

EL PASO ELECTRIC CO /TX/
Form 10-Q
August 07, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2015

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

Commission file number 001-14206

El Paso Electric Company
(Exact name of registrant as specified in its charter)
Texas
(State or other jurisdiction of incorporation or organization)

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

Stanton Tower, 100 North Stanton, El Paso, Texas
(Address of principal executive offices)
(915) 543-5711
(Registrant’s telephone number, including area code)

79901
(Zip Code)

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

Indicate by check mark whether the registrant submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

As of July 31, 2015, there were 40,424,525 shares of the Company’s no par value common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

EL PASO ELECTRIC COMPANY
BALANCE SHEETS

	June 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
(In thousands)		
Utility plant:		
Electric plant in service	\$3,557,941	\$3,229,255
Less accumulated depreciation and amortization	(1,303,188	) (1,266,672)
Net plant in service	2,254,753	1,962,583
Construction work in progress	232,954	414,284
Nuclear fuel; includes fuel in process of \$31,378 and \$46,996, respectively	189,926	185,185
Less accumulated amortization	(74,877	) (73,701)
Net nuclear fuel	115,049	111,484
Net utility plant	2,602,756	2,488,351
Current assets:		
Cash and cash equivalents	10,364	40,504
Accounts receivable, principally trade, net of allowance for doubtful accounts of \$1,609 and \$2,253, respectively	91,947	71,165
Accumulated deferred income taxes	23,263	13,957
Inventories, at cost	48,702	45,889
Under-collection of fuel revenues	—	10,253
Prepayments and other	16,456	12,213
Total current assets	190,732	193,981
Deferred charges and other assets:		
Decommissioning trust funds	237,608	234,286
Regulatory assets	109,186	112,086
Other	31,193	30,597
Total deferred charges and other assets	377,987	376,969
Total assets	\$3,171,475	\$3,059,301

See accompanying notes to financial statements.

Table of ContentsEL PASO ELECTRIC COMPANY
BALANCE SHEETS (Continued)

	June 30, 2015 (Unaudited)	December 31, 2014
CAPITALIZATION AND LIABILITIES		
(In thousands except for share data)		
Capitalization:		
Common stock, stated value \$1 per share, 100,000,000 shares authorized, 65,705,078 and 65,725,246 shares issued, and 137,247 and 124,297 restricted shares, respectively	\$65,842	\$65,850
Capital in excess of stated value	318,927	318,515
Retained earnings	1,033,846	1,032,537
Accumulated other comprehensive loss, net of tax	(10,564	) (8,001
	1,408,051	) 1,408,901
Treasury stock, 25,416,441 and 25,492,919 shares, respectively, at cost	(423,373	) (424,647
Common stock equity	984,678	984,254
Long-term debt, net of current portion	1,134,231	1,134,179
Total capitalization	2,118,909	2,118,433
Current liabilities:		
Current maturities of long-term debt	15,000	15,000
Short-term borrowings under the revolving credit facility	128,072	14,532
Accounts payable, principally trade	61,676	78,862
Taxes accrued	23,772	28,210
Interest accrued	12,865	12,758
Over-collection of fuel revenues	1,512	932
Other	27,384	24,715
Total current liabilities	270,281	175,009
Deferred credits and other liabilities:		
Accumulated deferred income taxes	491,650	474,154
Accrued pension liability	89,231	94,272
Accrued post-retirement benefit liability	62,092	59,342
Asset retirement obligation	78,003	74,577
Regulatory liabilities	24,125	26,099
Other	37,184	37,415
Total deferred credits and other liabilities	782,285	765,859
Commitments and contingencies		
Total capitalization and liabilities	\$3,171,475	\$3,059,301
See accompanying notes to financial statements.		

Table of ContentsEL PASO ELECTRIC COMPANY
STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands except for share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Operating revenues	\$219,508	\$251,801	\$383,254	\$437,317
Energy expenses:				
Fuel	49,813	69,672	87,542	121,258
Purchased and interchanged power	11,742	18,128	22,917	36,043
	61,555	87,800	110,459	157,301
Operating revenues net of energy expenses	157,953	164,001	272,795	280,016
Other operating expenses:				
Other operations	57,656	60,285	113,255	116,423
Maintenance	19,857	15,945	35,417	30,227
Depreciation and amortization	23,135	21,083	44,700	41,651
Taxes other than income taxes	15,433	15,557	29,591	30,919
	116,081	112,870	222,963	219,220
Operating income	41,872	51,131	49,832	60,796
Other income (deductions):				
Allowance for equity funds used during construction	2,268	3,461	6,543	6,367
Investment and interest income, net	1,398	1,923	6,652	6,164
Miscellaneous non-operating income	507	590	687	2,107
Miscellaneous non-operating deductions	(1,271)	(599)	(1,762)	(1,018)
	2,902	5,375	12,120	13,620
Interest charges (credits):				
Interest on long-term debt and revolving credit facility	16,495	14,607	32,978	29,186
Other interest	354	288	517	461
Capitalized interest	(1,261)	(1,281)	(2,550)	(2,527)
Allowance for borrowed funds used during construction	(1,391)	(1,967)	(4,012)	(3,651)
	14,197	11,647	26,933	23,469
Income before income taxes	30,577	44,859	35,019	50,947
Income tax expense	9,505	14,763	10,489	16,236
Net income	\$21,072	\$30,096	\$24,530	\$34,711
Basic earnings per share	\$0.52	\$0.75	\$0.61	\$0.86
Diluted earnings per share	\$0.52	\$0.75	\$0.61	\$0.86
Dividends declared per share of common stock	\$0.295	\$0.280	\$0.575	\$0.545
Weighted average number of shares outstanding	40,269,885	40,180,569	40,256,615	40,164,913
Weighted average number of shares and dilutive potential shares outstanding	40,302,694	40,212,403	40,284,757	40,180,830

See accompanying notes to financial statements.

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STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands except for share data)

	Twelve Months Ended		
	June 30,		
	2015	2014	
Operating revenues	\$863,462	\$910,275	
Energy expenses:			
Fuel	217,289	242,197	
Purchased and interchanged power	51,678	69,616	
	268,967	311,813	
Operating revenues net of energy expenses	594,495	598,462	
Other operating expenses:			
Other operations	235,664	238,578	
Maintenance	70,819	62,758	
Depreciation and amortization	86,391	82,347	
Taxes other than income taxes	61,422	62,037	
	454,296	445,720	
Operating income	140,199	152,742	
Other income (deductions):			
Allowance for equity funds used during construction	14,838	11,197	
Investment and interest income, net	14,121	10,132	
Miscellaneous non-operating income	2,655	3,014	
Miscellaneous non-operating deductions	(4,943) (2,549)
	26,671	21,794	
Interest charges (credits):			
Interest on long-term debt and revolving credit facility	62,820	58,615	
Other interest	1,306	589	
Capitalized interest	(5,115) (5,217)
Allowance for borrowed funds used during construction	(8,729) (6,565)
	50,282	47,422	
Income before income taxes	116,588	127,114	
Income tax expense	35,341	40,647	
Net income	\$81,247	\$86,467	
Basic earnings per share	\$2.01	\$2.15	
Diluted earnings per share	\$2.01	\$2.15	
Dividends declared per share of common stock	\$1.135	\$1.075	
Weighted average number of shares outstanding	40,236,466	40,149,261	
Weighted average number of shares and dilutive potential shares outstanding	40,263,304	40,157,220	

