SAFEGUARD SCIENTIFICS INC
Form 10-Q
July 29, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q
(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2016
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 1-5620

Safeguard Scientifics, Inc.
(Exact name of registrant as specified in its charter)

Pennsylvania	
(State or other jurisdiction of incorporation or organization)	23-1609753 (I.R.S. Employer ID No.)
170 North Radnor-Chester Road Suite 200 Radnor, PA	19087
(Address of principal executive offices)	(Zip Code)

(610) 293-0600
Registrant’s telephone number, including area 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 þ No ¨
Indicate by check mark whether the Registrant has 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 þ 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. (Check one):

Large accelerated filer ¨ Accelerated filer þ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a 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 þ
Number of shares outstanding as of July 27, 2016
Common Stock 20,224,506

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SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited - In thousands, except per share data)

	June 30, 2016	December 31, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	$66,231	$ 32,838
Marketable securities	14,462	31,020
Prepaid expenses and other current assets	2,345	5,810
Total current assets	83,038	69,668
Property and equipment, net	2,055	2,145
Ownership interests in and advances to partner companies	176,059	171,601
Loan participations receivable	2,845	2,649
Long-term marketable securities	10,680	9,743
Other assets	992	1,037
Total Assets	$275,669	$ 256,843
LIABILITIES AND EQUITY		
Current Liabilities:		
Accounts payable	$155	$ 290
Accrued compensation and benefits	2,556	3,338
Accrued expenses and other current liabilities	2,550	2,789
Total current liabilities	5,261	6,417
Other long-term liabilities	4,010	3,965
Convertible senior debentures	51,740	50,956
Total Liabilities	61,011	61,338
Commitments and contingencies		
Equity:		
Preferred stock, $0.10 par value; 1,000 shares authorized	—	—
Common stock, $0.10 par value; 83,333 shares authorized; 21,573 shares issued at June 30, 2016 and December 31, 2015	2,157	2,157
Additional paid-in capital	817,614	817,434
Treasury stock, at cost; 1,351 and 993 shares at June 30, 2016 and December 31, 2015, respectively	(23,759)	(19,570)
Accumulated deficit	(581,118)	(604,270)
Accumulated other comprehensive loss	(236)	(246)
Total Equity	214,658	195,505
Total Liabilities and Equity	$275,669	$ 256,843

See Notes to Consolidated Financial Statements.

SAFEGUARD SCIENTIFICS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited - In thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
General and administrative expense	$4,849	$4,754	$10,077	$9,634
Operating loss	(4,849)	(4,754)	(10,077)	(9,634)
Other income (loss), net	659	(15)	659	(403)
Interest income	527	640	947	1,089
Interest expense	(1,155)	(1,128)	(2,304)	(2,250)
Equity income (loss)	43,794	(13,765)	34,299	(22,427)
Net income (loss) before income taxes	38,976	(19,022)	23,524	(33,625)
Income tax benefit (expense)	—	—	—	—
Net income (loss)	$38,976	$(19,022)	$23,524	$(33,625)
Net income (loss) per share:				
Basic	$1.92	$(0.91)	$1.15	$(1.61)
Diluted	$1.70	$(0.91)	$1.09	$(1.61)
Weighted average shares used in computing income (loss) per share:				
Basic	20,333	20,895	20,391	20,878

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Operating Statistics

	Year
	2005
Operating revenues (in thousands):	
Base revenues:	
Retail:	
Residential	$ 183,667
Commercial and industrial, small	167,241
Commercial and industrial, large	41,321
Sales to public authorities	73,677
Total retail base revenues (1)	465,906
Wholesale:	
Sales for resale	1,687
Total base revenues	467,593
Fuel Revenues:	
Recovered from customer during the period	164,500
Change in deferred fuel revenues	79,539
Total fuel revenues	244,039
Off-system sales	78,209
Other	14,072
Total operating revenues	$ 803,913
Number of customers (end of year):	
Residential	304,031
Commercial and industrial, small	31,969
Commercial and industrial, large	61
Other	4,792
Total	340,853
Average annual kWh use per residential customer	6,936
Energy supplied, net, kWh (in thousands):	
Generated	7,500,144
Purchased and interchanged	1,258,469
Total	8,758,613
Energy sales, kWh (in thousands):	
Retail:	
Residential	2,090,098
Commercial and industrial, small	2,126,918
Commercial and industrial, large	1,165,506
Sales to public authorities	1,270,116
Total retail	6,652,638

Wholesale:	
Sales for resale	41,883
Off-system sales	1,420,778
Total wholesale	1,462,661
Total energy sales	8,115,299
Losses and Company use	643,314
Total	8,758,613
Native system:	
Peak load, kW	1,376,000
Net generating capacity for peak, kW	1,500,000
Total system:	
Peak load, kW (3)	1,628,000
Net generating capacity for peak, kW (4)	1,500,000
System capacity factor (5)	57.8%

(1) Includes fuel recovered through New Mexico base rates of $29.4 million, $28.0 r
2004, and 2003, respectively.

(2) Revised to conform with new 2004 large commercial and industrial billing syster
service location rather than by meter. This change did not affect sales or revenue

(3) Includes spot firm sales and net losses of 252,000 kW, 243,000 kW and 360,000
respectively.

(4) Excludes 103,000 kW of firm on and off-peak purchases for 2005, 2004 and 200

(5) System capacity factor includes average firm system purchases of 103,000 kW f

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Regulation

General

In 1999, both the Texas and New Mexico legislatures enacted electric utility industry
competition in certain functions of the industry and ultimately in the Company s serv
exempt from the requirements of the Texas Restructuring Law, including utility restru
the expiration of the original Texas Freeze Period, which occurred in August 2005. Th
rule that further delays competition in the Company s Texas service territory until at
regional transmission organization (RTO) begins operation in its relevant power m
Restructuring Act was repealed and as a result, the Company s operations in New Me
regulated. The Company cannot predict at this time the effect electric restructuring wi
be required to ultimately implement the Texas Restructuring Law.

Federal Regulatory Matters

Federal Energy Regulatory Commission. The FERC has been conducting an investiga
electricity prices in the western United States during 2000 and 2001. On August 13, 2
Power Act (FPA) investigation into the Company s wholesale power trading in the
2001 to determine whether the Company and Enron engaged in misconduct and, if so,
The Company reached settlements with the FERC and other parties in 2002 and 2003.
order approving the settlement resolved all issues between the FERC and the other pa
settlements, the Company agreed to refund $15.5 million and to make wholesale sales
authority rather than its market-based rate authority for the period December 1, 2002 t
agreement allowed the Company to sell power into wholesale markets at its incremen
the extent that wholesale market prices exceeded these agreed upon amounts, the Com
these additional revenues. This provision did not have a significant impact on the Con
December 31, 2004. The Company s ability to make wholesale sales pursuant to its m
restored on January 1, 2005.

RTOs. FERC s rule (Order 2000) on RTOs strongly encourages, but does not requ
RTOs. The Company is an active participant in the development of WestConnect, for
Southwest Transmission and Reliability Operator. A WestConnect Memorandum of U
the October 2, 2001 MOU, was signed by the Company and nine other transmission o
November 21, 2005 an eleventh member joined. This MOU obligates the parties to pa
to ongoing joint efforts, including involvement with stakeholders, customers, local, st
personnel, and other Western Grid transmission providers to identify, develop and im
market enhancements on a voluntary, phased-in basis to add value in transmission acc
efficiency and reliability for wholesale users of the Western Grid. These enhancement
of an RTO. WestConnect will continue to work with the FERC and two other propose
seamless market structure.

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The Company, however, is approximately a 7% participant in WestConnect and canno
development. WestConnect as an RTO will not be operational for several years. The e
RTO in the Company s service area is a prerequisite for the Company to be considere
as defined in the Texas Restructuring Law. The timing of the operations of WestConn
the Company s Texas service territory is deregulated under the Texas Restructuring L

Department of Energy. The DOE regulates the Company s exports of power to the C
granted by the DOE and a presidential permit. The DOE has determined that all such
transmission lines shall be made in accordance with Order No. 888, which established

The DOE is authorized to assess operators of nuclear generating facilities a share of th
DOE s uranium enrichment facilities and for the ultimate costs of disposal of spent n
Verde Station Spent Fuel Storage for discussion of spent fuel storage and disposal

Nuclear Regulatory Commission. The NRC has jurisdiction over the Company s licen
operation of nuclear generating stations to protect the health and safety of the public f
also has the authority to grant license extensions pursuant to the Atomic Energy Act o

Texas Regulatory Matters

The rates and services of the Company are regulated in Texas by municipalities and b
largest municipality in the Company s service area is the City of El Paso (City). T
appellate jurisdiction to review municipal orders and ordinances regarding rates and s
Texas and original jurisdiction over certain other activities of the Company. The decis
subject to judicial review.

Deregulation. The Texas Restructuring Law required certain investor-owned electric
generation activities and retail service activities from transmission and distribution act
that date, retail competition for generation services was instituted in some parts of Tex
however, specifically recognized and preserved the Company s Texas Rate Stipulatio
by, among other things, exempting the Company s Texas service area from retail com
Period. On October 13, 2004, the Texas Commission approved a rule further delaying
Company s Texas service territory. The rule approved by the Texas Commission sets
milestones for the Company to reach before competition can begin. The first mileston
approval by the FERC, and commencement of independent operation of an RTO in th
service territory, including the development of retail market protocols to facilitate reta
transition to retail competition would occur upon the completion of the last milestone,
Commission s final evaluation of the market s readiness to offer fair competition and
customers. The Company believes that adoption of this rule will likely delay retail com
of years. There is substantial uncertainty about both the regulatory framework and ma

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conditions that will exist if and when retail competition is implemented in the Compar
Company may incur substantial preparatory, restructuring and other costs that may no
can be no assurance that deregulation would not adversely affect the future operations
of the Company.

Renewables and Energy Efficiency Programs. Notwithstanding the Texas Commissio
delaying competition in the Company s Texas service territory, the Company becam
energy efficiency requirements of the Texas Restructuring Law on January 1, 2006. U
requirements, the Company will have to annually obtain its pro rata share of renewab
the Program Administrator (the Electric Reliability Council of Texas) appointed by th
total Texas retail sales subject to renewable energy credit allocation. During the 2005
the statewide obligation to increase renewable energy capacity was raised from an add
additional 5,000 MW of additional renewable generating capacity in Texas by 2015. T
to obtain renewable energy credits will not be known until January 31 of the year follo
will have until March 31 to obtain, if necessary, and submit to the Program Administr
Company estimates that its Texas retail sales will represent approximately 2% of the t
In addition, by January 1, 2007, the Company will be required to fund incentives for e
achieve the goal of meeting 5% of its growth in demand through energy efficiency sav
every year thereafter, that goal is 10% of the Company s growth in demand through e
Preparatory costs incurred by the Company to meet these requirements may not be rec
service territory during the New Texas Freeze Period which expires June 2010. Pursu
Efficiency Plan filed with the Texas Commission, the Company estimates it will incu
for incentive payments to achieve its energy efficiency goal.

New Texas Freeze Period and Franchise Agreement. On July 21, 2005, the Company
City, the City Rate Agreement, to extend its existing freeze period for an additional fi
New Texas Freeze Period. Under the City Rate Agreement which became effective as
rates will remain at their current level for the next five years. If, during the term of the
on equity falls below the bottom of a defined range, the Company has the right to initi
adjustment to base rates. If the Company s return on equity exceeds the top of the ran
City s direction, an amount equal to 50% of the pre-tax return in excess of the ceiling
current rates, would be a range of approximately 8% to 12%.

Pursuant to the City Rate Agreement, the Company will share with its Texas custome
and wheeling revenues. Under the prior rate agreement, the Company shared 50% of
wheeling revenues with Texas customers. The City Rate Agreement requires a varian
Texas Commission regarding the sharing of margins. The Company has sought Texas
Docket No. 32289 filed on January 17, 2006 of the margin sharing provisions of the a
does not approve the margin sharing provisions of the City Rate Agreement, the Com
negotiate in good faith to amend the rate agreement to achieve a similar economic res

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parties. The Company is unable to predict when or if the Texas Commission will appr
Commission decision is expected in the second quarter of 2006.

In addition, the Company has committed to spend at least 0.3% of its El Paso revenue
within the City. The Company and the City have agreed to engage at the Company s
independent consultant to review the reasonableness of certain operating expenses of
finds such expenses to be unreasonable, the parties will seek to negotiate an appropria
to agree on a remedy, the agreement will terminate at the end of one year, and, thereaf
to traditional rate regulation. The City has retained a consultant to conduct this review
in the second quarter of 2006. Consistent with the prior rate agreement, the City Rate
by the City in the event of a merger or change in control of the Company to seek rate
synergy savings.

The City also granted to the Company a new 25-year franchise which became effectiv
franchise fee payments from 2% to 3.25% of gross receipts earned within the City lim
Company s usage of City-owned property and the payment of franchise fees.

Fuel and Purchased Power Costs. Although the Company s base rates are frozen und
pursuant to Texas Commission rules and the City Rate Agreement, the Company s fu
customers. In January and July of each year, the Company can request adjustments to
reflect projected energy costs associated with providing electricity, seek recovery of p
revenues, and refund past overcollections of fuel revenues. All such fuel revenue and
periodic final review by the Texas Commission in fuel reconciliation proceedings.

The Company reconciled its Texas jurisdictional fuel costs for the period January 1, 1
PUC Docket No. 26194, and on May 5, 2004, the Texas Commission issued its final c
request to recover an additional $15.8 million, before interest, from its Texas custome
undercollections from January 1999 through December 2001. The Texas Commission
$4.5 million of Texas jurisdictional expenses, before interest, consisting primarily of (
purchased power expenses which the Texas Commission characterized as imputed c
(ii) approximately $0.3 million in fees which were deemed to be administrative costs,
disallowance was recorded as a reduction of fuel revenue during the fourth quarter of
are not eligible for recovery as fuel expenses but are to be recovered through the Com
base rates were frozen during the period in which the imputed capacity charges were c
$4.2 million of imputed capacity charges were therefore permanently disallowed and r
customers. The Texas Commission s decision has been appealed by two parties and t
unable to predict the ultimate outcome of the appeals.

On August 31, 2004, the Company filed an application to reconcile Texas jurisdiction
January 1, 2002 through February 29, 2004 in PUC Docket No. 30143. The Company
costs similar to those that were at issue in PUC Docket

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No. 26194 during the period covered by this fuel reconciliation case. The Company b
purchased power costs during the reconciliation period covered by PUC Docket No. 3
the Texas Commission s decision in PUC Docket No. 26194. However, the Texas Co
generic rulemaking proceeding to determine a statewide policy for the appropriate rec
costs in purchased power contracts. There can be no assurance as to the outcome of th
impact on the Company with respect to fuel recovery in future reconciliation periods,
No. 30143. Additionally, intervenors in PUC Docket No. 30143 filed testimony dispu
requested fuel and purchased power costs. A stipulation resolving all issues in the fuel
January 27, 2006. The stipulation provides for a $9.0 million disallowance of the eligi
Company. The Company recorded a reserve including $1.5 million in the third quarter
the stipulated $9.0 million in fuel disallowances in PUC Docket No. 30143. The Texa
order on March 8, 2006 which was consistent with the stipulation.

On July 8, 2005, the Company filed a petition (PUC Docket No. 31332) with the Texa
fuel factors and to surcharge under-recovered fuel costs as a result of higher natural ga
an increase in its Texas jurisdiction fixed fuel factors of $30.6 million or 23% annuall
natural gas of $7.28 per MMBtu. The Company also requested a fuel surcharge to rec
$28.2 million of fuel undercollections through the end of May 2005. On September 13
petition to seek additional fuel under-recoveries through August 2005 and requested th
of $53.6 million, including interest as of the end of the under-recovery period, be surc
September 14, 2005, the Company filed a unanimous stipulation to approve the reque
fuel surcharge. The fixed fuel factor and surcharge were implemented effective with b
approval from the Texas Commission was received in November 2005.

On January 5, 2006, the Company filed a petition (PUC Docket No. 32240) with the T
fixed fuel factors and to surcharge under-recovered fuel costs as a result of higher natu
requested an increase in its Texas jurisdiction fixed fuel factors of $30.8 million or 16
cost of natural gas of $9.35 per MMBtu. The Company also requested a fuel surcharg
period approximately $34 million of fuel undercollections, including interest, for unde
September 2005 through November 2005. The requested fuel factor and fuel surcharg
interim basis subject to refund effective with February 2006 bills to customers. The C
with parties on a settlement to resolve this proceeding. Any settlement will be subject
Commission.

Palo Verde Performance Standards. The Texas Commission established performance
Verde pursuant to which each Palo Verde unit is evaluated annually to determine whe
capacity factor entitles the Company to a reward or subjects it to a penalty. The capac
of actual generation to maximum possible generation. If the capacity factor, as measur
consecutive 24-month period, should fall below 35%, the parties to the City Rate Agr
treatment for Palo Verde. The removal of Palo Verde from rate base could have a sign

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impact on the Company s revenues and financial condition. Under the performance s
earned a performance reward nor incurred a penalty for the 2005 reporting period. Th
performance rewards for the reporting periods ending in 2004 and 2003 to be approxi
$0.8 million, respectively. The 2003 reward was included in the Texas fuel reconcilia
along with energy costs incurred and fuel revenues billed. The 2004 reward will be in
incurred and fuel revenue billed as part of the Texas Commission s review during a f
proceeding as discussed above. Performance rewards are not recorded on the Compan
Commission has ordered a final determination in a fuel proceeding or comparable evi
Performance penalties are recorded when assessed as probable by the Company.

