



City Public Service of San Antonio, Texas

Basic Financial Statements
For the Fiscal Years Ended January 31, 2011 and 2010

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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, 2011 ("FY 2011"), compared to the fiscal year ended January 31, 2010 ("FY 2010"). It also provides an overview of CPS Energy's general financial condition and results of operations for FY 2010 compared to the previous fiscal year ended January 31, 2009 ("FY 2009"). 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") and pension obligations, other deferred costs and net capital assets.

Liabilities are also segregated into current and noncurrent categories. Current liabilities include the current maturities of debt, 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 cash flows from operating activities, capital and related financing activities, noncapital financing activities, and investing activities. These statements are prepared using the direct method, which reports gross 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 in FY 2010 to include both a debt and an equity component. The blended rate is composed of 50% equity and 50% debt based on construction funding forecasts. Both the investment rate and the debt rate will continue to be reviewed quarterly to determine if any adjustments are necessary. Alternate AFUDC rates are applied to projects costing more than \$100 million, reflecting 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 were issuable in calendar years 2009 and 2010 as taxable bonds. The BABs permit the issuer to receive subsidy payments equal to 35% of the bond’s interest costs directly from the U.S. Department of the Treasury. Transaction details for CPS Energy’s BABs issuances are provided in Note 6 – Revenue Bonds.

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 \$25.1 million at January 31, 2011, as compared with \$39.0 million at January 31, 2010, including donated assets of \$7.3 million and \$13.4 million, respectively. The portion of these balances that represent contributions received from customers as payments for utility extensions and services was \$17.5 million at January 31, 2011, and \$25.5 million at January 31, 2010.

Counterparty Risk – CPS Energy is exposed to counterparty risk associated with various transactions primarily related to debt, investments, fuel hedging, 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 & Solutions 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 determined by the most recent cost study) was recognized as a liability. In subsequent years, annual

decommissioning expense and an increase in the liability 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 Board (“FASB”) Statement No. 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 FASB Statement No. 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.

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 10 – Other Postemployment Benefits.

Federal Grant Programs – Federal stimulus funds have been made available to CPS Energy as a subrecipient for a portion of the grant funds allocated to the state of Texas for a number of programs under the American Recovery and Reinvestment Act of 2009. Used primarily for the weatherization of qualifying homes, grant receipts are recorded as nonoperating income and are to reimburse CPS Energy for costs, recorded as operating expenses, incurred in the administration of the program. This accounting treatment results in no impact to fund net assets. Revenues associated with the stimulus programs are exempt from City payment.

Flexible Rate Revolving Note (“FRRN”) 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 through annual renewals authorizes the issuance of such notes through November 1, 2028. The FRRN has been classified as short-term in accordance with the financing terms under the Note Purchase Agreement. At January 31, 2011, the note outstanding under this program totaled \$25.2 million. There was no outstanding balance at January 31, 2010. See Note 8 – Flexible Rate Revolving Note.

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. In FY 2011, 25% of distribution and 35% of generation natural gas volumes were hedged. GASB Statement No. 53 and its impact on the financial statements are addressed in Note 12 – Other Financial Instruments.

New Generation Assets – In FY 2011, CPS Energy brought new generation facilities on-line, J.K. Spruce Unit 2 (“Spruce 2”) and the four V.H. Braunig (“VHB”) peaking units. These facilities were tested prior to commercial operation, and the power that was produced during this testing period is referred to as precommercial generation. In accordance with Federal Energy Regulatory Commission (“FERC”) guidance, revenues and expenses associated with precommercial generation were capitalized as components of construction costs.

Nodal Market Implementation – On December 1, 2010, the Electric Reliability Council of Texas (“ERCOT”) went from a zonal market with four congestion management zones to a nodal market with more than 4,000 pricing nodes. In the nodal market design, generators are required to make their capacity and ancillary services available to ERCOT, and load-serving entities purchase their supply needs from ERCOT in the day-ahead market and true up in the real-time market. As both a generator and load-serving entity, CPS Energy is an active participant in the new nodal market design.

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 9 – Employee Pension Plan.

Rate Increase – Rates are set by the Board and approved by the San Antonio 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.

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 projected to spend approximately \$849 million over the next 12 years on energy efficiency and conservation through STEP. Annually, the first \$8 million of STEP expenses are funded through the electric base rate and reported as CPS Energy operation and maintenance (“O&M”) expenses.

STEP expenses over the initial \$8 million per year are recovered through the fuel adjustment factor over a twelve-month period beginning in the subsequent fiscal year after they are incurred and have been independently validated. These STEP recoveries are deferred as STEP net costs recoverable in accordance with guidance provided by FASB Statement No. 71. This guidance requires that certain costs be capitalized as a regulatory asset until they are recovered through future rates.

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 Units 1 and 2 – 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 FASB. See Note 14 – South Texas Project.

STP Units 3 and 4 – 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. Excluding AFUDC of \$21.0 million, project costs incurred by CPS Energy to date of \$370.0 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 14 – 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			
	2011	2010	2009	2011 vs. 2010	2010 vs. 2009		
Revenues and nonoperating income							
Electric	\$ 1,846,046	\$ 1,717,077	\$ 1,899,457	\$ 128,969	7.5%	\$ (182,380)	-9.6%
Gas	222,640	213,798	251,884	8,842	4.1%	(38,086)	-15.1%
Total operating revenues	2,068,686	1,930,875	2,151,341	137,811	7.1%	(220,466)	-10.2%
Nonoperating income, net	46,285	44,329	72,008	1,956	4.4%	(27,679)	-38.4%
Total revenues and nonoperating income	2,114,971	1,975,204	2,223,349	139,767	7.1%	(248,145)	-11.2%
Expenses							
Operating expenses							
Fuel, purchased power and distribution gas	671,110	689,225	899,314	(18,115)	-2.6%	(210,089)	-23.4%
STP operation and maintenance	143,813	142,865	139,073	948	0.7%	3,792	2.7%
CPS Energy operation and maintenance	322,708	299,420	303,284	23,288	7.8%	(3,864)	-1.3%
Annual OPEB cost	7,405	8,798	13,054	(1,393)	-15.8%	(4,256)	-32.6%
Annual pension cost	33,957	23,503	20,590	10,454	44.5%	2,913	14.1%
Grant program expenditures	6,890	30	-	6,860	22866.7%	30	-
Energy efficiency and conservation (STEP)	19,816	12,599	-	7,217	57.3%	12,599	-
STEP net costs recoverable	(12,302)	(12,599)	-	297	-2.4%	(12,599)	-
Regulatory assessments	42,980	36,051	31,257	6,929	19.2%	4,794	15.3%
Decommissioning	21,340	24,310	21,201	(2,970)	-12.2%	3,109	14.7%
Depreciation and amortization	321,998	285,823	283,398	36,175	12.7%	2,425	0.9%
Total operating expenses	1,579,715	1,510,025	1,711,171	69,690	4.6%	(201,146)	-11.8%
Nonoperating expenses							
Interest and debt-related	174,833	133,743	139,485	41,090	30.7%	(5,742)	-4.1%
Payments to the City of San Antonio	276,863	260,636	282,140	16,227	6.2%	(21,504)	-7.6%
Total nonoperating expenses	451,696	394,379	421,625	57,317	14.5%	(27,246)	-6.5%
Total expenses	2,031,411	1,904,404	2,132,796	127,007	6.7%	(228,392)	-10.7%
Income before other changes in fund net assets							
	83,560	70,800	90,553	12,760	18.0%	(19,753)	-21.8%
Other payments to the City of San Antonio	(15,054)	(11,980)	(9,203)	(3,074)	25.7%	(2,777)	30.2%
CIED distributions	(750)	-	-	(750)	-	-	-
Contributed capital	25,107	38,991	30,218	(13,884)	-35.6%	8,773	29.0%
Effect of defined benefit plan funding obligations - STP							
	(14,072)	9,788	(29,726)	(23,860)	-243.8%	39,514	-132.9%
Change in fund net assets	78,791	107,599	81,842	(28,808)	-26.8%	25,757	31.5%
Fund net assets - beginning	3,219,150	3,111,551	3,029,709	107,599	3.5%	81,842	2.7%
Fund net assets - ending	\$ 3,297,941	\$ 3,219,150	\$ 3,111,551	\$ 78,791	2.4%	\$ 107,599	3.5%

Total Revenues and Nonoperating Income

FY 2011 – Representing 97.8% of total revenues and nonoperating income, electric and gas revenues of \$2.1 billion increased by \$137.8 million, or 7.1%, compared to FY 2010. Additionally, CPS Energy had \$46.3 million in net nonoperating income for FY 2011 compared to \$44.3 million for FY 2010.

Electric energy is primarily generated from three sources—coal, nuclear and gas/oil. Approximately 85.9% and 84.0% of its customers' electric energy needs in FY 2011 and FY 2010, respectively, were produced from CPS Energy's generating units. To meet its total sales requirements for retail customers within the greater San Antonio certificated area, combined with its sales to wholesale customers outside of this area, energy is also purchased from third-party providers. This purchased power includes renewables, such as wind-generated and solar-generated energy.

Representing 87.3% of CPS Energy's total revenues and nonoperating income, electric operating revenue of \$1.8 billion increased \$129.0 million from FY 2010. Contributing to this increase were higher system nonfuel recoveries primarily due to the increase in the base rate effective in March 2010,

See accompanying independent auditors' report.

partially offset by lower fuel recoveries that were passed through to customers. Customer growth for FY 2011 contributed to a portion of the increase in nonfuel recoveries in comparison to FY 2010. Also contributing to higher electric operating revenue were higher off-system revenues due to more capacity available for wholesale market sales.

Representing 10.5% of total revenues and nonoperating income, gas revenue for FY 2011 totaled \$222.6 million, an \$8.8 million increase from FY 2010. The increase was due to higher nonfuel recoveries resulting from an increase in the base rate effective in March 2010 and higher sales volumes. The increase was partially offset by lower fuel recoveries as a result of lower unit costs.

Net nonoperating income of \$46.3 million increased \$2.0 million from FY 2010. This was primarily due to an increase in STP decommissioning net cost recoverable of \$13.1 million and an increase in grant program revenues of \$6.9 million. The increase was offset by a decrease in the change in fair value of \$2.0 million for CPS Energy's investments and a decrease in STP decommissioning investment income and change in fair value of \$16.1 million.

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.

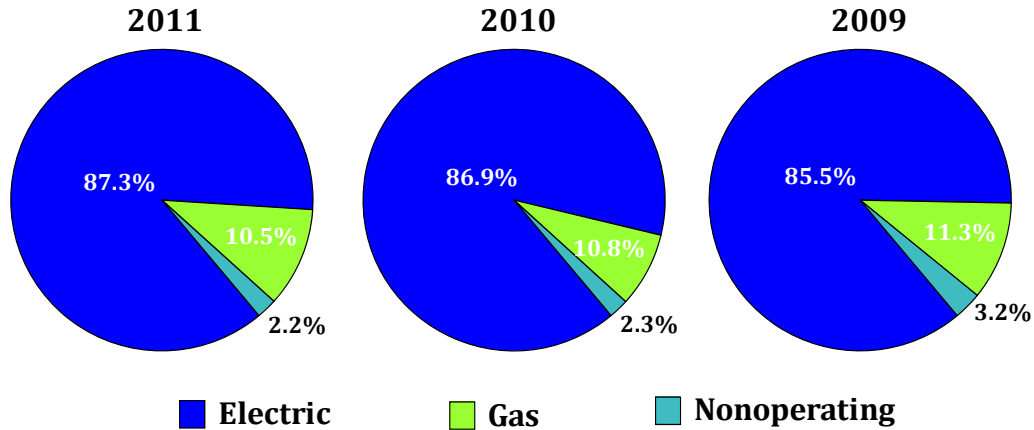
Approximately 84.0% and 89.0% of its customers' electric energy needs for FY 2010 and FY 2009, respectively, were produced from CPS Energy's generating units.

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 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.

**Total Revenues and Nonoperating Income
Fiscal Year Ended January 31,**



Operating Expenses

FY 2011 – Operating expenses totaled \$1.6 billion and were \$69.7 million, or 4.6%, higher than last year’s total of \$1.5 billion.

Within total operating expenses, the combined fuel, purchased power and distribution gas costs of \$671.1 million decreased \$18.1 million and represented 42.5% of total operating expenses. Of the \$671.1 million, electric fuel and purchased power costs decreased \$14.9 million from FY 2010 to \$547.2 million due to a decrease in the average unit fuel cost resulting from the addition of Spruce 2, a new coal plant that supplies fuel at a lower per-unit cost. Distribution gas costs of \$123.9 million decreased by \$3.2 million from last year due to a decrease in the average unit fuel cost.

STP O&M expenses of \$143.8 million were comparable at \$0.9 million, or 0.7%, above last year.

CPS Energy’s O&M expenses of \$364.1 million, including annual OPEB and pension costs, were \$32.3 million higher than last year primarily due to cost reduction initiatives in the prior fiscal year.

Grant program expenditures were \$6.9 million in FY 2011 compared to \$30.0 thousand in the prior year as the program was in its initial stages last year.

Energy efficiency & conservation (STEP) expense was \$19.8 million compared to \$12.6 million last year. This amount represents costs incurred above the \$8 million funded through the base rate and recorded as CPS Energy O&M expenses.

Developed as a contra account to the item directly above, STEP net costs recoverable through future rates, was \$(12.3) million, which is comparable to \$(12.6) million for last year. This operating statement item reflects the transfer of these costs to the Balance Sheets.

Regulatory assessments, including those charged by the Public Utility Commission of Texas (“PUCT”) and ERCOT, increased \$6.9 million from FY 2010 to \$43.0 million. This was primarily due to increases in transmission costs of service (“TCOS”).

Decommissioning expense for FY 2011 totaled \$21.3 million, which was \$3.0 million lower than FY 2010. The decrease was due to a change in the inflation factor applied.

See accompanying independent auditors’ report.

Depreciation and amortization expense of \$322.0 million was \$36.2 million, or 12.7%, more than last year due to the increase in plant-in-service in the current year resulting from CPS Energy's new generation assets.

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 of \$562.1 million decreased by \$172.8 million from FY 2009 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 FY 2009. There were two refueling outages in the prior year versus one unplanned outage and one planned refueling outage in the current year; however, the FY 2010 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 \$8.0 million funded through the base rate and recorded as CPS Energy O&M expenses. As the STEP program was new in FY 2010, the \$12.6 million accounted for the entire variance over the prior fiscal year.

