare and bioscience industry remains one of the largest industries in the San Antonio economy. The industry is diversified, with related industries such as research, pharmaceuticals, and manufacturing contributing approximately the same economic impact as health services. According to the *San Antonio’s Health Care and Bioscience Industry: Economic Impact Study* commissioned by the Greater San Antonio Chamber of Commerce, the total economic impact from this industry sector totaled approximately \$16.3 billion in 2007. The industry provided 116,417 jobs, or approximately 14.2% of the City’s total employment. The healthcare and bioscience industry’s annual payroll in 2007 approached \$4.8 billion. The 2007 average annual wage of San Antonio workers was \$38,251, compared to \$40,784 for healthcare and bioscience employees. These 2007 economic impact figures represent growth of 6.5% over the previous year, or approximately \$1 billion. The Greater San Antonio Chamber of Commerce updates economic impact figures at the request of industry leaders and expects an update completed in the coming year.

*Health Care.* The 900-acre South Texas Medical Center (the “Medical Center”) has ten major hospitals and nearly 80 clinics, professional buildings, and health agencies with combined budgets of over \$3.34 billion as of January 2009. Approximately 27,884 Medical Center employees provided care for over 4.88 million outpatients and over 103,605 inpatients. Physical plant values, not adjusted for inflation, representing the original investments in physical facilities and equipment (less depreciation) represent approximately \$2.274 billion. The Medical Center has about 300 acres of undeveloped land still available for expansion. Capital projects planned for the years 2009 through 2013 total approximately \$1.238 billion.

Central to the Medical Center is The University of Texas Health Science Center at San Antonio (the “UTHSC”) with its five professional schools awarding more than 63 degrees and certificates, including Doctor of Medicine, Doctor of Dental Surgery, and Doctor of Philosophy in nursing, allied sciences, and other fields. The UTHSC has over two million square feet of education, research, treatment, and administrative facilities with a faculty and staff of approximately 5,000. The UTHSC oversees the federally-funded Regional Academic Health Center in the Rio Grande Valley with facilities in Harlingen, McAllen, Brownsville, and Edinburg. Another UTHSC South Texas campus is located in Laredo.

There are numerous other medical facilities outside the boundaries of the Medical Center, including 25 short-term general hospitals, two children’s psychiatric hospitals, and two state hospitals. There are three U.S. Department of Defense (“DoD”) hospitals, one of which is located in the Medical Center (as hereinafter described).

*Biomedical Research and Development.* Research and development are important areas that strengthen San Antonio's position as an innovator in the biomedical field, with total research economic impact exceeding \$1.005 billion annually.

The Texas Research Park (the "Park") is the site for the University of Texas Institute of Biotechnology/Department of Molecular Medicine, the Cancer Therapy and Research Center ("CTRC"), CTCRC's Institute for Drug Development, The Southwest Oncology Group, and dozens of new biotechnology-related companies, whose work involves various stages of the very complicated drug development process. The Park has over \$140 million invested in its facilities. The Park is owned and operated by the Texas Research and Technology Foundation, whose mission includes building a world-class center for life-science research and medical education and promoting economic development through job creation.

The Southwest Foundation for Biomedical Research (the "Foundation"), which conducts fundamental and applied research in the medical sciences, is one of the largest independent, non-profit, biomedical research institutions in the U.S. and is internationally renowned. The Foundation has a full-time staff of 85 doctoral level employees, a technical staff of 125, and an administrative and supporting staff of approximately 200 persons. Research departments include Departments of Genetics, Physiology and Medicine, Virology and Immunology, and Organic and Biological Chemistry. The Department of Laboratory Animal Medicine maintains the animal care facilities. The Foundation is also home to one of the few biosafety level ("BSL") 4 labs in the country, and its Genomics Computing is the world's largest computer cluster devoted to statistical genetic analysis.

The UTHSC has been a major bioscience research engine since its inception, with strong research groups in cancer, cancer prevention, diabetes, drug development, geriatrics, growth factor and molecular genetics, heart disease, stroke prevention, and many other fields. One of its latest achievements is the establishment of the Children's Cancer Research Center, endowed with \$200 million from the State of Texas's tobacco settlement. The UTHSC, along with the CTCRC, form the San Antonio Cancer Institute, a National Cancer Institute-designated Comprehensive Cancer Center.

The University of Texas at San Antonio ("UTSA") houses the Cajal Neuroscience Research Center, which is funded by \$6.3 million in ongoing grants and is tasked with training students in research skills while they perform basic neuroscience research on subjects such as aging and Alzheimer's disease. UTSA is also a partner in Morris K. Udall Centers of Excellence for Parkinson's Disease research which provides research for the causes and treatments of Parkinson's disease and other neurodegenerative disorders.

A number of highly successful private corporations, such as Mission Pharmacal, DPT Laboratories, Ltd., and Genzyme Oncology, Inc., operate their own research and development groups and act as guideposts for numerous biotech startups, bringing new dollars into the area's economy. A notable example of the results of these firms' research and development is Genzyme Oncology, Inc., which has developed eight of the last 11 cancer drugs approved for general use by the U.S. Food and Drug Administration.

In 2009, Medtronic, Inc. opened its Diabetes Therapy Management and Education Center in San Antonio. Medtronic, located at the Overlook at the Rim, is investing \$23 million and plans to hire 1,300 employees within its first five years. The new operation is expected to generate more than \$750 million in economic benefit for San Antonio and Texas each year.

*Military Health Care.* San Antonio currently has two major military hospitals, each of which has positively impacted the City for decades. Brooke Army Medical Center ("BAMC") conducts treatment and research in a 1.5 million square foot facility at Fort Sam Houston Army Base, providing health care to nearly 640,000 military personnel and their families annually. BAMC is a Level I trauma center (the only one in the Army medical care system) and contains the world-renowned Institute of Surgical Research Burn Center. BAMC also conducts bone marrow transplants in addition to more than 600 ongoing research studies.

Wilford Hall Medical Center ("Wilford Hall") is the largest medical facility of the U.S. Air Force. In addition to providing health care to military personnel and their families, Wilford Hall is also a Level I trauma center (the only one in the U.S. Air Force medical care system) that handles emergency medical care for approximately one-fourth of the City's emergency patients. Wilford Hall provides medical education for the

majority of its physician and dental specialists and other health professionals, conducts clinical investigations, and offers bone marrow and organ transplantation.

The San Antonio Military Medical Center (“SAMMC”) will be established as a result of the 2005 Base Realignment and Closure (“BRAC 2005”) and will combine the Level 1 Trauma elements of Wilford Hall and BAMC. Wilford Hall will be renamed SAMMC-South and BAMC was renamed SAMMC-North. SAMMC-North will double its Level I trauma facility and will incorporate the Level I trauma missions from SAMMC-South. SAMMC-South will become an outpatient facility and will receive outpatient missions from SAMMC-North. Wilford Hall Medical Center (SAMMC-South) will ultimately be replaced by a state of the art outpatient facility. Scheduled for completion in 2013, this \$450M center will provide world-class medical care for the community.

BRAC 2005 actions will have a major positive impact on military medicine in San Antonio resulting in \$3.1 billion in construction and the net gain of over 12,500 personnel in San Antonio by 2011. Currently, all U.S. Army combat medic training is conducted at Fort Sam Houston Army Base. As a result of BRAC 2005, all military combat medic training will be undertaken at the new Medical Education and Training Campus at Fort Sam Houston Army Base.

San Antonio will receive new medical research missions. BRAC 2005 will transform the U.S. Army Institute for Surgical Research into a tri-service Joint Center of Excellence for Battlefield Health and Trauma Research. This new research facility will be adjacent to SAMMC-North. The new mission will continue its cutting edge research in the areas of robotics, prosthetics, and regenerative medicine.

Audie L. Murphy Memorial Veterans Hospital, located in the Medical Center, is an acute care facility and supports a nursing home, the Spinal Cord Injury Center, an ambulatory care program, the Audie L. Murphy Research Services (which is dedicated to medical investigations), and the Frank Tejada Veterans Administration Outpatient Clinic (which serves veterans located throughout South Texas). The two military medical care facilities and the Veterans Hospital partner in a variety of ways, including clinical research and the provision of medical care to military veterans. This partnership is unique and represents a valuable resource to San Antonio and the nation.

### ***Hospitality Industry***

The City’s diversified economy includes a significant sector relating to the hospitality industry. A study prepared by Richard V. Butler, Ph.D. and Mary E. Stefl, Ph.D., both professors at Trinity University, found that in 2008 the hospitality industry had an economic impact of nearly \$11.0 billion. The estimated annual payroll for the industry in 2008 was \$1.99 billion, and the industry employed an estimated 106,311 people.

In 2009, the City’s overall level of hotel occupancy decreased by 11.5%. However, this is considering room supply increased by 6.0%. Total room nights sold in the destination decreased by 6.2%. The average daily room rate decreased 10.6%, revenue per available room decreased 20.9%, and overall revenue decreased 16.2%.

*Tourism.* The list of attractions in the San Antonio area includes, among many others, the Alamo (and other sites of historic significance), the River Walk, and two major theme parks (SeaWorld San Antonio and Six Flags Fiesta Texas). D.K. Shifflet & Associates, Ltd. reported San Antonio attracted 25 million visitors in 2008. Of these, 11 million were overnight leisure visitors, placing San Antonio as one of the top U.S. destinations in Texas. Recent initiatives contributing to this success are the City’s new brand image, the JW Marriot San Antonio Hill Country Resort and Spa (opened in January 2010), the River Walk Expansion Project (Museum Reach expansion completed in May 2009; Mission Ranch to be completed in 2013), and new events like the Rock ‘n’ Roll Marathon, held in November 2009.

*Conventions.* San Antonio is one of the top convention cities in the country, and the opening of the 1,003-room Grand Hyatt Hotel along with the 1,002-room JW Marriot allows the City to host more and larger conventions and meetings in the years to come. The City continues to be proactive in attracting convention business through its management practices and marketing efforts.

The following table shows both overall City performance as well as convention activity booked by the San Antonio Convention and Visitors Bureau for the calendar years indicated:

Calendar Year	Hotel Occupancy <sup>1</sup>	Revenue per Available		Convention Attendance <sup>2</sup>	Convention Room Nights <sup>2</sup>	Convention Delegate Expenditures (Millions) <sup>2,3</sup>
		Room (RevPAR) <sup>1</sup>	Room Nights Sold <sup>1</sup>			
2000	64.7%	\$55.34	6,549,812	389,448	696,215	\$350.8
2001	62.7	54.10	6,486,944	419,970	712,189	378.3
2002	64.0	56.26	6,741,011	483,452	693,921	435.5
2003	63.8	53.98	6,903,131	429,539	613,747	387.0
2004	64.4	55.80	7,022,152	491,287	621,640	510.5
2005	68.9	63.02	7,569,655	503,601	699,932	523.3
2006	69.1	69.14	7,699,411	467,426	736,659	485.8
2007	66.3	69.67	7,635,949	455,256	647,386	473.1
2008	64.9	70.93	7,756,481	563,164	691,525	607.5
2009	57.4	56.08	7,249,737	399,408	660,736	474.5

<sup>1</sup> Data obtained from Smith Travel Research based on hotels in the San Antonio selected zip code reports dated March 2007, February 2009, and January 2010.

<sup>2</sup> Reflects only those conventions hosted by the San Antonio Convention and Visitors Bureau.

<sup>3</sup> Beginning in 1998, the estimated dollar value is calculated in accordance with the 1998 DMAI Foundation Convention Income Survey Report conducted by Deloitte & Touche LLP, which reflected the average expenditure of \$900.89 per convention and trade show delegate. January 2004 – September 2008 are based on an average expenditure of \$1,039.20 per convention and trade show delegate, and October 2008 – December 2009 are based on an average expenditure of \$1,188.05 per convention and trade show delegate.

Source: San Antonio Convention and Visitors Bureau.

### **Military Industry**

The military represents a significant component of the City's economy providing an annual economic impact of over \$13 billion for the City. Three major military installations are currently located in Bexar County, including Lackland Air Force Base ("Lackland AFB"), Fort Sam Houston Army Post ("Fort Sam Houston"), and Randolph Air Force Base ("Randolph AFB"). In addition, the property of Brooks Air Force Base ("Brooks AFB"), a fourth major military installation, was transferred from the U.S. Air Force to the City-created Brooks Development Authority ("BDA") in 2002, as part of the Brooks City-Base Project ("Brooks City-Base"). Furthermore, the military is still leasing over two million square feet of space at Port San Antonio, which is the former Kelly Air Force Base that was closed in 2001.

One of the most significant events in San Antonio's recent economic history is the BRAC 2005. BRAC 2005's realignment of medical facilities resulted in a major positive impact on military medicine in San Antonio, with \$3.1 billion in construction and the addition of 12,500 jobs at Fort Sam Houston by September 2011. This is up from the \$1.6 billion in construction and 11,500 personnel projected in 2007. Currently, all U.S. Army combat medic training is conducted at Fort Sam Houston.

The BRAC 2005 will establish an internationally renowned teaching and research hospital by creating the largest school for training medical technicians in the world. Each year, San Antonio will graduate over 152,000 students across all three bases. BRAC 2005 will also bring management and command centers for the Fifth Army, Sixth Army, Military Property Management, and Military Health Care. As a result, it will provide jobs in six targeted industries: health care, health care education, communications, technology, intelligence, and security. BRAC 2005 will strengthen San Antonio's role as a leading military research, training, and education center. It will establish a Joint Base San Antonio, which will consolidate installation management at the three military bases in San Antonio, thereby creating the largest installation in the DoD, while supporting 78,000 personnel and \$10.3 billion in property.

*Port San Antonio.* On July 13, 2001, Kelly Air Force Base (“Kelly AFB”) officially closed and the land and facilities were transferred to the Greater Kelly Development Authority (“GKDA”), a City-created Local Redevelopment Authority responsible for overseeing the redevelopment of the base into a business and industrial park. The business park is now known as Port San Antonio (the “Port”). The Port has developed a rail port for direct international rail operations, including inland port distribution with the Port of Corpus Christi, and continues to work on establishing international air cargo operations and the expansion and addition of new tenants.

With a stable tenant base of over 70 companies and seven remaining Air Force agencies, the Port has over 8,500 workers generating a payroll of over \$520 million a year. Two new announcements at the Port include the Boeing Company’s decision to bring a portion of their 787 Dreamliner workload to the Port for follow-on refurbishment and testing following manufacturing. This new investment will potentially create another 400 aerospace jobs in FY 2010.

BRAC 2005 will bring an additional 2,900 military and DoD civilian personnel to the Port. Additionally, the Air Force is investing \$60 million in the remodeling of the 450,000 square foot building it is preparing to occupy. By September 2011, there will be over 6,000 DoD personnel at the Port. Another announcement in 2009 was the expansion of Affiliated Computer Services, a Fortune 500 Company, which is adding an additional 300 employees.

Other major commercial employers at the Port include Boeing, Lockheed Martin, General Dynamics, Standard Aero, Pratt & Whitney, Chromalloy, Gore Design Completions, and EG&G. By the end of 2010, the tenant employee base will have grown to over 12,000 as a result of these expansions.

In February 2009, the Port opened an on-site U.S. Customs and Homeland Security facility to enable international air cargo to develop at Kelly Field Industrial Airport. Mexpress International, Inc. now provides air cargo service between Mexico and San Antonio on a three times per week basis.

In September 2009, Boeing Global Services and Support, San Antonio, Texas was awarded a \$150 million contract for programmed depot maintenance, unprogrammed depot level maintenance, and modifications installations on C/KC-135 series aircraft, resulting in the retention of approximately 300-400 aerospace jobs at the Port.

With over 11 million square feet of industrial/commercial space, the Port is the largest commercial property leasing firm in San Antonio. In April 2007, the East Kelly Railport opened with a 360,000 square foot speculative building offered by a private developer that today is 100% occupied. Already proving to be a busy passageway, the East Kelly Railport saw a 30% increase in rail activity from 2007 to 2008, with revenues exceeding \$149,600 during the same period. The developer, Santa Barbara Development, has recently completed construction on a second 265,000 square foot speculative building.

*Brooks City-Base.* Brooks City-Base continues to draw private business investment. However, the military missions will be relocated over the next three to five years as a result of the BRAC 2005 recommendations. Of the approximately 21 missions currently located at Brooks City-Base, four will be relocated to Fort Sam Houston, seven to Lackland AFB, and two to Randolph AFB. This will account for approximately 950 personnel. While many of the military missions are being relocated from Brooks City-Base, private development is increasing. In addition, Brooks City-Base is continuing its goal of sustainability by creating a Tax Increment Reinvestment Zone (“TIRZ”). The TIRZ has been established and the City is planning to utilize the tax increments generated to assist in funding street infrastructure projects.

There are several projects currently underway or recently completed at Brooks City-Base. Some of these project highlights are included below.

Dermatological Products of Texas Laboratories’ new site at Brooks City-Base is a combination research and development warehouse and production facility of nearly 250,000 square feet. The project involves two new buildings with a capital investment of \$26 million.

In July 2008, Vanguard Health Systems, Inc. and its affiliate Baptist Health System purchased 28 acres at Brooks City-Base and have an option for an additional 20 acres under contract. Crews began site work on January 18, 2010 for the new Mission Trail Baptist Hospital at Brooks City-Base. This new hospital will replace the current Southeast Baptist Hospital. The new hospital will be completed in June 2011 and will have 81 beds but could be expanded up to 300 beds. Initially, the new hospital will employ 300 staff but will expand to 800 staff. This represents a significant economic investment in the community. Ultimately, the hospital will be part of a medical campus with one medical office building being constructed concurrently with the hospital and six additional buildings constructed under a phased timeline.

A \$24.5 million Emergency Operations Center (the “EOC”) began operations at Brooks City-Base in December 2007. The EOC was financed through City and Bexar County bond funds and will be a campus of City, County, Regional, State, and Federal departments and/or personnel.

The San Antonio Metropolitan Health District (“SAMHD”) has completed renovation of a Brooks City-Base facility to establish a BSL 3 Laboratory. SAMHD has instituted additional public health capabilities at Brooks City-Base and is investigating plans for additional expansions to the BSL 3 Laboratory.

The Brooks Academy of Science and Engineering moved into Brooks City-Base in March 2007. The school’s curriculum focuses on science and engineering by providing students with a unique opportunity to learn and participate in the cutting-edge Air Force programs found at Brooks City-Base and throughout San Antonio.

Brooks City-Base has leased 25 acres to the City for expansions of the existing sports fields and construction has recently begun on this project.

*Fort Sam Houston and Lackland AFB.* Fort Sam Houston is engaged in military-community partnership initiatives to help reduce infrastructure costs and pursue asset management opportunities using military facilities. In April 2000, the U.S. Army (the “Army”) entered into a partnership with the private organization, Fort Sam Houston Redevelopment Partners, Ltd. (“FSHRP”), for the redevelopment of the former Brooke Army Medical Center and two other buildings at Fort Sam Houston. These three buildings, totaling about 500,000 square feet in space and located in a designated historic district, had been vacant for several years and were in a deteriorating condition. On June 21, 2001, FSHRP signed a 50-year lease with the Army to redevelop and lease these three properties to commercial tenants.

In September 2003, the Army relocated Army South Headquarters from Puerto Rico to Fort Sam Houston, bringing approximately 500 new jobs to San Antonio with an annual economic impact of approximately \$200 million. The Army negotiated a lease with the FSHRP to locate U.S. Army South and the Southwest Region Installation Management Agency in the newly renovated historic facilities in the summer of 2004. The continued success of this unique public-private partnership at Fort Sam Houston is critical to assisting the Army in reducing infrastructure support costs, preserving historical assets, promoting economic development opportunities, and generating net cash flow for both the Army and FSHRP.

The potential economic impact from Fort Sam Houston due to the BRAC 2005 expansion is tremendous and projected at nearly \$8.3 billion. The economic impact due to the enormous amount of construction taking place on post, to accommodate the new missions, accounts for approximately 80% of the impact (\$6.7 billion). While the construction impact will be relatively short-lived, once BRAC 2005 is completed the economic impact from Fort Sam Houston will increase by nearly \$1.6 billion annually with additional annual sales tax revenue of \$4.9 million. After BRAC 2005 is completed, the increase in personnel and missions at Fort Sam Houston could support the employment of over 15,000 in the community.

Lackland Air Force Base is home to the 37<sup>th</sup> Training Group and is situated on 9,700 acres, all within the city limits of San Antonio. According to the 2008 Lackland AFB “Facts and Stats” report, over 54,000 military, civilian, student, contractors and military dependents work, receive training or utilize Lackland AFB’s services. On an annual basis, Lackland AFB will graduate 86,000 trainees per year.

In addition, the Air Force still maintains a significant presence at Port San Antonio (the former Kelly Air Force Base) which is adjacent and contiguous with Lackland. The Air Force and the Port jointly utilize the Kelly

Field runway for military and commercial airfield operations. The Air Force continues to lease over 54 facilities comprising two, 800,000 sq/ft of space and over 270 acres of property. The largest Air Force leaseback is at Building 171, a facility previously closed from the 1995 Base Realignment and Closure of Kelly AFB. Over 6,200 Air Force and other DoD employees will work at this and other facilities on the Port once BRAC 2005 is complete.

Much of the new BRAC 2005 growth occurring on PSA property will be at Building 171. The Air Force is spending \$26.5 million to renovate the building, which will house 11 missions. Seven missions and approximately 800 personnel are relocating to the building from Brooks City Base. These include the Air Force Center for Environment Excellence, four medical missions including Air Force Medical Operations Agency and other support missions. Building 171 will also house the new “Cyber” 24<sup>th</sup> Air Force consisting of approximately 450 personnel and the Air Force Real Property Agency.

The BRAC 2005 growth supports the City’s economic development strategy to promote development in targeted areas of the City, to leverage military installation economic assets to create jobs, and to assist our military installations in reducing base support operating costs. In addition, the Army intends to extend the public-private partnership initiative to include other properties at Fort Sam Houston currently available for redevelopment.

San Antonio recently received funding for two large projects that serve all of the military branches. On September 11, 2007, it was announced that the Veterans Administration will build a new \$67 million Level I Polytrauma Center at the Audie L. Murphy Veterans Administration hospital campus. The expansion began in early 2009 and is estimated to be completed in April 2011. These hospitals are designed to be the most advanced in the world and are capable of providing state-of-the art medical care to veterans with multiple serious injuries. San Antonio is also home to the National Trauma Institute (“NTI”), a collaborative military-civilian trauma institute involving SAMMC-North, SAMMC-South, University Hospital, the UTHSC, and the U.S. Army Institute of Surgical Research. The NTI coordinates resources from the institutions to most effectively treat the trauma victims and their families. The NTI received \$3.8 million in grants in FY 2008.

Congressional legislation for FY 2009 has been passed by the U.S. House of Representatives and by the U.S. Senate and provides \$610 million for Fort Sam Houston.

The San Antonio community has put in place organizations and mechanisms to assist the community and the military with the BRAC 2005 and other military-related issues. The Military Transformation Task Force (“MTTF”) is a City, Bexar County, and Greater San Antonio Chamber of Commerce organization that provides a single integrated voice from the community to the military. The MTTF has five committees: Transportation and Infrastructure, Healthcare Delivery and Medical Partnerships, Economic Development, Neighborhood Revitalization and Local Community Impacts, and Public and Legislative Affairs, each dedicated to working with the community and military on the BRAC 2005 actions. In addition, the MTTF, through the Community Advisory Council, has a seat on the Executive Integration and Oversight Board (“EIOB”) which is the military entity charged with the BRAC 2005 implementation in San Antonio. At EIOB meetings, the community can provide input to the military on the BRAC 2005.

In January 2007, the City established the Office of Military Affairs (“OMA”). The mission of OMA is to prepare the community for the challenges and opportunities associated with BRAC 2005-related growth, work with the military to sustain and enhance mission readiness, and develop and institutionalize relationships between the community and the military on issues of common concern. The OMA is the staff support to the MTTF and worked closely with each MTTF committee to develop a Growth Management Plan for the community in order to adequately prepare for the BRAC 2005 growth in San Antonio. OMA is also working with the local military bases to address incompatible land-use issues in order to enhance mission readiness as well as other issues of common concern to the community and military. Finally, the City and the military have established the Community-Military Advisory Council. This Council will provide a mechanism for local government, business, and military leaders to address issues of common concern.

In June 2009, the City established the “Fort Sam Houston Community Development Office.” The mission of this office is to work with the community and the military to revitalize the neighborhoods around Fort Sam Houston. The office will undertake initiatives in economic development, housing, public safety, and transportation.

## ***Other Major Industries***

*Aerospace.* According to the Economic Impact Study commissioned by the Greater San Antonio Chamber of Commerce the aerospace industry's annual economic impact to the City is about \$3.8 billion. This industry provides approximately 9,438 jobs, with employees earning total annual wages of over \$479 million. The aerospace industry continues to expand as the City leverages its key aerospace assets, which include San Antonio International Airport, Stinson Municipal Airport, Port San Antonio, Randolph AFB, Lackland AFB, and training institutions. Many of the major aerospace industry participants such as Boeing, Lockheed Martin, General Electric, Pratt & Whitney, Raytheon, Cessna, San Antonio Aerospace – a division of Singapore Technologies, Southwest Airlines, American Airlines, Delta Airlines, Continental Airlines, FedEx, UPS, and others, have significant operations in San Antonio. The industry in San Antonio is diversified with continued growth in air passenger service, air cargo, maintenance, repair, overhaul, and general aviation. The Greater San Antonio Chamber of Commerce updates economic impact figures at the request of industry leaders and expects an update completed in the coming year.

San Antonio Aerospace LP (“SAA”) is a subsidiary of ST Aerospace, a global company headquartered in Singapore with over 7,000 employees worldwide, providing aircraft maintenance support services for commercial and military aircraft. SAA began operations in April 2002, after acquiring Dee Howard aircraft maintenance facilities through the bankruptcy court. SAA decided to expand its MRO operations by investing \$16 million to construct an 80,000 sq. ft. maintenance hangar, an adjacent 61,500 sq. ft. warehouse, and a 21,000 sq. ft. office building at the Airport. SAA will retain 570 existing jobs and is expected to hire 100 new employees. SAA currently leases 2,106,107 square feet of ground space/hanger space at the San Antonio International Airport, and specializes in commercial MRO work on large aircraft, including Northwest Airlines, Delta, and United Parcel Service.

*Applied Research and Development.* The Southwest Research Institute is one of the original and largest independent, nonprofit, applied engineering and physical sciences research and development organizations in the U.S., serving industries and governments around the world in the engineering and physical sciences field. Southwest Research Institute has contracts with the Federal Aviation Administration, General Electric, Pratt & Whitney, and other organizations to conduct research on many aspects of aviation, including testing synthetic jet fuel, developing software to assist with jet engine design, and testing turbine safety and materials stability. Southwest Research Institute occupies 1,200 acres and provides nearly two million square feet of laboratories, test facilities, workshops, and offices for more than 3,100 scientists, engineers, and support personnel.

*Telecommunications Industry.* AT&T, with 310,070 employees worldwide as of August 2008, had approximately 5,300 employees in San Antonio and is home to the company's Telecom Operations Group. In August 2009, AT&T announced that by the end of 2010 it will open a U-verse service technical support center in San Antonio. The support center will create 200 jobs in San Antonio. AT&T's U-verse, a broadband, voice and digital cable services, debuted in San Antonio in 2006. Currently, AT&T serves over 16.3 wireless and wired broadband connections, including AT&T U-verse service. The City is partnering with Alamo Colleges to establish a customized training program to develop a pipeline of skilled workers to fill the new AT&T jobs.

*Information Technology.* A study conducted in 2008 indicates that the Information Technology (“IT”) industry in San Antonio registered an overall economic impact of approximately \$8 billion and employs about 15,648 people with a total annual payroll of approximately \$882 million. The Greater San Antonio Chamber of Commerce updates economic impact figures at the request of industry leaders and expects an update completed in the coming year. Further, these numbers only include the impact of IT-specific companies. There are also a substantial number of people employed in IT jobs in non-IT companies. For example, the study also found that there are approximately 4,800 IT workers employed in the 20 largest non-IT companies in San Antonio. The IT industry is particularly strong in the areas of information security and government contracting. The “Center for Infrastructure Assurance and Security” at UTSA is one of the leading research and education institutions in the area of information security in the country. In 2005, the U.S. National Security Agency re-designated UTSA as a “National Center of Excellence in Information Assurance” for three academic years. Our Lady of the Lake University also received this designation over the past year. San Antonio is also home to the Air Intelligence Agency, which is the premier IT agency for the U.S. Air Force and the DoD. Lackland Air Force Base was selected as the best location for the 24<sup>th</sup> Air Force-Cyber Command for its work as a center of information technology, information assurance and information security. San Antonio is rapidly increasing its sector of more than 80

IT/cyber-related businesses. Recently the NSA, constructed a data center, investing \$50 Million, creating 30 new jobs along with 1,500 construction jobs.

*Manufacturing Industry.* The manufacturing industry in San Antonio employed 52,786 people in 2006, according to an economic impact study. Workers earned an average annual wage of \$41,496, and the industry registered an economic impact of \$14.4 billion. The Greater San Antonio Chamber of Commerce updates economic impact figures at the request of industry leaders and expects an update completed in the coming year.

Toyota Motor Corp., one of the largest manufacturing employers in San Antonio with an estimated workforce of 1,850, announced that it will be expanding local production to include the Tacoma truck. Toyota is shifting its Tacoma manufacturing from Fremont, California to San Antonio and is expected to create an additional 1,100 new jobs. Toyota and its 18 on-site suppliers are located at the San Antonio's south side. Toyota also expects the suppliers to add about 1,000 jobs through 2013, bringing the total number of jobs supporting Toyota's operations to approximately 5,300, with an annual impact of \$1.7 Billion.

As a result of recalls earlier this year, the Toyota plant in San Antonio suspended production of the Tundra for one week in March and one week in April to help bring inventory in line with demand. However, Toyota is not laying off any employees and is continuing to ramp up employment to begin the Tacoma production.

*Creative Industry.* The Creative Industry in San Antonio had a \$3.38 billion economic impact, employed 26,744 people, and paid annual wages of over \$1 billion in 2006. Recognizing the overall impact of this industry, *The Cultural Collaborative: A Plan for San Antonio's Creative Economy*, was created and a strategic plan was developed to provide focus and initiative for the future of this industry. Seventy-eight percent of these strategies have either been fully implemented or are in the process of being implemented. The Strategic Alliance for Business and Economic Research Institute updates the Creative Industry impact and is planning an update in the coming year.

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*Sources: The Greater San Antonio Chamber of Commerce; San Antonio Medical Foundation; City of San Antonio, Department of International and Economic Development Department; Convention and Visitors Bureau; and the Strategic Alliance for Business and Economic Research Institute.*

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## Growth Indices

### *San Antonio Electric and Gas Customers*

For the Month of December	Electric Customers	Gas Customers
2000	575,461	305,181
2001	589,426	305,702
2002	594,945	306,503
2003	602,185	306,591
2004	617,261	308,681
2005	638,344	310,699
2006	662,029	314,409
2007	681,312	319,122
2008	693,815	320,407
2009	706,235	321,984

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Source: CPS.

### *San Antonio Water System Average Customers per Fiscal Year*

Fiscal Year Ended May 31 <sup>1,2</sup>	Water Customers <sup>3</sup>
2000	285,887
2001	293,299
2002	298,215
2003	303,917
2004	311,556
2005	320,661
2006	331,476
2007	341,220
2008	346,864
2009	350,860

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<sup>1</sup> On April 3, 2001, the SAWS Board of Trustees approved the changing of SAWS' fiscal year from a year-end of May 31 to December 31.

<sup>2</sup> Beginning in year 2001, for the 12 months ending December 31.

<sup>3</sup> Excluding SAWS irrigation customers.

Source: SAWS.

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## Construction Activity

Set forth below is a table showing building permits issued for construction within the City at December 31 for the years indicated:

Calendar Year	Residential Single Family		Residential Multi-Family <sup>1</sup>		Other <sup>2</sup>	
	Permits	Valuation	Permits	Valuation	Permits	Valuation
1999	5,771	\$398,432,375	404	\$157,702,704	9,870	\$ 911,543,958
2000	5,494	383,084,509	201	81,682,787	10,781	957,808,435
2001	6,132	426,766,091	449	142,506,920	12,732	1,217,217,803
2002	6,347	435,090,131	246	101,680,895	14,326	833,144,271
2003	6,771	521,090,684	141	2,738,551	13,813	1,041,363,980
2004	7,434	825,787,434	206	7,044,283	14,695	1,389,950,935
2005	8,207	943,804,795	347	5,221,672	20,126	1,772,959,286
2006	7,301	890,864,655	560	13,028,440	19,447	1,985,686,296
2007	4,053	617,592,057	29	4,715,380	13,268	2,343,382,743
2008	2,588	396,825,916	13	2,033,067	9,637	2,634,745,310
2009	2,084	311,309,870	50	5,692,447	6,933	1,684,823,866

<sup>1</sup> Includes two-family duplex projects.

<sup>2</sup> Includes commercial building permits, commercial additions, improvements, extensions, and certain residential improvements.

Source: City of San Antonio, Department of Development Services.

## Total Municipal Sales Tax Collections – Ten Largest Texas Cities

Set forth below in alphabetical order is total municipal sales tax collections for the calendar years indicated:

	2009	2008	2007	2006	2005
Amarillo	\$56,514,269	N/A	N/A	N/A	N/A
Arlington	80,170,009	\$81,851,457	\$80,701,278	\$77,179,657	\$61,983,154
Austin	131,403,989	147,051,782	147,310,525	133,503,393	118,853,520
Corpus Christi	57,311,248	62,076,566	58,502,801	55,663,395	51,046,479
Dallas	205,447,327	227,067,964	223,708,825	217,223,165	199,585,955
El Paso	64,480,623	67,821,673	64,508,591	60,737,389	54,217,823
Fort Worth	97,877,323	106,259,648	98,863,541	92,739,620	83,754,760
Houston	489,009,133	504,416,610	471,684,021	440,687,609	380,871,932
Plano	N/A	64,180,104	63,267,699	62,015,005	53,036,662
Round Rock	58,694,318	69,435,651	66,891,894	60,128,584	50,114,815
SAN ANTONIO	202,966,327	215,808,945	209,599,573	195,966,662	161,951,337

Source: State of Texas, Comptroller's Office.

## Education

There are 15 independent school districts within Bexar County with a combined enrollment of 309,930 encompassing 55 high schools, 73 middle/junior high schools, 255 early education/elementary schools, 15 all grade level schools, 10 magnet schools, and 34 alternative schools as of October 2009. There are an additional 28 charter school districts with 68 open enrollment charter schools at all grade levels. In addition, Bexar County has 96 accredited private and parochial schools at all education levels. Generally, students attend school in the districts in which they reside. There is currently no busing between school districts in effect. The six largest accredited and degree-granting universities, which include a medical school, a dental school, a law school, and five public community colleges, had combined enrollments of 109,134 for Fall 2009.

Source: Texas Education Agency.

## Employment Statistics

The following table shows current nonagricultural employment estimates by industry in the San Antonio MSA for the period of July 2010, as compared to the prior periods of June 2010, and July 2009.

### *Employment by Industry*

<u>San Antonio MSA<sup>1</sup></u>	<u>July 2010</u>	<u>June 2010</u>	<u>July 2009</u>
Mining and Logging	3,600	3,500	3,400
Construction	46,300	46,600	48,000
Manufacturing	41,800	41,700	42,200
Trade, Transportation, and Utilities	142,500	142,100	143,300
Information	18,200	18,400	19,400
Financial Activities	65,800	65,500	65,100
Professional and Business Services	98,000	98,900	98,000
Education and Health Services	122,100	123,200	122,400
Leisure and Hospitality	104,600	104,300	105,200
Other Services	30,700	30,700	31,400
Government	<u>155,700</u>	<u>162,200</u>	<u>151,700</u>
Total Nonagricultural Employment	829,300	837,100	830,100

<sup>1</sup> Based on Labor Market Information Department, Texas Workforce Commission (model-based methodology).

The following table shows civilian labor force estimates, the number of persons employed, the number of persons unemployed, and the unemployment rate in the San Antonio MSA, Texas, and the United States for the period of July 2010, as compared to the prior periods of June 2010, and July 2009.

### *Unemployment Information (all estimates are in thousands)*

<u>San Antonio MSA<sup>1</sup></u>	<u>July 2010</u>	<u>June 2010</u>	<u>July 2009</u>
Civilian Labor Force	985.2	983.4	978.7
Number of Employed	908.9	907.8	907.7
Number of Unemployed	76.3	75.6	71.0
Unemployment Rate %	7.7	7.7	7.3
<u>Texas (Actual)<sup>1</sup></u>	<u>July 2010</u>	<u>June 2010</u>	<u>July 2009</u>
Civilian Labor Force	12,206.4	12,176.7	12,063.1
Number of Employed	11,168.3	11,136.6	11,063.9
Number of Unemployed	1,038.1	1,040.1	999.2
Unemployment Rate %	8.5	8.5	8.3
<u>United States (Actual)<sup>1</sup></u>	<u>July 2010</u>	<u>June 2010</u>	<u>July 2009</u>
Civilian Labor Force	155,270.0	154,767.0	156,255.0
Number of Employed	140,134.0	139,882.0	141,055.0
Number of Unemployed	15,137.0	14,885.0	15,201.0
Unemployment Rate %	9.7	9.6	9.7

<sup>1</sup> Based on Labor Market Information Department, Texas Workforce Commission (model-based methodology).

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## **San Antonio Electric and Gas Systems**

San Antonio Electric and Gas Systems are covered in the body of this Official Statement.

## **San Antonio Water System**

### ***History and Management***

In 1992, the City Council consolidated all of the City's water-related functions, agencies, and activities into one agency. This action was taken due to the myriad of issues confronting the City related to the development and protection of its water resources. The consolidation provided the City with a single, unified voice of representation when promoting or defending the City's goals and objectives for water resource protection, planning, and development with local, regional, state, and federal water authorities and officials.

Final City Council approval for the consolidation was given on April 30, 1992 with the approval of Ordinance No. 75686 (the "System Ordinance"), which created the City's water system ("SAWS") into a single, unified system consisting of the former City departments comprising the waterworks, wastewater, and water reuse systems, together with all future improvements and additions thereto, and all replacements thereof. In addition, the System Ordinance authorizes the City to incorporate into SAWS a stormwater system and any other water-related system to the extent permitted by law.

The City believes that establishing SAWS has helped to reduce the costs of operating, maintaining, and expanding the water systems and has allowed the City greater flexibility in meeting future financing requirements. More importantly, it has allowed the City to develop, implement, and plan for its water needs through one agency.

The complete management and control of SAWS is vested in a board of trustees (the "SAWS Board") currently consisting of seven members, including the City's Mayor and six persons who are residents of the City or reside within the SAWS service area. With the exception of the Mayor, all SAWS Board members are appointed by the City Council for four-year staggered terms and are eligible for reappointment for one additional four-year term. Four SAWS Board members must be appointed from four different quadrants in the City, and two SAWS Board members are appointed from the City's north and south sides, respectively. SAWS Board membership specifications are subject to future change by City Council.

With the exception of fixing rates and charges for services rendered by SAWS, condemnation proceedings, and the issuance of debt, the SAWS Board has absolute and complete authority to control, manage, and operate SAWS, including the expenditure and application of gross revenues, the authority to make rules and regulations governing furnishing services to customers, and their subsequent payment for SAWS' services, along with the discontinuance of such services upon the customer's failure to pay for the same. The SAWS Board, to the extent authorized by law and subject to certain various exceptions, also has authority to make extensions, improvements, and additions to SAWS and to acquire, by purchase or otherwise, properties of every kind in connection therewith.

### ***Service Area***

SAWS provides water and wastewater service to the majority of the population within the corporate limits of the City and Bexar County, which totals approximately 1.6 million residents. SAWS employs approximately 1,700 personnel and maintains over 10,000 miles of water and sewer mains. The tables that follow show historical water consumption and water consumption by class for the fiscal years indicated.

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**Historical Water Consumption (Million Gallons) <sup>(1)</sup>**

Fiscal Year	Gallons of Water Production <sup>(b)</sup>	Gallons of Water Usage	Gallons of Water Unbilled	Average Percent Unbilled	Gallons of Wastewater Treated	Total Direct Rate			
						Water		Sewer	
						Base Rate <sup>(c)</sup>	Usage Rate <sup>(d)</sup>	Base Rate <sup>(e)</sup>	Usage Rate <sup>(f)</sup>
2009	60,646	55,391	5,255	8.67%	51,987	\$6.77	\$20.04	\$7.76	\$9.63
2008	67,523	58,828	8,695	12.88%	50,347	6.56	19.92	7.37	9.14
2007	55,043	49,511	5,532	10.05%	49,218	6.56	19.59	7.37	9.14
2006	63,388	57,724	5,664	8.94%	53,268	6.56	19.69	7.37	9.14
2005	58,990	55,005	3,985	6.76%	49,287	6.11	18.42	7.33	9.10
2004	51,231	49,366	1,865	3.64%	49,593	5.61	15.47	6.60	8.19
2003	55,039	50,576	4,463	8.11%	49,669	5.61	13.20	5.70	7.14
2002	52,691	51,850	841	1.60%	52,180	5.61	11.97	5.70	7.14
2001 <sup>(a)</sup>	36,883	34,716	2,167	5.88%	29,561	5.61	9.19	5.70	7.14
2001	57,243	53,047	4,196	7.33%	52,344	5.61	9.19	5.70	7.14

<sup>(1)</sup> Unaudited.

<sup>(a)</sup> Seven months ended December 31, 2001. In 2001, the SAWS Board of Trustees approved a change in the fiscal year-end from May 31<sup>st</sup> to December 31<sup>st</sup>.

<sup>(b)</sup> Pumpage is total potable water production less Aquifer Storage and Recovery recharge.

<sup>(c)</sup> Rate shown is for 5/8" meters.

<sup>(d)</sup> Represents standard (non-seasonal) usage charge for monthly residential water usage of 7,788 gallons per month. Includes water supply and EAA fees.

<sup>(e)</sup> Minimum service availability charge (includes charge for first 1,496 gallons).

<sup>(f)</sup> Represents usage charge for a residential customer based on winter average water consumption of 6,178 gallons per month.

Source: SAWS.

**Water Consumption by Customer Class (Million Gallons) <sup>(1)</sup>**

	Fiscal Year Ended December 31									
	2009	2008	2007	2006	2005	2004	2003	2002	2001 <sup>(a)</sup>	2001
Water Sales <sup>(b)</sup> :										
Residential Class	30,667	33,026	26,651	33,162	30,917	27,054	27,624	28,227	19,398	28,621
General Class	20,309	20,296	19,166	20,232	19,769	18,851	19,464	20,155	13,444	23,042
Wholesale Class	119	108	90	114	121	98	137	173	347	535
Irrigation Class	4,200	5,398	3,604	4,216	4,198	3,364	3,350	3,295	1,527	848
Total Water	55,295	58,828	49,511	57,724	55,005	49,367	50,575	51,850	34,716	53,046
Wastewater Sales:										
Residential Class	29,825	28,148	27,384	28,857	25,293	25,421	24,860	25,564	13,594	26,472
General Class	19,714	19,609	18,670	21,152	21,414	20,952	21,418	22,319	13,209	21,516
Wholesale Class	2,448	2,590	3,164	3,259	2,580	3,220	3,391	4,297	2,758	4,356
Total Wastewater	51,987	50,347	49,218	53,268	49,287	49,593	49,669	52,180	29,561	52,344
Conservation - Residential Class <sup>(c)</sup>	3,469	3,948	2,432	4,276	3,613	2,634	2,636	2,742	2,757	1,460
Recycled Water Sales	16,321	16,559	14,148	14,835	14,048	13,626	13,642	13,761	4,654	13,292

<sup>(1)</sup> Unaudited.

<sup>(a)</sup> Seven months ended December 31, 2001. In 2001, the SAWS Board of Trustees approved a change in the fiscal year end from May 31<sup>st</sup> to December 31<sup>st</sup>.

<sup>(b)</sup> Water Supply and EAA fees are billed based on the gallons billed for water sales.

<sup>(c)</sup> Gallons billed for conservation are included in the gallons billed for water sales.

Source: SAWS.

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## ***SAWS System***

SAWS includes all water resources, properties, facilities, and plants owned, operated, and maintained by the City relating to supply, storage, treatment, transmission, and distribution of treated potable water, chilled water, and steam (collectively, the “waterworks system”), collection and treatment of wastewater (the “wastewater system”), and treatment and recycle of wastewater (the “recycle water system”) (the waterworks system, the wastewater system, and the recycle water system, collectively, the “System”). The System does not include any “Special Projects,” which are declared by the City, upon the recommendation of the SAWS Board, not to be part of the System and are financed with obligations payable from sources other than ad valorem taxes, certain specified revenues, or any water or water-related properties and facilities owned by the City as part of its electric and gas system.

In addition to the water-related utilities that the SAWS Board has under its control, on May 13, 1993, the City Council approved an ordinance establishing initial responsibilities over the stormwater quality program with the SAWS Board and adopted a schedule of rates to be charged for stormwater drainage services and programs. As of the date hereof, the stormwater program is not deemed to be a part of the System.

SAWS’ operating revenues are provided by its four core businesses: Water Delivery, Water Supply, Wastewater, and Chilled Water and Steam. The SAWS rate structure is designed to provide a balance between residential and business rates and strengthen conservation pricing for all water users. For detailed information on the current rates charged by SAWS, see [www.saws.org/service/rates](http://www.saws.org/service/rates).

*Waterworks System.* The City originally acquired its waterworks system in 1925 through the acquisition of the San Antonio Water Supply Company, a privately owned company. Since such time and until the creation of SAWS in 1992, management and operation of the waterworks system was under the control of the City Water Board. The SAWS’ waterworks system currently extends over approximately 636 square miles, making it the largest water purveyor in Bexar County. SAWS serves more than 80% of the water utility customers in Bexar County. As of December 31, 2009, SAWS provided potable water service to approximately 352,000 customer connections, which includes residential, commercial, multifamily, industrial, and wholesale accounts. To service its customers, the waterworks system utilizes 30 elevated storage tanks and 30 ground storage reservoirs, of which 7 act as both, with combined storage capacities of 168 million gallons. As of December 31, 2009, the waterworks system had in place 4,866 miles of distribution mains, ranging in size from four to 60 inches in diameter (the majority being between six and 12 inches), and 26,599 fire hydrants distributed evenly throughout the SAWS service area.

*Wastewater System.* The San Antonio City Council created the City Wastewater System in 1894. A major sewer system expansion program began in 1960 with bond proceeds that provided for new treatment facilities and an enlargement of the wastewater system. In 1970, the City became the Regional Agent of the Texas Commission on Environmental Quality (“TCEQ”) (formerly known as the Texas Water Commission and the Texas Water Quality Board). In 1992, the wastewater system was consolidated with the City’s waterworks and recycle water system to form the System.

SAWS serves a substantial portion of the residents of the City, 12 governmental entities, and other customers outside the corporate limits of the City. As Regional Agent, SAWS has certain prescribed boundaries that currently cover an area of approximately 424 square miles. SAWS also coordinates with the City for wastewater planning for the City’s total planning area, ETJ, of approximately 1,107 square miles. The population for this planning area is approximately 1.6 million people. As of December 31, 2009, SAWS provided wastewater services to approximately 395,100 customers.

In addition to the treatment facilities owned by SAWS, there are six privately owned and operated sewage and treatment plants within the City’s ETJ.

The wastewater system is composed of approximately 5,085 miles of mains and three major treatment plants, Dos Rios, Leon Creek, and Medio Creek. All three plants are conventional activated sludge facilities. SAWS holds Texas Pollutant Discharge Elimination System wastewater discharge permits, issued by the TCEQ for 187 million gallons per day (“MGD”) in treatment capacity and 46 MGD in reserve permit capacity. The permitted

flows from the wastewater system's three regional treatment plants represent approximately 98% of the municipal discharge within the City's ETJ.

SAWS has applied to the TCEQ to expand its Certificates of Convenience and Necessity ("CCN") or service areas for water and sewer from the existing boundaries to the ETJ boundary of the City. When the TCEQ grants a CCN to a water or sewer purveyor, it provides that purveyor with a monopoly for retail service. By expanding the CCN's to the ETJ, developments needing retail water and sewer service within the ETJ must apply to SAWS. Service can then be provided according to SAWS standards and small, undersized systems can be avoided. SAWS' CCN application for water consists of 12 separate applications that cover approximately 64,000 acres and the applications for sewer consisted of eight separate applications that cover approximately 407,000 acres. Of the water applications, five applications have been finalized consisting of approximately 8,100 acres, which is now included in SAWS' CCN, with the remaining seven applications totaling 56,000 acres still under review. The eight sewer applications are currently under review. The expansion of the CCN to the ETJ supports development regulations for the City. Within the ETJ, the City has certain standards for development. These standards somewhat insure the City that areas developed in the ETJ and then annexed by the City, will already have some City development regulations in place.