In compliance with the Texas Commission s final order in PUC Docket No. 20450, t
November 2004 in the amount of $5.8 million of Palo Verde performance rewards fu
Assistance Agency and Big Bend Community Center Committee, Inc. to assist low-in
bills. In further compliance with the Texas Commission s order, the Company sough
El Paso City Council on January 3, 2006 to remit to the City approximately $5.8 milli
rewards funds to fund demand side management programs such as weatherization wi
small business and commercial customers.

New Mexico Regulatory Matters

The rates and services of the Company are regulated in New Mexico by the NMPRC.
Company s New Mexico service area is the City of Las Cruces. The NMPRC has jur
with municipalities regarding utility rates and services in New Mexico. The decisions
judicial review.

Deregulation. In April 2003, the New Mexico Restructuring Act was repealed, and as
in New Mexico will continue to be fully regulated.

New Mexico Rate Stipulation. On June 1, 2004, the Company implemented new rates
Stipulation whereby, among other things, the Company agreed for a period of three ye
(i) freeze base rates after an initial non-fuel base rate reduction of 1%; (ii) fix fuel and
with 10% of the Company s jurisdictional retail sales in New Mexico at $0.021 per k
reconciliation the remaining 90% of the Company s New Mexico jurisdictional fuel a
collected in base rates; (iv) continue the collection of a portion of fuel and purchased
presently collected in the amount of $0.01949 per kWh; (v) price power provided fro
its availability at an 80% nuclear, 20% gas fuel mix; and (vi) deem reconciled, for the
May 31, 2004, the Company s fuel and purchased power costs for the New Mexico j
Company must also make a New Mexico filing to set rates to be effective by June 1, 2

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Fuel and purchased power costs. In April 2004, the NMPRC, as part of the New Mex
purchased power cost adjustment clause. The Company will continue to recover fuel a
rates in the amount of $0.01949 per kWh and continue the fuel and purchased power c
the remaining fuel and purchased power costs. Fuel and purchased power costs associ
Company s jurisdictional retail sales in New Mexico are fixed at $0.021 per kWh.

On August 29, 2005, the Company filed the annual reconciliation of its Fuel and Purc
Clause (FPPCAC) for the period June 1, 2004 through May 31, 2005 in complianc
NMPRC s Final Order in NMPRC Case No. 03-00302-UT. The Company requested
purchased power costs for this period, and requested recovery of $1.3 million for the N
of purchased power capacity costs consistent with its interpretation of NMPRC rules.
recognized deferred fuel revenue through December 2005 to reflect recovery of these
case. Although a hearing date has not been established for this proceeding, the Compa
in the first half of 2006. While the Company believes that it has fully supported the re
and purchased power costs, the Company cannot predict when or how the NMPRC wi
ruling by the NMPRC could have a material negative effect on the Company s results

Renewables. The New Mexico Renewable Energy Act of 2004 requires that, by Janua
comprise no less than 5% of the Company s total retail sales to New Mexico custome
annually until January 1, 2011, when the renewable portfolio standard shall reach a le
retail sales to New Mexico customers and will remain fixed at such level thereafter. O
filed its Procurement Plan detailing its proposed actions to comply with the Renewabl

The NMPRC approved the Company s 2005 Annual Procurement Plan in December
(i) enter into a contract to purchase renewable energy certificates (RECs) for full re
approximately 50% of the Company s requirements in 2008 through 2011 and (ii) to
to recover from customers up to $0.2 million for costs related to the issuance of a dive
to meet the remaining requirements in the 2008 to 2011 timeframe and thereafter. Cos
purchase RECs to meet the requirements of the New Mexico Renewable Energy Act a
clause as purchased power costs from New Mexico customers pursuant to the Renewa
rules. The NMPRC s decision in this case has been appealed to the New Mexico Sup
Industrial Energy Consumers. The Company is unable to predict what, if any, action t
may take in this proceeding.

Sales for Resale

The Company provides up to 10 MW of firm capacity, associated energy, and transmi
Electric Cooperative pursuant to an ongoing contract which requires a two-year notice
been received.

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Power Sales Contracts

On November 3, 2005, the Company entered into a transaction for the sale of 25 MW
period in 2006, excluding the month of April. The Company has entered into addition
duration (three months or less).

Franchises and Significant Customers

City of El Paso Franchise

The Company s largest franchise agreement is with the City. The franchise agreemen
fee and allows the Company to utilize public rights-of-way necessary to serve its retai
franchise with the City extends through July 31, 2030.

Las Cruces Franchise

In February 2000, the Company and Las Cruces entered into a seven-year franchise ag
franchise fee (approximately $1.3 million per year) for the provision of electric distrib
prohibited during this seven-year period from taking any action to condemn or otherw
Company s distribution system, or attempt to operate or build its own electric distribu
90-day non-assignable option at the end of the Company s seven-year franchise agree
Company s distribution system that serves Las Cruces at a purchase price of 130% of
time. The Company must provide the book values of the assets covered by this agreem
Las Cruces by July 31, 2006. If Las Cruces exercises this option, it is prohibited from
two years. If Las Cruces fails to exercise this option, the franchise and standstill agree
additional two years.

Military Installations

The Company currently serves Holloman Air Force Base (Holloman), White Sands
United States Army Air Defense Center at Fort Bliss (Ft. Bliss). The Company s s
approximately 3% of annual operating revenues. The Company signed a contract with
which Ft. Bliss will take retail electric service from the Company through December 2
the Company entered into a ten-year contract to provide retail electric service to White
Company signed a new contract, subject to regulatory approval, with Holloman that p
retail electric service and limited wheeling services to Holloman for a ten-year term w

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Item 1A. Risk Factors

Like other companies in our industry, our consolidated financial results will be impac
service territory, fuel prices, the performance of our customers and the decisions of re
stock price and creditworthiness will be affected by national and international macroe
conditions and the expectations of the investment community, all of which are largely
the following statements highlight risk factors that may affect our consolidated financ
operations. These are not intended to be an exhaustive discussion of all such risks, and
together with factors discussed elsewhere in this document and in our other filings wi

Our Costs Could Increase or We Could Experience Reduced

There are Problems at the Palo Verde Nuclear Generatin

A significant percentage of our generating capacity, off-system sales margins, assets a
attributable to Palo Verde. Our 15.8% interest in each of the three Palo Verde units to
generating capacity. Palo Verde represents approximately 40% of our available net ge
approximately 46% of our available energy for the twelve months ended December 31
of our total net plant-in-service and Palo Verde expenses comprise a significant portio
expenses. We face the risk of additional or unanticipated costs at Palo Verde resulting
maintenance expenses; (ii) the replacement of steam generators in Palo Verde Unit 3;
vessel heads at the Palo Verde units; (iv) an extended outage of any of the Palo Verde
decommissioning costs; (vi) the storage of radioactive waste, including spent nuclear
generating output; (viii) insolvency of other Palo Verde Participants; and (ix) complia
and regulations governing commercial nuclear generating stations. At the same time,
effectively capped through June 2010. As a result, we cannot raise our base rates in T
non-fuel costs or loss of revenue unless our return on equity falls below the bottom of
which the bottom of the range is approximately 8%. Additionally, should retail compe
competitive pressure on our rates which could reduce profitability. We cannot assure
recover any increased costs, including any increased costs in connection with Palo Ve
a result of inflation, changes in tax laws or regulatory requirements, or other causes.

Typically, the Company realizes between 40% and 50% of its off-system sales margin
calendar year when the Company s native load is lower than at other times of the yea
wholesale market of relatively larger amounts of off-system energy generated from nu
availability is an important factor in realizing these off-system sales margins. The Co
output and upcoming outages at Palo Verde Unit 1, together with lower than originall
will result in reduced off-system sales margins of approximately $12 to $18 million fo
2006. The Company cautions that results would differ from its estimates to the extent
Verde Unit 1 operations and other factors vary from its assumptions. The adverse fina
continued reduced output and outages at Palo Verde Unit 1 could increase and would
margins, higher capital and/or operating costs and increased purchased power and oth

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Our City Rate Agreement with El Paso Could Termina

Under our City Rate Agreement, we agreed to engage the services of an independent c
reasonableness of certain operating expenses. If the consultant finds such expenses to
seek to negotiate an appropriate remedy. If the parties are unable to agree on a remedy
would expire on June 30, 2006. If that were to occur, we would be subject to tradition
appellate review by the Texas Commission beginning July 1, 2006. In such event, ther
would be able to maintain our Texas rates thereafter. In addition, the early termination
or denial by the Texas Commission to approve the fuel provision of the City Rate Agr
not be entitled to retain 75% of our margins from off-system sales retroactive to July 1
leads to lower rates or reduced off-system sales margin retention, there would be a po
our revenues, earnings, cash flows and financial position.

We May Not Be Able to Pass Through All of Our Fuel Expense

In general, by law, we are entitled to pass through our prudently incurred fuel and pur
customers in Texas and New Mexico. Nevertheless, we agreed in 2004 to a fixed fuel
kilowatt-hours of our retail customers in New Mexico pursuant to a base rate freeze th
also allows us to price a portion of power from Palo Verde Unit 3 at market prices wh
extent that this indirect hedge does not perfectly track our costs, we are subject to t
would not be recoverable. The portion of fuel expense that is not fixed is subject to re
Commission and the NMPRC. Prior to the completion of a reconciliation, we record f
revenues equal fuel expense except for the portion fixed in New Mexico. In the event
reconciliation proceeding, the amounts recorded for fuel and purchased power expens
we are allowed to collect from our customers and we would incur a loss to the extent

In New Mexico, the fuel adjustment clause allows us to reflect current fuel cost in the
under-recoveries and refund over-recoveries with a two month lag. In Texas, fuel cost
factor that may be adjusted two times per year. If we materially under-recover fuel co
recover those costs at the time of the next fuel factor filing. During periods of signific
such as occurred in 2004 and 2005, the Company realizes a lag in the ability to reflect
recovery mechanisms. As a result, the cash flow is impacted due to the lag in paymen
costs from customers. At December 31, 2005 and December 31, 2004, the Company h
$92 million and $19 million, respectively. A surcharge to collect fuel under-recoverie
period was placed into effect in Texas in October 2005. A second surcharge was place
Texas in February 2006 to collect $34 million over a twelve month period. To the ext
Texas and New Mexico do not provide for the timely recovery of fuel costs, the Comp
negative impact on its cash flow.

To insure that we have adequate liquidity we have recently begun the process of repla
credit facility with a new $150 million revolving credit facility. The new revolving cr
to the existing revolving credit facility and will provide up to $70 million for nuclear f
not borrowed for nuclear fuel purchases

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available for use for working capital. The Company expects, but has no assurance, tha
will be in place by the second quarter of 2006.

Equipment Failures and Other External Factors Can Adversely A

The generation and transmission of electricity require the use of expensive and compl
maintenance program in place, generating plants are subject to unplanned outages bec
particularly vulnerable to this due to the advanced age of several of our gas-fired gene
addition, we are seeking to extend the lives of these plants. In the event of unplanned
from others at unpredictable costs in order to supply our customers and comply with c
can materially increase our costs and prevent us from selling excess power at wholesa
addition, decisions or mistakes by other utilities may adversely affect our ability to us
import power, thus subjecting us to unexpected expenses or to the cost and uncertaint
are particularly vulnerable to this because a significant portion of our available energy
is located hundreds of miles from El Paso and Las Cruces and must be delivered to ou
transmission lines. These factors, as well as weather, interest rates, economic conditio
are largely beyond our control, but may have a material adverse effect on our consoli
financial position.

Competition and Deregulation Could Result in a Loss of Customers

As a result of changes in federal law, our wholesale and large retail customers already
sources of economical power, including co-generation of electric power. Texas has re
legislation requiring us to separate our transmission and distribution functions, which
power generation and energy services businesses, which would operate in a competiti
October 13, 2004, the Texas Commission approved a rule delaying retail competition
There is substantial uncertainty about both the regulatory framework and market cond
retail competition is implemented in our Texas service territory, and we may incur su
and other costs that may not ultimately be recoverable. There can be no assurance tha
affect our future operations, cash flows and financial condition.

Item 1B. Unresolved Staff Comments

We do not have unresolved SEC staff comments to disclose.

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Executive Officers of the Registrant

The executive officers of the Company as of February 2, 2006, were as follows:

Name	Age	Current Position and Business Experience
Gary R. Hedrick	51	Chief Executive Officer, President and Director since N President, Chief Financial and Administrative Officer fi 2001.
J. Frank Bates	55	Executive Vice President and Chief Operating Officer s President and Chief Operations Officer from November Transmission and Distribution from August 1996 to N
Scott D. Wilson	52	Executive Vice President, Chief Financial and Chief Ac 2006; Senior Vice President, Chief Financial Officer fro Vice President Corporate Planning and Controller fro Controller from September 2003 to February 2005; Ow from June 1992 to September 2003.
Steven P. Busser	37	Vice President Regulatory Affairs and Treasurer sinc February 2003 to February 2005; Assistant Chief Finan February 2003; Vice President International Controlle Inc. from August 2001 to June 2002; Vice President I Processing Company, Inc. from June 2000 to August 20
David G. Carpenter	50	Vice President Corporate Planning and Controller sin Regulatory Services for American Electric Power Servi August 2005 with responsibility for all regulatory activi American Electric Power Co., Inc. electric utility subsid
Fernando J. Gireud	48	Vice President Safety, Environmental, Power Market February 2006; Vice President Power Marketing and February 2003 to February 2006; Vice President Inter February 2003; Director International Business Affai Director International Business Affairs MiraSol fro
Helen Knopp	63	Vice President Customer and Public Affairs since Ap
Kerry B. Lore	46	Vice President Administration since May 2003; Cont 2003.
Robert C. McNiel	59	Vice President New Mexico Affairs since December
Hector R. Puente	49	Vice President Distribution since February 2006; Vic April 2001 to February 2006; Manager Substations an April 2001.
Andres Ramirez	45	Vice President Power Generation since February 200 Environmental and Resource Planning from July 2005 t Director Operations for Sempra Energy Texas Servic Senior Vice President Power Production for Austin E
Gary Sanders	47	General Counsel since February 2006; Assistant Genera from July 2004 to February 2006; Assistant General Co 2004; Shareholder in law firm of Gordon & Mott PC fr
Guillermo Silva, Jr.	52	Corporate Secretary since February 2006; Vice Presiden February 2003 to February 2006; Corporate Secretary f 2003.

John A. Whitacre	56	Vice President	Transmission since February 2006; Vi Distribution from July 2002 to February 2006; Assistan Operations from August 1989 to July 2002.

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

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Item 2. Properties

The principal properties of the Company are described in Item 1, Business, and suc
by reference. Transmission lines are located either on private rights-of-way, easement
public consent. Substantially all of the Company s utility plant is subject to liens to se
Series H First Mortgage Bonds.

In addition, the Company leases executive and administrative offices in El Paso, Texa
May 2007 and certain warehouse facilities in El Paso, Texas under a lease which expi
concurrent renewal options of six months each.

Item 3. Legal Proceedings

The Company is a party to various legal actions. In many of these matters, the Compa
insurance that covers the various claims, actions and complaints. Based upon a review
insurance coverage, to the extent that the Company has been able to reach a conclusio
believes that none of these claims will have a material adverse effect on the financial p
cash flows of the Company.

On January 16, 2003, the Company was served with a complaint on behalf of a purpo
violations of the federal securities laws (*Roth v. El Paso Electric Company, et al.,* No.
was filed in the El Paso Division of the United States District Court for the Western D
undisclosed compensatory damages for the class as well as costs and attorneys fees.
Pension Fund of Illinois, filed a consolidated amended complaint on July 2, 2003, alle
Company and certain of its current and former directors and officers violated securitie
some of the Company s revenues and income were derived from an allegedly unlawf
allegations arise out of the FERC investigation of the power markets in the western U
which the Company previously settled with the FERC Trial Staff and certain interveni
the Company and the individual defendants filed a motion to dismiss the complaint fo
which relief can be granted. On November 26, 2003, the Court denied the motion to d
of the individual defendants and granted the motion to dismiss as to two individual de
Court granted a motion of the Company and the remaining individual defendants requ
interlocutory appeal to the U. S. Court of Appeals for the Fifth Circuit regarding certa
Court s denial of the motion to dismiss the complaint as to those defendants. On Apri
order staying the district court proceedings until the Fifth Circuit completed its review
of Appeals denied the appeal which automatically lifted the stay in the district court. V
lawsuit was without merit, the parties reached a settlement to resolve this case. The pa
Settlement with the Court on June 2, 2005, and the Court issued a final order approvin
2005. The settlement was paid by the Company s insurance carrier since the deductib
any further charge to the Company s earnings.

On May 21, 2003, the Company was served with a complaint by the Port of Seattle se
Sherman Act, the Racketeer Influenced and Corrupt Organization Act, and state

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antitrust laws, as well as for fraud (*Port of Seattle v. Avista Corporation, et al.*, No. C
filed in the United States District Court for the Western District of Washington. The c
indirectly through its dealings with Enron, conspired with the other named defendants
energy market, which had the effect of artificially inflating the price that the Port of S
Company, together with several other defendants, filed a motion to dismiss. On May
Company s motion, and the suit was dismissed. The Port of Seattle has filed an appe
U. S. Court of Appeals for the Ninth Circuit. The parties are awaiting a hearing and de
Company believes that these matters are without merit, the Company is unable to pre
possible loss.