See accompanying notes to financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,		Twelve Months Ended June 30,	
	2015	2014	2015	2014	2015	2014
Net income	\$21,072	\$30,096	\$24,530	\$34,711	\$81,247	\$86,467
Other comprehensive income (loss):						
Unrecognized pension and post-retirement benefit costs:						
Net gain (loss) arising during period	—	—	—	19,700	(74,028)	102,664
Prior service benefit	—	—	—	—	34,200	97
Reclassification adjustments included in net income for amortization of:						
Prior service benefit	(1,662)	(2,070)	(3,325)	(3,529)	(7,455)	(6,289)
Net loss	2,250	1,829	4,500	2,952	7,730	8,004
Net unrealized gains/losses on marketable securities:						
Net holding gains (losses) arising during period	(1,563)	6,070	(549)	7,068	3,210	20,206
Reclassification adjustments for net (gains) losses included in net income	182	(102)	(3,563)	(2,967)	(7,946)	(3,432)
Net losses on cash flow hedges:						
Reclassification adjustment for interest expense included in net income	116	109	230	216	452	425
Total other comprehensive income (loss) before income taxes	(677)	5,836	(2,707)	23,440	(43,837)	121,675
Income tax benefit (expense) related to items of other comprehensive income (loss):						
Unrecognized pension and post-retirement benefit costs	(291)	90	(622)	(7,332)	14,761	(39,817)
Net unrealized losses (gains) on marketable securities	325	(1,215)	881	(858)	979	(3,321)
Losses on cash flow hedges	(43)	(40)	(115)	(132)	(197)	(210)
Total income tax benefit (expense)	(9)	(1,165)	144	(8,322)	15,543	(43,348)
Other comprehensive income (loss), net of tax	(686)	4,671	(2,563)	15,118	(28,294)	78,327
Comprehensive income	\$20,386	\$34,767	\$21,967	\$49,829	\$52,953	\$164,794
See accompanying notes to financial statements.						

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

	Six Months Ended	
	June 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$24,530	\$34,711
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of electric plant in service	44,700	41,651
Amortization of nuclear fuel	21,379	21,877
Deferred income taxes, net	8,789	15,141
Allowance for equity funds used during construction	(6,543	) (6,367
Other amortization and accretion	8,888	9,145
Gain on sale of property, plant and equipment	—	(2,083
Net gains on sale of decommissioning trust funds	(3,563	) (2,967
Other operating activities	243	(64
Change in:		
Accounts receivable	(20,782	) (33,585
Inventories	(2,813	) (100
Net over-collection (under-collection) of fuel revenues	10,833	(13,369
Prepayments and other	(7,476	) (6,691
Accounts payable	(15,528	) 1,983
Other current liabilities	(214	) 428
Deferred charges and credits	(2,068	) (2,739
Net cash provided by operating activities	60,375	56,971
Cash flows from investing activities:		
Cash additions to utility property, plant and equipment	(147,040	) (105,999
Cash additions to nuclear fuel	(22,424	) (17,690
Capitalized interest and AFUDC:		
Utility property, plant and equipment	(10,555	) (10,018
Nuclear fuel	(2,550	) (2,527
Allowance for equity funds used during construction	6,543	6,367
Decommissioning trust funds:		
Purchases, including funding of \$2.3 million	(41,029	) (40,924
Sales and maturities	37,158	36,374
Proceeds from sale of property, plant and equipment	—	2,377
Other investing activities	82	1,650
Net cash used for investing activities	(179,815	) (130,390
Cash flows from financing activities:		
Dividends paid	(23,220	) (21,969
Borrowings under the revolving credit facility:		
Proceeds	167,103	142,951
Payments	(53,563	) (59,531
Other financing activities	(1,020	) (928
Net cash provided by financing activities	89,300	60,523
Net decrease in cash and cash equivalents	(30,140) (12,896
Cash and cash equivalents at beginning of period	40,504	25,592

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Cash and cash equivalents at end of period	\$10,364	\$12,696
See accompanying notes to financial statements.		

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EL PASO ELECTRIC COMPANY
 NOTES TO FINANCIAL STATEMENTS
 (Unaudited)

A. Principles of Preparation

These condensed financial statements should be read in conjunction with the financial statements and notes thereto in the Annual Report of El Paso Electric Company on Form 10-K for the year ended December 31, 2014 (the "2014 Form 10-K"). Capitalized terms used in this report and not defined herein have the meaning ascribed to such terms in the 2014 Form 10-K. In the opinion of the Company's management, the accompanying financial statements contain all adjustments necessary to present fairly the financial position of the Company at June 30, 2015 and December 31, 2014; the results of its operations and comprehensive operations for the three, six and twelve months ended June 30, 2015 and 2014; and its cash flows for the six months ended June 30, 2015 and 2014. The results of operations and comprehensive operations for the three and six months ended June 30, 2015 and the cash flows for the six months ended June 30, 2015 are not necessarily indicative of the results to be expected for the full calendar year.

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

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

Revenues. Revenues related to the sale of electricity are generally recorded when service is rendered or electricity is delivered to customers. The billing of electricity sales to retail customers is based on the reading of their meters, which occurs on a systematic basis throughout the month. Unbilled revenues are estimated based on monthly generation volumes and by applying an average revenue/kWh to the number of estimated kWhs delivered but not billed. Accounts receivable included accrued unbilled revenues of \$34.1 million at June 30, 2015 and \$21.2 million at December 31, 2014. The Company presents revenues net of sales taxes in its statements of operations.

Supplemental Cash Flow Disclosures (in thousands)

	Six Months Ended	
	June 30,	
	2015	2014
Cash paid for:		
Interest on long-term debt and borrowing under the revolving credit facility	\$30,922	\$27,216
Income tax paid, net	1,680	2,862
Non-cash investing and financing activities:		
Changes in accrued plant additions	(1,227	) 2,100
Grants of restricted shares of common stock	1,106	2,930

New Accounting Standards. In May 2014, the Financial Accounting Standards Board ("FASB") issued new guidance (Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606)) to provide a framework that replaces the existing revenue recognition guidance. ASU 2014-09 is the result of a joint effort by the FASB and the International Accounting Standards Board intended to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. Generally Accepted Accounting Principles ("GAAP") and International Financial Reporting Standards. ASU 2014-09 provides that an entity should recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 was originally intended to be effective for annual periods and interim periods within that reporting period beginning after December 15, 2016, for public business entities. On April 1, 2015, the FASB voted to propose to defer the effective date to December 15, 2017. Early adoption of ASU 2014-09 is permitted after December 15, 2016. The Company is currently assessing the future impact of this ASU.

In April 2015, the FASB issued new guidance (ASU 2015-03, Interest - Imputation of Interest (Topic 715)) to simplify the presentation of debt issuance costs. ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented

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EL PASO ELECTRIC COMPANY
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. ASU 2015-03 is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The Company does not expect this ASU will materially impact the Company's results of operations and cash flows.