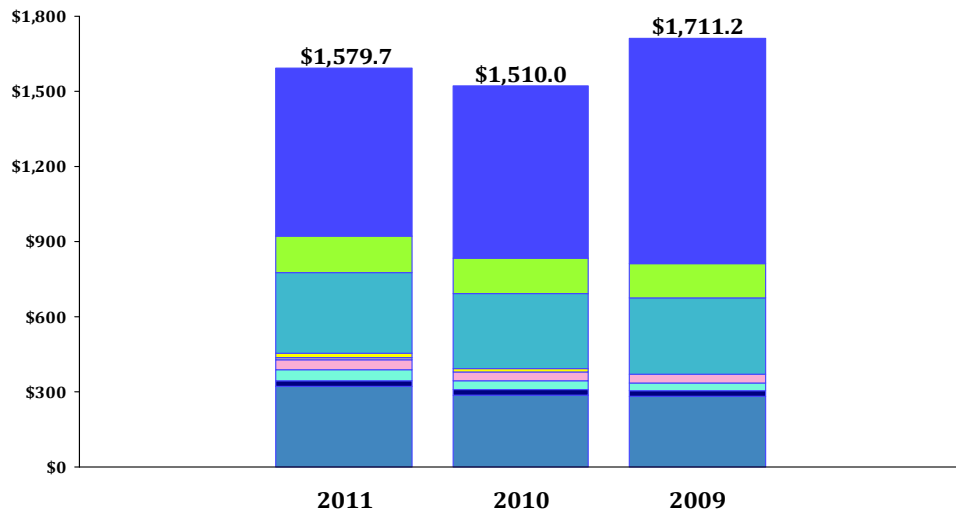
STEP net costs recoverable was \$(12.6) million. This reflects the deferral of these costs as a regulatory asset on the Balance Sheets to be recovered through future rates. As the STEP program was new, the \$(12.6) million accounted for the entire variance over the prior year.

Regulatory assessments, including those charged by the PUCT and ERCOT, increased \$4.8 million from FY 2009 to \$36.1 million. This was primarily due to increases in TCOS in the Texas market. 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.

Total Operating Expenses
 Fiscal Year Ended January 31,
 (In millions)



	2011	2010	2009
Fuel, purchased power and distribution gas	\$671.1	\$689.2	\$899.3
STP O&M	143.8	142.9	139.1
CPS Energy O&M	322.7	299.4	303.3
Annual OPEB and pension costs	41.4	32.3	33.6
Grant program expenditures	6.9	-	-
Energy efficiency and conservation (STEP)	19.8	12.6	-
STEP net costs recoverable	(12.3)	(12.6)	-
Regulatory assessments	43.0	36.1	31.3
Decommissioning	21.3	24.3	21.2
Depreciation and amortization	322.0	285.8	283.4

Nonoperating Expenses

FY 2011 – Interest expense and other debt-related costs of \$174.8 million were \$41.1 million higher than last year due to a higher level of senior lien debt obligations. Additionally, capitalized interest, also known as Allowance for Funds Used During Construction (“AFUDC”), was lower due to a decrease in assets under construction as new generation units went into commercial operation.

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 Systems revenues can be remitted to the City each year. The recorded payments to the City were \$276.9 million, which was \$16.2 million more than last year primarily due to the higher revenues that were driven by the increase in wholesale sales and the base rate increase that took effect in March 2010. See Other Changes in Fund Net Assets for information on other payments to the City.

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 Spruce 2, the VHB peaking units and spending toward the development of STP Units 3 and 4.

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 lower fuel recoveries.

See accompanying independent auditors’ report.

Other Changes in Fund Net Assets

FY 2011 – The year-to-date income before other changes in fund net assets totaled \$83.6 million for FY 2011, an increase of \$12.8 million from FY 2010. Primarily contributing to this variance was higher operating income resulting from stronger wholesale sales and the base rate increases, offset by higher nonoperating expenses. The additional favorable variance, which flows to the Repair and Replacement Account, provides additional funding for the capital program.

In FY 2011, the Company recorded \$15.1 million in other payments to the City, of which \$10.1 million was in lieu of Community Infrastructure and Economic Development (“CIED”) funding and \$5.0 million was from the CIED Fund (see Note 1 – Summary of Significant Accounting Policies for further information). Total payments to the City did not exceed the 14% of gross revenue limitation as required by bond ordinance. In addition, CPS Energy recorded a \$750.0 thousand payment to Bexar County for CIED funding.

The Company recorded \$25.1 million in contributed capital from third parties, a decrease of \$13.9 million from last year. Additionally, this year’s effect on fund net assets for the STP defined benefit plan funding obligations was a reduction of \$14.1 million compared to an increase of \$9.8 million last year due to a change in assumptions (see Note 14 – South Texas Project for more details on assumptions). This represents 40% of the adjustment for the unfunded pension and other post-retirement benefits liability at STP.

After recording the above adjustments, CPS Energy’s change in fund net assets for FY 2011 was \$78.8 million, a decrease of \$28.8 million from last year.

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 in FY 2010, 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 CIED funding and \$2.3 million was from the CIED Fund. 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	
	2011	2010	2009	2011 vs. 2010	2010 vs. 2009
Assets					
Current assets	\$ 768,015	\$ 866,159	\$ 1,064,921	\$ (98,144) -11.3%	\$ (198,762) -18.7%
Noncurrent assets					
Restricted assets	1,247,310	821,794	729,504	425,516 51.8%	92,290 12.7%
Other noncurrent assets	503,087	510,231	512,292	(7,144) -1.4%	(2,061) -0.4%
Capital assets, net	7,217,041	7,064,193	6,409,849	152,848 2.2%	654,344 10.2%
Total assets	<u>\$ 9,735,453</u>	<u>\$ 9,262,377</u>	<u>\$ 8,716,566</u>	<u>\$ 473,076</u> 5.1%	<u>\$ 545,811</u> 6.3%
Liabilities					
Current liabilities	\$ 539,860	\$ 646,506	\$ 803,988	\$ (106,646) -16.5%	\$ (157,482) -19.6%
Long-term debt, net	4,862,548	4,407,284	3,844,121	455,264 10.3%	563,163 14.6%
Other noncurrent liabilities	1,035,104	989,437	956,906	45,667 4.6%	32,531 3.4%
Total liabilities	<u>6,437,512</u>	<u>6,043,227</u>	<u>5,605,015</u>	<u>394,285</u> 6.5%	<u>438,212</u> 7.8%
Fund net assets					
Invested in capital assets, net of related debt	2,525,771	2,585,351	2,469,539	(59,580) -2.3%	115,812 4.7%
Restricted	449,821	338,412	352,392	111,409 32.9%	(13,980) -4.0%
Unrestricted	322,349	295,387	289,620	26,962 9.1%	5,767 2.0%
Total fund net assets	<u>3,297,941</u>	<u>3,219,150</u>	<u>3,111,551</u>	<u>78,791</u> 2.4%	<u>107,599</u> 3.5%
Total liabilities and fund net assets	<u>\$ 9,735,453</u>	<u>\$ 9,262,377</u>	<u>\$ 8,716,566</u>	<u>\$ 473,076</u> 5.1%	<u>\$ 545,811</u> 6.3%

Current Assets

FY 2011 – Current assets at January 31, 2011, of \$768.0 million were \$98.1 million lower than the balance at January 31, 2010. The largest contributor was a decrease of \$35.5 million in General Account cash and investments used primarily to lower CPS Energy's accounts payable and accrued liabilities, as well as STP's operation, maintenance and construction payables. In addition, customer accounts receivable decreased \$33.3 million primarily due to lower fuel commodity costs, prepayments decreased \$9.7 million, and securities lending cash collateral was \$29.8 million lower due to a change in the mix between securities collateral and cash collateral. The overall decreases were partially offset by \$12.4 million higher miscellaneous receivables.

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.

Noncurrent Restricted Assets

FY 2011 – Noncurrent restricted assets totaled \$1.2 billion as of January 31, 2011, an increase of \$425.5 million compared to January 31, 2010. The overall increase was largely attributable to increases of \$279.6 million for the Capital Projects Fund from proceeds from the 2010A Senior Lien and 2010A Junior Lien Bond issuances, \$123.1 million for the Repair and Replacement Account, and \$35.8 million in

See accompanying independent auditors' report.

the Decommissioning Trusts. Partially offsetting the increases were decreases of \$10.2 million in the CIED fund and \$2.7 million in the Debt Service Fund.

FY 2010 – Noncurrent restricted 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.

Other Noncurrent Assets

FY 2011 – Other noncurrent assets decreased to \$503.1 million at January 31, 2011, from \$510.2 million at January 31, 2010. The \$7.1 million decrease related 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, \$6.6 million lower net OPEB obligations, and \$1.6 million lower net pension obligations. Partially offsetting these decreases were \$7.3 million higher STEP net costs recoverable, a \$7.6 million increase related to fuel hedges, a \$4.6 million increase in unamortized bond expense as a result of bond activity in FY 2011, and a \$0.9 million increase for deferred preliminary survey expense.

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 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 FY 2010.

Capital Assets, Net

Summary of Capital Assets
Net of Accumulated Depreciation and Amortization

(Dollars in thousands)

	January 31,			Change			
	2011	2010	2009	2011 vs. 2010		2010 vs. 2009	
Nondepreciable assets							
Land	\$ 41,023	\$ 33,151	\$ 31,939	\$ 7,872	23.7%	\$ 1,212	3.8%
Land easements	78,278	73,999	67,183	4,279	5.8%	6,816	10.1%
Construction-in-progress	671,735	1,893,686	1,346,182	(1,221,951)	-64.5%	547,504	40.7%
Total nondepreciable assets	791,036	2,000,836	1,445,304	(1,209,800)	-60.5%	555,532	38.4%
Nuclear fuel	82,572	107,092	70,750	(24,520)	-22.9%	36,342	51.4%
Depreciable assets							
Electric plant							
Buildings and structures	561,848	542,426	560,527	19,422	3.6%	(18,101)	-3.2%
Systems and improvements	4,877,583	3,551,285	3,463,405	1,326,298	37.3%	87,880	2.5%
Machinery and equipment	(5,798)	(2,742)	(1,300)	(3,056)	-111.5%	(1,442)	-110.9%
Total electric plant	5,433,633	4,090,969	4,022,632	1,342,664	32.8%	68,337	1.7%
Gas plant							
Buildings and structures	17	2	3	15	750.0%	(1)	-33.3%
Systems and improvements	434,195	418,294	408,895	15,901	3.8%	9,399	2.3%
Total gas plant	434,212	418,296	408,898	15,916	3.8%	9,398	2.3%
General plant							
Buildings and structures	121,180	121,593	121,854	(413)	-0.3%	(261)	-0.2%
Machinery and equipment	258,787	249,671	268,248	9,116	3.7%	(18,577)	-6.9%
Software	91,324	71,073	63,908	20,251	28.5%	7,165	11.2%
Other	4,297	4,663	8,255	(366)	-7.8%	(3,592)	-43.5%
Total general plant	475,588	447,000	462,265	28,588	6.4%	(15,265)	-3.3%
Total depreciable assets	6,343,433	4,956,265	4,893,795	1,387,168	28.0%	62,470	1.3%
Total capital assets, net	\$ 7,217,041	\$ 7,064,193	\$ 6,409,849	\$ 152,848	2.2%	\$ 654,344	10.2%

FY 2011 – At January 31, 2011, net capital assets of \$7.2 billion increased \$152.8 million from the amount reported for FY 2010. Contributing to this variance were total additions to plant-in-service of \$1.7 billion and a decrease in construction-in-progress of \$1.2 billion, partially offset by depreciation and amortization of \$322.0 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.

Decreases in construction-in-progress were mainly due to moving Spruce 2, related coal yard improvements and the VHB peaking units from construction-in-progress to plant-in-service.

Of the total plant-in-service and construction-in-progress additions, \$494.4 million related to new construction and removal costs. These additions were funded with \$375.6 million of debt, \$5.8 million from the CIED Fund, \$17.7 million from contributed capital, and \$95.3 million from the Repair and Replacement Account. Additionally, a \$100.0 million reimbursement was made to the Repair and Replacement Account to transfer funding to the 2010A Senior Lien Bond proceeds for capital expenditures that were incurred from August 2008 through January 2010. Included in capital assets is CPS Energy's 40% interest in STP Units 1 and 2 and a 7.625% interest in STP Units 3 and 4.

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

See accompanying independent auditors' report.

\$304.8 million and an increase in construction-in-progress of \$547.5 million, partially offset by depreciation and amortization of \$285.8 million.

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.

Current Liabilities

FY 2011 – Excluding current maturities of debt of \$199.9 million, current liabilities decreased \$144.3 million, from \$484.3 million as of January 31, 2010, to \$340.0 million as of January 31, 2011. The decrease was due in large part to \$42.7 million lower STP operation, maintenance and construction payables; \$46.2 million lower operating payables; \$29.8 million lower securities lending cash collateral; \$20.6 million less for natural gas payables; and \$13.7 million lower investments payables. Partially offsetting the decreases were \$4.4 million higher City of San Antonio payables.

FY 2010 – Excluding current maturities of 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.

Other Noncurrent Liabilities

FY 2011 – Excluding the noncurrent portion of debt of \$4.9 billion, long-term liabilities increased \$45.7 million to \$1.0 billion as of January 31, 2011, primarily due to a \$35.8 million increase in the STP decommissioning liabilities, a \$10.3 million increase in the liabilities for STP pension, \$9.3 million higher STP OPEB liabilities, and a \$7.9 million increase for fuel hedges. These overall increases were partially offset by a \$22.6 million decrease for deferred lease revenue amortization.

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 in operating reserves.

FINANCING AND DEBT COVENANTS COMPLIANCE

Long-Term Debt (Excluding Tax-Exempt Commercial Paper)

FY 2011 – ***Issuances*** – The American Recovery and Reinvestment Act of 2009 provided authority for the issuance of Build America Bonds (“BABs”), which were issuable in calendar years 2009 and 2010 as

taxable bonds. The BABs permit the issuer to receive subsidy payments equal to 35% of the bond's interest costs directly from the U.S. Department of the Treasury. On March 23, 2010, CPS Energy issued \$380.0 million of Taxable Senior Lien New Series 2010A Revenue Direct Subsidy BABs. Including the BABs subsidy, the true interest cost for this issue, which has two term bonds maturing in 2041, was 3.8%. Total bond proceeds are being used to fund generation, electric distribution and other qualified construction projects.

On November 4, 2010, CPS Energy issued \$300.0 million of Junior Lien Taxable Series 2010A Revenue Direct Subsidy BABs ("2010A Junior Lien BABs") and \$200.0 million of Junior Lien Taxable Series 2010B Revenue Refunding Direct Subsidy BABs ("2010B Junior Lien BABs"). Including the BABs subsidy, the true interest cost for the 2010A Junior Lien BABs, which have a term bond maturing in 2041, was 3.8%. Total bond proceeds are being used to fund general System improvements. Including the BABs subsidy, the true interest cost for the 2010B Junior Lien BABs, which have a term bond maturing in 2037, was 4.1%. On November 5, 2010, proceeds from the 2010B Junior Lien BABs issuance were used to refund \$200.0 million of outstanding TECP obligations.