*Recycling Water System.* SAWS is authorized to provide Type I (higher quality) recycled water from its wastewater treatment plants and has been doing so since 2000. The water recycling program is designed to provide up to 35,000 acre-feet ("af") per year of recycled water to commercial and industrial businesses in San Antonio. This system was originally comprised of two north/south transmission lines. In 2008, an interconnection of these two lines was constructed at the north end of the lines, providing additional flexibility with respect to this valuable water resource. Currently, approximately 125 miles of pipeline deliver highly treated effluent to over 52 customers consisting of golf courses, universities, parks, and commercial and industrial customers throughout the city. The system was also designed to provide baseflows in the upper San Antonio River and Salado Creek, and the result has been significant and lasting environmental improvements for the aquatic ecosystems in these streams.

*Chilled Water and Steam System.* SAWS owns, operates, and maintains six thermal energy facilities providing chilled water and steam services to governmental and private entities. Two of the facilities, located in the City's downtown area, provide chilled water and/or steam service to 23 customers. Various City facilities, that include the Henry B. Gonzalez Convention Center and Alamodome, constitute a large percentage of the downtown system's chilled water and steam annual production requirements. In addition to these City facilities, the two central plants also provide chill water and/or steam service to a number of major hotels in the downtown area include the Grand Hyatt, Marriott and the Hilton Palacio Del Rio. The other four central thermal energy facilities, owned and operated by SAWS, are located at the Port of San Antonio (formerly Kelly AFB) and provide chilled water and steam services to large industrial customers that include Lockheed Martin and Boeing Aerospace. SAWS' chilled water-producing capacity places it as one of the largest producers of chilled water in the immediate south Texas area. SAWS also currently operates and maintains the central thermal energy plants at Brooks City-Base under an agreement with the Brooks Development Authority.

*Stormwater System.* In September 1997, the City created its Municipal Drainage Utility and established its Municipal Drainage Utility Fund to capture revenues and expenditures for services related to the management of the municipal drainage activity in response to Environmental Protection Agency-mandated stormwater runoff and treatment requirements under the 40 CFR 122.26. The City, along with SAWS, has the responsibility, pursuant to the Permit from the TCEQ, for water-quality monitoring and maintenance. The City and SAWS have entered into an interlocal agreement to set forth the specific responsibilities of each regarding the implementation of the requirements under the Permit. The approved annual budget for the SAWS share of program responsibilities for FY 2010 is \$4,809,147, for which SAWS is reimbursed \$3,758,241 from the stormwater utility fee imposed by the City.

### ***Water Supply***

In May 2009, the System completed a comprehensive analysis of its existing water supply projects and developed a series of conservation and water resource strategies that will enable it to provide adequate water supplies, even during critical drought periods; postpone dependence on more costly resources, when possible; promote greater use of non-Edwards Aquifer supplies in the long-term; fulfill the needs of San Antonio customers, and recognize the reality that future water supplies must be affordable.

These strategies are outlined in the 2009 Water Management Plan. The 2009 Plan is a continuation of the process that began in 1996 to develop a 50-year plan. In 1996, the City Council appointed a 34-member citizens committee to develop strategic policies and goals for water resource management. The Citizens Committee on Water Policy report, entitled “A Framework for Progress: Recommended Water Policy Strategy for the San Antonio Area,” was unanimously accepted by City Council, becoming the foundation for the System’s “Water Resources Plan.” On November 5, 1998, the City Council accepted the Water Resources Plan “Securing Our Water Future Together” as the first comprehensive widely supported water resource plan for San Antonio. The 1998 Plan established programs for immediate implementation, as well as a process for developing long-term water resources. In October 2000, the City Council created a permanent funding mechanism (known as the Water Supply Fee) for water supply development and water quality protection. The Water Supply Fee provides a specific fund for the development of water resources.

In August 2005, SAWS’ Board of Trustees unanimously approved the 2005 Update. The 2005 Update is a comprehensive review of the assumptions governing population and per capita consumption projections in Bexar County through 2050. The 2005 Update includes an analysis of each water supply alternative available for meeting future needs and demonstrates SAWS’ commitment to obtaining additional water supplies. The projected capital cost of the water supply approved in the 2005 Update originally totaled more than \$2 billion; however, more recent cost re-estimates have increased this amount to more than \$3 billion. As a result of some of the identified cost increases, other potential changes in the projects, and changes in personnel, a new Water Supply Task Force was assembled in June 2008 to review, evaluate, and update SAWS’ Water Resource plan. This task force completed its review in early 2009. After a comprehensive public outreach period, the Board of Trustees and the City Council of San Antonio approved the 2009 Water Management Plan in May 2009.

The 2009 Water Management Plan outlines a diversified foundation of San Antonio’s water supply. While the Edwards Aquifer will always be the cornerstone of San Antonio’s water supply, the System has already successfully developed several alternative water sources, such as Canyon Lake, the Trinity Aquifer, and the Carrizo Aquifer. The System’s recycled water program provides highly treated wastewater to CPS and other industrial customers who would otherwise use potable water. The System’s underground Aquifer Storage and Recovery reservoir allows us to collect unused Edwards Aquifer water during wet years and use it in times of drought.

As of December 31, 2009, the System utilizes the following water supplies, Edwards Aquifer, 251,411 af which represents 59% of the System’s total supply, Aquifer Storage and Recovery underground storage, 67,000 af or 16% of total supply, Recycle Water to CPS, 50,000 af or 12% of total supply, Recycle Water to other customers, 35,000 af or 8% of total supply, Canyon Lake, 9,300 af or 2% of total supply, Carrizo Aquifer, 6,400 af or 2% of total supply, and Trinity Aquifer, 3,500 af or 1% of total supply.

### ***Edwards Aquifer***

Historically, the City obtained nearly all of its water from the Edwards Aquifer. The Edwards Aquifer lies beneath an area approximately 3,600 square miles in size. Including its recharge zone, it underlies all or part of 13 counties, varying from five to 30 miles in width, and stretching over 175 miles in length, beginning in Brackettville, Kinney County, Texas, in the west and stretching to Kyle, Hays County, Texas, in the east. The Edwards Aquifer receives most of its water from rainfall runoff, rivers, and streams flowing across the 4,400 square miles of drainage basins located above it.

Much of the Edwards Aquifer region consists of agricultural land, but it also includes areas of population ranging from communities with only a few hundred residents to the City, which serves as a home for well over one million residents. In 2009, the Edwards Aquifer supplied 90% of the potable water for municipal, domestic, industrial, and commercial needs for the SAWS service area. Naturally occurring artesian springs, such as the Comal Springs and the San Marcos Springs, are fed by Edwards Aquifer water and are utilized for commercial, municipal, agricultural, and recreational purposes, while at the same time supporting ecological systems containing rare and unique aquatic life.

The Edwards Aquifer is recharged by seepage from streams and by precipitation infiltrating directly into the cavernous, honeycombed, limestone outcroppings in its north and northwestern areas. Practically continuous recharge is furnished by spring-fed streams, with stormwater runoff adding additional recharge, as well. The

historical annual recharge, from 1934 to the present, to the reservoir is approximately 684,700 af. The average annual recharge over the last four decades is approximately 797,900 af. The lowest recorded recharge was 43,000 af in 1956, while the highest was 2,485,000 af in 1992. Recharge has been increased by the construction of recharge dams over an area of the Edwards Aquifer exposed to the surface known as the recharge zone. The recharge dams, or flood-retarding structures, slow floodwaters and allow much of the water that would have otherwise bypassed the recharge zone to infiltrate the Edwards Aquifer.

In 1993, the Texas Legislature created the Edwards Aquifer Authority (“EAA”) to manage groundwater withdrawals from the Edwards Aquifer through a permitting system and to provide for appropriate springflow during drought periods. As a consequence of the EAA’s permitting regime, SAWS’ access to Edwards Aquifer supplies is now limited to its historic use plus any additional supplies SAWS can acquire by lease or purchase. All Edwards Aquifer supplies are subject to regulation, with more stringent use limitations applied during periods of drought.

In 2007, the Texas Legislature passed Senate Bill 3, which established a new pumping cap and placed restrictions on supply availability during drought periods into State statute. Senate Bill 3 established a regional pumping cap of 572,000 af. As of December 31, 2009, through permitting, purchases, and leases, SAWS has access to 251,411 af of Edwards Aquifer water rights, which is approximately 44% of the regional pumping cap. Senate Bill 3 incorporates restrictions on supply availability during drought periods into State statute, thus making these restrictions State law. Under current law, when aquifer levels or springflow fall to certain trigger points, pumping allocations are reduced by 20% to 40% depending on the severity of the drought. In February 2009, City Ordinances were updated to ensure that restrictions on water usage commence in close proximity to the occurrence of these restrictions on pumping. In addition, to support ongoing efforts to identify and evaluate methods to protect threatened and endangered species, the State Legislature prescribed in detail an Edwards Aquifer Recovery Implementation Plan (“EARIP”) for the Edwards Aquifer region. The EARIP, which will be undertaken in coordination with U.S. Fish and Wildlife Service, is intended to balance the recovery of the listed species with water use and development through a multi-stakeholder process with a Habitat Conservation Plan as the intended result. The program is scheduled to be completed by the end of 2012. The process could result in additional reductions on pumping during periods of drought.

As part of its Water Management Plan for 2009, the System will continue its effort to maintain the extent of its leased water (37,000 af) through lease renewal or purchase during the entirety of the plan. In addition, the System will seek to add 2,000 af per year through purchases beginning in 2009 and continuing through 2014.

The Plan also identifies the potential lease or purchase of an additional 11,700 af of Edwards Aquifer water in the period between 2014 and 2034 if alternate water sources such as the Regional Carrizo or additional Brackish Groundwater are not available as expected.

Throughout 2009, SAWS has been very active in acquiring additional Edwards Aquifer water rights through either lease or purchase with a total of more than 26,000 af of Edwards Aquifer permits added to SAWS’ inventory over the course of the year. As of December 31, 2009, SAWS’ total inventory of Edwards Aquifer permitted rights stand at 251,411, with approximately 220,000 af of this inventory owned and the remainder leased. As a result of the increased amount of Edwards permits, SAWS was able to add more than 15,500 af of water to the Aquifer Storage and Recovery (“ASR”), bringing the total amassed storage to more than 67,000 af as of December 31, 2009.

### ***Edwards Aquifer Recharge Initiatives***

Recharge dams are structures that retain rainfall runoff water for short periods of time over the Edwards Aquifer Recharge Zone. Recharge dams retain storm runoff and retain it long enough to allow for a larger volume of water to enter into the Edwards Aquifer. During storm events, storm runoff flows at a faster rate than what can be taken by the recharge features located in the stream channels. The recharge dam allows for a longer retention for more water to filter into the Edwards Aquifer, thus increasing recharge amounts.

SAWS is evaluating the feasibility of the development of recharge structures in the Cibolo Creek Watershed and the Nueces River Basin in concert with a host of local agencies, including the Guadalupe-Blanco

River Authority, San Antonio River Authority, and the U.S. Army Corps of Engineers. Feasibility analyses continued to refine sites for potential dams, evaluate surface water storage potential, and prepare for environmental permitting.

The 2009 Water Management Plan calls for the System to continue to cooperate with other Regional entities to complete the studies and construct a Recharge Project to produce over 13,400 af of water by 2020.

### ***Recharge and Recirculation***

SAWS partnered with EAA to fund the Recharge and Recirculation: Edwards Aquifer Optimization Program, Phase III and IV Report. This report indicates that considerable potential exists to extend the concept of recharge of the Edwards Aquifer to the idea of applying recharge at specific places in the Aquifer where, because of the geologic characteristics of these locations, this recharge will provide long-term enhancement of Edwards Aquifer water levels and springflow.

Increased Edwards Aquifer levels and springflow during drought periods could decrease the necessity of declaring drought restrictions by the Edwards Aquifer Authority through increased (higher) aquifer water levels and provide minimum springflow to help protect endangered species. SAWS could be rewarded for building a Recharge and Recirculation Project by receiving access to increased Edwards Aquifer water during drought periods.

Costs and extent of the water resources that will be available from the Project are undetermined at this time, but the potential is high enough that the Recharge and Recirculation Project is included as a project for consideration in the 2014-2034 mid-term period in the 2009 Water Management Plan.

### ***Trinity Aquifer Projects***

SAWS reached a milestone in February 2002 with the introduction of the first non-Edwards drinking water supply from the Lower Glen Rose/Cow Creek formation of the Trinity Aquifer in northern Bexar County. The System has wholesale contracts with Massah Corporation (“Oliver Ranch”) and Sneckner Partners, Ltd. (“BSR Water Company”) for delivery of up to 5,000 af per year of non-Edwards groundwater from the Trinity Aquifer from two properties located in north-central Bexar County. The construction cost to produce and deliver this water supply is approximately \$15.8 million. Initial delivery of water from the Oliver Ranch project began in February 25, 2002 with BSR Water Company wells 1 and 2 production commencing in July 2003. The BSR Water Company project was fully operational in June 2004 with the connection of BSR Water Company wells 3 and 4 to SAWS’ distribution system.

In 2007, production from Oliver Ranch and BSR Water Company projects was 3,126 af, while in 2008, production from these combined projects totaled 3,422 af. As a result of the severe drought conditions experienced across the region the first eight months of the year, 2009 production totaled 1,739 af. The 2009 Water Management Plan identifies that 3,500 af of water will be obtained from Trinity Aquifer sources in normal rainfall years. In severe drought, the 2009 Water Management Plan acknowledges that the Trinity Aquifer water may not be available.

### ***Lower Colorado River Authority Project***

The Lower Colorado River Authority-San Antonio Water System (“LCRA-SAWS”) Water Project was conceived to develop and make available up to 150,000 af per year of surface water supplies for San Antonio in 2025 while firming up water supplies in the Colorado River Basin. In 2001, legislation was passed to authorize LCRA to sell water outside its statutory boundary to SAWS. SAWS and LCRA executed a definitive agreement (2002) outlining LCRA’s and SAWS’ obligations. The agreement calls for a multi-year study period, at the end of which both SAWS and LCRA will determine whether or not to proceed with implementation of the project. SAWS and LCRA are now entering the sixth year of the study period to assess the environmental, engineering, and cost impacts. Finalization of studies and obtaining appropriate permits for the project are expected to be completed between 2013 and 2015.

Throughout the study period, SAWS and LCRA evaluate the Project's viability on an ongoing basis. Specific legislative criteria (Texas Water Code § 222.030) must be met before any water is transferred from the Colorado River basin. Among other requirements, the project must provide for beneficial inflow sufficient to maintain the ecologic health and productivity of the Matagorda Bay System; protect and benefit the lower Colorado River Basin; raise the highland lake levels; and provide for a broad, public, and scientific review process. In 2008, research activities focused on development of bay health species and inflow criteria; water quality; instream flow criteria; agricultural conservation; groundwater development; socioeconomic considerations; waterfowl; surface water availability modeling; the identification of a preferred alternative site for the location of an off-channel storage facility and river intake facility; the transportation system, treatment, and integration system from the LCRA basin boundary to San Antonio; and project permitting.

In December 2008, the LCRA Board of Directors adopted several water supply planning guidance resolutions which led to a conclusion by LCRA that there would be no firm water supply available for San Antonio from the planned project. In a series of meetings and letters over the next four months, SAWS conveyed to LCRA SAWS' belief that this action by the LCRA Board was inconsistent with the Definitive Agreement between the parties. On May 5, 2009, SAWS' Board of Trustees declared LCRA in breach of the 2002 Definitive Agreement and directed SAWS staff to pursue all available remedies for the breach. The parties conducted formal mediation on August 5, 2009, but the mediation was unsuccessful. SAWS filed suit against LCRA on August 24, 2009, in the 200th Judicial District Court of Travis County, Texas. The cause number is D-6N-09-002760, styled *City of San Antonio, Acting by and Through the San Antonio Water System vs. Lower Colorado River Authority, et al.* LCRA filed a Plea to the Jurisdiction and Original Answer on September 25, 2009, asserting full or partial governmental immunity from suit and generally denying that it has breached the Definitive Agreement. On February 1, 2010, the district judge ruled in favor of LCRA by granting LCRA's Plea to the Jurisdiction in agreement with LCRA's contention that its sovereign status immunized it from suit by SAWS, dismissing the System's lawsuit. On February 17, 2010, SAWS filed an appeal to the Court of Appeals for the Third Appellant District of Texas in Austin, Texas. Following a decision by the Court of Appeals, either party may further appeal to the Supreme Court of Texas. However, consideration by the Supreme Court is discretionary with the Court and may be refused. Resolution of the appeal on the issue of governmental immunity is expected to take from two to five years, although the time is very difficult to predict.

During the course of the study and planning periods since 2002, SAWS incurred certain costs with respect to the design of the pipeline which was to be utilized to transport water from the LCRA basin boundary to San Antonio. These costs totaling \$2.7 million were recorded as an asset on SAWS' balance sheet. Given the uncertain nature of this project at the current time, SAWS is currently in the process of evaluating any potential impairment to this asset. Should it ultimately be determined that this asset has suffered a permanent, unrecoverable impairment it will be written down to its fair value, which is likely to be \$0.

The 2009 Water Management Plan calls for one or more of several Water Resources Projects to provide at least 75,600 af of water to meet SAWS' long-term water needs in approximately 2060. In addition to the LCRA-SAWS Project, Seawater Desalination, an additional Aquifer Storage and Recover project, and other Water Supplies were listed as options.

### ***Bexar County Aquifer Storage and Recovery***

An ASR project involves injecting ground or surface water into an aquifer, storing it, and later retrieving it for use. Essentially, it accomplishes storage that is traditionally provided through surface water reservoirs without the concern of evaporation. The ASR is primarily designed to optimize use of water from the Edwards Aquifer and may be expanded to inject water from currently planned water supply projects. In December 2002, the Evergreen Underground Water Conservation District and SAWS approved an Aquifer Protection and Management Agreement. This agreement ensures operation of the ASR site if the property is annexed into the district, manages groundwater production, and commits SAWS to monitoring water levels and mitigation of potential negative impacts.

SAWS began a study of an ASR project in 1996, acquired 3,200 acres in southern Bexar County, and has completed construction of Phase I of the \$125 million ASR project and the approximately \$60 million "integration facilities" to transport this water into SAWS' distribution system. Phase I of the project was dedicated on June 18, 2004 and gives SAWS the ability to inject or recover up to 30,000 af of Edwards Aquifer water per year.

In 2006, the ASR was an integral component of SAWS' drought management strategy. Approximately 5,800 af of supplies were withdrawn primarily during the hot, dry summer months in order to reduce peak demand during the drought period. Effective scheduling and use of this additional inventory enabled SAWS to ensure its compliance with the EAA's rules for groundwater withdrawals.

In 2008, SAWS continued capital improvements to complete Phase II of the project, which involved well field expansion through the completion of 13 additional wells, the addition of a 7.5 million gallon tank, and the addition of various pumping facilities, among other improvements. The \$55 million Phase II expansion was completed in 2009 and effectively doubled SAWS' ability to inject or recover Edwards Aquifer to 55,000 af per year. While underway, SAWS has continued to store water in the ASR. During July 2008, ASR was again recovered and returned to SAWS' distribution system when the Edwards Aquifer Authority implemented water restrictions. SAWS' ASR facility was recognized in 2007 by the National Groundwater Association as the "2007 Outstanding Groundwater Project."

In the 2009 Water Management Plan, ASR's role has been expanded with the decision to transition this facility to a long-term storage reserve. In addition, the 2009 Water Management Plan refers to expansion of ASR storage capability as a long-term strategy to optimize available water resources. A study commenced in 2009 to determine the total storage capability of the current ASR site and options for additional sites that would increase the ASR storage capability two times or more. As of December 31, 2009, SAWS had amassed rent storage of more than 67,000 af of water that will be used in long-term drought situations to help meet SAWS water needs. SAWS will continue to store water when it is available and recover water when required during drought.

### ***Western Canyon Project***

SAWS, Comal and Kendall County participants, and the Guadalupe-Blanco River Authority ("GBRA") are working together on the Western Canyon Project for the delivery of water from Canyon Lake Reservoir. GBRA is required through a contract to divert, treat and deliver the water to a certain point into SAWS' delivery system. SAWS will initially receive over 9,000 af per year for service to northern Bexar County. Over time, this amount will decline to 4,000 af, as GBRA's in-district participants in the project complete infrastructure necessary to enable them to obtain supplies and growth allows the participants to utilize their full allotment of reserved water.

SAWS began receiving water from this project in April 2006. In 2006, SAWS received 4,957 af of supplies from this project. In 2007, SAWS produced approximately 7,597 af of supplies from this project, in addition to completing the addition of a storage tank and integration pipeline to facilitate delivery of this supply into the SAWS distribution system. In 2008, 8,943 af was delivered from this project. In 2009, SAWS received 8,734 af of water from this project. Pursuant to the terms of the contract with GBRA, this contract will terminate in 2037, with an option to extend until 2077 under new payment terms.

### ***Brackish Groundwater Desalination Project***

Such a project is well suited for the south central Texas region, which contains more than 300,000,000 af of brackish groundwater. Hydrologic research on the sustainability of supply and water quality parameters began in December 2005. The 2009 Water Management Plan calls for completion of a brackish water desalination plan to produce 11,800 af of potable water per year by 2014. The plan will rely on brackish water pumped from Bexar County. The plan also makes provision for the Project to include other water from Wilson and Atascosa Counties to provide at least an additional 11,700 af by 2034, depending on how other mid-range Projects develop.

In 2007 and 2008, the System continued its hydrogeologic evaluation on four (4) test sites in the saline portions of the Edwards and Wilcox Aquifers in Atascosa and Bexar Counties. The hydrogeologic evaluation involves the construction of test and monitoring wells that will provide an indication of the firm supply of water available for the project and the impacts of the System's production on the Carrizo-Wilcox Aquifer system. The data obtained from the tests and monitoring wells will support the evaluation of various pre-treatment, treatment, and concentrate management strategies.

The majority of feasibility work for the brackish groundwater desalination project was completed in 2008. Raw water quality is favorable for development of a desalination facility and there is sufficient raw water to support

a plant for greater than 50 years. The reverse osmosis treatment plant will be located in southern Bexar County on property owned by the System. Water from the desalination plant will be integrated by pipeline into the northwest portion of San Antonio. Reverse osmosis pilot testing has been completed. A test report was submitted to the Texas Commission on Environmental Quality (“TCEQ”) in early May 2010 for review and approval. Deep well injection is proposed for the concentrate disposal.

### ***Carrizo Aquifer Projects***

The 2009 Water Management Plan includes the Regional Carrizo Project to obtain 11,687 af from the Carrizo Aquifer in Gonzales County in time to meet mid-term needs of the System.

Development of the Carrizo Aquifer project depends upon issuance of permits for groundwater drilling, production, and transport from local groundwater conservation districts. The System submitted an initial, consolidated permit application for production and transportation permits for 11,687 af to the Gonzales County Underground Water Conservation District (the “GCUWD”) in June 2006. Pursuant to GCUWD rules, production permits have a term of five years, after which a renewed permit may be issued upon application, subject to the notice and hearing requirements applicable to permit applications. The applications were declared administratively complete on July 12, 2006 and contested by several parties on October 10, 2006.

Throughout 2007, 2008, and 2009, SAWS participated in several public hearings and multiple mediation sessions as part of the contested case hearing process. The contested case hearing took place October 5-13, 2009 and December 4, 2009 in Gonzales, Texas. Mediation sessions were held on December 18, 2009 and February 3, 2010 resulting in three entities dropping their protests of SAWS applications. The entities continue to oppose the applications. Resolution is anticipated in early to mid-2010 with design and construction activities commencing soon after permits are issued.

SAWS is also exploring the possibility of partnering with other agencies that either produce or will produce water in Gonzales County. These efforts would explore transporting water from Gonzales County to Bexar County or near Bexar County in order to share costs and reduce the cost of obtaining water for all participants. Discussions are on-going.

### **Local Carrizo Water Supply Project**

A provision of the 2002 Water Resource Protection and Management Agreement with the Evergreen Underground Water Conservation District gives SAWS the ability to withdraw up to 2 af of Carrizo Aquifer water per surface acre of land owned or leased (controlled). This equates to approximately 6,400 af of Carrizo Aquifer production per year. Thus, in 2006, SAWS initiated the Local Carrizo Program at the ASR site with dual goals in mind. The first was to provide SAWS with access to approximately 6,400 af of Carrizo Aquifer water, while the second was to counter the natural south-southeast drift of the stored Edwards Aquifer water away from the ASR wellfield with water wells drilled north-northwest of the stored Edwards Aquifer water.

The approximately \$17 million Local Carrizo Water Supply program is comprised of two phases: an ASR onsite phase and an ASR offsite phase. The onsite began production in August 2008, with production of 383 af in 2008. Total production during 2009 was 5,934 af.

The offsite phase is anticipated to be completed by July 2010. While this additional phase will reduce the effects of this naturally occurring movement of water and provide increased operational flexibility of recovering the stored water, no additional production capacity accompanies the offsite phase.

### ***Other Potential Water Supply Projects***

The System periodically receives unsolicited proposals for new water supply projects. Recent proposals have included large groundwater projects in Val Verde, Kinney, and Uvalde Counties to the west of San Antonio, Comal County north of San Antonio, and Brazos, Burtleson, Lee, Leon, Milam, and Robertson Counties northeast of San Antonio. Each of these projects would include a requirement for construction of both production facilities and transmission infrastructure. Each project would have to be undertaken within the regulatory constraints of local

groundwater conservation district rules. The proposals generally vary in terms of ownership, permitting, construction, financing and operational responsibilities.

The 2009 Water Management Plan calls for a request for qualifications (“RFQ”) solicitation to occur in early 2010 to provide an opportunity for these and other potential water providers to present the characteristics of their projects in a common form for SAWS’ consideration. The RFQ response will allow SAWS to identify projects that can help meet mid- to long-term water needs.

### ***Ocean Desalination***

In 2009, the Water Management Plan includes the development of an ocean desalination project as one of the options to meet SAWS’ long-term water needs of 75,600 af. Beginning in 2009, the feasibility study will be initiated to identify potential sites, pipeline routes, permitting requirements, construction challenges, and partnership opportunities. Communications and outreach activities were undertaken in 2009 and will continue through 2010 prior to and after an RFQ is issued to select a consultant to begin a feasibility/conceptual study regarding siting of a desalination facility. Partnering opportunities will be explored during the outreach phase and will continue to be explored in the future. Ocean desalination appears to be the most expensive source of new water resources. The study will provide some certainty to cost estimates for informed consideration in the future.

### ***Water Reuse Program***

SAWS owns the treated effluent from its wastewater treatment plants and has the authority to contract to acquire and to sell non-potable water inside and outside SAWS’ water and wastewater service area. SAWS has developed a water reuse program utilizing the wastewater stream. Currently, approximately 23,000 af are under contractual commitment and 12,600 af are online. SAWS delivers up to 35,000 af per year of reuse water for non-potable water uses including golf courses and industrial uses that are currently being supplied from the Edwards Aquifer. This represents approximately 20% of SAWS’ current usage. Reuse water is delivered for industrial processes, cooling towers, and irrigation, which would otherwise rely on potable quality water. Combined with the 45,000–50,000 af per year used by CPS, this is the largest reuse water project in the country. SAWS has a contract with CPS through 2030 for the provision of such reused water. The revenues derived from the CPS contract have been excluded from the calculation of gross revenues, and are not included in any transfers to the City.

### ***Integration Pipeline***

The 2009 Water Management Plan addresses the operating challenge of co-locating the Brackish Groundwater Project, Regional Carrizo outlet, Local Carrizo and Aquifer Storage and Recovery Projects at a single site (Twin Oaks in Southern Bexar County) by expediting the Integration Pipeline Project. It will bring water to the Western part of the City to match the System’s current capability to bring water to the Eastern part of the City. The Project is scheduled for completion by 2014.

### ***Conservation***

Beginning in 1994, SAWS progressively implemented aggressive water conservation programs, which have reduced total per capita water production and use by 43.2%, going from 213 gallons-per-capita-per day (“gpcd”) in 1994 to approximately 121 gpcd in 2004. Given these accomplishments, the 2005 Update to SAWS’ fifty-year Water Resource Plan set a new goal for conservation that includes the provision to reduce per capita consumption to 116 gpcd during normal-year conditions and 122 gpcd during dry-year conditions by 2016. As SAWS has experienced three more dry years (2005, 2006, and 2008) and one more wet year (2007) since the adoption of these goals, an evaluation of these per capita usage goals for both normal and dry-year conditions is being preformed as part of the Water Supply Task Force review of SAWS’ Water Resource Plan. The goal for normal conditions remains 116 gpcd by 2016, with 126 gpcd in dry years and 106 gpcd in wet years.

In 2006, these efforts earned SAWS the 2006 City Water Conservation Achievement Award. This award, sponsored by the U.S. Conference of Mayors, recognizes a city’s ability to significantly reduce water use. In 2007, SAWS’ conservation activities were recognized by Harvard University and the Ford Foundation as one of 18 finalists for the 2007 Innovations in American Government Awards.

### ***Indoor Residential Conservation***

Indoor residential conservation programs encourage customers to save water inside their homes. A variety of education and rebate incentive programs assist ratepayers in achieving conservation. Customers learn about these programs through SAWS' website, public events, direct mail inserts in bills, paid advertisements, and educational materials in popular local periodicals. SAWS' most effective programs for indoor water use reduction include:

“Toilet Retrofits,” which involve the distribution of high-efficiency toilets, provide a substantial water savings for San Antonio. SAWS sponsors activities like the “Season to Save Community Challenge,” which tests the idea that non-profit organizations are effective at motivating ratepayers to participate in resource management programs. In 2007, the System distributed 27,000 high-efficiency toilets (HET)/low flow toilets (LFT), in 2008, 25,000 HET/LFT were distributed and in 2009, 19,000 HET/LFT were distributed.

“Plumbers to People” provides leak repairs and retrofits to qualified low-income homeowner customers. SAWS, in cooperation with the City's Department of Community Initiatives - Center for Working Families, qualifies applicants based on the current Federal Assistance Guidelines. Only leaks that result in a loss of potable water are eligible for repair under the program. Water Conservation is achieved by quickly repairing leaks that would otherwise continue due to the cost of repairs. Analysis of program costs and water savings indicate that this affordability program is also one of our most effective at conserving water at a reasonable cost per unit.

### ***Outdoor Residential Conservation***

Residential outdoor programs address landscape and irrigation practices of homeowners. Outdoor use can account for up to 50% of total residential water use in the summers and average 20% of the water used annually. Education programs help ratepayers understand how following best practices can save water and money. Among SAWS' most effective programs for outdoor water use reduction:

“Irrigation Check-Ups” provide SAWS' ratepayers with a free analysis of their in-ground irrigation system. Trained conservation technicians visit homes to review each component of irrigation systems to determine maintenance needs to make suggestions for improving efficiency. Customers are invited to participate in the review process to get the maximum benefit from the site visit. A report that outlines any necessary maintenance repairs, suggestions for design improvements and how much water the system uses is provided to customers. The consultation visit includes suggestions on rebate incentive amounts available for making suggested design improvements. These check-ups result in an average 9% drop in consumption for residential customers.

“WaterSaver E-Newsletter” is a free information service provided to customers who want expert advice on how to take care of their Texas landscape. It includes timely lawn irrigation advice that is based on current weather conditions. Local horticulture experts provide weekly articles on seasonal landscape care. Plants that thrive in San Antonio are featured. A gardening expert responds to regularly submitted questions. In addition, gardening related events are highlighted in an events calendar. This weekly communication is currently going to 8,000 customers. Master Gardener volunteers help to promote the free service and subscriptions are regularly growing.

### ***Commercial and Industrial Programs***

SAWS has been working closely with commercial customers to help them conserve water for several years. In 1998, the commercial and industrial programs were expanded to include the toilet retrofit rebates previously offered only to residential customers. Water audits and case-by-case rebates for large-scale retrofits are also available. Since 1996, car wash businesses that meet certain conservation criteria are certified and provided a sign to be posted on their place of business. Every year SAWS presents the WaterSaver Awards to recognize businesses, organizations, and/or individuals that voluntarily initiated water conservation practices. Among SAWS' most effective programs for commercial and industrial water use reduction:

“Commercial Retrofit Program” allows businesses with older, high-flow toilets to replace them by receiving free fixtures from SAWS. The facility needing a retrofit is analyzed to determine which fixtures should be changed and what new product will best meet the needs of the site. Fixtures targeted for change include toilet, showerheads, faucet aerators, urinals, ice machines and restaurant spray valves. Plumbing services to install the fixtures may be provided by SAWS if it is determined that the amount of water saved is high enough to offset the additional expense. Four-star hotels around San Antonio have completed these retrofits and had high customer ratings for their quality. The water consumption at hotels that are retrofitted reduces by 20% or more after retrofits are complete.

“Restaurant Certification Program” is the result of SAWS’ working with the San Antonio Restaurant Association. Participating restaurants receive replacement spray valves for their kitchen, have older toilets replaced, and learn about other ways they can reduce their water bills. The program has been very popular with restaurants. To date, 1,268 restaurants have been certified, with the replacement of 2,322 high-flow pre-rinse spray valves and 726 high-flow toilets. Total water savings associated with this program equates to 610 af per year. A list of the Certified WaterSavers Restaurants is available on SAWS’ website.

“Large-scale Retrofits Program” allows large-scale water users to apply on a case-by-case basis for a rebate for installation of water conserving equipment. The rebate may be for up to one-half of the cost of the retrofit, depending on the amount of water to be saved and other factors. The program requires a pre-audit, a pre-inspection, and ongoing verification of water savings. Examples of retrofit projects are diverse and include reclaim of air conditioning condensate, a change in process water usage, or retrofit to a non-water use technology.

“Cooling Tower Audits” help businesses manage their cooling towers as efficiently as possible. This program provides free audits of all cooling towers within SAWS’ service area. A cooling tower audit provides the customer with a detailed engineering report on their specific operation, as well as recommendations for achieving water and energy savings through increased cycles of concentration, capture of blowdown water for reuse in other applications, or installation of other water-conserving equipment.

### ***Water Quality***

SAWS’ Resource Protection and Compliance Department is responsible for protecting the quality of the Edwards Aquifer and conducting technical evaluations of how to increase its yield. The TCEQ has adopted rules relating to the activities of landowners in the recharge and drainage zones of the Edwards Aquifer. The City has adopted ordinances applicable within its City limits that limit or regulate activities, which could be harmful to water quality and has, through its Unified Development Code, regulated certain development within the City’s ETJ (five miles from city limits).

Research on the Edwards Aquifer is conducted as part of the Edwards Aquifer Optimization program. This is a comprehensive program that identifies and evaluates technical options to increase available yield from the Edwards Aquifer and to attempt to use the aquifer’s storage capacity more efficiently. In 2007, SAWS continued its investigative studies concerning the freshwater/saline-water interface of the Edwards Aquifer. The goal of these studies is to gain a better understanding of the hydrogeologic framework, chemical and hydraulic characteristics, and ground water flowpaths of the freshwater-saline water interface of the Edwards Aquifer. The USGS study of the San Marcos springs hydrogeology and water balance is currently in Year 3 of a 4 Year Study. The San Marcos Springs Recharge – Investigative Study effort encompasses scientific investigative work to refine the hydrogeologic setting, determine the hydraulic properties and groundwater flow gradient, and perhaps define local sources and flowpaths providing flow from San Marcos Springs. This study would provide data for evaluation of the local versus regional sourcing of springflow, the effectiveness of current management strategies, and the need for revised management policies to maintain San Marcos Spring flow. The data collection phase of the study is winding down, with the final report due to SAWS by December 31, 2011.

### **Water Supply Fee**

In October 2000, the City Council created a permanent funding mechanism (the “Water Supply Fee”) to be used for water supply development and water quality projection. The Water Supply Fee is assessed on all potable water service for water usage in every instance of service for each month or fraction thereof. Effective January 13, 2009, the per 100-gallon fee was increased to \$0.1529. On June 17, 2010, City Council approved a change to the rate structure and rates charged for the Water Supply Fee to be effective on or about November 1, 2010. For detailed information on the current rates charged by SAWS, see [www.saws.org/service/rates](http://www.saws.org/service/rates).

### **Capital Improvement Plan**

The following is a proposed five-year Capital Improvement Program for SAWS. It is the intention of SAWS to fund the program with tax-exempt commercial paper, impact fees, system revenues, and future bond issues. SAWS budgeted the following capital improvement projects during calendar year 2010:

- \$8.7 million for the wastewater treatment program to repair, replace, or upgrade treatment facilities;
- \$65.4 million for the wastewater collection program to fix deteriorated components of the collection system, and provide capacity for future growth;
- \$20.3 million to replace sewer and water mains;
- \$54.5 million for the governmental replacement and relocation program;
- \$27.8 million to construct new and fix deteriorated components of the production facilities;
- \$9.0 million for the water distribution program to fix deteriorated components of the distribution system, and provide capacity for future growth; and
- \$99.9 million for water supply development, water treatment, and water transmission projects for new sources of water.

SAWS anticipates the following capital improvement projects for the five fiscal years listed:

	Fiscal Year					Total
	2010	2011	2012	2013	2014	
Water Supply	\$ 100,971,787	\$ 102,011,490	\$ 95,804,426	\$ 165,378,445	\$ 92,048,300	\$ 556,214,448
Water Delivery	78,137,301	58,912,200	47,161,726	55,047,848	52,829,779	292,088,854
Wastewater	118,507,888	147,826,262	143,976,992	113,842,621	135,798,806	659,952,569
Heating and Cooling	100,000	250,000	100,000	1,600,000	100,000	2,150,000
<b>Total</b>	<b>\$ 297,716,976</b>	<b>\$ 308,999,952</b>	<b>\$ 287,043,144</b>	<b>\$ 335,868,914</b>	<b>\$ 280,776,885</b>	<b>\$ 1,510,405,871</b>

Source: SAWS.

The following table was prepared by SAWS staff based upon information and assumptions it deems reasonable, and shows the projected financing sources to meet the projected capital needs.

	Fiscal Year					Total
	2010	2011	2012	2013	2014	
Revenues	\$ 19,171,463	\$ 78,801,738	\$ 31,840,901	\$ 39,409,741	\$ 64,071,559	\$ 233,295,402
Impact Fees	42,131,297	30,000,000	32,000,000	34,000,000	34,000,000	172,131,297
Debt Proceeds	236,414,216	200,198,214	223,202,243	262,459,173	182,705,326	1,104,979,172
<b>Total</b>	<b>\$ 297,716,976</b>	<b>\$ 308,999,952</b>	<b>\$ 287,043,144</b>	<b>\$ 335,868,914</b>	<b>\$ 280,776,885</b>	<b>\$ 1,510,405,871</b>

Source: SAWS.

**San Antonio Water System Summary of Pledged Revenues for Debt Coverage<sup>(1)</sup>**  
**(\$000)**

Year	Gross Revenues <sup>(c)</sup>	Operating Expenses <sup>(d)</sup>	Net Revenue Available	Revenue Bond Debt Service <sup>(b)</sup>				Maximum Annual Debt Service Requirements			
				Principal	Interest	Total	Coverage	Total Debt <sup>(e)</sup>	Coverage	Senior Lien Debt <sup>(e)</sup>	Coverage <sup>(f)</sup>
2009	\$370,464	\$219,523	\$150,941	\$34,900	\$75,398	\$110,298	1.37	\$123,182	1.23	\$103,205	1.46
2008	387,516	208,774	178,742	27,360	69,860	97,220	1.84	98,840	1.81	86,140	2.08
2007	347,391	188,180	159,211	24,880	67,785	92,665	1.72	102,880	1.55	86,138	1.85
2006	374,831	179,903	194,928	22,415	62,947	85,362	2.28	91,175	2.14	78,373	2.49
2005	332,669	173,490	159,179	16,505	54,987	71,492	2.23	94,992	1.68	78,373	2.03
2004	264,782	153,860	110,922	7,735	52,205	59,940	1.85	84,941	1.31	67,203	1.65
2003	242,488	152,743	89,745	5,515	44,614	50,129	1.79	76,075	1.18	61,511	1.46
2002	240,375	134,977	105,398	25,045	39,589	64,634	1.63	66,268	1.59	61,511	1.71
2001 <sup>(a)</sup>	136,235	78,448	57,787	0	20,345	20,345	n/a	n/a	n/a	n/a	n/a
2001	207,225	121,351	85,874	23,760	36,661	60,421	1.42	66,994	1.28	56,293	1.53

<sup>(1)</sup> Unaudited.

<sup>(a)</sup> Seven months ended December 31, 2001. In 2001, the SAWS Board of Trustees approved a change in the fiscal year end from May 31<sup>st</sup> to December 31<sup>st</sup>.

<sup>(b)</sup> Represents current year debt service payments. Details regarding outstanding debt can be found in the notes to the financial statements. All bonded debt is secured by revenue and is included in these totals.

<sup>(c)</sup> Gross Revenues are defined as operating revenues plus nonoperating revenues less revenues from the City Public Service contract and interest on Project Funds.

<sup>(d)</sup> Operating Expenses reflect operating expenses before depreciation as shown on the Statement of Revenues, Expenses, and Changes in Equity.

<sup>(e)</sup> Maximum annual debt service requirements consist of principal and interest payments prior to the U.S. federal interest subsidy on the Series 2009A revenue bonds.

<sup>(f)</sup> SAWS bond ordinance requires the maintenance of a debt coverage ratio of at least 1.25x the annual debt service on outstanding senior lien debt.

n/a Not applicable due to short period.

Source: SAWS.

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## **The Airport System**

### ***General***

The City's airport system consists of the San Antonio International Airport (the "International Airport" or the "Airport") and Stinson Municipal Airport ("Stinson") (the International Airport and Stinson, collectively, the "Airport System"), both of which are owned by the City and operated by its Department of Aviation (the "Department").

The International Airport, located on a 2,600-acre site that is adjacent to Loop 410 freeway and U.S. Highway 281, is eight miles north of the City's downtown business district. The International Airport consists of three runways with the main runway measuring 8,502 feet and able to accommodate the largest commercial passenger aircraft. Its two terminal buildings contain 24 second-level gates. Presently, the following domestic air carriers provide service to San Antonio: AirTran, American, American Eagle, Continental, Express Jet, Delta, Delta Connection/ASA, Delta Connection/Comair, Frontier, Mesa, Midwest, Northwest, Southwest, United, United Express/Skywest, United Express/GoJet, , and US Airways. AeroMéxico Connect, Aeromar, and Aerolitoral are Mexican airlines that provide passenger service to Mexico.

In May 2009, work began on a new Master Plan for the International Airport. The Master Plan will guide future development through 2030 and beyond. The Master Plan is scheduled for acceptance by the Federal Aviation Administration ("FAA") in early 2011. The Master Plan will guide Airport development for the 5, 10, and 20-year future.

The International Airport is considered a medium hub facility by the FAA. For the calendar year ended December 31, 2009, the International Airport enplaned 3,905,439 passengers. Airport management has determined that of the Airport's passenger traffic, 92% is origination and destination in nature (which is important because it demonstrates strong travel to and from the City, independent from any single airline's hubbing strategies).

Stinson Municipal Airport, located on approximately 375 acres, is approximately 6 miles south of the City's downtown business district. Stinson was established in 1915 and is one of the country's first municipally owned airports. It is the second oldest continuously operating general aviation airport in the U.S. and serves as the general aviation reliever to San Antonio International Airport. An Airport Master Plan for Stinson was initiated in March 2001 to facilitate the development of Stinson and to expand its role as a general aviation reliever to the International Airport. The Texas Department of Transportation ("TxDOT") accepted the Master Plan in 2002 and has recommended \$16.0 million in grant funding for capital improvements over the 15-year future. The expansion of Stinson's facilities is also needed to take advantage of new, complementary business opportunities evolving with the synergy between Brooks City-Base, Port San Antonio, and Stinson. A Target Industry Study was completed in 2003 as part of the master planning process. The study helped facilitate development of Stinson properties through the identification of industries and businesses considered compatible for locating at Stinson.

### ***Capital Improvement Plan***

In FY 2002, the City commenced implementation of a ten-year Capital Improvement Plan (the "CIP"). The FY 2010 through FY 2015 CIP began in 2006. Included in the program are projects planned or currently under construction at the Airport and Stinson. The six-year program totals \$287 million. The projects are necessary to accommodate the expected growth in the aircraft and passenger activity at the Airport and to replace or rehabilitate certain facilities and equipment at the Airport and Stinson. The CIP addresses terminal and airfield improvements, including the addition of Terminal B and the removal of the existing Terminal 2, as well as roadway improvements, airfield improvements, residential acoustical treatment and other building and drainage improvements.

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The anticipated sources of funding for the Airport’s CIP for fiscal years 2010 through 2015 are as follows:

<u>Funding Sources</u>	<u>Anticipated Funding</u> (\$000)
Grants	
AIP Grants	\$107,162
Texas State Grants	3,260
Passenger Facility Charges (“PFC”)	
Pay-As-You-Go	26,883
PFC Secured Bonds	55,135
Other Funding	
General Airport Revenue Bonds	58,778
Airport Capital Funds	<u>36,330</u>
Total	<u>\$287,548</u>

The CIP included capital improvements, which are generally described as follows:

<u>Improvement</u>	<u>Amount</u> (\$000)
International Airport	
Terminal/Gate Expansion	\$100,796
Airfield Improvements	51,952
Apron	27,254
Acoustical Treatment	61,250
Other Projects	41,834
Stinson Airport	<u>4,462</u>
Total	<u>\$287,548</u>

Please note that the City issued \$34.5 million of Tax Notes, Series 2010 (the “Notes”) for the interim financing of the CIP. The City plans to refund these Notes in the Fall of 2010 when the City issues Airport bonds.

*PFC Projects.* In the United States, the federal Passenger Facility Charge (“PFC”) Program allows the collection of PFC fees up to \$4.50 for every enplaned passenger at commercial airports controlled by public agencies. Airports use these fees to fund FAA-approved projects that enhance safety, security, or capacity; reduce noise; or increase air carrier competition. Federal law limits use of PFC funds strictly to the above categories. Public agencies wishing to impose passenger facility charges are required to apply to the FAA for such authority and must meet certain requirements and implementing regulations issued by the FAA.

The FAA issued a “Record of Decision” on August 29, 2001 approving the City’s initial PFC application. The City, as the owner and operator of the Airport, received authority to impose a \$3.00 PFC and to collect, taken together, approximately \$102,500,000 in PFC revenues. On February 15, 2005, the FAA approved an application amendment increasing the PFC funding by a net amount of \$13,893,537. On February 22, 2005, the FAA approved the City’s application for an additional \$50,682,244 in PFC collections to be used for eleven new projects. On June 26, 2007, the FAA approved two amendments to approved applications increasing the PFC funding by a net amount of \$121,611,491 for two projects and \$67,621,461 for four projects. On October 4, 2007, the FAA issued a “Final Agency Decision” for a PFC application to be used for four new projects and increased the impose authority by an additional \$24,625,453. Additionally, the FAA approved the increased collection rate from \$3.00 to \$4.50 effective October 1, 2007.

On October 1, 2007, the City began collecting a \$4.50 PFC (less than \$0.11 air carrier collection charge) per paying passenger enplaned. A total of approximately \$381 million in PFC revenues will be required to provide funding for the projects included in the Airport’s CIP. The City has received PFC “impose and use” authority, meaning that it may impose the PFC and use the resultant PFC revenues for all projects, contemplated to be completed using bond proceeds. The estimated PFC collection expiration date is March 1, 2019.

To date, the following projects have been approved as “impose and use” projects:

- Replace Remain Overnight Apron
- Rehabilitate Terminals 1 & 2
- Reconstruct Perimeter Road
- Construct New Concourse B
- Acoustical Treatment Program
- Construct Elevated Terminal Roadway
- Upgrade Central Utility Plant
- Construct Apron – Terminal Expansion
- Install Utilities – Terminal Expansion
- Replace Two Airport Fire & Rescue Vehicles
- Conduct Environmental Impact Statement
- Reconstruct Terminal Area Roadway
- Install Noise Monitoring Equipment
- Install Terminal and Airfield Security Improvements
- Install Airfield Electrical Improvements
- PFC Development and Administration Costs
- Terminal 1 Modifications
- RSAT Airfield Improvements
- Runway 3-21 Extension
- Extend Taxiway R

Airport management has amended its PFC funding authorization to increase the amount of PFC funding that may be used in the current capital program. The Airport management has coordinated PFC Program amendments with the airlines, the FAA, and the public, which will increase the authorization by \$192,810,480. This will increase the overall PFC authorization to collect from \$380,958,549 to \$573,769,029. FAA approval of the amendments was received on May 28, 2010.

Projects that will be funded with the additional PFC proceeds include Noise Attenuation, Construction of Terminal B, New Utilities Plant Expansion, Terminal 1 Modifications, and Taxiway R Extension.

*Terminal Expansion.* The terminal expansion project will include an eight-gate Terminal B, a new consolidated baggage handling system and a new central utility plant. Terminal B will replace Terminal 2, which is obsolete and will be demolished. Terminal B is schedule for completion in November 2010.