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NOTES TO FINANCIAL STATEMENTS
(Unaudited)

B. Accumulated Other Comprehensive Income (Loss)

Changes in Accumulated Other Comprehensive Income (Loss) (net of tax) by component are presented below (in thousands):

	Three Months Ended June 30, 2015				Three Months Ended June 30, 2014			
	Unrecognized Pension and Post-retirement Benefit Costs	Unrealized Gains (Losses) on Marketable Securities	Net Losses on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)	Unrecognized Pension and Post-retirement Benefit Costs	Unrealized Gains (Losses) on Marketable Securities	Net Losses on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)
Balance at beginning of period	\$(34,628)	\$ 36,782	\$(12,032)	\$ (9,878)	\$(9,388)	\$ 34,730	\$(12,283)	\$ 13,059
Other comprehensive income (loss) before reclassifications	—	(1,191)	—	(1,191)	—	4,845	—	4,845
Amounts reclassified from accumulated other comprehensive income (loss)	297	135	73	505	(151)	(92)	69	(174)
Balance at end of period	\$(34,331)	\$ 35,726	\$(11,959)	\$ (10,564)	\$(9,539)	\$ 39,483	\$(12,214)	\$ 17,730
	Six Months Ended June 30, 2015				Six Months Ended June 30, 2014			
	Unrecognized Pension and Post-retirement Benefit Costs	Unrealized Gains (Losses) on Marketable Securities	Net Losses on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)	Unrecognized Pension and Post-retirement Benefit Costs	Unrealized Gains (Losses) on Marketable Securities	Net Losses on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)
Balance at beginning of period	\$(34,884)	\$ 38,957	\$(12,074)	\$ (8,001)	\$(21,330)	\$ 36,240	\$(12,298)	\$ 2,612
Other comprehensive income (loss)	—	(369)	—	(369)	12,147	5,644	—	17,791

income (loss) before reclassifications Amounts reclassified from accumulated other comprehensive income (loss) Balance at end of period	553	(2,862)	115	(2,194)	(356)	(2,401)	84	(2,673)
	\$(34,331)	\$ 35,726	\$(11,959)	\$(10,564)	\$(9,539)	\$ 39,483	\$(12,214)	\$ 17,730

	Twelve Months Ended June 30, 2015				Twelve Months Ended June 30, 2014			
	Net Unrecognized Pension and Post-retirement Benefit Costs	Unrealized Gains (Losses) on Marketable Securities	Net Losses on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)	Net Unrecognized Pension and Post-retirement Benefit Costs	Unrealized Gains (Losses) on Marketable Securities	Net Losses on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)
Balance at beginning of period	\$(9,539)	\$ 39,483	\$(12,214)	\$ 17,730	\$(74,198)	\$ 26,030	\$(12,429)	\$(60,597)
Other comprehensive income (loss) before reclassifications Amounts reclassified from accumulated other comprehensive income (loss) Balance at end of period	(24,775)	2,681	—	(22,094)	63,518	16,206	—	79,724
	(17)	(6,438)	255	(6,200)	1,141	(2,753)	215	(1,397)
	\$(34,331)	\$ 35,726	\$(11,959)	\$(10,564)	\$(9,539)	\$ 39,483	\$(12,214)	\$ 17,730

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NOTES TO FINANCIAL STATEMENTS
(Unaudited)

Amounts reclassified from accumulated other comprehensive income (loss) for the three, six and twelve months ended June 30, 2015 and 2014 are as follows (in thousands):

Details about Accumulated Other Comprehensive Income (Loss) Components	Three Months Ended June 30,		Six Months Ended June 30,		Twelve Months Ended June 30,		Affected Line Item in the Statement of Operations
	2015	2014	2015	2014	2015	2014	
Amortization of pension and post-retirement benefit costs:							
Prior service benefit	\$1,662	2,070	\$3,325	3,529	\$7,455	\$6,289	(a)
Net loss	(2,250)	(1,829)	(4,500)	(2,952)	(7,730)	(8,004)	(a)
	(588)	241	(1,175)	577	(275)	(1,715)	(a)
Income tax effect	291	(90)	622	(221)	292	574	
	(297)	151	(553)	356	17	(1,141)	(a)
Marketable securities:							
Net realized gain (loss) on sale of securities	(182)	102	3,563	2,967	7,946	3,432	Investment and interest income, net
	(182)	102	3,563	2,967	7,946	3,432	Income before income taxes
Income tax effect	47	(10)	(701)	(566)	(1,508)	(679)	Income tax expense
	(135)	92	2,862	2,401	6,438	2,753	Net income
Loss on cash flow hedge:							
Amortization of loss	(116)	(109)	(230)	(216)	(452)	(425)	Interest on long-term debt and revolving credit facility
	(116)	(109)	(230)	(216)	(452)	(425)	Income before income taxes
Income tax effect	43	40	115	132	197	210	Income tax expense
	(73)	(69)	(115)	(84)	(255)	(215)	Net income
Total reclassifications	\$(505)	\$174	\$2,194	\$2,673	\$6,200	\$1,397	

(a) These items are included in the computation of net periodic benefit cost. See Note I, Employee Benefits, for additional information.

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EL PASO ELECTRIC COMPANY

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

C. Regulation

General

The rates and services of the Company are regulated by incorporated municipalities in Texas, the Public Utility Commission of Texas ("PUC"), the New Mexico Public Regulation Commission ("NMPC"), and the Federal Energy Regulatory Commission ("FERC"). Municipal orders, ordinances and other agreements regarding rates and services adopted by Texas municipalities are subject to review and approval by the PUC. The FERC has jurisdiction over the Company's wholesale (sales for resale) transactions, transmission service and compliance with federally-mandated reliability standards. The decisions of the PUC, the NMPC and the FERC are subject to judicial review.

Texas Regulatory Matters

2012 Texas Retail Rate Case. On April 17, 2012, the El Paso City Council approved the settlement of the Company's 2012 Texas retail rate case and fuel reconciliation in PUC Docket No. 40094. The PUC issued a final order approving the settlement on May 23, 2012 and the rates were effective as of May 1, 2012. As part of the 2012 Texas retail rate settlement, the Company agreed to submit a future fuel reconciliation request covering the period beginning July 1, 2009 and ending no later than June 30, 2013 by December 31, 2013 or as part of its next rate case, if earlier. The Company filed a fuel reconciliation request covering the period July 1, 2009 through March 31, 2013, as discussed below. The 2012 Texas retail rate settlement also provided for the continuation of the energy efficiency cost recovery factor and the military base discount recovery factor. Both of these surcharges require annual filings to reconcile and revise the recovery factors.

Energy Efficiency Cost Recovery Factor. The Company made its annual filing to establish its energy efficiency cost recovery factor for 2015 on May 1, 2014. In addition to projected energy efficiency costs for 2015 and true-up to prior year actual costs, the Company requested approval of a \$2.0 million bonus for the 2013 energy efficiency program results in accordance with PUC rules. The PUC approved the Company's request at its November 14, 2014 open meeting. The Company recorded the \$2.0 million bonus as operating revenue in the fourth quarter of 2014.

On May 1, 2015, the Company made its annual filing to establish its energy efficiency cost recovery factor for 2016. In addition to projected energy efficiency costs for 2016 and true-up to prior year actual costs, the Company requested approval of a \$1.0 million bonus for the 2014 energy efficiency program results in accordance with PUC rules. This case was assigned PUC Docket No. 44677. A hearing on the merits is currently scheduled for mid August 2015.

Fuel and Purchased Power Costs. The Company's actual fuel costs, including purchased power energy costs, are recovered from customers through a fixed fuel factor. The PUC has adopted a fuel cost recovery rule (the "Texas Fuel Rule") that allows the Company to seek periodic adjustments to its fixed fuel factor. The Company can seek to revise its fixed fuel factor based upon the approved formula at least four months after its last revision except in the month of December. The Texas Fuel Rule requires the Company to request to refund fuel costs in any month when the over-recovery balance exceeds a threshold material amount and it expects fuel costs to continue to be materially over-recovered. The Texas Fuel Rule also permits the Company to seek to surcharge fuel under-recoveries in any month the balance exceeds a threshold material amount and it expects fuel cost recovery to continue to be materially under-recovered. Fuel over- and under-recoveries are considered material when they exceed 4% of the previous twelve months' fuel costs. All such fuel revenue and expense activities are subject to periodic final review by the PUC in fuel reconciliation proceedings.

On April 15, 2014, the Company filed a request, which was assigned PUC Docket No. 42384, to increase its fixed fuel factor by approximately \$10.7 million annually or 6.9%, pursuant to its approved formula. The revised fixed fuel factor reflected an expected increase in prices for natural gas over the twelve month period beginning March 2014. The increase in the fixed fuel factor received final approval on May 28, 2014 and was effective with May 2014 billings. On April 15, 2015, the Company filed a request, which was assigned PUC Docket No. 44633, to reduce its fixed fuel factor by approximately 24% to reflect an expected reduction in fuel expense. The over-recovered balance

was below the materiality threshold. The reduction in the fixed fuel factor was effective on an interim basis May 1, 2015 and approved by the PUCT on May 20, 2015. As of June 30, 2015, the Company had over-recovered fuel costs in the amount of \$1.1 million for the Texas jurisdiction.