Reductions – On May 11, 2010, CPS Energy used a combination of taxable debt from its flexible rate revolving note program and cash to defease \$25.7 million of the allocable portion of the debt associated with the common facilities of STP Units 1 and 2 that were assigned to NINA in March 2010 when CPS Energy reduced its ownership share of STP Units 3 and 4 to 7.625%.

CPS Energy made principal payments of \$161.9 million in FY 2011.

Summary of Debt Rollforward Activity¹

(In thousands)

FY 2011			
Balance Outstanding February 1, 2010	Additions During Year	Decreases During Year	Balance Outstanding January 31, 2011
\$ 4,143,495	\$ 880,000	\$ (187,675)	\$ 4,835,820

¹Excludes commercial paper, discounts, premiums, reacquisition costs and other debt-related amounts.

FY 2010 – Issuances – 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.

On June 12, 2009, CPS Energy issued \$375.0 million of taxable New Series 2009C Revenue Direct Subsidy BABs ("2009C BABs"). Including the BABs subsidy, the true interest cost for this issue, which has maturities that extend from 2033 to 2039, was 3.9%. Total bond proceeds were used to fund generation, electric distribution and other qualified 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.

See accompanying independent auditors' report.

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.

Reductions – CPS Energy made principal payments of \$148.7 million in FY 2010.

Summary of Debt Rollforward Activity¹
(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

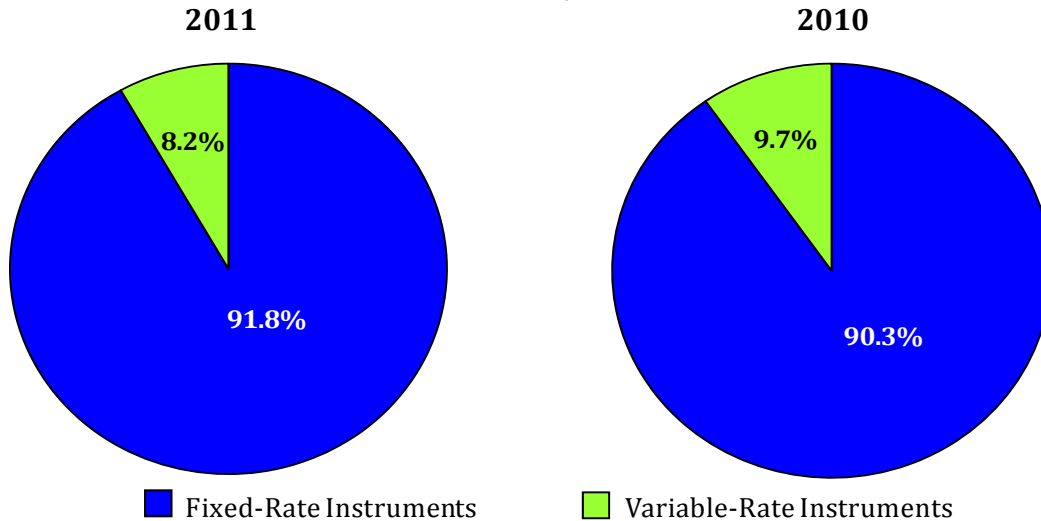
¹Excludes commercial paper, discounts, premiums, reacquisition costs and other debt-related amounts.

Existing Debt

FY 2011 – At January 31, 2011, CPS Energy’s total debt was \$4.8 billion, excluding commercial paper, the flexible rate revolving note, discounts, premiums, reacquisition costs and other debt-related amounts. This long-term debt was composed of \$4.4 billion in fixed-interest-rate instruments and \$397.6 million in variable-interest-rate instruments. The true interest costs on all long-term debt had an overall weighted-average yield of 4.3%. Separately, the variable-rate debt had a blended interest rate of 0.6%.

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%.

**Allocation of Debt
at January 31,**



Note: Graphs exclude tax-exempt commercial paper and the flexible rate revolving note.

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 2011 - Issuances - As of January 31, 2011, there were no new TECP issuances.

Reductions - On April 1, 2010, the unused TECP funds issued in January 2010 were used to pay down TECP principal in the amount of \$20.0 million. On November 5, 2010, proceeds from the 2010B Junior Lien BABs issuance were used to refund \$200.0 million of outstanding TECP obligations. As of January 31, 2011, the current outstanding TECP balance was \$130.0 million.

Summary of TECP Rollforward Activity
(In thousands)

FY 2011			
Balance Outstanding February 1, 2010	Additions During Year	Decreases During Year	Balance Outstanding January 31, 2011
\$ 350,000	\$ -	\$ (220,000)	\$ 130,000

FY 2010 - Issuances - 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 was used to remediate debt.

Reductions - On March 12, 2009, CPS Energy refunded \$450.0 million of outstanding TECP obligations.

See accompanying independent auditors' report.

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

The weighted-average interest rate on outstanding commercial paper was 0.3% at both January 31, 2011, and January 31, 2010. The weighted-average maturity of commercial paper at January 31, 2011, and January 31, 2010, was 124 and 93 days, respectively.

Flexible Rate Revolving Note

CPS Energy maintains a flexible rate revolving note ("FRRN") placement program to provide taxable and tax-exempt financing to assist in the interim funding of eligible projects in an aggregate amount not to exceed \$100 million. The FRRN has been classified as short-term in accordance with the financing terms under the Note Purchase Agreements. See Note 8 – Flexible Rate Revolving Note.

FY 2011 – Issuances – On May 10, 2010, CPS Energy issued \$25.2 million of the taxable Flexible Rate Revolving Note, Series A. On May 11, 2010, the proceeds from the issuance, along with cash, were used to defease \$25.7 million in principal amounts of the allocable portion of the debt associated with the common facilities of STP Units 1 and 2 that were assigned to NINA in March 2010 when CPS Energy reduced its ownership share of STP Units 3 and 4 to 7.625%.

As of January 31, 2011, the outstanding FRRN balance was \$25.2 million.

FY 2010 – There were no borrowings under the FRRN program during FY 2010.

Compliance

With respect to all New Series Bonds outstanding at January 31, 2011, 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.

On October 18, 2010, CPS Energy received notice from the Internal Revenue Service that it would be conducting an audit of the 2009C BABs. The IRS routinely examines municipal debt issuances to confirm compliance with applicable federal tax law. The Company is fully addressing the requests made by the IRS in conjunction with this audit.

The Variable Rate Demand Obligations ("VRDOs") and 2010A and 2010B Junior Lien BABs were 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.

Under the terms of the current FRRN taxable purchase agreement, \$100 million of the credit facility is taxable and secured by collateral pledged in the form of investments and a limited, subordinate and inferior lien on and pledge of net revenues in the amount of \$100.0 thousand.

As of January 31, 2011, and January 31, 2010, CPS Energy was in compliance with the terms and provisions of the documents related to the senior and junior lien obligations, the VRDOs, and the TECP and FRRN programs.

Debt Service

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, 2011, the debt service coverage calculations included a BABs direct subsidy deduction of \$14.5 million for the senior lien debt and \$17.0 million for both the senior and junior lien debt. The table below illustrates the debt service coverage ratios in accordance with the bond ordinances and also provides the ratios without the direct subsidy deduction:

Debt Service Coverage Ratios at January 31, 2011

	<u>With BABs Subsidy</u>	<u>Without BABs Subsidy</u>
Senior lien debt	2.43x	2.33x
Senior and junior lien debt	2.35x	2.25x

Debt Service Coverage Ratios at January 31, 2010

	<u>With BABs Subsidy</u>	<u>Without BABs Subsidy</u>
Senior lien debt	2.33x	2.30x
Senior and junior lien debt	2.29x	2.25x

The ratio of debt to debt and fund net assets was 60.2% at January 31, 2011, and 58.2% at January 31, 2010.

Summary of CPS Energy's Bond and Commercial Paper Ratings

	<u>Ratings at January 31, 2011</u>		
	<u>Senior Lien Debt</u>	<u>Junior Lien Debt</u>	<u>TECP</u>
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+

See accompanying independent auditors' report.

CURRENTLY KNOWN FACTS

Solar Energy – CPS Energy is considering the creation of a new public facility corporation to prepay for solar energy. While this long-term structure would be used to accommodate various future transactions, as deemed applicable, CPS Energy's current power purchase agreements ("PPAs") with SunEdison for 30 megawatts of generation are being considered for conversion to prepayment and facility buyout terms. If a new public facility corporation is created and prepaid contracts are applied therein, CPS Energy would purchase all power from this entity as it is delivered. Savings created from the transaction would flow entirely to CPS Energy customers.

Legislation – The Patient Protection and Affordable Healthcare Act was signed into law on March 23, 2010, and the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed on July 21, 2010. While many of the components of these Acts are still being defined, CPS Energy is continually monitoring the requirements under this legislation to assess the impact to the Company.

STP Units 3 and 4 – On February 17, 2010, CPS Energy and Nuclear Innovation North America LLC ("NINA"), the nuclear development company jointly owned by NRG Energy, Inc. ("NRG") and Toshiba American Nuclear Energy Corporation ("TANE"), 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 retained 92.375% ownership. CPS Energy is not liable for any project development costs incurred after January 31, 2010. Project costs incurred by CPS Energy as of January 31, 2011, totaled \$391.0 million.

Shortly after the announcement on February 17, Tokyo Electric Power Company ("TEPCO") expressed conditional interest in participating in the project. TEPCO operates multiple nuclear units in Japan, including six that were in operation at its Fukushima plant.

On March 11, 2011, a region of Japan sustained significant loss of life and destruction as a result of a major earthquake and resulting tsunami. Included in the damage areas were the Fukushima nuclear units, which lost power to components of the backup and safety control systems and began emitting radiation into the surrounding environment. Following the incident, the NRC began looking into the safety aspects of nuclear plant operations in the United States with the objective of assuring that events such as those at the Fukushima plant do not occur in this country. While the NRC's assessments are tentatively due by July 19, 2011, and because the review process is just beginning, it is unknown what the exact implications will be to safety standards at existing and proposed nuclear operations in the United States.

On March 21, 2011, NINA initially announced that it was reducing the scope of development of STP Units 3 and 4 to allow time for the NRC to assess the lessons that can be learned from the events in Japan. They further stated that continuing work, for the time being, would be limited to licensing and securing the DOE loan guarantee.

In the wake of the disaster, TEPCO is now expected to focus its most immediate efforts in Japan. It is currently unknown whether TEPCO will continue with its planned investment in STP Units 3 and 4 in the long-term.

On April 19, 2011, NRG announced that it will not invest additional capital in the STP Units 3 and 4 development effort and in the first quarter it would write off the entire value of its investment to date in the project while continuing to own a legal interest. TANE will be responsible for funding ongoing costs to continue the licensing process; however, TANE has yet to publicly disclose any specific plans beyond its possible short-term licensing effort. In light of the unclear path forward due to the reduction in scope

of the project and uncertainty regarding timelines and long-term milestone commitments, CPS Energy's management is currently in the process of evaluating whether a full or partial write-down of its STP Units 3 and 4 asset may be appropriate. The Company is expected to make a write-down decision by the end of the second quarter of FY 2012. Due to the unusual and infrequent nature of the circumstances that have to be considered, management currently believes that, if applicable, the impact of writing down the project would be treated as an extraordinary item on its Statements of Revenues, Expenses and Changes in Fund Net Assets.

Excluding AFUDC of \$21.0 million, project costs incurred by CPS Energy to date of \$370.0 million are included in construction-in-progress.

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, 2011 and 2010, 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, 2010 or 2009. The financial information related to the Employee Plans is included in footnote 9 and 10, 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. The January 31, 2011 audit was also conducted in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. 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, 2011 and 2010, 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 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.

In accordance with *Government Auditing Standards*, we will also issue a report on our consideration of CPS Energy's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 2 through 22 and the schedules of funding progress in footnotes 9 and 10 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.

Murga, Preis + Co., LLC Baker Gilly Vinchow Krause, LLP Robert Williams CPA

April 25, 2011

BALANCE SHEETS

	January 31,	
	2011	2010
(In thousands)		
Assets		
Current assets		
Cash and cash equivalents	\$ 154,063	\$ 298,818
Cash collateral from securities lending	2,055	31,815
Investments	215,881	102,996
Interest and other receivables	29,947	17,660
Customer accounts receivable, less allowance for doubtful accounts of \$14.1 million at January 31, 2011, and \$15.9 million at January 31, 2010 (includes unbilled revenue of \$33.2 million for January 2011 and \$40.1 million for January 2010)	168,736	202,060
Inventories, at average costs		
Materials and supplies	84,149	84,478
Fossil fuels	61,949	66,536
Prepayments, deferred and other	51,235	61,796
Total current assets	<u>768,015</u>	<u>866,159</u>
Noncurrent assets		
Restricted		
Cash and cash equivalents	253,798	39,102
Investments	987,142	779,092
Interest receivable	6,370	3,600
Prepaid rent – leaseback	397,444	417,234
Net OPEB and pension obligations	32,664	40,868
Other deferred costs	72,979	52,129
Capital assets, net	7,217,041	7,064,193
Total noncurrent assets	<u>8,967,438</u>	<u>8,396,218</u>
Total assets	<u>\$ 9,735,453</u>	<u>\$ 9,262,377</u>
Liabilities		
Current liabilities		
Current maturities of debt	\$ 199,890	\$ 162,235
Accounts payable and accrued liabilities	337,915	452,456
Securities lending obligation	2,055	31,815
Total current liabilities	<u>539,860</u>	<u>646,506</u>
Noncurrent liabilities		
Long-term debt, net	4,862,548	4,407,284
Decommissioning	336,116	325,973
STP decommissioning net costs refundable	89,091	63,456
Deferred lease revenue	453,091	475,651
Other noncurrent liabilities and deferred credits	156,806	124,357
Total noncurrent liabilities	<u>5,897,652</u>	<u>5,396,721</u>
Total liabilities	<u>6,437,512</u>	<u>6,043,227</u>
Fund net assets		
Invested in capital assets, net of related debt	2,525,771	2,585,351
Restricted		
Debt service	531	3,210
Ordinance	449,290	335,202
Unrestricted	322,349	295,387
Total fund net assets	<u>3,297,941</u>	<u>3,219,150</u>
Total liabilities and fund net assets	<u>\$ 9,735,453</u>	<u>\$ 9,262,377</u>

See accompanying Notes to Basic Financial Statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS

	Fiscal Year Ended January 31,	
	2011	2010
	(In thousands)	
Operating revenues		
Electric	\$ 1,846,046	\$ 1,717,077
Gas	222,640	213,798
Total operating revenues	<u>2,068,686</u>	<u>1,930,875</u>
Operating expenses		
Fuel, purchased power and distribution gas	671,110	689,225
STP operation and maintenance	143,813	142,865
CPS Energy operation and maintenance	322,708	299,420
Annual OPEB and pension costs	41,362	32,301
Grant program expenditures	6,890	30
Energy efficiency and conservation (STEP)	19,816	12,599
STEP net costs recoverable	(12,302)	(12,599)
Regulatory assessments	42,980	36,051
Decommissioning	21,340	24,310
Depreciation and amortization	321,998	285,823
Total operating expenses	<u>1,579,715</u>	<u>1,510,025</u>
Operating income	<u>488,971</u>	<u>420,850</u>
Nonoperating income (expense)		
Interest and other income, net	20,273	22,208
Grant programs	6,890	30
Decommissioning Trusts investment income and change in fair market value	44,756	60,822
STP decommissioning net costs recoverable (refundable)	(25,634)	(38,731)
Interest and other expense	(209,712)	(193,867)
Amortization of debt-related costs	(538)	959
Allowance for funds used during construction	35,417	59,165
Payments to the City of San Antonio	(276,863)	(260,636)
Total nonoperating income (expense)	<u>(405,411)</u>	<u>(350,050)</u>
Income before other changes in fund net assets	83,560	70,800
Other payments to the City of San Antonio	(15,054)	(11,980)
CIED distributions	(750)	-
Contributed capital	25,107	38,991
Effect of defined benefit plan funding obligations – STP	(14,072)	9,788
Change in fund net assets	78,791	107,599
Fund net assets – beginning	3,219,150	3,111,551
Fund net assets – ending	<u>\$ 3,297,941</u>	<u>\$ 3,219,150</u>

See accompanying Notes to Basic Financial Statements.