On May 5, 2004, Wah Chang, a specialty metals manufacturer which operates a plant
Company and other defendants in the United States District Court for the District of O
Corporation, et al., No. 04-619AS). The complaint makes substantially the same alleg
Seattle and seeks the same types of damages. In addition, on June 7, 2004, the City of
Company and other defendants in the United States District Court for the Western Dis
Tacoma v. American Electric Power Service Corp., et al., C04-5325RBL). This comp
same allegations as were made in *Port of Seattle* and seeks civil damages (including t
and the other defendants for violations of certain antitrust provisions under the Sherm
transferred to the same court that heard and dismissed the *Port of Seattle* lawsuit and
granted the Company s motion to dismiss both cases. Wah Chang and the City of Ta
appeal with the U.S. Court of Appeals for the Ninth Circuit. The parties have filed bri
hearing and decision. While the Company believes that these matters are without meri
vigorously, the Company is unable to predict the outcome or range of possible loss.

See Regulation for discussion of the effects of government legislation and regulati

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

No matter was submitted to vote of the Company s security holders through the solic
the fourth quarter of 2005.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matte Equity Securities

The Company s common stock trades on the New York Stock Exchange under the sy sales prices for the Company s common stock, as reported in the consolidated reporti Exchange for the periods indicated below were as follows:

2004
First Quarter
Second Quarter
Third Quarter
Fourth Quarter
2005
First Quarter
Second Quarter
Third Quarter
Fourth Quarter

As of January 31, 2006, there were 4,293 holders of record of the Company s commo anticipate paying dividends on its common stock in the near-term. The Company inte programs with the goal of maintaining or improving its capital structure, bond ratings

Since the inception of the stock repurchase programs in 1999, the Company has repur 15.3 million shares of its common stock at an aggregate cost of $175.6 million, includ 1.7 million shares remain authorized to be repurchased under the currently authorized repurchased during 2005. The Company may continue making purchases of its stock p plan at open market prices and may engage in private transactions, where appropriate. available for issuance under employee benefit and stock option plans, or may be retire

For Equity Compensation Plan Information see Part III, Item 12 Security Ownershi Management.

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Item 6. Selected Financial Data

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

			Years Ended De
	2005	2004	2003
Operating revenues	$ 803,913	$ 708,628	$ 664
Operating income	$ 107,883	$ 93,071	$ 79
Income before cumulative effect of accounting change and extraordinary item	$ 36,615	$ 33,369	$ 20
Cumulative effect of accounting change, net of tax	$ (1,093)	$	$ 39
Extraordinary gain on re-application of SFAS No. 71, net of tax	$	$ 1,802	$
Net income	$ 35,522	$ 35,171	$ 59
Basic earnings per share:			
Income before cumulative effect of accounting change and extraordinary item	$ 0.77	$ 0.70	$
Cumulative effect of accounting change, net of tax	$ (0.02)	$	$
Extraordinary gain on re-application of SFAS No. 71, net of tax	$	$ 0.04	$
Net income	$ 0.75	$ 0.74	$
Weighted average number of shares outstanding	47,711,894	47,426,813	48,424
Diluted earnings per share:			
Income before cumulative effect of accounting change and extraordinary item	$ 0.76	$ 0.69	$
Cumulative effect of accounting change, net of tax	$ (0.02)	$	$
Extraordinary gain on re-application of SFAS No. 71, net of tax	$	$ 0.04	$
Net income	$ 0.74	$ 0.73	$
Weighted average number of shares and dilutive potential shares outstanding	48,307,910	48,019,721	48,814
Cash additions to utility property, plant and equipment	$ 88,263	$ 72,092	$ 77
Total assets	$ 1,665,449	$ 1,580,835	$ 1,596
Long-term debt and financing and capital lease obligations, net of current portion	$ 611,018	$ 379,636	$ 608
Common stock equity	$ 556,439	$ 532,147	$ 495

Certain amounts presented for prior years have been reclassified to conform with the 2

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Item 7. Management s Discussion and Analysis of Financial Condition and R
As you read this Management s Discussion and Analysis, please refer to our Consoli
accompanying notes, which contain our operating results.

Summary of Critical Accounting Policies and Estimates

Note A to the Consolidated Financial Statements contains a summary of significant ac
of our financial statements requires management to make estimates and assumptions t
the consolidated financial statements and related notes for the periods presented and a
periods from those estimates. Critical accounting policies and estimates are both impo
financial condition and results of operations and require complex, subjective judgmen

- SFAS No. 71
- Collection of fuel expense
- Value of net utility plant in service
- Decommissioning costs and estimated asset retirement obligation
- Future pension and other postretirement obligations
- Reserves for tax dispute

SFAS No. 71

Regulated electric utilities typically prepare their financial statements in accordance w
accounting standard, certain recoverable costs are shown as either assets or liabilities
regulator provides assurance that these costs will be charged to and collected from the
permitted such cost recovery). The resulting regulatory assets or liabilities are amortiz
upon their respective amortization periods in a utility s cost of service.

Beginning in 1991, we discontinued the application of SFAS No. 71 to our financial s
on our determination that our rates were no longer designed to recover our costs of pr
emerging from bankruptcy in 1996, we again concluded that we did not meet the crite
because of the ten-year rate freeze in Texas and our ongoing intention not to seek cha
which had been established in 1990. Although we believe the rates established in 199
service, the unusual length of the rate freeze period created substantial uncertainty as
over the entire freeze period. Consequently, we determined that we should not re-appl
New Mexico jurisdictions at the time we emerged from bankruptcy in February 1996.

During 2004, we determined that we met the criteria necessary to re-apply SFAS No.
jurisdictional operations. Two key events transpired in New Mexico that, when consi
decision to re-apply SFAS No. 71. In April of 2004, we received a final order approvi
established new base and fuel rates for our New Mexico customers which were imple
rates were based upon our cost of providing service in New Mexico. That event, coup

electric utility

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industry restructuring law which occurred in April of 2003, resulted in us meeting the
SFAS No. 71 to New Mexico, beginning July 1, 2004. The re-application of SFAS No
jurisdiction resulted in the recording of $18.5 million of regulatory assets, $5.0 million
income tax assets, $16.2 million of regulatory liabilities, $5.5 million in related accum
$1.8 million extraordinary gain, net of tax, or $0.04 basic and diluted earnings per sha

We have not reapplied SFAS No. 71 to our Texas jurisdiction. However, we are curre
SFAS No. 71 to our Texas jurisdiction based upon the expiration of the ten year rate f
competition in 2004, and a new rate settlement agreement with the City of El Paso. In
settlement agreement with the City (City Rate Agreement) which provides for a ne
Period) until June 30, 2010. The City Rate Agreement specifically provides for our r
equity falls below a range around a calculated return on equity under current market c
Freeze Period, we may seek to increase rates. Likewise, if our return on equity exceed
must be paid to the City. The City Rate Agreement provides for the City to conduct a
and provides for revision of the rate agreement if they are not determined to be within
the utility industry. Also, the City Rate Agreement allows us to retain 75% of off-syst
previous 50%. While the City Rate Agreement has been approved by the City, in orde
the Texas Commission must approve the sharing of off-system sales margin provision
the entire agreement for the Texas customers outside the City. Once the City Rate Agr
Commission, we will complete the evaluation as to whether SFAS No. 71 should be r
The re-application of SFAS No. 71 will result in the recognition of regulatory assets a
material effect on our consolidated financial statements. However, the re-application c
on our cash flow.

Collection of Fuel Expense

In general, through regulation, our fuel and purchased power expenses are passed thro
later, in times of rising fuel prices, we experience a lag in recovery of higher fuel cost
reconciliation by the Texas Commission and the NMPRC. Prior to the completion of a
transactions such that fuel revenues equal fuel expense except for the fixed portion in
disallowance occurs during a reconciliation proceeding, the amounts recorded for fuel
could differ from the amounts we are allowed to collect from our customers, and we c
the disallowance.

Value of Net Utility Plant in Service

In 1996, when we emerged from bankruptcy, we recast our financial statements by ap
accordance with Statement of Position 90-7 Financial Reporting by Entities in Reorg
Code. In this process, we attributed value to our integrated utility system after we ha
forma capital structure based on management s estimates of future operating results.
depreciated value of our assets would be approximately equal to their estimated fair va

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The depreciation of the fresh-start asset value was completed in July 2005. If at any ti
undiscounted future net cash flows from the operations of our assets are not sufficient
then we will be required to write down the value of these assets to their fair values. A
charged to earnings. We currently believe that our rates are sufficient and that future r
be sufficient to recover their net book values.

Decommissioning Costs and Estimated Asset Retirement Obligation

Pursuant to the ANPP Participation Agreement and federal law, we must fund our sha
decommission Palo Verde Units 1, 2 and 3 and associated common areas. We recorde
asset for the fair value of our decommissioning obligation upon implementation of SF
Retirement Obligations. We will adjust the liability to its present value periodically
asset will be depreciated over its useful life. The determination of the estimated liabili
assumptions pertaining to decommissioning costs, escalation and discount rates.

We and other Palo Verde Participants rely upon decommissioning cost studies and ma
inflation projections to determine funding requirements and estimate liabilities related
year outside engineers perform a study to estimate decommissioning costs associated
and associated common areas. We determine how we will fund our share of those esti
assumptions about future investment returns and future decommissioning cost escalati
professionally managed investment trust accounts. We are required to establish a mini
funding level in our decommissioning trust accounts at the end of each annual reporti
ANPP Participation Agreement. If actual decommissioning costs exceed our estimates
related to decommissioning. Further, if the rates of return earned by the trusts fail to m
required to increase our funding to the decommissioning trust accounts. Although we
studies, we believe that the liability we have recorded for our decommissioning costs
of the costs, assuming that Palo Verde Units 1, 2 and 3 operate over their remaining li
of the probability of a license extension) and that the DOE assumes responsibility for
plant shut down. We believe that our current annual funding levels of the decommissi
for the cash requirements associated with decommissioning. Historically, regulated ut
to collect in rates in Texas and New Mexico the costs of nuclear decommissioning. Sh
Texas Restructuring Law, we will be able to collect from regulated transmission and d
decommissioning. Reference is made to Note D, Accounting for Asset Retirement O
Consolidated Financial Statements.

Future Pension and Other Postretirement Obligations

Our obligations to retirees under various benefit plans are recorded as a liability on th
liability is calculated on the basis of significant assumptions regarding discount rate, e
of compensation increase and health care cost inflation. Our assumptions as well as a
hypothetical changes in certain assumptions are set forth in detail in Note K, Employ
Consolidated

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Financial Statements. Changes in these assumptions could have a material impact on l
of liabilities reflected on the consolidated balance sheets.

In developing the assumptions, management makes judgments based on the advice of
our review of third-party and market-based data. These sources include life expectanc
and health care cost trends, and historical and expected return data on various categori
discount rate applied to future plan obligations is based at each measuring date on pre
inherent in high quality (AA and better) corporate bonds that would provide future cas
as they become due, as well as on publicly available bond issues. We regularly review
reassessment at least once a year. We do not expect that any such change in assumptio
net income for 2006.

Reserves for Tax Dispute

Our federal income tax returns for the years 1999 through 2002 have been examined b
(IRS). On May 9, 2005, we received a notice of proposed deficiency from the IRS.
proposed by the IRS related to (i) whether we were entitled to currently deduct payme
Verde Unit 2 steam generators or whether these payments should be capitalized and d
entitled to currently deduct payments related to the dry cask storage facilities for spen
payments should be capitalized and depreciated. The proposed IRS adjustments go to
their ultimate deductibility for federal tax purposes. We have protested the audit adjus
appeals and believe that our treatment of the payments is supported by substantial leg
IRS prevails, the resulting income tax and interest payments could be material to our c
performing an examination of the 2003 and 2004 income tax returns. We have establis
re-evaluate, an estimated contingent tax liability on our consolidated balance sheet to
adverse outcomes in tax proceedings. Although the ultimate outcome of the appeals ca
cannot be predicted with certainty, we believe that, as of December 31, 2005, adequat
additional tax that may be due.

Overview

The following is an overview of our results of operations for the years ended Decemb
Income for the years ended December 31, 2005, 2004 and 2003 is shown below:

Net income before cumulative effect of accounting change and extraordinary item (in thousands)
Basic earnings per share before cumulative effect of accounting change and extraordinary item

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The following table and accompanying explanation show the primary factors affecting
before cumulative effect of accounting changes and extraordinary item between the ca
2004 and 2003, and 2003 and 2002 (in thousands):

	2005
Prior year December 31 income before cumulative effect of accounting change and extraordinary item	$ 33,369
Change in (net of tax):	
Decreased (increased) depreciation and amortization expense	6,760
Increased retail base revenues	5,905
Decreased interest charges on long-term debt	5,212
Coal reclamation liability adjustment (d)	1,902
Increased (decreased) off-system sales margins	456
Decreased (increased) maintenance at coal and gas-fired generating plants	147
Impairment loss (e)	
Texas fuel disallowances (f)	
FERC settlements (g)	
Decreased sales for resale	
Decreased (increased) loss on extinguishments of debt	(8,807
2004 IRS settlement (j)	(6,200
Increased Palo Verde operations and maintenance expense	(2,189
Decreased (increased) taxes other than income taxes	(1,514
Increased ARO accretion	(259
Other	1,833
Current year December 31 net income before cumulative effect of accounting change and extraordinary item	$ 36,615

(a) Depreciation and amortization decreased due to completing the recovery of certa
related assets over the term of the Texas Rate Stipulation which ended in July 20

(b) Retail base revenues increased in 2005 compared to 2004 primarily due to (i) inc
customers reflecting growth in the number of customers served and (ii) favorable

(c) Interest charges decreased due to lower interest expense on long-term debt and fi
the refinancing of first mortgage bonds with long-term senior notes and the Augu
of pollution control bonds at lower interest rates.

(d) The coal reclamation liability adjustment pertains to the updated 2004 reclamatio
supplies the Four Corners power plant. We had previously recorded this liability
the liability in December 2004. An additional true-up was recorded in September

(e) We abandoned the development of a customer information system project and re
in the third quarter of 2003.

(f) Texas fuel disallowance in Docket No. 26194 was recorded in 2003.

(g) The FERC settlements relate to the settlements with FERC Trial Staff and princi
agreed to refund revenues we earned on wholesale power transactions in 2000 an
recorded in December 2002.

(h) The 2003 decrease in wholesale sales revenue relates primarily to the expiration

(i) Loss on extinguishments of debt in 2005 increased compared to 2004, reflecting
our first mortgage bonds in June 2005.

(j) A benefit was recorded in the third quarter of 2004 from a settlement of an IRS a
with no comparable amount in 2005.

(k) Palo Verde operations and maintenance expense increased in 2005 when compar
operations and maintenance expense at Unit 1 during the planned replacement of
outage in late 2005, and increased administrative and general expenses.

(l) Taxes other than income taxes increased in 2005 compared to 2004 due to an inc
fee rate which took effect on August 2, 2005, partially offset by a decrease in pro

(m) Accretion expense pursuant to SFAS No. 143 was first recognized in 2003.

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Historical Results of Operations

The following discussion includes detailed descriptions of factors affecting individual
operations. The amounts presented below are presented on a pre-tax basis.

Operating revenues

We realize revenue from the sale of electricity to retail customers at regulated rates an
wholesale power market generally at market based prices. Sales for resale (which are
territory) accounted for less than 1% of revenues. Off-system sales are wholesale sale
territory. Off-system sales are primarily made in off-peak periods when we have com
available after meeting our regulated service obligations. Under the terms of our City
Texas customers 25% of our off-system sales margins and wheeling revenues.

Revenues from the sale of electricity include fuel costs, which are substantially passe
adjustment mechanisms in Texas and New Mexico and a portion through base revenu
deferred fuel revenues for the difference between fuel costs and fuel revenues until su
refunded to customers. Base revenues refers to our revenues from the sale of electr
for a portion of fuel costs in New Mexico.

Retail base revenues. Retail base revenues increased by $9.5 million or 2.1% for the t
2005 when compared to the same period in 2004. Retail kilowatt-hour sales in the twe
December 31, 2005 were 1.1% higher than the twelve month period ended December
average number of retail customers served in 2005 accounted for most of the growth i
summer of 2005 (increased cooling degree days) resulted in higher sales, they were o
earlier in 2005 (decreased heating degree days).

Retail base revenues increased by $3.1 million for the twelve months ended Decembe
same period in 2003. Retail kilowatt-hour sales in the twelve month period ended De
than the twelve month period ended December 31, 2003. A 2.7% growth in the avera
served in 2004 accounted for most of the growth in sales. Cooler weather in the summ
degree days) resulted in lower sales and were only partially offset by the colder winte
days).

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Retail base revenue percentages by customer class are presented below:

Residential
Commercial and industrial, small
Commercial and industrial, large
Sales to public authorities
Total base revenues

No retail customer accounted for more than 2% of our base revenues during such peri
residential and small commercial customers comprise 75% of our revenues. While thi
also more sensitive to changes in weather conditions. As a result, our business is seas
the summer cooling season. The following table sets forth the percentage of our reven
the periods presented:

January 1 to March 31
April 1 to June 30
July 1 to September 30
October 1 to December 31
Total

Heating and cooling degree days can be used to evaluate the effect of weather on ener
outdoor temperature varies from a standard of 65 degrees Fahrenheit a degree day is r
below, combined heating and cooling degree days were below average in 2004 and 20

Heating degree days
Cooling degree days

Fuel revenues. Fuel revenues consists of two parts, revenues collected from customers
approved by the state commissions, and deferred fuel revenues which are comprised o
and fuel revenues collected from customers. In New Mexico, the fuel adjustment clau
costs in the clause and to recover under or refund over-recoveries in the clause with a
are recovered through a fixed fuel factor that may be adjusted two times per year. In a
over-recover fuel costs, we must seek to refund the over-recovery, and if we materiall
seek a surcharge to recover those costs. Natural gas prices increased significantly in 2
significant increase in deferred fuel revenues particularly in Texas due to the lag in re
fuel recovery mechanism. The increase in

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deferred fuel revenues for the twelve months ended December 31, 2005 when compar
increase in deferred fuel revenues for the twelve months ended December 31, 2004 w
$30.6 million.