*Airfield Improvements.* Implementation of the Master Plan Airfield Recommendations required an Environmental Impact Statement (“EIS”) to assess the environmental impacts associated with the capacity enhancing runway/taxiway projects. Public involvement throughout the process is essential to the successful completion of these projects. Airport Master Plan projects included as part of the EIS include extension of Runway 3/21 and Taxiways N and Q; reconstruction and upgrade of Runway 12L/30R and associated taxiways from general aviation to air carrier dimensions of approximately 8,500 feet by 150 feet; as well as the installation of an instrument landing system. With a determination from the FAA that the Runway 12L/30R project was not yet critical to airfield capacity and that the required length of extension for Runway 3/21 was 1,000 feet rather than 1,500 feet proposed by the Master Plan, the EIS was reclassified as an environmental assessment (“EA”) for the remaining work. The final public meeting for the EA was held on August 28, 2007 and a finding of no significant impact was received. In 2008, Taxiway’s G and N were widened and airfield lighting was enhanced as part of the ongoing apron improvements. The extension of runway 3/21 is being funded with incremental Airport Improvement Program Grants and therefore will be constructed in phases as grant funds become available. The extension project began in 2009 and is expected to be completed in late 2012.

*Parking Improvements.* As of Fall 2009, the International Airport operates and maintains approximately 8,668 public parking spaces and 1,263 employee parking spaces for a total of 9,931 parking spaces. In June 2008, a 2,400 parking space expansion was completed. With completion of the expansion, parking facilities are expected to accommodate demand through 2020.

*Cargo Improvements.* The International Airport has two designated cargo areas: the West Cargo Area, which was constructed in 1974 and refurbished in 1990, and the East Cargo Area, which was completed in 1992 and expanded in 2003. The East Cargo Area is specifically designed for use by all-cargo, overnight-express carriers. Custom-built cargo facilities in the East Cargo Area are leased to DHL, UPS, and Federal Express, while Lynx constructed a processing facility in the year 2000. Foreign trade zones exist at both cargo areas. Enplaned and deplaned cargo for 2009 totaled 259,814,742 pounds.

## **Airport Operations**

The City is responsible for the issuance of revenue bonds for the Airport System and preparation of long-term financial feasibility studies for Airport System development. The Department exercises direct supervision of airport operations. The Department is responsible for: (i) managing, operating, and developing the International Airport, Stinson, and any other airfields that the City may control in the future; (ii) negotiating leases, agreements, and contracts; (iii) computing and supervising the collection of revenues generated by the Airport System under its management; and (iv) coordinating aviation activities under the FAA.

The FAA has regulatory authority over navigational aid equipment, air traffic control, and operating standards at both the International Airport and Stinson.

The passage of the Aviation and Transportation Security Act in November of 2001, created the Transportation Security Administration (“TSA”). The Department has worked closely with the TSA to forge a higher level of security for the traveling public. TSA employs about 300 individuals at the International Airport to meet the federal security requirements.

The number of based aircraft and volume of aircraft operations at Stinson Airport has been relatively constant over the past few years. Material growth in aircraft operations and number of base aircraft is expected to increase over the next few years as additional common use hangars and T-hangars are constructed and come online.

Because of its potential growth, the TxDOT Aviation Division approved grant funds for various projects at Stinson. To accommodate the demand for services at Stinson, a \$4.8 million terminal expansion project added approximately 24,000 square feet of additional concession, administrative, education, and corporate aviation space to the existing 7,000 square-foot terminal building. With Airport System funds, the Stinson Terminal Building was completed in November 2008. The terminal expansion project adds administrative offices, classrooms, concession, retail space, and conference rooms to accommodate and attract new business. In November 2007, the Environmental Assessment for the runway extension and related airfield projects were approved when the TxDOT Aviation Division issued a “Finding of No Significant Impact.” The runway project completed in March 2010 provides a usable runway length of 5,000 feet. The additional runway length will allow Stinson to serve additional types of general aviation aircraft to include operators of corporate jets. The expansion, along with a runway extension and other infrastructure improvements, will allow for the growth of existing tenants as well as create opportunities for new business to locate at Stinson. Palo Alto Community College moved its Aviation Program to Stinson in the expanded terminal space in June 2009.

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**Comparative Statement of Gross Revenues and Expenses - San Antonio Airport System**

The historical financial performance of the Airport System is shown below for the last five fiscal years:

	Fiscal Year Ended September 30				
	2005	2006	2007	2008	2009
Gross Revenues <sup>1</sup> :	\$47,180,690	\$52,785,593	\$56,682,447	\$65,187,888	\$61,248,835
Airline Rental Credit	<u>5,322,516</u>	<u>7,988,304</u>	<u>8,831,771</u>	<u>5,040,274</u>	<u>4,429,593</u>
Adjusted Gross Revenues	\$52,503,206	\$60,773,897	\$65,514,218	\$70,228,162	\$65,678,428
Expenses	<u>(26,411,104)</u>	<u>(29,471,313)</u>	<u>(32,583,693)</u>	<u>(41,585,794)</u>	<u>(40,476,525)</u>
Net Income	<u>\$26,092,102</u>	<u>\$31,302,584</u>	<u>\$32,930,525</u>	<u>\$28,642,368</u>	<u>\$25,201,903</u>

<sup>1</sup> As reported in the City's audited financial statements.

Source: City of San Antonio, Department of Finance.

**Total Domestic and International Enplaned Passengers - San Antonio International Airport**

The total domestic and international enplaned passengers on a calendar year basis, along with year-to-year percentage change are shown below:

Calendar Year	Total	Increase/ (Decrease)	Percent (%) Change
2000	3,647,094	---	---
2001	3,444,875	(202,219)	(5.54)
2002	3,349,283	(95,592)	(2.78)
2003	3,250,911	(98,372)	(2.94)
2004	3,498,895	247,984	7.63
2005	3,713,792	214,897	6.14
2006	4,003,075	289,283	7.79
2007	4,030,571	27,496	0.69
2008	4,167,440	136,869	3.40
2009*	3,905,439	(262,001)	(6.29)

\* The decline in enplaned passengers is attributable to general economic conditions and two airlines failing.

Source: City of San Antonio, Department of Aviation.

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**Total Enplaned and Deplaned International Passengers - San Antonio International Airport**

The total enplaned and deplaned for international passengers on a calendar year basis, along with year-to-year percentage change are shown below:

Calendar <u>Year</u>	<u>Total</u>	Increase/ <u>(Decrease)</u>	Percent (%) <u>Change</u>
2000	243,525	---	---
2001	219,352	(24,173)	(9.93)
2002	201,274	(18,078)	(8.24)
2003	159,576	(41,698)	(20.72)
2004	191,254	31,678	19.85
2005	185,992	(5,262)	(2.75)
2006	199,138	13,146	7.07
2007	197,585	(1,553)	(0.78)
2008	177,219	(20,366)	(10.31)
2009	139,286	(37,933)	(21.40)

*Source: City of San Antonio, Department of Aviation.*

**Air Carrier Landed Weight - San Antonio International Airport**

The historical aircraft landed weight in 1,000-pound units on a calendar year basis is shown below. Landed weight is utilized in the computation of the Airport's landed fee.

Calendar <u>Year</u>	<u>Total</u>	Increase/ <u>(Decrease)</u>	Percent (%) <u>Change</u>
2000	5,838,185	---	---
2001	5,546,561	(291,624)	(5.00)
2002	5,559,018	12,457	0.23
2003	5,391,301	(167,717)	(3.02)
2004	5,416,555	25,254	0.47
2005	5,650,228	233,673	4.32
2006	5,946,232	296,004	5.24
2007	6,098,276	152,044	2.56
2008	6,209,192	110,916	1.82
2009	5,487,537	(721,655)	(11.62)

*Source: City of San Antonio, Department of Aviation.*

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**APPENDIX B**



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**CITY PUBLIC SERVICE**

**AUDITED FINANCIAL STATEMENTS  
FOR THE FISCAL YEARS ENDED  
JANUARY 31, 2010 AND 2009  
AND INDEPENDENT AUDITORS' REPORT**

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## MANAGEMENT'S DISCUSSION AND ANALYSIS

### INTRODUCTION

The following Management's Discussion and Analysis ("MD&A") serves as an introduction to the financial statements of City Public Service of San Antonio (also referred to as "CPS Energy," "CPS" or the "Company"). It is intended to be an objective and easily understandable analysis of significant financial and operating activities and events for the fiscal year ended January 31, 2010 ("FY 2010"), compared to the fiscal year ended January 31, 2009 ("FY 2009"). It also provides an overview of CPS Energy's general financial condition and results of operations for FY 2009, compared to the previous fiscal year ended January 31, 2008 ("FY 2008"). This MD&A has been prepared in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and should be read in conjunction with the audited financial statements and accompanying notes that follow.

### BASIC FINANCIAL STATEMENTS

The Balance Sheets present CPS Energy's assets, liabilities and fund net assets as of the end of each fiscal year. Assets are separated into current and noncurrent categories and are reported in the order of liquidity. Current assets include unrestricted cash and cash equivalents, cash collateral from securities lending, investments, receivables and inventories, as well as prepayments, deferred and other current assets. Noncurrent assets include cash and cash equivalents, investments, and interest receivable that have been restricted by state laws, ordinances or contracts. Noncurrent assets also include prepayments, the net other postemployment benefits ("OPEB") obligation, other deferred costs and net capital assets.

Liabilities are also segregated into current and noncurrent categories. Current liabilities include the current maturities of revenue bonds, accounts payable and accrued liabilities, as well as the obligation to repay cash collateral from securities lending. Noncurrent liabilities include net long-term debt, the South Texas Project ("STP") decommissioning liability, STP decommissioning net costs refundable, deferred lease revenue, and other noncurrent liabilities and deferred credits.

The Balance Sheets report fund net assets as the difference between total assets and total liabilities. The fund net assets are classified as invested in capital assets, net of related debt; restricted; or unrestricted. An unrestricted designation indicates the funds are available for operations.

Within the Statements of Revenues, Expenses and Changes in Fund Net Assets, operating results are reported separately from nonoperating activities, which primarily relate to financing and investing. Other payments to the City of San Antonio, contributed capital, and the effect of STP's defined benefit plan funding obligations are also reported separately as components of the change in fund net assets. These statements identify revenue generated from sales to cover operating and nonoperating expenses. Operating expenses are presented by major cost categories. Revenues remaining are available to service debt, to fulfill city payment commitments, to finance capital expenditures and to cover contingencies.

The Statements of Cash Flows present operating activities, capital and related financing activities, noncapital financing activities, and investing activities. These statements are prepared using the direct method, which reports cash receipts and payments, and presents a reconciliation of operating income to net cash provided by operating activities. These statements also separately list the noncash financing and investing activities.

## FINANCIAL HIGHLIGHTS AND SIGNIFICANT ACCOUNTING POLICIES

**Allowance for Funds Used During Construction (“AFUDC”)** – To more accurately reflect funding methodology, the AFUDC rate was modified effective for FY 2010 to include both a debt and an equity component. The new blended rate is composed of 50% equity and 50% debt based on construction funding forecasts for FY 2010. Both the investment rate as well as the debt rate will continue to be reviewed quarterly to determine if any adjustments are necessary. Projects costing more than \$100 million use alternate AFUDC rates, which reflect the method by which they are funded.

**Build America Bonds (“BABs”)** – The American Recovery and Reinvestment Act of 2009 provided authority for the issuance of BABs, which are issuable in calendar years 2009 and 2010, limited to new money capital expenditures, and only issued as taxable bonds. The BABs also permit the issuer (or the bondholder) to receive a subsidy payment equal to 35% of the bond’s interest directly from the U.S. Department of the Treasury. On June 12, 2009, CPS Energy issued \$375.0 million of taxable New Series 2009C Revenue Direct Subsidy BABs. Additional transaction details are provided in Note 6 – Revenue Bonds. See the Currently Known Facts section of the MD&A for an additional BABs transaction that occurred after the end of FY 2010.

**The City of San Antonio** – CPS Energy is owned by the City of San Antonio, Texas (“City”). In turn, CPS Energy is treated as a component unit of the City, which has a fiscal year that ends September 30.

**Contributed Capital** – Third-party contributions made for construction of capital assets flow through the Statements of Revenues, Expenses and Changes in Fund Net Assets and are shown on the Balance Sheets as part of fund net assets that are invested in capital assets. The amount reported for contributed capital was \$39.0 million at January 31, 2010, as compared with \$30.2 million at January 31, 2009. The portion of these balances that represents contributions received from customers as payments for utility extensions and services was \$25.5 million at January 31, 2010, and \$30.1 million at January 31, 2009.

**Counterparty Risk** – CPS Energy is exposed to counterparty risk associated with various transactions primarily related to debt, investments, a lease/leaseback transaction and wholesale power. Counterparty risk is the risk that a counterparty will fail to meet its obligations in accordance with the terms and conditions of its contract with the Company. The Company has policies and practices in place to ensure the solvency of counterparties is assessed accurately, monitored regularly, and managed actively through its Enterprise Risk Management Division.

**CPS Energy Component Units** – Under GASB Statement No. 14, *The Financial Reporting Entity*, the assets and liabilities accumulated for CPS Energy’s two decommissioning trusts for STP Units 1 and 2 (“Decommissioning Trusts” or “Trusts”) are combined into the CPS Energy financial statements using the blended method of inclusion. Initially, CPS Energy owned a 28% interest in STP. In May 2005, CPS Energy purchased an additional 12% interest in STP Units 1 and 2. Assets from an associated decommissioning trust were also received with this purchase. CPS Energy reports the assets in both Trusts—the 28% interest and the 12% interest—as component units.

**Decommissioning** – In FY 2009, the Company changed its method of accounting for the Decommissioning Trusts. Under the new method, a pro rata share of total decommissioning costs (as

See accompanying independent auditors’ report.

determined by the most recent cost study) has been recognized as a liability. In subsequent years, annual decommissioning expense and an increase in the liability will include the effects of inflation and an additional year of plant usage.

Additionally, due to requirements under the Code of Federal Regulations governing nuclear decommissioning trust funds, guidance provided in Financial Accounting Standard (“FAS”) 71, *Accounting for the Effects of Certain Types of Regulation*, has been followed. Under this guidance, the zero fund net assets approach to accounting for the Decommissioning Trusts has been retained. In accordance with FAS 71, the cumulative effect of activity in the Trusts has been recorded as a regulatory liability reported on the Balance Sheets as STP decommissioning net costs refundable since any excess funds are payable to customers. Going forward, prolonged unfavorable economic conditions could result in the assets of the Trusts being less than the estimated decommissioning liability. In that case, instead of an excess as currently exists, there would be a deficit that would be reported as STP decommissioning net costs recoverable. This amount would be receivable from customers.

Current-year and prior-year activity in the Trusts has been reported in the nonoperating income (expense) section of the Statements of Revenues, Expenses and Changes in Fund Net Assets as STP decommissioning net costs recoverable (refundable). There was no impact to fund net assets as a result of this change in accounting method. FY 2008 amounts were reclassified to conform to the current-year presentation.

**Employee Benefit Plans** – The City Public Service Group Disability, Life and Health Plans (“Employee Benefit Plans”) are separately audited and reported. The financial results of the Employee Benefit Plans are not included herein except for certain disclosures as provided in Note 9 – Other Postemployment Benefits.

**Flexible Rate Revolving Note Private Placement Program** - On January 20, 2009, CPS Energy’s Board of Trustees (“Board”) authorized the establishment of a flexible rate revolving note program to provide additional liquidity in support of the Company’s electric and gas systems (“Systems”). Under the program, CPS Energy can issue taxable or tax-exempt notes with individual maturities of one year or less at fixed or variable interest rates in an aggregate principal amount at any one time outstanding not to exceed \$100 million. The program became effective on April 28, 2009, and authorizes the issuance of such notes through November 1, 2028. There were no outstanding notes under this program as of January 31, 2010.

**Hedging Derivative Instruments** – GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, was implemented in FY 2010. This accounting standard requires that hedging derivative instruments be reported at fair value on the Balance Sheets. The primary derivative instruments currently used by CPS Energy are fuel hedges, which are used to reduce price risk for natural gas purchases. GASB Statement No. 53 and its impact on the financial statements are addressed in Note 11 – Other Financial Instruments.

**Pension Plan** – The financial statements of CPS Energy’s pension plan (“Pension Plan”) are separately audited and reported. The financial results of the Pension Plan are not included herein except for certain disclosures as provided in Note 8 – Employee Pension Plan.

**Rate Increase** – Rates are set by the Board and approved by the City of San Antonio’s City Council. The City Council approved a 3.5% increase in the Company’s natural gas and electric rates on May 15, 2008, which became effective on September 1, 2008. See the Currently Known Facts section of MD&A for the rate increases that became effective March 1, 2010.

**Reclassifications** – Certain amounts in the prior years’ financial statements have been reclassified to conform to the current-year presentation.

**SA Energy Acquisition Public Facility Corporation (“PFC”)** – The PFC is a public, nonprofit corporation organized under the laws of the State of Texas pursuant to the Texas Public Facility Corporation Act, Chapter 303, Texas Local Government Code. The PFC was organized in FY 2008 to assist its sponsor, the City, in financing, refinancing or providing public facilities, including natural gas, to be devoted to public use. The PFC is a component unit of the City.

On June 14, 2007, the PFC entered into a Natural Gas Supply Agreement with the City, acting by and through CPS Energy. This gas supply agreement provides for the sale to CPS Energy, on a pay-as-you-go basis, of all natural gas to be delivered to the PFC under a Prepaid Natural Gas Sales Agreement. Under this prepaid gas agreement between the PFC and a third-party gas supplier, the PFC has prepaid the cost of a specified supply of natural gas to be delivered over 20 years. CPS Energy’s net savings resulting from this transaction are passed on, in their entirety, to its distribution gas customers. The financial statements of the PFC are separately audited and reported.

**Save for Tomorrow Energy Program (“STEP”)** – During FY 2009, CPS Energy committed to spending approximately \$849 million over the next 12 years on energy efficiency and conservation through STEP. Annually, the first \$8 million of STEP expenses will be funded through the base rate and will be reported as CPS Energy operation and maintenance (“O&M”) expenses.

STEP expenses over the initial \$8 million per year will be recovered through the fuel adjustment factor in the year after they are incurred and have been independently validated. These STEP recoveries will be deferred as STEP net costs recoverable in accordance with guidance provided by FAS 71. This guidance requires that certain costs be capitalized as a regulatory asset until they are recovered through future rates. As a result, there is no impact to net income from the STEP expenses over the initial \$8 million.

**Securities Lending** – CPS Energy and the Decommissioning Trusts engage in securities lending transactions under a contract with their lending agent, Frost National Bank, a Texas-based financial institution. GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, provides guidance for entities reporting and disclosing securities lending transactions. This guidance includes reporting certain securities lending collateral on the balance sheet as an asset, with a corresponding liability for the obligation to repay the collateral.

**STP** – Correlating to CPS Energy’s 40% interest in STP Units 1 and 2 that have been in operation since 1988 and 1989, respectively, the applicable financial results of the nonprofit special-purpose operations project were combined within these financial statements. STP follows guidance provided by the Financial Accounting Standards Board (“FASB”). FY 2008 reflects the impact of the implementation of FAS 158, *Employer’s Accounting for Defined Benefit Pension and Other Postretirement Plans*. This statement required STP to recognize additional liabilities and eliminate an intangible asset related to certain of its qualified and nonqualified plans. FAS 158 and its impact on the financial statements are addressed in Note 13 – South Texas Project.

**RESULTS OF OPERATIONS****Summary of Revenues, Expenses and Changes in Fund Net Assets**

(Dollars in thousands)

	Fiscal Year Ended January 31,			Change			
	2010	2009	2008	2010 vs. 2009		2009 vs. 2008	
Revenues and nonoperating income							
Electric	\$ 1,717,077	\$ 1,899,457	\$ 1,605,238	\$ (182,380)	-9.6%	\$ 294,219	18.3%
Gas	213,798	251,884	255,439	(38,086)	-15.1%	(3,555)	-1.4%
Total operating revenues	1,930,875	2,151,341	1,860,677	(220,466)	-10.2%	290,664	15.6%
Nonoperating income, net	44,329	72,008	116,956	(27,679)	-38.4%	(44,948)	-38.4%
Total revenues and nonoperating income	1,975,204	2,223,349	1,977,633	(248,145)	-11.2%	245,716	12.4%
Expenses							
Operating expenses							
Fuel, purchased power and distribution gas	689,225	899,314	701,190	(210,089)	-23.4%	198,124	28.3%
STP operation and maintenance	142,865	139,073	121,754	3,792	2.7%	17,319	14.2%
CPS Energy operation and maintenance	299,450	303,284	290,569	(3,834)	-1.3%	12,715	4.4%
Annual OPEB cost	8,798	13,054	13,377	(4,256)	-32.6%	(323)	-2.4%
Annual pension cost	23,503	20,590	20,868	2,913	14.1%	(278)	-1.3%
Energy efficiency and conservation (STEP)	12,599	-	-	12,599	-	-	-
STEP net costs recoverable	(12,599)	-	-	(12,599)	-	-	-
Regulatory assessments	36,051	31,257	23,192	4,794	15.3%	8,065	34.8%
Decommissioning	24,310	21,201	25,608	3,109	14.7%	(4,407)	-17.2%
Depreciation, depletion and amortization	285,823	283,398	264,657	2,425	0.9%	18,741	7.1%
Total operating expenses	1,510,025	1,711,171	1,461,215	(201,146)	-11.8%	249,956	17.1%
Nonoperating expenses							
Interest and debt-related	133,743	139,485	157,519	(5,742)	-4.1%	(18,034)	-11.4%
Payments to the City of San Antonio	260,636	282,140	247,854	(21,504)	-7.6%	34,286	13.8%
Total nonoperating expenses	394,379	421,625	405,373	(27,246)	-6.5%	16,252	4.0%
Total expenses	1,904,404	2,132,796	1,866,588	(228,392)	-10.7%	266,208	14.3%
Income before other changes in fund net assets	70,800	90,553	111,045	(19,753)	-21.8%	(20,492)	-18.5%
Other payments to the City of San Antonio	(11,980)	(9,203)	(9,460)	(2,777)	-30.2%	257	-2.7%
Contributed capital	38,991	30,218	29,937	8,773	29.0%	281	0.9%
Effect of defined benefit plan funding obligations – STP	9,788	(29,726)	(21,174)	39,514	132.9%	(8,552)	-40.4%
Change in fund net assets	107,599	81,842	110,348	25,757	31.5%	(28,506)	-25.8%
Fund net assets – beginning	3,111,551	3,029,709	2,919,361	81,842	2.7%	110,348	3.8%
Fund net assets – ending	\$ 3,219,150	\$ 3,111,551	\$ 3,029,709	\$ 107,599	3.5%	\$ 81,842	2.7%

**Total Revenues and Nonoperating Income**

***FY 2010*** – Representing 97.7% of total revenues and nonoperating income, electric and gas revenues of \$1.9 billion decreased by \$220.5 million, or 10.2%, compared to FY 2009. Additionally, CPS Energy had \$44.3 million in net nonoperating income for FY 2010 compared to \$72.0 million for FY 2009.

Electric energy is generated from four sources—coal, nuclear, gas and oil. Approximately 84.0% and 89.0% of its customers' energy needs for FY 2010 and FY 2009, respectively, were produced from CPS Energy's generating units. To meet its total sales requirements for its retail customers within the greater San Antonio certificated area and its wholesale customers outside of this area, energy is also purchased from third-party providers. Purchased power includes renewables, such as wind-generated energy.

Representing 86.9% of CPS Energy's total revenues and nonoperating income, electric operating revenue of \$1.7 billion decreased 9.6% from FY 2009. This was due primarily to decreases of \$120.4 million in system fuel recoveries and \$125.5 million in off-system revenues. These decreases were partially offset by \$60.5 million higher system nonfuel recoveries resulting from the base rate increase effective September 1, 2008, and higher sales volumes in FY 2010 versus FY 2009. Lower fuel

See accompanying independent auditors' report.

costs for FY 2010 contributed to lower fuel recovery revenue. Overall, electric sales decreased 0.5% primarily as a result of lower off-system sales due mainly to lower natural gas prices. However, electric system sales increased 1.9% as a result of hotter temperatures and continued customer growth.

Representing 10.8% of total revenues and nonoperating income, gas revenue for FY 2010 totaled \$213.8 million, a 15.1% reduction from FY 2009. This was due primarily to decreases in fuel recoveries of \$43.3 million as a result of lower distribution gas costs, partially offset by an increase of \$5.1 million in nonfuel recoveries resulting from the September 2008 base rate increase and a 7.3% increase in sales volumes.

Net nonoperating income of \$44.3 million decreased \$27.7 million from FY 2009. This was primarily due to a decrease in interest and other income of \$28.6 million, resulting from lower yields.

***FY 2009*** – Representing 96.8% of total revenues and nonoperating income, electric and gas revenues of \$2.2 billion increased by \$290.7 million, or 15.6%, compared to FY 2008. Additionally, CPS Energy had \$72.0 million in net nonoperating income for FY 2009 compared to \$117.0 million for FY 2008.

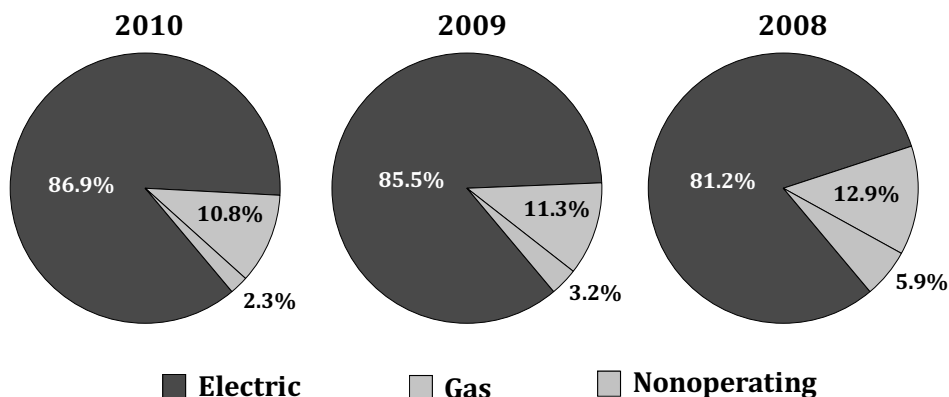
Approximately 89.0% and 90.1% of its customers’ energy needs in FY 2009 and FY 2008, respectively, were produced from CPS Energy’s generating units.

Representing 85.5% of CPS Energy’s total revenues and nonoperating income, electric operating revenue of \$1.9 billion increased 18.3% from FY 2008. This was due primarily to increases of \$191.3 million in system fuel recoveries, \$52.8 million in system nonfuel recoveries, \$47.5 million in off-system revenues, and other revenues of \$2.6 million. A rise in fuel costs during the summer of 2008 contributed to higher fuel recovery revenue. In addition, overall electric sales increased 1.2% as a result of slightly warmer temperatures and continued customer growth.

Representing 11.3% of total revenues and nonoperating income, gas revenue for FY 2009 totaled \$251.9 million, a 1.4% reduction from FY 2008. This was due primarily to decreases in fuel recoveries of \$3.0 million and a decrease of \$0.6 million in nonfuel recoveries as a result of lower sales volumes due to milder temperatures in the late fall and early winter months of FY 2009.

Net nonoperating income of \$72.0 million decreased \$44.9 million from FY 2008. This was due to a decrease in interest and other income, resulting from a lower level of invested funds and lower yields.

**Total Revenues and Nonoperating Income  
Fiscal Year Ended January 31,**



See accompanying independent auditors’ report.

## Operating Expenses

**FY 2010** – Operating expenses totaled \$1.5 billion and were \$201.1 million, or 11.8% lower than FY 2009.

Within total operating expenses, the combined fuel, purchased power and distribution gas costs of \$689.2 million decreased \$210.1 million and represented 45.6% of total operating expenses. Of the \$689.2 million, electric fuel and purchased power costs decreased \$172.8 million from FY 2009 to \$562.1 million due to a decrease in average fuel commodity costs. Distribution gas costs of \$127.1 million decreased by \$37.3 million from FY 2009 due to a decrease in the average unit fuel cost.

STP O&M expenses of \$142.9 million for FY 2010 were \$3.8 million higher than last year. There were two refueling outages in the prior year versus one unplanned outage and one planned refueling outage in the current year; however, this year's refueling outage was longer than planned. In addition, in FY 2010 costs related to benefits and outside services increased.

CPS Energy O&M expenses of \$299.4 million combined with annual OPEB cost of \$8.8 million and annual pension cost of \$23.5 million totaled \$331.8 million, a decrease of \$5.1 million, or 1.5% below FY 2009. Primarily contributing to the decrease were lower labor costs associated with meriting, incentive pay and various benefits. Meriting and wage-scale increases were not awarded in FY 2010. The Pension Administrative Committee recommended, and management approved, a target amortization period of 20 years, resulting in the \$2.9 million increase in annual pension cost as compared to FY 2009.

Energy efficiency and conservation ("STEP") expense was \$12.6 million. This amount represents costs incurred above the \$8 million funded through the base rate and recorded as CPS O&M expenses. As the STEP program is new, the \$12.6 million accounted for the entire variance over the prior fiscal year.

STEP net costs recoverable was \$(12.6) million. This reflects the deferral of these costs as a regulatory asset on the Balance Sheets to be recovered through future rates. As the STEP program is new, the \$(12.6) million accounted for the entire variance over the prior year.

Regulatory assessments, including those charged by the Public Utility Commission of Texas ("PUCT") and the Electric Reliability Council of Texas ("ERCOT"), increased \$4.8 million from FY 2009 to \$36.1 million. This was primarily due to increases in transmission costs of service ("TCOS") in the Texas market, of which \$10.5 million, or approximately 7% of total market costs, was assessed to CPS Energy. The increase in TCOS was partially offset by a decrease in ERCOT costs.

Decommissioning expense for FY 2010 totaled \$24.3 million, or \$3.1 million higher than FY 2009. The increase resulted from higher funding requirements for projected decommissioning costs.

Depreciation and amortization expense of \$285.8 million for FY 2010 increased by \$2.4 million from FY 2009 due to the increase in depreciation related to additions to plant-in-service. The increase was partially offset by depreciation adjustments related to a reclassification of assets to more appropriate categories that have longer lives.

**FY 2009** – Operating expenses totaled \$1.7 billion and were \$250.0 million, or 17.1%, higher than FY 2008.

Within total operating expenses, the combined fuel, purchased power and distribution gas costs of \$899.3 million increased \$198.1 million and represented 52.6% of total operating expenses. Of this total, electric fuel and purchased power costs increased \$200.5 million over FY 2008 to \$734.9 million due to higher generation requirements and an increase in the average unit fuel cost. The increase in

average unit cost was primarily due to higher fuel commodity prices in the current year, as well as a generation mix that had a higher ratio of more expensive renewables and other purchased power. Distribution gas costs of \$164.4 million decreased slightly by \$2.3 million from FY 2008. The slight increase in the average unit cost was more than offset by lower sales due to the effect of milder temperatures in FY 2009.

STP O&M expenses totaled \$139.1 million and were \$17.3 million higher than last year. This increase was the result of two refueling outages in the current year versus one in FY 2008.

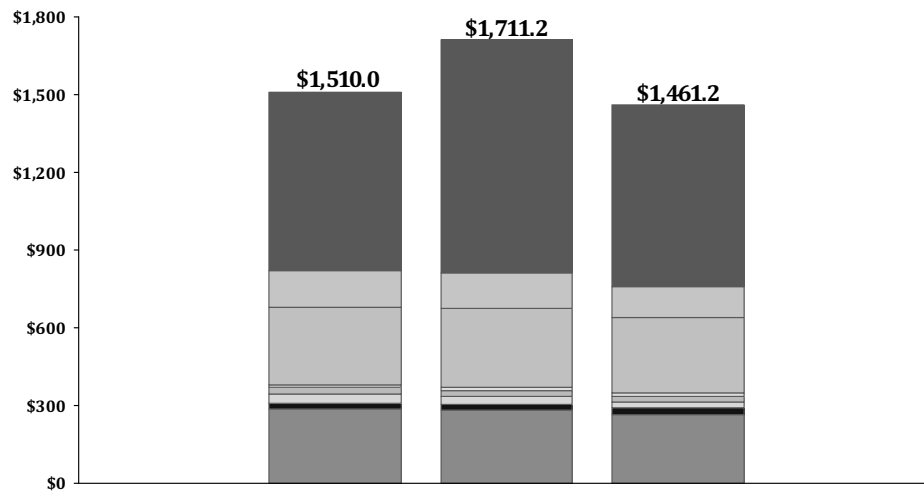
CPS Energy O&M expenses of \$303.3 million combined with annual OPEB cost of \$13.0 million and annual pension cost of \$20.6 million totaled \$336.9 million, an increase of \$12.1 million over FY 2008. Primarily contributing to the increase were higher labor costs associated with increases in general wages, meriting and various benefits and an increase in energy efficiency rebates provided to customers.

Regulatory assessments, including those charged by the PUCT and ERCOT, were \$31.3 million, an increase of \$8.1 million from FY 2008. PUCT-related expenses increased \$4.1 million and ERCOT-related costs increased \$4.0 million due primarily to balancing energy adjustments.

Decommissioning expense for FY 2009 totaled \$21.2 million compared to \$25.6 million for FY 2008. The decrease mainly resulted from lower funding requirements for projected decommissioning costs.

Depreciation, depletion and amortization expense of \$283.4 million for FY 2009 increased \$18.7 million, or 7.1%, from the prior year as a result of an increase in assets placed in service.

**Total Operating Expenses**  
Fiscal Year Ended January 31,  
(In millions)



	2010	2009	2008
Fuel, purchased power and distribution gas	\$ 689.2	\$ 899.3	\$ 701.2
STP O&M	142.9	139.1	121.7
CPS Energy O&M	299.4	303.3	290.5
Annual OPEB cost	8.8	13.0	13.4
Annual pension cost	23.5	20.6	20.9
Regulatory assessments	36.1	31.3	23.2
Decommissioning	24.3	21.2	25.6
Depreciation, depletion and amortization	285.8	283.4	264.7

See accompanying independent auditors' report.

## **Nonoperating Expenses**

**FY 2010** – Interest expense and other debt-related costs of \$133.7 million were \$5.7 million lower than FY 2009 primarily due to greater AFUDC, or capitalized interest. AFUDC increased in FY 2010 as a result of increased construction, including J.K. Spruce Unit 2 (“Spruce 2”), the V.H. Braunig (“VHB”) peaking units and spending toward the development of STP Units 3 and 4.

CPS Energy is a wholly owned component unit of the City. In accordance with the Company’s bond ordinances, no more than 14% of CPS Energy’s gross system revenues can be remitted to the City each year. Payments to the City for FY 2010 totaled \$260.6 million and were \$21.5 million lower than FY 2009 primarily as a result of lower applicable revenues due mainly to less fuel recoveries. See Other Changes in Fund Net Assets for information on other payments to the City.

**FY 2009** – Interest expense and debt-related costs of \$139.5 million were \$18.0 million lower than FY 2008 primarily due to greater AFUDC in the current year as a result of increased construction, including Spruce 2.

Payments to the City for FY 2009 totaled \$282.1 million and were \$34.3 million more than FY 2008. Higher electric system sales, combined with higher system fuel recoveries due to increased average unit fuel costs, were the primary contributors to the increase. See Other Changes in Fund Net Assets for information on other payments to the City.

## **Other Changes in Fund Net Assets**

**FY 2010** – Income before other changes in fund net assets totaled \$70.8 million for FY 2010, a decrease of \$19.8 million from FY 2009. After recording a \$12.0 million additional payment to the City, \$39.0 million in contributed capital from third parties, and the \$9.8 million effect of STP’s defined benefit plan funding obligations, CPS Energy’s change in fund net assets for FY 2010 was \$107.6 million, an increase of \$25.8 million from FY 2009. The increase was primarily driven by the effect of STP’s defined benefit plan funding obligations. As the market improved this past year, the plan’s funding requirements were lower than FY 2009.

In FY 2010, CPS Energy recorded \$12.0 million in other payments to the City, of which \$9.7 million was in lieu of Community Infrastructure and Economic Development (“CIED”) funding and \$2.3 million was from the CIED Fund (see Note 1 – Summary of Significant Accounting Policies for further information). This additional distribution is reported separately with other changes in fund net assets. After this additional distribution, CPS Energy was still in accordance with its bond ordinances, as distributions to the City were under the 14% threshold.

**FY 2009** – Income before other changes in fund net assets totaled \$90.6 million for FY 2009, a decrease of \$20.5 million from FY 2008. After recording \$9.2 million of additional payments to the City, \$30.2 million in contributed capital from third parties, and the \$29.7 million change due to the effect of STP’s defined benefit plan funding obligations, CPS Energy’s change in fund net assets was \$81.8 million, which was \$28.5 million lower than last year.

In FY 2009, CPS Energy recorded \$9.2 million in other payments to the City in lieu of CIED funding. This additional distribution is reported separately with other changes in fund net assets. After this additional distribution, CPS Energy was still in accordance with its bond ordinances, as distributions to the City were under the 14% threshold.

## FINANCIAL POSITION

### Balance Sheets Summary (Dollars in thousands)

	January 31,			Change			
	2010	2009	2008	2010 vs. 2009		2009 vs. 2008	
<b>Assets</b>							
Current assets	\$ 866,159	\$ 1,064,921	\$ 1,199,128	\$ (198,762)	-18.7%	\$ (134,207)	-11.2%
Noncurrent assets							
Restricted assets	821,794	729,504	1,252,557	92,290	12.7%	(523,053)	-41.8%
Other noncurrent assets	510,231	512,292	524,957	(2,061)	-0.4%	(12,665)	-2.4%
Capital assets, net	7,064,193	6,409,849	5,805,531	654,344	10.2%	604,318	10.4%
Total assets	<u>\$ 9,262,377</u>	<u>\$ 8,716,566</u>	<u>\$ 8,782,173</u>	<u>\$ 545,811</u>	6.3%	<u>\$ (65,607)</u>	-0.7%
<b>Liabilities</b>							
Current liabilities	\$ 646,506	\$ 803,988	\$ 989,617	\$ (157,482)	-19.6%	\$ (185,629)	-18.8%
Long-term debt, net	4,407,284	3,844,121	3,689,746	563,163	14.6%	154,375	4.2%
Other noncurrent liabilities	989,437	956,906	1,073,101	32,531	3.4%	(116,195)	-10.8%
Total liabilities	<u>6,043,227</u>	<u>5,605,015</u>	<u>5,752,464</u>	<u>438,212</u>	7.8%	<u>(147,449)</u>	-2.6%
<b>Fund net assets</b>							
Invested in capital assets, net of related debt	2,585,351	2,469,539	2,259,547	115,812	4.7%	209,992	9.3%
Restricted	338,412	352,392	506,007	(13,980)	-4.0%	(153,615)	-30.4%
Unrestricted	295,387	289,620	264,155	5,767	2.0%	25,465	9.6%
Total fund net assets	<u>3,219,150</u>	<u>3,111,551</u>	<u>3,029,709</u>	<u>107,599</u>	3.5%	<u>81,842</u>	2.7%
Total liabilities and fund net assets	<u>\$ 9,262,377</u>	<u>\$ 8,716,566</u>	<u>\$ 8,782,173</u>	<u>\$ 545,811</u>	6.3%	<u>\$ (65,607)</u>	-0.7%

### Current Assets

***FY 2010*** – Current assets at January 31, 2010, of \$866.2 million were \$198.8 million lower than the balance at January 31, 2009. The primary contributors were a decrease of \$178.1 million in securities lending cash collateral due primarily to a change in the mix between securities collateral and cash collateral; an \$85.3 million decrease in prepayments primarily attributable to lower prepaid fuel margin and fuel hedges; a \$5.7 million decrease in interest and other receivables; a \$5.4 million decrease in coal inventories; and a \$4.2 million decrease in customer accounts receivable. Partially offsetting the overall decrease was a \$78.0 million increase in General Account cash and investments.

***FY 2009*** – Current assets at January 31, 2009, of \$1.1 billion were \$134.2 million lower than the balance at January 31, 2008. The primary contributors were a decrease of \$190.4 million in securities lending cash collateral due to a reduction in loaned securities and a decrease of \$78.7 million in General Account cash and investments. Partially offsetting the overall decrease was a \$102.9 million increase in prepayments attributable primarily to increases in the prepaid fuel margin and fuel hedges, a \$25.5 million increase in customer accounts receivable, and a \$7.1 million increase in coal and natural gas inventories.

### Noncurrent Restricted Assets

***FY 2010*** – Restricted noncurrent assets totaled \$821.8 million as of January 31, 2010, an increase of \$92.3 million compared to January 31, 2009. The increase was primarily attributable to an increase in the Decommissioning Trusts of \$68.5 million due to higher investment earnings and an increase of \$38.4 million in the Bond Construction Fund. The increase was partially offset by a decrease of \$7.6 million in the CIED Fund and a decrease of \$8.4 million in the Repair and Replacement Account.

See accompanying independent auditors' report.

**FY 2009** – Restricted noncurrent assets totaled \$729.5 million as of January 31, 2009, a decrease of \$523.1 million compared to last year. There were decreases of \$244.0 million in the Bond Construction Fund due to higher levels of construction, \$141.5 million in the Repair and Replacement Account due to the funding of capital projects, \$123.5 million in the Decommissioning Trusts primarily due to lower valuations for decommissioning investments, and a \$13.0 million decrease in the CIED Fund.

### Other Noncurrent Assets

**FY 2010** – Other noncurrent assets decreased from \$512.3 million as of January 31, 2009, to \$510.2 million as of January 31, 2010. The \$2.1 million decrease related primarily to the \$19.8 million amortization of prepayments from a June 2000 lease/leaseback transaction for CPS Energy’s J.K. Spruce Unit 1 (“Spruce 1”) property, along with a \$5.6 million decrease for fuel hedges. Partially offsetting these decreases were a \$12.6 million accrual of STEP net costs recoverable, a \$5.8 million increase in the net OPEB obligation, and a \$5.5 million increase in unamortized bond expense as a result of bond activity in the current fiscal year.

**FY 2009** – Other noncurrent assets decreased from \$525.0 million as of January 31, 2008, to \$512.3 million as of January 31, 2009. The \$12.7 million decrease related primarily to the \$19.8 million amortization of prepayments from the lease/leaseback transaction for Spruce 1, along with a \$3.7 million decrease in miscellaneous receivables. Partially offsetting these decreases were a \$5.5 million increase in other deferred costs related to fuel hedges, a \$2.7 million change in the net OPEB obligation, and a \$2.1 million increase in the intangible asset related to CIED for a project initiated in September 2008 that is being amortized over 20 years.

### Capital Assets, Net

#### Summary of Capital Assets Net of Accumulated Depreciation, Depletion and Amortization (Dollars in thousands)

	January 31,			Change			
	2010	2009	2008	2010 vs. 2009		2009 vs. 2008	
Nondepreciable assets							
Land	\$ 107,150	\$ 99,122	\$ 63,411	\$ 8,028	8.1%	\$ 35,711	56.3%
Construction-in-progress	1,893,686	1,346,182	846,682	547,504	40.7%	499,500	59.0%
Total nondepreciable assets	<u>2,000,836</u>	<u>1,445,304</u>	<u>910,093</u>	<u>555,532</u>	38.4%	<u>535,211</u>	58.8%
Nuclear fuel	<u>107,092</u>	70,750	65,110	<u>36,342</u>	51.4%	<u>5,640</u>	8.7%
Depreciable assets							
Electric plant							
Buildings and structures	542,426	560,527	591,191	(18,101)	-3.2%	(30,664)	-5.2%
Systems and improvements	3,551,285	3,463,405	3,393,568	87,880	2.5%	69,837	2.1%
Machinery and equipment	(2,742)	(1,300)	(2,860)	(1,442)	-110.9%	1,560	54.5%
Total electric plant	<u>4,090,969</u>	<u>4,022,632</u>	<u>3,981,899</u>	<u>68,337</u>	1.7%	<u>40,733</u>	1.0%
Gas plant							
Buildings and structures	2	3	3	(1)	-33.3%	-	-
Systems and improvements	418,294	408,895	399,596	9,399	2.3%	9,299	2.3%
Total gas plant	<u>418,296</u>	<u>408,898</u>	<u>399,599</u>	<u>9,398</u>	2.3%	<u>9,299</u>	2.3%
General plant							
Buildings and structures	121,593	121,854	123,329	(261)	-0.2%	(1,475)	-1.2%
Machinery and equipment	320,744	332,156	324,803	(11,412)	-3.4%	7,353	2.3%
Other	4,663	8,255	698	(3,592)	-43.5%	7,557	1082.7%
Total general plant	<u>447,000</u>	<u>462,265</u>	<u>448,830</u>	<u>(15,265)</u>	-3.3%	<u>13,435</u>	3.0%
Total depreciable assets	<u>4,956,265</u>	<u>4,893,795</u>	<u>4,830,328</u>	<u>62,470</u>	1.3%	<u>63,467</u>	1.3%
Total capital assets, net	<u>\$7,064,193</u>	<u>\$6,409,849</u>	<u>\$5,805,531</u>	<u>\$654,344</u>	10.2%	<u>\$604,318</u>	10.4%

See accompanying independent auditors’ report.

**FY 2010** – At January 31, 2010, net capital assets of \$7.1 billion increased \$654.3 million from the amount reported for FY 2009. Contributing to this variance were total additions to plant-in-service of \$304.8 million and an increase in construction-in-progress of \$547.5 million, partially offset by depreciation and amortization of \$285.8 million.

Net capital assets include reserves for dismantling costs. These reserves are reflected in the Summary of Capital Assets table under the categories electric plant, gas plant and general plant.

Increases in construction-in-progress included expenditures for Spruce 2, coal yard improvements to support Spruce 2, continued development of STP Units 3 and 4, and the VHB peaking units.

Of the total plant-in-service and construction-in-progress additions, \$895.0 million related to new construction and removal costs. These additions were funded from \$49.0 million of tax-exempt bonds, \$303.8 million of taxable bonds, \$330.3 million of tax-exempt commercial paper (“TECP”), \$7.9 million from the CIED Fund, \$25.5 million from contributed capital, and \$178.5 million from the Repair and Replacement Account. Included in capital assets is CPS Energy’s 40% interest in STP Units 1 and 2 and a 50% interest in STP Units 3 and 4.

**FY 2009** – At January 31, 2009, net capital assets of \$6.4 billion increased \$604.3 million from the amount reported for FY 2008. Contributing to this variance were total additions to plant-in-service of \$339.2 million and an increase in construction-in-progress of \$499.5 million, partially offset by depreciation and amortization of \$283.4 million.

Of the total plant-in-service and construction-in-progress additions, \$884.5 million related to new construction and removal costs. These additions were funded from \$517.1 million of tax-exempt bonds, \$36.6 million of TECP, \$12.1 million from the CIED Fund, \$30.2 million from contributed capital, and \$288.5 million from the Repair and Replacement Account.

## **Current Liabilities**

**FY 2010** – Excluding current maturities on long-term debt of \$162.2 million, current liabilities decreased \$171.0 million, from \$655.3 million as of January 31, 2009, to \$484.3 million as of January 31, 2010. The decrease was due in large part to a decrease of \$178.1 million for cash collateral under the securities lending program and \$8.7 million lower operating payables. Partially offsetting the decreases were \$11.3 million higher STP operating payables, \$3.2 million higher City payables, and \$1.6 million greater current customer deposits.

**FY 2009** – Excluding current maturities on long-term debt of \$148.7 million, current liabilities decreased \$181.4 million, from \$836.7 million as of January 31, 2008, to \$655.3 million as of January 31, 2009. The decrease was primarily due to a \$190.4 million lower amount of cash collateral under the securities lending program, \$2.1 million lower bond and other interest payable, and a \$2.0 million lower City payable. Partially offsetting the decrease was \$6.6 million higher operating payables and \$7.2 million higher STP operating payables.

## **Other Noncurrent Liabilities**

**FY 2010** – Excluding the noncurrent portion of debt of \$4.4 billion, long-term liabilities increased \$32.5 million to \$989.4 million as of January 31, 2010, primarily due to a \$38.7 million increase in STP decommissioning net costs refundable, a \$29.6 million increase in the STP decommissioning liability, and a \$1.2 million increase in customer deposits. The increases were partially offset by a \$22.6 million decrease in the deferred lease revenue amortization, a \$6.1 million decrease related to fuel hedges, a

\$3.8 million decrease in customer advances for construction, and a \$1.3 million decrease for operating reserves.

***FY 2009*** – Excluding the noncurrent portion of debt of \$3.8 billion, long-term liabilities decreased \$116.2 million to \$956.9 million as of January 31, 2009, primarily due to a \$92.8 million decrease in STP decommissioning net costs refundable and a \$30.4 million decrease in the STP decommissioning liability. Additionally, the noncurrent deferred lease revenue amortization was \$22.6 million lower, and customer advances for construction decreased \$4.9 million. The decreases were partially offset by increases of \$30.4 million in STP pension and OPEB liabilities and a \$5.5 million increase related to fuel hedges.