STATEMENTS OF CASH FLOWS

	Fiscal Year Ended January 31,	
	2011	2010
	(In thousands)	
Cash flows from operating activities		
Cash received from customers	\$ 2,090,576	\$ 1,942,236
Cash payments to suppliers for goods and services	(1,056,542)	(939,418)
Cash payments to employees for service	(173,592)	(165,473)
Net cash provided (used) by operating activities	<u>860,442</u>	<u>837,345</u>
Cash flows from capital and related financing activities		
Cash paid for additions to utility plant and net removal costs	(514,611)	(810,564)
Cash paid for nuclear fuel purchases	(11,963)	(68,838)
Contributed capital	17,809	25,566
Proceeds from issuance of revenue bonds	880,000	379,720
Proceeds from issuance of commercial paper	-	350,000
Principal payments on revenue bonds and cash defeasance of debt	(384,749)	(148,705)
Interest paid	(210,067)	(192,845)
Debt issue and cash defeasance costs paid	(7,716)	(8,880)
Net cash provided (used) by capital and related financing activities	<u>(231,297)</u>	<u>(474,546)</u>
Cash flows from noncapital financing activities		
Cash payments to the City of San Antonio	(295,922)	(275,509)
Net cash provided (used) by noncapital financing activities	<u>(295,922)</u>	<u>(275,509)</u>
Cash flows from investing activities		
Purchases of investments	(1,286,372)	(888,708)
Proceeds from sales and maturities of investments	977,095	763,524
Interest and other income	45,995	34,269
Net cash provided (used) by investing activities	<u>(263,282)</u>	<u>(90,915)</u>
Net increase (decrease) in cash and cash equivalents	69,941	(3,625)
Cash and cash equivalents at beginning of period	337,920	341,545
Cash and cash equivalents at end of period	<u>\$ 407,861</u>	<u>\$ 337,920</u>
<u>Reconciliation of operating income to net cash provided by operating activities</u>		
Cash flows from operating activities		
Operating income	\$ 488,971	\$ 420,850
Noncash items included		
Depreciation and amortization	321,998	285,823
Nuclear fuel amortization	36,482	32,496
Provision for doubtful accounts	8,939	12,747
Changes in current assets and liabilities		
(Increase) decrease in customer accounts receivable, net	24,385	(8,553)
(Increase) decrease in other receivables	(12,427)	5,953
(Increase) decrease in materials and supplies	329	2,510
(Increase) decrease in fossil fuels	4,587	6,079
(Increase) decrease in prepayments, deferred and other	10,270	52,951
Increase (decrease) in accounts payable and accrued liabilities	(51,906)	20,925
Changes in noncurrent and other assets and liabilities		
(Increase) decrease in other noncurrent assets and deferred costs	(900)	(18,539)
Increase (decrease) in customer service deposits payable	993	1,214
Increase (decrease) in decommissioning liability	19,045	21,854
Increase (decrease) in noncurrent liabilities and deferred credits	9,676	1,035
Net cash provided (used) by operating activities	<u>\$ 860,442</u>	<u>\$ 837,345</u>
<u>Noncash financing activities</u>		
Bond proceeds deposited into an escrow account for purposes of refunding long-term debt	\$ 25,249	\$ 679,143
Donated assets received and recorded	\$ 7,298	\$ 13,425
<u>Noncash investing activities</u>		
Securities lending cash collateral (increase) decrease – CPS Energy	\$ 29,760	\$ 178,066
Securities lending cash collateral (increase) decrease – Decommissioning Trusts	\$ 8,867	\$ (7,904)

See accompanying Notes to Basic Financial Statements.

NOTES TO BASIC FINANCIAL STATEMENTS

January 31, 2011 and 2010

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 10 – 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 9 – 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, 2011, and January 31, 2010, are referred to herein as FY 2011 and FY 2010, 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 FASB Statement 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 2011 GASB pronouncement implementations:

- GASB Statement No. 59, *Financial Instruments Omnibus*. This statement provides updated guidance regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. CPS Energy does not currently own any of the applicable financial instruments; therefore, there was no impact to the Company's financial statements as a result of this implementation.

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 is 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 12 – 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.

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 current-year presentation.

Rate Increase – Rates are set by the Board of Trustees ("Board") and approved by the San Antonio City Council. 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, 2011, and January 31, 2010, including estimates for electric fuel and gas costs, were \$33.2 million and \$40.1 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 ("PUC") 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, 2011, and January 31, 2010, were \$43.0 million and \$36.1 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, and grant programs. 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 2011 and FY 2010 were recorded net of expenses.

Federal Grant Programs – Federal stimulus funds have been made available to CPS Energy as a subrecipient for a portion of the grant funds allocated to the state of Texas for a number of programs under the American Recovery and Reinvestment Act of 2009. Used primarily for the weatherization of qualifying homes, grant receipts are recorded as nonoperating income and are to reimburse CPS Energy for costs, recorded as operating expenses, incurred in the administration of the program. This accounting treatment results in no impact to fund net assets. Revenues associated with the stimulus programs are exempt from City payment.

New Generation Assets – In FY 2011, CPS Energy brought new generation facilities on-line, J.K. Spruce Unit 2 ("Spruce 2") and the four V.H. Braunig ("VHB") peaking units. These facilities were tested prior to

commercial operation, and the power that was produced during this testing period is referred to as precommercial generation. In accordance with Federal Energy Regulatory Commission ("FERC") guidance, revenues and expenses associated with precommercial generation were capitalized as components of construction costs.

Allowance for Funds Used During Construction ("AFUDC") – To more accurately reflect funding methodology, the AFUDC rate was modified in FY 2010 to include both a debt and an equity component. The blended rate is composed of 50% equity and 50% debt based on construction funding forecasts. Both the investment rate and the debt rate will continue to be reviewed quarterly to determine if any adjustments are necessary. Alternate AFUDC rates are applied to projects costing more than \$100 million, reflecting the method by which they are funded.

Save for Tomorrow Energy Program ("STEP") – During FY 2009, CPS Energy projected to spend approximately \$849 million over the next 12 years on energy efficiency and conservation through STEP. Annually, the first \$8 million of STEP expenses are funded through the base rate and are reported as CPS Energy operation and maintenance ("O&M") expenses.

STEP expenses over the initial \$8 million per year are recovered through the fuel adjustment factor over a twelve-month period beginning in the subsequent fiscal year after they are incurred and have been independently validated. These STEP recoveries are deferred as STEP net costs recoverable in accordance with guidance provided by FASB Statement No. 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.

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, tax-exempt commercial paper ("TECP"), the flexible rate revolving note ("FRRN") 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 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 Fund is to be used to support qualified capital projects that provide

economic benefit within the communities served. At January 31, 2011, and January 31, 2010, 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 12 – 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 \$146.1 million and \$151.0 million at January 31, 2011, and January 31, 2010, respectively. Included in these amounts was CPS Energy's portion of STP inventories valued at \$43.7 million and \$44.0 million at January 31, 2011, and January 31, 2010, 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 other postemployment benefits ("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, 2011, and January 31, 2010, the net OPEB obligation was \$(32.0) million and \$(38.7) million, respectively. For additional information, see Note 10 – Other Postemployment Benefits.

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 cumulative difference between annual pension cost and the employer's contributions into the pension plan. The net pension obligation was \$(0.6) million at January 31, 2011, and \$(2.2) million at January 31, 2010. For additional information, see Note 9 – Employee Pension Plan.

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 and are classified as a component of other deferred costs 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 noncurrent deferred (inflows) outflows of resources totaled \$7.9 million at January 31, 2011, and \$376.4 thousand at January 31, 2010.

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 \$25.1 million for FY 2011 and \$39.0 million for FY 2010. These amounts include \$7.3 million in FY 2011 and \$13.4 million in FY 2010 for donated assets. The portion of these balances that represents contributions received from customers as payments for utility extensions and services was \$17.5 million for FY 2011 and \$25.5 million for FY 2010.

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 3.1% for FY 2011 and 3.3% for FY 2010.

The estimated useful lives of depreciable capital assets for both FY 2011 and FY 2010 were as follows:

<u>Depreciable Capital Assets</u>	<u>Estimated Useful Life</u>
Buildings and structures	20–60 years
Systems and improvements	
Generation	18–60 years
Transmission and distribution	20–55 years
Gas	50–65 years
Software	10 years
Machinery and equipment	4–30 years
Mineral rights and other	20–40 years
Nuclear fuel	Units of Production

Capitalization thresholds contained in the Company’s capitalization policy for both FY 2011 and FY 2010 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) was 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 FASB Statement No. 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 FASB Statement No. 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, 2011, and January 31, 2010, the accruals for those vested benefits were \$16.2 million and \$15.5 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, 2011, and January 31, 2010, 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.

Subject to applicable timing restrictions that may prevent early payoff, CPS Energy also has the option to defease or extinguish debt. A defeasance occurs when funds are 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, 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.

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.

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 were issuable in calendar years 2009 and 2010 as taxable bonds. The BABs permit the issuer to receive subsidy payments equal to 35% of the bond’s interest costs directly from the U.S. Department of the Treasury. Transaction details for CPS Energy’s BABs issuances are provided in Note 6 – Revenue Bonds.

Flexible Rate Revolving Note (“FRRN”) Private Placement Program – On January 20, 2009, CPS Energy’s Board authorized the establishment of an FRRN 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 through annual renewals authorizes the issuance of such notes through November 1, 2028. The FRRN has been classified as short-term in accordance with the financing terms under the Note Purchase Agreement and is reported on the Balance Sheets under current maturities of debt. At January 31, 2011, the notes outstanding under this program totaled \$25.2 million. There were no outstanding notes at January 31, 2010. See Note 8 – Flexible Rate Revolving Note.

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, 2011, and January 31, 2010, were either insured by federal depository insurance or collateralized by banks. While not entirely collateralized as stipulated in the Company’s investment policy, all noninterest-bearing cash deposits were fully insured by the Federal Deposit Insurance Corporation (“FDIC”) in accordance with the Dodd-Frank financial reform legislation that was enacted in the summer of 2010. The Company’s investment policy was revised effective March 1, 2011, to allow for a reduction in collateral to the extent of FDIC coverage. 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,	
	<u>2011</u>	<u>2010</u>
Petty cash funds on hand	\$ 117	\$ 89
Deposits with financial institutions		
CPS Energy deposits – unrestricted	16,111	1,497
CPS Energy deposits – restricted		
Debt service	213	333
Project Warm	70	159
Investments with original maturities of 90 days or less		
CPS Energy – unrestricted (current)	137,835	297,232
CPS Energy – restricted (noncurrent)	235,467	24,304
Decommissioning Trusts – restricted (noncurrent)	<u>18,048</u>	<u>14,306</u>
Total cash and cash equivalents	<u>407,861</u>	337,920
CPS Energy – securities lending cash collateral	<u>2,055</u>	<u>31,815</u>
Total cash, cash equivalents and securities lending cash collateral	<u><u>\$ 409,916</u></u>	<u><u>\$ 369,735</u></u>

**Summary of Cash and Cash Equivalents,
Along with Current and Noncurrent Investments**

(In thousands)

	January 31,	
	2011	2010
Cash and cash equivalents		
CPS Energy – unrestricted and restricted	\$ 389,813	\$ 323,614
Decommissioning Trusts – restricted	18,048	14,306
Total cash and cash equivalents	407,861	337,920
Gross investments – current and noncurrent		
CPS Energy – unrestricted and restricted	1,172,121	829,847
Decommissioning Trusts – restricted	422,252	388,083
Total gross investments	1,594,373	1,217,930
Investments with original maturities of 90 days or less included in cash and cash equivalents		
CPS Energy – unrestricted and restricted	(373,302)	(321,536)
Decommissioning Trusts – restricted	(18,048)	(14,306)
Total cash equivalents	(391,350)	(335,842)
Net investments	1,203,023	882,088
Total cash, cash equivalents and investments	\$ 1,610,884	\$ 1,220,008

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, as well as PUCT and Nuclear Regulatory Commission (“NRC”) guidelines. 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). In accordance with the Trusts’ Investment Policy, 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>2011</u>	<u>2010</u>
Unrestricted		
Cash and cash equivalents	\$ 154,063	\$ 298,818
Investments	<u>215,881</u>	<u>102,996</u>
Total unrestricted (current)	<u>369,944</u>	<u>401,814</u>
Restricted		
Debt service		
Cash and cash equivalents	<u>545</u>	<u>3,210</u>
Total debt service	<u>545</u>	<u>3,210</u>
Capital projects		
Cash and cash equivalents	<u>227,622</u>	<u>13,913</u>
Investments	<u>138,983</u>	<u>73,707</u>
Total capital projects	<u>366,605</u>	<u>87,620</u>
Ordinance		
Investments	<u>443,955</u>	<u>331,608</u>
Total ordinance	<u>443,955</u>	<u>331,608</u>
Project Warm		
Cash and cash equivalents	<u>7,583</u>	<u>7,673</u>
Total Project Warm	<u>7,583</u>	<u>7,673</u>
Decommissioning Trusts		
Cash and cash equivalents	<u>18,048</u>	<u>14,306</u>
Investments	<u>404,204</u>	<u>373,777</u>
Total Decommissioning Trusts	<u>422,252</u>	<u>388,083</u>
Total restricted		
Cash and cash equivalents	<u>253,798</u>	<u>39,102</u>
Investments	<u>987,142</u>	<u>779,092</u>
Total restricted (noncurrent)	<u>1,240,940</u>	<u>818,194</u>
Total cash, cash equivalents and investments (unrestricted and restricted)	<u>\$ 1,610,884</u>	<u>\$ 1,220,008</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 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,	
	2011	2010
CPS Energy investments		
U.S. Treasuries, Government Agencies, certificates of deposit and money market funds	<u>\$ 1,172,121</u>	<u>\$ 829,847</u>
Decommissioning Trusts		
U.S. Treasuries, Government Agencies and money market funds	156,189	148,004
Corporate bonds	56,340	61,646
Foreign bonds	6,005	4,255
Subtotal	<u>218,534</u>	213,905
Common stock	<u>203,718</u>	174,178
Total Decommissioning Trusts	<u>422,252</u>	388,083
Total – all investments	<u>\$ 1,594,373</u>	<u>\$ 1,217,930</u>

Investment Policies – In accordance with state law, the Trusts’ Investment Policy allows for investment in additional types of securities, such as corporate bonds and equity securities. The policy provides 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 Policy continues to follow the “prudent person” concept.