Fuel Reconciliation Proceeding. Pursuant to the 2012 Texas retail rate settlement discussed above, on September 27, 2013, the Company filed an application with the PUCT, designated as PUCT Docket No. 41852, to reconcile \$545.3 million of fuel and purchased power expenses incurred during the 45-month period from July 1, 2009 through March 31, 2013. A settlement was

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reached and a final order was issued by the PUCT on July 11, 2014. The PUCT's final order completes the regulatory review and reconciliation of the Company's fuel expenses for the period through March 31, 2013.

The settlement provides that 100% of margins on non-arbitrage off-system sales (as defined by the settlement) and 50% of margins on arbitrage off-system sales be shared with its Texas customers beginning April 1, 2014. For the period April 1, 2014 through June 30, 2015, the Company's total share of margins assignable to Texas retail jurisdiction, on arbitrage and non-arbitrage off-system sales, may not exceed 10% of the total margins assignable to the Texas retail jurisdiction on all off-system sales. The Company also agreed to file with the PUCT a proceeding to address the reasonableness of the Company's decision to not continue to participate in the Four Corners Generating Station ("Four Corners") after July 2016. It is expected that the final coal mine closing and reclamation costs will be addressed in that proceeding as well as other issues related to post-participation events such as the asset retirement obligations related to those two units.

Montana Power Station Approvals. The Company has received a Certificate of Convenience and Necessity ("CCN") from the PUCT to construct four natural gas fired generating units at the Montana Power Station ("the MPS") in El Paso County, Texas. The Company also obtained air permits from the Texas Commission on Environmental Quality ("TCEQ") and the U.S. Environmental Protection Agency ("EPA").

The PUCT has issued final orders approving CCNs for the MPS to Caliente transmission line, MPS In & Out transmission line and the MPS to Montwood transmission line. These transmission lines will connect MPS to the Company's transmission system for delivery of electricity throughout its service territory. MPS Units 1 and 2 and the MPS to Caliente and MPS In & Out transmission lines became operational in March 2015.

Solar Generation CCN Filing. On April 20, 2015, the Company filed a petition with the PUCT requesting CCN authorization to construct a new 20 MW solar-powered generation facility to be located on Fort Bliss in the Company's service territory in Texas. The new facility will be a Company-owned system resource. The Company has requested a PUCT final order by November 30, 2015 so that the project can be completed before December 31, 2016 to maximize potential tax benefits. This case was assigned PUCT Docket No. 44637. A hearing on the merits is currently scheduled for September 2015.

Community Solar. On June 8, 2015, the Company filed a petition with the PUCT to initiate a community solar program to include construction and ownership of a 3 MW solar photovoltaic system located at the MPS. Participation will be on a voluntary basis, and customers will contract for a set capacity (kW) amount and receive all energy produced. The Company has requested a PUCT final order approving the program so that the project can be completed before December 31, 2016 to maximize potential tax benefits. This case was assigned PUCT Docket No. 44800. No procedural schedule has yet been issued.

Four Corners Generating Station. On June 10, 2015, the Company filed an application requesting reasonableness and public interest findings and certain rate- and accounting- related findings to sell its ownership interest in Four Corners to Arizona Public Service Company ("APS") pursuant to a Purchase and Sale Agreement executed February 17, 2015. The anticipated closing date is July 6, 2016, pending regulatory approval. This case was assigned PUCT Docket No. 44805. The deadline for parties to request hearing is set as November 20, 2015, and the deadline for the PUCT Staff to file a recommendation in the case is November 30, 2015, if no hearing is requested. The Company cannot predict the outcome of the case at this time.

Other Required Approvals. The Company has obtained other required approvals for tariffs and approvals as required by the Public Utility Regulatory Act (the "PURA") and the PUCT.

New Mexico Regulatory Matters

2009 New Mexico Stipulation. On December 10, 2009, the NMPRC issued a final order conditionally approving the stipulated rates in NMPRC Case No. 09-00171-UT. The stipulated rates went into effect with January 2010 bills. The stipulated rates provide for an Efficient Use of Energy Factor Rate Rider to recover energy efficiency expenditures which are updated annually for adjustment to the recovery factors.

2015 New Mexico Rate Case Filing. On May 11, 2015, the Company filed with the NMPRC (NMPRC Case No. 15-00127-UT) for an annual increase in non-fuel base rates of approximately \$8.6 million or 7.1%. The filing also requests an annual reduction of \$15.4 million, or 21.5%, for fuel and purchased power costs recovered in base rates. The reduction in fuel and purchased power rates reflects reduced fuel prices and improvements in system heat rates due to new generating unit additions. Based on the standard procedural schedule, the Company expects new rates to go into effect early in the second quarter of 2016. A hearing in the case has been set to begin in November 2015. The Company cannot predict the outcome of the case at this time.

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Fuel and Purchased Power Costs. Fuel and purchased power costs are recovered through base rates and a Fuel and Purchased Power Cost Adjustment Clause (the "FPPCAC") that accounts for changes in the costs of fuel relative to the amount included in base rates. On January 8, 2014, the NMPRC approved the continuation of the FPPCAC without modification in NMPRC Case No. 13-00380-UT. Fuel and purchased power costs are reconciled to actual costs on a monthly basis and recovered or refunded to customers the second succeeding month. The Company recovers costs related to Palo Verde Unit 3 capacity and energy in New Mexico through the FPPCAC as purchased power using a proxy market price approved in the 2014 FPPCAC continuation.

Montana Power Station Approvals. The Company has received a CCN from the NMPRC to construct four units at the MPS and associated transmission lines. The Company also obtained all necessary air permits from the TCEQ and EPA. A final order in NMPRC Case No. 13-00297-UT approving the CCN for MPS Units 3 and 4 was issued on June 11, 2014. MPS Units 1 and 2 and the MPS to Caliente and MPS In & Out transmission lines became operational in March 2015.

Solar Generation CCN Filing. On April 20, 2015, the Company filed a petition with the NMPRC requesting CCN authorization to construct a new 20 MW solar-powered generation facility to be located on Fort Bliss in the Company's service territory in Texas. The new facility will be a Company-owned system resource. The Company has requested expedited approval and a NMPRC final order by November 30, 2015 so that the project can be completed before December 31, 2016 to maximize potential tax benefits. This case was assigned NMPRC Case No. 15-00099-UT. Hearings are currently scheduled for late August 2015.

Four Corners Generating Station. On April 27, 2015, the Company filed an application requesting all necessary regulatory approvals to sell its ownership interest in Four Corners to APS pursuant to a Purchase and Sale Agreement executed February 17, 2015. The anticipated closing date is July 6, 2016, pending regulatory approval. This case was assigned NMPRC Case No. 15-00109-UT. Hearings in the case are scheduled for January 2016. The Company cannot predict the outcome of the case at this time.

Expedited Approval for CCN (5 MW Holloman Facility). On June 15, 2015, the Company filed a petition with the NMPRC requesting CCN authorization to construct a 5 MW solar-powered generation facility to be located at Holloman Air Force Base ("HAFB") in the Company's service territory in New Mexico. The new facility will be a dedicated Company-owned resource serving HAFB. The Company has requested approval such that the project can be completed before December 31, 2016 to maximize potential tax benefits. This case was assigned NMPRC Case No. 15-00185-UT. Hearings in the case have been set to begin in September 2015.