In July 2005 we filed for an increase in our fixed fuel factor and to surcharge fuel und
Commission. A settlement approved by the Texas Commission has allowed us to incr
surcharge $53.6 million of fuel under-recoveries, including interest as of the end of th
24-month period. In January 2006, we again filed with the Texas Commission to incre
surcharge approximately $34 million for additional fuel under-recoveries, including in
through November 2005, over a twelve-month period. We received Commission appr
factor and surcharge on an interim basis beginning with February 2006 billings.

Fuel revenues recovered from customers increased $20.8 million for the twelve month
compared to 2004 and $7.7 million for the twelve months ended December 31, 2004 c
are primarily due to the increased fuel costs that are collected from our New Mexico c
the increase in Texas fuel factors in October 2005 along with an increase in kWh sales
revenues also increased for the twelve months ended December 31, 2004 compared to
disallowance in Docket No. 26194 of $4.5 million that was recorded in 2003 with no c

Off-system sales. Off-system sales are primarily made in off-peak periods when we ha
available after meeting our regulated service obligations. Off-system sales decreased $
ended December 31, 2005 when compared to 2004 due to a decline in energy availabl
because of a decline in output at the Palo Verde station due to an extended planned re
replacement for Unit 1 and unplanned outages at Palo Verde Units 2 and 3. Offsetting
were higher average market prices. Off-system sales increased $2.0 million for the tw
2004 when compared to 2003 primarily due to higher average market prices.

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Comparisons of kWh sales and operating revenues are shown below (in thousands):

Years Ended December 31:	**2005**	**200**
kWh sales:		
Retail:		
Residential	2,090,098	1,986
Commercial and industrial, small	2,126,918	2,115
Commercial and industrial, large	1,165,506	1,236
Sales to public authorities	1,270,116	1,243
Total retail sales	6,652,638	6,581
Wholesale:		
Sales for resale	41,883	41
Off-system sales	1,420,778	1,838
Total wholesale sales	1,462,661	1,879
Total kWh sales	8,115,299	8,460
Operating revenues:		
Base revenues:		
Retail:		
Residential	$ 183,667	$ 174
Commercial and industrial, small	167,241	165
Commercial and industrial, large	41,321	43
Sales to public authorities	73,677	72
Total retail base revenues (1)	465,906	456
Wholesale:		
Sales for resale	1,687	1
Total base revenues	467,593	458
Fuel revenues:		
Recovered from customers during the period	164,500	143
Change in deferred fuel revenues	79,539	17
Total fuel revenues	244,039	161
Off-system sales	78,209	78
Other	14,072	10
Total operating revenues	$ 803,913	$ 708

(1) Includes fuel recovered through New Mexico base rates of $29.4 million and $28
respectively.

(2) Primarily due to reduced output from Palo Verde.

(3) Primarily due to an increase in recoverable fuel expenses as a result of an increas
gas burned and an increase in purchased power costs.

(4) Represents revenues with no related kWh sales.

(5) Primarily due to increased transmission revenues.

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Years Ended December 31:	2004	2003
kWh sales:		
Retail:		
Residential	1,986,085	1,932,
Commercial and industrial, small	2,115,822	2,096,
Commercial and industrial, large	1,236,426	1,197,
Sales to public authorities	1,243,003	1,224,
Total retail sales	6,581,336	6,450,
Wholesale:		
Sales for resale	41,094	67,
Off-system sales	1,838,467	1,920,
Total wholesale sales	1,879,561	1,988,
Total kWh sales	8,460,897	8,439,
Operating revenues:		
Base revenues:		
Retail:		
Residential	$ 174,752	$ 171,
Commercial and industrial, small	165,760	165,
Commercial and industrial, large	43,150	43,
Sales to public authorities	72,720	73,
Total retail base revenues (1)	456,382	453,
Wholesale:		
Sales for resale	1,675	3,
Total base revenues	458,057	456,
Fuel revenues:		
Recovered from customers during the period	143,692	135,
Change in deferred fuel revenues	17,360	(13,
Total fuel revenues	161,052	122,
Off-system sales	78,533	76,
Other	10,986	8,
Total operating revenues	$ 708,628	$ 664,

(1) Includes fuel recovered through New Mexico base rates of $28.0 million and $27
respectively.

(2) Primarily due to 2003 CFE wholesale power sales with no comparable sales in 20

(3) Primarily due to increase in recoverable fuel expenses as a result of an increase i
gas burned and an increase in purchased power costs.

(4) Represents revenues with no related kWh sales.

(5) Primarily due to increased transmission revenues.

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Energy expenses

Our energy sources are derived from nuclear fuel, natural gas, coal, and purchased po
approximately 40% of our available net generating capacity and approximately 46% c
twelve months ended December 31, 2005.

Our energy expenses increased $82.0 million for the twelve months ended December
primarily due to (i) increased natural gas costs of $72.2 million due to increased price
(ii) increased costs of purchased power of $13.6 million due to higher market prices. T
in 2005 by a $0.7 million decrease to our coal reclamation liability record in 2005 co
our coal reclamation costs recorded in 2004. Energy expenses increased $39.9 million
December 31, 2004 compared to 2003 primarily due to (i) increased natural gas costs
prices and volume burned; (ii) increased costs for purchased power of $10.9 million d
average market prices; and (iii) a $2.2 million increase in our coal reclamation liabilit
amount in 2003.

	2005		
Fuel Type	Cost (in thousands)	MWh	Cost per MWh (i
Natural Gas	$ 230,900	2,643,584	$ 87.34
Coal	11,003(b)	779,002	14.12
Nuclear	21,619	4,077,558	5.30
Total	263,522	7,500,144	35.14
Purchased power	80,040	1,258,469	63.60
Total energy	$ 343,562	8,758,613	39.23

(a) Excludes a $0.7 million contract termination fee.

(b) Excludes a reduction of $0.7 million and an increase of $2.2 million to our coal r
2005 and 2004, respectively.

Other operations expense

Other operations expense increased $4.8 million in 2005 compared to 2004 primarily
expense of $3.1 million; (ii) increased other postretirement benefit costs of $2.0 millio
costs of $1.9 million. These increases were partially offset by decreased regulatory ex
FERC matters and the receipt of a sales tax refund of $0.9 million in 2005 with no co

Other operations expense increased $5.7 million in 2004 compared to 2003 primarily
benefits expense of $6.1 million (including a $3.2 million increase in employee bonus
operations expense of $1.7 million. These increases were partially offset by decreased
million and decreased customer accounts expense of $1.5 million.

Maintenance expense

Maintenance expense increased $2.1 million in 2005 compared to 2004 primarily due
expenses of $1.2 million related to remediation projects and increased maintenance at

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Maintenance expense decreased $3.1 million in 2004 compared to 2003 primarily due
expense at our gas-fired generating plants of $5.4 million offset by increased mainten
due to the timing of scheduled refueling and maintenance outages.

Impairment loss on CIS project

We abandoned a customer information system (CIS) project and recognized an asset i
September 2003.

Depreciation and amortization expense

Depreciation and amortization expense decreased $10.9 million in 2005 compared to 2
the recovery of certain fresh-start accounting related assets over the term of the Texas
July 2005. The decrease was partially offset by higher depreciation due to increases in
Depreciation and amortization expense increased $5.8 million in 2004 compared to 20
on new Palo Verde Unit 2 steam generators of $2.2 million, the implementation of new
depreciation study resulting in an increase of $1.9 million and increased other depreci
increase of $1.7 million.

Taxes other than income taxes

Taxes other than income taxes increased by $2.4 million, or 5.7%, in 2005 compared t
in the El Paso city franchise fees which took effect August 2, 2005, which was partial
New Mexico occupation street rental tax. As a result of a June 2004 change in New M
rental tax on retail sales of electricity is now collected directly from retail customers a
Taxes other than income taxes were relatively unchanged in 2004 compared to 2003.

Other income (deductions)

Other income (deductions) decreased $12.8 million in 2005 compared to 2004 primari
extinguishment of debt of $14.2 million, as a result of the refinancing of our first mort
of 2005. This decrease was partially offset by increased interest income in 2005 of $2
$1.1 million adjustment to reduce interest income associated with the resolution of the
Docket No. 26194 recorded in 2004 with no comparable activity in 2005, and the rece
to a sales tax refund in 2005.

Other income (deductions) decreased $4.9 million in 2004 compared to 2003 primaril
extinguishment of debt of $5.4 million recorded in 2004 with no comparable activity i
reduction in interest income in 2004 associated with the resolution of the Texas fuel re
No. 26194; and (iii) $1.0 million related to certain tax refunds received in 2003 with n
These decreases were partially offset by an increase of $2.4 million in investment and
decommissioning trust fund.

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Interest charges (credits)

Interest charges (credits) decreased $10.6 million in 2005 compared to 2004 due to an
on long-term debt and financing obligations resulting from (i) the repurchase and retir
(ii) the May 2005 issuance of unsecured senior notes at a lower interest rate than the f
reissuance or remarketing of our pollution control bonds in August 2005 at lower inte
due to increased capitalized interest of $2.4 million due to an increase in construction
Palo Verde Unit 1 and Unit 3 steam generators. Interest charges (credits) decreased sl
primarily due to decreased interest expense of $2.2 million due to a reduction of outst
market purchases of our first mortgage bonds, partially offset by a reduction in capital
result of transferring new Palo Verde Unit 2 steam generators to plant in service.

Income tax expense

Income tax expense, before the cumulative effect of an accounting change and an extr
$9.4 million in 2005 compared to 2004 and decreased $4.0 million in 2004 compared
$6.2 million benefit from the IRS settlement recorded in the third quarter of 2004 and
certain permanent differences.

Cumulative effect of accounting change

The cumulative effect of accounting change for 2005 of $1.1 million, net of tax, relate
Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, (
provides guidance on the recognition and measurement of liabilities associated with t
obligations of tangible long-lived assets not already accounted for under SFAS No. 14
for the disposal obligations of our fuel oil storage tanks, water wells, evaporative pon
generating stations. The cumulative effect of accounting change for 2003 relates to th
January 1, 2003, which also provides guidance on the recognition and measurement o
retirement of tangible long-lived assets. SFAS No. 143 affected the accounting for the
the Palo Verde and Four Corners Stations and changed the method used to report the

Extraordinary gain

The extraordinary gain on re-application of SFAS No. 71 relates to our third quarter 2
criteria necessary to re-apply SFAS No. 71 to our New Mexico jurisdiction. The decis
NMPRC s approval for new rates that were based upon our cost of service and the fa
electric utility restructuring law. The re-application of SFAS No. 71 to our New Mexi
recording of a $1.8 million extraordinary gain, net of tax, in the third quarter of 2004.

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New accounting standards

In November 2004, the FASB issued SFAS No. 151, Inventory Costs an amendn
No. 43, (ARB No. 43), (Inventory Pricing). ARB No. 43 previously stated that
idle facility expense, excessive spoilage, double freight and rehandling costs may be s
as current period charges. SFAS No. 151 requires that those items be recognized as c
whether they meet the criterion of so abnormal. The provisions of this statement ar
during fiscal years beginning after June 15, 2005. We do not believe SFAS No. 151 w
consolidated financial statements.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary As
Principles Board Opinion No. 29 (APB No. 29), Accounting for Nonmonetary Tr
No. 29 is based on the principle that exchanges of nonmonetary assets should be meas
assets exchanged, with certain exceptions. SFAS No. 153 eliminates the exception for
productive assets and replaces it with a general exception for exchanges of nonmoneta
commercial substance. A nonmonentary exchange has commercial substance if
expected to change significantly as a result of the exchange. The provisions of this sta
periods beginning after June 15, 2005. We do not believe SFAS No. 153 will have a s
consolidated financial statements.

In December 2004, the FASB issued a revision of SFAS No. 123, Accounting for St
No. 123 (revised) focuses primarily on accounting for transactions in which an entity
share-based payment transactions. SFAS No. 123 (revised) requires a public entity to
services received in exchange for an award of equity instruments based on the grant-d
some limited exceptions). That cost will be recognized over the period during which a
service in exchange for the award the requisite service period typically the vest
recognized for equity instruments for which employees do not render the requisite ser
effective for public entities that do not file as small business issuers as of the beginnin
reporting period that begins after December 15, 2005. SFAS No. 123 (revised) applies
required effective date and to awards modified, repurchased or cancelled after that dat
for outstanding awards for which the requisite service has not been rendered as of the
the requisite service is rendered on or after the required effective date. The compensat
shall be based on the grant-date fair value of those awards as calculated for pro forma
The Company anticipates using the modified perspective method of adopting SFAS
estimated the ultimate impact that this new pronouncement will have on our financial
$1.0 million and do not expect this statement to have an effect materially different tha
provided in Note A Summary of Significant Accounting Policies and Estimates to
Statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corre
Opinion No. 20, and FASB Statement No. 3. SFAS No. 154 requires retrospective ap
statements of changes in accounting principle, unless it is impracticable to determine
the cumulative effect of the change.

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SFAS No. 154 also requires that retrospective application of a change in accounting p
effects of the change. Indirect effects of a change in accounting principle, such as a ch
payments resulting from an accounting change, should be recognized in the period of
No. 154 also requires that a change in depreciation, amortization, or depletion method
be accounted for as a change in accounting estimate affected by a change in accountin
period of change. SFAS No. 154 is effective for accounting changes and corrections o
beginning after December 15, 2005. We will adopt the provisions of SFAS No. 154, i

For the last several years, inflation has been relatively low and, therefore, has had littl
operations and financial condition.

Liquidity and Capital Resources

Our principal liquidity requirements in the near-term are expected to consist of the int
indebtedness, capital expenditures related to our generating facilities and transmission
operating expenses including fuel costs and taxes. We expect that cash flows from ope
purposes, assuming that we receive timely recognition of recent increases in natural ga
December 31, 2005, we had approximately $8.0 million in cash and cash equivalents,
the balance of $29.4 million on December 31, 2004.

Capital Requirements. Substantial increases in the cost of natural gas during 2005 and
costs in fixed fuel factors in Texas have led to the under-recovery of the Texas jurisdic
$84.9 million, including interest, for the period from March 2004 to December 2005.
Commission approved a settlement of a fuel factor filing to (i) surcharge fuel under-re
August 2005 which then totaled $53.6 million; (ii) surcharge the under-recovery over
(iii) approve new fuel factors which reflected natural gas costs of $7.28 per mmbtu. W
implement the increase in the fuel factor and the fuel surcharge on an interim basis be

In January 2006, we filed a request with the Texas Commission for an additional incre
surcharge approximately $34 million for fuel under-recoveries including interest for th
November 2005 over a twelve-month period. The requested fuel factor and fuel surcha
interim basis subject to refund effective with February 2006 bills to customers. We are
on a settlement to resolve this proceeding. Any settlement will be subject to final appr
Until the balance of fuel under-recoveries is recovered from customers, we will be req
costs from internal sources of cash rather than use such cash for other purposes.

Our long-term capital requirements consist primarily of construction of electric utility
on and refinancing of debt. Utility construction expenditures will consist primarily of
transmission and distribution systems, addition of new generation, and the cost of cap
replacements at Palo Verde and other generating facilities, including the replacement
Unit 3. See Part I, Item 1,

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Business Construction Program. We expect that all of our construction expenditu
sources of funds through 2008.

During the twelve months ended December 31, 2005, we generated $89.2 million of f
carryforwards and $42.0 million of state income tax loss carryforwards as a result of (
that are not taxable until collected; (ii) deductible premiums on retired debt; and (iii) i
method changes primarily related to tax depreciation and repair allowances. We antici
tax loss carryforwards will be fully utilized in 2006 and our cash flow requirements fo
expected to increase over that required in recent years.

We continually evaluate our funding requirements related to our retirement plans, oth
decommissioning trust funds. We have contributed $19.9 million and $15.7 million to
twelve months ended December 31, 2005 and 2004, respectively. We have also contri
postretirement benefit plan for both 2005 and 2004 and $6.2 million and $5.9 million
during the twelve months ended December 31, 2005 and 2004, respectively.

The Company does not pay dividends on common stock. Since 1999, the Company ha
15.3 million shares of common stock at an aggregate cost of $175.6 million, including
repurchase plan. The Board of Directors authorized the repurchase of up to 2 million s
February 2004 of which 1,705,158 shares remain available to be repurchased. No shar
We may continue making purchases of our stock pursuant to our stock repurchase pla
engage in private transactions, where appropriate. The repurchased shares will be avai
benefit and stock option plans, or may be retired. Common stock equity as a percentag
current portion of long-term debt and financing obligations, was 47% as of December

Capital Sources. We filed a shelf registration statement on Form S-3 with the SEC wh
2005. The shelf registration statement enables us to offer and issue debt securities, firs
and certain other securities from time to time in one or more offerings of up to $1.0 bi
to this shelf registration, we issued $400.0 million of 6% Senior Notes (the Notes)
the issuance of the Notes were $397.7 million, net of a $2.3 million discount and the e
anticipation of issuing the Notes, we entered into treasury rate lock agreements to hed
the treasury reference interest rates. These treasury rate locks expired during the secon
fell after we entered into these agreements, and as a result, we made a cash payment o
treasury rate locks at the termination of these agreements in May 2005, which are bein
related debt.