GASB Statement No. 40 – 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 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, 2011				January 31, 2010			
	Carrying Value	Market Value	Allocation	WAM	Carrying Value	Market Value	Allocation	WAM
U.S. Agencies								
Federal Home Loan Mortgage Corp	\$ 105,850	\$ 105,879	9.03%	4.1	\$ 124,228	\$ 124,228	14.97%	3.9
Federal National Mortgage Assn	292,763	292,750	24.97%	2.6	95,467	95,467	11.50%	4.0
Federal Home Loan Bank	284,297	284,335	24.26%	0.8	147,419	147,461	17.77%	0.7
Federal Farm Credit Bank	19,981	19,981	1.70%	3.3	7,551	7,551	0.91%	2.4
Federal Agriculture Mortgage Corp	7,159	7,165	0.61%	0.5	-	-	-	-
Municipal bonds	58,810	58,806	5.03%	1.8	20,645	20,645	2.49%	1.3
Certificates of deposit	10,000	10,000	0.85%	0.7	113,000	113,000	13.62%	0.4
Commercial paper	19,969	19,969	1.70%	0.5	-	-	-	-
Repurchase agreement	181,904	181,904	15.52%	-	-	-	-	-
Money market mutual funds	191,388	191,388	16.33%	-	321,537	321,537	38.74%	-
Total fixed-income investments	1,172,121	1,172,177	100.00%	1.6	829,847	829,889	100.00%	2.1
Cash collateral – securities lending	2,055	2,055			31,815	31,815		
Total fixed-income portfolio	\$ 1,174,176	\$ 1,174,232			\$ 861,662	\$ 861,704		

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, 2011, and January 31, 2010, CPS Energy held no debt securities with a credit rating below “Aa.”

Credit Rating	January 31, 2011			January 31, 2010		
	Carrying Value	Market Value	Allocation	Carrying Value	Market Value	Allocation
AAA	\$ 914,269	\$ 914,326	77.87%	\$ 733,725	\$ 733,767	85.16%
Aaa	7,800	7,800	0.66%	200	200	0.02%
SP-1+	2,805	2,805	0.24%	-	-	-
AA+	4,453	4,453	0.38%	-	-	-
AA-	2,668	2,668	0.23%	-	-	-
AA	25,107	25,105	2.14%	13,664	13,664	1.59%
Aa1	1,876	1,876	0.16%	-	-	-
Aa2	650	650	0.06%	-	-	-
Aa3	2,676	2,676	0.23%	-	-	-
A1	19,968	19,969	1.70%	-	-	-
Aa	-	-	-	1,073	1,073	0.12%
Not rated ¹	191,904	191,904	16.33%	113,000	113,000	13.11%
Total fixed-income portfolio	\$ 1,174,176	\$ 1,174,232	100.00%	\$ 861,662	\$ 861,704	100.00%

¹The category is composed of certificates of deposit that are 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, which was 4.98 for 2010 and 4.40 for 2009.

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, 2010, total other debt securities (corporate and foreign issuers) amounted to 36.4% of the fixed-income portfolio for the 28% Decommissioning Trust and 16.8% for the 12% Decommissioning Trust.

The following tables list the fixed-income investment holdings by type:

(Dollars in thousands)	December 31, 2010			December 31, 2009		
	Market Value	Allocation	WAD	Market Value	Allocation	WAD
Investment Type - 28% Interest						
U.S. Treasuries	\$ 16,061	10.61%	4.8	\$ 8,349	5.92%	3.8
U.S. Agencies						
Federal National Mortgage Assn	34,281	22.65%	2.8	32,318	22.90%	2.7
Federal Home Loan Mortgage Corp	15,894	10.50%	3.1	16,312	11.56%	3.0
Small Business Admin	3,774	2.49%	5.9	4,581	3.25%	6.1
Government National Mortgage Assn	2,802	1.85%	3.5	2,003	1.42%	3.5
Municipal bonds - Texas	496	0.33%	6.0	624	0.44%	4.9
Municipal bonds - other states	7,407	4.89%	9.7	5,951	4.22%	9.5
Corporate bonds	49,131	32.45%	6.2	54,417	38.57%	6.0
Foreign bonds	6,005	3.97%	5.3	4,255	3.01%	6.0
Money market mutual funds	15,540	10.26%	-	12,287	8.71%	-
Total fixed-income investments	<u>151,391</u>	<u>100.00%</u>	4.9	<u>141,097</u>	<u>100.00%</u>	4.8
Cash collateral - securities lending	17,230			20,407		
Total fixed-income portfolio	<u>\$ 168,621</u>			<u>\$ 161,504</u>		

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<u>Investment Type – 12% Interest</u>	December 31, 2010			December 31, 2009		
	Market Value	Allocation	WAD	Market Value	Allocation	WAD
U.S. Treasuries	\$ 13,868	32.24%	4.9	\$ 7,788	19.57%	6.8
U.S. Agencies						
Federal National Mortgage Assn	6,812	15.84%	3.2	9,429	23.69%	3.3
Federal Home Loan Mortgage Corp	4,902	11.40%	3.0	6,289	15.80%	3.4
Government National Mortgage Assn	3,660	8.51%	6.5	2,867	7.20%	6.8
Municipal bonds – Texas	674	1.57%	12.8	2,026	5.09%	6.3
Municipal bonds – other states	3,375	7.85%	10.5	2,159	5.42%	3.2
Corporate bonds	7,209	16.76%	5.6	7,229	18.16%	5.6
Money market mutual funds	2,508	5.83%	-	2,019	5.07%	-
Total fixed-income investments	43,008	100.00%	5.3	39,806	100.00%	4.9
Cash collateral – securities lending	6,905			12,595		
Total fixed-income portfolio	\$ 49,913			\$ 52,401		

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. As noted in the tables below, which list the fixed-income holdings by credit rating, investments with a credit rating below BBB- totaled 1.7% and 0.8% of the fixed-income portfolio for the 28% Trust and the 12% Trust, respectively. Standard & Poor’s (“S&P”) ratings are provided when available; if no S&P rating is available, the Moody’s rating is listed.

<u>Credit Rating – 28% Interest</u>	December 31, 2010		December 31, 2009	
	Market Value	Allocation	Market Value	Allocation
U.S. Treasuries	\$ 16,061	9.53%	\$ 8,349	5.17%
AAA	99,797	59.19%	100,280	62.09%
Aaa	1,051	0.62%	1,215	0.75%
AA+	2,189	1.30%	1,414	0.88%
AA	1,322	0.78%	1,198	0.74%
Aa1	121	0.07%	-	-
Aa2	126	0.08%	296	0.18%
AA-	3,055	1.81%	3,095	1.92%
Aa3	82	0.05%	78	0.05%
A+	3,782	2.24%	2,347	1.46%
A	7,926	4.70%	10,539	6.53%
A-	10,510	6.23%	8,916	5.52%
A1	136	0.08%	-	-
A3	-	-	150	0.09%
BBB+	6,469	3.84%	5,131	3.18%
BBB	6,548	3.88%	10,321	6.39%
BBB-	6,624	3.93%	5,025	3.11%
BB+	1,501	0.89%	-	-
BB	-	-	1,681	1.04%
BB-	217	0.13%	-	-
B	58	0.03%	57	0.04%
B-	47	0.03%	39	0.02%
CCC	477	0.28%	471	0.29%
CC	5	-	-	-
D	-	-	71	0.04%
Not rated	517	0.31%	831	0.51%
Total fixed-income portfolio	\$ 168,621	100.00%	\$ 161,504	100.00%

(Dollars in thousands)	December 31, 2010		December 31, 2009	
<u>Credit Rating - 12% Interest</u>	<u>Market Value</u>	<u>Allocation</u>	<u>Market Value</u>	<u>Allocation</u>
U.S. Treasuries	\$ 13,868	27.78%	\$ 7,788	14.86%
AAA	26,172	52.43%	35,724	68.17%
AA+	1,005	2.01%	1,393	2.66%
AA	1,648	3.30%	522	1.00%
AA-	846	1.70%	538	1.03%
A+	492	0.99%	526	1.00%
A	1,316	2.64%	2,859	5.46%
A-	2,768	5.55%	1,401	2.67%
BBB+	982	1.97%	925	1.77%
BBB	397	0.79%	725	1.38%
BB-	419	0.84%	-	-
Total fixed-income portfolio	<u>\$ 49,913</u>	<u>100.00%</u>	<u>\$ 52,401</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. All foreign bonds outstanding were issued in the U.S. and amounted to \$6.0 million as of December 31, 2010, and \$4.3 million as of December 31, 2009. In accordance with the Investment Policy, investments in international portfolios are limited to international commingled funds, American Depositary Receipts and exchange-traded funds that are diversified across countries and industries. The international portfolio is limited to 20% of the total equity portfolio. At December 31, 2010, total foreign equity securities amounted to 13.7% of the 28% Trust's equity portfolio compared to 14.6% at December 31, 2009. There were no foreign equity securities held by the 12% Trust at December 31, 2010, or December 31, 2009.

3. Disaggregation of Current Receivables and Payables

Receivables – Net customer accounts receivable as of January 31, 2011, included \$33.2 million for unbilled revenue receivables and \$135.5 million for billed utility services. Interest and other receivables included \$5.9 million for regulatory-related receivables, \$1.3 million for interest receivable and \$22.7 million for other miscellaneous 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 \$4.0 million for regulatory-related receivables, \$1.5 million for interest receivable and \$12.2 million for other miscellaneous receivables.

Payables – At January 31, 2011, accounts payable and accrued liabilities included \$184.6 million related to standard operating supplier and vendor payables, including fuels payable; \$34.7 million for employee-related payables; \$22.6 million for the current portion of deferred lease revenue; and \$96.9 million for other miscellaneous payables and accrued liabilities.

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.

4. Capital Assets, Net

General Description – CPS Energy’s plant-in-service includes four power stations that are solely owned and operated by the Company. In total, there are 24 generating units at these four power stations—four are coal-fired and 20 are gas-fired. Following is a list of power stations and relative generating units:

<u>Power Station</u>	<u>Generating Units</u>	<u>Type</u>	<u>Power Station</u>	<u>Generating Units</u>	<u>Type</u>
Calaveras	6	Coal (4)/Gas (2)	Leon Creek	6	Gas
Braunig	8	Gas	Tuttle	4*	Gas

*Included as a part of the 20 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 have been fully depreciated.

During FY 2011, CPS Energy placed into service Spruce 2 and the VHB peaking units. Construction on Spruce 2 was started on March 21, 2006. The plant went into commercial operation on May 28, 2010. Spruce 2 is a 750-megawatt unit and is the largest of the coal units at Calaveras Lake. The plant is equipped with current emissions-control technology. Construction of the VHB peaking units project began on September 10, 2008. The peaking units went into commercial operation on December 1, 2010. 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 and provide quick response capacity as necessary.

Other notable capital assets in electric and gas plant include supporting coal yard assets, a fleet of railcars, a transmission network for the movement of electric power from the generating stations to substations, electric and gas distribution systems, and metering.

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. Intangible assets consist of easements and software.

Impairments – There were no capital asset impairments that were identified for FY 2011 or for FY 2010.

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. See Note 14 – 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. Excluding AFUDC of \$21.0 million, project costs incurred by CPS Energy to date of \$370.0 million are included in construction-in-progress. For more detailed information on project development and legal events associated with STP Units 3 and 4, see Note 14 – South Texas Project.

STP Capital Investment, Net

(Dollars in thousands)

	January 31,	
	<u>2011</u>	<u>2010</u>
STP capital assets, net		
Land	\$ 5,701	\$ 5,701
Construction-in-progress, STP Units 1 and 2	25,013	35,785
Construction-in-progress, STP Units 3 and 4	390,963	380,030
Electric and general plant	1,177,220	1,224,797
Software	72	89
Nuclear fuel	82,572	107,092
Total STP capital assets, net	<u>\$ 1,681,541</u>	<u>\$ 1,753,494</u>
Total CPS Energy capital assets, net	<u>\$ 7,217,041</u>	<u>\$ 7,064,193</u>
STP capital investment as a percentage of total CPS Energy capital assets, net	23.3%	24.8%

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 2011 and for FY 2010:

FY 2011 Capital Asset Rollforward

(In thousands)

	<u>2-1-2010</u>	Additions/ Increases	Transfers In/(Out)	Reductions/ Decreases	<u>1-31-2011</u>
Nondepreciable assets					
Land	\$ 33,151	\$ -	\$ 7,952	\$ (80)	\$ 41,023
Land easements	73,999	-	4,279	-	78,278
Construction-in-progress	<u>1,893,686</u>	<u>436,072</u>	<u>(1,658,023)</u>	<u>-</u>	<u>671,735</u>
Total nondepreciable assets	<u>2,000,836</u>	<u>436,072</u>	<u>(1,645,792)</u>	<u>(80)</u>	<u>791,036</u>
Depreciable assets					
Electric plant	7,318,256	36,247	1,550,519	(26,506)	8,878,516
Gas plant	662,763	4,486	26,130	(31)	693,348
General plant	569,887	8,477	37,084	(20,989)	594,459
Software	146,452	2,307	32,059	(454)	180,364
Nuclear fuel	<u>643,545</u>	<u>11,963</u>	<u>-</u>	<u>-</u>	<u>655,508</u>
Total depreciable assets	<u>9,340,903</u>	<u>63,480</u>	<u>1,645,792</u>	<u>(47,980)</u>	<u>11,002,195</u>
Accumulated depreciation and amortization					
Electric plant	(3,227,287)	(255,783)	-	38,187	(3,444,883)
Gas plant	(244,467)	(15,047)	-	378	(259,136)
General plant	(193,960)	(36,894)	-	20,659	(210,195)
Software	(75,379)	(14,127)	-	466	(89,040)
Nuclear fuel	<u>(536,453)</u>	<u>(36,483)</u>	<u>-</u>	<u>-</u>	<u>(572,936)</u>
Total accumulated depreciation and amortization	<u>(4,277,546)</u>	<u>(358,334)</u>	<u>-</u>	<u>59,690</u>	<u>(4,576,190)</u>
Capital assets, net	<u>\$ 7,064,193</u>	<u>\$141,218</u>	<u>\$ -</u>	<u>\$ 11,630</u>	<u>\$ 7,217,041</u>

Cash flow information – Cash paid for additions and net removal costs was \$514.6 million. This included \$487.6 million in additions to construction-in-progress and electric, gas and general plant, partially offset by \$35.4 million in AFUDC and \$7.3 million in donated assets.