Other Required Approvals. The Company has obtained other required approvals for other tariffs, securities transactions, long-term resource plans, recovery of energy efficiency costs through a base rate rider and other approvals as required by the NMPRC.

Federal Regulatory Matters

Four Corners Generating Station. On June 26, 2015, APS filed an application requesting authorization from FERC to purchase 100% of the Company's ownership interest in Units 4 and 5 of Four Corners and the associated transmission interconnection facilities and rights. APS has requested authorization be granted by FERC on or before December 24, 2015. The Company cannot predict the outcome of the case at this time.

Public Service Company of New Mexico's ("PNM") Transmission Rate Case. On December 31, 2012, PNM filed with FERC to change its method of transmission rate recovery for its transmission delivery services from stated rates to formula rates. The Company takes transmission service from PNM and is among the PNM transmission customers affected by PNM's shift to formula rates. On March 1, 2013, the FERC issued an order rejecting in part PNM's filing, and establishing settlement judge and hearing procedures. On March 20, 2015, PNM filed with FERC a settlement agreement and offer of settlement resolving all issues set for hearing in the proceeding. The Company cannot predict the outcome of the case at this time.

Other Required Approvals. The Company has obtained required approvals for rates and tariffs, securities transactions and other approvals as required by the FERC.

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D. Palo Verde

Spent Nuclear Fuel and Waste Disposal

Pursuant to the Nuclear Waste Policy Act of 1982, as amended in 1987 (the "NWPA"), the U.S. Department of Energy ("DOE") is legally obligated to accept and dispose of all spent nuclear fuel and other high-level radioactive waste generated by all domestic power reactors by 1998. The DOE's obligations are reflected in a contract for Disposal of Spent Nuclear Fuel and/or High-Level Radioactive Waste (the "Standard Contract") with each nuclear power plant. The DOE failed to begin accepting spent nuclear fuel by 1998. On December 19, 2012, APS, acting on behalf of itself and the participant owners of Palo Verde, filed a second breach of contract lawsuit against the DOE. This lawsuit sought to recover damages incurred due to the DOE's failure to accept Palo Verde's spent nuclear fuel for the period beginning January 1, 2007 through June 30, 2011. On August 18, 2014, APS and the DOE entered into a settlement agreement, stipulating to a dismissal of the lawsuit and payment of \$57.4 million by the DOE to the Palo Verde owners for certain specified costs incurred by Palo Verde during the period January 1, 2007 through June 30, 2011. On October 8, 2014, the Company received approximately \$9.1 million, representing its share of the award. The majority of the award was credited to customers through the applicable fuel adjustment clauses. On October 31, 2014, APS acting on behalf of itself and the participant owners of Palo Verde, submitted to the government an additional request for reimbursement of spent nuclear fuel storage costs for the period July 1, 2011 through June 30, 2014. The accepted claim amount was \$42.0 million. On June 1, 2015, the Company received approximately \$6.6 million, representing its share of the award. The majority of the award was credited to customers through the applicable fuel adjustment clauses in March 2015.

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E. Common Stock

Dividends. The Company paid \$11.9 million and \$11.3 million in quarterly cash dividends during the three months ended June 30, 2015 and 2014, respectively. The Company paid a total of \$23.2 million and \$45.8 million in quarterly cash dividends during the six and twelve months ended June 30, 2015, respectively. The Company paid a total of \$22.0 million and \$43.3 million in quarterly cash dividends during the six and twelve months ended June 30, 2014, respectively. On July 23, 2015, the Board of Directors declared a quarterly cash dividend of \$0.295 per share payable on September 30, 2015 to shareholders of record as of September 16, 2015.

Basic and Diluted Earnings Per Share. The basic and diluted earnings per share are presented below (in thousands except for share data):

	Three Months Ended June 30,	
	2015	2014
Weighted average number of common shares outstanding:		
Basic number of common shares outstanding	40,269,885	40,180,569
Dilutive effect of unvested performance awards	32,809	31,834
Diluted number of common shares outstanding	40,302,694	40,212,403
Basic net income per common share:		
Net income	\$21,072	\$30,096
Income allocated to participating restricted stock	(65	) (103
Net income available to common shareholders	\$21,007	\$29,993
Diluted net income per common share:		
Net income	\$21,072	\$30,096
Income reallocated to participating restricted stock	(65	) (103
Net income available to common shareholders	\$21,007	\$29,993
Basic net income per common share:		
Distributed earnings	\$0.295	\$0.280
Undistributed earnings	0.225	0.470
Basic net income per common share	\$0.520	\$0.750
Diluted net income per common share:		
Distributed earnings	\$0.295	\$0.280
Undistributed earnings	0.225	0.470
Diluted net income per common share	\$0.520	\$0.750

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	Six Months Ended June 30,	
	2015	2014
Weighted average number of common shares outstanding:		
Basic number of common shares outstanding	40,256,615	40,164,913
Dilutive effect of unvested performance awards	28,142	15,917
Diluted number of common shares outstanding	40,284,757	40,180,830
Basic net income per common share:		
Net income	\$24,530	\$34,711
Income allocated to participating restricted stock	(71	) (115
Net income available to common shareholders	\$24,459	\$34,596
Diluted net income per common share:		
Net income	\$24,530	\$34,711
Income reallocated to participating restricted stock	(71	) (115
Net income available to common shareholders	\$24,459	\$34,596
Basic net income per common share:		
Distributed earnings	\$0.575	\$0.545
Undistributed earnings	0.035	0.315
Basic net income per common share	\$0.610	\$0.860
Diluted net income per common share:		
Distributed earnings	\$0.575	\$0.545
Undistributed earnings	0.035	0.315
Diluted net income per common share	\$0.610	\$0.860

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	Twelve Months Ended June 30,	
	2015	2014
Weighted average number of common shares outstanding:		
Basic number of common shares outstanding	40,236,466	40,149,261
Dilutive effect of unvested performance awards	26,838	7,959
Diluted number of common shares outstanding	40,263,304	40,157,220
Basic net income per common share:		
Net income	\$81,247	\$86,467
Income allocated to participating restricted stock	(253)	(273)
Net income available to common shareholders	\$80,994	\$86,194
Diluted net income per common share:		
Net income	\$81,247	\$86,467
Income reallocated to participating restricted stock	(253)	(273)
Net income available to common shareholders	\$80,994	\$86,194
Basic net income per common share:		
Distributed earnings	\$1.135	\$1.075
Undistributed earnings	0.875	1.075
Basic net income per common share	\$2.010	\$2.150
Diluted net income per common share:		
Distributed earnings	\$1.135	\$1.075
Undistributed earnings	0.875	1.075
Diluted net income per common share	\$2.010	\$2.150

The amount of restricted stock awards and performance shares at 100% performance level excluded from the calculation of the diluted number of common shares outstanding because their effect was antidilutive is presented below:

	Three Months Ended June 30,		Six Months Ended June 30,		Twelve Months Ended June 30,	
	2015	2014	2015	2014	2015	2014
Restricted stock awards	48,669	41,753	58,432	60,583	59,380	57,945
Performance shares (a)	59,898	86,110	59,898	107,309	48,136	99,128

(a) Certain performance shares were excluded from the computation of diluted earnings per share as no payouts would have been required based upon performance at the end of each corresponding period.

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F. Income Taxes

The Company files income tax returns in the United States ("U.S.") federal jurisdiction and in the states of Texas, New Mexico and Arizona. The Company is no longer subject to tax examination by the taxing authorities in the federal and New Mexico jurisdictions for years prior to 2010. The Company is currently under audit in Texas for tax years 2007 through 2011 and in Arizona for tax years 2009 through 2012.