During the second quarter of 2005, we tendered for and/or exercised our right to legal
Series D First Mortgage Bonds due February 1, 2006 and our 9.40% Series E First Mo
which were callable beginning on February 1, 2006 (collectively, the Bonds). The t
outstanding Bonds was approximately $359.4 million. The net proceeds from the issu
the retirement of the Bonds.

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On August 1, 2005, we issued three series of pollution control bonds in the amounts o
$37.1 million. The $59.2 million bonds, which mature in 2040, were issued with a fix
effective interest rate of 5.27% after considering related insurance and issuance costs.
$37.1 million bonds, which also mature in 2040, were issued with a variable rate that
mature in 2040. We also remarketed $33.3 million of pollution control bonds, which b
August 1, 2012, which is the date the bonds are due to be remarketed. The effective in
after considering related insurance and issuance costs. The issuance and remarketing r
were subject to mandatory tender or remarketing as of August 1, 2005.

Our $100 million revolving credit facility provides up to $70 million for nuclear fuel p
borrow for nuclear fuel purchases are available for working capital needs. As of Dece
$41.9 million had been drawn for nuclear fuel purchases and no borrowings were outs
capital needs. The revolving credit facility was renewed for a five-year term in Decem
agreement, the revolving credit facility may be increased to $150 million.

Given the favorable movements of interest rates in the bank markets and the increased
in the natural gas markets, we have recently begun the process of replacing our $100 r
with a new $150 million revolving credit facility. The new revolving credit facility wi
revolving credit facility and will provide up to $70 million for nuclear fuel purchases
nuclear fuel purchases available for use for working capital. The Company expects, bu
revolving credit facility will be in place by the second quarter of 2006.

Contractual Obligations. Our contractual obligations as of December 31, 2005 are as

		Paymer
	Total	**2006**
Long-Term Debt (including interest):		
Senior notes	$ 1,106,000	$ 24,000
Pollution control bonds (1)(2)	421,295	7,697
Financing Obligations (including interest):		
Nuclear fuel (3)	44,037	22,831
Purchase Obligations:		
Capacity power contract	264,808	11,320
Fuel contracts:		
Coal (4)	78,792	7,504
Gas (4)	91,182	53,419
Nuclear fuel (5)	11,404	11,404
Retirement Plans and Other Postretirement Benefits (6)	5,124	5,124
Decommissioning trust funds (7)	266,045	6,686
Operating lease (8)	2,200	1,300
Total	$ 2,290,887	$ 151,285

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(1) The $33.3 million series of pollution control bonds is scheduled for remarketing

(2) Two series of the pollution control bonds are remarketed and the interest rates ar
series of pollution control bonds are scheduled for remarketing and/or mandatory

(3) Interest on nuclear fuel is based on actual interest rates at the end of 2005.

(4) Amount is based on the minimum volumes per the contract and market price at t
includes a gas storage contract for 2006 and 2007, with an option to renew annua

(5) Some of the nuclear fuel contracts are based on a fixed price adjusted for an inde
index at the end of 2005.

(6) These obligations include our minimum contractual funding requirements for the
plan and the other postretirement benefits for 2006. We have no minimum contra
to our retirement income plan for 2006. However, we may decide to fund at a hig
contractual funding amounts and expect to contribute $13.7 million and $3.4 mil
postretirement benefit plan in 2006, as disclosed in Part II, Item 8, Notes to Cons
K, Employee Benefits. Minimum contractual funding requirements for 2007 and
uncertainty of interest rates and the related return on assets.

(7) These obligations represent funding requirements under the ANPP Participation
rate of return on investments.

(8) We have an operating lease for administrative offices which expires in May 2007
a warehouse which expires in December 2009 with three concurrent renewal opti

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have
financial condition, changes in financial condition, revenues or expenses, results of op
expenditures or capital resources.

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Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The following discussion regarding our market-risk sensitive instruments contains for
involving risks and uncertainties. The statements regarding potential gains and losses
occur in the future. Actual future results may differ materially from those estimates pr
the risks and uncertainties involved.

We are exposed to market risk due to changes in interest rates, equity prices and comm
financial instruments and positions we hold are held for purposes other than trading an

Interest Rate Risk

Our long-term debt obligations are all fixed-rate obligations with varying maturities, e
control bond series which are repriced weekly and our revolving credit facility, which
and working capital, and is based on floating rates.

On August 1, 2005, we issued two series of pollution control bonds in the amounts of
with a variable rate that is repriced weekly until they mature in 2040. These pollution
balance sheet at their face value. At December 31, 2005 the variable interest rates wer
$63.5 million and the $37.1 million pollution control bond series, respectively. A hyp
rates, annualized from the December 31, 2005 rate, would cause an approximate $0.3
expense.

Interest rate risk, if any, related to the revolving credit facility is substantially mitigate
Texas Commission and NMPRC rules which establish energy cost recovery clauses (
fuel clauses, energy costs, including interest expense on nuclear fuel financing, except
New Mexico Regulatory Matters Fuel, are passed through to customers.

Our decommissioning trust funds consist of equity securities and fixed income instrum
value. We face interest rate risk on the fixed income instruments, which consist prima
corporate bonds and which were valued at $39.3 million and $57.3 million as of Dece
respectively. A hypothetical 10% increase in interest rates would reduce the fair value
and $0.8 million based on their fair values at December 31, 2005 and 2004, respective

Equity Price Risk

Our decommissioning trust funds include marketable equity securities of approximate
at December 31, 2005 and 2004, respectively. A hypothetical 20% decrease in equity
of these funds by $11.3 million and $6.4 million based on their fair values at Decemb

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Commodity Price Risk

We utilize contracts of various durations for the purchase of natural gas, uranium conc
manage our available fuel portfolio. These agreements contain variable pricing provis
delivery. The fuel contracts with variable pricing provisions, as well as substantially a
requirements, are exposed to fluctuations in prices due to unpredictable factors, incluc
worldwide events, which impact supply and demand. However, our exposure to fuel a
substantially mitigated through the operation of the Texas Commission and NMPRC r
discussed previously.

In the normal course of business, we enter into contracts of various durations for the f
electricity to effectively manage our available generating capacity and supply needs. S
contracts for the sale of generating capacity and energy during periods when our avail
to exceed the requirements of our retail native load and sales for resale. They also incl
purchase of wholesale capacity and energy during periods when the market price of el
incremental power production costs or to supplement our generating capacity when de
capacity. As of January 31, 2006, we had entered into forward sales and purchase con
Part I, Item 1, Business Energy Sources Purchased Power and Regulation F
generally fixed-priced contracts which qualify for the normal purchases and normal
No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS
133 on Derivative Instruments and Hedging Activities, including any effective imple
FASB Derivatives Implementation Group and are not recorded at their fair value in ou
the operation of the Texas Commission and NMPRC rules and our fuel clauses, these
significant commodity price risk.

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Management Report on Internal Control Over Financial

The Company s management is responsible for establishing and maintaining adequat
reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d
Securities Exchange Act of 1934 as a process designed by, or under the supervision o
and principal financial officers and affected by the Company s board of directors, ma
provide reasonable assurance regarding the reliability of financial reporting and the p
for external purposes in accordance with generally accepted accounting principles and
procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and
dispositions of the assets of the Company;

Provide reasonable assurance that transactions are recorded as necessary to p
statements in accordance with generally accepted accounting principles, and
Company are being made only in accordance with authorizations of managem
and

Provide reasonable assurance regarding prevention or timely detection of una
use or disposition of the Company s assets that could have a material effect

Because of its inherent limitations, internal control over financial reporting may not p
Projections of any evaluation of effectiveness to future periods are subject to the risk
inadequate because of changes in conditions, or that the degree of compliance with th
deteriorate.

The Company s management assessed the effectiveness of the Company s internal c
December 31, 2005. In making this assessment, the Company s management used th
of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Co

Based on its assessment, management believes that, as of December 31, 2005, the Co
financial reporting is effective based on those criteria.

The Company s independent registered public accounting firm, KPMG LLP, has issu
assessment of the Company s internal control over financial reporting. This report ap

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Item 8. Financial Statements and Supplementary Data

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Reports of Independent Registered Public Accounting Firm

Consolidated Balance Sheets at December 31, 2005 and 2004

Consolidated Statements of Operations for the years ended December 31, 2005, 2004

Consolidated Statements of Comprehensive Operations for the years ended December

Consolidated Statements of Changes in Common Stock Equity for the years ended De and 2003

Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004

Notes to Consolidated Financial Statements

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Report of Independent Registered Public Accounting

The Board of Directors and Shareholders

El Paso Electric Company:

We have audited the accompanying consolidated balance sheets of El Paso Electric C
December 31, 2005 and 2004, and the related consolidated statements of operations, c
in common stock equity, and cash flows for each of the years in the three-year period
consolidated financial statements are the responsibility of the Company s managemen
opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Acc
States). Those standards require that we plan and perform the audit to obtain reasonab
financial statements are free of material misstatement. An audit includes examining, o
the amounts and disclosures in the financial statements. An audit also includes assessi
and significant estimates made by management, as well as evaluating the overall finan
believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, i
position of El Paso Electric Company and subsidiary as of December 31, 2005 and 20
operations and their cash flows for each of the years in the three-year period ended De
with U.S. generally accepted accounting principles.

As discussed in Note D to the consolidated financial statements, the Company change
retirement obligations in 2005 and 2003.

We also have audited, in accordance with the standards of the Public Company Accou
States), the effectiveness of El Paso Electric Company s internal control over financi
2005, based on criteria established in *Internal Control Integrated Framework* issued
Organizations of the Treadway Commission (COSO), and our report dated March 10,
opinion on management s assessment of, and the effective operation of, internal cont

KPMG LLP

El Paso, Texas

March 10, 2006

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Report of Independent Registered Public Accounting

The Board of Directors and Shareholders

El Paso Electric Company:

We have audited management s assessment, included in the accompanying Managem
Financial Reporting, that El Paso Electric Company maintained effective internal cont
December 31, 2005, based on criteria established in *Internal Control Integrated Fran*
Sponsoring Organizations of the Treadway Commissions (COSO). El Paso Electric C
responsible for maintaining effective internal control over financial reporting and for i
of internal control over financial reporting. Our responsibility is to express an opinion
an opinion on the effectiveness of the Company s internal control over financial repo

We conducted our audit in accordance with the standards of the Public Company Acc
States). Those standards require that we plan and perform the audit to obtain reasonab
effective internal control over financial reporting was maintained in all material respe
understanding of internal control over financial reporting, evaluating management s a
the design and operating effectiveness of internal control, and performing such other p
necessary in the circumstances. We believe that our audit provides a reasonable basis

A company s internal control over financial reporting is a process designed to provid
reliability of financial reporting and the preparation of financial statements for externa
generally accepted accounting principles. A company s internal control over financia
and procedures that (1) pertain to the maintenance of records that, in reasonable detail
transactions and dispositions of the assets of the company; (2) provide reasonable assu
recorded as necessary to permit preparation of financial statements in accordance with
principles, and that receipts and expenditures of the company are being made only in a
management and directors of the company; and (3) provide reasonable assurance rega
detection of unauthorized acquisition, use, or disposition of the company s assets that
financial statements.

Because of its inherent limitations, internal control over financial reporting may not p
Also, projections of any evaluation of effectiveness to future periods are subject to the
inadequate because of changes in conditions, or that the degree of compliance with th
deteriorate.

In our opinion, management s assessment that El Paso Electric Company maintained
financial reporting as of December 31, 2005, is fairly stated, in all material respects, b
Internal Control Integrated Framework issued by COSO. Also, in our opinion, El Pa
all material respects, effective internal control over financial reporting as of Decembe
established in *Internal Control Integrated Framework* issued by COSO.

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We also have audited, in accordance with the standards of the Public Company Accou
States), the consolidated balance sheets of El Paso Electric Company and subsidiary a
and the related consolidated statements of operations, comprehensive operations, char
cash flows for each of the years in the three-year period ended December 31, 2005, an
expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

El Paso, Texas

March 10, 2006

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EL PASO ELECTRIC COMPANY AND SUBSIDI

CONSOLIDATED BALANCE SHEETS

ASSETS **(In thousands)**
Utility plant:
Electric plant in service
Less accumulated depreciation and amortization
Net plant in service
Construction work in progress
Nuclear fuel; includes fuel in process of $6,990 and $7,128, respectively
Less accumulated amortization
Net nuclear fuel
Net utility plant
Current assets:
Cash and temporary investments
Accounts receivable, principally trade, net of allowance for doubtful accounts of $2,4 and $3,071, respectively
Accumulated deferred income taxes
Inventories, at cost
Under collection of fuel revenues
Income taxes receivables
Prepayments and other
Total current assets
Deferred charges and other assets:
Decommissioning trust funds
Regulatory assets
Under collection of fuel revenues, non-current
Other
Total deferred charges and other assets
Total assets

See accompanying notes to consolidated financial stater

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EL PASO ELECTRIC COMPANY AND SUBSIDI

CONSOLIDATED BALANCE SHEETS (Continu

CAPITALIZATION AND LIABILITIES (In thousands)
Capitalization:
Common stock, stated value $1 per share, 100,000,000 shares authorized, 63,382,456 62,665,550 shares issued, and 124,973 and 102,630 restricted shares, respectively
Capital in excess of stated value
Deferred and unearned compensation
Retained earnings
Accumulated other comprehensive loss, net of tax
Treasury stock, 15,365,108 shares at cost
Common stock equity
Long-term debt, net of current portion
Financing obligations, net of current portion
Total capitalization
Current liabilities:
Current portion of long-term debt and financing obligations
Accounts payable, principally trade
Taxes accrued other than federal income taxes
Interest accrued
Other
Total current liabilities
Deferred credits and other liabilities:
Accumulated deferred income taxes
Accrued postretirement benefit liability
Asset retirement obligation
Accrued pension liability
Regulatory liabilities
Other
Total deferred credits and other liabilities
Commitments and contingencies
Total capitalization and liabilities

See accompanying notes to consolidated financial stater

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EL PASO ELECTRIC COMPANY AND SUBSIDI

CONSOLIDATED STATEMENTS OF OPERATIO

(In thousands except for share data)

	Ye
	2005
Operating revenues	$ 803,913
Energy expenses:	
Fuel	262,870
Purchased and interchanged power	80,040
	342,910
Operating revenues net of energy expenses	461,003
Other operating expenses:	
Other operations	178,287
Maintenance	47,338
Impairment loss on CIS project	
Depreciation and amortization	82,468
Taxes other than income taxes	45,027
	353,120
Operating income	107,883
Other income (deductions):	
Investment and interest income, net	5,625
Loss on extinguishments of debt	(19,561)
Miscellaneous non-operating income	1,121
Miscellaneous non-operating deductions	(4,186)
	(17,001)
Interest charges (credits):	
Interest on long-term debt and financing obligations	40,762
Other interest	699
Capitalized interest and AFUDC	(5,783)
	35,678
Income before income taxes, cumulative effect of accounting change and extraordinary item	55,204
Income tax expense	18,589
Income before cumulative effect of accounting change and extraordinary item	36,615

Cumulative effect of accounting change, net of tax		(1,093)
Extraordinary gain on re-application of SFAS No. 71, net of tax		
Net income	$	35,522
Basic earnings (losses) per share:		
Income before cumulative effect of accounting change and extraordinary item	$	0.77
Cumulative effect of accounting change, net of tax		(0.02)
Extraordinary gain on re-application of SFAS No. 71, net of tax		
Net income	$	0.75
Diluted earnings (losses) per share:		
Income before cumulative effect of accounting change and extraordinary item	$	0.76
Cumulative effect of accounting change, net of tax		(0.02)
Extraordinary gain on re-application of SFAS No. 71, net of tax		
Net income	$	0.74
Weighted average number of shares outstanding		47,711,894
Weighted average number of shares and dilutive potential shares outstanding		48,307,910

See accompanying notes to consolidated financial stater

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EL PASO ELECTRIC COMPANY AND SUBSIDI

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (

(In thousands)

Net income
Other comprehensive income (loss):
Minimum pension liability adjustment
Net unrealized gains (losses) on marketable securities:
Net holding gains (losses) arising during period
Reclassification adjustments for net (gains) losses included in net income
Net losses on cash flow hedges:
Losses arising during period
Reclassification adjustment for interest expense included in net income
Total other comprehensive income (loss) before income taxes
Income tax benefit (expense) related to items of other comprehensive income (loss):
Minimum pension liability adjustment
Net unrealized gains (losses) on marketable securities
Losses on cash flow hedges
Total income tax benefit (expense)
Other comprehensive income (loss), net of tax
Comprehensive income

See accompanying notes to consolidated financial stater

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EL PASO ELECTRIC COMPANY AND SUBSIDL

CONSOLIDATED STATEMENTS OF CHANGES IN COMMON

(In thousands except for share data)