## **FINANCING AND DEBT COVENANTS COMPLIANCE**

### **Long-Term Debt (Excluding Tax-Exempt Commercial Paper)**

***FY 2010 – Issuance*** – On March 12, 2009, CPS Energy issued \$442.0 million of New Series 2009A Revenue Refunding Bonds. The true interest cost for this issue, which has maturities that extend from 2015 to 2034, was 4.9%. The bond proceeds, including the premium associated with the bonds, were used on March 13, 2009, to refund \$450.0 million of outstanding TECP obligations.

The American Recovery and Reinvestment Act of 2009 provided authority for the issuance of Build America Bonds (“BABs”), which are issuable in calendar years 2009 and 2010, limited to new money capital expenditures, and issued as taxable bonds. The BABs also permit the issuer (or the bondholder) to receive a subsidy payment equal to 35% of the bond’s interest directly from the U.S. Department of the Treasury. On June 12, 2009, CPS Energy issued \$375.0 million of taxable New Series 2009C Revenue Direct Subsidy BABs. The true interest cost for this issue, which has maturities that extend from 2033 to 2039, was 3.9%. Total bond proceeds are primarily being used to fund generation and electric distribution construction projects.

At one point, CPS Energy contemplated issuing a portion of the 2009C instruments as nontaxable bonds. These would have been 2009B Revenue Bonds (“2009B Bonds”). Since the effective interest rate and investor interest were more favorable for BABs, the 2009B Bonds were not pursued.

On July 30, 2009, CPS Energy issued \$207.9 million of tax-exempt New Series 2009D Revenue Refunding Bonds. The true interest cost for this issue, which has maturities that extend from 2017 to 2021, was 3.7%. On September 1, 2009, the escrowed proceeds, including the premium associated with the bonds, were used to refund \$227.7 million par value of the remaining New Series 1998A Bonds (“1998A Bonds”). This refunding transaction resulted in a net present value debt service savings of \$14.8 million, or 6.5% of the par amount of the bonds being refunded.

***Other Reductions*** – CPS Energy made principal payments of \$148.7 million in FY 2010.

**Summary of Debt Rollforward Activity<sup>1</sup>**  
(In thousands)

FY 2010			
Balance Outstanding February 1, 2009	Additions During Year	Decreases During Year	Balance Outstanding January 31, 2010
\$ 3,494,915	\$ 1,024,945	\$ (376,365)	\$ 4,143,495

<sup>1</sup>Excludes commercial paper, discounts, premiums, reacquisition costs and other debt-related amounts.

***FY 2009 – Issuance*** – On June 25, 2008, CPS Energy issued \$287.9 million of tax-exempt New Series 2008 Revenue Bonds. The true interest cost for this issue, which has maturities that extend from 2017 to 2032, was 4.6%. Total bond proceeds, including the net original issue premium, are being used to fund construction projects related to generation, as well as electric and gas distribution.

On December 23, 2008, CPS Energy issued \$158.0 million of tax-exempt New Series 2008A Revenue Refunding Bonds. The true interest cost for this issue, which has maturities that extend from 2010 to 2016, was 3.7%. The bond proceeds were deposited into an escrow fund irrevocably pledged to the refunding of \$165.3 million par value of the tax-exempt 1998A Bonds. As a result, this was considered to be an in-substance defeasance for accounting and financial reporting purposes; therefore, at January 31, 2009, the related liability was not reflected on the Balance Sheets. On February 1, 2009, the escrowed proceeds were used to refund \$165.3 million par value of the 1998A Bonds. This refunding transaction resulted in a net present value debt service savings of \$6.2 million, or 3.8% of the par amount of the bonds refunded.

***Other Reductions*** – CPS Energy made principal payments of \$152.9 million in FY 2009.

**Summary of Debt Rollforward Activity<sup>1</sup>**  
(In thousands)

FY 2009			
Balance Outstanding February 1, 2008	Additions During Year	Decreases During Year	Balance Outstanding January 31, 2009
\$ 3,367,090	\$ 445,965	\$ (318,140)	\$ 3,494,915

<sup>1</sup>Excludes commercial paper, discounts, premiums, reacquisition costs and other debt-related amounts.

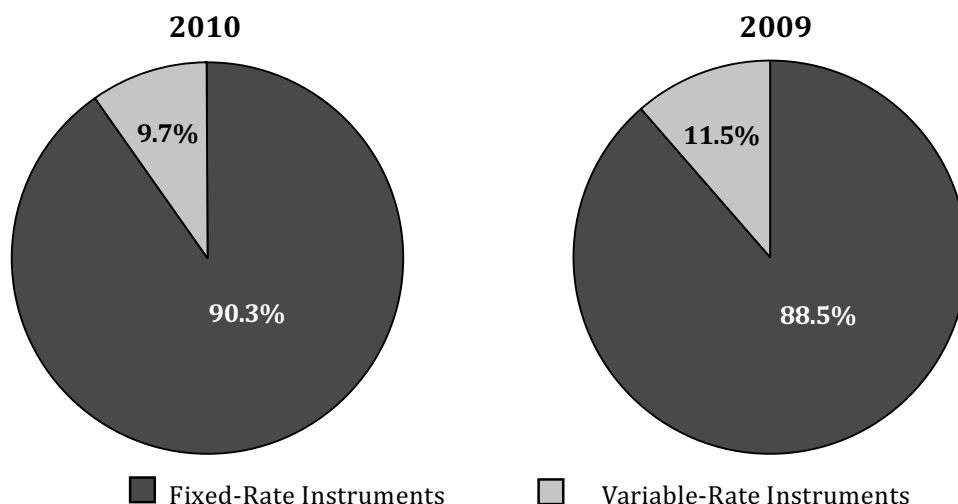
## Existing Debt

***FY 2010*** – At January 31, 2010, CPS Energy’s total debt was \$4.1 billion, excluding commercial paper, discounts, premiums, reacquisition costs and other debt-related amounts. This long-term debt was composed of \$3.7 billion in fixed-interest-rate instruments and \$402.0 million in variable-interest-rate instruments. The true interest costs on all long-term debt had an overall weighted-average yield of 4.6%. Separately, the variable-rate debt had a blended interest rate of 1.5%.

See accompanying independent auditors’ report.

***FY 2009*** – At January 31, 2009, CPS Energy’s total debt was \$3.5 billion, excluding commercial paper, discounts, premiums, reacquisition costs and other debt-related amounts. This long-term debt was composed of \$3.1 billion in fixed-interest-rate instruments and \$402.0 million in variable-interest-rate instruments. The true interest costs on all long-term debt had an overall weighted-average yield of 4.7%. Separately, the variable-rate debt had a blended interest rate of 1.7%.

**Allocation of Debt  
at January 31,**



**Note: Graphs exclude Tax-Exempt Commercial Paper**

**Tax-Exempt Commercial Paper**

CPS Energy maintains a TECP program to provide tax-exempt financing for various purposes. The program is currently authorized to have notes outstanding in an amount not to exceed \$450 million.

***FY 2010 – Issuance*** – On March 16, 2009, CPS Energy issued \$260.0 million of TECP. On November 24 and December 29, 2009, CPS Energy issued \$30.0 million and \$40.0 million of TECP, respectively. All proceeds were used to fund generation and distribution construction projects.

On January 28, 2010, the Company issued an additional \$20.0 million of TECP, which will be used to remediate debt.

***Reduction*** – On March 12, 2009, CPS Energy refunded \$450.0 million of outstanding TECP obligations.

**Summary of TECP Rollforward Activity**

(In thousands)

FY 2010			
Balance Outstanding February 1, 2009	Additions During Year	Decreases During Year	Balance Outstanding January 31, 2010
\$ 450,000	\$ 350,000	\$ (450,000)	\$ 350,000

See accompanying independent auditors’ report.

**FY 2009** – ***Issuance*** – There were no new TECP issuances in FY 2009.

### Summary of TECP Rollforward Activity

(In thousands)

FY 2009			
Balance Outstanding February 1, 2008	Additions During Year	Decreases During Year	Balance Outstanding January 31, 2009
\$ 450,000	\$ -	\$ -	\$ 450,000

### Compliance

With respect to all New Series Bonds outstanding at January 31, 2010, the net revenues of the Systems are pledged to the payment of principal and interest thereon. All New Series Bonds are issued as Senior Lien Obligations, and the principal and interest thereon have a first lien upon the net revenues of CPS Energy's Systems.

The Variable Rate Demand Obligations ("VRDOs") are issued as Junior Lien Obligations. The borrowings from the Junior Lien Obligations are equally and ratably secured by and payable from the net revenues of CPS Energy's Systems. The pledge is subordinate and inferior to the pledge of net revenues securing the Senior Lien Obligations, but prior and superior to the lien on, and pledge of, the net revenues securing the payment of the TECP notes.

The current TECP revolving credit agreement permits CPS Energy to borrow up to an aggregate amount, not to exceed \$450 million, for the purpose of paying amounts due under the TECP program. The TECP outstanding is also secured by the net revenues of the Systems. Such pledge of net revenues is subordinate and inferior to the pledge securing payment of Senior Lien and Junior Lien Obligations.

As of January 31, 2010, and January 31, 2009, CPS Energy was in compliance with the terms and provisions of the documents related to the New Series Bonds, the VRDOs and the TECP program.

### Debt Service

CPS Energy's debt service coverage ratio for the New Series Bonds, in accordance with the ordinances, was 2.33x for FY 2010 and 2.53x for FY 2009. CPS Energy has taken the position that the BABs direct subsidy should be deducted from debt service when calculating the debt service coverage ratio. Therefore, at January 31, 2010, the debt service coverage calculation included a BABs direct subsidy deduction of \$5.0 million. Without deducting the direct subsidy, the debt service coverage ratio at January 31, 2010, would have been 2.30x. The ratio of debt to debt and fund net assets was 58.2% at January 31, 2010, compared to 55.9% at January 31, 2009.

See accompanying independent auditors' report.

The weighted-average interest rate on outstanding commercial paper was 0.3% at January 31, 2010, and 1.2% at January 31, 2009. The weighted-average maturity of commercial paper at January 31, 2010, and January 31, 2009, was 93 and 96 days, respectively.

### Summary of CPS Energy's Bond and Commercial Paper Ratings

	Ratings at January 31, 2010		
	Senior Lien Debt	Junior Lien Debt	TECP
Fitch Ratings	AA+	AA+ / F1+	F1+
Moody's Investors Service, Inc.	Aa1	Aa2 / VMIG 1	P-1
Standard & Poor's Ratings Services	AA	AA- / A-1+	A-1+

### CURRENTLY KNOWN FACTS

**Debt Issuances** – On March 23, 2010, CPS Energy issued \$380.0 million of taxable New Series 2010A Revenue Direct Subsidy BABs. The true interest cost for this issue, which has two term bonds maturing in 2041, was 3.8%. Total bond proceeds are primarily being used to fund generation and electric distribution construction projects.

In March 2010, Fitch Ratings, Moody's Investors Service, Inc. and Standard & Poor's Rating Services each reaffirmed the Company's long-term bond ratings of "AA+," "Aa1" and "AA," respectively.

**STP Units 3 and 4 Litigation Settlement** – On December 6, 2009, CPS Energy filed a petition in Bexar County district court seeking declaratory relief related to a series of agreements entered into with NRG Energy, Inc. ("NRG") and Nuclear Innovation North America, LLC ("NINA"). The petition related to development of STP Units 3 and 4, two new nuclear generation units to be constructed in Bay City, Texas, on the site where STP Units 1 and 2 currently operate. CPS Energy asked the court to determine the rights and obligations of CPS Energy and NINA should either decide to withdraw from the project. NRG escalated the litigation when it sued CPS Energy and claimed the Company should forfeit all investment to date and lose all value in the project's land and water rights. CPS Energy amended its petition on December 23, 2009, and raised significant issues concerning misconduct by NRG and NINA. The Company specified actual and exemplary damages of \$32.0 billion.

On February 17, 2010, CPS Energy and NINA announced that a proposed settlement had been reached that ended the parties' legal disagreement and allowed the proposed expansion of STP Units 3 and 4 to proceed. As a result of the settlement, CPS Energy's ownership stake in STP Units 3 and 4 was reduced from 50% to 7.625%, while NINA and Toshiba Corporation retained 92.375% ownership. NINA will pay all development costs incurred after January 31, 2010. CPS Energy has withdrawn its pending application for a Department of Energy ("DOE") loan guarantee and will support the NRG/NINA loan guarantee applications. In addition to receiving a higher ownership level at 7.625% than approximates CPS Energy's expenditures to date, NINA agreed to pay CPS Energy \$80.0 million, in two \$40.0 million payments, conditional on their loan guarantees being approved by the DOE. NINA also agreed to make a contribution of \$10.0 million over a four-year period to the Residential Energy Assistance Partnership, which provides emergency bill payment assistance to low-income customers residing in San Antonio and Bexar County. The settlement agreement was finalized on March 1, 2010. Additional details on STP Units 3 and 4 are provided in Note 13 – South Texas Project.

**Rate Increase** – The City of San Antonio's City Council unanimously approved a 7.5% increase in the Company's electric base rates and an 8.5% increase in its natural gas base rates on February 18, 2010, which became effective on March 1, 2010.

See accompanying independent auditors' report.

## **REQUESTS FOR INFORMATION**

For more information about CPS Energy, contact Lisa Lewis, Director of Corporate Communications and Community Relations, at 210-353-2344 or at P.O. Box 1771, San Antonio, Texas 78296-1771.

**INDEPENDENT AUDITORS' REPORT**

The Board of Trustees  
City Public Service of San Antonio, Texas

We have audited the accompanying balance sheets of City Public Service of San Antonio, Texas (CPS Energy), a component unit of the City of San Antonio, Texas, as of January 31, 2010 and 2009, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of CPS Energy's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of City Public Service Employees' Pension Plan or the City Public Service Disability Income, Group Life Insurance and Group Health Plans (Employee Plans) as of December 31, 2009 or 2008. The financial information related to the Employee Plans is included in footnote 8 and 9, respectively, of the notes to the financial statements. Those financial statements were audited by other auditors, for the years indicated, whose reports thereon have been furnished to us, and our opinion on the CPS Energy financial statements, insofar as it relates to the amounts and disclosures included for the Employee Plans is based solely on the reports of other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CPS Energy's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of CPS Energy as of January 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in footnote 1 of the notes to the financial statements, CPS Energy changed its method of accounting for CPS Energy's two decommissioning trusts in fiscal year 2009. In addition, CPS Energy adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* and GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* as of February 1, 2009.

The Board of Trustees  
City Public Service of San Antonio, Texas

The management's discussion and analysis on pages 2 through 19 and the schedules of funding progress in footnotes 8 and 9 of the notes to the financial statements are not a required part of the basic financial statements, but are supplementary information required by generally accepted accounting principles in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Maya, Price + Co., LLC Baker Gilly Vinchow Krause, LLP Robert Williams CPA*

April 26, 2010

## BALANCE SHEETS

	January 31,	
	2010	2009
	(In thousands)	
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 298,818	\$ 271,990
Cash collateral from securities lending	31,815	209,881
Investments	102,996	46,779
Interest and other receivables	17,660	23,340
Customer accounts receivable, less allowance for doubtful accounts of \$15.9 million at January 31, 2010, and \$12.7 million at January 31, 2009 (includes unbilled revenue of \$40.1 million for January 2010 and \$65.1 million for January 2009)	202,060	206,254
Inventories, at average costs		
Materials and supplies	84,478	86,988
Fossil fuels	66,536	72,615
Prepayments, deferred and other	61,796	147,074
Total current assets	<u>866,159</u>	<u>1,064,921</u>
Noncurrent assets		
Restricted		
Cash and cash equivalents	39,102	69,555
Investments	779,092	656,020
Interest receivable	3,600	3,929
Prepaid rent – leaseback	417,234	437,023
Net OPEB obligation	38,694	32,915
Other deferred costs	54,303	42,354
Capital assets, net	7,064,193	6,409,849
Total noncurrent assets	<u>8,396,218</u>	<u>7,651,645</u>
Total assets	<u>\$ 9,262,377</u>	<u>\$ 8,716,566</u>
<b>Liabilities</b>		
Current liabilities		
Current maturities of revenue bonds	\$ 162,235	\$ 148,705
Accounts payable and accrued liabilities	452,456	445,402
Securities lending obligation	31,815	209,881
Total current liabilities	<u>646,506</u>	<u>803,988</u>
Noncurrent liabilities		
Long-term debt, net	4,407,284	3,844,121
Decommissioning	325,973	296,363
STP decommissioning net costs refundable	63,456	24,725
Deferred lease revenue	475,651	498,212
Other noncurrent liabilities and deferred credits	124,357	137,606
Total noncurrent liabilities	<u>5,396,721</u>	<u>4,801,027</u>
Total liabilities	<u>6,043,227</u>	<u>5,605,015</u>
<b>Fund net assets</b>		
Invested in capital assets, net of related debt	2,585,351	2,469,539
Restricted		
Debt service	3,210	1,089
Ordinance	335,202	351,303
Unrestricted	295,387	289,620
Total fund net assets	<u>3,219,150</u>	<u>3,111,551</u>
Total liabilities and fund net assets	<u>\$ 9,262,377</u>	<u>\$ 8,716,566</u>

See accompanying Notes to Basic Financial Statements.

## STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS

	Fiscal Year Ended January 31,	
	2010	2009
	(In thousands)	
Operating revenues		
Electric	\$ 1,717,077	\$ 1,899,457
Gas	213,798	251,884
Total operating revenues	<u>1,930,875</u>	<u>2,151,341</u>
Operating expenses		
Fuel, purchased power and distribution gas	689,225	899,314
STP operation and maintenance	142,865	139,073
CPS Energy operation and maintenance	299,450	303,284
Annual OPEB cost	8,798	13,054
Annual pension cost	23,503	20,590
Energy efficiency and conservation (STEP)	12,599	-
STEP net costs recoverable	(12,599)	-
Regulatory assessments	36,051	31,257
Decommissioning	24,310	21,201
Depreciation and amortization	285,823	283,398
Total operating expenses	<u>1,510,025</u>	<u>1,711,171</u>
Operating income	<u>420,850</u>	<u>440,170</u>
Nonoperating income (expense)		
Interest and other income, net	22,238	50,807
Decommissioning Trusts investment income and change in fair market value	60,822	(71,564)
STP decommissioning net costs recoverable (refundable)	(38,731)	92,765
Interest and other expense	(193,867)	(180,431)
Amortization of debt-related costs	959	(2,439)
Allowance for funds used during construction	59,165	43,385
Payments to the City of San Antonio	(260,636)	(282,140)
Total nonoperating income (expense)	<u>(350,050)</u>	<u>(349,617)</u>
Income before other changes in fund net assets	70,800	90,553
Other payments to the City of San Antonio	(11,980)	(9,203)
Contributed capital	38,991	30,218
Effect of defined benefit plan funding obligations – STP	9,788	(29,726)
Change in fund net assets	107,599	81,842
Fund net assets – beginning	3,111,551	3,029,709
Fund net assets – ending	<u>\$ 3,219,150</u>	<u>\$ 3,111,551</u>

See accompanying Notes to Basic Financial Statements.

## STATEMENTS OF CASH FLOWS

	Fiscal Year Ended January 31,	
	2010	2009
	(In thousands)	
Cash flows from operating activities		
Cash received from customers	\$ 1,942,236	\$ 2,128,495
Cash payments to suppliers for goods and services	(939,418)	(1,312,378)
Cash payments to employees for service	(165,473)	(176,931)
Net cash provided (used) by operating activities	<u>837,345</u>	<u>639,186</u>
Cash flows from capital and related financing activities		
Cash paid for additions to utility plant and net removal costs	(810,564)	(832,527)
Cash paid for nuclear fuel purchases	(68,838)	(36,350)
Contributed capital	25,566	30,218
Proceeds from issuance of revenue bonds	379,720	288,387
Proceeds from issuance of commercial paper	350,000	-
Premium received from revenue bonds issued	-	14,109
Principal payments on revenue bonds and cash defeasance of debt	(148,705)	(152,875)
Interest paid	(192,845)	(181,685)
Debt issue and cash defeasance costs paid	(8,880)	(2,523)
Net cash provided (used) by capital and related financing activities	<u>(474,546)</u>	<u>(873,246)</u>
Cash flows from noncapital financing activities		
Cash payments to the City of San Antonio	(275,509)	(292,801)
Net cash provided (used) by noncapital financing activities	<u>(275,509)</u>	<u>(292,801)</u>
Cash flows from investing activities		
Purchases of investments	(888,708)	(1,585,236)
Proceeds from sales and maturities of investments	763,524	2,140,387
Interest and other income	34,269	74,105
Net cash provided (used) by investing activities	<u>(90,915)</u>	<u>629,256</u>
Net increase (decrease) in cash and cash equivalents	(3,625)	102,395
Cash and cash equivalents at beginning of period	341,545	239,150
Cash and cash equivalents at end of period	<u>\$ 337,920</u>	<u>\$ 341,545</u>
<u>Reconciliation of operating income to net cash provided by operating activities</u>		
Cash flows from operating activities		
Operating income	\$ 420,850	\$ 440,170
Noncash items included		
Depreciation and amortization	285,823	283,398
Nuclear fuel amortization	32,496	30,710
Provision for doubtful accounts	12,747	10,134
Changes in current assets and liabilities		
(Increase) decrease in customer accounts receivable, net	(8,553)	(35,648)
(Increase) decrease in other receivables	5,953	3,271
(Increase) decrease in materials and supplies	2,510	522
(Increase) decrease in fossil fuels	6,079	(7,041)
(Increase) decrease in prepayments, deferred and other	52,951	(68,319)
Increase (decrease) in accounts payable and accrued liabilities	20,925	(28,265)
Changes in noncurrent and other assets and liabilities		
(Increase) decrease in other noncurrent assets and deferred costs	(18,539)	(4,842)
Increase (decrease) in customer service deposits payable	1,214	(603)
Increase (decrease) in decommissioning liability	21,854	20,818
Increase (decrease) in noncurrent liabilities and deferred credits	1,035	(5,119)
Net cash provided (used) by operating activities	<u>\$ 837,345</u>	<u>\$ 639,186</u>
<u>Noncash financing activities</u>		
Bond proceeds deposited into an escrow account for purposes of refunding long-term debt	\$ 679,143	\$ 167,828
Donated assets received and recorded	\$ 13,425	\$ -
<u>Noncash investing activities</u>		
Securities lending cash collateral (increase) decrease – CPS Energy	\$ (178,066)	\$ 190,425
Securities lending cash collateral (increase) decrease – Decommissioning Trusts	\$ (7,904)	\$ 51,595

See accompanying Notes to Basic Financial Statements.

# NOTES TO BASIC FINANCIAL STATEMENTS

## January 31, 2010, and January 31, 2009

### 1. Summary of Significant Accounting Policies

**Reporting Entity** – City Public Service of San Antonio (also referred to as “CPS Energy,” “CPS” or the “Company”) has been owned by the City of San Antonio, Texas (“City”) since 1942. CPS Energy provides electricity and natural gas to San Antonio and surrounding areas. As a municipally owned utility, CPS Energy is exempt from the payment of income taxes, state franchise taxes, use taxes, and real and personal property taxes. CPS Energy provides certain payments and benefits to the City as permitted by bond ordinances. CPS Energy’s financial results are also included within the comprehensive annual financial report of the City.

The decision to include applicable component units in CPS Energy’s financial statements was made by applying the criteria set forth in Governmental Accounting Standards Board (“GASB”) Statement No. 14, *The Financial Reporting Entity*. The following component units, which are legally separate but for which CPS Energy is financially accountable, meet those criteria; therefore, their financial statements are blended with those of CPS Energy:

- The City Public Service Restated Decommissioning Master Trust for the South Texas Project (“28% Decommissioning Trust”), and
- The City Public Service Decommissioning Master Trust (TCC Funded) (“12% Decommissioning Trust”).

These two component units are collectively referred to herein as the Decommissioning Trusts or the Trusts.

The City Public Service Group Disability, Life and Health Plans (“Employee Benefit Plans”) are separately audited and reported. The financial results of the Employee Benefit Plans are not included herein except for certain disclosures as provided in Note 9 – Other Postemployment Benefits.

The financial statements of CPS Energy’s pension plan (“Pension Plan”) are separately audited and reported. The financial results of the Pension Plan are not included herein except for certain disclosures as provided in Note 8 – Employee Pension Plan.

Included in CPS Energy’s financial statements are the applicable financial results for 40% of the South Texas Project (“STP”) Units 1 and 2.

**Fiscal Year (“FY”)** – The fiscal years ended January 31, 2010, and January 31, 2009, are referred to herein as FY 2010 and FY 2009, respectively.

**Basis of Accounting** – The financial statements of CPS Energy are presented in accordance with U.S. generally accepted accounting principles (“GAAP”) for proprietary funds of governmental entities. CPS Energy, including the Decommissioning Trusts, complies with all applicable pronouncements of GASB. In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, CPS Energy has elected not to follow the pronouncements of the Financial Accounting Standards Board (“FASB”) issued after November 30, 1989. On June 30, 2009, FASB launched its Accounting Standards Codification™ (“ASC”). Any references to FASB guidance cited herein are to the pre-ASC standard numbers.

STP is a nonprofit special-purpose entity that reports under FASB standards, including Financial Accounting Standard (“FAS”) No. 117, *Financial Reporting for Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to STP’s financial information within CPS Energy’s financial statements for these differences.

FY 2010 GASB pronouncement implementations:

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This statement provides additional guidance for accounting and reporting standards for intangible assets. The objective of this statement is to reduce inconsistencies in financial reporting by providing further guidance on classification, recognition, measurement, impairment, presentation and disclosures related to intangible assets. There was no impact to the Company’s financial statements as a result of this implementation.
- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This Statement addresses the recognition, measurement and disclosure of information regarding derivative instruments entered into by state and local governments. It generally requires that derivatives be reported on the balance sheet at fair value and gains (losses) be reported on the statement of revenues, expenses and change in fund net assets. As an exception, hedge accounting would be required for potential hedging derivative instruments that are determined to be effective. Under hedge accounting, gains (losses) are reported on the balance sheet as deferred (inflows) outflows of resources until termination, at which time the deferred amounts are reported as an adjustment to the underlying hedged transaction. Disclosure requirements are presented in Note 11 – Other Financial Instruments.
- GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The GAAP hierarchy governs what constitutes GAAP for all state and local governmental entities. It lists the order of priority of pronouncements that a governmental entity should refer to for accounting and financial reporting guidance. There was no impact to the Company’s financial statements as a result of this implementation.
- GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. The objective of GASB Statement No. 56 is to incorporate three issues that were not previously addressed in the authoritative literature that establishes accounting principles—going concern considerations, related-party transactions and subsequent events—which are currently addressed in the American Institute of Certified Public Accountants’ Statements on Auditing Standards. The purpose of the statement is not to issue new guidance, but to incorporate existing guidance into the GASB standards to improve financial reporting by consolidating all sources of GAAP for state and local governments into one source. There was no impact to the Company’s financial statements as a result of this implementation.

FY 2009 GASB pronouncement implementations:

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This statement provides guidance that explains when pollution remediation-related obligations should be reported and how pollution remediation costs and liabilities should be determined. Disclosure requirements are presented in Note 16 – Pollution Remediation Obligation.
- Technical Bulletin 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*. This technical bulletin provides guidance that allows the annual

required contribution (“ARC”) adjustment for other postemployment benefits (“OPEBs”) to be based on actual amounts associated with the amortization of past contribution deficiencies and excesses included in the ARC in cases in which those amounts are known by the actuary. There was no impact to the Company’s financial statements as a result of this implementation.

In accordance with the utility systems’ revenue bond ordinances, CPS Energy has adopted the uniform system of accounts prescribed by the National Association of Regulatory Utility Commissioners. The financial statements are presented using the economic resources measurement focus and the accrual basis of accounting.

**Reclassifications** – Certain amounts in the prior year’s financial statements have been reclassified to conform to the new accounting method.

**Rate Increase** – Rates are set by the Board and approved by the City of San Antonio’s City Council. The City Council approved a 3.5% increase in the Company’s natural gas and electric rates on May 15, 2008, which became effective on September 1, 2008. On February 18, 2010, the City Council unanimously approved a 7.5% increase in the Company’s electric base rates and an 8.5% increase in its natural gas base rates, which became effective on March 1, 2010.

**Revenues and Expenses** – Revenues are recorded when earned. Customers’ meters are read and bills are prepared monthly based on billing cycles. Rate tariffs include adjustment clauses that permit recovery of electric and gas fuel costs. Since FY 2004, CPS Energy has used historical information from the relative prior fiscal years as partial bases to estimate and record earned revenue not yet billed. This process has involved an extrapolation of customer usage over the days since the last meter read through the last day of the monthly period. Also included in unbilled revenue are the over/under-recoveries of electric and gas fuel costs and regulatory assessments. The amounts of unbilled revenue receivable recorded at January 31, 2010, and January 31, 2009, including estimates for electric fuel and gas costs, were \$40.1 million and \$65.1 million, respectively.

An adjustment clause in CPS Energy’s rate tariffs also permits recovery of regulatory assessments. Specifically, beginning in March 2000, CPS Energy began recovering assessments from the Public Utility Commission of Texas (“PUCT”) for transmission access charges and from the Texas Independent System Operator, also known as the Electric Reliability Council of Texas (“ERCOT”), for its operating costs and other charges applicable to CPS Energy as a wholesale provider of power to other utilities. Regulatory assessments for the fiscal years ended January 31, 2010 and 2009, were \$36.1 million and \$31.3 million, respectively.

Operating revenues include receipts from energy sales and miscellaneous revenue related to the operation of electric and gas systems (“Systems”). Other revenues include late payment fees, rental income, jobbing and contracting work, and ancillary services. Operating expenses are recorded as incurred and include those costs that result from the ongoing operations of the Systems.

Nonoperating income consists primarily of investment income, including fair value adjustments. The amortization of net gains from the lease/leaseback of J.K. Spruce Unit 1 (“Spruce 1”) is also included. Certain miscellaneous income amounts from renting general property and providing various services are also recorded as nonoperating income when they are not directly identified with the Systems. These amounts for FY 2010 and FY 2009 were recorded net of expenses.

**Allowance for Funds Used During Construction (“AFUDC”)** – To more accurately reflect funding methodology, the AFUDC rate was modified effective for FY 2010 to include both a debt and an equity component. The new blended rate is composed of 50% equity and 50% debt based on construction funding forecasts for FY 2010. Both the investment rate as well as the debt rate will continue to be

reviewed quarterly to determine if any adjustments are necessary. Projects costing more than \$100 million use alternate AFUDC rates, which reflect the method by which they are funded.

**Save for Tomorrow Energy Program (“STEP”)** – During FY 2009, CPS Energy committed to spending approximately \$849 million over the next 12 years on energy efficiency and conservation through STEP. Annually, the first \$8 million of STEP expenses will be funded through the base rate and will be reported as CPS Energy operation and maintenance (“O&M”) expenses.

STEP expenses over the initial \$8 million per year will be recovered through the fuel adjustment factor in the year after they are incurred and have been independently validated. These STEP recoveries will be deferred as STEP net costs recoverable in accordance with guidance provided by FAS 71, *Accounting for the Effects of Certain Types of Regulation*. This guidance requires that certain costs be capitalized as a regulatory asset until they are recovered through future rates. As a result, there is no impact to net income from the STEP expenses over the initial \$8 million.

**Cash Equivalents and Investments, Unrestricted and Restricted** – CPS Energy’s investments with a maturity date within one year of the purchase date are reported at amortized cost, which approximates fair value. Amortization of premium and accretion of discount are recorded over the terms of the investments. CPS Energy’s investments with a maturity date longer than one year from the purchase date are accounted for at fair value. As available, fair values are determined by using generally accepted financial reporting services, publications, and broker/dealer information. The specific identification method is used to determine costs in computing gains or losses on sales of securities. CPS Energy reports all investments of the Decommissioning Trusts at fair value.

Restricted funds are generally for uses other than current operations. They are designated by law, ordinance or contract and are often used to acquire or construct noncurrent assets. Restricted funds consist primarily of unspent bond or commercial paper proceeds, debt service required for the New Series Bonds, Junior Lien Obligations and Tax-Exempt Commercial Paper (“TECP”), and funds for future construction or contingencies. This category also includes customer assistance programs where proceeds are received from outside parties. The assets of the Decommissioning Trusts are also considered restricted.

The Repair and Replacement Account is restricted in accordance with the Company’s bond ordinances. In compliance with a bond ordinance, CPS Energy’s Board of Trustees (“Board”) authorized that a portion of the Repair and Replacement Account be designated for converting overhead electric facilities to underground (also referred to as the Overhead Conversion Fund).

In January 2005, the Board approved a policy to expand the use of the Overhead Conversion Fund. Beginning in FY 2006, the annual 1% funding was redesignated to the Community Infrastructure and Economic Development (“CIED”) Fund. Additionally, the basis of the funding was modified to be 1% of the prior fiscal year’s Electric Base Rate Revenue, which excludes applicable fuel adjustments and regulatory fees. All amounts in the original Overhead Conversion Fund were transferred to the CIED Fund. In general, the restricted CIED funds are to be used to support qualified capital projects that provide economic benefit within the communities served. At January 31, 2010, and January 31, 2009, all such appropriated funds were included with the assets restricted by bond ordinance.

As initiated in FY 2006, in lieu of CIED funding, the City may alternatively request an equivalent amount of general funds to be transferred for its use. In such cases, the amount previously designated for CIED funding is returned to the Repair and Replacement Account and general funds are transferred to the City. In accordance with bond ordinances, the combined total of all payments to the City may not exceed 14% of gross revenues.

CPS Energy and the Decommissioning Trusts have agreements with Frost National Bank, a Texas-based financial institution, for the purpose of securities lending. The cash collateral received for CPS Energy's securities lending transactions is reported as a current asset on the Balance Sheets, and the corresponding obligation to repay the cash collateral is reported on the Balance Sheets as a current liability that directly offsets the amount received from broker dealers in exchange for securities loaned. See Note 11 – Other Financial Instruments for details regarding securities lending.

For additional disclosures provided in accordance with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, see Note 2 – Cash, Cash Equivalents and Investments. These disclosures address investment exposure to interest rate risk, credit risk (including custodial credit risk and concentration of credit risk), and foreign currency risk, as applicable.

**Inventories** – CPS Energy maintains inventories for its materials and supplies and fossil fuels. In total, CPS Energy reported ending inventories of \$151.0 million and \$159.6 million at January 31, 2010, and January 31, 2009, respectively. Included in these amounts was CPS Energy's portion of STP inventories valued at \$44.0 million and \$43.1 million at January 31, 2010, and January 31, 2009, respectively. STP values its inventories at the lower of average cost or net realizable value. CPS Energy's remaining directly managed inventories are valued using an average costing approach.

**Other Noncurrent Assets and Deferred Costs** – In June 2000, CPS Energy entered into a lease/leaseback transaction with an affiliate of Exelon Corporation (“Exelon”), formerly known as Unicom Corporation. The long-term portion of prepaid rent related to this transaction was recorded as a deferred cost in FY 2001. In addition, \$12.3 million was paid to the City, in accordance with the New Series Bond Ordinances, for its 14% share of the net benefit from the transaction. This was recorded as a prepaid item and is being amortized over the 32-year lease term.

A net OPEB obligation was recorded in accordance with the implementation of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension*. The obligation represents the cumulative difference between the annual OPEB cost and the employer's contributions to the Employee Benefit Plans. At January 31, 2010, and January 31, 2009, the net OPEB obligation was \$(38.7) million and \$(32.9) million, respectively.

A net pension obligation was recorded in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. The obligation represents the difference between annual pension cost and the employer's contributions into the pension plan. The net pension obligation was \$(2.2) million at January 31, 2010, and \$(1.9) million at January 31, 2009.

**Capital Assets** – The costs of additions and replacements of assets identified as major components or property units are capitalized. Maintenance and replacements of minor items are charged to operating expenses. Except for certain assets that may become impaired, the cost of depreciable plant retired, plus removal costs and less salvage, is charged to accumulated depreciation. Per the financial reporting requirements of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, any losses associated with capital asset impairments will be charged to operations, not to accumulated depreciation.

Utility plant is stated at the cost of construction, including expenditures for contracted services; direct equipment, material and labor; indirect costs, including general engineering, labor, equipment and material overheads; and AFUDC, or capitalized interest. AFUDC is applied to projects that require 30 days or more to complete.

Proceeds from customers to partially fund construction expenditures are reported as contributed capital in the Statements of Revenues, Expenses and Changes in Fund Net Assets as increases in fund net assets

in accordance with the requirements of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. The amount reported for contributed capital was \$39.0 million at January 31, 2010, including \$13.4 million in donated assets. As a comparison, contributed capital totaled \$30.2 million at January 31, 2009. The portion of these balances that represents contributions received from customers as payments for utility extensions and services was \$25.5 million at January 31, 2010, and \$30.1 million at January 31, 2009.

Except for nuclear fuel, which is amortized over units of production, CPS Energy computes depreciation using the straight-line method over the estimated service lives of the depreciable property according to asset type. Total depreciation as a percent of total depreciable assets, excluding nuclear fuel, was 3.3% for FY 2010 and 3.4% for FY 2009.

The estimated useful lives of depreciable capital assets for both FY 2010 and FY 2009 were as follows:

Buildings and structures	20–60 years
Systems and improvements	
Generation	18–60 years
Transmission and distribution	20–55 years
Gas	50–65 years
Machinery and equipment	4–30 years
Nuclear fuel	Units of Production

Capitalization thresholds contained in the Company's capitalization policy for both FY 2010 and FY 2009 were as follows:

<u>Asset Class</u>	<u>Threshold</u>
Land, land improvements and certain easements	Capitalize all
Buildings and building improvements	\$ 10,000
Computer software – purchased	10,000
Computer software – internally developed	100,000
Computer software – enhancements/upgrades	100,000
Computer hardware	3,000
All other assets	3,000

**Decommissioning** – In FY 2009, the Company changed its method of accounting for the Decommissioning Trusts. Under the new method, a pro rata share of total decommissioning costs (as determined by the most recent cost study) has been recognized as a liability. In subsequent years, annual decommissioning expense and an increase in the liability will include the effects of inflation and an additional year of plant usage.

Additionally, due to requirements under the Code of Federal Regulations governing nuclear decommissioning trust funds, guidance under FAS 71 has been followed. Under this guidance, the zero fund net assets approach to accounting for the Decommissioning Trusts has been retained. In accordance with FAS 71, the cumulative effect of activity in the Trusts has been recorded as a regulatory liability reported on the Balance Sheets as STP decommissioning net costs refundable since any excess funds are payable to customers. Going forward, prolonged unfavorable economic conditions could result in the assets of the Trusts being less than the estimated decommissioning liability. In that case, instead of an excess as currently exists, there would be a deficit that would be reported as STP decommissioning net costs recoverable. This amount would be receivable from customers.

Current-year and prior-year activity in the Trusts has been reported in the nonoperating income (expense) section of the Statements of Revenues, Expenses and Changes in Fund Net Assets as STP decommissioning net costs recoverable (refundable). There was no impact to fund net assets as a result of this change in accounting method.

**Compensated Absences** – Employees earn vacation benefits based upon their employment status and years of service. As of January 31, 2010, and January 31, 2009, the accruals for those vested benefits were \$15.5 million and \$15.3 million, respectively.

**Long-Term Debt** – To support its long-term capital financing needs, CPS Energy uses several types of debt instruments. As of January 31, 2010, and January 31, 2009, these included fixed-rate and variable-rate bonds, as well as commercial paper. Relative to the bond instruments, provisions may be included that allow for refunding after specified time periods during the bond term.

Current refundings involve issuing new debt (“refunding bonds”) to redeem existing debt (“refunded bonds”) that can be called within 90 days of issuing the refunding bonds. Advance refunding of bonds involves issuing new debt to redeem existing debt that cannot be called within 90 days of issuing the refunding bonds. In these circumstances, the refunding bond proceeds are irrevocably escrowed with a third party. These proceeds, and income thereon, are used to pay the debt service on the refunded bonds until the refunded bonds can be called. Refunding bonds are generally issued to achieve debt service savings.

Subject to applicable timing restrictions that may prevent early payoff, CPS Energy also has the option to defease or extinguish debt with cash. A bond defeasance occurs when cash is placed in an irrevocable trust to be used solely for satisfying scheduled payments of both interest and principal of the defeased debt, which fully discharges the bond issuer’s obligation. At the time of an extinguishment with cash, since the issuer no longer has the legal obligation, the defeased debt is removed from the Balance Sheets, the related unamortized costs are expensed and the gain or loss is immediately recognized.

For current and advance refundings, the difference between the reacquisition price and the net carrying amount of the old debt is deferred and reported as a deduction from or addition to the new debt liability. The deferred amount is amortized as a component of interest expense over the shorter remaining life of the refunding or the refunded debt.

**Build America Bonds (“BABs”)** – The American Recovery and Reinvestment Act of 2009 provided authority for the issuance of BABs, which are issuable in calendar years 2009 and 2010, limited to new money capital expenditures, and only issued as taxable bonds. The BABs also permit the issuer (or the bondholder) to receive a subsidy payment equal to 35% of the bond’s interest directly from the U.S. Department of the Treasury. On June 12, 2009, CPS Energy issued \$375.0 million of taxable New Series 2009C Revenue Direct Subsidy BABs. Additional transaction details are provided in Note 6 – Revenue Bonds.

**Flexible Rate Revolving Note Private Placement Program** - On January 20, 2009, CPS Energy’s Board authorized the establishment of a flexible rate revolving note program to provide additional liquidity in support of the Systems. Under the program, the Company can issue taxable or tax-exempt notes with individual maturities of one year or less at fixed or variable interest rates in an aggregate principal amount at any one time outstanding not to exceed \$100 million. The program became effective on April 28, 2009, and authorizes the issuance of such notes through November 1, 2028. There were no outstanding notes under this program as of January 31, 2010.

**Other Noncurrent Liabilities and Deferred Credits** – The long-term portion of the deferred revenue associated with a lease/leaseback was recorded as a deferred credit and is being amortized over the life of the lease.

Other liabilities and deferred credits include the decommissioning liability, fuel hedges liabilities, customer service deposits, advance payments from customers for construction, and the pollution remediation liability. The long-term portion of the payable to the Port Authority of San Antonio, formerly known as the Greater Kelly Development Authority, for the purchase of electric and gas properties in FY 2000, has also been recorded in other noncurrent liabilities.

**Statements of Cash Flows** – For purposes of reporting cash flows, CPS Energy considers all highly liquid debt instruments purchased with an original maturity of 90 days or less to be cash equivalents. CPS Energy's Statements of Cash Flows separately list the noncash transactions.

**Use of Estimates** – The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. Those estimates and assumptions affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the amounts of revenues and expenses reported during the fiscal periods. Accordingly, actual results could differ from those estimates.

## 2. Cash, Cash Equivalents and Investments

**Investment Options** – CPS Energy's cash deposits at January 31, 2010 and 2009, were entirely insured by federal depository insurance or collateralized by banks. For deposits that were collateralized, the securities were U.S. Government, U.S. Government Agency or U.S. Government-guaranteed obligations held in book entry form by the Federal Reserve Bank of New York in CPS Energy's name.

Since the assets in the Decommissioning Trusts are restricted for use only for decommissioning at some future date, securities lending cash collateral related to the Trusts has been treated as long-term and thus has been classified as an investment in the Trusts. Consistent with other investments in the Trusts, securities lending cash collateral is shown separately on the table that lists investments by type in the Decommissioning Trusts section of this note.

**Separation** – CPS Energy's cash, cash equivalents and investments can be separated in the following manner:

- Those directly managed by CPS Energy, and
- Those managed through the Decommissioning Trusts.

For financial reporting purposes, cash, cash equivalents and investments managed directly by CPS Energy have been consistently measured as of the end of the applicable fiscal years. The Decommissioning Trusts are reported on a calendar-year basis.

**Cash, Cash Equivalents and  
Securities Lending Cash Collateral**  
(In thousands)

	January 31,	
	2010	2009
Petty cash funds on hand	\$ 89	\$ 102
Deposits with financial institutions		
CPS Energy deposits – unrestricted	1,497	(713)
CPS Energy deposits – restricted		
Debt service	333	129
Project Warm	159	314
Investments with original maturities of 90 days or less		
CPS Energy – unrestricted (current)	297,232	272,601
CPS Energy – restricted (noncurrent)	24,304	58,036
Decommissioning Trusts – restricted (noncurrent)	14,306	11,076
Total cash and cash equivalents	337,920	341,545
CPS Energy – securities lending cash collateral	31,815	209,881
Total cash, cash equivalents and securities lending cash collateral	\$ 369,735	\$ 551,426

**Summary of Cash and Cash Equivalents,  
Along with Current and Noncurrent Investments**  
(In thousands)

	January 31,	
	2010	2009
Cash and cash equivalents		
CPS Energy – unrestricted and restricted	\$ 323,614	\$ 330,469
Decommissioning Trusts – restricted	14,306	11,076
Total cash and cash equivalents	337,920	341,545
Gross investments – current and noncurrent		
CPS Energy – unrestricted and restricted	829,847	724,953
Decommissioning Trusts – restricted	388,083	319,559
Total gross investments	1,217,930	1,044,512
Investments with original maturities of 90 days or less included in cash and cash equivalents		
CPS Energy – unrestricted and restricted	(321,536)	(330,637)
Decommissioning Trusts – restricted	(14,306)	(11,076)
Total cash equivalents	(335,842)	(341,713)
Net noncurrent investments	882,088	702,799
Total cash, cash equivalents and investments	\$ 1,220,008	\$ 1,044,344

**Public Funds Investment Act (“PFIA”)** – CPS Energy’s investments and the investments held in the Decommissioning Trusts are subject to the rules and regulations of the PFIA. The PFIA regulates what types of investments can be made, requires written investment policies, mandates training requirements of investment officers, requires internal management reports to be produced at least quarterly, and provides for the selection of authorized brokers. In September 2005, the Texas

legislature passed a law to allow the decommissioning trust funds for municipally owned nuclear power plants to hold investments authorized by Subtitle B, Title 9, of the Property Code (i.e., corporate bonds and equities such as common stocks).

**Investments of CPS Energy** – CPS Energy’s allowable investments are defined by CPS Energy Board Resolution, CPS Energy Investment Policy, bond ordinances, TECP ordinance and state law. These investments are subject to market risk, and their market value will vary as interest rates fluctuate. All CPS Energy investments are held in trust custodial funds by an independent bank.

**Investments of the Decommissioning Trusts** – CPS Energy’s investments in the Decommissioning Trusts are held by an independent trustee. Investments are limited to those defined by CPS Energy Board Resolution, the South Texas Project Decommissioning Trust Investment Policy, the Investment Strategy Committee, the Trust Agreements and state law. Allowable investments for the Decommissioning Trusts include those directly permissible for CPS Energy, as well as equities and corporate bonds (including international securities traded in U.S. dollars and on U.S stock exchanges). Specifically, starting in September 2005, in accordance with the applicable amended Investment Policies, total investments can include a maximum of 60% equity securities.

### Permissible Investments

Investment Description	CPS Energy Investments	Decommissioning Trusts
U.S. Government, Government Agency, or U.S. Government-guaranteed obligations	✓	✓
Collateralized mortgage obligations issued by the U.S. Government	✓	✓
Fully secured certificates of deposit issued by a state, national or savings bank domiciled in the state of Texas	✓	✓
Direct repurchase agreements	✓	✓
Reverse repurchase agreements	✓	✓
Defined bankers’ acceptances and commercial paper	✓	✓
No-load money market mutual funds	✓	✓
Other specific types of secured or guaranteed investments	✓	✓
Equities		✓
Corporate bonds		✓
International securities		✓
Securities lending	✓	✓

**Cash, Cash Equivalents and Investments by Fund**

(In thousands)

	January 31,	
	<u>2010</u>	<u>2009</u>
Unrestricted		
Cash and cash equivalents	\$ 298,818	\$ 271,990
Investments	<u>102,996</u>	<u>46,779</u>
Total unrestricted (current)	<u>401,814</u>	<u>318,769</u>
Restricted		
Debt service		
Cash and cash equivalents	<u>3,210</u>	<u>1,088</u>
Total debt service	<u>3,210</u>	<u>1,088</u>
Capital projects		
Cash and cash equivalents	13,913	49,055
Investments	<u>73,707</u>	<u>-</u>
Total capital projects	<u>87,620</u>	<u>49,055</u>
Ordinance		
Investments	<u>331,608</u>	<u>347,537</u>
Total ordinance	<u>331,608</u>	<u>347,537</u>
Project Warm		
Cash and cash equivalents	<u>7,673</u>	<u>8,336</u>
Total Project Warm	<u>7,673</u>	<u>8,336</u>
Decommissioning Trusts		
Cash and cash equivalents	14,306	11,076
Investments	<u>373,777</u>	<u>308,483</u>
Total Decommissioning Trusts	<u>388,083</u>	<u>319,559</u>
Total restricted		
Cash and cash equivalents	39,102	69,555
Investments	<u>779,092</u>	<u>656,020</u>
Total restricted (noncurrent)	<u>818,194</u>	<u>725,575</u>
Total cash, cash equivalents and investments (unrestricted and restricted)	<u>\$ 1,220,008</u>	<u>\$ 1,044,344</u>

**Risk Exposure** – Cash equivalents and fixed-income investments are exposed to interest rate risk, credit risk (including custodial credit risk and concentration of credit risk), and foreign currency risk. Equity investments are exposed to credit risk (including custodial credit risk and concentration of credit risk) and foreign currency risk. Interest rate risk is the exposure to fair value losses resulting from rising interest rates. Credit risk is the risk that an issuer of an investment will not fulfill its obligations (will be unable to make timely principal and interest payments on the security). Foreign currency risk is the exposure to fair value losses arising from changes in exchange rates. Cash, cash equivalents and fixed-income investments are also exposed to inflation, liquidity, political, legal, event, reinvestment and timing (call) risks. Additionally, equity investments are exposed to political, legal, event, market and general economic risks. Due to market fluctuations, it is possible that substantial changes in the market value of investments could occur after the end of the reporting period.