For the three months ended June 30, 2015 and 2014, the Company's effective tax rate was 31.1% and 32.9%, respectively. For the six months ended June 30, 2015 and 2014, the Company's effective tax rate was 30.0% and 31.9%, respectively. For the twelve months ended June 30, 2015 and 2014, the Company's effective tax rate was 30.3% and 32.0%, respectively. The Company's effective tax rate for all time periods differs from the federal statutory tax rate of 35.0% primarily due to the allowance for equity funds used during construction and state income taxes. The Company's effective tax rate for the six months ended June 30, 2015 also differs from the federal statutory tax rate of 35.0% due to capital gains in the qualified decommissioning trust realized in the first quarter of 2015, which are taxed at a federal tax rate of 20.0%.

In June 2015, legislation was approved in Texas which permanently reduced the Texas Franchise Tax rate to 0.75% tax on taxable margins down from an interim rate of 0.95%. The rate reduction is applicable to tax reports originally due on or after January 1, 2016 and is retroactive to January 1, 2015 tax accruals. The implementation of this rate change in June 2015 did not have a material impact on the financial statements of the Company.

G. Commitments, Contingencies and Uncertainties

For a full discussion of commitments and contingencies, see Note K of Notes to Financial Statements in the 2014 Annual Report on Form 10-K. In addition, see Notes C and D above and Notes C and E of Notes to Financial Statements in the 2014 Annual Report on Form 10-K regarding matters related to wholesale power sales contracts and transmission contracts subject to regulation and Palo Verde, including decommissioning, spent nuclear fuel and waste disposal, and liability and insurance matters.

Power Purchase and Sale Contracts

To supplement its own generation and operating reserves, and to meet required renewable portfolio standards, the Company engages in firm power purchase arrangements which may vary in duration and amount based on evaluation of the Company's resource needs, the economics of the transactions, and specific renewable portfolio requirements. For a full discussion of power purchase and sale contracts that the Company has entered into with various counterparties, see Note K of Notes to Financial Statements in the 2014 Form 10-K.

Environmental Matters

General. The Company is subject to extensive laws, regulations and permit requirements with respect to air and greenhouse gas emissions, water discharges, soil and water quality, waste management and disposal, natural resources and other environmental matters by federal, state, regional, tribal and local authorities. Failure to comply with such laws, regulations and requirements can result in actions by authorities or other third parties that might seek to impose on the Company administrative, civil and/or criminal penalties or other sanctions. In addition, releases of pollutants or contaminants into the environment can result in costly cleanup liabilities. These laws, regulations and requirements are subject to change through modification or reinterpretation, or the introduction of new laws and regulations and, as a result, the Company may face additional capital and operating costs to comply. For a more detailed discussion of certain key environmental issues, laws and regulations facing the Company see Note K of Notes to Financial Statements in the 2014 Form 10-K.

Clean Air Interstate Rule/Cross State Air Pollution Rule. The EPA promulgated the Cross-State Air Pollution Rule ("CSAPR") in August 2011, which rule involves requirements to limit emissions of nitrogen oxides ("NOx") and sulfur dioxide ("SO2") from certain of the Company's power plants in Texas and/or purchase allowances representing other parties' emissions reductions. CSAPR was intended to replace the EPA's 2005 Clean Air Interstate Rule ("CAIR"). While the U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") vacated CSAPR in

August 2012 and allowed CAIR to stand until the EPA issued a proper replacement, on April 29, 2014, the U.S. Supreme Court reversed and upheld CSAPR, remanding certain portions of CSAPR to the D.C. Circuit for further consideration. On June 26, 2014, the EPA filed a motion asking the D.C. Circuit to lift its stay on CSAPR, and on October 23, 2014, the D.C. Circuit lifted its stay of CSAPR. On July 28, 2015, the D.C. Circuit ruled that the

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EPA's emissions budgets for 13 states including Texas are invalid but leaves the rule in place on remand. While we are unable to determine the full impact of this decision until EPA takes further action, the Company believes it is currently positioned to comply with CSAPR.

National Ambient Air Quality Standards. Under the Clean Air Act ("CAA"), the EPA sets National Ambient Air Quality Standards ("NAAQS") for six criteria pollutants considered harmful to public health and the environment, including particulate matter ("PM"), NO_x, carbon monoxide ("CO"), ozone and SO₂. NAAQS must be reviewed by the EPA at five-year intervals. In 2010, the EPA tightened the NAAQS for both NO_x and SO₂. The EPA is considering a 1-hour secondary NAAQS for NO_x and SO₂. In January 2013, the EPA tightened the NAAQS for fine PM. On November 26, 2014, the EPA announced a proposal to tighten the 2008 primary and secondary ground-level ozone NAAQS. Ozone is the main component of smog. While not directly emitted into the air, it forms from precursors, including NO_x and volatile organic compounds, in combination with sunlight. EPA proposes to tighten the current 8-hour primary (health-based) standard of 75 parts per billion ("ppb") to a level within its preferred range of 65 to 70 ppb, while also taking comment on a potential standard as low as 60 ppb and on retaining the current standard. The EPA is expected to issue a final rule by November 2015 and make attainment/nonattainment designations for any revised standards by November 2017. The Company continues to evaluate what impact these final and proposed NAAQS could have on its operations. If the Company is required to install additional equipment to control emissions at its facilities, the revised NAAQS could have a material impact on its operations and financial results.

Utility MACT. The operation of coal-fired power plants, such as the Company's Four Corners plant, results in emissions of mercury and other air toxics. In December 2011, the EPA finalized Mercury and Air Toxics Standards (known as the "Utility MACT", or "MATS Rule") for oil-and coal-fired power plants, which requires significant reductions in emissions of mercury and other air toxics. Several judicial and other challenges were made to this rule, and on June 29, 2015, the U.S. Supreme Court remanded the rule to the D.C. Circuit Court, which rule remains in effect until the D.C. Circuit Court and the EPA take action. The legal status of the MATS Rule notwithstanding, the Four Corners plant operator, APS, believes Units 4 and 5 will require no additional modifications to achieve compliance with the MATS Rule, as currently written. We cannot currently predict, however, what additional modifications or costs may be incurred if the EPA rewrites the MATS Rule on remand.

Other Laws and Regulations and Risks. The Company has entered into an agreement to sell its interest in Four Corners to APS at the expiration of the 50-year participation agreement in July 2016. The Company believes that it has better economic and cleaner alternatives for serving the energy needs of its customers than coal-fired generation, which is subject to extensive regulation and litigation. By ceasing its participation in Four Corners, the Company will avoid the significant cost required to install expensive pollution control equipment in order to continue operation of the plant as well as the risks of water availability that might adversely affect the amount of power available, or the price thereof, from Four Corners in the future. The closing of the transaction is subject to the receipt of regulatory approvals.

Coal Combustion Waste. On April 17, 2015 the EPA published a final rule regulating the disposal of coal combustion residuals (the "CCR Rule") from electric utilities as solid waste. The Company has a 7% ownership interest in Units 4 and 5 of Four Corners, the only coal-fired generating facility for which the Company has an ownership interest subject to the CCR Rule. The Company entered into a Purchase and Sale Agreement with APS in February 2015 to sell the Company's entire ownership interest in Four Corners. For a discussion on the Purchase and Sale Agreement see Note E of the Notes to the Financial Statements in the 2014 Annual Report on Form 10-K. The CCR Rule essentially will require plant owners to treat coal combustion residuals as Subtitle D (as opposed to a more costly Subtitle C) waste. The Four Corners plant operator, APS, is reviewing the requirements of the CCR Rule and expects to be in material compliance with the rule by the effective date, October 14, 2015. In general, the Company would be liable for only 7% of costs to comply with the CCR Rule (consistent with our ownership percentage). The Company, however,

believes under the terms of the Four Corners Purchase Agreement and after the pending sale, as a former owner, that the Company would not be responsible for a significant portion of the costs under the CCR Rule, such as ongoing operational costs. Accordingly, the Company does not expect the CCR Rule to have a significant impact on our financial condition or results of operations.