	Common Stock		Capital in Excess of Stated	Deferred and Unearned	Retained	Accumul Othe Comprehe Incom (Loss Net o
	Shares	Amount	Value	Compensation	Earnings	Tax
Balances at December 31, 2002	62,592,461	$ 62,592	$ 262,480	$ (1,442)	$ 290,982	$ (14,4
Grants of restricted common stock	63,090	63	661	(724)		
Deferred compensation-restricted stock				1,288		
Stock awards withheld for taxes	(21,799)	(22)	(209)			
Deferred taxes on stock incentive plan			1,008			
Adjustment to federal valuation allowance			295			
Net income					59,957	
Other comprehensive income						4,8
Treasury stock acquired, at cost						
Balances at December 31, 2003	62,633,752	62,633	264,235	(878)	350,939	(9,6
Grants of restricted common stock	56,413	56	756	(812)		
Deferred compensation-restricted stock and performance shares				2,804		
Stock awards withheld for taxes	(12,753)	(12)	(160)			
Forfeitures of restricted common stock	(1,074)	(1)	(12)	13		
Deferred taxes on stock incentive plan			(409)			
Stock options exercised	91,842	92	981			
Adjustment to federal valuation allowance			3,380			

Net income					35,171	
Other comprehensive loss						(9
Treasury stock acquired, at cost						
Balances at December 31, 2004	62,768,180	62,768	268,771	1,127	386,110	(10,5
Grants of restricted common stock	104,907	105	1,870	(1,975)		
Deferred compensation-restricted stock and performance shares				2,926		
Stock awards withheld for taxes	(7,907)	(8)	(144)			
Forfeitures of restricted common stock	(4,251)	(4)	(68)	72		
Deferred taxes on stock incentive plan			170			
Stock options exercised	646,500	646	4,794			
Net income					35,522	
Other comprehensive loss						(19,6
Balances at December 31, 2005	63,507,429	$ 63,507	$ 275,393	$ 2,150	$ 421,632	$ (30,1

See accompanying notes to consolidated financial stater

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EL PASO ELECTRIC COMPANY AND SUBSIDI

CONSOLIDATED STATEMENTS OF CASH FLO

(In thousands)

	200
Cash Flows From Operating Activities:	
Net income	$ 35
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization of electric plant in service	82
Impairment loss on CIS project	
Amortization of nuclear fuel	15
Cumulative effect of accounting change, net of tax	1
Extraordinary gain on the re-application of SFAS No. 71, net of tax	
Deferred income taxes, net	25
Loss on extinguishments of debt	19
Other amortization and accretion	11
Gain on sale of asset	
Other operating activities	
Change in:	
FERC settlements payable	
Accounts receivable	(5
Inventories	
Net (under)/overcollection of fuel revenues	(73
Prepayments and other	
Accounts payable	12
Taxes accrued other than federal income taxes	
Interest accrued	(9
Other current liabilities	
Deferred charges and credits	(7
Net cash provided by operating activities	106
Cash Flows From Investing Activities:	
Cash additions to utility property, plant and equipment	(88
Cash additions to nuclear fuel	(15
Proceeds from sale of asset	1
Capitalized interest and AFUDC:	
Utility property, plant and equipment	(5
Nuclear fuel	
Decommissioning trust funds:	
Purchases, including funding of $6.2 million, $5.9 million and $10.4 million, respectively	(42
Sales and maturities	33
Other investing activities	
Net cash used for investing activities	(117
Cash Flows From Financing Activities:	

Proceeds from exercise of stock options	5
Repurchases of treasury stock	
Settlement on derivative instruments classified as cash flow hedges	(22
Proceeds from issuance of long-term notes payable	397
Repurchases of and payments on first mortgage bonds	(381
Pollution control bonds:	
Proceeds	193
Payments	(193
Financing obligations:	
Proceeds	18
Payments	(17
Other financing activities	(9
Net cash used for financing activities	(10
Net decrease in cash and temporary investments	(21
Cash and temporary investments at beginning of period	29
Cash and temporary investments at end of period	$ 7

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Note B. Regulation

Note C. Utility Plant, Palo Verde and Other Jointly-Owned Utility Plant

Note D. Accounting for Asset Retirement Obligations

Note E. Common Stock

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Note G. Long-Term Debt and Financing Obligations

Note H. Income Taxes

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EL PASO ELECTRIC COMPANY AND SUBSIDI

NOTES TO CONSOLIDATED FINANCIAL STATEM

A. Summary of Significant Accounting Policies

General. El Paso Electric Company is a public utility engaged in the generation, trans
electricity in an area of approximately 10,000 square miles in west Texas and southern
Company also serves wholesale customers in Texas and periodically in the Republic o

Principles of Consolidation. The consolidated financial statements include the accoun
its wholly-owned subsidiary, MiraSol Energy Services, Inc. (MiraSol) (collectively
began operations as a separate subsidiary in March 2001, provided energy efficiency p
provided by the Company s Energy Services Business Group. On July 19, 2002, all s
MiraSol remains a going concern in order to satisfy current contracts and warranty an
installed projects. See Note I. All intercompany transactions and balances have been e

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

Basis of Presentation. The Company maintains its accounts in accordance with the Un
prescribed by the Federal Energy Regulatory Commission (the FERC).

Application of SFAS No. 71. Regulated electric utilities typically prepare their financia
SFAS No. 71, Accounting for the Effects of Certain Types of Regulation. Under th
recoverable costs are shown as either assets or liabilities on a utility s balance sheet i
that these costs will be charged to and collected from its customers (or has already per
resulting regulatory assets or liabilities are amortized in subsequent periods based upo
periods in a utility s cost of service.

Beginning in 1991, the Company discontinued the application of SFAS No. 71 to its f
was based on the Company s determination that its rates were no longer designed to r
to customers. Upon emerging from bankruptcy in 1996, the Company again conclude
applying SFAS No. 71 because of the ten-year rate freeze in Texas and its ongoing int
New Mexico rates, which had been established in 1990. Although the Company believ
were based upon its costs of service, the unusual length of the rate freeze period create
ultimate recovery of its costs over the entire freeze period. Consequently, the

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NOTES TO CONSOLIDATED FINANCIAL STATEM

Company determined that it should not re-apply SFAS No. 71 to its Texas and New M
emerged from bankruptcy in February 1996.

During 2004, the Company determined that it met the criteria necessary to re-apply SF
jurisdictional operations. Two key events transpired in New Mexico that, when consid
Company s decision to re-apply SFAS No. 71. In April of 2004, the Company receiv
unanimous stipulation which established new base and fuel rates for its New Mexico c
on June 1, 2004. The Company s approved rates were based upon its cost of providin
event, coupled with the repeal of New Mexico s electric utility industry restructuring
resulted in the Company meeting the criteria for the re-application of SFAS No. 71 to
2004. The re-application of SFAS No. 71 to the Company s New Mexico jurisdiction
$18.5 million of regulatory assets, $5.0 million in related accumulated deferred incom
regulatory liabilities, $5.5 million in related accumulated deferred tax liabilities and a
of tax, or $0.04 basic and diluted earnings per share.

The Company has not reapplied SFAS No. 71 to its Texas jurisdiction. However, the C
the reapplication of SFAS No. 71 to its Texas jurisdiction based upon the expiration o
the delay of retail competition in 2004, and a new rate settlement agreement with the C
the Company entered into a settlement agreement with the City (City Rate Agreeme
freeze (New Texas Freeze Period) until June 30, 2010. The City Rate Agreement s
rates to be cost based. If the Company s return on equity falls below a range around a
current market conditions during the New Texas Freeze Period, the Company may see
Company s return on equity exceeds the range, 50% of the excess must be paid to the
provides for the City to conduct a review of the Company s operating expenses and p
agreement if they are not determined to be within a reasonable range compared to the
Agreement provides for the Company to retain 75% of off-system sales margins rathe
City Rate Agreement has been approved by the City, in order to fully implement the a
must approve the sharing of off-system sales margins provisions of the agreement and
the Texas customers outside the City. Once the City Rate Agreement is approved by t
Company will complete the evaluation as to whether SFAS No. 71 should be reapplie
re-application of SFAS No. 71 will result in the recognition of regulatory assets and li
effect on our consolidated financial statements. However, the re-application of SFAS
cash flow.

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NOTES TO CONSOLIDATED FINANCIAL STATEM

Comprehensive Income. Certain gains and losses that are not recognized currently in t
operations are reported as other comprehensive income in accordance with SFAS No.
Income.

Utility Plant. Depreciation is provided on a straight-line basis over the estimated rema
from 5 to 31 years), except for approximately $298 million of reorganization value all
transmission, distribution and general plant in service. This amount was depreciated o
ten-year period of the Texas Rate Stipulation which ended in July 2005. For all other u
Mexico depreciation lives are the same.

In conjunction with a certain regulatory filing in the New Mexico jurisdiction, the Co
depreciation rates effective January 1, 2004. The new rates had the effect of increasing
expense by approximately $1.9 million and decreasing net income, after tax, by appro
and diluted earnings per share for the year ending December 31, 2004 compared to the

The Company charges the cost of repairs and minor replacements to the appropriate o
capitalizes the cost of renewals and betterments. When property subject to composite
disposed of in the normal course of business, its original cost together with the cost
to accumulated depreciation. For other property dispositions, the applicable cost and a
removed from the balance sheet accounts and a gain or loss is recognized.

The cost of nuclear fuel is amortized to fuel expense on a units-of-production basis. A
costs is charged to expense based on requirements of the Department of Energy (the
approximately one-tenth of one cent on each kWh generated. The Company is also am
associated with on-site spent fuel storage casks at Palo Verde over the burn period of t
of the storage casks. See Note C.

Impairment of Long-Lived Assets. In accordance with SFAS No. 144, Accounting fo
Long-Lived Assets, long-lived assets, such as property, plant, and equipment and pu
amortization, are reviewed for impairment whenever events or changes in circumstanc
amount of an asset may not be recoverable. Recoverability of assets to be held and use
the carrying amount of an asset to estimated undiscounted future cash flows expected
carrying amount of an asset exceeds its estimated undiscounted future cash flows, an i
the amount by which the carrying amount of the asset exceeds the fair value of the ass

Capitalized Interest. The Company capitalizes interest cost to construction work in pr
in accordance with SFAS No. 34, Capitalization of Interest Cost for its Texas juris
New Mexico jurisdictional operations, the Company capitalizes interest

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EL PASO ELECTRIC COMPANY AND SUBSIDI

NOTES TO CONSOLIDATED FINANCIAL STATEM

and common equity costs to construction work in progress and nuclear fuel in process
Uniform System of Accounts as provided for in SFAS No. 71. The amount of the equi
capitalized to construction work in progress was $0.9 million and $0.3 million for the
and 2004, respectively.

Asset Retirement Obligation. Effective January 1, 2003, the Company adopted SFAS
Retirement Obligations. SFAS No. 143 sets forth accounting requirements for the re
liabilities associated with the retirement of tangible long-lived assets. An asset retirem
with long-lived assets included within the scope of SFAS No. 143 is that for which a l
enacted laws, statutes, written or oral contracts, including obligations arising under th
Under the statement, these liabilities are recognized as incurred if a reasonable estima
and are capitalized as part of the cost of the related tangible long-lived assets. In Janu
recording the increase in the ARO due to the passage of time as an operating expense
December 31, 2005, the Company adopted FASB Interpretation No. 47, Accounting
Obligations, (FIN 47). FIN 47 clarifies that the term conditional as used in SF
perform an asset retirement activity even if the timing and/or settlement are condition
may not be within the control of an entity. See Note D.

Cash and Cash Equivalents. All temporary cash investments with an original maturity
considered cash equivalents.

Investments. The Company s marketable securities, included in decommissioning tru
reported at fair market value and consist primarily of equity securities and municipal,
funds established for decommissioning of its interest in Palo Verde. Such marketable
available-for-sale securities and, as such, unrealized gains and losses are included i
income as a separate component of common stock equity. However, if declines in fair
below original cost basis are determined to be other than temporary, then the declines
consolidated statement of operations and a new cost basis is established for the affect
M.

Derivative Accounting. As of January 1, 2001, the Company adopted SFAS No. 133,
Instruments and Hedging Activities, as amended by SFAS No. 149, Amendment o
Instruments and Hedging Activities, including any effective implementation guidanc
Derivatives Implementation Group. This standard requires the recognition of derivativ
the balance sheet with measurement of those instruments at fair value. Any changes i
are recorded in earnings or other comprehensive income. See Note M.

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EL PASO ELECTRIC COMPANY AND SUBSIDI

NOTES TO CONSOLIDATED FINANCIAL STATEM

Inventories. Inventories, primarily parts, materials, supplies and fuel oil are stated at a
recoverable cost.

Operating Revenues Net of Energy Expenses. The Company accrues revenues for serv
electric service revenues. Energy expenses are stated at actual cost incurred. The Com
presently being billed under a fixed fuel factor approved by the Public Utility Commis
Commission). As of June 2003, the Company s New Mexico retail customers are be
clause which is adjusted monthly, as approved by the New Mexico Public Regulation
2004. The Company s recovery of energy expenses in these jurisdictions is subject to
energy expenses incurred to actual fuel revenues collected. The difference between en
revenues charged to the Company s Texas and New Mexico customers, as determine
NMPRC rules, is reflected as net over/undercollection of fuel revenues in the consolid
Amounts not expected to be collected within the next twelve months are classified as
non-current.

Unbilled Revenues. Accounts receivable include accrued unbilled revenues of $16.4 m
December 31, 2005 and 2004, respectively.

Allowance for Doubtful Accounts. Additions, deductions and balances for allowance f
2004 and 2003 are as follows (in thousands):

Balance at beginning of year
Additions:
Charged to costs and expense
Recovery of previous write-offs
Uncollectible receivables written off
Balance at end of year

Income Taxes. The Company accounts for federal and state income taxes under the as
accounting for income taxes. Under this method, deferred income taxes are recognize
consequences of temporary differences by applying enacted statutory tax rates for e
future years to differences between the financial statement carrying amounts and the t
liabilities. The Company records a valuation allowance to reduce its deferred tax asse
not that such deferred tax assets will not be realized. The effect on deferred tax assets
rate is recognized in income in the period that includes the enactment date.

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EL PASO ELECTRIC COMPANY AND SUBSIDI

NOTES TO CONSOLIDATED FINANCIAL STATEM

Earnings per Share. Basic earnings per share is computed by dividing net income by t
shares outstanding. Diluted earnings per share is computed by dividing net income by
shares and the dilutive impact of the sum of unvested restricted stock and the stock op
the period with the amount of outstanding options calculated by using the treasury sto

Stock Options and Restricted Stock. The Company has two stock-based long-term inc
under the recognition and measurement principles of APB Opinion No. 25, Account
and related interpretations. Stock options have typically been granted with an exercise
the date of grant and, accordingly, no compensation expense is recorded by the Comp
granted at fair market value. Accordingly, the Company recognizes compensation exp
market value of the restricted stock determined at the date of grant over the restriction
compensation expense for the option portion of the plans had been determined based o
grant date and amortized on a straight-line basis over the vesting period, consistent wi
Accounting for Stock-Based Compensation, the Company s net earnings and earn
to the pro forma amounts presented below:

Net income, as reported
Deduct: Compensation expense, net of tax
Pro forma net income
Basic earnings per share:
As reported
Pro forma
Diluted earnings per share:
As reported
Pro forma

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NOTES TO CONSOLIDATED FINANCIAL STATEM

The fair value for these options was estimated at the grant date using the Black-Schol
options were granted in 2005. Weighted average assumptions and grant-date fair valu
below:

Risk-free interest rate
Expected life, in years
Expected volatility
Expected dividend yield
Fair value per option

Restricted Stock. Restricted stock has been granted at fair market value. Compensatio
awards is recognized on a fair value basis and is measured by referencing the quoted m
grant date, amortized ratably over the restriction period. Unearned compensation relat
reduction of common stock equity and included in deferred and unearned compensatio
balance sheets.

Performance Shares. Subject to meeting certain performance criteria, performance sh
officers under the Company s existing long-term incentive plan on January 1, 2006 a
recognizes the related compensation expense by ratably amortizing the current fair ma
granted based on the current performance of the Company over the performance cycle
APB Opinion No. 25, compensation expense for performance shares determined using
adjusted for subsequent changes (such as the number of shares to be granted, if any, a
Company s stock) in the expected outcome of the performance-related conditions unt
Any such adjustments are accounted for as a change in estimate, and the cumulative e
prior periods is recognized in the period of the change.

Other New Accounting Standards. In November 2004, the FASB issued SFAS No. 15
of Accounting Research Bulletin No. 43 (ARB No. 43), (Inventory Pricing). AR
some circumstances, items such as idle facility expense, excessive spoilage, double fr
so abnormal as to require treatment as current period charges. SFAS No. 151 require
current-period charges regardless of whether they meet the criterion of so abnormal.
effective for inventory costs incurred during fiscal years beginning after June 15, 200
SFAS No. 151 will have a significant impact on the Company s consolidated financia

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary As
Principles Board Opinion No. 29 (APB No. 29), Accounting for Nonmonetary Tr
No. 29 is based on the principle that exchanges of nonmonetary assets should be meas
assets exchanged, with certain exceptions. SFAS No. 153 eliminates the exception for
productive

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NOTES TO CONSOLIDATED FINANCIAL STATEM

assets and replaces it with a general exception for exchanges of nonmonetary assets th
substance. A nonmonetary exchange has commercial substance if the future cash
change significantly as a result of the exchange. The provisions of this statement are e
beginning after June 15, 2005. The Company does not believe SFAS No. 153 will hav
Company s consolidated financial statements.