CPS Energy's investments and the investments in the Decommissioning Trusts are managed with a conservative focus. The Investment Policies are structured to ensure compliance with bond ordinances, the PFIA, the Public Funds Collateral Act, the Nuclear Regulatory Commission ("NRC"), the PUCT, other

applicable state statutes, and Board resolutions relating to investments. CPS Energy identifies and manages risks by following an appropriate investment oversight strategy, establishing and monitoring compliance with Investment Policies and procedures, and continually monitoring prudent controls over risks.

**Summary of Gross Investments (Including Cash Equivalents)  
by Organizational Structure and Type**  
(In thousands)

	January 31,	
	<u>2010</u>	<u>2009</u>
CPS Energy investments		
U.S. Treasuries, Government Agencies, certificates of deposit and money market funds <sup>1</sup>	<u>\$ 829,847</u>	<u>\$ 724,953</u>
Decommissioning Trusts		
U.S. Treasuries, Government Agencies and money market funds	<u>148,004</u>	141,359
Corporate bonds	<u>61,646</u>	53,662
Foreign bonds	<u>4,255</u>	3,946
Subtotal	<u>213,905</u>	198,967
Common stock	<u>174,178</u>	120,592
Total Decommissioning Trusts	<u>388,083</u>	319,559
Total - all investments	<u>\$ 1,217,930</u>	<u>\$ 1,044,512</u>

**Investment Policies and the Adoption of GASB Statement No. 40** – Effective September 1, 2005, as a result of a change in Texas law, the Investment Policies of the Decommissioning Trusts were revised to allow for investment in additional types of securities, such as corporate bonds and equity securities. The policies provide guidelines to ensure all funds are invested in authorized securities in order to earn a reasonable return. The primary emphasis is placed on long-term growth commensurate with the need to preserve the value of the assets and, at the time funds are needed for decommissioning costs, on liquidity. The Investment Policies continue to follow the “prudent person” concept.

In accordance with GASB Statement No. 40, additional disclosures have been provided in this note that address investment exposure to interest rate risk, credit risk (including custodial credit risk and concentration of credit risk), and foreign currency risk, as applicable. CPS Energy’s investments and those in the Decommissioning Trusts do not have custodial credit risk, as all investments are held either by an independent trustee or bank and are in CPS Energy’s or the Decommissioning Trusts’ names.

### CPS Energy Investments

In accordance with GASB Statement No. 40, the following tables address credit risk (including custodial credit risk and concentration of credit risk) and interest rate risk exposure by investment type using the weighted-average maturity (“WAM”) method. Since CPS Energy does not hold foreign instruments in its direct investments (those held by CPS Energy), foreign currency risk is not applicable.

**Interest rate risk** – In accordance with its Investment Policy, CPS Energy manages exposure to fair value losses resulting from rising interest rates by limiting the portfolio’s WAM to two years or less. WAM is defined as the weighted-average time to return a dollar of principal. It is used as an estimate of the interest rate risk of a fixed-income investment. CPS Energy invests the cash collateral received from

securities lending and other funds in money market mutual funds that have no fixed maturities. Accordingly, a WAM in terms of years for money market mutual funds is not applicable.

**Concentration of credit risk** – In accordance with its Investment Policy, CPS Energy manages exposure to concentration of credit risk through diversification and by limiting investment in each federal agency to 50% and investment in any other issuer of debt securities to 5% of the total fixed-income portfolio. Additionally, negotiable certificates of deposit are limited to 50% per issuer.

Investment Type	January 31, 2010				January 31, 2009			
	Carrying Value	Market Value	Allocation	WAM	Carrying Value	Market Value	Allocation	WAM
(Dollars in thousands)								
U.S. Agencies								
Federal Home Loan Mortgage Corp	\$ 124,228	\$ 124,228	14.97%	3.9	\$ 83,537	\$ 83,537	11.52%	3.7
Federal National Mortgage Assn	95,467	95,467	11.50%	4.0	40,336	40,336	5.56%	2.8
Federal Home Loan Bank	147,419	147,461	17.77%	0.7	103,674	104,024	14.34%	1.4
Federal Farm Credit Bank	7,551	7,551	0.91%	2.4	25,097	25,097	3.46%	2.8
Municipal bonds	20,645	20,645	2.49%	1.3	-	-	-	-
Certificates of deposit	113,000	113,000	13.62%	0.4	125,000	125,000	17.23%	0.3
Money market mutual funds	321,537	321,537	38.74%	-	347,309	347,309	47.89%	-
Total fixed-income investments	829,847	829,889	100.00%	2.1	724,953	725,303	100.00%	1.8
Cash collateral – securities lending	31,815	31,815			209,881	209,881		
Total fixed-income portfolio	\$ 861,662	\$ 861,704			\$ 934,834	\$ 935,184		

**Credit risk** – In accordance with its Investment Policy, CPS Energy manages exposure to credit risk by limiting debt security investments to a credit rating of “A” or better. As of January 31, 2010, and January 31, 2009, CPS Energy held no debt securities with a credit rating below “Aa.”

Credit Rating	January 31, 2010			January 31, 2009		
	Carrying Value	Market Value	Allocation	Carrying Value	Market Value	Allocation
(Dollars in thousands)						
AAA	\$ 733,725	\$ 733,767	85.16%	\$ 809,834	\$ 810,184	86.63%
Aaa	200	200	0.02%	-	-	-
AA	13,664	13,664	1.59%	-	-	-
Aa	1,073	1,073	0.12%	-	-	-
Not rated <sup>1</sup>	113,000	113,000	13.11%	125,000	125,000	13.37%
Total fixed-income portfolio	\$ 861,662	\$ 861,704	100.00%	\$ 934,834	\$ 935,184	100.00%

<sup>1</sup>Certificates of deposit fully insured or collateralized at a minimum of 102%.

## Decommissioning Trusts Investments

As mentioned above, the Decommissioning Trusts report their assets on a calendar-year basis; therefore, the tables in this section are as of December 31. These tables address interest rate risk exposure by investment type, credit risk, concentration of credit risk and foreign currency risk. All investments held by the Decommissioning Trusts are long-term in nature and are recorded at fair value.

**Interest rate risk** – Generally, the long-term nature of the liabilities and the limited need for daily operating liquidity allow interim fluctuations in market value to occur without jeopardizing the ultimate value of the assets. Where long-term securities are held, the interim market value of assets can be sensitive to changes in interest rates. As the general level of interest rates moves up and down, the interim market value of longer-maturity bonds may change substantially.

To mitigate interest rate risk, a limitation is placed on the weighted-average duration (“WAD”) of the fixed-income portfolio. WAD is defined as the weighted-average time to return a dollar of principal and interest and also incorporates potential changes in the timing of principal and interest return that may occur as a result of changes in interest rates. It makes assumptions regarding the most likely timing and amounts of variable cash flows and is used as an estimate of the interest rate risk of a fixed-income investment—especially those with payment terms dependent on market interest rates. The overall portfolio duration is limited by the Investment Policy to a deviation of no more than +/- 1.5 years from the WAD of the Investment Strategy Committee’s specified fixed-income index. The Investment Strategy Committee’s fixed-income index is based on the Barclays Capital Aggregate Index (formerly the Lehman Brothers Aggregate Index), which was 4.4 for 2009 and 3.7 for 2008.

**Concentration of credit risk** – In accordance with the Investment Policy, exposure to concentration of credit risk is managed through diversification and by limiting investments in each federal agency to 30% and investments in any other issuer of debt securities to 5% of the total fixed-income portfolio (excluding cash collateral from securities lending). Likewise, equity investments are limited to 5% of the total portfolio for any one issuer. At December 31, 2009, total other debt securities (corporate and foreign issuers) amounted to 41.6% of the 28% Decommissioning Trust and 18.2% of the 12% Decommissioning Trust.

The following tables list the fixed-income investment holdings by type:

(Dollars in thousands)	December 31, 2009			December 31, 2008		
	Market Value	Allocation	WAD	Market Value	Allocation	WAD
<b>Investment Type – 28% Interest</b>						
U.S. Treasuries	\$ 8,349	5.92%	3.8	\$ 9,738	7.25%	3.6
U.S. Agencies						
Federal National Mortgage Assn	32,318	22.90%	2.7	33,999	25.31%	2.8
Federal Home Loan Mortgage Corp	16,312	11.56%	3.0	21,949	16.34%	3.1
Small Business Admin	4,581	3.25%	6.1	4,745	3.53%	6.0
Government National Mortgage Assn	2,003	1.42%	3.5	-	-	-
Municipal bonds – Texas	624	0.44%	4.9	151	0.11%	1.5
Municipal bonds – other states	5,951	4.22%	9.5	3,561	2.65%	9.5
Corporate bonds	54,417	38.57%	6.0	47,487	35.36%	6.1
Foreign bonds	4,255	3.01%	6.0	3,813	2.84%	8.7
Money market mutual funds	12,287	8.71%	-	8,872	6.61%	-
Total fixed-income investments	141,097	100.00%	4.8	134,315	100.00%	4.7
Cash collateral – securities lending	20,407			21,158		
Total fixed-income portfolio	\$ 161,504			\$ 155,473		

(Dollars in thousands)	December 31, 2009			December 31, 2008		
	Market Value	Allocation	WAD	Market Value	Allocation	WAD
<b>Investment Type – 12% Interest</b>						
U.S. Treasuries	\$ 7,788	19.57%	6.8	\$ 1,663	4.20%	7.2
U.S. Agencies						
Federal National Mortgage Assn	9,429	23.69%	3.3	10,749	27.18%	2.9
Federal Home Loan Mortgage Corp	6,289	15.80%	3.4	6,606	16.70%	3.4
Government National Mortgage Assn	2,867	7.20%	6.8	2,901	7.34%	7.3
Municipal bonds – Texas	2,026	5.09%	6.3	2,656	6.71%	11.1
Municipal bonds – other states	2,159	5.42%	3.2	6,468	16.35%	4.4
Corporate bonds	7,229	18.16%	5.6	6,175	15.61%	5.6
Foreign bonds	-	-	-	133	0.34%	9.7
Money market mutual funds	2,019	5.07%	-	2,204	5.57%	-
Total fixed-income investments	39,806	100.00%	4.9	39,555	100.00%	4.8
Cash collateral – securities lending	12,595			3,939		
Total fixed-income portfolio	\$ 52,401			\$ 43,494		

**Credit risk** – In accordance with the Investment Policy, exposure to credit risk is managed by limiting all fixed-income investments to a credit rating of “BBB-” or better from at least two nationally recognized credit rating agencies. If a security’s rating falls below the minimum investment grade rating of BBB- after it has been purchased, the Investment Policy allows investment managers to continue to hold the security as long as the total fair value of securities rated below investment grade does not exceed 5% of the total fixed-income portfolio.

The following tables list the fixed-income investment holdings by credit rating:

(Dollars in thousands)	December 31, 2009		December 31, 2008	
<b>Credit Rating – 28% Interest</b>	<b>Market Value</b>	<b>Allocation</b>	<b>Market Value</b>	<b>Allocation</b>
U.S. Treasuries	\$ 8,349	5.17%	\$ 9,738	6.26%
AAA	100,280	62.09%	102,105	65.67%
Aaa	1,215	0.75%	311	0.20%
AA+	1,414	0.88%	106	0.07%
AA	1,198	0.74%	3,993	2.57%
Aa2	296	0.18%	105	0.07%
AA-	3,095	1.92%	203	0.13%
Aa3	78	0.05%	-	-
A+	2,347	1.46%	6,041	3.89%
A	10,539	6.53%	7,497	4.82%
A-	8,916	5.52%	7,222	4.64%
A3	150	0.09%	161	0.10%
BBB+	5,131	3.18%	8,653	5.57%
BBB	10,321	6.39%	4,284	2.75%
BBB-	5,025	3.11%	4,022	2.59%
BB	1,681	1.04%	167	0.11%
B	57	0.04%	47	0.03%
B-	39	0.02%	-	-
CCC	471	0.29%	-	-
D	71	0.04%	-	-
Not rated	831	0.51%	818	0.53%
Total fixed-income portfolio	<u>\$ 161,504</u>	<u>100.00%</u>	<u>\$ 155,473</u>	<u>100.00%</u>

(Dollars in thousands)	December 31, 2009		December 31, 2008	
<b>Credit Rating – 12% Interest</b>	<b>Market Value</b>	<b>Allocation</b>	<b>Market Value</b>	<b>Allocation</b>
U.S. Treasuries	\$ 7,788	14.86%	\$ 1,663	3.82%
AAA	35,724	68.17%	32,447	74.60%
AA+	1,393	2.66%	289	0.67%
AA	522	1.00%	3,469	7.98%
AA-	538	1.03%	-	-
A+	526	1.00%	434	1.00%
A	2,859	5.46%	2,379	5.47%
A-	1,401	2.67%	766	1.76%
BBB+	925	1.77%	1,211	2.78%
BBB	725	1.38%	836	1.92%
Total fixed-income portfolio	<u>\$ 52,401</u>	<u>100.00%</u>	<u>\$ 43,494</u>	<u>100.00%</u>

**Foreign currency risk** – With the exception of dedicated foreign-equity portfolios, all investments authorized for purchase by the Decommissioning Trusts are in U.S. dollars. This reduces the potential foreign currency risk exposure of the portfolio. Total foreign bonds outstanding amounted to \$4.3 million as of December 31, 2009, and \$3.9 million as of December 31, 2008. In accordance with the Investment Policy, investments in international portfolios are limited to international commingled funds and Exchange Traded Funds that are diversified across countries and industries. The international portfolio will be limited to 20% of the total equity portfolio. At December 31, 2009, total foreign equity securities amounted to 14.6% of the 28% Trust’s equity portfolio. There were no foreign equity securities held by the 12% Trust at December 31, 2009.

### 3. Disaggregation of Current Receivables and Payables

**Receivables** – Net customer accounts receivable as of January 31, 2010, included \$40.1 million for unbilled revenue receivables and \$162.0 million for billed utility services. Interest and other receivables included \$2.7 million for regulatory-related receivables, \$1.5 million for interest receivable and \$13.5 million for other miscellaneous receivables.

Net customer accounts receivable as of January 31, 2009, included \$65.1 million for unbilled revenue receivables and \$141.2 million for billed utility services. Interest and other receivables included \$3.2 million for regulatory-related receivables, \$1.2 million for interest receivable and \$18.9 million for other miscellaneous receivables.

**Payables** – At January 31, 2010, accounts payable and accrued liabilities included \$296.9 million related to standard operating supplier and vendor payables, including fuels payable; \$26.2 million for employee-related payables; \$22.6 million for the current portion of deferred lease revenue; and \$106.8 million for other miscellaneous payables and accrued liabilities.

At January 31, 2009, accounts payable and accrued liabilities included \$281.1 million related to standard operating supplier and vendor payables, including fuels payable; \$34.5 million for employee-related payables; \$22.6 million for the current portion of deferred lease revenue; and \$107.2 million for other miscellaneous payables and accrued liabilities.

### 4. Capital Assets, Net

**General Description** – CPS Energy’s plant-in-service includes seven power plants that are solely owned and operated by the Company. In total, the plants have 19 generating units—three are coal-fired and 16 are gas-fired. The following is a list of plants and relative generating units:

Plant	Generating Units	Type	Plant	Generating Units	Type
J.T. Deely	2	Coal	V.H. Braunig	3	Gas
J.K. Spruce	1	Coal	W.B. Tuttle	4 *	Gas
Arthur von Rosenberg	1	Gas	Leon Creek	6	Gas
O.W. Sommers	2	Gas			

\*Included as a part of the 16 gas generating units is W.B. Tuttle Unit 2, which is currently not available for use, and W.B. Tuttle Units 1, 3 and 4, which were mothballed in FY 2010. All W.B. Tuttle units are fully depreciated.

Construction on J.K. Spruce Unit 2 (“Spruce 2”) was started on March 21, 2006, with plans for commercial operation in FY 2011. Spruce 2, a 750-megawatt unit, will be the largest of the coal units at Calaveras Lake and will be equipped with current emissions-control technology.

Construction of the V.H. Braunig (“VHB”) peaking units project began on September 10, 2008, and commercial operations is expected to begin in FY 2011. The peaking units will provide an additional 186 megawatts of capacity to the CPS Energy generation portfolio to meet customer demand during periods of peak load.

Other notable capital assets in electric and gas plant include a fleet of rail cars, a transmission network for the movement of electric power from the generating stations to substations, and electric and gas distribution systems.

Included in general plant are the Energy Management Center; the main office complex; the construction and customer service centers; the Villita Assembly Building; and a fleet of automobiles, trucks and work equipment.

**Impairments** – No capital asset impairments were identified for FY 2010 or for FY 2009.

**Investment in STP** – STP is currently a two-unit nuclear power plant located in Matagorda County, Texas. It is maintained and operated by the STP Nuclear Operating Company (“STPNOC”), a nonprofit Texas corporation special-purpose entity. It is financed and controlled by the owners—CPS Energy; the City of Austin; and NRG South Texas LLP, a wholly owned subsidiary of NRG Energy, Inc. CPS Energy’s 40% interest in STP Units 1 and 2 is included in plant assets. Also, see Note 13 – South Texas Project.

On October 29, 2007, the Board approved a resolution enabling CPS Energy to participate in development activities related to new nuclear generation units to be constructed in Bay City, Texas, on a site where STP Units 1 and 2 currently operate. These generation units are referred to as STP Units 3 and 4. At January 31, 2010, CPS Energy held a 50% interest in the development. As a result of a litigation settlement with Nuclear Innovation North America, Inc. (“NINA”), the Company’s partner in the project, CPS Energy’s ownership in STP Units 3 and 4 was reduced from 50% to 7.625% effective March 1, 2010. Project costs to date of \$380.0 million are included in construction-in-progress. For more detailed information on project development and legal issues associated with STP Units 3 and 4, see Note 13 – South Texas Project.

**STP Capital Investment, Net**  
(Dollars in thousands)

	January 31,	
	<u>2010</u>	<u>2009</u>
STP capital assets, net		
Land	\$ 5,701	\$ 5,701
Construction-in-progress, STP Units 1 and 2	35,785	34,429
Construction-in-progress, STP Units 3 and 4	380,030	175,052
Electric and general plant	1,224,886	1,268,652
Nuclear fuel	107,092	70,750
Total STP capital assets, net	<u>\$ 1,753,494</u>	<u>\$ 1,554,584</u>
Total CPS Energy capital assets, net	<u>\$ 7,064,193</u>	<u>\$ 6,409,849</u>
STP capital investment as a percentage of total CPS Energy capital assets, net	<b>24.8%</b>	24.3%

**Capital Asset Rollforward** – The following tables provide more detailed information on the activity of CPS Energy’s net capital assets as presented on the Balance Sheets, including capital asset activity for FY 2010 and for FY 2009:

### FY 2010 Capital Asset Rollforward

(In thousands)

	February 1, 2009	Additions/ Increases	Transfers In/(Out)	Reductions/ Decreases	January 31, 2010
<b>Nondepreciable assets</b>					
Land	\$ 99,122	\$ -	\$ 8,032	\$ (4)	\$ 107,150
Construction-in-progress	1,346,182	842,027	(294,523)	-	1,893,686
Total nondepreciable assets	<u>1,445,304</u>	<u>842,027</u>	<u>(286,491)</u>	<u>(4)</u>	<u>2,000,836</u>
<b>Depreciable assets</b>					
Electric plant	7,058,003	43,465	242,451	(25,663)	7,318,256
Gas plant	639,943	4,015	19,320	(515)	662,763
General plant	702,660	5,698	24,720	(16,739)	716,339
Nuclear fuel	574,707	68,838	-	-	643,545
Total depreciable assets	<u>8,975,313</u>	<u>122,016</u>	<u>286,491</u>	<u>(42,917)</u>	<u>9,340,903</u>
<b>Accumulated depreciation and amortization</b>					
Electric plant	(3,035,371)	(227,037)	-	35,121	(3,227,287)
Gas plant	(231,045)	(14,335)	-	913	(244,467)
General plant	(240,395)	(44,346)	-	15,402	(269,339)
Nuclear fuel	(503,957)	(32,496)	-	-	(536,453)
Total accumulated depreciation and amortization	<u>(4,010,768)</u>	<u>(318,214)</u>	<u>-</u>	<u>51,436</u>	<u>(4,277,546)</u>
Capital assets, net	<u>\$ 6,409,849</u>	<u>\$ 645,829</u>	<u>\$ -</u>	<u>\$ 8,515</u>	<u>\$ 7,064,193</u>

**Cash flow information** – Cash paid for additions and net removal costs was \$810.6 million. This included \$895.2 million in additions to construction-in-progress and electric, gas and general plant, partially offset by \$59.2 million in AFUDC and \$13.4 million in donated assets.

**Other** – The increases in electric plant included new substations and distribution infrastructure. Depreciation and amortization totaled \$285.8 million, which included \$105.0 thousand related to intangible assets.

**FY 2009 Capital Asset Rollforward**  
(In thousands)

	February 1, 2008	Additions/ Increases	Transfers In/(Out)	Reductions/ Decreases	January 31, 2009
<b>Nondepreciable assets</b>					
Land	\$ 63,411	\$ -	\$ 35,711	\$ -	\$ 99,122
Construction-in-progress	846,682	830,855	(331,355)	-	1,346,182
Total nondepreciable assets	<u>910,093</u>	<u>830,855</u>	<u>(295,644)</u>	<u>-</u>	<u>1,445,304</u>
<b>Depreciable assets</b>					
Electric plant	6,864,060	29,396	221,981	(57,434)	7,058,003
Gas plant	617,685	3,495	19,238	(475)	639,943
General plant	649,129	10,670	54,425	(11,564)	702,660
Nuclear fuel	538,357	36,350	-	-	574,707
Total depreciable assets	<u>8,669,231</u>	<u>79,911</u>	<u>295,644</u>	<u>(69,473)</u>	<u>8,975,313</u>
<b>Accumulated depreciation and amortization</b>					
Electric plant	(2,882,161)	(218,362)	-	65,152	(3,035,371)
Gas plant	(218,086)	(13,733)	-	774	(231,045)
General plant	(200,299)	(51,268)	-	11,172	(240,395)
Nuclear fuel	(473,247)	(30,710)	-	-	(503,957)
Total accumulated depreciation and amortization	<u>(3,773,793)</u>	<u>(314,073)</u>	<u>-</u>	<u>77,098</u>	<u>(4,010,768)</u>
Capital assets, net	<u>\$ 5,805,531</u>	<u>\$ 596,693</u>	<u>\$ -</u>	<u>\$ 7,625</u>	<u>\$ 6,409,849</u>

**Cash flow information** – Cash paid for additions and net removal costs was \$832.5 million. This included \$874.4 million in additions to construction-in-progress and electric, gas and general plant, partially offset by \$43.4 million in AFUDC.

**Other** – The increases in electric plant included new substations and distribution infrastructure. Depreciation and amortization totaled \$283.4 million, which included \$35.0 thousand related to intangible assets.

## 5. Revenue Bond and Commercial Paper Ordinances Requirements

**Senior Lien** – As of January 31, 2010, the bond ordinances for New Series Bonds issued on and after February 1, 1994, contained, among others, the following provisions:

Revenue deposited in CPS Energy's General Account shall be pledged and appropriated to be used in the following priority for:

- Maintenance and operating expenses of the Systems;
- Payments of the New Series Bonds;
- Payment of Prior Lien Bonds, including Junior Lien Obligations;
- Payment of the Notes and the Credit Agreement (as defined in the ordinance authorizing Commercial Paper);
- Payment of any Inferior Lien Obligations issued, which are inferior in lien to the New Series Bonds, the Prior Lien Bonds and the Notes and Credit Agreement;
- An annual amount equal to 6% of the gross revenues of the Systems to be deposited in the Repair and Replacement Account;
- Cash payments and benefits to the General Fund of the City not to exceed 14% of the gross revenues of the Systems; and
- Any remaining net revenues of the Systems in the General Account to the Repair and Replacement Account, which is used to partially fund construction costs.

The maximum amount in cash to be transferred or credited to the City's General Fund from the net revenues of the Systems during any fiscal year shall not exceed 14% of the gross revenues of the

Systems, less the value of gas and electric services of the Systems used by the City for municipal purposes and the amounts expended during the fiscal year for additions to the street lighting system and other authorized exclusions. The percentage of gross revenues of the Systems to be paid over, or credited to, the City's General Fund each fiscal year shall be determined (within the 14% limitation) by the governing body of the City.

The net revenues of the Systems are pledged to the payment of principal and interest on the New Series Bonds, which are classified as Senior Lien Obligations. All New Series Bonds and the interest thereon shall have a first lien upon the net revenues of the Systems.

**Junior Lien** – The Junior Lien, Variable Rate Demand Obligation (“VRDO”) bonds are debt instruments of the City payable solely from, and equally and ratably secured by, a junior lien on and pledge of the net revenues of the Systems, subject and subordinate to liens and pledges securing the outstanding Senior Lien Obligations and any additional Senior Lien Obligations hereafter issued, and superior to the pledge and lien securing the currently outstanding Commercial Paper Obligations, all as fully set forth in the ordinances authorizing the issuance of the Junior Lien Obligations as noted below:

The City agrees that it will at all times maintain rates and charges for the sale of electric energy, gas or other services furnished, provided and supplied by the Systems to the City and all other consumers, which shall be reasonable and nondiscriminatory and which will produce income and revenues sufficient to pay:

- All operation and maintenance expenses, depreciation, replacement and betterment expenses, and other costs as may be required by Chapter 1502 of the Texas Government Code, as amended;
- The interest on, and principal of, all Parity Bonds, as defined in the New Series Bond Ordinances, as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the Parity Bonds;
- The interest on, and principal of, the Prior Lien Bonds, including the Junior Lien Obligations and any additional Junior Lien Obligations hereafter issued (all as defined in the New Series Bond Ordinances), as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the Junior Lien Obligations and any additional Junior Lien Obligations;
- To the extent the same are reasonably anticipated to be paid with available revenues (as defined in the Ordinance authorizing the Commercial Paper), the interest on and principal of all Notes (as defined in said Ordinance), and the Credit Agreement (as defined in said Ordinance); and
- Any legal debt or obligation of the Systems as and when the same shall become due.

**Tax-Exempt Commercial Paper (“TECP”)** – As of January 31, 2010, the TECP Ordinance contains, among others, the following provisions:

To secure the payment of TECP principal and interest, a pledge is made of:

- Proceeds from
  - The sale of bonds and additional notes issued for such purposes, and
  - The sale of TECP;
- Loans under and pursuant to the revolving credit agreement; and
- The net revenues of the Systems, after payment on New Series Bond requirements and Prior Lien Bond Obligations.

## 6. Revenue Bonds

On March 12, 2009, CPS Energy issued \$442.0 million of New Series 2009A Revenue Refunding Bonds. The true interest cost for this issue, which has maturities that extend from 2015 to 2034, was 4.9%. The bond proceeds, including the premium associated with the bonds, were used on March 13, 2009, to refund \$450.0 million of outstanding TECP obligations.

The American Recovery and Reinvestment Act of 2009 provided authority for the issuance of Build America Bonds ("BABs"), which are issuable in calendar years 2009 and 2010, limited to new money capital expenditures, and only issued as taxable bonds. The BABs also permit the issuer (or the bondholder) to receive a subsidy payment equal to 35% of the bond's interest directly from the U.S. Department of the Treasury. On June 12, 2009, CPS Energy issued \$375.0 million of taxable New Series 2009C Revenue Direct Subsidy BABs. The true interest cost for this issue, which has maturities that extend from 2033 to 2039, was 3.9%. The total BABs subsidy received in FY 2010 was \$5.0 million. Total bond proceeds are primarily being used to fund generation and electric distribution construction projects.

At one point, CPS Energy contemplated issuing a portion of the 2009C instruments as nontaxable bonds. These would have been 2009B Revenue Bonds ("2009B Bonds"). Since the effective interest rate and investor interest were more favorable for BABs, the 2009B Bonds were not pursued.

On July 30, 2009, CPS Energy issued \$207.9 million of tax-exempt New Series 2009D Revenue Refunding Bonds. The true interest cost for this issue, which has maturities that extend from 2017 to 2021, was 3.7%. On September 1, 2009, the escrowed proceeds, including the premium associated with the bonds, were used to refund \$227.7 million par value of the remaining New Series 1998A Bonds. This refunding transaction resulted in a net present value debt service savings of \$14.8 million, or 6.5% of the par amount of the bonds being refunded.

On March 23, 2010, CPS Energy issued \$380.0 million of taxable New Series 2010A Revenue Direct Subsidy BABs. The true interest cost for this issue, which has two term bonds maturing in 2041, was 3.8%. Total bond proceeds are primarily being used to fund generation and electric distribution construction projects.

In March 2010, Fitch Ratings, Moody's Investors Service, Inc. and Standard & Poor's Rating Services each reaffirmed the Company's long-term bond ratings of "AA+", "Aa1" and "AA," respectively.

### Revenue Bond Summary

(Dollars in thousands)

Issues / Maturities	Weighted-Average Yield on Outstanding Bonds at January 31, 2010	January 31,	
		2010	2009
Tax-exempt new series			
bonds 1994A-2009D, 2011-2034	4.8%	\$ 3,366,495	\$ 3,092,915
Taxable new series			
bonds 2009C, 2033-2039	3.9%	375,000	-
Total	4.6%	3,741,495	3,092,915
Tax-exempt variable rate series			
bonds 2003-2004, 2024-2033		402,000	402,000
Total long-term revenue bonds outstanding		4,143,495	3,494,915
Less: Current maturities of bonds		162,235	148,705
Total revenue bonds outstanding, net of current maturities		\$ 3,981,260	\$ 3,346,210

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As of January 31, 2010, principal and interest amounts due for all revenue bonds outstanding for each of the next five years and thereafter to maturity are:

(In thousands)

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Direct Subsidy</u>	<u>Total</u>
2011	\$ 162,235	\$ 197,855	\$ (7,855)	\$ 352,235
2012	176,190	189,476	(7,855)	357,811
2013	173,925	180,519	(7,855)	346,589
2014	184,255	171,335	(7,855)	347,735
2015	157,035	161,584	(7,855)	310,764
2016-2020	863,970	684,623	(39,277)	1,509,316
2021-2025	1,185,445	449,965	(39,277)	1,596,133
2026-2030	496,965	238,727	(39,277)	696,415
2031-2035	476,333	135,727	(37,803)	574,257
2036-2039	267,142	40,734	(14,257)	293,619
Totals	<u>\$ 4,143,495</u>	<u>\$ 2,450,545</u>	<u>\$ (209,166)</u>	<u>\$ 6,384,874</u>

The above table includes Senior Lien and Junior Lien Bonds. Interest on the Senior Lien Bonds is based upon the stated coupon rates of each series of bonds outstanding. The direct subsidy associated with the New Series 2009C BABs has been presented in a separate column. CPS Energy has taken the position that the BABs direct subsidy should be deducted when calculating total debt service.

The 2003 Junior Lien Bonds were issued as variable-rate bonds and as such have interest rates that reset on a weekly basis. On December 1, 2007, the 2004 Junior Lien Bonds were remarketed for a three-year term at an interest rate of 3.625%. This interest rate will remain in effect until the next interest reset date of December 1, 2010. The total interest amounts for all revenue bonds outstanding included a blended interest rate for the 2003 and 2004 Junior Lien Bonds of 1.5% at January 31, 2010, and 1.7% at January 31, 2009.

The interest rate term mode for the Junior Lien Revenue Bonds, or any portion thereof, may be converted to a different mode, or to an auction rate or term rate with an interest rate period of different duration, at the direction of the City. Following such a conversion, the Junior Lien Bonds, or portion thereof, will bear interest at the corresponding daily, weekly, auction, commercial paper, term or fixed rate.

The turmoil in the capital markets has had a minimal impact on CPS Energy's variable-rate debt. Initially, rates increased during a two-month period at the onset of the financial crisis, but have since decreased and stabilized. The Company continues to monitor the markets on a daily basis and is in close communication with its remarketing agents, financial advisors and bond counsel.

**FY 2010 Long-Term Debt Activity**  
(Dollars in thousands)

	<u>Original Amount</u>	<u>Final Principal Payment</u>	<u>Interest Rate (%)</u>	<u>Balance Outstanding 2-1-09</u>	<u>Additions During Year</u>	<u>Decreases During Year</u>	<u>Balance Outstanding 1-31-10</u>
Revenue and refunding bonds							
1994A tax-exempt	\$ 684,700	2012	5.008	\$ 68,965	\$ -	\$ -	\$ 68,965
1998A tax-exempt	785,515	2021	4.918	227,660	-	(227,660)	-
2000A tax-exempt	170,770	2010	5.374	2,490	-	(2,490)	-
2001 tax-exempt	115,280	2011	3.843	38,135	-	(25,710)	12,425
2002 tax-exempt	436,090	2017	4.055	406,610	-	(45,030)	361,580
2002 tax-exempt	140,615	2015	4.751	10,525	-	-	10,525
2003 tax-exempt – Junior Lien	250,000	2033	Variable	250,000	-	-	250,000
2003A tax-exempt	93,935	2014	3.675	81,550	-	(310)	81,240
2003 tax-exempt	350,490	2013	3.081	144,785	-	(25,835)	118,950
2004 tax-exempt – Junior Lien	160,000	2027	Variable	152,000	-	-	152,000
2005 tax-exempt	294,625	2020	4.381	294,625	-	-	294,625
2005 tax-exempt	240,675	2025	4.683	240,675	-	-	240,675
2005A tax-exempt	197,335	2025	4.571	197,335	-	-	197,335
2006A tax-exempt	384,185	2025	4.555	371,515	-	(13,290)	358,225
2006B tax-exempt	128,845	2021	3.974	112,670	-	(8,540)	104,130
2007 tax-exempt	46,195	2018	4.159	46,195	-	-	46,195
2007 tax-exempt	403,215	2032	4.575	403,215	-	-	403,215
2008 tax-exempt	287,935	2032	4.582	287,935	-	-	287,935
2008A tax-exempt	158,030	2016	3.736	158,030	-	(27,500)	130,530
2009A tax-exempt	442,005	2034	4.863	-	442,005	-	442,005
2009C taxable	375,000	2039	3.944	-	375,000	-	375,000
2009D tax-exempt	207,940	2021	3.720	-	207,940	-	207,940
Bonds outstanding				3,494,915	1,024,945	(376,365)	4,143,495
Bond current maturities				(148,705)	(13,530)	-	(162,235)
Bond (discount) premium				124,408	33,975	(21,051)	137,332
Bond reacquisition costs				(76,497)	(11,889)	27,078	(61,308)
Revenue bonds, net				3,394,121	1,033,501	(370,338)	4,057,284
Tax-exempt commercial paper			Variable	450,000	350,000	(450,000)	350,000
Long-term debt, net				<u>\$3,844,121</u>	<u>\$1,383,501</u>	<u>\$(820,338)</u>	<u>\$ 4,407,284</u>

**FY 2009 Long-Term Debt Activity**  
(Dollars in thousands)

	Original Amount	Final Principal Payment	Interest Rate (%)	Balance Outstanding 2-1-08	Additions During Year	Decreases During Year	Balance Outstanding 1-31-09
Revenue and refunding bonds							
1994A tax-exempt	\$ 684,700	2012	5.008	\$ 68,965	\$ -	\$ -	\$ 68,965
1998A tax-exempt	785,515	2021	4.918	430,980	-	(203,320)	227,660
2000A tax-exempt	170,770	2010	5.374	4,880	-	(2,390)	2,490
2001 tax-exempt	115,280	2011	3.843	62,615	-	(24,480)	38,135
2002 tax-exempt	436,090	2017	4.055	426,040	-	(19,430)	406,610
2002 tax-exempt	140,615	2015	4.751	10,525	-	-	10,525
2003 tax-exempt – Junior Lien	250,000	2033	Variable	250,000	-	-	250,000
2003A tax-exempt	93,935	2014	3.675	81,855	-	(305)	81,550
2003 tax-exempt	350,490	2013	3.081	192,055	-	(47,270)	144,785
2004 tax-exempt – Junior Lien	160,000	2027	Variable	152,000	-	-	152,000
2005 tax-exempt	294,625	2020	4.381	294,625	-	-	294,625
2005 tax-exempt	240,675	2025	4.683	240,675	-	-	240,675
2005A tax-exempt	197,335	2025	4.571	197,335	-	-	197,335
2006A tax-exempt	384,185	2025	4.555	384,185	-	(12,670)	371,515
2006B tax-exempt	128,845	2021	3.974	120,945	-	(8,275)	112,670
2007 tax-exempt	46,195	2018	4.159	46,195	-	-	46,195
2007 tax-exempt	403,215	2032	4.575	403,215	-	-	403,215
2008 tax-exempt	287,935	2032	4.582	-	287,935	-	287,935
2008A tax-exempt	158,030	2016	3.736	-	158,030	-	158,030
Bonds outstanding				3,367,090	445,965	(318,140)	3,494,915
Bond current maturities				(152,875)	-	4,170	(148,705)
Bond (discount) premium				117,105	25,185	(17,882)	124,408
Bond reacquisition costs				(91,574)	(10,428)	25,505	(76,497)
Revenue bonds, net				3,239,746	460,722	(306,347)	3,394,121
Tax-exempt commercial paper			Variable	450,000	-	-	450,000
Long-term debt, net				<u>\$3,689,746</u>	<u>\$ 460,722</u>	<u>\$ (306,347)</u>	<u>\$ 3,844,121</u>

## 7. Commercial Paper and Related Revolving Credit Agreement

In 1988, the San Antonio City Council adopted an ordinance authorizing the issuance of up to \$300 million in TECP. This ordinance, as amended in June 1997, provides for funding to assist in the interim financing of eligible projects in an aggregate amount not to exceed \$450 million. Eligible projects include fuel acquisition, capital improvements to the Systems, and refinancing or refunding any outstanding obligations, which are secured by and payable from a lien and/or a pledge of net revenues of the Systems. Such pledge of net revenues is subordinate and inferior to the pledge securing payment of existing New Series Bonds and Junior Lien Obligations. Scheduled maximum maturities cannot extend beyond November 1, 2028.

On March 12, 2009, CPS Energy issued \$442.0 million of New Series 2009A Revenue Refunding Bonds to refund \$450.0 million of outstanding TECP. On March 16, 2009, the Company issued \$260.0 million of TECP. On November 24 and December 29, 2009, CPS Energy issued \$30.0 million and \$40.0 million of TECP, respectively. All proceeds were used to fund generation and distribution construction projects.

On January 28, 2010, the Company issued an additional \$20.0 million of TECP, which will be used to remediate debt.

The current outstanding TECP balance as of January 31, 2010, was \$350.0 million. Of the total TECP outstanding as of January 31, 2010, \$130.0 million was used to fund the development of STP Units 3 and 4.

The TECP has been classified as long-term in accordance with the refinancing terms under a revolving credit agreement with a consortium of banks, which supports the commercial paper. Under the terms of the amended revolving credit agreement effective September 6, 2007, CPS Energy may borrow up to an aggregate amount not to exceed \$450 million for the purpose of paying principal due under the TECP program. On September 6, 2007, the revolving credit agreement was extended until November 1, 2012. At January 31, 2010, there was no amount outstanding under the agreement. Further, there have been no borrowings under the agreement since inception.

### TECP Summary

(Dollars in thousands)	January 31,	
	2010	2009
TECP outstanding	\$ 350,000	\$ 450,000
TECP new money issues	350,000	-
Weighted-average interest rate of outstanding TECP	0.3%	1.2%
Average life of outstanding TECP (number of days)	93	96

## 8. Employee Pension Plan

**Plan Description** – The CPS Energy Pension Plan is a self-administered, single-employer, defined-benefit contributory pension plan (“Plan”) covering substantially all employees who have completed one year of service. It is an unconsolidated entity within which normal retirement age is 65; however, early retirement is available with 25 years of benefit service, as well as to those employees who are age 55 or older with at least ten years of benefit service. Retirement benefits are based on length of service and compensation, and benefits are reduced for retirement before age 55 with 25 years or more of benefit service or before age 62 with less than 25 years of service.

The Plan is sponsored by and may be amended at any time by CPS Energy, acting by and through the Oversight Committee, which includes the General Manager and CEO, the Chief Financial Officer and the Audit Committee Chair of the Board. Pension Plan assets are segregated from CPS Energy’s assets and are separately managed by the Administrative Committee, whose members are appointed by the Oversight Committee.

The Plan reports results on a calendar-year basis, and the separately audited financial statements, which contain historical trend information, may be obtained by contacting Benefit Trust Administration at CPS Energy. Plan net assets had a market value of \$973.7 million at December 31, 2009, and \$806.0 million at December 31, 2008.

In addition to the defined-benefit pension plan, CPS Energy has two Restoration Plans that were effective as of January 1, 1998, which supplement benefits paid from the Pension Plan due to Internal Revenue Code restrictions on benefit limits. The benefits due under those Restoration Plans have been paid annually by CPS Energy.

Employees who retired prior to 1983 receive annuity payments from an insurance carrier, as well as some benefits directly from CPS Energy. The costs for the benefits directly received from the Company were \$120.0 thousand for FY 2010 and \$129.0 thousand for FY 2009. These costs were recorded when paid.

**Funding Policy** – The current policy of CPS Energy is to establish funding levels, considering annual actuarial valuations and recommendations of the Administrative Committee, using both employee and employer contributions. Generally, participating employees contribute 5.0% of their total compensation and are typically fully vested in CPS Energy’s matching contribution after completing seven years of credited service or upon reaching age 40. Employee contributions commence with the effective date of participation and continue until normal or early retirement, completion of 44 years of benefit service, or termination of employment. The employee contribution interest crediting rate was 8.0% for FY 2010 and FY 2009.

The balance of Plan contributions is the responsibility of CPS Energy, giving consideration to actuarial information, budget controls, legal requirements, compliance, and industry and/or community norms. For FY 2010 and FY 2009, the amount to be funded was established using a general target near the 20-year funding contribution level as determined by the Plan’s actuary. CPS Energy’s contributions in relation to the annual required contribution (“ARC”) amounted to 10.8% of covered payroll for FY 2010 and 9.5% of covered payroll in FY 2009.

**Annual Pension Cost and Net Pension Obligation** – CPS Energy’s annual pension cost (“APC”) and net pension obligation (“NPO”) for FY 2010 and FY 2009 are presented below. The NPO may be either positive, reflecting a liability, or negative, reflecting an asset. The term net pension obligation, as used in this note, refers to either situation.

(In thousands)	<u>Fiscal Year Ended January 31,</u>	
	<u>2010</u>	<u>2009</u>
Annual required contribution (ARC)	\$ 23,468	\$ 20,561
Interest on net pension obligation	(156)	(164)
Adjustment to ARC	<u>191</u>	<u>193</u>
Annual pension cost (APC)	23,503	20,590
Employer contributions in relation to ARC	<u>(23,732)</u>	<u>(20,561)</u>
Increase (decrease) in net pension obligation	(229)	29
Net pension obligation – beginning of year	<u>(1,944)</u>	<u>(1,973)</u>
Net pension obligation – end of year	<u>\$ (2,173)</u>	<u>\$ (1,944)</u>

### Three-Year Trend Information

(Dollars in thousands)

Fiscal Year Ended	APC	Percentage of APC Contributed	NPO
1-31-2010	\$ 23,503	101.0%	\$ (2,173)
1-31-2009	20,590	99.9%	(1,944)
1-31-2008	20,868	109.5%	(1,973)

**Funded Status and Funding Progress** – The funded status of the Plan as of the February 1, 2009, valuation date was as follows:

(Dollars in thousands)	<u>February 1, 2009</u>
Actuarial value of plan assets (a)	\$ 1,145,029
Actuarial accrued liability (b)	<u>1,169,302</u>
Unfunded actuarial accrued liability (funding excess) (b) - (a)	<u>\$ 24,273</u>
Funded ratio (a) / (b)	97.9%
Covered payroll (c)	\$ 219,716
Unfunded actuarial accrued liability (funding excess) as a percentage of covered payroll $[(b) - (a)] / (c)$	11.0%

The schedule of funding progress, presented as required supplementary information, presents multiyear trend information that shows whether the actuarial value of Plan assets is increasing or decreasing over time relative to the actuarial accrued liability (“AAL”) for benefits.

**Actuarial Methods and Assumptions** – Beginning with the 2008 Plan year, the cost method was revised to project January 1 data to February 1 of the next calendar year based on assumptions. Actuarial valuation methods used for the February 1, 2009 and 2008, valuations included: (a) the five-year smoothed market method for asset valuation, (b) the projected-unit-credit actuarial cost method for the AAL, and (c) the 20-year level-dollar open method for amortization of pension service costs.

The actuarial assumptions were changed for January 1, 2007, as a result of an experience study and actuarial assumption review covering 2001 through 2006 actuarial valuation data. The assumed termination, retirement, mortality, base salary increases and overtime rates were updated to reflect recent experience and future expectations, and a separate incentive pay assumption was adopted based on current policies and expectations. The changes in actuarial assumptions increased the AAL as of January 1, 2007, by \$77.7 million (from \$964.3 million under the prior assumptions to \$1.0 billion under the new assumptions) and increased the employer normal cost from 8.0% of reported earnings to 9.8% of reported earnings.

Significant actuarial assumptions used for the February 1, 2009, actuarial valuation included: (a) a rate of return on the investment of present and future assets of 8.0%, (b) projected salary increases averaging 5.8%, and (c) post retirement cost-of-living increases of 1.8%. The projected salary increases included an inflation rate of 3.5%.

**REQUIRED SUPPLEMENTARY INFORMATION****Schedule of Funding Progress (Unaudited)**

(Dollars in thousands)

Actuarial Valuation Date <sup>1</sup>	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) <sup>2</sup> (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ([b - a] / c)
2-1-2009	\$ 1,145,029	\$ 1,169,302	\$ 24,273	97.9%	\$ 219,716	11.0%
2-1-2008	1,084,569	1,103,865	19,296	98.3%	217,018	8.9%
1-1-2007	1,012,067	1,041,471	29,404	97.2%	209,070	14.1%

<sup>1</sup> Subsequent to the January 1, 2007, valuation, the cost method was revised to project January 1 data to February 1 of the next calendar year based on assumptions.

<sup>2</sup> Actuarial assumptions were changed for the January 1, 2007, valuation as a result of an experience study and actuarial assumptions review covering 2001 through 2006 actuarial valuation data.

**9. Other Postemployment Benefits**

**Plan Descriptions** – CPS Energy provides certain health, life insurance and disability income benefits for employees. Additionally, most CPS Energy employees continue eligibility upon retirement from the Company. Assets of the plans are held in three separate, single-employer contributory plans:

- City Public Service of San Antonio Group Health Plan (“Health Plan”)—a contributory group health plan that provides health, dental and vision benefits.
- City Public Service of San Antonio Group Life Insurance Plan (“Life Plan”)—a contributory plan that provides life insurance benefits.
- City Public Service of San Antonio Group Disability Income Plan (“Disability Plan”)—an employer funded plan that provides disability income benefits.

The Employee Benefit Plans may be amended at any time by CPS Energy, acting by and through an Oversight Committee, which includes the General Manager and CEO, the Chief Financial Officer, and the Audit Committee Chair of the Board.

The Employee Benefit Plans’ assets are segregated from CPS Energy’s assets and are separately managed by an Administrative Committee whose members are appointed by the Oversight Committee. The plans report results on a calendar-year basis and issue separately audited financial statements that may be obtained by contacting Benefit Trust Administration at CPS Energy. The Health Plan’s net assets had a market value of \$181.1 million at December 31, 2009, and \$147.0 million at December 31, 2008. The Life Plan’s net assets had a market value of \$41.3 million at December 31, 2009, and \$35.3 million at December 31, 2008. The Disability Plan’s net assets had a market value of \$3.2 million at December 31, 2009, and \$2.5 million at December 31, 2008.

**Funding Policy** – The funding requirements for both the plan participants and the employer are established by and may be amended by CPS Energy. Funding is based on projected pay-as-you-go financing requirements, with an additional amount to prefund benefits as determined annually by the Company.

Retired employees contribute to the Health Plan in varying amounts depending upon an equity formula that considers age and years of service. Individuals who retired before February 1, 1993, contribute a base rate plus 2.25% of the difference between that amount and the aggregate rate for each year that the

sum of age and service is less than 95. Those who retired on or after February 1, 1993, contribute a base rate plus a percentage of the CPS Energy contribution, based on the number of years of service, if they retire with less than 35 years. Retirees and covered dependents contributed \$4.1 million in FY 2010 and \$3.1 million in FY 2009 for their health insurance benefits.