In 2012, several environmental groups filed a lawsuit in federal district court against the Office of Surface Mining Reclamation and Enforcement ("OSM") of the U.S. Department of the Interior challenging OSM's 2012 approval of a permit revision which allowed for the expansion of mining operations into a new area of the mine that serves Four Corners ("Area IV North"). In April 2015, the court issued an order invalidating the permit revision, thereby prohibiting mining in Area IV North until OSM takes action to cure the defect in its permitting process identified by the court. Navajo Transitional Energy Company, the owner of the mine and supplier of coal to Four Corners, has indicated that it does not anticipate any near-term interruption of coal supply to the plant as a result of the suspension of mining in Area IV North. The Company cannot predict the time period that will be required

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for OSM's further permitting process to be completed or whether the outcome of the process will be sufficient to allow the permit to be reinstated.

Climate Change. The U.S. federal government has either considered, proposed and/or finalized legislation or regulations limiting greenhouse gas ("GHG") emissions, including carbon dioxide ("CO₂"). In particular, the U.S. Congress has considered legislation to restrict or regulate GHG emissions. In the past few years, the EPA began using the CAA to regulate CO₂ and other GHG emissions, such as the 2009 GHG Reporting Rule and the EPA's sulfur hexafluoride ("SF₆") reporting rule, both of which apply to the Company, as well as the EPA's 2010 actions to impose permitting requirements on new and modified sources of GHG emissions. After announcing his plan to address climate change in 2013, the President directed the EPA to issue proposals for GHG rulemaking addressing power plants. In August 2015, the EPA issued a final rule establishing new source performance standards limiting CO₂ emissions from new, modified and reconstructed electric generating units. In August 2015, the EPA also issued a rule establishing guidelines for states to regulate CO₂ emissions from existing power plants. The standards for existing plants are known as the Clean Power Plan ("CPP"), under which rule interim emissions performance rates must be achieved beginning in 2022 and final emissions performance rates by 2030. Legal challenges to the CPP are expected. We are evaluating the CPP and cannot at this time determine the impact of the CPP on our financial position, results of operations or cash flows.

Environmental Litigation and Investigations. Since 2009, the EPA and certain environmental organizations have been scrutinizing, and in some cases, have filed lawsuits, relating to certain air emissions and air permitting matters related to Four Corners. In particular, since July 2011, the U.S. Department of Justice (the "DOJ"), on behalf of the EPA, and APS have been engaged in substantive settlement negotiations in an effort to resolve certain of the pending matters. The allegations being addressed through settlement negotiations are that APS failed to obtain the necessary permits and install the controls necessary under the CAA to reduce SO₂, NO_x, and PM, and that defendants failed to obtain an operating permit under Title V of the CAA that reflects applicable requirements imposed by law. In November 2014, the DOJ provided APS with a draft consent decree to settle the EPA matter, which decree contains specific provisions for the reduction and control of NO_x, SO₂, and PM, as well as provisions for a civil penalty, and expenditures on environmental mitigation projects with an emphasis on projects that address alleged harm to the Navajo Nation. On June 24, 2015, the parties filed with the U.S. District Court for New Mexico a settlement agreement ("CAA Settlement Agreement") resolving this matter. The CAA Settlement Agreement, which is subject to final court approval, if finalized as currently written, would impose a total civil penalty payable by the co-owners of Four Corners collectively in the amount of \$1.5 million, and it requires the co-owners to pay \$6.7 million for environmental mitigation projects. The Company has accrued a total of \$0.6 million as its estimated share of the loss contingency related to this matter.

Earthjustice filed a lawsuit in the United States District Court for New Mexico on October 4, 2011 for alleged violations of the Prevention of Significant Deterioration ("PSD") provisions of the CAA related to Four Corners. On January 6, 2012, Earthjustice filed a First Amended Complaint adding claims for violations of the CAA's New Source Performance Standards ("NSPS") program. Among other things, the plaintiffs seek to have the court enjoin operations at Four Corners until APS applies for and obtains any required PSD permits and complies with the referenced NSPS program. The plaintiffs further request the court to order the payment of civil penalties, including a beneficial mitigation project. On April 2, 2012, APS and the other Four Corners participants filed motions to dismiss with the court. The case is being held in abeyance while the parties seek to negotiate a settlement. On March 30, 2013, upon joint motion of the parties, the court issued an order deeming the motions to dismiss withdrawn without prejudice during pendency of the stay. Based on the CAA Settlement Agreement, it is anticipated that the parties will file motions to dismiss this matter in the event the court approves such settlement agreement. The Company does not expect the outcome of this matter to have a material impact on its financial position, results of operations or cash flows.

New Mexico Tax Matter Related to Coal Supplied to Four Corners

On May 23, 2013, the New Mexico Taxation and Revenue Department issued a notice of assessment for coal severance surtax, penalty, and interest totaling approximately \$30 million related to coal supplied under the coal supply agreement for Four Corners (the "Assessment"). The Company's share of the Assessment is approximately \$1.5 million. On behalf of the Four Corners participants, the coal supplier made a partial payment of the Assessment and immediately filed a refund claim with respect to that partial payment in August 2013. The New Mexico Taxation and Revenue Department denied the refund claim. On December 19, 2013, the coal supplier and APS, on its own behalf and as operating agent for Four Corners, filed complaints with the New Mexico District Court contesting both the validity of the Assessment and the refund claim denial. On June 30, 2015, the court ruled that the Assessment was not valid and further ruled that APS and the other Four Corners co-owners receive a refund of all of the contested amounts previously paid under the applicable tax statute. The New Mexico Taxation and Revenue Department has indicated it intends to appeal the decision. The Company cannot predict the timing, results, or potential impacts of the outcome of this litigation.

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H. Litigation

The Company is a party to various legal actions. In many of these matters, the Company has excess casualty liability insurance that covers the various claims, actions and complaints. Based on a review of these claims and applicable insurance coverage, the Company believes that none of these claims will have a material adverse effect on the financial position, results of operations or cash flows of the Company. The Company expenses legal costs, including expenses related to loss contingencies, as they are incurred.

See Notes C and G above and Notes C and K of the Notes to Financial Statements in the 2014 Annual Report on Form 10-K for discussion of the effects of government legislation and regulation on the Company.

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I. Employee Benefits

Retirement Plans

The net periodic benefit cost recognized for the three, six and twelve months ended June 30, 2015 and 2014 is made up of the components listed below as determined using the projected unit credit actuarial cost method (in thousands):

	Three Months Ended		Six Months Ended		Twelve Months Ended	
	June 30, 2015	2014	June 30, 2015	2014	June 30, 2015	2014
Components of net periodic benefit cost:						
Service cost	\$2,100	\$2,189	\$4,200	\$4,362	\$8,425	\$8,859
Interest cost	3,625	3,790	7,250	7,660	14,632	14,474
Expected return on plan assets	(4,948)	(4,656)	(9,895)	(9,336)	(19,258)	(17,894)
Amortization of:						
Net loss	2,750	2,515	5,500	4,288	10,065	9,966
Prior service benefit	(887)	(894)	(1,775)	(1,153)	(3,528)	(1,106)
Net periodic benefit cost	\$2,640	\$2,944	\$5,280	\$5,821	\$10,336	\$14,299

During the six months ended June 30, 2015, the Company contributed \$6.6 million of its projected \$11.1 million 2015 annual contribution to its retirement plans.