In December 2004, the FASB issued a revision of SFAS No. 123, Accounting for St
No. 123 (revised) focuses primarily on accounting for transactions in which an entity
share-based payment transactions. SFAS No. 123 (revised) requires a public entity to
services received in exchange for an award of equity instruments based on the grant-d
some limited exceptions). That cost will be recognized over the period during which a
service in exchange for the award the requisite service period typically the ves
recognized for equity instruments for which employees do not render the requisite ser
effective for public entities that do not file as small business issuers as of the beginnin
reporting period that begins after December 15, 2005. SFAS No. 123 (revised) applies
required effective date and to awards modified, repurchased or cancelled after that dat
for outstanding awards for which the requisite service has not been rendered as of the
the requisite service is rendered on or after the required effective date. The compensat
shall be based on the grant-date fair value of those awards as calculated for pro forma
The Company anticipates using the modified perspective method of adopting SFA
estimated the ultimate impact that this new pronouncement will have on its financial s
$1.0 million and do not expect this statement to have an effect materially different tha
provided above.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corre
Opinion No. 20, and FASB Statement No. 3. SFAS No. 154 requires retrospective a
statements of changes in accounting principle, unless it is impracticable to determine
the cumulative effect of the change. SFAS No. 154 also requires that retrospective ap
principle be limited to the direct effects of the change. Indirect effects of a change in a
change in contractual bonus payments resulting from an accounting change, should be
accounting change. SFAS No. 154 also requires that a change in depreciation, amortiz
long-lived, nonfinancial assets be accounted for as a change in accounting estimate af
principle and recognized in the period of change. SFAS No. 154 is effective for accou
errors made in fiscal years beginning after December 15, 2005. The Company will ad
No. 154, if applicable, beginning in 2006.

Reclassification. Certain amounts in the consolidated financial statements for 2004 an
conform with the 2005 presentation.

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B. Regulation
General

In 1999, both the Texas and New Mexico legislatures enacted electric utility industry
competition in certain functions of the industry and ultimately in the Company s serv
exempt from the requirements of the Texas Restructuring Law, including utility restru
the expiration of the original Texas Freeze Period, which occurred in August 2005. Th
rule that further delays competition in the Company s Texas service territory until at
regional transmission organization (RTO) begins operation in its relevant power m
Restructuring Act was repealed and as a result, the Company s operations in New Me
regulated. The Company cannot predict at this time the effect electric restructuring wi
be required to ultimately implement the Texas Restructuring Law.

Federal Regulatory Matters

Federal Energy Regulatory Commission. The FERC has been conducting an investiga
electricity prices in the western United States during 2000 and 2001. On August 13, 2
Power Act (FPA) investigation into the Company s wholesale power trading in th
2001 to determine whether the Company and Enron engaged in misconduct and, if so,
The Company reached settlements with the FERC and other parties in 2002 and 2003.
order approving the settlement resolved all issues between the FERC and the other pa
settlements, the Company agreed to refund $15.5 million and to make wholesale sales
authority rather than its market-based rate authority for the period December 1, 2002 t
agreement allowed the Company to sell power into wholesale markets at its incremen
the extent that wholesale market prices exceeded these agreed upon amounts, the Com
these additional revenues. This provision did not have a significant impact on the Con
December 31, 2004. The Company s ability to make wholesale sales pursuant to its m
restored on January 1, 2005.

RTOs. FERC s rule (Order 2000) on RTOs strongly encourages, but does not requ
RTOs. The Company is an active participant in the development of WestConnect, for
Southwest Transmission and Reliability Operator. A WestConnect Memorandum of U
the October 2, 2001 MOU, was signed by the Company and nine other transmission o
November 21, 2005 an eleventh member joined. This MOU obligates the parties to pa
to ongoing joint efforts, including involvement with stakeholders, customers, local, st
personnel, and other Western Grid transmission providers to identify, develop and im

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cost-effective wholesale market enhancements on a voluntary, phased-in basis to add
wholesale market efficiency and reliability for wholesale users of the Western Grid. T
include formation of an RTO. WestConnect will continue to work with the FERC and
west to achieve a seamless market structure. The Company, however, is approximatel
and cannot control the terms or timing of its development. WestConnect as an RTO w
years. The establishment of an independent RTO in the Company s service area is a p
considered part of a Qualified Power Region as defined in the Texas Restructuring La
WestConnect will affect when and whether the Company s Texas service territory is
Restructuring Law.

Department of Energy. The DOE regulates the Company s exports of power to the C
granted by the DOE and a presidential permit. The DOE has determined that all such
transmission lines shall be made in accordance with Order No. 888, which established

The DOE is authorized to assess operators of nuclear generating facilities a share of th
DOE s uranium enrichment facilities and for the ultimate costs of disposal of spent n
discussion of spent fuel storage and disposal costs.

Nuclear Regulatory Commission. The NRC has jurisdiction over the Company s lice
operation of nuclear generating stations to protect the health and safety of the public f
also has the authority to grant license extensions pursuant to the Atomic Energy Act o

Texas Regulatory Matters

The rates and services of the Company are regulated in Texas by municipalities and b
largest municipality in the Company s service area is the City of El Paso (City). T
appellate jurisdiction to review municipal orders and ordinances regarding rates and s
Texas and original jurisdiction over certain other activities of the Company. The decis
subject to judicial review.

Deregulation. The Texas Restructuring Law required certain investor-owned electric
generation activities and retail service activities from transmission and distribution act
that date, retail competition for generation services was instituted in some parts of Tex
however, specifically recognized and preserved the Company s Texas Rate Stipulatio
by, among other things, exempting the Company s Texas service area from retail con
Period. On October 13, 2004, the Texas Commission approved a rule further delaying
Company s Texas service territory. The rule approved by the Texas Commission sets

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identifies various milestones for the Company to reach before competition can begin.
development, approval by the FERC, and commencement of independent operation of
the Company s service territory, including the development of retail market protocols
complete transition to retail competition would occur upon the completion of the last r
Texas Commission s final evaluation of the market s readiness to offer fair competit
customers. The Company believes that adoption of this rule will likely delay retail com
of years. There is substantial uncertainty about both the regulatory framework and ma
when retail competition is implemented in the Company s service territory, and the C
preparatory, restructuring and other costs that may not ultimately be recoverable. Ther
deregulation would not adversely affect the future operations, cash flows and financia

Renewables and Energy Efficiency Programs. Notwithstanding the Texas Commissio
delaying competition in the Company s Texas service territory, the Company became
energy efficiency requirements of the Texas Restructuring Law on January 1, 2006. U
requirements, the Company will have to annually obtain its pro rata share of renewabl
the Program Administrator (the Electric Reliability Council of Texas) appointed by th
total Texas retail sales subject to renewable energy credit allocation. During the 2005
the statewide obligation to increase renewable energy capacity was raised from an add
additional 5,000 MW of additional renewable generating capacity in Texas by 2015. T
to obtain renewable energy credits will not be known until January 31 of the year follo
will have until March 31 to obtain, if necessary, and submit to the Program Administr
Company estimates that its Texas retail sales will represent approximately 2% of the t
In addition, by January 1, 2007, the Company will be required to fund incentives for e
achieve the goal of meeting 5% of its growth in demand through energy efficiency sav
every year thereafter, that goal is 10% of the Company s growth in demand through e
Preparatory costs incurred by the Company to meet these requirements may not be rec
service territory during the New Texas Freeze Period which expires June 2010. Pursua
Efficiency Plan filed with the Texas Commission, the Company estimates it will incur
for incentive payments to achieve its energy efficiency goal.

New Texas Freeze Period and Franchise Agreement. On July 21, 2005, the Company
City, the City Rate Agreement, to extend its existing freeze period for an additional fi
New Texas Freeze Period. Under the City Rate Agreement which became effective as
rates will remain at their current level for the next five years. If, during the term of the
on equity falls below the bottom of a defined range, the Company has the right to initi

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adjustment to base rates. If the Company s return on equity exceeds the top of the ran
City s direction, an amount equal to 50% of the pre-tax return in excess of the ceiling
current rates, would be a range of approximately 8% to 12%.

Pursuant to the City Rate Agreement, the Company will share with its Texas custome
and wheeling revenues. Under the prior rate agreement, the Company shared 50% of
wheeling revenues with Texas customers. The City Rate Agreement requires a varian
Texas Commission regarding the sharing of margins. The Company has sought Texas
Docket No. 32289 filed on January 17, 2006 of the margin sharing provisions of the a
does not approve the margin sharing provisions of the City Rate Agreement, the Com
negotiate in good faith to amend the rate agreement to achieve a similar economic res
unable to predict when or if the Texas Commission will approve such provisions. A T
expected in the second quarter of 2006.

In addition, the Company has committed to spend at least 0.3% of its El Paso revenue
within the City. The Company and the City have agreed to engage at the Company s
independent consultant to review the reasonableness of certain operating expenses of
finds such expenses to be unreasonable, the parties will seek to negotiate an appropria
to agree on a remedy, the agreement will terminate at the end of one year, and, therea
to traditional rate regulation. The City has retained a consultant to conduct this review
in the second quarter of 2006. Consistent with the prior rate agreement, the City Rate
by the City in the event of a merger or change in control of the Company to seek rate
synergy savings.

The City also granted to the Company a new 25-year franchise which became effectiv
franchise fee payments from 2% to 3.25% of gross receipts earned within the City lim
Company s usage of City-owned property and the payment of franchise fees.

Fuel and Purchased Power Costs. Although the Company s base rates are frozen und
pursuant to Texas Commission rules and the City Rate Agreement, the Company s fu
customers. In January and July of each year, the Company can request adjustments to
reflect projected energy costs associated with providing electricity, seek recovery of p
revenues, and refund past overcollections of fuel revenues. All such fuel revenue and
periodic final review by the Texas Commission in fuel reconciliation proceedings.

The Company reconciled its Texas jurisdictional fuel costs for the period January 1, 1
PUC Docket No. 26194, and on May 5, 2004, the Texas Commission

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issued its final order. At issue was the Company s request to recover an additional $1
Texas customers as a surcharge due to fuel undercollections from January 1999 throu
Commission disallowed approximately $4.5 million of Texas jurisdictional expenses,
primarily of (i) approximately $4.2 million of purchased power expenses which the Te
imputed capacity charges, and (ii) approximately $0.3 million in fees which were d
recoverable as fuel. This disallowance was recorded as a reduction of fuel revenue du
Texas, capacity charges are not eligible for recovery as fuel expenses but are to be rec
rates. As the Company s base rates were frozen during the period in which the imput
have been incurred, the $4.2 million of imputed capacity charges were therefore perm
recoverable from its Texas customers. The Texas Commission s decision has been ap
Company, and the Company is unable to predict the ultimate outcome of the appeals.

On August 31, 2004, the Company filed an application to reconcile Texas jurisdiction
January 1, 2002 through February 29, 2004 in PUC Docket No. 30143. The Company
costs similar to those that were at issue in PUC Docket No. 26194 during the period c
case. The Company believes that it has accounted for its purchased power costs durin
by PUC Docket No. 30143 in a manner consistent with the Texas Commission s deci
However, the Texas Commission is currently conducting a generic rulemaking procee
policy for the appropriate recovery mechanism for such capacity costs in purchased p
assurance as to the outcome of the rulemaking and its potential impact on the Compa
future reconciliation periods, including that in PUC Docket No. 30143. Additionally,
No. 30143 filed testimony disputing as much as $44 million of the requested fuel and
stipulation resolving all issues in the fuel reconciliation was filed on January 27, 200
$9.0 million disallowance of the eligible fuel costs requested by the Company. The C
including $1.5 million in the third quarter of 2005, sufficient to provide for the stipula
disallowances in PUC Docket No. 30143. The Texas Commission approved a final or
consistent with the stipulation.

On July 8, 2005, the Company filed a petition (PUC Docket No. 31332) with the Tex
fuel factors and to surcharge under-recovered fuel costs as a result of higher natural g
an increase in its Texas jurisdiction fixed fuel factors of $30.6 million or 23% annual
natural gas costs of $7.28 per MMBtu. The Company also requested a fuel surcharge
period $28.2 million of fuel undercollections through the end of May 2005. On Septe
amended its petition to seek additional fuel under-recoveries through August 2005 an
under-recoveries of $53.6 million, including interest as of the end of the under-recove
24-month period. On September 14, 2005, the Company filed a unanimous stipulation

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to approve the requested fixed fuel factor and amended fuel surcharge. The fixed fuel
implemented effective with billings in October 2005 and final approval from the Texa
November 2005.

On January 5, 2006, the Company filed a petition (PUC Docket No. 32240) with the T
fixed fuel factors and to surcharge under-recovered fuel costs as a result of higher natu
requested an increase in its Texas jurisdiction fixed fuel factors of $30.8 million or 16
cost of natural gas of $9.35 per MMBtu. The Company also requested a fuel surcharge
period approximately $34 million of fuel undercollections, including interest, for unde
September 2005 through November 2005. The requested fuel factor and fuel surcharg
interim basis subject to refund effective with February 2006 bills to customers. The C
with parties on a settlement to resolve this proceeding. Any settlement will be subject
Commission.

Palo Verde Performance Standards. The Texas Commission established performance
Verde pursuant to which each Palo Verde unit is evaluated annually to determine whe
capacity factor entitles the Company to a reward or subjects it to a penalty. The capac
of actual generation to maximum possible generation. If the capacity factor, as measur
consecutive 24-month period, should fall below 35%, the parties to the City Rate Agre
treatment for Palo Verde. The removal of Palo Verde from rate base could have a sign
Company s revenues and financial condition. Under the performance standards the C
performance reward nor incurred a penalty for the 2005 reporting period. The Compa
rewards for the reporting periods ending in 2004 and 2003 to be approximately $0.2 m
respectively. The 2003 reward was included in the Texas fuel reconciliation in PUC D
energy costs incurred and fuel revenues billed. The 2004 reward will be included alon
fuel revenue billed as part of the Texas Commission s review during a future periodic
discussed above. Performance rewards are not recorded on the Company s books unt
a final determination in a fuel proceeding or comparable evidence of collectibility is o
recorded when assessed as probable by the Company.

In compliance with the Texas Commission s final order in PUC Docket No. 20450, th
November 2004 in the amount of $5.8 million of Palo Verde performance rewards fur
Assistance Agency and Big Bend Community Center Committee, Inc. to assist low-in
bills. In further compliance with the Texas Commission s order, the Company sough
El Paso City Council on January 3, 2006 to remit to the City approximately $5.8 milli
rewards

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funds to fund demand side management programs such as weatherization with a focus
business and commercial customers.

New Mexico Regulatory Matters

The rates and services of the Company are regulated in New Mexico by the NMPRC.
Company s New Mexico service area is the City of Las Cruces. The NMPRC has jur
with municipalities regarding utility rates and services in New Mexico. The decisions
judicial review.

Deregulation. In April 2003, the New Mexico Restructuring Act was repealed, and as
in New Mexico will continue to be fully regulated.

New Mexico Rate Stipulation. On June 1, 2004, the Company implemented new rates
Stipulation whereby, among other things, the Company agreed for a period of three ye
(i) freeze base rates after an initial non-fuel base rate reduction of 1%; (ii) fix fuel and
with 10% of the Company s jurisdictional retail sales in New Mexico at $0.021 per k
reconciliation the remaining 90% of the Company s New Mexico jurisdictional fuel a
collected in base rates; (iv) continue the collection of a portion of fuel and purchased p
presently collected in the amount of $0.01949 per kWh; (v) price power provided from
its availability at an 80% nuclear, 20% gas fuel mix; and (vi) deem reconciled, for the
May 31, 2004, the Company s fuel and purchased power costs for the New Mexico ju
Company must also make a New Mexico filing to set rates to be effective by June 1, 2

Fuel and purchased power costs. In April 2004, the NMPRC, as part of the New Mex
purchased power cost adjustment clause. The Company will continue to recover fuel a
rates in the amount of $0.01949 per kWh and continue the fuel and purchased power c
the remaining fuel and purchased power costs. Fuel and purchased power costs associ
Company s jurisdictional retail sales in New Mexico are fixed at $0.021 per kWh.

On August 29, 2005, the Company filed the annual reconciliation of its Fuel and Purc
Clause (FPPCAC) for the period June 1, 2004 through May 31, 2005 in complianc
NMPRC s Final Order in NMPRC Case No. 03-00302-UT. The Company requested
purchased power costs for this period, and requested recovery of $1.3 million for the N
of purchased power capacity costs consistent with its interpretation of NMPRC rules.
recognized deferred fuel revenue through December 2005 to reflect recovery of these
case. Although a hearing date has not been established for this proceeding, the

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Company expects a final order in this case in the first half of 2006. While the Compar
supported the recovery of all of its applicable fuel and purchased power costs, the Co
the NMPRC will rule on this case. An adverse ruling by the NMPRC could have a ma
Company s results of operations.

Renewables. The New Mexico Renewable Energy Act of 2004 requires that, by Janua
comprise no less than 5% of the Company s total retail sales to New Mexico custome
annually until January 1, 2011, when the renewable portfolio standard shall reach a le
retail sales to New Mexico customers and will remain fixed at such level thereafter. O
filed its Procurement Plan detailing its proposed actions to comply with the Renewabl

The NMPRC approved the Company s 2005 Annual Procurement Plan in December
(i) enter into a contract to purchase renewable energy certificates (RECs) for full re
approximately 50% of the Company s requirements in 2008 through 2011 and (ii) to
to recover from customers up to $0.2 million for costs related to the issuance of a dive
to meet the remaining requirements in the 2008 to 2011 timeframe and thereafter. Cos
purchase RECs to meet the requirements of the New Mexico Renewable Energy Act a
clause as purchased power costs from New Mexico customers pursuant to the Renewa
rules. The NMPRC s decision in this case has been appealed to the New Mexico Sup
Industrial Energy Consumers. The Company is unable to predict what, if any, action t
may take in this proceeding.