CPS Energy's contributions in relation to the ARC for the Health Plan amounted to 6.3% of covered payroll in FY 2010 and 7.0% of covered payroll in FY 2009.

The Medicare Prescription Drug Improvement and Modernization Act of 2003, which was effective January 1, 2006, established prescription drug coverage for Medicare beneficiaries known as Medicare Part D. One of the provisions of Medicare Part D entitled the Health Plan to receive retiree drug subsidy payments from the federal government to offset pharmacy claims paid by the Health Plan on behalf of certain plan participants. These payments totaled \$645.9 thousand for FY 2010 and \$785.7 thousand for FY 2009. In accordance with GASB Technical Bulletin 2006-01, *Accounting and Financial Reporting by Employers for Payments from the Federal Government Pursuant to the Retiree Drug Subsidy Provisions of Medicare Part D*, future projected payments from the federal government have not been used to lessen total projected obligations under the Company's Health Plan.

Employees who retired prior to February 1, 1993, contribute to the Life Plan at a rate of \$0.13 per \$1,000 of insurance per month on amounts in excess of \$20,000 plus 2.25% of the difference between that amount and the aggregate rate for retiree coverage for each year the sum of retirement age and service is less than 95. Those who retired on or after February 1, 1993, contribute \$0.13 per \$1,000 of insurance per month on amounts in excess of \$20,000 plus a percentage of the CPS Energy contribution, based on number of years of service, if they retire with less than 35 years. Retirees and covered dependents contributed \$228.0 thousand in FY 2010 and \$221.2 thousand in FY 2009 for their life insurance benefits. CPS Energy's contributions in relation to the ARC for the Life Plan amounted to 0.1% of covered payroll in both FY 2010 and FY 2009.

The Disability Plan is funded completely by CPS Energy. The Company's contributions in relation to the ARC were 0.3% of covered payroll in FY 2010 and 0.2% of covered payroll in FY 2009.

**Annual OPEB Cost and Net OPEB Obligation** – CPS Energy's annual OPEB cost is calculated based on the ARC of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The annual OPEB cost consists of the ARC, interest on the net OPEB obligation, and adjustments to the ARC for the Health, Life and Disability Plans. The annual OPEB cost was \$8.8 million for FY 2010 and \$13.0 million for FY 2009. The following table shows the components of the Company's annual OPEB cost for FY 2010 and FY 2009, the contributions in relation to the ARC, and changes in the net OPEB obligation for each of the plans. The net OPEB obligation may be either positive, reflecting a liability, or negative, reflecting an asset. The term net OPEB obligation, as used in this note, refers to either situation.

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The following table shows the ARC, annual OPEB cost and net OPEB obligation for each of the three Employee Benefit Plans and in total for FY 2010 and FY 2009:

(In thousands)

	Health Plan	Life Plan	Disability Plan	Total
<b>FY 2010</b>				
Annual required contribution	\$ 7,940	\$ -	\$ 381	\$ 8,321
Interest on net OPEB obligation	(2,578)	(45)	(10)	(2,633)
Adjustment to annual required contribution	3,040	58	12	3,110
Annual OPEB cost	8,402	13	383	8,798
Contributions in relation to ARC	(13,820)	(140)	(617)	(14,577)
Decrease in net OPEB obligation	(5,418)	(127)	(234)	(5,779)
Net OPEB obligation – beginning of year	(32,232)	(558)	(125)	(32,915)
Net OPEB obligation – end of year	<u>\$ (37,650)</u>	<u>\$ (685)</u>	<u>\$ (359)</u>	<u>\$ (38,694)</u>
<b>FY 2009</b>				
Annual required contribution	\$ 12,337	\$ -	\$ 285	\$ 12,622
Interest on net OPEB obligation	(2,385)	(35)	2	(2,418)
Adjustment to annual required contribution	2,810	42	(2)	2,850
Annual OPEB cost	12,762	7	285	13,054
Contributions in relation to ARC	(15,191)	(127)	(433)	(15,751)
Decrease in net OPEB obligation	(2,429)	(120)	(148)	(2,697)
Net OPEB obligation – beginning of year	(29,803)	(438)	23	(30,218)
Net OPEB obligation – end of year	<u>\$ (32,232)</u>	<u>\$ (558)</u>	<u>\$ (125)</u>	<u>\$ (32,915)</u>

CPS Energy's annual OPEB cost, the percentage of annual OPEB cost contributed, and the net OPEB obligation for FY 2010, FY 2009 and FY 2008 for each of the plans were as follows:

(Dollars in thousands)

	Health Plan	Life Plan	Disability Plan	Total
<b>FY 2010</b>				
Annual OPEB cost	\$ 8,402	\$ 13	\$ 383	\$ 8,798
Percentage of annual OPEB cost contributed	164.5%	1039.3%	160.9%	165.7%
Net OPEB obligation	\$ (37,650)	\$ (685)	\$ (359)	\$ (38,694)
<b>FY 2009</b>				
Annual OPEB cost	\$ 12,762	\$ 7	\$ 285	\$ 13,054
Percentage of annual OPEB cost contributed	119.0%	2028.4%	151.9%	120.7%
Net OPEB obligation	\$ (32,232)	\$ (558)	\$ (125)	\$ (32,915)
<b>FY 2008</b>				
Annual OPEB cost	\$ 13,168	\$ 1	\$ 208	\$ 13,377
Percentage of annual OPEB cost contributed	333.1%	27007.3%	140.0%	332.7%
Net OPEB obligation	\$ (29,803)	\$ (438)	\$ 23	\$ (30,218)

**Funded Status and Funding Progress** – CPS Energy began partial funding of projected future benefits in 1992. The funded status of the plans as of the February 1, 2009, valuation date was as follows:

(Dollars in thousands)

	Health Plan	Life Plan <sup>1</sup>	Disability Plan <sup>1</sup>
Actuarial value of plan assets (a)	\$204,246	\$ 49,614	\$ 3,763
Actuarial accrued liability (b)	<u>219,364</u>	<u>35,491</u>	<u>6,575</u>
Unfunded actuarial accrued liability (funding excess) (b) - (a)	<u>\$ 15,118</u>	<u>\$(14,123)</u>	<u>\$ 2,812</u>
Funded ratio (a) / (b)	93.1%	139.8%	57.2%
Covered payroll (c)	219,716	198,669	198,669
Unfunded actuarial accrued liability (funding excess) as a percentage of covered payroll $[(b) - (a)] / (c)$	6.9%	-7.1%	1.4%

<sup>1</sup> CPS Energy has selected the aggregate cost method for determining Life and Disability Plan funding amounts. Since this method does not identify or separately amortize unfunded actuarial liabilities, information about the funded status and funding progress has been prepared using the entry-age actuarial cost method, which approximates the funding progress of the plans.

**Actuarial Methods and Assumptions** – Actuarial valuations of ongoing plans involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the plans and the annual required contributions of the employer are subject to continued revision as actual results are compared with past expectations and new estimates are made about the future. The schedules of funding progress, presented as required supplementary information on the following pages, present multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting are based on the substantive plans (the plans as understood by the employer and plan members) and include the types of benefits provided for at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

For the Health Plan, the actuarial cost method used was the projected-unit-credit actuarial cost method. For the Life and Disability Plans, the aggregate actuarial cost method was used to determine the cost of benefits. Since this method does not identify or separately amortize unfunded actuarial liabilities, information about funded status and funding progress was prepared using the entry-age actuarial cost method, which is intended to approximate the funding progress of the plans.

The amortization method used for all three plans was the level-dollar open method. Effective with the January 1, 2007, valuation, the Company elected to establish an amortization period of 20 years to be used for actuarial valuations for the current and future periods. The asset valuation method used for all three plans was the five-year smoothed market valuation method. Beginning with the 2008 plan year,

the cost method was revised to project January 1 data to February 1 of the next calendar year based on assumptions.

Significant actuarial assumptions used in the calculations for February 1, 2009, included (a) a rate of return on the investment of present and future assets of 8.0% for the Health, Life and Disability Plans, (b) a Consumer Price Index increase of 4.0% for the Disability Plan, (c) projected salary increases for the Health Plan ranging from 4.1% to 10.5% depending on age for base and other salaries and an inflation rate for salary increases of 3.5% for the Life and Disability Plans, and (d) medical cost increases projected at 8.5% for 2009, decreasing annually to 5.5% in 2016 and thereafter.

## REQUIRED SUPPLEMENTARY INFORMATION

### Health Plan Schedule of Funding Progress (Unaudited) (Dollars in thousands)

Actuarial Valuation Date <sup>1</sup>	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) <sup>2</sup> (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ([b - a] / c)
2-1-2009	\$ 204,246	\$ 219,364	\$ 15,118	93.1%	\$ 219,716	6.9%
2-1-2008	194,876	247,283	52,407	78.8%	217,018	24.1%
1-1-2007	150,818	220,691	69,873	68.3%	209,070	33.4%

<sup>1</sup> Subsequent to the January 1, 2007, valuation, the cost method was revised to project January 1 data to February 1 of the next calendar year based on assumptions.

<sup>2</sup> The AAL consisted of the liability for both retired employees and active employees. The AAL for retired employees was \$87.9 million for February 1, 2009; \$94.2 million for February 1, 2008; and \$97.9 million for January 1, 2007.

### Life Plan Schedule of Funding Progress (Unaudited) (Dollars in thousands)

Actuarial Valuation Date <sup>1</sup>	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) <sup>2</sup> (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ([b - a] / c)
2-1-2009	\$ 49,614	\$ 35,491	\$ (14,123)	139.8%	\$ 198,669	-7.1%
2-1-2008	49,098	33,024	(16,074)	148.7%	185,090	-8.7%
1-1-2007	47,809	31,219	(16,590)	153.1%	177,558	-9.3%

<sup>1</sup> Subsequent to the January 1, 2007, valuation, the cost method was revised to project January 1 data to February 1 of the next calendar year based on assumptions.

<sup>2</sup> CPS Energy has selected the aggregate cost method for determining Life Plan funding amounts. Since this method does not identify or separately amortize unfunded actuarial liabilities, information about the funded status and funding progress has been prepared using the entry-age actuarial cost method, which approximates the funding progress of the plan.

**Disability Plan**  
**Schedule of Funding Progress (Unaudited)**  
(Dollars in thousands)

Actuarial Valuation Date <sup>1</sup>	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) <sup>2</sup> (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ([b - a] / c)
2-1-2009	\$ 3,763	\$ 6,575	\$ 2,812	57.2%	\$ 198,669	1.4%
2-1-2008	3,734	5,712	1,978	65.4%	185,090	1.1%
1-1-2007	3,925	5,211	1,286	75.3%	177,558	0.7%

<sup>1</sup> Subsequent to the January 1, 2007, valuation, the cost method was revised to project January 1 data to February 1 of the next calendar year based on assumptions.

<sup>2</sup> CPS Energy has selected the aggregate cost method for determining Disability Plan funding amounts. Since this method does not identify or separately amortize unfunded actuarial liabilities, information about the funded status and funding progress has been prepared using the entry-age actuarial cost method, which approximates the funding progress of the plan.

## 10. Other Obligations and Risk Management

**Other Liabilities and Deferred Credits** – CPS Energy maintains other obligations as noted below. The relative long-term portion of these obligations compared to the total was 95.1% as of January 31, 2010, and 95.2% as of January 31, 2009.

**FY 2010 Other Liabilities and Deferred Credits**  
(In thousands)

	Rollforward			Balance Outstanding 1-31-2010	Total	
	Balance Outstanding 2-1-2009	Additions During Year	Decreases During Year		Amounts Due within One Year	Long-Term Balance Outstanding
STP decommissioning	\$ 296,363	\$ 42,380	\$ (12,770)	\$ 325,973	\$ -	\$ 325,973
STP decommissioning net costs refundable	24,725	38,731	-	63,456	-	63,456
Deferred lease revenue	520,773	-	(22,561)	498,212	22,561	475,651
	<u>841,861</u>	<u>81,111</u>	<u>(35,331)</u>	<u>887,641</u>	<u>22,561</u>	<u>865,080</u>
Other						
Customer deposits	26,507	21,368	(18,601)	29,274	19,513	9,761
Operating reserves	19,173	6,683	(7,739)	18,117	4,529	13,588
STP pension and OPEBs	69,902	8,055	(10,470)	67,487	-	67,487
Pollution remediation liability	1,019	617	(749)	887	440	447
Project Warm	7,774	613	(713)	7,674	-	7,674
Retainage interest expense payable	2,881	102	-	2,983	-	2,983
Notes payable	4,289	-	(285)	4,004	490	3,514
Customer advances	24,271	20,163	(23,181)	21,253	2,978	18,275
Deferred credits	7,005	14,795	(21,769)	31	-	31
Other	588	17	(8)	597	-	597
Total other liabilities	<u>163,409</u>	<u>72,413</u>	<u>(83,515)</u>	<u>152,307</u>	<u>27,950</u>	<u>124,357</u>
Total other long-term liabilities and deferred credits	<u>\$1,005,270</u>	<u>\$ 153,524</u>	<u>\$(118,846)</u>	<u>\$ 1,039,948</u>	<u>\$ 50,511</u>	<u>\$ 989,437</u>

**FY 2009 Other Liabilities and Deferred Credits**  
(In thousands)

	Rollforward			Total		
	Balance Outstanding 2-1-2008	Additions During Year	Decreases During Year	Balance Outstanding 1-31-2009	Amounts Due within One Year	Long-Term Balance Outstanding
STP decommissioning	\$ 326,758	\$ 39,833	\$ (70,228)	\$ 296,363	\$ -	\$ 296,363
STP decommissioning net costs refundable	117,488	-	(92,763)	24,725	-	24,725
Deferred lease revenue	543,333	-	(22,560)	520,773	22,561	498,212
	<u>987,579</u>	<u>39,833</u>	<u>(185,551)</u>	<u>841,861</u>	<u>22,561</u>	<u>819,300</u>
Other						
Customer deposits	26,107	17,356	(16,956)	26,507	17,960	8,547
Operating reserves	16,725	13,661	(11,213)	19,173	4,292	14,881
STP pension and OPEBs	39,494	34,754	(4,346)	69,902	-	69,902
Pollution remediation liability	852	1,812	(1,645)	1,019	716	303
Project Warm	7,686	235	(147)	7,774	-	7,774
Retainage interest expense payable	2,020	864	(3)	2,881	-	2,881
Notes payable	4,631	96	(438)	4,289	602	3,687
Customer advances	31,033	19,692	(26,454)	24,271	2,233	22,038
Deferred credits	2,615	45,826	(41,436)	7,005	-	7,005
Other	572	25	(9)	588	-	588
Total other liabilities	<u>131,735</u>	<u>134,321</u>	<u>(102,647)</u>	<u>163,409</u>	<u>25,803</u>	<u>137,606</u>
Total other long-term liabilities and deferred credits	<u>\$1,119,314</u>	<u>\$ 174,154</u>	<u>\$(288,198)</u>	<u>\$ 1,005,270</u>	<u>\$ 48,364</u>	<u>\$ 956,906</u>

**Insurance and Reserves** – CPS Energy is exposed to various risks of loss including, but not limited to, those related to torts, theft or destruction of assets, errors and omissions, and natural disasters. CPS Energy maintains property and liability insurance programs that combine self-insurance with commercial insurance policies to cover major risks. The property insurance program provides \$4.7 billion of replacement-value coverage for property and boiler machinery loss, including comprehensive automobile coverage, fire damage coverage for construction equipment and valuable papers coverage. The deductible for the property insurance policy is \$5 million per occurrence, with a secondary deductible of \$1 million per occurrence applicable to non-power-plant and non-substation property locations. The liability insurance program includes:

- \$100 million of excess general liability coverage over a retention amount of \$2 million;
- \$25 million of fiduciary liability coverage;
- \$100 million of employment practices liability coverage; and
- Other property and liability insurance coverage, which includes commercial crime, employee travel and event insurance.

CPS Energy also manages its own workers' compensation program. Additionally, to support this program, \$35 million of excess workers' compensation coverage over a retention amount of \$2 million is maintained. No claims settlements exceeded insurance coverage in FY 2010, FY 2009 or FY 2008.

Actuarial studies are performed periodically to assess the adequacy of CPS Energy insurance reserve retentions. Actuarial valuations include nonincremental claims expenses. An actuarial study was performed during the third quarter of FY 2010.

In the table below, the remaining balance under the property reserve column at January 31, 2010, relates to estimated obligations for the cleanup, closure and post-closure care requirements of the Company's landfills. CPS Energy has seven landfill sites, four of which are at full capacity. The estimates for landfill liability are based upon capacity to date and are subject to change due to inflation or deflation, as well as new developments in technology, applicable laws or regulations.

Under CPS Energy's reserve program, all claims are recorded against the reserve.

(In thousands)	Reserve Rollforward		
	Employee & Public Liability Claims	Property Reserves	Total Insurance Reserves
Balance – FY 2008	\$ 8,231	\$ 3,671	\$ 11,902
Payments	(4,586)	-	(4,586)
Other claims adjustments	6,658	(566)	6,092
Balance – FY 2009	10,303	3,105	13,408
Payments	(4,254)	-	(4,254)
Other claims adjustments	4,314	799	5,113
Balance – FY 2010	<u>\$ 10,363</u>	<u>\$ 3,904</u>	<u>\$ 14,267</u>

**Counterparty Risk** – CPS Energy is exposed to counterparty risk associated with various transactions primarily related to debt, investments, a lease/leaseback transaction, suppliers and wholesale power. Counterparty risk is the risk that a counterparty will fail to meet its obligations in accordance with the terms and conditions of its contract with the Company. The Company has policies and practices in place to ensure the solvency of counterparties is assessed accurately, monitored regularly and managed actively through its Enterprise Risk Management Division.

## 11. Other Financial Instruments

**Fuel Hedging** – The 1999 Texas utility deregulation legislation, Senate Bill 7, contains provisions modifying the PFIA to allow municipal utilities the ability to purchase and sell energy-related derivative instruments in order to hedge or mitigate the effect of market price fluctuations of natural gas, fuel oil and electric energy. In 2002, CPS Energy began hedging its exposure to changes in natural gas prices, with the goal of controlling fuel costs to native load customers and stabilizing the expected cash flows associated with wholesale power transactions.

In FY 2010, the Company implemented GASB Statement No. 53, which addresses recognition, measurement and disclosures related to derivative instruments. CPS Energy does not use derivative instruments for speculative purposes. The only derivative instruments entered into are for the purposes of risk mitigation; therefore, these instruments are considered potential hedging derivative instruments under GASB Statement No. 53.

On January 20, 2009, the Board reaffirmed the Energy Price Risk Management Policy, which sets forth the guidelines for the purchase and sale of certain financial instruments and certain physical products, collectively defined as hedge instruments. The essential goal of the Energy Price Risk Management Policy is to provide a framework for the operation of a fuel and energy price hedging program to better manage CPS Energy's risk exposure in order to stabilize pricing and costs for the benefit of CPS Energy and its customers.

In accordance with the requirements of GASB Statement No. 53, all fuel hedges are reported on the Balance Sheets at fair value. The fair value of option contracts is determined using New York Mercantile Exchange ("NYMEX") closing settlement prices as of the last day of the reporting period. For futures and basis swap contracts, the fair value is calculated by deriving the difference between the closing futures prices on the last day of the reporting period and the futures or basis swap purchase prices at the time the positions were established, less applicable commissions.

All potential hedging derivative instruments were evaluated for effectiveness at January 31, 2010, and were determined to be effective in substantially offsetting the changes in cash flows of the hedgeable items. The instruments were categorized into two broad groups for purposes of this testing. In one category, hedges utilize only NYMEX natural gas futures and options that are priced based on the underlying Henry Hub natural gas price, while the physical gas is typically purchased at prices based on either the Western Area Hub Association ("WAHA") or the Houston Ship Channel ("HSC"). Therefore, effectiveness testing was based on the extent of correlation between the first of the month index prices of natural gas at each of these locations and the settlement price at Henry Hub. The correlation coefficient was established at the critical term to be evaluated, with 0.8944 established as the minimum standard tolerated. The testing, based on two different location hubs (WAHA and HSC), demonstrated a substantial offset in the fair values, as evidenced by their calculated R values, 0.9664 and 0.9961, respectively, indicating that the changes in cash flows substantially offset the changes in cash flows of the hedgeable item. Additionally, the substantive characteristics of the hedge have been considered, and the evaluation of this effectiveness measure has been sufficiently completed and documented such that a different evaluator, using the same method and assumptions, would reach substantially similar results.

In the second category, hedges utilize both NYMEX natural gas futures and their associated location basis. The effectiveness of these hedges was tested using a quantitative method similar to the synthetic instrument method prescribed by GASB Statement No. 53, with the combination of the hedging instrument and the hedged expected transaction substantively resulting in a hedged fixed price for natural gas. The method requires that the hedged fixed price fall within a range of 90% to 111% of the confirmed price. Effectiveness testing demonstrated that the hedged price was fixed within the tolerable range, thus demonstrating that the variable cash flows of the hedged instrument substantially offset the variable cash flows of the hedgeable item to create a synthetic price that is effectively fixed. Additionally, the substantive characteristics of the hedge have been considered, and the evaluation of this effectiveness measure has been sufficiently completed and documented such that a different evaluator, using the same method and assumptions, would reach substantially similar results.

As of January 31, 2010, the total fair value of outstanding hedge instruments was a net liability of \$5.5 million. Fuel hedging instruments with a fair value of \$(5.5) million are reported as a current liability and classified on the Balance Sheets as a component of accounts payable and accrued liabilities. Long-term fuel hedging instruments with a fair value of \$5.8 thousand are reported as a noncurrent asset and classified as a component of noncurrent and other assets. Additionally, long-term fuel hedges with a fair value of \$(31.0) thousand are reported as a noncurrent liability and classified as a component of other liabilities and deferred credits.

At January 31, 2009, the total fair value of outstanding hedge instruments was a net liability of \$41.6 million. Fuel hedging instruments with a fair value of \$(35.7) million are reported as a current liability and classified as a component of accounts payable and accrued liabilities. Long-term fuel hedges with a fair value of \$(5.9) million are reported as a noncurrent liability and classified as a component of other noncurrent liabilities and deferred credits.

Consistent with hedge accounting treatment required for derivative instruments that are determined to be effective in offsetting changes in the cash flows of the hedged item, changes in fair value are reported as deferred (inflows) outflows of resources on the Balance Sheets until the contract expiration that occurs in conjunction with the hedged expected fuel purchase transaction. When fuel hedging contracts expire, at the time the purchase transactions occur, the deferred balance is recorded as an adjustment to fuel expense. The current deferred (inflows) outflows of resources related to fuel hedges totaled \$6.4 million at January 31, 2010, and \$36.9 million at January 31, 2009. These amounts are reported on the Balance Sheets as current assets and are classified as a component of prepayments, deferred and other current assets. The noncurrent deferred (inflows) outflows of resources totaled \$376.4 thousand

at January 31, 2010, and \$5.9 million at January 31, 2009. These amounts are reported on the Balance Sheets as noncurrent assets and are classified as a component of other deferred costs.

In FY 2010, some hedging derivative instruments were terminated early, causing them to be ineffective under GASB Statement No. 53. Accordingly, losses from the closed positions were recorded as a decrease in investment income of \$2.1 million.

Following is information related to CPS Energy's outstanding fuel hedging derivative instruments:

### Fuel Derivative Transactions as of January 31, 2010 (In thousands)

Type of Transaction	Referenced Index	Duration	Volumes in MMBtu	Fair Value	Change in Fair Value
Long Call	Henry Hub	Mar 2010 through Jul 2011	4,750,000	\$ 1,308	\$ (1,388)
Long Put	Henry Hub	Mar 2010 through Jul 2010	980,000	66	(58)
Short Put	Henry Hub	Mar 2010 through Jul 2011	4,320,000	(1,468)	61
Long Natural gas futures	Henry Hub	Mar 2010 through Dec 2010	5,510,000	(5,960)	(1,881)
Long Ship Channel basis swap	Henry Hub	Feb 2010 through Dec 2010	3,475,000	534	527
				<u>\$ (5,520)</u>	<u>\$ (2,739)</u>

### Fuel Derivative Transactions as of January 31, 2009 (In thousands)

Type of Transaction	Referenced Index	Duration	Volumes in MMBtu	Fair Value	Change in Fair Value
Long Call	Henry Hub	Mar 2009 through Mar 2010	930,000	\$ 54	\$ (574)
Short Call	Henry Hub	Mar 2009 through Dec 2009	6,270,000	(71)	2,871
Long Put	Henry Hub	Mar 2009 through Dec 2009	6,270,000	24,975	21,055
Short Put	Henry Hub	Mar 2009 through Mar 2010	930,000	(2,561)	(2,160)
Long Natural gas futures	Henry Hub	Mar 2009 through Oct 2010	19,270,000	(67,728)	(68,085)
Short Natural gas futures	Henry Hub	Mar 2009 through Dec 2009	850,000	4,060	4,059
Long Ship Channel basis swap	Henry Hub	Feb 2009 through Nov 2009	4,867,500	(371)	(381)
				<u>\$ (41,642)</u>	<u>\$ (43,215)</u>

In the event purchased options are allowed to expire, the related premiums paid to acquire those options will be lost. When a short position is established and options are sold, premiums are received and an obligation to honor the terms of the option contract, if exercised, is created. The decision to exercise the options or let them expire rests with the purchasing party.

Futures contracts represent a firm obligation to buy or sell the underlying asset. If held to expiration, the contract holder must take delivery of, or deliver, the underlying asset at the established contract price. Basis swap contracts represent a financial obligation to buy or sell the underlying delivery point basis. If held to expiration, the financial difference determined by mark-to-market valuation must be settled on a cash basis. Only if expressly requested in advance may an exchange for physical assets take place.

**Preassigned Congestion Rights** - In the normal course of business, CPS Energy acquires Preassigned Congestion Rights ("PCRs") and Transmission Congestion Rights ("TCRs") as a hedge against unexpected congestion costs. The TCRs are purchased at auction, annually and monthly, at market value. Municipally owned utilities are granted the right to purchase PCRs annually at 15% of the cost of TCRs. This low initial investment is an indication of the leverage characteristic of derivatives. Additionally, PCRs exhibit the other two characteristics of derivatives as defined by GASB Statement No. 53 (settlement factors and net settlement). Therefore, PCRs are reported at fair value on the Balance

Sheets in accordance with GASB Statement No. 53, with fair value determined by the cost of annual TCRs purchased at the same time.

The effectiveness of these hedges is satisfied utilizing the “consistent critical terms method” prescribed under GASB Statement No. 53, whereby the forward contract is for the same quantity of the hedgeable item (one Megawatt per PCR) and covers the same time (15-minute intervals over the course of a month) and location (a specified directional constraint). When combined with the hedgeable item (congestion cost), the contract value is zero since the reference rate of the contract is consistent with the rate of the hedgeable item.

PCRs had a market value of \$2.6 million and \$2.2 million at January 31, 2010 and 2009, respectively. These hedging derivative instruments were reported as current assets and classified as a component of prepayments, deferred and other current assets. The deferred (inflows) outflows of resources related to PCRs was \$(2.2) million and \$(1.8) million at January 31, 2010 and 2009, respectively. These balances are reported on the Balance Sheets as noncurrent liabilities and are classified as a component of accounts payable and accrued liabilities.

#### Preassigned Congestion Rights as of January 31, 2010

<u>Purchase Date</u>	<u>Direction</u>	<u>MWhs</u>	<u>Fair Value</u>	<u>Cost</u>
December 11, 2009	North to West	8,760	\$ 52	\$ 8
December 11, 2009	North to South	8,760	2,502	375
			<u>\$ 2,554</u>	<u>\$ 383</u>

#### Preassigned Congestion Rights as of January 31, 2009

<u>Purchase Date</u>	<u>Direction</u>	<u>MWhs</u>	<u>Fair Value</u>	<u>Cost</u>
December 17, 2008	North to West	8,760	\$ 158	\$ 24
December 17, 2008	North to South	8,760	2,012	302
			<u>\$ 2,170</u>	<u>\$ 326</u>

**Credit Risk** – The fuel hedging contracts expose CPS Energy to a minimal amount of credit risk. In the event of default or nonperformance by brokers or NYMEX, the operations of CPS Energy could be materially affected. However, CPS Energy does not expect the brokerages to fail in meeting their obligations given their high credit rating and the strict and deep credit requirements upheld by NYMEX, of which these brokerage firms are members.

**Termination Risk** – All of CPS Energy’s fuel hedges are exchange-traded instruments; therefore, the risk of termination is greatly reduced by the strict rules and guidelines established by NYMEX, which is governed by the Commodity Futures Trade Commission.

**Basis risk** – The Company is exposed to basis risk on its fuel hedges because the expected commodity purchases being hedged will price based on a pricing point (HSC or WAHA) different than that at which the contracts are expected to settle (Henry Hub). For January 2010, the HSC price was \$5.83 per MMBtu, the WAHA price was \$5.71 per MMBtu, and the Henry Hub price was \$5.81 per MMBtu.

**Securities Lending** – CPS Energy and the Decommissioning Trusts engage in securities lending transactions under a contract with their lending agent, Frost National Bank. Authority to engage in

these transactions is granted under each entity's Investment Policy. The entities are authorized to loan up to 100% of their investments in securities lending transactions.

GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, provides guidance for entities reporting and disclosing securities lending transactions. This guidance includes reporting certain securities lending collateral on the balance sheet as an asset, with a corresponding liability for the obligation to repay the collateral.

In securities lending transactions, CPS Energy and the Decommissioning Trusts, through their lending agent, transfer securities to brokers/dealers in exchange for collateral and simultaneously agree to return the collateral for the same securities in the future. Cash collateral received from the borrower is invested entirely in money market mutual funds. The liquidity provided by the money market mutual funds allows for the easy return of collateral at the termination of a security loan.

Lending income is earned if the returns on the cash collateral invested exceed the rebate paid to borrowers of the securities. The income is then shared with the lending agent to cover its fees based on a contractually negotiated rate split. However, if the investment of the cash collateral does not provide a return exceeding the rebate or if the investment incurs a loss of principal, part of the payment to the borrower would come from CPS Energy's or the Decommissioning Trusts' resources and the lending agent based on the rate split.

Loans that are collateralized with securities generate income when the borrower pays a loan premium for the securities loaned. This income is split at the same ratio as the earnings for cash collateral. The collateral pledged to CPS Energy or the Decommissioning Trusts for the loaned securities is held by the lending agent. These securities are not available to the Company or the Decommissioning Trusts for selling or pledging unless the borrower is in default of the loan.

Any collateral received is required to have a fair value of 102% of the loaned securities. Securities are marked to market daily, and additional cash or securities are required from the borrower if the market value of the collateral falls below 100%. Cash collateral is reported on the Balance Sheets as an asset, with a corresponding liability for the obligation to repay the cash collateral. Noncash collateral for securities lending activities is not recorded as an asset because it remains under the control of the transferor, except in the event of default.

In the event of default, where the borrower is unable to return the securities loaned, CPS Energy and the Decommissioning Trusts have authorized the lending agent to seize the collateral held. The collateral would then be used to replace the borrowed securities where possible. Due to some market conditions, it is possible that the original securities may not be able to be replaced. The lending agent has indemnified CPS Energy and the Decommissioning Trusts from any loss due to borrower default in the event the collateral is not sufficient to replace the securities.

At January 31, 2010 and 2009, neither CPS Energy nor the Decommissioning Trusts had any credit risk exposure to borrowers because the amounts the Company and the Decommissioning Trusts owed to borrowers exceeded the amounts the borrowers owed. There were no violations of legal or contractual provisions nor were there any borrower or lending agent default losses related to securities lending in FY 2010 or FY 2009.

### **CPS Energy Investment Securities and Collateral**

At January 31, 2010, there was a total of \$181.3 million in securities, or 21.8% of the Company's investments, out on loan to brokers/dealers. In exchange, the Company received \$31.8 million in cash collateral and \$153.5 million in securities collateral, or 102.2% of the market value of the corresponding

securities loaned. Income generated from securities lending transactions amounted to \$921.5 thousand in FY 2010, of which 30.0% was paid as fees to the lending agent totaling \$276.5 thousand.

At January 31, 2009, there was a total of \$254.3 million in securities, or 35.1% of the Company's investments, out on loan to brokers/dealers. In exchange, the Company received \$209.9 million in cash collateral and \$50.1 million in securities collateral, or 102.2% of the market value of the corresponding securities loaned. Income generated from securities lending transactions amounted to \$4.5 million in FY 2009, of which 30.0% was paid as fees to the lending agent totaling \$1.4 million.

### **Decommissioning Trusts Investment Securities and Collateral**

For the 28% Decommissioning Trust at December 31, 2009, there was a total of \$20.3 million in securities, or 7.6% of the Decommissioning Trust's investments, out on loan to brokers/dealers. In exchange, the Trust received \$20.4 million in cash collateral and \$464.3 thousand in securities collateral, or a total of 102.9% of the market value of the corresponding securities loaned. Income generated from securities lending transactions for this Decommissioning Trust amounted to \$66.6 thousand in calendar year 2009, of which 30.0% was paid as fees to the lending agent totaling \$20.0 thousand.

For the 28% Decommissioning Trust at December 31, 2008, there was a total of \$20.7 million in securities, or 9.5% of the Decommissioning Trust's investments, out on loan to brokers/dealers. In exchange, the Trust received \$21.2 million in cash collateral, or a total of 102.3% of the market value of the corresponding securities loaned. Income generated from securities lending transactions for this Decommissioning Trust amounted to \$320.6 thousand in calendar year 2008, of which 30.0% was paid as fees to the lending agent totaling \$96.2 thousand.

For the 12% Decommissioning Trust at December 31, 2009, there was a total of \$13.0 million in securities, or 14.5% of the Decommissioning Trust's investments, out on loan to brokers/dealers. In exchange, the Trust received \$12.6 million in cash collateral and \$830.0 thousand in securities collateral, or a total of 102.9% of the market value of the corresponding securities loaned. Income generated from securities lending transactions for this Decommissioning Trust amounted to \$27.2 thousand in calendar year 2009, of which 30.0% was paid as fees to the lending agent totaling \$8.1 thousand.

For the 12% Decommissioning Trust at December 31, 2008, there was a total of \$4.4 million in securities, or 5.7% of the Decommissioning Trust's investments, out on loan to brokers/dealers. In exchange, the Trust received \$3.9 million in cash collateral and \$534.8 thousand in securities collateral, or a total of 102.3% of the market value of the corresponding securities loaned. Income generated from securities lending transactions for this Decommissioning Trust amounted to \$64.4 thousand in calendar year 2008, of which 30.0% was paid as fees to the lending agent totaling \$19.3 thousand.

## **12. Lease/Leaseback**

In June 2000, CPS Energy entered into a lease/leaseback transaction with an affiliate of Exelon involving CPS Energy's Spruce 1 coal-fired electric generating unit. The transaction included a lease for a term of approximately 65 years in combination with a leaseback of the facility by CPS Energy for approximately 32 years.

CPS Energy retains fee simple title to, and operating control of, the facility and retains all revenues generated from sales of electricity produced from the facility. CPS Energy received the appraised fair value of the unit, \$725.0 million, which is being amortized over 381 months. The transaction expenses and leaseback costs of \$628.3 million were recorded as prepaid items in FY 2001 and are being amortized over 381 months.

CPS Energy has the option to cancel the leaseback after it expires by making a payment to Exelon's affiliate. CPS Energy entered into a collateralized payment-undertaking agreement that is expected to generate amounts sufficient to fund the cancellation option.

CPS Energy's net benefits associated with the transaction were approximately \$88.0 million. The City was paid \$12.3 million in accordance with the provisions of the New Series Bond Ordinance that permit 14% of this net benefit to be distributed. The distribution was recorded as a prepayment in 2001 and is being amortized over 381 months, or approximately 32 years. As a result, net proceeds from the transaction of approximately \$75.7 million are being recognized over the 32-year leaseback term. In both FY 2010 and FY 2009, the net amount recorded as income by CPS Energy was \$2.8 million for each period.

### **13. South Texas Project**

**Units 1 and 2** – CPS Energy is one of three participants in STP, currently a two-unit nuclear power plant with each unit having a nominal output of approximately 1,350 megawatts. The units, along with their support facilities and administrative offices, are located on a 12,220-acre site in Matagorda County, Texas. In-service dates for STP were August 1988 for Unit 1 and June 1989 for Unit 2. The other participants in STP Units 1 and 2 are NRG South Texas LLP, a wholly owned subsidiary of NRG Energy, Inc. ("NRG") and the City of Austin.

Effective November 17, 1997, the Participation Agreement among the owners of STP was amended and restated. At that time, STPNOC, a Texas nonprofit, nonmember corporation created by the participants, assumed responsibility as the licensed operator of STP. The participants share costs in proportion to ownership interests, including all liabilities and expenses of STPNOC. STPNOC is financed and controlled by the owners pursuant to an operating agreement among the owners and STPNOC. Currently, a four-member board of directors governs STPNOC, with each owner appointing one member to serve with STPNOC's chief executive officer.

CPS Energy amortizes its share of nuclear fuel for STP to fuel expense on a units-of-production method. Under the Nuclear Waste Policy Act of 1982, the federal government assumed responsibility for the permanent disposal of spent nuclear fuel. CPS Energy is charged a fee for disposal of spent nuclear fuel, which is based upon CPS Energy's share of STP generation that is available for sale to CPS Energy customers. This charge is included in fuel expense monthly.

CPS Energy's 40% ownership in STP Units 1 and 2 represents approximately 1,080 megawatts of total plant capacity. See Note 4 – Capital Assets, Net for more information about CPS Energy's capital investment in STP.

**Units 3 and 4 Development** – On June 28, 2006, NRG announced plans to construct two additional reactors ("STP Units 3 and 4") at the current two-unit STP site. With this addition, energy production at that site is projected to increase by approximately 2,700 megawatts. In July 2006, in response to NRG's announcement, CPS Energy formed a cross-functional task force of more than 30 in-house staff from various disciplines and external consultants who conducted an extensive feasibility study comparing the proposed development of new nuclear plants against CPS Energy's alternatives for other sources of baseload generation ("Feasibility Study"). The initial results of the Feasibility Study were reported to the Board in early 2007, and an ongoing due diligence team was established to monitor project developments and make additional recommendations regarding CPS Energy's potential participation in STP Units 3 and 4.

In September 2007, NRG and CPS Energy signed the South Texas Project Supplemental Agreement (“Supplemental Agreement”) under which CPS Energy elected to participate in the development of STP Units 3 and 4 pursuant to the terms of the participation agreement among the STP owners and agreed to potentially own up to 50% of STP Units 3 and 4. The Supplemental Agreement provided for CPS Energy to reimburse NRG for its pro rata share, based on its ownership percentage, of initial project costs incurred and to pay its pro rata share of future development costs. The Boards of CPS Energy and NRG subsequently approved the Supplemental Agreement, which was effective on October 29, 2007. CPS Energy’s adoption of its resolution to participate in the initial development of STP Units 3 and 4 did not constitute a commitment to make the complete investment in the proposed construction and operation of new nuclear units at STP.

Also in September 2007, STPNOC, on behalf of CPS Energy and NRG, filed with the NRC a combined construction and operating license application (“COLA”) to build and operate STP Units 3 and 4. This COLA was the first complete application for new commercial nuclear units to be filed with the NRC in nearly 30 years. On November 29, 2007, the NRC announced it had accepted the COLA for review.

On March 26, 2008, NRG announced the formation of Nuclear Innovation North America, LLC (“NINA”). NRG has an 88.0% ownership interest in NINA, while Toshiba Corporation (“Toshiba”) owns the remaining 12%. Upon the formation of NINA, NRG contributed its 50% ownership of, and its development rights to, STP Units 3 and 4 to NINA. As a result, NINA is now CPS Energy’s partner for the co-development of STP Units 3 and 4.

On September 24, 2008, STPNOC, on behalf of CPS Energy and NINA, filed with the NRC an updated COLA naming Toshiba as the provider of STP Units 3 and 4. On February 10, 2009, the NRC issued a schedule for completing its review of the COLA. The NRC expects to issue the final Safety Evaluation Report in September 2011. Receipt of the NRC-approved combined operating license is a condition precedent to starting significant project construction.

Also in September 2008, CPS Energy filed a Phase I application for a Department of Energy (“DOE”) loan guarantee related to its portion of the estimated project costs. Following the DOE’s evaluation of all Phase I applications, the DOE ranked the project third out of a field of fourteen nuclear loan guarantee project applications that were submitted. Subsequently, the DOE narrowed the list of nuclear project candidates for DOE loan guarantees to four projects, including STP Units 3 and 4.

On November 5, 2008, STPNOC and the DOE executed a Standard Contract in which the DOE undertook the obligation to provide for permanent disposal of used nuclear fuel from the proposed STP Units 3 and 4 project.

On January 20, 2009, the Board authorized the Company to work with STPNOC to enter into an engineering, procurement and construction (“EPC”) agreement with Toshiba for STP Units 3 and 4. The EPC agreement did not commit CPS Energy to build the new nuclear units. Instead, it enabled the Company to lock in favorable terms and conditions with the contractor prior to a final construction decision once the NRC issues a license for the project. The agreement was subsequently signed by all parties on February 24, 2009.

On October 13, 2009, the Board approved selection of STP Units 3 and 4 as the next baseload generation resource and approved a request for \$400.0 million in bonds to support the project. However, amid reports that CPS Energy had knowledge that costs of the project might be significantly higher than previously reported, the City Council’s vote on the bonds was postponed. This higher project cost estimate prompted the San Antonio City Council to reevaluate CPS Energy’s stake in the project and members of CPS Energy’s management to engage in negotiations with representatives from Toshiba Corporation in November 2009.

Following the postponement of the City Council's vote, the Board undertook an investigation to determine whether CPS Energy's management had knowledge of an increase in the preliminary cost estimate for STP Units 3 and 4 and why that information was not previously communicated to the Board. The results of this investigation were reported to the Board in late 2009 and, based on the report, the Board adopted a resolution finding that there was a failure of the communication from certain members of CPS Energy executive management to the Board and the City Council regarding a revised cost estimate that was publicly disclosed in October 2009. The investigation report also concluded that there was no malicious intent on the part of any member of the management team in connection with the failure of the communication. Further, the report found that no member of management instructed any other employee to conceal or withhold any information from the Board and that lack of information flowing to the Board was, at worst, due to a difference of opinion about what information should be deemed material and deserving of the Board's attention.

While the project's cost controversy was being investigated, CPS Energy explored all its options regarding participation in or withdrawal from the project. On December 6, 2009, the Company filed a petition in Bexar County district court to clarify the roles and obligations of CPS Energy and NINA to define the rights of both parties should either decide to withdraw from the project. NRG escalated the litigation when it sued CPS Energy and claimed the Company should forfeit all investment to date and lose all value in the project's land and water rights. CPS Energy amended its petition on December 23, 2009, and raised significant issues concerning misconduct by NRG and NINA. The Company specified actual and exemplary damages of \$32.0 billion.

On February 17, 2010, CPS Energy and NINA announced that a proposed settlement had been reached that ended the parties' legal disagreement and allowed the proposed expansion of STP Units 3 and 4 to proceed. As a result of the settlement, CPS Energy's ownership stake in STP Units 3 and 4 was reduced from 50% to 7.625%, while NINA and Toshiba Corporation retained 92.375% ownership. NINA will pay all development costs incurred after January 31, 2010. CPS Energy has withdrawn its pending application for a DOE loan guarantee and will support the NINA loan guarantee applications. In addition to receiving a higher ownership level at 7.625% than approximates CPS Energy's expenditures to date, NINA agreed to pay CPS Energy \$80.0 million, in two \$40.0 million payments, conditional on their loan guarantees being approved by the DOE. NINA also agreed to make a contribution of \$10.0 million over a four-year period to the Residential Energy Assistance Partnership, which provides emergency bill payment assistance to low-income customers in San Antonio and Bexar County. The settlement agreement was finalized on March 1, 2010. CPS Energy's project costs to date of \$380.0 million for development of STP Units 3 and 4 are included in construction-in-progress.

**Nuclear Insurance** – The Price-Anderson Act is a comprehensive statutory arrangement for providing limitations on liability and governmental indemnities with respect to nuclear accidents or events. The maximum amount that each licensee may be assessed following a nuclear incident at any insured facility is \$100.6 million, subject to adjustment for inflation, for the number of operating nuclear units and for each licensed reactor, payable at \$10 million per year per reactor for each nuclear incident. CPS Energy and each of the other participants of STP are subject to such assessments, which will be borne on the basis of their respective ownership interests. For purposes of these assessments, STP currently has two licensed reactors. The participants have purchased the maximum limits of nuclear liability insurance, as required by law, and have executed indemnification agreements with the NRC in accordance with the financial protection requirements of the Price-Anderson Act. A Master Worker Nuclear Liability policy, with a maximum limit of \$300 million for the nuclear industry as a whole, provides protection from nuclear-related claims.

NRC regulations require licensees of nuclear power plants to obtain on-site property damage insurance in a minimum amount of approximately \$1.1 billion. NRC regulations also require that the proceeds from this insurance be used first to ensure that the licensed reactor is in a safe and stable condition so as

to prevent any significant risk to the public health or safety, and then to complete any decontamination operations that may be ordered by the NRC. Any funds remaining would then be available for covering direct losses to property.

The owners of STP Units 1 and 2 currently maintain approximately \$2.8 billion of nuclear property insurance, which is above the legally required amount of \$1.1 billion. The \$2.8 billion of nuclear property insurance consists of \$500 million in primary property damage insurance and approximately \$2.3 billion of excess property damage insurance, both subject to a retrospective assessment being paid by all members of Nuclear Electric Insurance Limited ("NEIL"). A retrospective assessment could occur if property losses, as a result of an accident at any nuclear plant insured by NEIL, exceed the accumulated funds available to NEIL.

**Nuclear Decommissioning** – In 1991, CPS Energy started accumulating funds for decommissioning of its 28% ownership in STP Units 1 and 2 in an external trust in accordance with NRC regulations. The 28% Decommissioning Trust's assets and related liabilities are included in CPS Energy's financial statements as a component unit. Excess or deficient funds related to the 28% Trust will be distributed to or received from CPS Energy's ratepayers after decommissioning is complete.

In conjunction with the acquisition of the additional 12% interest in STP Units 1 and 2 in May 2005, the Company also assumed control of a relative portion of the decommissioning trust previously established by the prior owner, American Electric Power ("AEP"). The 12% Decommissioning Trust's assets and related liabilities are also included in CPS Energy's financial statements as a component unit. Subject to PUCT approval as may be requested in the future, excess or deficient funds related to the 12% Trust will be distributed to or received from AEP's ratepayers after decommissioning is complete.

CPS Energy, together with the other owners of STP Units 1 and 2, files a certificate of financial assurance with the NRC for the decommissioning of the nuclear power plant every two years or upon transfer of ownership. The certificate assures that CPS Energy and the other owners meet the minimum decommissioning funding requirements mandated by the NRC. The owners agreed in the financial assurance plan that their estimate of decommissioning costs would be reviewed and updated periodically. The most recent cost study conducted by the owners dated March 2008 showed that decommissioning costs for the 28% ownership in STP Units 1 and 2 were estimated at \$386.3 million in 2007 dollars. Included in the cost study was a 10% contingency component as required to comply with the PUCT. Based on the level of funds accumulated in the 28% Trust and an analysis of this cost study, the Company determined that no further decommissioning contributions will be required to be deposited into the Trust.

CPS Energy has determined that some decommissioning activities will be required prior to shutdown of STP Units 1 and 2 at the end of the plant's life. Since the NRC prohibits any spending out of the Trusts for other than administrative expenses prior to shutdown, the Company established a preshutdown account to fund decommissioning expenses incurred prior to shutdown. Contributions to fund preshutdown decommissioning costs for CPS Energy's 28% ownership in STP amounted to \$2.2 million in FY 2010. Preshutdown decommissioning expenses for the 28% ownership totaled \$269.9 thousand for FY 2010. For the 12% ownership, preshutdown costs were funded by AEP's ratepayers; preshutdown decommissioning expenses for this ownership totaled \$115.7 thousand for FY 2010.

Excluding securities lending cash collateral, as of December 31, 2009, and December 31, 2008, CPS Energy had accumulated approximately \$266.8 million and \$219.1 million, respectively, in the 28% Trust. Total funds are allocated to decommissioning costs, spent fuel management and site restoration. Based on the most recent annual calculation of financial assurance required by the NRC, the 28% Trust funds allocated to decommissioning costs totaled \$153.9 million, which exceeded the calculated financial assurance amount of \$107.7 million at December 31, 2008.

The March 2008 cost study estimated decommissioning costs for the 12% ownership in STP Units 1 and 2 at \$165.6 million in 2007 dollars. Excluding securities lending cash collateral, as of December 31, 2009, and December 31, 2008, approximately \$90.3 million and \$77.4 million, respectively, had been accumulated in the 12% Trust. Total funds are allocated to decommissioning costs, spent fuel management and site restoration. Based on the most recent annual calculation of financial assurance required by the NRC, the 12% Trust funds allocated to decommissioning costs totaled \$54.4 million, which exceeded the calculated financial assurance amount of \$46.1 million at December 31, 2008.