Other – The increases in electric plant included new generating power stations and distribution infrastructure. Depreciation and amortization totaled \$322.0 million, which included \$146.2 thousand related to CIED intangible assets.

FY 2010 Capital Asset Rollforward

(In thousands)

	2-1-2009	Additions/ Increases	Transfers In/(Out)	Reductions/ Decreases	1-31-2010
Nondepreciable assets					
Land	\$ 31,939	\$ -	\$ 1,216	\$ (4)	\$ 33,151
Land easements	67,183	-	6,816	-	73,999
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>
Depreciable assets					
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	576,821	5,233	3,998	(16,165)	569,887
Software	125,839	465	20,722	(574)	146,452
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>
Accumulated depreciation and amortization					
Electric plant	(3,035,371)	(227,037)	-	35,121	(3,227,287)
Gas plant	(231,045)	(14,335)	-	913	(244,467)
General plant	(178,464)	(30,324)	-	14,828	(193,960)
Software	(61,931)	(14,022)	-	574	(75,379)
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 CIED intangible assets.

5. Revenue Bond and Commercial Paper Ordinances Requirements

Senior Lien – As of January 31, 2011, 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 obligations are composed of two categories of debt: fixed interest rate and variable interest rate. The junior lien fixed interest rate debt is similar to the senior lien New Series Bonds, as they have fixed and set interest rates for the life of the bonds. The junior lien, Variable Rate Demand Obligation ("VRDO") bonds are variable interest rate debt instruments of the City. The junior lien obligations are 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, 2011, 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 were issuable in calendar years 2009 and 2010 as taxable bonds. The BABs permit the issuer 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 (“2009C BABs”). Including the BABs subsidy, the true interest cost for this issue, which has maturities that extend from 2033 to 2039, was 3.9%. The subsidy received for the 2009C BABs was \$3.9 million for FY 2011 and \$5.0 million for FY 2010. Total bond proceeds were used to fund generation, electric distribution and other 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. Including the BABs subsidy, the true interest cost for this issue, which has two term bonds maturing in 2041, was 3.8%. The subsidy received through January 31, 2011, for the 2010A BABs was \$2.8 million. Total bond proceeds are being used to fund generation, electric distribution and other qualified construction projects.

On November 4, 2010, CPS Energy issued \$300.0 million of Junior Lien Taxable Series 2010A Revenue Direct Subsidy BABs (“2010A Junior Lien BABs”) and \$200.0 million of Junior Lien Taxable Series 2010B Revenue Refunding Direct Subsidy BABs (“2010B Junior Lien BABs”). Including the BABs subsidy, the true interest cost for the 2010A Junior Lien BABs, which have a term bond maturing in 2041, was 3.8%. Total bond proceeds are being used to fund general system improvements. Including the BABs subsidy, the true interest cost for the 2010B Junior Lien BABs, which have a term bond maturing in 2037, was

4.1%. On November 5, 2010, proceeds from the 2010B Junior Lien BABs issuance were used to refund \$200.0 million of outstanding TECP obligations.

Revenue Bond Summary

(Dollars in thousands)

Issues / Maturities	Weighted-Average Yield on Outstanding Bonds at January 31, 2011	January 31,	
		2011	2010
Tax-exempt new series bonds			
1994A-2009D, 2011-2034	4.8%	\$ 3,183,205	\$ 3,366,495
Taxable new series bonds ¹			
2009C and 2010A, 2033-2041	3.8%	755,000	375,000
Total new series bonds	4.4%	3,938,205	3,741,495
Taxable series bonds ¹			
2010A-2010B, 2037-2041	3.8%	500,000	-
Tax-exempt variable rate series bonds			
2003-2004, 2024-2033		397,615	402,000
Total series bonds		897,615	402,000
Total long-term revenue bonds outstanding		4,835,820	4,143,495
Less: Current maturities of bonds		174,690	162,235
Total revenue bonds outstanding, net of current maturities		\$ 4,661,130	\$ 3,981,260

¹ Direct Subsidy Build America Bonds

As of January 31, 2011, principal and interest amounts due for all revenue bonds outstanding for each of the next five years and thereafter to maturity are:

(In thousands)

Fiscal Year	Principal	Interest	Direct Subsidy	Total
2012	\$ 174,690	\$ 236,967	\$ (26,132)	\$ 385,525
2013	171,175	228,085	(26,132)	373,128
2014	183,610	219,045	(26,132)	376,523
2015	157,035	209,328	(26,132)	340,231
2016	157,735	201,236	(26,132)	332,839
2017-2021	894,730	881,725	(130,659)	1,645,796
2022-2026	1,042,395	636,090	(130,659)	1,547,826
2027-2031	558,750	468,511	(130,659)	896,602
2032-2036	705,635	353,835	(119,399)	940,071
2037-2041	790,065	136,831	(47,891)	879,005
Totals	\$ 4,835,820	\$ 3,571,653	\$ (689,927)	\$ 7,717,546

The above table includes senior lien and junior lien bonds. Interest on the senior lien bonds and the junior lien fixed-rate bonds are based upon the stated coupon rates of each series of bonds outstanding. The direct subsidy associated with the 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.

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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, 2010, the 2004 Junior Lien Bonds were remarketed for a two-year term at an interest rate of 1.15%. This interest rate will remain in effect until the next interest reset date of December 1, 2012. The total interest amounts for all revenue bonds outstanding included a blended interest rate for the 2003 and 2004 Junior Lien Bonds of 0.6% at January 31, 2011, and 1.5% at January 31, 2010.

The interest rate term mode for the junior lien variable-rate 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.

On October 18, 2010, CPS Energy received notice from the Internal Revenue Service that it would be conducting an audit of the 2009C BABs. The IRS routinely examines municipal debt issuances to confirm compliance with applicable federal tax law. The Company is fully complying with the requests made by the IRS in conjunction with this audit.

FY 2011 Long-Term Debt Activity (Dollars in thousands)

	Original Amount	Final Principal Payment	Interest Rate (%)	Balance Outstanding 2-1-10	Additions During Year	Decreases During Year	Balance Outstanding 1-31-11
Revenue and refunding bonds							
1994A tax-exempt	\$ 684,700	2012	5.008	\$ 68,965	\$ -	\$ (1,500)	\$ 67,465
2001 tax-exempt	115,280	2011	3.843	12,425	-	(12,425)	-
2002 tax-exempt	436,090	2017	4.055	361,580	-	(35,520)	326,060
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	81,240	-	(7,030)	74,210
2003 tax-exempt	350,490	2013	3.081	118,950	-	(68,625)	50,325
2004 tax-exempt - Junior Lien	160,000	2027	Variable	152,000	-	(4,385)	147,615
2005 tax-exempt	294,625	2020	4.381	294,625	-	-	294,625
2005 tax-exempt	240,675	2025	4.683	240,675	-	(875)	239,800
2005A tax-exempt	197,335	2025	4.571	197,335	-	(2,120)	195,215
2006A tax-exempt	384,185	2025	4.555	358,225	-	(13,940)	344,285
2006B tax-exempt	128,845	2021	3.974	104,130	-	(8,880)	95,250
2007 tax-exempt	46,195	2018	4.159	46,195	-	-	46,195
2007 tax-exempt	403,215	2032	4.575	403,215	-	(1,085)	402,130
2008 tax-exempt	287,935	2032	4.582	287,935	-	-	287,935
2008A tax-exempt	158,030	2016	3.736	130,530	-	(23,910)	106,620
2009A tax-exempt	442,005	2034	4.863	442,005	-	(2,505)	439,500
2009C taxable	375,000	2039	3.944	375,000	-	-	375,000
2009D tax-exempt	207,940	2021	3.720	207,940	-	(4,875)	203,065
2010A taxable	380,000	2041	3.834	-	380,000	-	380,000
2010A taxable - Junior Lien	300,000	2041	3.806	-	300,000	-	300,000
2010B taxable - Junior Lien	200,000	2037	4.101	-	200,000	-	200,000
Bonds outstanding				4,143,495	880,000	(187,675)	4,835,820
Current maturities				(162,235)	(12,841)	386	(174,690)
(Discount) premium				137,332	6	(20,076)	117,262
Reacquisition costs				(61,308)	(2,870)	18,334	(45,844)
Revenue bonds, net				4,057,284	864,295	(189,031)	4,732,548
Tax-exempt commercial paper			Variable	350,000	-	(220,000)	130,000
Long-term debt, net				\$ 4,407,284	\$ 864,295	\$ (409,031)	\$ 4,862,548

FY 2010 Long-Term Debt Activity
(Dollars in thousands)

	Original Amount	Final Principal Payment	Interest Rate (%)	Balance Outstanding 2-1-09	Additions During Year	Decreases During Year	Balance Outstanding 1-31-10
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>

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 April 1, 2010, the unused TECP funds issued in January 2010 were used to pay down TECP principal in the amount of \$20.0 million. On November 5, 2010, proceeds from the 2010B Junior Lien BABs issuance were used to refund \$200.0 million of outstanding TECP obligations. As of January 31, 2011, the current outstanding TECP balance was \$130.0 million.

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, 2011, there was no amount outstanding under the revolving credit agreement. Further, there have been no borrowings under the agreement since inception.

TECP Summary

(Dollars in thousands)	January 31,	
	2011	2010
TECP outstanding	\$ 130,000	\$ 350,000
TECP new money issues	-	350,000
Weighted-average interest rate of outstanding TECP	0.3%	0.3%
Average life of outstanding TECP (number of days)	124	93

8. Flexible Rate Revolving Note

In FY 2010, the San Antonio City Council adopted an ordinance authorizing the establishment of the Flexible Rate Revolving Note (“FRRN”) Private Placement Program, under which CPS Energy may issue taxable or tax-exempt notes, bearing interest at fixed or variable rates in an aggregate principal amount at any one time outstanding not to exceed \$100 million. This ordinance provides for funding to assist in the interim financing of eligible projects that include the acquisition or construction of improvements, additions, or extensions to the Systems, including capital assets and facilities incident and related to the operation, maintenance, and administration of fuel acquisition and development and facilities for the transportation thereof; capital improvements to the Systems; and refinancing or refunding of any outstanding obligations secured by the net revenues of the Systems; or with respect to the payment of any obligation of the Systems pursuant to any credit. Under the program, maturity dates cannot extend beyond November 1, 2028.

On May 10, 2010, CPS Energy issued a \$25.2 million taxable Flexible Rate Revolving Note, Series A, under its taxable Note Purchase Agreement with JPMorgan Chase Bank, N.A, which currently serves as the note purchaser under the program. On May 11, 2010, the proceeds from the note, along with cash, were used to defease \$25.7 million in principal amounts of the allocable portion of the debt associated with the common facilities of STP Units 1 and 2 that were assigned to NINA in March 2010 when CPS Energy reduced its ownership share of STP Units 3 and 4 to 7.625%. The outstanding FRRN balance at January 31, 2011, was \$25.2 million.

The FRRN has been classified as short-term in accordance with the financing terms under the taxable Note Purchase Agreement and is reported on the Balance Sheets under current maturities of debt. At January 31, 2011, only the taxable facility was being utilized through the taxable Note Purchase Agreement. The taxable notes are being secured by a pledge of investment collateral and a limited, subordinate and inferior lien on and pledge of net revenues in the amount of \$100.0 thousand. The current taxable Note Purchase Agreement will expire on December 31, 2011, but through an annual renewal process may be extended through November 1, 2028.

9. 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 President 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 \$1.1 billion at December 31, 2010, and \$973.7 million at December 31, 2009.

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 and compensation 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 \$108.6 thousand for FY 2011 and \$120.0 thousand for FY 2010. These costs were recorded when paid.

Funding Policy – The current policy of CPS Energy is to use each actuarial valuation as the basis for determining monthly employer contributions to the Plan during the fiscal year beginning in the calendar year after the valuation year. The January 1, 2009, valuation was the basis for contributions in FY 2011. The Company establishes funding levels, considering annual actuarial valuations and recommendations of the Administrative Committee, which is composed of a cross-functional group of active and retired CPS Energy employees, 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 both FY 2011 and FY 2010.

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 2011 and FY 2010, the amount to be funded was established using a general target near the 30-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 14.6% of covered payroll in FY 2011 and 10.8% of covered payroll for FY 2010.

Annual Pension Cost and Net Pension Obligation – CPS Energy’s annual pension cost (“APC”) and net pension obligation (“NPO”) for FY 2011 and FY 2010 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)	Fiscal Year Ended January 31,	
	2011	2010
Annual required contribution (ARC)	\$ 33,921	\$ 23,468
Interest on net pension obligation	(169)	(156)
Adjustment to ARC	205	191
Annual pension cost (APC)	33,957	23,503
Employer contributions in relation to ARC	(32,400)	(23,732)
Increase (decrease) in net pension obligation	1,557	(229)
Net pension obligation – beginning of year	(2,173)	(1,944)
Net pension obligation – end of year	\$ (616)	\$ (2,173)

Three-Year Trend Information

(Dollars in thousands)

Fiscal Year Ended	APC	Percentage of APC Contributed	NPO
1-31-2011	\$ 33,957	95.4%	\$ (616)
1-31-2010	23,503	101.0%	(2,173)
1-31-2009	20,590	99.9%	(1,944)

Funded Status and Funding Progress – The funded status of the Plan as of the January 1, 2009, valuation date was as follows:

(Dollars in thousands)	January 1, 2009
Actuarial value of plan assets (a)	\$ 1,067,841
Actuarial accrued liability (b)	1,183,961
Unfunded actuarial accrued liability (funding excess) (b) - (a)	\$ 116,120
Funded ratio (a) / (b)	90.2%
Covered payroll (c)	\$ 222,427
Unfunded actuarial accrued liability (funding excess) as a percentage of covered payroll $[(b) - (a)] / (c)$	52.2%

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, valuation 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 cost method was revised for the 2010 Plan year to eliminate the 13-month projection from January 1 to February 1 of the succeeding year. Instead, the January 1 valuation results were used to determine the contributions for the fiscal year commencing in the succeeding calendar year. There was no change in actuarial valuation methods for the 2010 Plan year.

Significant actuarial assumptions used for the January 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	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) (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)
1-1-2009 ¹	\$1,067,841	\$1,183,961	\$116,120	90.2%	\$222,427	52.2%
2-1-2009 ²	1,145,029	1,169,302	24,273	97.9%	219,716	11.0%
2-1-2008 ²	1,084,569	1,103,865	19,296	98.3%	217,018	8.9%

¹ The cost method was revised to eliminate the 13-month projection from January 1 to February 1 of the succeeding year. Instead, the January 1 valuation results were used to determine the contribution for the fiscal year commencing in the succeeding calendar year.