Other Postretirement Benefits

The net periodic benefit cost recognized for the three, six and twelve months ended June 30, 2015 and 2014 is made up of the components listed below (in thousands):

	Three Months Ended		Six Months Ended		Twelve Months Ended	
	June 30, 2015	2014	June 30, 2015	2014	June 30, 2015	2014
Components of net periodic benefit cost:						
Service cost	\$875	\$722	\$1,750	\$1,422	\$3,173	\$3,065
Interest cost	1,025	1,107	2,050	2,232	4,281	4,638
Expected return on plan assets	(525)	(533)	(1,050)	(1,058)	(2,108)	(2,059)
Amortization of:						
Prior service benefit	(775)	(1,176)	(1,550)	(2,376)	(3,927)	(5,183)
Net gain	(500)	(686)	(1,000)	(1,336)	(2,335)	(1,962)
Net periodic benefit cost (benefit)	\$100	\$(566)	\$200	\$(1,116)	\$(916)	\$(1,501)

The Company has not contributed to its other postretirement benefits plan during the six months ended June 30, 2015 and does not expect to contribute to its other postretirement benefit plan in 2015.

J. Financial Instruments and Investments

FASB guidance requires the Company to disclose estimated fair values for its financial instruments. The Company has determined that cash and temporary investments, investment in debt securities, accounts receivable, decommissioning trust funds, long-term debt, short-term borrowings under the Revolving Credit Facility ("RCF"), accounts payable and customer deposits meet the definition of financial instruments. The carrying amounts of cash and temporary investments, accounts receivable, accounts payable and customer deposits approximate fair value because of the short maturity of these items. Investments in debt securities and decommissioning trust funds are carried at fair value.

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Long-Term Debt and Short-Term Borrowings Under the RCF. The fair values of the Company's long-term debt and short-term borrowings under the RCF are based on estimated market prices for similar issues and are presented below (in thousands):

	June 30, 2015		December 31, 2014	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Pollution Control Bonds	\$ 193,135	\$ 209,499	\$ 193,135	\$ 213,083
Senior Notes	846,096	973,648	846,044	968,728
RGRT Senior Notes (1)	110,000	117,005	110,000	117,215
RCF (1)	128,072	128,072	14,532	14,532
Total	\$ 1,277,303	\$ 1,428,224	\$ 1,163,711	\$ 1,313,558

(1) Nuclear fuel financing as of June 30, 2015 and December 31, 2014 is funded through the \$110 million RGRT Senior Notes and \$18.1 million and \$14.5 million, respectively under the RCF. As of June 30, 2015, \$110.0 million was outstanding under the RCF for working capital or general corporate purposes. As of December 31, 2014, no amount was outstanding under the RCF for working capital or general corporate purposes. The interest rate on the Company's borrowings under the RCF is reset throughout the quarter reflecting current market rates. Consequently, the carrying value approximates fair value.

Marketable Securities. The Company's marketable securities, included in decommissioning trust funds in the balance sheets, are reported at fair value which was \$237.6 million and \$234.3 million at June 30, 2015 and December 31, 2014, respectively. These securities are classified as available for sale under FASB guidance for certain investments in debt and equity securities and are valued using prices and other relevant information generated by market transactions involving identical or comparable securities. The reported fair values include gross unrealized losses on marketable securities whose impairment the Company has deemed to be temporary. The tables below present the gross unrealized losses and the fair value of these securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

Description of Securities (1):	June 30, 2015					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Federal Agency Mortgage Backed Securities	\$5,420	\$(223)	\$2,230	\$(81)	\$7,650	\$(304)
U.S. Government Bonds	9,910	(95)	16,405	(604)	26,315	(699)
Municipal Obligations	14,691	(404)	8,632	(517)	23,323	(921)
Corporate Obligations	4,938	(64)	3,694	(173)	8,632	(237)
Total Debt Securities	34,959	(786)	30,961	(1,375)	65,920	(2,161)
Common Stock	4,159	(234)	—	—	4,159	(234)
Total Temporarily Impaired Securities	\$ 39,118	\$(1,020)	\$ 30,961	\$(1,375)	\$ 70,079	\$(2,395)

(1) Includes 151 securities.

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Description of Securities (2):	December 31, 2014					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Federal Agency Mortgage Backed Securities	\$—	\$—	\$2,383	\$(57)	\$2,383	\$(57)
U.S. Government Bonds	1,552	(2)	20,060	(573)	21,612	(575)
Municipal Obligations	6,433	(65)	8,570	(410)	15,003	(475)
Corporate Obligations	2,455	(24)	2,461	(111)	4,916	(135)
Total Debt Securities	10,440	(91)	33,474	(1,151)	43,914	(1,242)
Common Stock	1,475	(229)	—	—	1,475	(229)
Common Collective Trust-Equity Funds	22,736	(821)	—	—	22,736	(821)
Total Temporarily Impaired Securities	\$34,651	\$(1,141)	\$33,474	\$(1,151)	\$68,125	\$(2,292)

(2)Includes 106 securities.

The Company monitors the length of time the security trades below its cost basis along with the amount and percentage of the unrealized loss in determining if a decline in fair value of marketable securities below recorded cost is considered to be other than temporary. In addition, the Company will research the future prospects of individual securities as necessary. As a result of these factors, as well as the Company's intent and ability to hold these securities until their market price recovers, these securities are considered temporarily impaired. The Company does not anticipate expending monies held in trust before 2044 or a later period when the Company is expected or is scheduled to decommission Palo Verde.

The reported fair values also include gross unrealized gains on marketable securities which have not been recognized in the Company's net income. The table below presents the unrecognized gross unrealized gains and the fair value of these securities, aggregated by investment category (in thousands):

Description of Securities:	June 30, 2015		December 31, 2014	
	Fair Value	Unrealized Gains	Fair Value	Unrealized Gains
Federal Agency Mortgage Backed Securities	\$11,484	\$521	\$15,388	\$665
U.S. Government Bonds	17,082	261	20,016	567
Municipal Obligations	6,832	325	11,642	595
Corporate Obligations	11,542	436	13,762	850
Total Debt Securities	46,940	1,543	60,808	2,677
Common Stock	90,241	44,636	99,160	48,253
Common Collective Trust-Equity Funds	24,043	1,382	—	—
Cash and Cash Equivalents	6,305	—	6,193	—
Total	\$167,529	\$47,561	\$166,161	\$50,930

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The Company's marketable securities include investments in municipal, corporate and federal debt obligations. Substantially all of the Company's mortgage-backed securities, based on contractual maturity, are due in ten years or more. The mortgage-backed securities have an estimated weighted average maturity which generally range from two years to six years and reflects anticipated future prepayments. The contractual year for maturity of these available-for-sale securities as of June 30, 2015 is as follows (in thousands):

	Total	2015	2016 through 2019	2020 through 2024	2025 and Beyond
Municipal Debt Obligations	\$30,155	\$515	\$10,772	\$13,095	\$5,773
Corporate Debt Obligations	20,174	705	5,763	7,530	6,176
U.S. Government Bonds	43,397	3,052	17,460	13,612	9,273

The Company recognizes impairment losses on certain of its securities deemed to be other than temporary. In accordance with FASB guidance, these impairment losses are recognized in net income, and a lower cost basis is established for these securities. The Company did not recognize other than temporary impairment losses on its available-for-sale securities in the three, six and twelve month periods ending June 30, 2015 and 2014, respectively. The Company's marketable securities in its decommissioning trust funds are sold from time to time and the Company uses the specific identification basis to determine the amount to reclassify out of accumulated other comprehensive income and into net income. The proceeds from the sale of these securities and the related effects on pre-tax income are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,		Twelve Months Ended June 30,	
	2015	2014	2015	2014	2015	2014
Proceeds from sales or maturities of available-for-sale securities	\$12,516	\$7,547	\$37,158	\$36,374	\$109,095	\$70,160
Gross realized gains included in pre-tax income	\$33	\$249				