In FY 2009, the Company changed its method of accounting for the Decommissioning Trusts. Under the new method, a pro rata share of total decommissioning costs (as determined by the March 2008 cost study) has been recognized as a liability. In subsequent years, annual decommissioning expense and an increase in the liability will reflect the effects of inflation and an additional year of plant usage. Additionally, guidance under FAS 71, *Accounting for the Effects of Certain Types of Regulation*, will be followed to retain the zero fund net assets approach to accounting for the Decommissioning Trusts. There was no impact to fund net assets as a result of this change in accounting method.

Both Decommissioning Trusts also have separate calendar-year financial statements, which are separately audited and can be obtained by contacting the Controller at CPS Energy.

**STP Pension Plan and Other Postretirement Benefits** – STP maintains a noncontributory defined-benefit pension plan covering most employees. Retirement benefits are based on length of service and compensation. Plan assets are invested in various equity and fixed-income securities. Pension contributions of \$13.6 million were made in fiscal year 2008 for plan year 2008. Contributions totaling \$11.3 million were made in fiscal year 2009, of which \$10.5 million related to the 2009 plan year, while \$800.0 thousand related to plan year 2008. A final contribution of \$447.7 thousand for plan year 2009 will be required to be made by September 15, 2010, in order to meet minimum funding requirements of the Internal Revenue Code.

In September 2006, the FASB issued FAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – An Amendment of FASB Statements No. 87, 88, 106 and 132(R)*. FAS 158 required STP, as the sponsor of a plan, to (a) recognize on its balance sheets as an asset the plan's overfunded status or as a liability the plan's underfunded status, (b) measure the plan's assets and obligations as of the end of the calendar year, and (c) recognize changes in the funded status of the plans in the year in which changes occur. Additional minimum liabilities were also to be derecognized upon adoption of the new standard. FAS 158 required STP to recognize additional liabilities and eliminate the intangible asset related to certain of its qualified and nonqualified plans. The effect of the defined benefit funding obligations to CPS Energy was \$(9.8) million for FY 2010 and was reflected as an increase in Other Changes in Fund Net Assets on the Statements of Revenues, Expenses and Changes in Fund Net Assets. For FY 2009, the effect of the defined benefit funding obligations was \$29.7 million and was reflected as a reduction in Other Changes in Fund Net Assets.

Employees whose pension benefits exceed \$230 thousand for the 2008 Employee Retirement Income Security Act limitations are covered by a supplementary nonqualified, unfunded pension plan, which is provided for by charges to operations sufficient to meet the projected benefit obligation. The accruals for the cost of that plan are based on substantially the same actuarial methods and economics as the noncontributory defined-benefit pension plan.

STPNOC approved a change to the pension plan, effective January 1, 2007, to preclude the eligibility of employees hired after December 31, 2006, in the plan. Employees hired after this date will receive enhanced matching contributions under the STP Nuclear Operating Company Savings Plan.

STP also maintains a defined-benefit postretirement plan that provides medical, dental and life insurance benefits for substantially all retirees and eligible dependents. The cost of these benefits is recognized in the project statements during an employee's active working career. STP has a trust to partially meet the obligations of the plan.

The owners of STP, including CPS Energy, share in all plan costs in the same proportion as their respective ownership percentages.

## REQUIRED SUPPLEMENTARY INFORMATION

### STP Pension Plan (Reported at 100%) Schedule of Funding Status (Unaudited) Calendar Years 2009 and 2008

(Dollars in thousands)

	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Change in benefit obligation				
Benefit obligation – beginning	\$ 240,915	\$ 204,650	\$ 70,701	\$ 60,500
Service cost	9,675	9,457	5,839	4,930
Interest cost	14,336	12,758	4,151	3,708
Actuarial loss	(2,331)	11,496	(953)	1,853
Effect of FAS 158 change in measurement date	-	5,554	-	2,160
Benefits paid	(3,350)	(3,000)	(2,748)	(2,450)
Benefit obligation – ending	<u>259,245</u>	<u>240,915</u>	<u>76,990</u>	<u>70,701</u>
Change in plan assets				
Fair value of plan assets – beginning	132,279	158,274	8,706	11,260
Actual return on plan assets	21,593	(36,626)	1,511	(2,079)
Employer contributions	11,323	13,631	2,196	1,975
Benefits paid	(3,350)	(3,000)	(2,748)	(2,450)
Fair value of plan assets – ending	<u>161,845</u>	<u>132,279</u>	<u>9,665</u>	<u>8,706</u>
Funded status – ending	(97,400)	(108,636)	(67,325)	(61,995)
Unrecognized net actuarial loss	79,835	101,146	23,798	27,200
Unrecognized prior service cost	6,752	7,922	(12,023)	(13,449)
Unrecognized transition obligation	-	-	251	307
Cumulative difference between recognized and unrecognized net expense and funding	<u>\$ (10,813)</u>	<u>\$ 432</u>	<u>\$ (55,299)</u>	<u>\$ (47,937)</u>
Amount recognized in other liabilities	<u>\$ (97,400)</u>	<u>\$ (108,636)</u>	<u>\$ (67,325)</u>	<u>\$ (61,995)</u>
Weighted-average assumptions				
Discount rate	6.00%	6.00%	6.00%	6.00%
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%
Rate of compensation increase	3.00%	4.00%	3.00%	4.00%

## 14. Commitments and Contingencies

Purchase and construction commitments approximated \$2.4 billion at January 31, 2010. This amount includes provisions for natural gas purchases expected through June 2027; the actual amount to be paid will depend upon CPS Energy's actual requirements during the contract period and the price of gas. Also

included are provisions for coal purchases through December 2021 and for coal transportation through December 2014.

CPS Energy has other commitments totaling \$2.8 billion. This amount includes provisions for wind power through May 2030, solar power through December 2040, landfill power through December 2020, and raw uranium associated with STP fabrication and conversion services needed for refueling through May 2026.

On January 20, 2009, the Board approved a policy statement on sustainability. The basis of the policy is to affirm that CPS Energy's strategic direction centers on transforming from a company focused on providing low-cost power from traditional generation sources to a company providing competitively priced power from a variety of sources. To be sustainable, CPS Energy has to balance its financial viability, environmental commitments and social responsibility as a community-owned provider. Further, the objective of sustainable energy development is to meet current needs without compromising the ability of future generations to meet their needs. A total of \$5.7 billion has been committed over the next 12 years in the areas of renewable energy, energy efficiency and conservation, transition to a smart grid, compliance with state energy conservation mandates, energy research and environmental improvements.

In October 2008, CPS Energy agreed to an amendment with Calaveras Power Partners, L.P. under which CPS Energy is obligated to pay up to \$10 million if the milestones and progress are achieved per the amendment. CPS Energy has paid \$7.4 million of this amount to date. In the event the provisional acceptance is completed by the commercial operation date of June 2010, an additional \$10 million will be paid to Calaveras Power Partners, L.P.

During FY 2008, CPS Energy entered into a Natural Gas Supply Agreement with the SA Energy Acquisition Public Facility Corporation ("PFC"), a component unit of the City, to purchase, to the extent of its gas utility requirements, all natural gas to be delivered under a Prepaid Natural Gas Sales Agreement. Under the Prepaid Natural Gas Sales Agreement between the PFC and a third-party gas supplier, the PFC has prepaid the cost of a specified supply of natural gas to be delivered over 20 years. CPS Energy's 20-year commitment under the Natural Gas Supply Agreement is included in the aforementioned \$2.4 billion purchase and construction commitments amount.

In December 2007, CPS Energy and Exelon Generation Company LLC ("Exelon") signed an agreement granting CPS Energy an option to participate in a possible joint investment in a nuclear-powered electric generation facility in Southeast Texas (the "Exelon Project"). Preliminary plans indicated that the Exelon Project would be located in Victoria County, Texas, and would involve the development of two Economic Simplified Boiling Water Reactors ("ESBWR"), nominally rated at 1,520 megawatts each. Under this agreement, CPS Energy has the option to acquire between a 25% and a 40% ownership in the Exelon Project. Exelon submitted the COLA for the Exelon Project to the NRC on September 3, 2008. On October 30, 2008, the NRC accepted the application for a detailed review. Exelon announced on November 24, 2008, that they intended to select an alternate technology, other than the ESBWR, for the Exelon Project. Subsequently, on December 18, 2008, the NRC placed the review of Exelon's COLA on hold. On March 27, 2009, Exelon announced that it had selected Hitachi's Advanced Boiling Water Reactor design for the Exelon Project, and that it planned to revise the COLA and its DOE loan guarantee application accordingly. The Exelon Project failed to qualify for the initial round of DOE loan guarantees. Exelon has delayed development of the Exelon Project but will continue to pursue an Early Site Permit for the Victoria County location. The parties are in discussions to execute a new agreement, with a possible change in ownership percentage. Exelon has not notified CPS Energy of any intention to terminate the agreement or to abandon the project.

In FY 2003, CPS Energy entered into a 20-year agreement with Brooks Development Authority (“BDA”) to upgrade the electric and gas utility systems located within Brooks City-Base. CPS Energy and BDA have each committed to invest \$6.3 million (\$4.2 million in year 2002 dollars, which accumulates interest at the rate of 3.7% compounded annually) to upgrade the infrastructure at that location. Annual reductions to BDA’s obligation are made from incremental revenues to the City for electric and gas sales to customers that reside on the BDA-developed property. Annual reductions to BDA’s obligation are also made in accordance with contract terms for economic development at Brooks City-Base that benefits CPS Energy’s Systems. To the extent that the capital renewals and upgrades do not total \$12.6 million by September 2022, BDA’s and CPS Energy’s obligations each will be reduced equally. To date, CPS Energy has invested \$5.1 million and BDA has met its obligation, net of annual interest, of \$4.2 million.

## 15. Leases

### Capital Leases

**CPS Energy as Lessee** – As of January 31, 2010, CPS Energy had one capital lease arrangement for the use of computer servers, associated software and maintenance of the hardware and software. The four-year lease began in FY 2007 and will end in FY 2011. As of January 31, 2010, there were no future lease payments associated with this capital lease. The value of the assets acquired through the capital lease at January 31, 2010 and 2009, was as follows:

	January 31,	
	2010	2009
(In thousands)		
Equipment	\$ 2,723	\$ 2,723
Accumulated depreciation	<u>(2,159)</u>	<u>(2,007)</u>
Net book value	<u>\$ 564</u>	<u>\$ 716</u>

### Operating Leases

**CPS Energy as Lessee** – CPS Energy has entered into operating lease agreements to secure the usage of natural gas storage facilities, land, a building, office space, parking lot space and engineering equipment. The lease of the building contains an escalation clause whereby the minimum monthly lease payments will increase by \$3.3 thousand per month beginning in the sixth year of the lease. Additionally, the building lease contains an option to purchase the facility before the end of the third year of the lease. The leases for the parking lot space contain a provision for a slight escalation in the monthly payment amount after the first year of each lease.

As of January 31, 2010, the future minimum lease payments made by CPS Energy for noncancelable operating leases with terms in excess of one year were as follows:

Year Ended January 31,	Operating Lease Payments
2011	\$ 5,192
2012	2,329
2013	499
2014	365
2015	-
Later years	-
Total future minimum lease payments	<u>\$ 8,385</u>

CPS Energy's minimum lease payments for all operating leases for which the Company was the lessee amounted to \$6.3 million in FY 2010 compared to \$6.2 million in FY 2009. There were no contingent lease or sublease payments in FY 2010 or in FY 2009.

**CPS Energy as Lessor** – CPS Energy has entered into operating lease agreements allowing cable and telecommunication companies to attach telephone, cable and fiber-optic lines to CPS Energy's electric poles. Operating leases also exist between CPS Energy and telecommunication companies allowing the companies to attach communication equipment to CPS Energy's communication towers. Additionally, CPS Energy has three operating leases for the use of land that CPS Energy owns, and the Company has entered into multiple agricultural leases allowing the lessees to use CPS Energy's land for sheep and cattle grazing. The majority of the operating leases pertaining to the use of CPS Energy's communication towers contain a provision for contingent lease receipts that will equal the lesser of a 15% increase in the prior five-year lease payment or the percentage increase in the Consumer Price Index over the same five-year period. Furthermore, the three land leases also contain a provision for contingent lease receipts based on the Consumer Price Index.

As of January 31, 2010, the future minimum lease receipts to CPS Energy for noncancelable operating leases with terms in excess of one year were as follows:

(In thousands)	
<u>Year Ended January 31,</u>	<u>Operating Lease Receipts</u>
2011	\$ 2,188
2012	2,180
2013	2,101
2014	1,566
2015	590
Later years	<u>2,407</u>
Total future minimum lease receipts	<u>\$ 11,032</u>

CPS Energy's minimum lease receipts for all operating leases for which the Company was the lessor amounted to \$8.6 million in FY 2010 compared to \$8.5 million in FY 2009. Contingent lease receipts amounted to \$552.9 thousand for FY 2010 compared to \$246.3 thousand for FY 2009. There were no sublease receipts in FY 2010 or in FY 2009.

## 16. Pollution Remediation Obligation

GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, requires that a liability be recognized for expected outlays for remediating existing pollution when certain triggering events occur. The general nature of existing pollution that has been identified at CPS Energy sites is consistent with that experienced within the electric and gas utilities industry. Under most circumstances, the triggering event most relevant to the Company is the voluntary commencement of activities to clean up pollution.

Under Federal Energy Regulatory Commission guidance, reserves have been established for dismantling and closure costs. In FY 2008, in preparation for implementation of GASB Statement No. 49, a portion of those reserves were reclassified to remediation and dismantling reserve accounts reported on the Balance Sheets within other liabilities and deferred credits. When a triggering event occurs, those reserves will be reclassified as a pollution remediation liability also reported within other liabilities and deferred credits.

## CPS Energy FY 2010 Annual Report

The pollution remediation liability was \$887.6 thousand as of January 31, 2010, and was \$1.0 million as of January 31, 2009. Costs were estimated using the expected cash flow technique prescribed under GASB Statement No. 49 utilizing information provided by the Company's environmental staff and consultants. FY 2009 beginning balances were not restated as a result of the implementation of GASB Statement No. 49 due to immateriality.

## GLOSSARY OF TERMS

**Advance Refunding:** A bond issuance in which new bonds are sold at a lower interest rate than outstanding ones. The proceeds are then invested in an irrevocable escrow; when the older bonds become callable, they are paid off with the invested proceeds.

**Allowance for Funds Used During Construction (“AFUDC”):** A cost accounting procedure whereby interest, charges on borrowed funds and a return on equity for capital used to finance construction are added to the cost of utility plant being constructed (i.e., capitalized interest).

**Amortize:** To reduce an original amount or an account balance on an installment basis.

**Annual Other Postemployment Benefit (“OPEB”) Cost:** An accrual-basis measure of the periodic cost of an employer’s participation in a defined benefit OPEB plan.

**Annual Pension Cost (“APC”):** A measure of the periodic cost of an employer’s participation in a defined benefit pension plan.

**Annual Required Contribution (“ARC”):** The employer’s periodic required contributions to a defined benefit OPEB plan or defined benefit pension plan, calculated in accordance with the parameters.

**Assets:** Resources of value to the company to which it has exclusive rights of use.

**Balance Sheet:** A statement of financial position as of a specific date, listing assets, liabilities and fund net assets.

**Build America Bonds (“BABs”):** Taxable municipal bonds created under the American Recovery and Reinvestment Act of 2009 that carry special federal subsidies for either the bondholder or the bond issuer.

**Call:** An option contract giving the owner the right (but not the obligation) to buy a specified amount of an underlying asset at a specified price within a specified time.

**Capital Asset:** An asset with a life of more than one year that is not bought and sold in the ordinary course of business.

**Cash and Cash Equivalents:** The value of assets that can be converted into cash immediately. Usually includes bank accounts and marketable securities, such as government bonds. Cash equivalents on the Balance Sheets include securities with an original maturity of 90 days or less.

**Community Infrastructure and Economic Development (“CIED”) Fund:** Funds used to support qualified capital projects that provide economic benefit within the communities served by CPS Energy.

**Component Unit:** A legally separate entity for which the elected officials of the primary government are financially accountable and for which the nature and significance of its relationship with the primary government are such that exclusion would cause the reporting entity’s financial statements to be misleading or incomplete.

**Cooling-Degree Day:** The measure of how high the average daily temperature is relative to a reference temperature of 72 degrees Fahrenheit. For example, if the average temperature for the day is 78 degrees, then the cooling-degree days are equal to 6.

**Decommissioning:** The process related to permanently taking a nuclear plant out of service, including decontaminating and removing buildings or other structures.

**Defeasance:** A provision that legally discharges a borrower for debt incurred when the borrower sets aside cash or bonds sufficient to service the outstanding debt.

**Depletion:** The systematic allocation of the cost of a natural resource from the balance sheet to the income statement.

**Depreciation:** Amount allocated during the period to expense the cost of acquiring a capital asset over the useful life of the asset.

**Derivative:** In finance, a security for which price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Examples of derivatives include futures and options.

**Electric Reliability Council of Texas (“ERCOT”):** An organization whose mission is to direct and ensure reliable and cost-effective operation of the electric transmission grid in Texas and to enable fair and efficient market-driven solutions to meet customers’ electric service needs.

**Fair Value:** The amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

**Federal Energy Regulatory Commission (“FERC”):** Independent federal agency created within the U.S. Department of Energy. FERC is vested with broad regulatory authority over wholesale electric, natural gas and oil production, and the licensing of hydroelectric facilities.

**Financial Accounting Standards Board (“FASB”):** Board composed of independent members who create and interpret generally accepted accounting principles (“GAAP”).

**Fiscal Year (“FY”):** The 12-month period covered by the income statement. A fiscal year may or may not coincide with a calendar year. For CPS Energy, the fiscal year is from February 1 through January 31.

**Futures:** Financial contracts obligating the buyer to purchase an asset (or the seller to sell an asset), such as a physical commodity or a financial instrument, at a predetermined future date and price. Futures contracts detail the quality and quantity of the underlying asset; they are standardized to facilitate trading on a futures exchange.

**Generally Accepted Accounting Principles (“GAAP”):** Conventions, rules and procedures that serve as the norm for the fair presentation of financial statements. The Governmental Accounting Standards Board is responsible for setting GAAP for state and local governments.

**Governmental Accounting Standards Board (“GASB”):** The authoritative standard-setting body for accounting and financial reporting for governmental entities in the United States.

**Heating-Degree Day:** The measure of how low the average daily temperature is relative to a reference temperature of 65 degrees Fahrenheit. For example, if the average temperature for the day is 60 degrees, then the heating-degree days are equal to 5.

**Hedging:** The process of buying and selling fuel oil; natural gas; and electric energy futures, options or similar contracts to protect against loss due to price fluctuations.

**Kilowatt (“kW”):** A measure of electric power. A kilowatt equals 1,000 watts. It produces enough energy to light up ten 100-watt light bulbs.

**Kilowatt-hour (“kWh”):** A measure of electric power consumption. A kilowatt-hour equals 1,000 watts of energy flowing for a one-hour period.

**Lease:** A legal agreement to pay rent to the lessor for a stated period of time. Sometimes the lease is in substance a purchase of an asset and a financing arrangement (i.e., a capital lease).

**Lease/Leaseback:** A financing transaction that involves a company leasing an asset to another entity and that entity subleasing the asset back to the company.

**Liabilities:** Claims by creditors against the assets of the company.

**MCF:** A measure of natural gas volumes. An MCF equals 1,000 cubic feet.

**MMBtu:** 1,000,000 British Thermal Units (“BTU”). A BTU is the standard unit for measuring the quantity of heat energy, such as the heat content of fuel. It is the amount of heat energy necessary to raise the temperature of one pound of water one degree Fahrenheit at sea level pressure.

**Management’s Discussion & Analysis (“MD&A”):** A section of the annual report that contains objective and easily readable analysis from management about the company’s financial condition and its operations to assist users in assessing the company’s financial position.

**Megawatt (“MW”):** A measure of electric power. A megawatt equals 1,000 kilowatts or 1,000,000 watts.

**Megawatt-hour (“MWh”):** A measure of electric power consumption. A megawatt-hour equals one megawatt of power flowing for one hour.

**Mothballed:** A generation resource that is placed in an inactive state so that it can neither be brought into operation immediately nor counted towards the Grid’s reserve margin.

**National Association of Regulatory Utility Commissioners (“NARUC”):** A nonprofit organization whose members include the governmental agencies that are engaged in the regulation of utilities and carriers in the 50 United States, the District of Columbia, Puerto Rico and the Virgin Islands. NARUC’s member agencies regulate the activities of energy, water and telecommunications utilities.

**Natural Gas Basis Swap:** A financial contract which allows the purchaser to lock in the price difference between two natural gas delivery points or hubs, such as Houston Ship Channel and Henry Hub, LA.

**Net Costs Recoverable/Refundable:** Certain costs that are required to be deferred as a regulatory asset or a regulatory liability under FAS 71, *Accounting for the Effects of Certain Types of Regulation*, if regulation provides assurance that these costs can be recovered or refunded through rates in the future.

**Net OPEB Obligation:** The cumulative difference between annual OPEB cost and the employer’s contributions to the plan.

**Net Pension Obligation:** The cumulative difference between annual pension cost and the employer’s contributions to the plan.

**Net Revenue:** Per the New Series Bond Ordinance, all income and revenues from the operation of the Systems after the deduction of maintenance and operating expenses.

**New Series Bonds:** A CPS Energy term used to distinguish bonds that have a first lien on the net revenues of CPS Energy’s Systems.

**Off-System Sales:** Wholesale electric sales outside its utility’s certificated service area. (Also see “System Sales.”)

**Other Postemployment Benefits (“OPEBs”):** Postemployment benefits other than pension benefits. OPEBs include postemployment healthcare benefits, regardless of the type of plan that provides them, and all postemployment benefits provided separately from a pension plan, excluding benefits defined as termination benefits.

**Overhead Conversion Fund:** A portion of CPS Energy’s Repair and Replacement Account that is authorized to be used for converting overhead electric facilities to underground. All amounts in this fund were transferred to the CIED Fund in January 2005.

**Public Utility Commission of Texas (“PUCT”):** The governmental commission that regulates the rates and services of telephone utilities; investor-owned electric, water and sewer utilities; electric, water and sewer utilities in unincorporated areas; and radio companies statewide. The PUCT does not have authority to regulate retail activities of municipally owned utilities.

**Put:** An option contract giving the owner the right (but not the obligation) to sell a specified amount of an underlying asset at a set price within a specified time.

**Refunding:** Retiring an outstanding bond issue after the first call date by using money from the sale of a new offering.

**Required Supplementary Information:** Schedules, statistical data and other information that are an essential part of financial reporting and should be presented with, but are not part of, the basic financial statements of a governmental entity.

**Revenue Bonds:** Bonds issued by a municipality in which the issuer pledges to the bondholders its revenues as security for the bonds.

**SA Energy Acquisition Public Facility Corporation (“PFC”):** A public nonprofit corporation organized under the laws of the State of Texas pursuant to the Texas Public Facility Corporation Act, Chapter 303, Texas Local Government Code. The Corporation was organized to assist the City of San Antonio in financing, refinancing or providing public facilities, including natural gas, to be devoted to public use.

**Securities Lending:** An investment strategy that involves the temporary loan of securities to another party, typically dealers. For the full time that the securities are out on loan, they are secured with cash and/or noncash collateral in excess of the value of the securities that are lent, and in return for the use of securities, the lender earns a spread on the cash pledged as collateral.

**South Texas Project (“STP”):** Currently a two-unit nuclear plant that is one of the newest and largest nuclear power plants in the country. STP’s two reactors have a capacity of 2,700 megawatts of electricity, enough to provide service for more than one million homes and businesses.

**STP Nuclear Operating Company (“STPNOC”):** A not-for-profit entity that provides for the licensing, construction, operation and maintenance of the jointly owned and operated electric generation facilities of STP.

**System Sales:** Retail electric sales within the utility’s certificated service area.

**Tax-Exempt Bond:** A bond usually issued by a municipal, county or state government for which interest payments are not subject to the bondholders’ federal income tax and, in some cases, state and local income tax.

**Tax-Exempt Commercial Paper (“TECP”):** A short-term note with a maximum maturity of 270 days for which interest payments are not subject to the bondholders’ federal income tax

and, in some cases, state and local income tax. Maturities for TECP notes, however, can be extended indefinitely for the life of the program that supports the TECP notes.

**Transmission Costs of Service (“TCOS”):** A functional classification of expenses and capital expenditures relating to the operation and maintenance of the transmission plant. The transmission function is that portion of the utility system used for the purpose of transmitting electrical energy in bulk to other principal parts of the system or to other utility systems.

**Variable Rate Demand Obligation (“VRDO”):** A long-term bond with a floating interest rate that varies as it is re-determined periodically (daily, weekly, semi-annually, annually, etc.).

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APPENDIX C



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**CPS ENERGY**

**UNAUDITED FINANCIAL STATEMENTS  
FOR THE QUARTER AND TWELVE MONTHS ENDED  
JULY 31, 2010 AND 2009**

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## Balance Sheets

(In thousands)

	<u>July 31,</u> <u>2010</u>	<u>July 31,</u> <u>2009<sup>(1)</sup></u>
<b>ASSETS</b>		
Current Assets:		
Unrestricted cash and investments .....	\$ 335,742	\$ 655,853
Receivables, net .....	230,454	275,839
Inventories .....	153,129	165,847
Prepayments and other .....	<u>52,809</u>	<u>92,888</u>
Total current assets .....	<u>772,134</u>	<u>1,190,427</u>
Noncurrent assets:		
Cash and investments		
Restricted for debt service .....	181,886	161,862
Restricted for capital projects .....	181,588	324,915
Restricted per ordinance .....	447,200	328,609
Restricted per ordinance .....	44,596	49,368
Restricted for STP decommissioning .....	376,213	341,113
Restricted for Project Warm rate relief program .....	7,635	8,374
Other noncurrent assets and deferred costs .....	508,713	503,005
Capital assets, net .....	<u>7,119,369</u>	<u>6,695,377</u>
Total noncurrent assets .....	<u>8,867,200</u>	<u>8,412,623</u>
<b>TOTAL ASSETS</b> .....	<u>\$ 9,639,334</u>	<u>\$ 9,603,050</u>
<b>LIABILITIES</b>		
Current liabilities:		
Current maturities of revenue bonds .....	\$ 162,235	\$ 148,705
Accounts payable and accrued liabilities .....	<u>442,951</u>	<u>838,441</u>
Total current liabilities .....	<u>605,186</u>	<u>987,146</u>
Noncurrent liabilities:		
Long-term debt, net .....	4,762,269	4,481,757
STP decommissioning liability .....	375,851	339,656
Other noncurrent liabilities and deferred credits .....	<u>596,909</u>	<u>622,999</u>
Total noncurrent liabilities .....	<u>5,735,029</u>	<u>5,444,412</u>
Total liabilities .....	<u>6,340,215</u>	<u>6,431,558</u>
<b>FUND NET ASSETS</b>		
Invested in plant, net of related debt .....	2,379,617	2,393,015
Restricted .....	578,098	456,396
Unrestricted .....	<u>341,404</u>	<u>322,081</u>
Total fund net assets .....	<u>3,299,119</u>	<u>3,171,492</u>
<b>TOTAL LIABILITIES AND FUND NET ASSETS</b> .....	<u>\$ 9,639,334</u>	<u>\$ 9,603,050</u>

(1) Certain amounts in the prior year have been reclassified to conform to the current-year presentation.

## Statements of Revenues, Expenses and Changes in Fund Net Assets

(In thousands)

	Quarter Ended July 2010	Quarter Ended July 2009	12 Months Ended July 2010	12 Months Ended July 2009
<b>Revenues</b>				
Electric .....	\$ 541,352	\$ 560,998	\$ 1,752,492	\$ 1,747,170
Gas .....	35,828	32,157	247,460	202,943
Total operating revenue .....	577,180	593,155	1,999,952	1,950,113
Nonoperating income, net .....	12,454	9,002	46,194	57,306
Total revenue.....	589,634	602,157	2,046,146	2,007,419
<b>Expenses</b>				
Fuel, purchased power and distribution gas .....	172,139	218,532	697,045	708,798
CPS Energy operation and maintenance <sup>(1)</sup> .....	80,798	87,992	326,837	350,945
STP O&M, including decommissioning.....	39,699	38,764	187,700	156,775
Regulatory assessments .....	11,074	8,543	35,912	36,313
Depreciation and amortization.....	76,512	72,741	298,256	280,599
Interest and other expense .....	40,035	33,925	140,486	135,783
Payments to the City of San Antonio .....	88,688	79,262	268,447	263,930
Total expenses .....	508,945	539,759	1,954,683	1,933,143
<b>Income (loss) before other changes</b>				
<b>in fund net assets</b> .....	80,689	62,398	91,463	74,276
Other payments to the City of San Antonio.....	-	-	(9,630)	(11,553)
Contributed capital .....	3,840	6,664	36,006	26,702
Effect of defined benefit plan funding obligations - STP.....	-	-	9,788	(29,726)
<b>CHANGE IN FUND NET ASSETS</b> .....	84,529	69,062	127,627	59,699
<b>FUND NET ASSETS – BEGINNING</b> .....	3,214,590	3,102,430	3,171,492	3,111,793
<b>FUND NET ASSETS – ENDING</b> .....	\$ 3,299,119	\$ 3,171,492	\$ 3,299,119	\$ 3,171,492

(1) Includes annual OPEB costs, annual pension costs, pollution remediation and Save for Tomorrow Energy Program expenses.

**APPENDIX D**



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**CPS ENERGY**

**CERTAIN PROVISIONS OF THE JUNIOR LIEN ORDINANCE**

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## APPENDIX D

### CERTAIN PROVISIONS OF THE ORDINANCE

The following constitutes a summary of certain selected provisions of the Ordinance. This summary should be qualified by reference to other provisions of the Ordinance referred to elsewhere in this Official Statement, and all references and summaries pertaining to the Ordinance in this Official Statement are, separately and in whole, qualified by reference to the exact terms of the Ordinance, a copy of which may be obtained from the City.

SECTION 6. Definitions. Unless the context shall indicate contrary meaning or intent, the terms below defined, for all purposes of this Ordinance or any ordinance amendatory or supplemental hereto, shall be construed, are used, and are intended to have meanings as follows:

A. *Additional Inferior Lien Obligations* – (i) any bonds, notes, warrants, certificates of obligation, or other Debt (other than the currently authorized Inferior Lien Obligations) hereafter issued by the City that are payable, in whole or in part, from and equally and ratably secured by a lien on and pledge of the Net Revenues that is subordinate and inferior to the lien on and pledge of the Net Revenues that have or will be granted as security for the currently outstanding Senior Lien Obligations, Junior Lien Obligations, and Commercial Paper Obligations and any Additional Senior Lien Obligations and Additional Junior Lien Obligations hereafter issued by the City, on a parity with the lien on and pledge of the Net Revenues that have been or are being granted as security for the currently authorized Inferior Lien Obligations, including certificates of obligation as described in Section 271.052, as amended, Texas Government Code, and (ii) obligations hereafter issued to refund any of the foregoing if issued in a manner that provides that the refunding bonds are payable from and equally and ratably secured, in whole or in part, by such a subordinate and inferior lien on and pledge of the Net Revenues as determined by the City Council in accordance with applicable law.

B. *Additional Junior Lien Obligations* – (i) any bonds, notes, warrants, certificates of obligation, or other Debt (other than the Bonds and the Series 2010B Bonds and the currently outstanding Junior Lien Obligations) hereafter issued by the City that are payable, in whole or in part, from and equally and ratably secured by a lien on and pledge of the Net Revenues that is junior and inferior to the lien on and pledge of the Net Revenues that have or will be granted as security for the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued by the City, on a parity with the lien on and pledge of the Net Revenues that have been or are being granted as security for the currently outstanding Junior Lien Obligations, the Bonds, and the Series 2010B Bonds, and prior and superior to the lien on and pledge of the Net Revenues that have or will be granted as security for the Commercial Paper Obligations, the Inferior Lien Obligations, and any Additional Inferior Lien Obligations hereafter issued by the City and (ii) obligations hereafter issued to refund any of the foregoing if issued in a manner that provides that the refunding bonds are payable from and equally and ratably secured, in whole or in part, by such a junior and inferior lien on and pledge of the Net Revenues as determined by the City Council in accordance with applicable law.

C. *Additional Senior Lien Obligations* – (i) any bonds, notes, warrants, certificates of obligation, or other evidences of indebtedness which the City reserves the right to issue or enter

into, as the case may be, in the future under the terms and conditions provided in Section 18 and which are equally and ratably secured solely by a prior and first lien on and pledge of the Net Revenues of the Systems and (ii) any obligations hereafter issued to refund any of the foregoing if issued in a manner so as to be payable from and secured by a prior and first lien on and pledge of the Net Revenues as determined by the City Council in accordance with applicable law..

D. *Board of Trustees, Board, or City Public Service Board* – the City Public Service Board of San Antonio, Texas, existing and functioning pursuant to the ordinances authorizing the issuance of the Senior Lien Obligations and this Ordinance.

E. *Bond Date* – shall mean October 1, 2010.

F. *Bonds* – the bonds authorized by this Ordinance.

G. *City or Issuer* – the City of San Antonio, Texas.

H. *Closing Date* – the date of physical delivery of the Initial Bonds in exchange for the payment in full by the Purchasers.

I. *Commercial Paper* – means (i) the currently authorized obligations of the City from time to time outstanding and unpaid that are payable wholly or in part from a lien on and pledge of the Net Revenues that is subordinate and inferior to the pledge thereof securing payment of the currently outstanding Senior Lien Obligations and the Junior Lien Obligations and any Additional Senior Lien Obligations and Additional Junior Lien Obligations hereafter issued by the City, identified as follows:

“City of San Antonio, Texas Electric and Gas Systems Commercial Paper Notes, Series A”, originally authorized in the aggregate principal amount of \$450,000,000, including the Credit Agreement (as defined in the ordinance authorizing the issuance of the Commercial Paper Obligations); and

(ii) obligations hereafter issued to refund any of the foregoing if issued in a manner that provides that the refunding obligations are payable from and equally and ratably secured, in whole or in part, by such a subordinate and inferior lien on and pledge of the Net Revenues as determined by the City Council in accordance with applicable law.

J. *Debt* – (i) all indebtedness payable from Net Revenues incurred or assumed by the City for borrowed money (including indebtedness payable from Net Revenues arising under Credit Agreements (as such term is defined in the ordinances of the City authorizing the issuances of the Outstanding Junior Lien Obligations)) and all other financing obligations of the Systems payable from Net Revenues that, in accordance with generally accepted accounting principles, are shown on the liability side of a balance sheet; and (ii) all other indebtedness payable from Net Revenues (other than indebtedness otherwise treated as Debt hereunder) for borrowed money or for the acquisition, construction, or improvement of property or capitalized lease obligations pertaining to the Systems that is guaranteed, directly or indirectly, in any manner by the City, or that is in effect guaranteed, directly or indirectly, by the City through an agreement, contingent or otherwise, to purchase any such indebtedness or to advance or supply funds for the payment or purchase of any such indebtedness or to purchase property or services

primarily for the purpose of enabling the debtor or seller to make payment of such indebtedness, or to assure the owner of the indebtedness against loss, or to supply funds to or in any other manner invest in the debtor (including any agreement to pay for property or services irrespective of whether or not such property is delivered or such services are rendered), or otherwise. For the purpose of determining Debt, there shall be excluded any particular Debt if, upon or prior to the maturity thereof, there shall have been deposited with the proper depository (a) in trust the necessary funds (or investments that will provide sufficient funds, if permitted by the instrument creating such Debt) for the payment, redemption, or satisfaction of such Debt or (b) evidence of such Debt deposited for cancellation; and thereafter it shall not be considered Debt. No item shall be considered Debt unless such item constitutes indebtedness under generally accepted accounting principles applied on a basis consistent with the financial statements of the Systems in prior Fiscal Years.

K. *Debt Service Requirements* – as of any particular date of computation, with respect to any obligations and with respect to any period, the aggregate of the amounts to be paid or set aside by the City as of such date or in such period for the payment of the principal of, premium, if any, and interest (to the extent not capitalized) on or other payments due under such obligation, (i) assuming, in the case of obligations without a fixed numerical rate, that such obligations bear interest or other payment obligations calculated by assuming (1) that such non-fixed interest rate for every future 12-month period is equal to the rate of interest reported in the most recently published edition of The Bond Buyer (or its successor) at the time of calculation as the “Revenue Bond Index” or, if such Revenue Bond Index is no longer being maintained by The Bond Buyer (or its successor) at the time of calculation, such interest rate shall be assumed to be 80% of the most recently reported yield, as of the time of calculation, at which United States Treasury obligations of like maturity have been sold and (2) that, in the case of bonds not subject to fixed scheduled mandatory sinking fund redemptions, that the principal of such bonds is amortized such that annual debt service is substantially level over the remaining stated life of such bonds, and in the case of obligations required to be redeemed or prepaid as to principal prior to Stated Maturity according to a fixed schedule, the principal amounts thereof will be redeemed prior to stated maturity in accordance with the mandatory redemption provisions applicable thereto (in each case notwithstanding any contingent obligation to redeem bonds more rapidly); and (ii) after giving effect as an offset to regularly-scheduled debt service on a series of obligations the receipt or anticipated receipt of a refundable tax credit (such as the Tax Credit) or similar payment from the United States Department of the Treasury to which the City is entitled as a result of the City’s irrevocable designation of such series of obligations as “build America bonds” and “qualified bonds” under the Code (or such similar designations that results in the City’s receipt of a similar payment from the United States Department of the Treasury). For the term of any interest rate hedge agreement entered into in connection with any such obligations, Debt Service Requirements shall be computed by netting the amounts payable to the City under such hedge agreement from the amounts payable by the City under such hedge agreement and such obligations. This definition shall apply to all series of Parity Bonds now or hereafter Outstanding.

L. *Depository* – such bank or banks at any time selected by the Board of Trustees to serve as depository of the funds hereinafter provided for with relation to the Bonds.

M. *Extraordinary Event* – the occurrence of a change to sections 54AA or 6431 of the Code (as such sections were added by section 1531 of the Stimulus Act, pertaining to build America bonds) or if there is any guidance published by the Internal Revenue Service or the United States Treasury with respect to such Sections or any other determination by the Internal Revenue Service or the United States Treasury, which determination is not the result of an act or omission by the City to satisfy the requirements to receive the 35% cash subsidy payment from the United States Treasury, pursuant to which the City’s 35% cash subsidy payment from the United States Treasury is reduced or eliminated.

N. *Extraordinary Redemption Price* – an amount, as determined by a Designated Financial Officer, equal to the greater of: (1) the issue price of the Bonds set forth herein (but not less than 100% of the principal amount of the Bonds) to be redeemed or (2) the sum of the present value of the remaining scheduled payments of principal and interest on the Bonds to be redeemed to the maturity date of such Bonds, not including any portion of those payments of interest accrued and unpaid as of the date on which the Bonds are to be redeemed, discounted to the date on which the Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year containing twelve 30-day months, at the Treasury Rate plus \_\_\_\_\_ (\_\_\_\_\_) basis points, plus accrued interest on the Bonds to be redeemed to the redemption date.

O. *Fiscal Year* – the twelve-month operational period of the Systems commencing on February 1 of each year and ending on the following January 31.

P. *Government Securities* – (i) direct noncallable obligations of the United States, including obligations that are unconditionally guaranteed by, the United States of America, or (ii) noncallable obligations of an agency or instrumentality of the United States, including obligations that are unconditionally guaranteed or insured by the agency or instrumentality and that, on the date the governing body of the issuer adopts or approves the proceedings authorizing the issuance of refunding bonds, are rated as to investment quality by a nationally recognized investment rating firm not less than “AAA” or its equivalent, or (iii) noncallable obligations of a state or an agency or a county, municipality, or other political subdivision of a state that have been refunded and that, on the date the governing body of the issuer adopts or approves the proceedings authorizing the issuance of refunding bonds, are rated as to investment quality by a nationally recognized investment rating firm not less than “AAA” or its equivalent.

Q. *Inferior Lien Obligations* – means (i) any bonds, notes, warrants, certificates of obligation, or other similar debt currently outstanding or hereafter issued by the City that are payable from and equally and ratably secured by a lien on and pledge of the Net Revenues that is subordinate and inferior to the pledges thereof securing payment of the currently outstanding Senior Lien Obligations, the Junior Lien Obligations, the Commercial Paper Obligations, and any Additional Senior Lien Obligations and Additional Junior Lien Obligations hereafter issued by the City, including the “City of San Antonio, Texas Electric and Gas Systems Tax Exempt Flexible Rate Revolving Notes, Series A” and the “City of San Antonio, Texas Electric and Gas Systems Taxable Flexible Rate Revolving Notes, Series A”, authorized in an aggregate principal amount at any one time outstanding not to exceed \$100,000,000, (ii) any obligations that are issued subject to the limitations in Section 1502.052, as amended, Texas Government Code, and (iii) obligations hereafter issued to refund any of the foregoing if issued in a manner that provides that the refunding bonds are payable from and equally and ratably secured, in whole or

in part, by such an inferior lien on and pledge of the Net Revenues as determined by the City Council in accordance with applicable law.

R. *Junior Lien Obligations* – means (i) the currently authorized obligations of the City from time to time outstanding and unpaid that are payable wholly or in part from a lien on and pledge of the Net Revenues that is junior and inferior to the pledge thereof securing payment of the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued by the City, identified as follows:

(1) “City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Bonds, Series 2003”, originally authorized in the aggregate principal amount of \$250,000,000, including the Credit Agreement (as defined in the ordinance authorizing the issuance of the Junior Lien Obligations);

(2) “City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Bonds, Series 2004”, originally authorized in the aggregate principal amount of \$160,000,000, including the Credit Agreement (as defined in the ordinance authorizing the issuance of the Junior Lien Obligations);

(3) upon issuance, the Bonds and the Series 2010B Bonds; and

(ii) obligations hereafter issued to refund any of the foregoing if issued in a manner that provides that the refunding bonds are payable from and equally and ratably secured, in whole or in part, by such a junior and inferior lien on and pledge of the Net Revenues as determined by the City Council in accordance with applicable law.

S. *Maintenance and Operating Expenses* – those expenses required by law (Section 1502.056, as amended, Texas Government Code) to be a first lien on and charge against the income of the Systems, including the cost of insurance; the purchase and carrying of stores, materials, and supplies; the purchase, manufacture, and production of gas and electricity for distribution and resale; the payment of salaries; and the payment of all other expenses properly incurred in operating and maintaining the Systems and keeping them in good repair and operating condition (classed as a maintenance and operating expense as opposed to a capital expenditure under the Uniform System of Accounts adopted by the National Association of Regulatory Utility Commissioners). Depreciation on the properties of the Systems shall not be considered or included as Maintenance and Operating Expenses in the determination of Net Revenues of the Systems.

T. *Make-Whole Redemption Price* – an amount, as determined by a Designated Financial Officer, equal to the greater of: (1) the issue price of the Bonds set forth herein (but not less than 100% of the principal amount of the Bonds) to be redeemed or (2) the sum of the present value of the remaining scheduled payments of principal and interest on the Bonds to be redeemed to the maturity date of such Bonds, not including any portion of those payments of interest accrued and unpaid as of the date on which the Bonds are to be redeemed, discounted to the date on which the Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year containing twelve 30-day months, at the Treasury Rate plus \_\_\_\_\_ (\_\_\_) basis points, plus accrued interest on the Bonds to be redeemed to the redemption date.

U. *Net Revenues* – all income and revenues from the operation of the Systems after the deduction of Maintenance and Operating Expenses. The term *Net Revenues* shall also include any additional and further security for the payment of the Bonds as may be pledged therefor consistent with the then applicable laws of the State of Texas, provided that any such additional and further security is made equally and ratably applicable as security for all Parity Bonds.

V. *Outstanding* – as of the date of determination, all Parity Bonds theretofore issued and delivered except:

(1) those Parity Bonds theretofore canceled by the respective paying agents for such Parity Bonds or delivered to such paying agents for cancellation;

(2) those Parity Bonds for which payment has been duly provided by the City by the irrevocable deposit with the respective paying agents for such Parity Bonds of money in the amount necessary to fully pay principal of, premium, if any, and interest thereon to maturity or redemption, if any, as the case may be, provided that, if such Parity Bonds are to be redeemed, notice of redemption thereof shall have been duly given pursuant to the ordinance authorizing the issuance of such Parity Bonds or irrevocably provided to be given to the satisfaction of such paying agents, or waived;

(3) those Parity Bonds that have been mutilated, destroyed, lost, or stolen and for which replacement bonds have been registered and delivered in lieu thereof; and

(4) those Parity Bonds for which the payment of principal, premium, if any, and interest has been duly provided for by the City by the deposit in trust of money or Government Securities, or both.

W. *Parity Bonds* – the Junior Lien Obligations, the Bonds, the Series 2010B Bonds, and any Additional Junior Lien Obligations.

X. *Paying Agent/Registrar* – the financial institution named in Section 3 of this Ordinance, or any successor thereto named in accordance with the provisions of Section 3 of this Ordinance.

Y. *Registered Bonds* – any Bonds issued as fully-registered bonds, without coupons.

Z. *Senior Lien Obligations* – means (i) the outstanding and unpaid obligations of the City that are payable solely from and equally and ratably secured by a prior and first lien on and pledge of the Net Revenues of the Systems, identified as follows: “City of San Antonio, Texas Electric and Gas Systems Revenue Refunding Bonds, New Series 1994-A”, dated February 1, 1994 and originally issued in the total aggregate principal amount of \$684,700,000; “City of San Antonio, Texas Electric and Gas Systems Revenue Refunding Bonds, New Series 1998A”, dated November 1, 1998 and originally issued in the total aggregate principal amount of \$785,515,000; “City of San Antonio, Texas Electric and Gas Systems Revenue Bonds, New Series 2000A”, dated November 15, 2000 and originally issued in the total aggregate principal amount of \$170,770,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Refunding Bonds, New Series 2001”, dated October 1, 2001 and originally issued in the total aggregate

principal amount of \$115,280,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue and Refunding Bonds, New Series 2002”, dated August 1, 2002 and originally issued in the total aggregate principal amount of \$576,705,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Refunding Bonds, New Series 2003A”, dated July 1, 2003 and originally issued in the total aggregate principal amount of \$93,935,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Refunding Bonds, New Series 2003 (Forward Delivery)”, dated July 1, 2003 and originally issued in the total aggregate principal amount of \$350,490,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Refunding Bonds, New Series 2005”, dated March 15, 2005 and originally issued in the total aggregate principal amount of \$294,625,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Bonds, New Series 2005”, dated March 15, 2005 and originally issued in the total aggregate principal amount of \$240,675,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Refunding Bonds, New Series 2005A”, dated October 1, 2005 and originally issued in the total aggregate principal amount of \$197,335,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Bonds, New Series 2006A”, dated August 15, 2006 and originally issued in the total aggregate principal amount of \$384,185,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Refunding Bonds, New Series 2006B”, dated January 15, 2007 and originally issued in the total aggregate principal amount of \$128,845,000; “City of San Antonio, Texas Electric and Gas Systems Revenue and Refunding Bonds, New Series 2007”, dated June 15, 2007 and originally issued in the principal amount of \$449,410,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Bonds, New Series 2008”, dated June 15, 2008 and originally issued in the principal amount of \$287,935,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Refunding Bonds, New Series 2008A, dated December 1, 2008 and originally issued in the principal amount of \$158,030,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Refunding Bonds, New Series 2009A,” dated February 1, 2009 and originally issued in the principal amount of \$442,005,000; “City of San Antonio, Texas, Electric and Gas Systems Revenue Bonds, Taxable New Series 2009C (Direct Subsidy—Build America Bonds,” dated May 1, 2009 and originally issued in the principal amount of \$375,000,000; and “City of San Antonio, Texas, Electric and Gas Systems Revenue Bonds, Taxable New Series 2010A (Direct Subsidy—Build America Bonds,” dated February 1, 2010 and originally issued in the principal amount of \$380,000,000; and (ii) obligations hereafter issued to refund any of the foregoing if issued in a manner so as to be payable from and equally and ratably secured by a first lien on and pledge of the Net Revenues of the Systems as determined by the City Council in accordance with any applicable law.

AA. *Series 2010B Bonds* – the bonds of the City designated as “City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Refunding Bonds, Taxable Series 2010B (Direct Subsidy—Build America Bonds)” dated October 1, 2010 and issued concurrently with the Bonds in the aggregate principal amount of \$200,000,000.