² Subsequent to the valuation date of January 1, 2007, the cost method was revised to project January 1 data to February 1 of the next calendar year based on assumptions.

10. 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 President 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 \$202.3 million at December 31, 2010, and \$181.1 million at December 31, 2009. The Life Plan's net assets had a market value of \$44.9 million at December 31, 2010, and \$41.3 million at December 31, 2009. The Disability Plan's net assets had a market value of \$3.9 million at December 31, 2010, and \$3.2 million at December 31, 2009.

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. The current policy of CPS Energy is to use each actuarial valuation as the basis for determining monthly employer contributions to the plans during the fiscal year beginning in the calendar year after the valuation year. The January 1, 2009, valuation was the basis for contributions in FY 2011.

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 \$4.2 million in FY 2011 and \$4.1 million in FY 2010 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. There were no contributions in relation to the ARC in FY 2011.

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 \$696.4 thousand for FY 2011 and \$645.9 thousand for FY 2010. 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 \$234.0 thousand in FY 2011 and \$228.0 thousand in FY 2010. CPS Energy's contributions in relation to the ARC for the Life Plan amounted to 0.1% of covered payroll in both FY 2011 and FY 2010.

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 both FY 2011 and FY 2010.

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 \$7.4 million for FY 2011 and \$8.8 million for FY 2010. The following table shows the components of the Company’s annual OPEB cost for FY 2011 and FY 2010, 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.

(In thousands)

	Health Plan	Life Plan	Disability Plan	Total
FY 2011				
Annual required contribution	\$ 6,507	\$ -	\$ 341	\$ 6,848
Interest on net OPEB obligation	(3,012)	(55)	(40)	(3,107)
Adjustment to annual required contribution	3,551	65	47	3,663
Annual OPEB cost	7,046	10	348	7,404
Contributions in relation to ARC	-	(140)	(617)	(757)
Increase (decrease) in net OPEB obligation	7,046	(130)	(269)	6,647
Net OPEB obligation – beginning of year	(37,650)	(685)	(359)	(38,694)
Net OPEB obligation – end of year	<u>\$ (30,604)</u>	<u>\$ (815)</u>	<u>\$ (628)</u>	<u>\$ (32,047)</u>
FY 2010				
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)
Increase (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>

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CPS Energy's annual OPEB cost, the percentage of annual OPEB cost contributed, and the net OPEB obligation for FY 2011, FY 2010 and FY 2009 for each of the plans were as follows:

(Dollars in thousands)

<u>FY 2011</u>	<u>Health Plan</u>	<u>Life Plan</u>	<u>Disability Plan</u>	<u>Total</u>
Annual OPEB cost	\$ 7,046	\$ 10	\$ 348	\$ 7,404
Percentage of annual OPEB cost contributed	-	1428.9%	177.2%	10.2%
Net OPEB obligation	\$ (30,604)	\$ (815)	\$ (628)	\$ (32,047)
<u>FY 2010</u>				
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)
<u>FY 2009</u>				
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)

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 January 1, 2009, valuation date was as follows:

(Dollars in thousands)

	<u>Health Plan</u>	<u>Life Plan¹</u>	<u>Disability Plan¹</u>
Actuarial value of plan assets (a)	\$ 199,195	\$ 46,815	\$ 3,631
Actuarial accrued liability (b)	<u>198,286</u>	<u>36,091</u>	<u>6,945</u>
Unfunded actuarial accrued liability (funding excess) (b) - (a)	<u>\$ (909)</u>	<u>\$ (10,724)</u>	<u>\$ 3,314</u>
Funded ratio (a) / (b)	100.5%	129.7%	52.3%
Covered payroll (c)	222,427	200,342	200,342
Unfunded actuarial accrued liability (funding excess) as a percentage of covered payroll $[(b) - (a)] / (c)$	-0.4%	-5.4%	1.7%

¹ 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.

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.

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.

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, with an amortization period of 20 years. 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. The cost method was revised for the 2010 plan year to eliminate the 13-month projection from January 1 to February 1 of the succeeding year. Instead, the January 1 valuation results were used to determine the contributions for the fiscal year commencing in the succeeding calendar year.

Significant actuarial assumptions used in the calculations for the January 1, 2009, actuarial valuation 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	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) ¹ (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)
1-1-2009 ²	\$ 199,195	\$ 198,286	\$ (909)	100.5%	\$ 222,427	-0.4%
2-1-2009 ³	204,246	219,364	15,118	93.1%	219,716	6.9%
2-1-2008 ³	194,876	247,283	52,407	78.8%	217,018	24.1%

¹ The AAL consisted of the liability for both retired employees and active employees. The AAL for retired employees was \$83.6 million for January 1, 2009; \$87.9 million for February 1, 2009; and \$94.2 million for February 1, 2008.

² The cost method was revised to eliminate the 13-month projection from January 1 to February 1 of the succeeding year. Instead, the January 1 valuation results were used to determine the contribution for the fiscal year commencing in the succeeding calendar year.

³ Subsequent to the valuation date of January 1, 2007, the cost method was revised to project January 1 data to February 1 of the next calendar year based on assumptions.

Life Plan
Schedule of Funding Progress (Unaudited)
(Dollars in thousands)

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) ¹ (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
1-1-2009 ²	\$ 46,815	\$ 36,091	\$ (10,724)	129.7%	\$ 200,342	-5.4%
2-1-2009 ³	49,614	35,491	(14,123)	139.8%	198,669	-7.1%
2-1-2008 ³	49,098	33,024	(16,074)	148.7%	185,090	-8.7%

¹ 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.

² The cost method was revised to eliminate the 13-month projection from January 1 to February 1 of the succeeding year. Instead, the January 1 valuation results were used to determine the contribution for the fiscal year commencing in the succeeding calendar year.

³ Subsequent to the valuation date of January 1, 2007, the cost method was revised to project January 1 data to February 1 of the next calendar year based on assumptions.

Disability Plan
Schedule of Funding Progress (Unaudited)
(Dollars in thousands)

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) ¹ (b - a)	Funded Ratio (a / b)	Annual Covered Total Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
1-1-2009 ²	\$ 3,631	\$ 6,945	\$ 3,314	52.3%	\$ 200,342	1.7%
2-1-2009 ³	3,763	6,575	2,812	57.2%	198,669	1.4%
2-1-2008 ³	3,734	5,712	1,978	65.4%	185,090	1.1%

¹ 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.

² The cost method was revised to eliminate the 13-month projection from January 1 to February 1 of the succeeding year. Instead, the January 1 valuation results were used to determine the contribution for the fiscal year commencing in the succeeding calendar year.

³ Subsequent to the valuation date of January 1, 2007, the cost method was revised to project January 1 data to February 1 of the next calendar year based on assumptions.

11. 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 95.3% as of January 31, 2011, and 95.1% as of January 31, 2010.

FY 2011 Other Liabilities and Deferred Credits
(In thousands)

	Rollforward			Total		
	Balance Outstanding 2-1-2010	Additions During Year	Decreases During Year	Balance Outstanding 1-31-2011	Amounts Due within One Year	Long-Term Balance Outstanding
STP decommissioning	\$ 325,973	\$ 29,342	\$ (19,199)	\$ 336,116	\$ -	\$ 336,116
STP decommissioning net costs refundable	63,456	75,324	(49,689)	89,091	-	89,091
Deferred lease revenue	498,212	-	(22,561)	475,651	22,560	453,091
	<u>887,641</u>	<u>104,666</u>	<u>(91,449)</u>	<u>900,858</u>	<u>22,560</u>	<u>878,298</u>
Other						
Customer deposits	29,274	23,898	(22,206)	30,966	20,212	10,754
Operating reserves	18,117	15,673	(14,558)	19,232	4,512	14,720
STP pension and OPEBs	67,487	21,812	(2,163)	87,136	-	87,136
Pollution remediation liability	887	2,057	(367)	2,577	1,216	1,361
Project Warm	7,674	164	(254)	7,584	-	7,584
Retainage interest expense payable	2,983	27	(29)	2,981	-	2,981
Notes payable	4,004	217	(507)	3,714	289	3,425
Customer advances	21,253	18,134	(17,271)	22,116	2,458	19,658
Deferred credits	31	37,538	(29,576)	7,993	-	7,993
Other	597	610	(13)	1,194	-	1,194
Total other liabilities	<u>152,307</u>	<u>120,130</u>	<u>(86,944)</u>	<u>185,493</u>	<u>28,687</u>	<u>156,806</u>
Total other long-term liabilities and deferred credits	<u>\$1,039,948</u>	<u>\$ 224,796</u>	<u>\$(178,393)</u>	<u>\$ 1,086,351</u>	<u>\$51,247</u>	<u>\$ 1,035,104</u>

FY 2010 Other Liabilities and Deferred Credits
(In thousands)

	Rollforward			Total		
	Balance	Additions	Decreases	Balance	Long-Term	
	Outstanding 2-1-2009			During Year		During Year
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>

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 \$5.9 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 property locations. The liability insurance program includes:

- \$100 million of excess general liability coverage over a retention amount of \$3 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 \$3 million is maintained. No claims settlements exceeded insurance coverage and there were no decreases in coverage in FY 2011, FY 2010 or FY 2009.

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 last performed during the third quarter of FY 2011.

In the table below, the remaining balance under the property reserve column at January 31, 2011, 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 2009	\$ 10,303	\$ 3,105	\$ 13,408
Payments	(4,254)	-	(4,254)
Other claims adjustments	4,314	799	5,113
Balance - FY 2010	10,363	3,904	14,267
Payments	(4,427)	-	(4,427)
Other claims adjustments	6,343	344	6,687
Balance - FY 2011	<u>\$ 12,279</u>	<u>\$ 4,248</u>	<u>\$ 16,527</u>

Counterparty Risk – CPS Energy is exposed to counterparty risk associated with various transactions primarily related to debt, investments, fuel hedging, 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 & Solutions Division.

12. 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 December 20, 2010, 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, 2011, 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 natural gas futures, swaps 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, 0.9064 and 0.9683, 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.

The second category includes hedges with both Henry Hub priced swaps and basis swaps to the appropriate natural gas hub (WAHA or HSC) with volumes matching the underlying expected physical transaction. Considering the substantive characteristics of these hedge transactions, these instruments were determined to be effective utilizing the consistent critical terms method prescribed under GASB Statement No. 53.

As of January 31, 2011, the total fair value of outstanding hedge instruments was a net liability of \$14.2 million. Fuel hedging instruments with a fair value of \$(6.3) 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 hedges with a fair value of \$(7.9) million are reported as a noncurrent liability and classified as a component of other liabilities and deferred credits.

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.

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 \$6.9 million at January 31, 2011, and \$6.4 million at January 31, 2010. 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 \$7.9 million at January 31, 2011, and \$376.4 thousand at January 31, 2010. 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, 2011

(Dollars in thousands)

Type of Transaction		Referenced Index	Duration	Volumes in MMBtu	Fair Value	Change in Fair Value
Long	Call	Henry Hub	Feb 2011 through Sep 2011	2,130,000	\$ 4	\$ (1,328)
Short	Call	Henry Hub	Mar 2011 through Mar 2011	260,000	-	35
Long	Put	Henry Hub	Mar 2011 through Mar 2011	260,000	193	29
Short	Put	Henry Hub	Feb 2011 through Jul 2011	1,560,000	(1,179)	186
Long	Fixed Price Natural Gas	Henry Hub	Feb 2011 through Jan 2014	22,374,416	(13,883)	(13,160)
Short	Fixed Price Natural Gas	Henry Hub	Feb 2011 through Mar 2011	600,000	676	676
Long	HSC Basis Swap	Henry Hub	Feb 2011 through Jun 2011	1,400,000	(3)	(106)
Short	WAHA Basis Swap	Henry Hub	Feb 2011 through Mar 2011	600,000	(38)	(38)
					<u>\$ (14,230)</u>	<u>\$ (13,706)</u>

Fuel Derivative Transactions as of January 31, 2010

(Dollars 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	Fixed Price Natural Gas	Henry Hub	Mar 2010 through Dec 2010	5,510,000	(5,960)	(1,881)
Long	HSC Basis Swap	Henry Hub	Feb 2010 through Dec 2010	3,475,000	534	527
					<u>\$ (5,520)</u>	<u>\$ (2,739)</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 at January 31, 2010. These hedging derivative instruments are 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 at January 31, 2010. This amount is reported on the Balance Sheets as a noncurrent liability and is classified as a component of accounts payable and accrued liabilities. Due to ERCOT's conversion from a zonal to nodal market in December 2010, annual auction rights will not be available until later in the 2011. Consequently, there were no PCRs held at January 31, 2011.

Preassigned Congestion Rights as of January 31, 2010

(Dollars in thousands)

<u>Purchase Date</u>	<u>Direction</u>	<u>MWhs</u>	<u>Fair Value</u>	<u>Cost</u>
December 11, 2009	North to West	8,030	\$ 52	\$ 8
December 11, 2009	North to South	8,030	2,502	375
			<u>\$ 2,554</u>	<u>\$ 383</u>

Credit Risk – CPS Energy began executing over-the-counter hedge transactions directly with approved counterparties in April 2010. These counterparties are generally highly rated entities that are leaders in their respective industries. CPS Energy monitors the creditworthiness of these entities on a daily basis and manages the resulting financial exposure via a third-party, vertically integrated risk system. Contractual terms with each existing counterparty vary, but each is structured so that should the counterparty's credit rating fall below BBB- with S&P or Baa3 with Moody's, no unsecured credit would be granted and the counterparty would be required to post collateral for any calculated credit exposure. In the event of default or nonperformance by counterparties, brokers or NYMEX, the operations of CPS Energy could be materially affected. However, CPS Energy does not expect these entities to fail to meet their obligations given the level of their credit ratings and the monitoring procedures in place with which to manage this risk. As of January 31, 2011, the exposure to all hedge-related counterparties was such that no counterparty credit risk existed.

Termination Risk – For CPS Energy's fuel hedges that are executed over the counter directly with approved counterparties, the possibility exists that one or more of these derivative instruments may end earlier than expected, thereby depriving CPS Energy of the protection from the underlying risk that was being hedged or potentially requiring CPS Energy to make a significant termination payment. This termination payment between CPS Energy and its counterparty is determined based on current market prices. In the event a transaction is terminated early, CPS Energy would likely be able to replace the transaction at current market prices with similar, although not exact, terms with one of its other approved counterparties.

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 2011, the HSC price was \$4.10 per MMBtu, the WAHA price was \$3.91 per MMBtu and the Henry Hub price was \$4.22 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, 2011 and 2010, 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 2011 or FY 2010.

CPS Energy Investment Securities and Collateral

At January 31, 2011, there was a total of \$488.2 million in securities, or 42.2% of the Company's investments, out on loan to brokers/dealers. In exchange, the Company received \$2.1 million in cash collateral and \$496.7 million in securities collateral, or 102.2% of the market value of the corresponding securities loaned. Income generated from securities lending transactions amounted to \$1.2 million in FY 2011, of which 30.0% was paid as fees to the lending agent totaling \$371.3 thousand.