BB. *Systems* – the entire electric light and power plants and systems and gas distribution system and all property of every kind appurtenant to and used or acquired in connection with said electric light and power plant and systems and gas distribution system owned by the City, together with all property of every kind now and hereafter owned or acquired by the City as a part of or for use in the operation of the City’s electric light and power plants and systems and gas distribution system. Notwithstanding the foregoing, upon payment in full, or provision for such payment, of the Senior Lien Obligations issued before May 29, 1997, and

the defeasance of the ordinances authorizing the issuance of such Senior Lien Obligations, the term Systems shall not mean or include facilities of any kind which are declared not to be a part of the Systems and which are acquired or constructed by or on behalf of the City with the proceeds from the issuance of *Special Facilities Bonds*, which are hereby defined as being special revenue obligations of the City which are not payable from Net Revenues but which are payable from and equally and ratably secured by other liens on and pledges of any revenues, sources or payments, not pledged to the payment of the Senior Lien Obligations including, but not limited to, special contract revenues or payments received from any other legal entity in connection with such facilities.

CC. *Treasury Rate* – with respect to any redemption date for a particular Bond, the yield to maturity as of such redemption date of United States Treasury securities with a constant maturity (as compiled and published in the most recent Federal Reserve Statistical Release H.15 (519) that has become publicly available at least five business days prior to the redemption date (excluding inflation indexed securities) (or, if such Statistical Release is no longer published, any publicly available source of similar market data)) most nearly equal to the period from the redemption date to the maturity date of the Bond to be redeemed; provided, however, that if the period from the redemption date to such maturity date is less than one year, the weekly average yield on actually traded United States Treasury securities adjusted to a constant maturity of one year will be used.

#### SECTION 7. Pledge.

A. Payment of the principal of and interest on the Bonds are and shall be secured by and payable solely from, and the City hereby grants a junior lien on and pledge of, the Net Revenues, *subject* and *subordinate* to the liens on and pledges of Net Revenues heretofore or hereafter made to secure payment of the Senior Lien Obligations and the Additional Senior Lien Obligations (and equally and ratably with the lien on and pledge of Net Revenues heretofore or hereafter made to secure payment of the Junior Lien Obligations and Additional Junior Lien Obligations, as well as with respect to any payment obligation arising under a “credit agreement”, as such terms is defined in Chapter 1371, relating to any series of Parity Bonds. The Bonds are not secured by or payable from a mortgage or deed of trust on any properties, whether real, personal, or mixed, constituting the Systems. The Bonds are being issued as Additional Junior Lien Obligations. As such, the Bonds are special limited obligations of the City payable solely from the Net Revenues, and the holders thereof shall never have the right to demand payment out of funds raised or to be raised by taxation.

Subject to making the deposits required by this Ordinance or any other ordinance of the City Council, the excess Net Revenues of the Systems may be used by the Board for any lawful purpose.

B. Chapter 1208, Texas Government Code, applies to the issuance of the Bonds and the pledge of Net Revenues granted by the City under subsection (a) of this Section, and such pledge is therefore valid, effective, and perfected. If Texas law is amended at anytime while the Parity Bonds are outstanding and unpaid such that the pledge of the Net Revenues granted by the City is to be subject to the filing requirements of Chapter 9, Texas Business & Commerce Code, then in order to preserve to the registered owners of the Parity Bonds the perfection of the

security interest in this pledge, the City agrees to take such measures as it determines are reasonable and necessary under Texas law to comply with the applicable provisions of Chapter 9, Texas Business & Commerce Code and enable a filing to perfect the security interest in this pledge to occur.

SECTION 8. Rates and Charges. While any of the Bonds authorized hereby are Outstanding, the City shall establish and maintain rates and charges for facilities and services afforded by the Systems that are reasonably expected, on the basis of available information and experience and with due allowance for contingencies, to produce income and revenues in each Fiscal Year sufficient, after considering as an off-set to regularly-scheduled debt service any refundable tax credit (such as the Tax Credit) to be received by the City with respect to any obligation secured by and payable from a pledge of Net Revenues that has been designated by the City as a “build America bond” and “qualified bond” under the Code (or such similar designations under the Code) entitling the City to receive from the United States Department of the Treasury a refundable tax credit or similar payment with respect thereto (including the Tax Credit) (which provision hereby amends and is added to any similar provision included in an ordinance of the City authorizing a series of Outstanding Junior Lien Obligations):

A. *Prior Lien Expenses.* to pay all Maintenance and Operating Expenses, depreciation, replacement and betterment expenses, and other costs as may be required by Chapter 1502, as amended, Texas Government Code;

B. *Senior Lien Expenses.* to produce Net Revenues, together with any other lawfully available funds, sufficient to satisfy the rate covenant contained in the ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations and to pay the interest on and principal of all Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued, as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the Senior Lien Obligations;

C. *Junior Lien Expenses.* to produce Net Revenues, together with any other lawfully available funds, to pay the interest on and principal of all Junior Lien Obligations, the Bonds, and any Additional Junior Lien Obligations hereafter issued, as well as any “credit agreement” authorized under Chapter 1371 relating to any of the foregoing, as and when the same shall become due, and for the establishment and maintenance of the funds and accounts created for the payment and security of the Bonds;

D. *Commercial Paper Expense.* to the extent the same are reasonably anticipated to be paid with Available Revenues (as defined in the ordinance authorizing the Commercial Paper Obligations), the interest on and principal of all Notes (as defined in said ordinance) and the Credit Agreement (as defined in said ordinance); and

E. *Inferior Lien Expenses.* to pay the Inferior Lien Obligations, any Additional Inferior Lien Obligations, or any other legal debt or obligation of the Systems as and when the same shall become due.

SECTION 9. General Account. The City, acting through the Board of Trustees, hereby covenants with respect to the holders of the Bonds that all revenues of every nature received

through the operation of the Systems shall be deposited as received in the “City of San Antonio Electric and Gas Systems General Account” (the *General Account*), which shall be kept separate and apart from all other funds of the City. Revenues received for the General Account shall be deposited from time to time as received in such Depository as may be selected by the Board of Trustees in accordance with applicable laws relating to the selection of City depositories.

SECTION 10. Flow of Funds. The City, acting through the Board of Trustees, hereby agrees and reaffirms its covenant to the holders of the Parity Bonds that funds in the General Account shall be pledged and appropriated to the following uses and in the order of priority shown below:

FIRST: to the payment of reasonable and proper Maintenance and Operating Expenses of the Systems upon approval by the Board of Trustees;

SECOND: to the payment of the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued by the City, including the establishment and maintenance of the reserve therefor;

THIRD: to the payment of the Junior Lien Obligations, the Bonds, the Series 2010B Bonds, and any Additional Junior Lien Obligations hereafter issued by the City or any other Prior Lien Bonds (as defined in the ordinance authorizing the Commercial Paper Obligations), as well as any “credit agreement” authorized under Chapter 1371 relating to any of the foregoing and the establishment and maintenance of a reserve therefor;

FOURTH: to the payment and security of the Notes and the Credit Agreement (as defined in the ordinance authorizing the Commercial Paper);

FIFTH: to the payment and security of the Inferior Lien Obligations and any Additional Inferior Lien Obligations hereafter issued, including obligations hereinafter issued which are inferior in lien to the Senior Lien Obligations, any Additional Senior Lien Obligations, the Junior Lien Obligations, the Bonds, the Series 2010B Bonds, any Additional Junior Lien Obligations, and the Notes, as well as any “credit agreement” authorized under Chapter 1371 relating to any of the foregoing;

SIXTH: to the payment of an annual amount equal to six percent (6%) of the gross revenues of the Systems to be deposited in the Repair and Replacement Account provided for in Section 12 of this Ordinance;

SEVENTH: to the payment of the annual amount due the General Fund of the City of San Antonio, as provided in Section 13 of this Ordinance; and

EIGHTH: any remaining Net Revenues of the Systems in the General Account, to the Repair and Replacement Account in accordance with Section 12 of this Ordinance.

Any Net Revenues remaining in the General Account after satisfying the foregoing payments, or making adequate and sufficient provision for the payment thereof, may be appropriated and used for any other Board purpose now or hereafter permitted by law and the

ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations, subject to Section 12.

SECTION 12. Repair and Replacement Account. The City reaffirms its covenant with the holders of Parity Bonds that a special fund or account shall be created and established to be known as the “City of San Antonio Electric and Gas Systems Repair and Replacement Account” (the *Repair and Replacement Account*) at such Depository as may be designated by the Board of Trustees. Money on deposit in the Repair and Replacement Account shall be used for the following purposes: providing extensions, additions, and improvements to the Systems; meeting contingencies of any nature in connection with the operations, maintenance, improvement, replacement, or restoration of properties of the Systems; and paying bonds or other obligations for which other funds are not available, or for any or all of such purposes, as, from time to time, may be determined by the Board of Trustees.

From the Net Revenues remaining in the General Account after payments in accordance with *Clauses First through Fifth* of Section 10 of this Ordinance and after payment and provisions for payments and additions to the Bond Fund in accordance with the provisions of Section 11, there shall be paid into the Repair and Replacement Account an annual sum equal to six percent (6%) of the gross revenues of the Systems for the then current Fiscal Year. This annual payment to the Repair and Replacement Account shall be accumulated each Fiscal Year by monthly installments, such monthly installments to be based on each month’s gross revenues to the extent funds in the General Account are available each month; provided, however, should the total annual payment to the Repair and Replacement Account in any Fiscal Year exceed six percent (6%) of the gross revenues of the Systems, as shown by the Systems’ audited annual financial statement, proper year-end adjustments shall be made (on or before March 1 after the close of each Fiscal Year) by causing any excess amount deposited therein to be transferred to the General Account.

No deposit in excess of six percent (6%) of the annual gross revenues of the Systems shall be made to the Repair and Replacement Account (as provided in the preceding paragraph) unless and until complete and full payments, or provisions for such payments, shall have been paid over or credited to the General Fund of the City in accordance with Section 13 of this Ordinance. After complete and full payments, or provisions for such payments, shall have been paid over or credited to the General Fund of the City to the full extent required in Section 13 hereof, additional deposits may be made to the Repair and Replacement Account; and at the close of each Fiscal Year, all Net Revenues of the Systems remaining in the General Account after full and complete payment to the General Fund of the City has been made (except such amounts as may be required to meet unpaid accounts and obligations which have accrued or are payable during the year to insure continued operation of the Systems), shall be deposited in the Repair and Replacement Account.

SECTION 13. Payments or Credits to the General Fund of the City. In accordance with the provisions of the ordinances authorizing the issuance of the Senior Lien Ordinance and this Ordinance, and after the payments specified in *Clauses First through Fifth* of Section 10 and the Repair and Replacement Account (for purposes of accumulating therein an amount equal to six percent (6%) of the annual gross revenues of the Systems) have been made in full in accordance with the provisions of Sections 10, 11, and 12 of this Ordinance, there shall be paid over or

credited to the General Fund of the City (for general purposes of the City), to the extent Net Revenues of the Systems are available in the General Account and in monthly installments, an amount in cash not to exceed 14% of the gross revenues of the Systems for the month next preceding the month in which the monthly deposit is made, less the value of gas and electric services of the Systems used by the City for municipal purposes and the amount expended for additions to the street lighting system for the month for which such payment is being made. The maximum amount in cash to be transferred or credited to the General Fund of the City from the Net Revenues of the Systems during any Fiscal Year shall not exceed 14% of the gross revenues of the Systems less the value of gas and electric services of the Systems used by the City for municipal purposes and the amounts expended during the Fiscal Year for additions to the street lighting system. The percentage of gross revenues of the Systems to be paid over or credited to the General Fund of the City each Fiscal Year shall be determined (within the 14% limitation) by the governing body of the City.

SECTION 14. Investments. Funds on deposit in the General Account, the Construction Account (hereinafter defined), the Bond Fund and the Repair and Replacement Account may be, at the option of the Board of Trustees, invested in any investment permitted by the provisions of the Board of Trustees' Investment Policy and the Public Funds Investment Act, as amended, Chapter 2256, Texas Government Code, or in any other investment authorized under applicable laws of the State of Texas from time to time, including time deposits, certificates of deposit, guaranteed investment contracts or similar contractual agreements. Any obligations, or evidences of ownership of said obligations, in which funds on deposit in the aforementioned Accounts are so invested shall be kept in escrow in the respective Depositories for such Accounts, and such investments shall be promptly sold when required and the proceeds of the sale applied to the making of payments required to be made from the Account from which the investment was made whenever such payments are necessary to be made. All income and profits received from the investment of funds in the Repair and Replacement Account shall be transferred and credited to the General Account. Income and profits received from investments of funds on deposit in the Bond Fund shall be used only for the purposes of paying the principal of and interest on the Bonds, as and when the same shall become due.

SECTION 15. Transfer of Funds to the Paying Agent/Registrar. On or before an interest or principal payment date of any Bonds, the Treasurer of the Board shall make transfer of funds on deposit in the Bond Fund to the Paying Agent/Registrar in the amounts calculated as fully sufficient to pay and discharge promptly, as due, each installment of interest and principal pertaining to the Bonds then Outstanding. In making such transfers, the Treasurer shall take into account any money on deposit with the Paying Agent/Registrar relating to the Bonds. In the event Bonds may be called for redemption prior to stated maturity, the Treasurer of the Board shall cause amounts calculated as sufficient to pay and discharge the Bonds (including accrued interest) so called for redemption to be transferred to the paying agent or paying agents (including the Paying Agent/Registrar) on or before the date fixed for the redemption of such bonds.

SECTION 16. Security of Funds. All money on deposit in the special Accounts for which this Ordinance makes provision (except any portions thereof as may be at any time properly invested) shall be secured in the manner and to the fullest extent required by the laws of the State of Texas for the security of public funds.

SECTION 18. Issuance of Additional Senior Lien Obligations, Additional Junior Lien Obligations, Commercial Paper Obligations, and Additional Inferior Lien Obligations. The City hereby expressly reserves the right to hereafter issue bonds, notes, warrants, certificates of obligation, or similar obligations payable wholly or in part from and secured by a pledge of and lien on the Net Revenues of the Systems with the following priorities, without limitation as to principal amount, but subject to any terms, conditions, or restrictions applicable thereto under existing ordinances, laws, or otherwise:

A. *Senior Lien.* Additional Senior Lien Obligations payable from and equally and ratably secured by a first and prior lien on and pledge of the Net Revenues of the Systems upon (1) satisfying each of the conditions precedent contained in the ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations or, in the event no Senior Lien Obligations are outstanding, the conditions precedent contained in the most recently adopted ordinance authorizing Senior Lien Obligations and (2) execution by a Designated Financial Officer of the certificates described in Subsections B(1) and B(2) of this Section, taking into account the Senior Lien Obligations then proposed to be issued;

B. *Junior Lien.* Additional Junior Lien Obligations payable from and equally and ratably secured by a junior lien on and pledge of the Net Revenues that is subordinate and inferior to the liens and pledges made to secure payment of the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations hereafter issued, upon satisfying each of the conditions precedent contained in the ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations and upon satisfying each of the following conditions precedent:

1) No Default Certificate: a Designated Financial Officer (or other official of the City having primary responsibility for the fiscal affairs of the City) shall have executed a certificate stating that (a) except for a refunding to cure a default, or the deposit of a portion of the proceeds of any Additional Junior Lien Obligations to satisfy the City's obligations under this Ordinance, the City is not then in default as to any covenant, obligation, or agreement contained in any ordinance or other proceedings relating to any obligations of the City payable from and secured by a lien on and pledge of the Net Revenues of the Systems and (b) all payments into all special funds or accounts created and established for the payment and security of all outstanding obligations payable from and secured by a lien on and pledge of the Net Revenues of the Systems have been duly made and that the amounts on deposit in such special funds or accounts are the amounts then required to be deposited therein;

2) Coverage Certificate: a Designated Financial Officer shall have executed a certificate to the effect that, according to the books and records of the Systems, the Net Revenues of the Systems for the preceding Fiscal Year or for any 12 consecutive months out of the 18 months immediately preceding the month the ordinance authorizing the Additional Junior Lien Obligations is adopted (determined without regard to revenue received by the City under any interest rate hedge agreement entered into in connection with any Senior Lien Obligations, Additional Senior Lien Obligations, or Parity Bonds) are at least equal to 100% of the average annual Debt Service Requirements for all Senior Lien Obligations, Junior Lien Obligations, Bonds, the Series 2010B Bonds, Additional

Senior Lien Obligations, and Additional Junior Lien Obligations in any future Fiscal Year while the Additional Junior Lien Obligations then proposed to be issued are to be outstanding, after giving effect to such Additional Junior Lien Obligations (and, in making a determination of the Net Revenues, such Designated Financial Officer may take into consideration a change in the rates and charges for services and facilities afforded by the Systems that became effective at least 60 days prior to the last day of the period for which Net Revenues are to be determined and, for purposes of satisfying the above Net Revenues test, make a pro forma determination of the Net Revenues for the period of time covered by the certification based on such change in rates and charges being in effect for the entire period covered by such Designated Financial Officer's certificate); and

3) Debt Service Deposits: the ordinance authorizing the issuance of the Additional Junior Lien Obligations provides for monthly deposits to be made to a debt service fund for such obligations in amounts sufficient to pay the Additional Junior Lien Obligations when due; and

C. Inferior Lien. Commercial Paper Obligations, Inferior Lien Obligations, and Additional Inferior Lien Obligations payable from and secured by a lien on and pledge of the Net Revenues of the Systems that is inferior and subordinate to the liens and pledges made to secure payment of the Senior Lien Obligations, Additional Senior Lien Obligations, the Bonds, the Series 2010B Bonds, and Additional Junior Lien Obligations, upon satisfying each of the conditions precedent contained in the ordinances authorizing the issuance of the currently outstanding Senior Lien Obligations, the ordinances authorizing the issuance of the currently outstanding Junior Lien Obligations, this Ordinance, the respective ordinances authorizing the issuance of the Series 2010B Bonds and Commercial Paper Obligations, and, to the extent applicable, the ordinance authorizing the issuance of the Inferior Lien Obligations.

SECTION 19. Management of the Systems. In accordance with the provisions of the ordinances authorizing the currently outstanding Senior Lien Obligations, the currently outstanding Junior Lien Obligations, the Series 2010B Bonds, and this Ordinance, the City hereby agrees, covenants, and reaffirms that during such time as any Bonds issued hereunder are Outstanding and unpaid, the complete management and control of the Systems, pursuant to the authority contained in Section 1502.070, as amended, Texas Government Code, shall be vested in a Board of Trustees consisting of five citizens (one of whom shall be the Mayor of the City) of the United States of America permanently residing in Bexar County, Texas, to be known as the "City Public Service Board of San Antonio, Texas". The Mayor of the City shall be a voting member of the Board, shall represent the City Council thereon, and shall be charged with the duty and responsibility of keeping the City Council fully advised and informed at all times of any actions, deliberations and decisions of the Board and its conduct of the management of the Systems.

All vacancies in membership on the Board (excluding the Mayor of the City), whether occasioned by failure or refusal of any person previously named to accept appointment or by expiration of term of office or otherwise, shall be filled in the following manner: a nominee to fill such vacancy shall be elected by the majority vote of the remaining members of the Board of Trustees, such majority vote to include the vote of the Mayor. The name of such nominee shall

then be submitted by the Mayor to the vote of the City Council, which by a majority vote of the members thereof then in office shall, as evidenced by ordinance or resolution, either confirm or reject such nominee; provided, however, if the City Council fails to act upon such nominee, such failure to do so shall be considered as a rejection of such nominee and another nominee shall be selected by the Board. If a vacancy occurs and the remaining members of the Board (including the Mayor) fail to elect a nominee to fill such vacancy within sixty (60) days after the vacancy occurs (or fail to select another nominee within sixty (60) days after rejection of a nominee by the City Council), the City Council, by a majority vote of the members thereof then in office, shall elect a person to fill such vacancy and shall appoint such Trustee by resolution or ordinance. In the event the City rejects or fails to confirm three (3) consecutive nominees of the Board to fill a vacancy on the Board, the City Council shall, within thirty (30) days after the third rejection, appoint a temporary Trustee to fill such vacancy pending the appointment of a permanent Trustee to fill such vacancy. The appointment of a temporary Trustee by the City Council shall constitute the nomination of such appointee as the permanent Trustee to fill such vacancy. Unless the remaining members of the Board, by a majority vote, reject the nominee selected by the City Council within thirty (30) days after his appointment as a temporary Trustee, the appointment shall become final and the temporary Trustee shall automatically become the permanent Trustee to fill such vacancy. In such vote, the vote of the Mayor shall automatically be cast as a vote in favor of the confirmation of such Trustee, whether cast by the Mayor or not.

If the nominee of the City Council is rejected by a majority vote of the remaining Trustees, the remaining Trustees shall within thirty (30) days after such rejection elect another nominee to fill such vacancy. Such nominee shall be considered by the City Council and if approved shall become the permanent Trustee. If such nominee is rejected by a majority vote of the members of the City Council then in office, or in the event the City Council fails to act upon such nomination within thirty (30) days after the nomination is presented to the City Council, the temporary Trustee theretofore appointed by the City Council shall automatically become the permanent Trustee to fill such vacancy. The term of office of each member appointed to the Board shall be five (5) years. A person who has served as an appointed member of the Board for a single five-year term shall be eligible for reappointment for one additional five-year term and one only. A member who is appointed to the Board to serve out an unexpired portion of a retired member's term shall not be considered to have served a "term" unless the unexpired portion of the term so served is three (3) years or more. Permanent removal of residence from Bexar County by any appointed member of the Board shall vacate his office as a member of the Board, or any member (other than the Mayor of the City) who shall be continuously absent from all meetings held by the Board for a period of four (4) consecutive months shall, unless he shall have been granted leave of absence by the unanimous vote of the remaining members of the Board, be considered to have vacated his office as a member of the Board. Any member of the Board, other than the Mayor of the City, may, by unanimous vote of the remaining members of the Board, be removed from office, but only for adequate cause.

Notwithstanding any of the foregoing provisions as contained in this Section or in any other section of this Ordinance pertaining to the appointment or selection of Trustees to the Board, the City Council reserves unto itself the absolute right at any time upon passage of an ordinance approved by a majority vote of its members to change the method of selection of and appointment to the Board of Trustees to direct selection by the City Council, with such change of

method to direct selection being at the sole option of the City Council without approval of any persons, party, holder of Bonds, or the Board of Trustees.

Except as otherwise specifically provided in this Ordinance, the Board of Trustees shall have absolute and complete authority and power with reference to the control, management, and operation of the Systems and the expenditure and application of the revenues of the Systems subject to the provisions contained in this Ordinance, all of which shall be binding upon and shall govern the Board of Trustees. In connection with the management and operation of the Systems and the expenditure and application of the revenues therefrom, the Board of Trustees shall be vested with all of the powers of the City with respect thereto, including all powers necessary or appropriate for the performance of all of the covenants, undertakings, and agreements of the City contained in this Ordinance, and shall have full power and authority to make rules and regulations governing the furnishing of electric and gas service to customers and for the payment of the same, and for the discontinuance of such services upon failure of customers to pay therefor, and, to the extent authorized by law, shall have full authority with reference to making of extensions, improvements, and additions to the Systems and the acquiring by purchase or condemnation of properties of every kind in connection therewith.

The Board of Trustees, in exercising the management powers granted herein, will ensure that policies adopted affecting research, development, and corporate planning will be consistent with City Council policy, and policies adopted by the Board of Trustees pertaining to such matters will be subject to City Council review.

The Board of Trustees shall elect one of its members as Chairman and one as Vice Chairman of the Board and shall appoint a Secretary and a Treasurer, or a Secretary-Treasurer, who may, but need not be, a member or members of the Board. If a member of the Board of Trustees is not appointed as Secretary or Treasurer, or Secretary-Treasurer, then an employee or employees of the Board whose duties in the operation of the Systems require performance of similar duties may be appointed as Secretary or Treasurer or Secretary-Treasurer. The Board of Trustees may follow and adopt such rules for the orderly handling of its affairs as it may see fit and may manage and conduct the affairs of the Systems with the same freedom and in the same manner ordinarily employed by the board of directors of private corporations operating properties of a similar nature. No member of the Board of Trustees, however, shall ever vote by proxy in the exercise of his duties as a Trustee.

The Board of Trustees shall appoint and employ all officers, employees, and professional consultants which it may deem desirable, including without limitation, a General Manager and CEO of the Systems, attorneys, engineers, architects, and other advisors. No officer or employee of the Board of Trustees may be employed who shall be related within the second degree of consanguinity or affinity to any member of the Board of Trustees.

The Board of Trustees shall obtain and keep continually in force an employees' fidelity and indemnity bond of the so-called "blanket" type, written by a solvent and recognized indemnity company authorized to do business in the State of Texas and covering losses to the amount of not less than One Hundred Thousand Dollars (\$100,000).

The members of the Board of Trustees, other than the Mayor of the City, shall receive annual compensation in the minimum amount of Two Thousand Dollars (\$2,000.00), except that the Chairman of the Board shall receive annual compensation in the minimum amount of Two Thousand Five Hundred Dollars (\$2,500.00). Such compensation may be increased from time to time by the majority vote of the City Council then in office.

The members of the Board of Trustees and administrative officers shall not be personally liable, either individually or collectively, for any act or omission not willfully fraudulent or in bad faith.

SECTION 20. Maintenance and Operation--Insurance. The City hereby agrees and reaffirms that the Systems shall be maintained in good condition and operated in an efficient manner and at reasonable cost. So long as any of the Bonds are Outstanding, the City, acting by and through the Board of Trustees, agrees to maintain insurance of a kind and in an amount (including self insurance) which usually would be carried by private companies engaged in a similar type of business.

SECTION 21. Records--Accounts--Accounting Reports. The City, acting by and through the Board of Trustees, hereby agrees, covenants, and reaffirms that so long as any Bonds, or any interest thereon, remain Outstanding and unpaid, a proper and complete set of records and accounts pertaining to the operation of the Systems shall be kept and maintained separate and apart from all other records and accounts of the City, in which complete and correct entries shall be made of all transactions relating to the Systems as provided in Chapter 1502, as amended, Texas Government Code, and that the holder or holders of any of the Bonds or any duly authorized agent or agents of such holders shall have the right at all reasonable times to inspect all such records, accounts, and data relating thereto and to inspect the Systems and all properties comprising the same. The Board of Trustees shall, so far as practicable and to the extent consistent with the provisions of this Ordinance, keep its books and records in the manner prescribed in the Uniform System of Accounts adopted by the National Association of Regulatory Utility Commissioners. It is further agreed that as soon after the close of each Fiscal Year as may reasonably be done, the City (acting by and through the Board of Trustees) will cause an annual audit of such books and accounts to be made by an independent firm of certified public accountants. Each such audit, in addition to whatever other matters may be thought proper by the accountants, shall reflect the revenues and expenses of the Systems for said Fiscal Year, and the assets, liabilities, and financial condition of the Systems (in reasonable detail) at the close of such Fiscal Year.

Expenses incurred in making the audit referred to above are to be regarded as Maintenance and Operating Expenses and paid as such. A copy of the aforesaid annual audit shall be furnished to the Municipal Securities Rulemaking Board, where it will be available through the Electronic Municipal Market Access System, in accordance with the provisions of Section 44 hereof.

SECTION 22. Remedies in the Event of Default. In addition to all of the rights and remedies provided by the laws of the State of Texas, it is specifically covenanted and agreed particularly that in the event the City (i) defaults in the payments to be made to the Bond Fund as required by this Ordinance, or (ii) defaults in the observance or performance of any other of the

covenants, conditions, or obligations set forth in this Ordinance, the holder or holders of any Bonds shall be entitled to a writ of mandamus issued by a court of proper jurisdiction, compelling and requiring the City, its officers, the Board of Trustees, and/or all of them, to observe and perform any covenants, conditions, or obligations prescribed in this Ordinance.

No delay or omission to exercise any right or power accruing upon any default shall impair any such right or power, or shall be construed to be a waiver of any such default or acquiescence therein, and every such right and power may be exercised from time to time and as often as may be deemed expedient. The specific remedies herein provided shall be cumulative of all other existing remedies, and the specifications of such remedies shall not be deemed to be exclusive.

SECTION 23. Special Covenants. The City hereby further covenants as follows:

A. The City has secured from the Board of Trustees a resolution acknowledging its duties, responsibilities, and obligations under this Ordinance and agreeing to fully comply with all its terms and provisions, including the administration and operation of the Systems and the disposition of revenues of the Systems.

B. It has the lawful power to pledge the Net Revenues supporting the Bonds and has lawfully exercised said power under the laws of the State of Texas, including said power existing under the Acts, and the Additional Junior Lien Obligations, when issued, shall be equally and ratably secured under said pledge of income in such manner that one bond shall have no preference over any other bond of said issues.

C. Other than for the payment of the Senior Lien Obligations, the Junior Lien Obligations, the Bonds, the Series 2010B Bonds, the Commercial Paper Obligations, and the Inferior Lien Obligations, the rents, revenues and income of the Systems have not in any manner been pledged to the payment of any debt or obligation of the City or of the Systems, except that certain reimbursement agreements, indemnity agreements, credit facility agreements, and other financial or contractual arrangements which have been or may be entered into by the City grant a subordinate and inferior lien on and pledge of the Net Revenues of the Systems to secure the payment obligations of the City or the Board under these agreements, which lien is subordinate and inferior to the lien on and pledge thereof securing the payment of any Maintenance and Operating Expenses, the debt service requirements on the Senior Lien Obligations, the Junior Lien Obligations, the Bonds, the Series 2010B Bonds, the Commercial Paper Obligations, the Inferior Lien Obligations and any other provision of the ordinances authorizing the issuance of these obligations.

D. So long as any of the Bonds or any interest thereon remain Outstanding, the City will not sell or encumber the Systems or any substantial part thereof; *provided* that this shall not be construed to prohibit the sale of such machinery or other properties or equipment which has become obsolete or otherwise unsuited to the efficient operation of the Systems.

E. No free service of the Systems shall be allowed, and, should the City or any of its agents or instrumentalities make use of the services or facilities of the Systems, payments for services rendered by the Systems should either be made by the City or amounts equal in value to

the services rendered by the Systems shall be deducted from the annual payment due the General Fund of the City from the Net Revenues of the Systems as provided in Section 13 hereof.

F. To the extent it legally may, the City further covenants and agrees that, so long as any Bonds or any interest thereon are Outstanding, no franchise shall be granted for the installation or operation of any competing electric or gas system other than that owned by the City, and the operation of any such systems by anyone other than the City is hereby prohibited.

SECTION 24. Satisfaction of Obligation of City. If the City shall pay or cause to be paid, or there shall otherwise be paid to the Holders, the principal of, premium, if any, and interest on the Bonds, at the times and in the manner stipulated in this Ordinance, then the lien on and the pledge of Net Revenues and all covenants, agreements, and other obligations of the City to the Holders shall thereupon cease, terminate, and be discharged and satisfied.

The Bonds, or any principal amount(s) thereof, shall be deemed to have been paid within the meaning and with the effect expressed above in this Section when (i) money sufficient to pay in full such Bonds or the principal amount(s) thereof at Stated Maturity or to the redemption date therefor, together with all interest due thereon, shall have been irrevocably deposited with and held in trust by the Paying Agent/Registrar, or an authorized escrow agent, or (ii) Government Securities shall have been irrevocably deposited in trust with the Paying Agent/Registrar, or an authorized escrow agent, which Government Securities have been certified by an independent accounting firm to mature as to principal and interest in such amounts and at such times as will insure the availability, without reinvestment, of sufficient money, together with any money deposited therewith, if any, to pay when due the principal of and interest on such Bonds, or the principal amount(s) thereof, on and prior to the Stated Maturity thereof or (if notice of redemption has been duly given or waived or if irrevocable arrangements therefor acceptable to the Paying Agent/Registrar have been made) the redemption date thereof.

If for any reason, at any time, the cash balances on deposit or scheduled to be on deposit with the Paying Agent/Registrar or authorized escrow agent for the purpose or purposes described above shall be insufficient to accomplish the purpose or purposes for which such deposit was made, then the City shall timely deposit with the Paying Agent/Registrar or authorized escrow agent (as applicable), from lawfully available funds, additional funds in the amount of such insufficiency; provided, however, that this continuing obligation of the City shall not affect the termination, discharge, and satisfaction of the lien on and pledge of the Net Revenues and all other covenants, agreements, and obligations of the City to the Holders occurring upon the deposit of money and/or Government Securities, in the amounts specified in the preceding paragraph, with the Paying Agent/Registrar or authorized escrow agent to accomplish the economic defeasance of the subject Bonds.

Any money so deposited with the Paying Agent/Registrar, and all income from Government Securities held in trust by the Paying Agent/Registrar, or an authorized escrow agent, pursuant to this Section which is not required for the payment of the Bonds, or any principal amount(s) thereof, or interest thereon with respect to which such money has been so deposited shall be remitted to the City or deposited as directed by the City. Furthermore, any money held by the Paying Agent/Registrar for the payment of the principal of and interest on the Bonds and remaining unclaimed for a period of three (3) years after the Stated Maturity or

applicable redemption date of the Bonds, such money was deposited and is held in trust to pay shall upon the request of the City be remitted to the City against a written receipt therefor, subject to the unclaimed property laws of the State of Texas.

Notwithstanding any other provision of this Ordinance to the contrary, it is hereby provided that any determination not to redeem defeased Bonds that is made in conjunction with the payment arrangements specified in subsection (i) or (ii) above shall not be irrevocable, provided that: (1) in the proceedings providing for such defeasance, the City expressly reserves the right to call the defeased Bonds for redemption; (2) gives notice of the reservation of that right to the owners of the defeased Bonds immediately following the defeasance; (3) directs that notice of the reservation be included in any redemption notices that it authorizes; and (4) at the time of the redemption, satisfies the conditions of (i) or (ii) above with respect to such defeased debt as though it was being defeased at the time of the exercise of the option to redeem the defeased Bonds, after taking the redemption into account in determining the sufficiency of the provisions made for the payment of the defeased Bonds.

# APPENDIX E



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**CPS ENERGY**

## **FORMS OF OPINIONS OF CO-BOND COUNSELS**

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**Fulbright & Jaworski L.L.P.**  
**300 Convent Street, Suite 2200**  
**San Antonio, Texas 78205**

**West & Associates, L.L.P.**  
**111 Soledad, Suite 331**  
**San Antonio, Texas 78205**

**FINAL**

IN REGARD to the authorization and issuance of the “City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Bonds, Taxable Series 2010A (Direct Subsidy – Build America Bonds)” (the *Bonds*), dated October 1, 2010, in the aggregate principal amount of \$300,000,000, we have reviewed the legality and validity of the issuance thereof by the City of San Antonio, Texas (the *City*). The Bonds are issuable in fully registered form only, in denominations of \$5,000 or any integral multiple thereof, and have a Stated Maturity of February 1, 2041, unless mandatorily or optionally redeemed prior to Stated Maturity in accordance with the terms stated on the face of the Bonds. Interest on the Bonds accrues from the dates, at the rates, in the manner, and is payable on the dates, all as provided in the ordinance (the *Ordinance*) authorizing the issuance of the Bonds.

WE HAVE SERVED AS CO-BOND COUNSEL for the City solely to pass upon the legality and validity of the issuance of the Bonds under the laws of the State of Texas and for no other purpose. We have not been requested to investigate or verify, and have not independently investigated or verified, any records, data, or other material relating to the financial condition or capabilities of the City or the Systems and have not assumed any responsibility with respect to the financial condition or capabilities of the City or the disclosure thereof in connection with the sale of the Bonds. We express no opinion and make no comment with respect to the sufficiency of the security for or the marketability of the Bonds. Our role in connection with the City’s Official Statement prepared for use in connection with the sale of the Bonds has been limited as described therein.

WE HAVE EXAMINED the applicable and pertinent laws of the State of Texas and the United States of America. In rendering the opinions herein we rely upon, original or certified copies of the proceedings of the City Council of the City in connection with the issuance of the Bonds, including the Ordinance and the Paying Agent/Registrar Agreement between the City and The Bank of New York Mellon Trust Company, N.A., Dallas, Texas; a resolution adopted by the Board of Trustees (the *Board*) of the City Public Service Board of San Antonio, Texas; customary certifications and opinions of officials of the City and the Board; certificates executed by officers of the City and the Board relating to the expected use and investment of proceeds of the Bonds and certain other funds of the City and the Board, and to certain other facts within the knowledge and control of the City and the Board; and such other documentation, including an examination of the Bond executed and delivered initially by the City, which we found to be in due form and properly executed, and such matters of law as we deem relevant to the matters discussed below. In such examination, we have assumed the authenticity of all documents submitted to us as originals, the conformity to original copies of all documents submitted to us as certified copies, and the accuracy of the statements and information contained in such

**Legal Opinion of Fulbright & Jaworski L.L.P. and West & Associates, L.L.P. in connection with the authorization and issuance of “CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS JUNIOR LIEN REVENUE BONDS, TAXABLE SERIES 2010A (DIRECT SUBSIDY - BUILD AMERICA BONDS)”**

certificates. We express no opinion concerning any effect on the following opinions which may result from changes in law effected after the date hereof.

BASED ON OUR EXAMINATION, IT IS OUR OPINION that the Bonds have been duly authorized and issued in conformity with the laws of the State of Texas now in force and that the Bonds are valid and legally binding special obligations of the City enforceable in accordance with the terms and conditions described therein, except to the extent that the enforceability thereof may be affected by bankruptcy, insolvency, reorganization, moratorium, or other similar laws affecting creditors' rights or the exercise of judicial discretion in accordance with general principles of equity. The Bonds are payable from and equally and ratably secured, together with the currently outstanding Junior Lien Obligations and the Series 2010B Bonds (each as defined in the Ordinance), solely by a junior and inferior lien on and pledge of the Net Revenues (as defined in the Ordinance), such lien on and pledge of the Net Revenues being expressly junior and inferior to the lien on and pledge of Net Revenues as security for the payment of the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations (each as defined in the Ordinance) hereafter issued by the City in accordance with the Ordinance. In the Ordinance, the City retains the right to issue Additional Senior Lien Obligations, Additional Junior Lien Obligations, Commercial Paper Obligations, and Inferior Lien Obligations (each as defined in the Ordinance), without limitation as to principal amount but subject to any terms, conditions, or restrictions as may be applicable thereto under law or otherwise. The Bonds do not constitute a legal or equitable pledge, charge, lien, or encumbrance upon any property of the City, the Board or the Systems, except with respect to the Net Revenues. The holder of the Bonds shall never have the right to demand payment of the Bonds out of any funds raised or to be raised by taxation.

OUR OPINIONS ARE BASED on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective.

IRS CIRCULAR 230 DISCLOSURE:

TO ENSURE COMPLIANCE WITH REQUIREMENTS IMPOSED BY THE IRS, WE INFORM YOU THAT ANY U.S. FEDERAL TAX ADVICE CONTAINED IN THIS COMMUNICATION (INCLUDING ANY ATTACHMENTS) IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, FOR THE PURPOSE OF (I) AVOIDING PENALTIES UNDER THE INTERNAL REVENUE CODE OR (II) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY TRANSACTION OR TAX-RELATED MATTER[S].

**Fulbright & Jaworski L.L.P.**  
300 Convent Street, Suite 2200  
San Antonio, Texas 78205

**Shelton & Valadez, P.C.**  
600 Navarro, Suite 500  
San Antonio, Texas 78205

**FINAL**

IN REGARD to the authorization and issuance of the “City of San Antonio, Texas Electric and Gas Systems Junior Lien Revenue Refunding Bonds, Taxable Series 2010B (Direct Subsidy – Build America Bonds)” (the *Bonds*), dated October 1, 2010, in the aggregate principal amount of \$200,000,000, we have reviewed the legality and validity of the issuance thereof by the City of San Antonio, Texas (the *City*). The Bonds are issuable in fully registered form only, in denominations of \$5,000 or any integral multiple thereof, and have a Stated Maturity of February 1, 2037, unless mandatorily or optionally prior to Stated Maturity in accordance with the terms stated on the face of the Bonds. Interest on the Bonds accrues from the dates, at the rates, in the manner, and is payable on the dates, all as provided in the ordinance (the *Ordinance*) authorizing the issuance of the Bonds.

WE HAVE SERVED AS CO-BOND COUNSEL for the City solely to pass upon the legality and validity of the issuance of the Bonds under the laws of the State of Texas and for no other purpose. We have not been requested to investigate or verify, and have not independently investigated or verified, any records, data, or other material relating to the financial condition or capabilities of the City or the Systems and have not assumed any responsibility with respect to the financial condition or capabilities of the City or the disclosure thereof in connection with the sale of the Bonds. We express no opinion and make no comment with respect to the sufficiency of the security for or the marketability of the Bonds. Our role in connection with the City’s Official Statement prepared for use in connection with the sale of the Bonds has been limited as described therein.

WE HAVE EXAMINED the applicable and pertinent laws of the State of Texas and the United States of America. In rendering the opinions herein we rely upon, original or certified copies of the proceedings of the City Council of the City in connection with the issuance of the Bonds, including the Ordinance, the Paying Agent/Registrar Agreement between the City and The Bank of New York Mellon Trust Company, N.A., Dallas, Texas, and the Escrow and Trust Agreement (the *Escrow Agreement*) between the City and The Bank of New York Mellon Trust Company, N.A., Dallas, Texas (the *Escrow Agent*), and a special report (the *Report*) of Grant Thornton LLP, Minneapolis, Minnesota (the *Accountants*); a resolution adopted by the Board of Trustees (the *Board*) of the City Public Service Board of San Antonio, Texas; customary certifications and opinions of officials of the City and the Board; certificates executed by officers of the City and the Board relating to the expected use and investment of proceeds of the Bonds and certain other funds of the City and the Board, and to certain other facts within the knowledge and control of the City and the Board; and such other documentation, including an examination of the Bond executed and delivered initially by the City, which we found to be in due form and properly executed, and such matters of law as we deem relevant to the matters discussed below. In such

**Legal Opinion of Fulbright & Jaworski L.L.P. and Shelton & Valadez, P.C. in connection with the authorization and issuance of “CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS JUNIOR LIEN REVENUE REFUNDING BONDS, TAXABLE SERIES 2010B (DIRECT SUBSIDY - BUILD AMERICA BONDS)”**

examination, we have assumed the authenticity of all documents submitted to us as originals, the conformity to original copies of all documents submitted to us as certified copies, and the accuracy of the statements and information contained in such certificates. We express no opinion concerning any effect on the following opinions which may result from changes in law effected after the date hereof.

BASED ON OUR EXAMINATION, IT IS OUR OPINION that the Bonds have been duly authorized and issued in conformity with the laws of the State of Texas now in force and that the Bonds are valid and legally binding special obligations of the City enforceable in accordance with the terms and conditions described therein, except to the extent that the enforceability thereof may be affected by bankruptcy, insolvency, reorganization, moratorium, or other similar laws affecting creditors’ rights or the exercise of judicial discretion in accordance with general principles of equity. The Bonds are payable from and equally and ratably secured, together with the currently outstanding Junior Lien Obligations and the Series 2010A Bonds (each as defined in the Ordinance), solely by a junior and inferior lien on and pledge of the Net Revenues (as defined in the Ordinance), such lien on and pledge of the Net Revenues being expressly junior and inferior to the lien on and pledge of Net Revenues as security for the payment of the currently outstanding Senior Lien Obligations and any Additional Senior Lien Obligations (each as defined in the Ordinance) hereafter issued by the City in accordance with the Ordinance. In the Ordinance, the City retains the right to issue Additional Senior Lien Obligations, Additional Junior Lien Obligations, Commercial Paper Obligations and Inferior Lien Obligations (each as defined in the Ordinance), without limitation as to principal amount but subject to any terms, conditions, or restrictions as may be applicable thereto under law or otherwise. The Bonds do not constitute a legal or equitable pledge, charge, lien, or encumbrance upon any property of the City, the Board, or the Systems, except with respect to the Net Revenues. The holder of the Bonds shall never have the right to demand payment of the Bonds out of any funds raised or to be raised by taxation.

BASED ON OUR EXAMINATION, IT IS OUR OPINION that the Escrow Agreement has been duly authorized, executed, and delivered by the City and, assuming due authorization, execution, and delivery thereof by the Escrow Agent, is a valid and binding obligation, enforceable in accordance with its terms (except to the extent that the enforceability thereof may be affected by bankruptcy, insolvency, reorganization, moratorium, or other similar laws affecting creditors’ rights or the exercise of judicial discretion in accordance with general principles of equity), and that the outstanding obligations refunded, discharged, paid, and retired with the proceeds of the Bonds have been defeased and are regarded as being outstanding only for the purpose of receiving payment from the funds held in trust with the Escrow Agent, pursuant to the Escrow Agreement, the ordinance authorizing their issuance, and in accordance with the provisions of Chapter 1207, as amended, Texas Government Code. In rendering this opinion, we have relied upon the Report of the Accountants of the sufficiency of cash and investments deposited with the

**Legal Opinion of Fulbright & Jaworski L.L.P. and Shelton & Valadez, P.C. in connection with the authorization and issuance of “CITY OF SAN ANTONIO, TEXAS ELECTRIC AND GAS SYSTEMS JUNIOR LIEN REVENUE REFUNDING BONDS, TAXABLE SERIES 2010B (DIRECT SUBSIDY - BUILD AMERICA BONDS)”**

Escrow Agent pursuant to the Escrow Agreement for the purposes of paying the outstanding obligations refunded and to be retired with the proceeds of the Bonds and the interest thereon.

OUR OPINIONS ARE BASED on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective.

IRS CIRCULAR 230 DISCLOSURE:

TO ENSURE COMPLIANCE WITH REQUIREMENTS IMPOSED BY THE IRS, WE INFORM YOU THAT ANY U.S. FEDERAL TAX ADVICE CONTAINED IN THIS COMMUNICATION (INCLUDING ANY ATTACHMENTS) IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED, FOR THE PURPOSE OF (I) AVOIDING PENALTIES UNDER THE INTERNAL REVENUE CODE OR (II) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY TRANSACTION OR TAX-RELATED MATTER[S].

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**CPS ENERGY**

**TABLE OF REFUNDED OBLIGATIONS**

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**TABLE OF REFUNDED OBLIGATIONS**

City of San Antonio, Texas Electric and Gas Systems Commercial Paper Notes, Series A

Dealer: JPMorgan Chase, N. A.

Issue Date Date	Maturity Date	Principal Amount	Interest Amount	Interest (%)	Payment Amount
10/27/2010	11/05/2010	\$ 12,000,000.00	\$ 887.68	0.30	\$ 12,000,887.68
10/29/2010	11/05/2010	3,700,000.00	212.88	0.30	3,700,212.88
10/29/2010	11/05/2010	21,400,000.00	1,272.27	0.30	21,401,272.27
10/29/2010	11/05/2010	50,000,000.00	2,972.60	0.31	50,002,972.60
10/29/2010	11/05/2010	50,000,000.00	2,972.60	0.31	50,002,972.60
10/29/2010	11/05/2010	50,000,000.00	2,972.60	0.31	50,002,972.60
11/04/2010	11/05/2010	4,000,000.00	1,643.84	15.00 <sup>1</sup>	4,001,643.84
11/04/2010	11/05/2010	1,750,000.00	719.18	15.00 <sup>1</sup>	1,750,719.18
11/04/2010	11/05/2010	7,150,000.00	2,938.36	15.00 <sup>1</sup>	7,152,938.36
		<u>\$ 200,000,000.00</u>	<u>\$ 16,592.01</u>		<u>\$ 200,016,592.01</u>

(1) Not actual interest rates. Funded at the maximum lawful rate, for purposes of compliance with applicable Texas law.

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# APPENDIX G



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## CPS ENERGY

### PRINCIPAL PAYDOWN FACTOR TABLE

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**PRINCIPAL PAYDOWN FACTOR TABLE**

PRO RATA PASS THROUGH DISTRIBUTION OF PRINCIPAL

2041 Series 2010A Term Bond Principal Paydown Factor Table

Redemption/Principal Paydown Dates (February 1)	Mandatory Sinking Fund/Paydown Amounts	Paydown Amount per \$1,000	Remaining Balance per \$1,000	Paydown Factor	Remaining Bond Factor
	\$ -	\$ -	\$ 1,000.00	-	1.000000
2038	\$ 52,475,000	\$ 174.92	\$ 825.08	0.174917	0.825083
2039	\$ 53,550,000	\$ 178.50	\$ 646.58	0.178500	0.646583
2040	\$ 95,685,000	\$ 318.95	\$ 327.63	0.318950	0.327633
2041	\$ 98,290,000	\$ 327.63	\$ -	0.327633	0.000000

2037 Series 2010B Term Bond Principal Paydown Factor Table

Redemption/Principal Paydown Dates (February 1)	Mandatory Sinking Fund/Paydown Amounts	Paydown Amount per \$1,000	Remaining Balance per \$1,000	Paydown Factor	Remaining Bond Factor
	\$ -	\$ -	\$ 1,000.00	-	1.000000
2034	\$ 50,045,000	\$ 250.22	\$ 749.78	0.250225	0.749775
2035	\$ 48,750,000	\$ 243.75	\$ 506.03	0.243750	0.506025
2036	\$ 49,985,000	\$ 249.93	\$ 256.10	0.249925	0.256100
2037	\$ 51,220,000	\$ 256.10	\$ -	0.256100	0.000000

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MUNICIPALLY OWNED ELECTRIC & GAS UTILITY  
**SAN ANTONIO, TEXAS 2010**