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.

Decommissioning Trusts Investment Securities and Collateral

For the 28% Decommissioning Trust at December 31, 2010, there was a total of \$25.6 million in securities, or 8.6% of the Decommissioning Trust's investments, out on loan to brokers/dealers. In exchange, the Trust received \$17.2 million in cash collateral and \$8.9 million in securities collateral, or a total of 102.0% of the market value of the corresponding securities loaned. Income generated from securities lending transactions for this Decommissioning Trust amounted to \$26.7 thousand in calendar year 2010, of which 30.0% was paid as fees to the lending agent totaling \$8.0 thousand.

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 12% Decommissioning Trust at December 31, 2010, there was a total of \$12.2 million in securities, or 12.2% of the Decommissioning Trust's investments, out on loan to brokers/dealers. In exchange, the Trust received \$6.9 million in cash collateral and \$5.5 million in securities collateral, or a total of 101.8% of the market value of the corresponding securities loaned. Income generated from securities lending transactions for this Decommissioning Trust amounted to \$15.2 thousand in calendar year 2010, of which 30.0% was paid as fees to the lending agent totaling \$4.5 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.

13. 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 FY 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 2011 and FY 2010, the net amount recorded as income by CPS Energy was \$2.8 million for each period.

14. 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 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. 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. On October 28, 2010, STP submitted license renewal applications to the NRC. Upon approval of these applications, it is expected that STP Units 1 and 2 will be licensed for a total of 60 years of operation.

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 – 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 American Nuclear Energy Corporation ("TANE") 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 became 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 TANE as the provider of STP Units 3 and 4. The project expects to receive the final Safety Evaluation Report in late 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 CPS Energy to work with STPNOC to enter into an engineering, procurement and construction ("EPC") agreement with TANE 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.

Following notice published on February 21, 2009, on April 21, 2009, three individuals and three groups joined to file one Petition to Intervene against the STP Units 3 and 4 COLA. 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 the owners, plans to file supporting information as required to address any open issues, and the STPNOC staff believes these contentions can be resolved without hearings. The project schedule 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 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 TANE 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 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 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 retained 92.375% ownership. CPS Energy will not be liable for any 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 maintain the units. CPS Energy has withdrawn its pending application for a DOE loan guarantee. Also as a result of the settlement, NINA agreed to pay CPS Energy \$80.0 million, in two \$40.0 million payments, upon DOE issuance of a conditional loan guarantee. NINA also agreed to make a contribution of \$10.0 million over a four-year period to the Residential Energy Assistance Partnership ("REAP"), 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. As of January 31, 2011, CPS Energy had received \$2.5 million from NINA for REAP.

Shortly after the announcement on February 17, Tokyo Electric Power Company ("TEPCO") expressed conditional interest in participating in the project. TEPCO operates multiple nuclear units in Japan, including six that were in operation at its Fukushima plant.

On March 11, 2011, a region of Japan sustained significant loss of life and destruction as a result of a major earthquake and resulting tsunami. Included in the damage areas were the Fukushima nuclear units, which lost power to components of the backup and safety control systems and began emitting radiation into the surrounding environment. Following the incident, the NRC began looking into the safety aspects of nuclear plant operations in the United States with the objective of assuring that events such as those at the Fukushima plant do not occur in this country. While the NRC's assessments are

tentatively due by July 19, 2011, and because the review process is just beginning, it is unknown what the exact implications will be to safety standards at existing and proposed nuclear operations in the United States.

On March 21, 2011, NINA initially announced that it was reducing the scope of development of STP Units 3 and 4 to allow time for the NRC to assess the lessons that can be learned from the events in Japan. They further stated that continuing work, for the time being, would be limited to licensing and securing the DOE loan guarantee.

In the wake of the disaster, TEPCO is now expected to focus its most immediate efforts in Japan. It is currently unknown whether TEPCO will continue with its planned investment in STP Units 3 and 4 in the long-term.

On April 19, 2011, NRG announced that it will not invest additional capital in the STP Units 3 and 4 development effort and in the first quarter it would write off the entire value of its investment to date in the project while continuing to own a legal interest. TANE will be responsible for funding ongoing costs to continue the licensing process; however, TANE has yet to publicly disclose any specific plans beyond its possible short-term licensing effort. In light of the unclear path forward due to the reduction in scope of the project and uncertainty regarding timelines and long-term milestone commitments, CPS Energy's management is currently in the process of evaluating whether a full or partial write-down of its STP Units 3 and 4 asset may be appropriate. The Company is expected to make a write-down decision by the end of the second quarter of FY 2012. Due to the unusual and infrequent nature of the circumstances that have to be considered, management currently believes that, if applicable, the impact of writing down the project would be treated as an extraordinary item on its Statements of Revenues, Expenses and Changes in Fund Net Assets.

Excluding AFUDC of \$21.0 million, project costs incurred by CPS Energy to date of \$370.0 million 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 both FY 2011 and FY 2010. Preshutdown decommissioning expenses for the 28% ownership totaled \$77.9 thousand for FY 2011 and \$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 \$33.4 thousand for FY 2011 and \$115.7 thousand for FY 2010.

Excluding securities lending cash collateral, as of December 31, 2010, and December 31, 2009, CPS Energy had accumulated approximately \$301.7 million and \$266.8 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 \$209.0 million, which exceeded the calculated financial assurance amount of \$139.5 million at December 31, 2010.

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, 2010, and December 31, 2009, approximately \$100.1 million and \$90.3 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 \$68.9 million, which exceeded the calculated financial assurance amount of \$59.8 million at December 31, 2010.

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) was recognized as a liability. In subsequent years, annual decommissioning expense and an increase in the liability 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*, is 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 totaling \$8.7 million were made in fiscal year 2010 of which \$8.2 million related to the 2010 plan year while \$400.0 thousand related to the 2009 plan year. 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 \$6.2 million for plan year 2010 will be required to be made by September 15, 2011, 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)*. FASB 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 \$(14.7) million for FY 2011 and was reflected as a decrease in Other Changes in Fund Net Assets on the Statements of Revenues, Expenses and Changes in Fund Net Assets. For FY 2010, the effect of the defined benefit funding obligations was \$9.8 million and was reflected as an increase in Other Changes in Fund Net Assets.

Employees whose pension benefits exceed \$245 thousand for the 1974 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 has a supplemental retirement plan for certain key individuals.

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.

STPNOC 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. STPNOC 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 2010 and 2009

(Dollars in thousands)

	Pension Benefits		Other Benefits	
	2010	2009	2010	2009
Change in benefit obligation				
Benefit obligation - beginning	\$ 259,244	\$ 240,915	\$ 76,990	\$ 70,701
Service cost	8,652	9,675	6,264	5,839
Interest cost	15,415	14,336	4,511	4,151
Actuarial loss	29,732	(2,331)	16,827	(953)
Benefits paid	<u>(3,943)</u>	<u>(3,350)</u>	<u>(2,487)</u>	<u>(2,748)</u>
Benefit obligation - ending	<u>309,100</u>	<u>259,245</u>	<u>102,105</u>	<u>76,990</u>
Change in plan assets				
Fair value of plan assets - beginning	161,845	132,279	9,665	8,706
Actual return on plan assets	16,747	21,593	1,332	1,511
Employer contributions	8,665	11,323	2,125	2,196
Benefits paid	<u>(3,943)</u>	<u>(3,350)</u>	<u>(2,487)</u>	<u>(2,748)</u>
Fair value of plan assets - ending	<u>183,314</u>	<u>161,845</u>	<u>10,635</u>	<u>9,665</u>
Funded status - ending	(125,786)	(97,400)	(91,470)	(67,325)
Unrecognized net actuarial loss	100,137	79,835	38,668	23,798
Unrecognized prior service cost	5,581	6,752	(10,597)	(12,023)
Unrecognized transition obligation	<u>-</u>	<u>-</u>	<u>196</u>	<u>251</u>
Cumulative difference between recognized and unrecognized net expense and funding	<u>\$ (20,068)</u>	<u>\$ (10,813)</u>	<u>\$ (63,203)</u>	<u>\$ (55,299)</u>
Amount recognized in other liabilities	<u>\$ (125,786)</u>	<u>\$ (97,400)</u>	<u>\$ (91,470)</u>	<u>\$ (67,325)</u>
Weighted-average assumptions used to determine benefit obligation				
Discount rate	5.50%	6.00%	5.25%	6.00%
Expected return on plan assets	8.00%	8.00%	8.00%	8.00%
Rate of compensation increase	3.00%	3.00%	3.00%	3.00%

15. Commitments and Contingencies

Purchase and construction commitments approximated \$2.4 billion at January 31, 2011. 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 \$2.7 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. CPS Energy committed more than \$5 billion by 2020 toward sustainability initiatives.

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. CPS Energy's investment in the Exelon Project totaled \$2.7 million as of January 31, 2011.

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 \$5.6 million and BDA has met its obligation, net of annual interest, of \$4.2 million.

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.

CPS Energy sells its excess power into the wholesale market. While the majority of these transactions are conducted in the short-term market, from time to time, the Company enters into long-term wholesale power supply agreements with other public power entities. The Company currently has two such agreements, one covering the period from 2011 through 2016 and one from 2016 through 2023. The volumes committed under these agreements represent less than 2.0% of current capacity. The Company regularly monitors the market values of these transactions to manage contract provisions with the counterparties.

16. Leases

Capital Leases

CPS Energy as Lessee – As of January 31, 2011, CPS Energy had no capital leases in which the Company was the lessee. The only capital lease arrangement for which CPS Energy was the lessee, a four-year lease for the use of computer servers, ended on October 31, 2010. As such, there were no future lease payments associated with this capital lease. The value of the assets acquired through the completed computer capital lease at January 31, 2011, and January 31, 2010, was as follows:

(In thousands)

	January 31,	
	2011	2010
Equipment	\$ 2,723	\$ 2,723
Accumulated depreciation	<u>(2,723)</u>	<u>(2,159)</u>
Net book value	<u>\$ -</u>	<u>\$ 564</u>

Operating Leases

CPS Energy as Lessee – CPS Energy has entered into operating lease agreements to secure the usage of railroad cars, 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. 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.

The future minimum lease payments made by 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 Payments</u>
2012	\$ 5,852
2013	4,072
2014	2,130
2015	1,770
2016	738
Later years	-
Total future minimum lease payments	<u>\$ 14,562</u>

CPS Energy's minimum lease payments for all operating leases for which the Company was the lessee amounted to \$8.0 million in FY 2011 compared to \$6.3 million in FY 2010. There were no contingent lease or sublease payments in FY 2011 or in FY 2010.

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. New leases pertaining to the use of CPS Energy's communication towers contain an escalation clause whereby the annual lease payments will increase by 4% per year after the first year of each lease.

Additionally, CPS Energy has three operating leases for the use of land that the Company owns, and it 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.

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>
2012	\$ 2,746
2013	2,756
2014	2,701
2015	2,679
2016	2,182
Later years	10,307
Total future minimum lease receipts	<u>\$ 23,371</u>

CPS Energy's minimum lease receipts for all operating leases for which the Company was the lessor amounted to \$8.9 million in FY 2011 compared to \$8.6 million in FY 2010. Contingent lease receipts amounted to \$328.1 thousand for FY 2011 compared to \$552.9 thousand for FY 2010. There were no sublease receipts in FY 2011 or FY 2010.

17. 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 FERC 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.

The pollution remediation liability was \$2.6 million as of January 31, 2011, and was \$887.6 thousand as of January 31, 2010. 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.

18. Subsequent Events

On February 17, 2010, CPS Energy and Nuclear Innovation North America LLC ("NINA"), the nuclear development company jointly owned by NRG Energy, Inc. ("NRG") and Toshiba American Nuclear Energy Corporation ("TANE"), 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 retained 92.375% ownership. CPS Energy is not liable for any project development costs incurred after January 31, 2010. Project costs incurred by CPS Energy as of January 31, 2011, totaled \$391.0 million.

Shortly after the announcement on February 17, Tokyo Electric Power Company ("TEPCO") expressed conditional interest in participating in the project. TEPCO operates multiple nuclear units in Japan, including six that were in operation at its Fukushima plant.

On March 11, 2011, a region of Japan sustained significant loss of life and destruction as a result of a major earthquake and resulting tsunami. Included in the damage areas were the Fukushima nuclear units, which lost power to components of the backup and safety control systems and began emitting radiation into the surrounding environment. Following the incident, the NRC began looking into the safety aspects of nuclear plant operations in the United States with the objective of assuring that events such as those at the Fukushima plant do not occur in this country. While the NRC's assessments are tentatively due by July 19, 2011, and because the review process is just beginning, it is unknown what the exact implications will be to safety standards at existing and proposed nuclear operations in the United States.

On March 21, 2011, NINA initially announced that it was reducing the scope of development of STP Units 3 and 4 to allow time for the NRC to assess the lessons that can be learned from the events in Japan. They further stated that continuing work, for the time being, would be limited to licensing and securing the DOE loan guarantee.

In the wake of the disaster, TEPCO is now expected to focus its most immediate efforts in Japan. It is currently unknown whether TEPCO will continue with its planned investment in STP Units 3 and 4 in the long-term.

On April 19, 2011, NRG announced that it will not invest additional capital in the STP Units 3 and 4 development effort and in the first quarter it would write off the entire value of its investment to date in the project while continuing to own a legal interest. TANE will be responsible for funding ongoing costs to continue the licensing process; however, TANE has yet to publicly disclose any specific plans beyond its possible short-term licensing effort. In light of the unclear path forward due to the reduction in scope of the project and uncertainty regarding timelines and long-term milestone commitments, CPS Energy's management is currently in the process of evaluating whether a full or partial write-down of its STP Units 3 and 4 asset may be appropriate. The Company is expected to make a write-down decision by the end of the second quarter of FY 2012. Due to the unusual and infrequent nature of the circumstances that have to be considered, management currently believes that, if applicable, the impact of writing down the project would be treated as an extraordinary item on its Statements of Revenues, Expenses and Changes in Fund Net Assets.

Excluding AFUDC of \$21.0 million, project costs incurred by CPS Energy to date of \$370.0 million are included in construction-in-progress.

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 certain 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: 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 electric transmission 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 that allows the purchaser to lock in the price difference between two natural gas delivery points or hubs, such as the Houston Ship Channel and Henry Hub, Louisiana.

Net Costs Recoverable/Refundable: Certain costs that are required to be deferred as a regulatory asset or a regulatory liability under FASB 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 the annual OPEB cost and the employer’s contributions to the plan.

Net Pension Obligation: The cumulative difference between the 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 a 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 a 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.

True Interest Cost: The rate, compounded semi-annually, necessary to discount the amounts payable on the respective principal and interest payment dates to the purchase price received for the new issue of bonds.

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.).