Sales for Resale

The Company provides up to 10 MW of firm capacity, associated energy, and transmi
Electric Cooperative pursuant to an ongoing contract which requires a two-year notice
been received.

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C. Utility Plant, Palo Verde and Other Jointly-Owned Utility Plant

The table below presents the balance of each major class of depreciable assets at Dece

	Gross
Nuclear production	$ 63
Steam and other	26
Total production	89
Transmission	34
Distribution	58
General	7
Intangible and other	1
Total	$ 1,91

Amortization of intangible plant (software) is provided on a straight-line basis over th (ranging from 3 to 10 years). The amortization expense for intangible plant was $1.9 r $0.8 million for 2005, 2004 and 2003, respectively. The table below presents the estin next five years (in thousands):

2006
2007
2008
2009
2010

The Company owns a 15.8% interest in each of the three nuclear generating units and Palo Verde, in Wintersburg, Arizona. The Palo Verde Participants include the Compa Public Service Company (APS), Southern California Edison Company (SCE), P (PNM), Southern California Public Power Authority, Salt River Project Agricultur (SRP) and the Los Angeles Department of Water and Power. APS serves as operat operation of Palo Verde and the relationship among the Palo Verde Participants is gov Power Project Participation Agreement (the ANPP Participation Agreement).

Pursuant to the ANPP Participation Agreement, the Palo Verde Participants share cost the same proportion as their percentage interests in the generating units, and each part of fuel, other operations, maintenance and capital costs. The Company s share of dire jointly-owned utility plants is reflected in fuel expense, other operations expense, mai other deductions, and taxes other than income taxes in the Company s consolidated st

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Participation Agreement provides that if a participant fails to meet its payment obligat
participant shall pay its proportionate share of the payments owed by the defaulting pa
impracticable to predict defaulting participants, the Company cannot estimate the max
payment, if any, which could be required under this provision.

Other jointly-owned utility plant includes a 7% interest in Units 4 and 5 at Four Corne
Corners) and certain other transmission facilities. A summary of the Company s inv
excluding fuel, at December 31, 2005 and 2004 is as follows (in thousands):

	December 31, 2	
	Palo Verde	O
Electric plant in service	$ 633,620	$ 1
Accumulated depreciation	(136,119)	(1
Construction work in progress	28,501	
Total	$ 526,002	$

Palo Verde

Decommissioning. Pursuant to the ANPP Participation Agreement and federal law, th
the estimated costs to decommission Palo Verde Units 1, 2 and 3, including the Comm
their respective operating licenses. The Company s decommissioning costs are estim
engineering cost studies performed by outside engineers retained by APS.

In accordance with the ANPP Participation Agreement, the Company is required to m
and a minimum funding level in its decommissioning account at the end of each annu
the plant. The Company was above its minimum funding level as of December 31, 20
monitor the status of its decommissioning funds and adjust its deposits, if necessary, t
accumulation requirements in the future.

The Company has established external trusts with an independent trustee, which enab
deduction for federal income tax purposes of a portion of amounts funded. As of Dece
market value of the trust funds was approximately $96.0 million and $89.4 million, re
Company s consolidated balance sheets in deferred charges and other assets.

In 2005, the Palo Verde Participants approved the 2004 Palo Verde decommissioning
calculations occurred between the prior 2001 study and the 2004 study. The 2004 stud
fund approximately $335.7 million (stated in 2004 dollars) to cover its share of decom
cost estimate from the 2001 study estimated that the

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Company needed to fund approximately $311.6 million (stated in 2001 dollars). Had a
calculated for the 2001 study in 2004 dollars, based upon the same 3.6% escalation ra
previous estimate would have been $346.5 million. See Spent Fuel Storage below.

Although the 2004 study was based on the latest available information, there can be n
cost estimates will not continue to increase in the future or that regulatory requiremen
a new low-level radioactive waste repository opens and operates for a number of year
low-level radioactive waste are subject to significant uncertainty. The decommissioni
years. The 2007 study is expected to be complete in the second quarter of 2008. See
Waste below.

Historically, regulated utilities such as the Company have been permitted to collect in
the costs of nuclear decommissioning. The Company, through an affiliated transmissi
able to continue to collect from customers the costs of decommissioning if and when i
Restructuring Law. The collection mechanism utilized in Texas is a non-bypassable
customers, even those who choose to purchase energy from a supplier other than the C
required to pay a fee, which includes the cost of nuclear decommissioning, to the Com
distribution utility. In the Company s case, collection of the fee through the Company
utility will begin in Texas if and when retail competition is implemented in the Comp
Note B Texas Regulatory Matters Deregulation for further discussion.

Spent Fuel Storage. The original spent fuel storage facilities at Palo Verde had suffici
discharged from normal operation of all three Palo Verde units through 2003. Alterna
casks have been constructed to supplement the original facilities. In March 2003, APS
the original facilities as necessary, and placing it in special storage casks which are st
accepted by the DOE for permanent disposal. The 2004 decommissioning study assum
will become the responsibility of the DOE after 2037. APS believes that spent fuel sto
available to allow each Palo Verde unit to continue to operate through the term of its

Pursuant to the Nuclear Waste Policy Act of 1982, as amended in 1987 (the Waste A
accept and dispose of all spent nuclear fuel and other high-level radioactive waste gen
reactors. In accordance with the Waste Act, the DOE entered into a spent nuclear fuel
other Palo Verde Participants. The DOE has previously reported that its spent nuclear
be in operation until 2010. Subsequent judicial decisions required the DOE to start ac
January 31,

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1998. The DOE did not meet that deadline, and the Company cannot currently predict
DOE s permanent disposal site will commence.

The Company expects to incur significant costs for on-site spent fuel storage during th
Company believes are the responsibility of the DOE. These costs are identified to fuel
storage and amortized as that fuel is burned until an agreement is reached with the DO
December 2003, APS, in conjunction with other nuclear plant operators, filed suit aga
Verde Participants to recover monetary damages associated with the delay in the DOE
Company is unable to predict the outcome of these matters at this time.

Disposal of Low-Level Radioactive Waste. Congress has established requirements for
low-level radioactive waste generated within its borders. Arizona, California, North D
entered into a compact (the Southwestern Compact) for the disposal of low-level ra
the first host state of the Southwestern Compact, and Arizona will serve as the second
opening of the California low-level radioactive waste disposal site in Ward Valley has
public hearings, disputes over environmental issues and review of technical issues rela
Palo Verde is projected to undergo decommissioning during the period in which Arizo
Southwestern Compact. The opposition, delays, uncertainty and costs experienced in C
roadblocks that may be encountered when Arizona seeks to open its own waste reposi
interim low-level waste storage methods are or will be available to allow each Palo Ve
to store safely low-level waste until a permanent disposal facility is available.

Steam Generators. Because of degradation in the steam generator tubes of each unit, t
Palo Verde steam generators are reassessed by APS periodically in conjunction with i
outages at the Palo Verde units. New steam generators were installed at Unit 2 during
approximately $45.4 million. During 2005 Palo Verde completed the installation of ne
cost to the Company of approximately $36.8 million. The steam generator replacemen
economic benefit from expected improved performance of the respective units and the
production from the units over their full licensed lives. The output from Palo Verde U
17 to 25% since the unit returned to service after replacement of the steam generators
been limited due to excess vibration in one of the shutdown cooling lines. APS has inf
scheduling a one week outage in late March 2006 to install monitoring equipment in p
beginning in June 2006 to modify the cooling line in an attempt to eliminate the exces

Typically, the Company realizes between 40% and 50% of its off-system sales margin
calendar year when the Company s native load is lower than at other times of the yea
wholesale market of relatively larger amounts of off-system energy

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generated from nuclear fuel resources. Palo Verde s availability is an important facto
margins. The Company estimates that the reduced output and upcoming outages at Pa
lower than originally forecast wholesale energy prices, will result in reduced off-syste
$12 to $18 million for the period January through July 2006. The Company cautions t
estimates to the extent that actual market prices, Palo Verde Unit 1 operations and oth
assumptions. The adverse financial impact on the Company from continued reduced o
Unit 1 could increase and would include foregone off-system sales margins, higher ca
increased purchased power and other costs.

APS has identified accelerated degradation in the steam generator tubes in Unit 3 and
generators at this unit in 2007. The eventual total project cash expenditures for steam
2 and 3 are currently estimated to be $720.6 million in direct costs (the Company s p
December 31, 2005, the Company has paid approximately $71.1 million of such costs
will be funded with internally generated cash. See also Part II, Item 7, Management
Financial Condition and Results of Operations Overview.

Reactor Vessel Heads. In accordance with applicable NRC requirements, APS conduc
vessel heads at Palo Verde Units 1, 2 and 3. In an effort to reduce long-term operating
inspection of the reactor heads, related equipment, and possible repair costs, APS plan
Palo Verde. Reactor vessel head replacement is scheduled to occur at Units 1, 2 and 3
respectively. The Company s share of the costs for this project is estimated to be $21

Liability and Insurance Matters. The Palo Verde participants have insurance for publi
energy hazards to the full limit of liability under federal law. This potential liability is
insurance provided by commercial insurance carriers in the amount of $300 million an
retrospective assessment program. If losses at any nuclear power plant covered by the
funds, the Company could be assessed retrospective premium adjustments. Under fede
per reactor under the program for each nuclear incident is approximately $101 million
$10 million per incident. Based upon the Company s 15.8% interest in the three Palo
maximum potential assessment per incident for all three units is approximately $47.9
limitation of approximately $4.7 million.

The Palo Verde participants maintain all risk (including nuclear hazards) insurance
decontamination of, property at Palo Verde in the aggregate amount of $2.75 billion, a
first be applied to stabilization and decontamination. The Company has also secured i
increased cost of generation or purchased power and business interruption resulting fr
of any of the three units. The

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insurance coverage discussed in this and the previous paragraph is subject to certain p

D. Accounting for Asset Retirement Obligations

Effective January 1, 2003, the Company adopted SFAS No. 143, Accounting for Ass
adoption of SFAS No. 143 primarily affected the accounting for the decommissioning
Four Corners Stations and changed the method used to report the decommissioning ob
bankruptcy in 1996, the Company was required under fresh-start reporting to adopt th
draft of the SFAS No. 143 project and accordingly, recognized the present value of its
retirement costs as both a component of its capitalized cost of Palo Verde and as a dec
in 1996 and through 2002, the Company recognized accretion of the Palo Verde ARO
expense and depreciation of the Palo Verde asset retirement cost as depreciation exper
statements. Upon adoption of SFAS No. 143, the net difference between the amounts
and the Company s previous method of accounting for such activities was recognized
million, a decrease in net plant in service of $30.9 million, and a cumulative effect of
million, net of related taxes of $25.0 million. The cumulative effect of accounting cha
(i) using a longer discount period (i.e., longer remaining life) as a result of assessing th
extension at Palo Verde and (ii) a change in the discount rate used. In January 2003, th
increase in the ARO due to the passage of time as an operating expense (accretion exp
responsibility for the permanent disposal of spent fuel, spent fuel costs have not been
The Company has six external trust funds with an independent trustee which are legal
Palo Verde. The fair value of the funds at December 31, 2005 is $96.0 million.

A reconciliation of the Company s ARO liability recorded is as follows (in thousands

ARO liability at beginning of year
Liabilities incurred
Liabilities settled
Revisions to estimate
Accretion expense
ARO liability at end of year

(1) Results from the implementation of FIN 47 (see discussion below).

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The Company has transmission and distribution lines which are operated under variou
the easements were to be released, the Company may have a legal obligation to remov
has assessed the likelihood of this occurring as remote. The majority of these easemen
the Company routinely exercises.

In 2005, the Palo Verde Participants approved the 2004 Palo Verde decommissioning
calculations occurred between the prior 2001 study and the 2004 study. The 2004 stud
fund approximately $335.7 million (stated in 2004 dollars) to cover its share of decom
cost estimate from the 2001 study estimated that the Company needed to fund approxi
2001 dollars). Had an equivalent estimate been calculated for the 2001 study in 2004 d
escalation rate utilized in the 2001 study, the previous estimate would have been $346
under the 2004 study differs from the ARO liability of $63.5 million the Company rec
This difference can be attributed to how SFAS No. 143 measures the ARO liability, re
the inherent assumption in SFAS No. 143 that Palo Verde will operate until the end of
assessment of the probability of a license extension). The ARO liability calculation be
estimate referenced above, then escalates that cost over the remaining life of the plant
cost at a credit-risk adjusted discount rate. Since the Company assumed an escalation
adjusted discount rate of 9.5% in the original calculation of the ARO liability, the AR
Company s share of the current estimated cost to decommission Palo Verde in 2004 d
the end of its estimated useful life, the difference between the ARO liability and future
over time due to the accretion of the ARO liability.

SFAS No. 143 requires the Company to revise its previously recorded ARO for any ch
Any changes that result in an upward revision to estimated cash flows shall be treated
revisions to the estimated cash flows results in a reduction to the previously recorded A
a downward revision in the estimated cash flows for decommissioning costs from the
a $1.8 million reduction to its ARO asset and liability in the third quarter of 2005. Acc
related to the ARO will decrease approximately $0.3 million annually as a result of th

Effective December 31, 2005, the Company adopted FASB Interpretation No. 47, A
Retirement Obligations, (FIN 47). FIN 47 clarifies that the term conditional as
obligation to perform an asset retirement activity even if the timing and/or settlement
that may or may not be within the control of an entity. Accordingly, the entity must re
asset retirement obligation if the fair value of the obligation can be reasonably estimat
primarily affected the accounting for the disposal obligations of the Company s fuel o

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evaporative ponds and asbestos found at the Company s gas-fired generating plants. W
December 31, 2005, the Company recognized an increase in its ARO of $2.7 million,
of $0.9 million, and a cumulative effect of accounting change resulting in a loss of $1
of December 31, 2004 and 2003, the pro forma ARO liability related to FIN 47 would
$2.5 million, respectively.

Amounts recorded under SFAS No. 143 including amounts recorded under FIN 47 are
and determinations such as (i) whether a legal obligation exists to remove assets; (ii) e
costs of removal; (iii) when final removal will occur; (iv) future changes in decommis
(v) the credit-adjusted interest rates to be utilized in discounting future liabilities. Cha
regard to these assumptions and determinations will change amounts recorded in the f
the Company incurs or assumes any liability in retiring any asset at the end of its usef
do so, it will record such retirement costs as incurred.

E. Common Stock
Overview

The Company s common stock has a stated value of $1 per share, with no cumulative
Holders of the common stock have the right to elect the Company s directors and to v

Long-Term Incentive Plans

The Company s shareholders have approved the adoption of two stock-based long-ter
was approved in 1996 (the 1996 Plan) and authorized the issuance of up to 3.5 mill
benefit of officers, key employees and directors. The second plan was approved in 19
the issuance of up to two million shares of common stock for the benefits of directors,
employees and consultants. The common stock may be issued through the award or gr
incentive stock options, stock appreciation rights, restricted stock, bonus stock and pe

Stock Options. Stock options have been granted at exercise prices equal to or greater t
underlying shares at the date of grant. The options expire ten years from the date of gr
Board of Directors. The following table summarizes the transactions of the Company
2003:

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Unexercised options outstanding at December 31, 2002
Options granted
Options forfeited
Unexercised options outstanding at December 31, 2003
Options granted
Options exercised
Options forfeited
Unexercised options outstanding at December 31, 2004
Options exercised
Options forfeited
Unexercised options outstanding at December 31, 2005

Stock option awards provide for vesting periods of up to six years. Stock options outs
December 31, 2005 are set forth in the following table:

	Options Outstanding	
Exercise Price Range	Number Outstanding	Average Remaining Contractual Life in Years
$5.56 - $8.125	480,000	1.4
9.50 - 13.85	549,448	6.1
13.94 - 14.95	325,000	5.5
	1,354,448	

The number of stock options exercisable and the weighted average exercise price of th

	2005
Number of stock options exercisable	1,044,448
Weighted average exercise price	$ 10.42

Restricted Stock. The Company has awarded vested and unvested restricted stock awa
Restrictions from resale generally lapse, and unvested awards vest, over periods of thr
of vested restricted stock awards is expensed at the time of grant. The market value of
date of grant is recorded as deferred and unearned compensation and is shown as a sep
equity and is amortized to expense over the restriction period. During 2005, 2004 and

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$1.4 million, $1.2 million and $1.3 million, respectively, related to restricted stock aw
following table summarizes the vested and unvested restricted stock awards for 2005,

Restricted shares outstanding at December 31, 2002
Restricted stock awards
Lapsed restrictions and vesting
Restricted shares outstanding at December 31, 2003
Restricted stock awards
Lapsed restrictions and vesting
Forfeitures
Restricted shares outstanding at December 31, 2004
Restricted stock awards
Lapsed restrictions and vesting
Forfeitures
Restricted shares outstanding at December 31, 2005

The weighted average market values at grant date for restricted stock awarded during
$14.40 and $11.47, respectively.

The holder of a restricted stock award has rights as a shareholder of the Company, inc
applicable, receive cash dividends on restricted stock, except that certain restricted sto
dividend on restricted stock to be delivered to the Company in exchange for additiona
equivalent market value.

Performance Shares. On January 1, 2006 and 2007, subject to meeting certain perform
will be granted to certain officers under the Company s existing long-term incentive
recognizes the related compensation expense by ratably amortizing the current fair ma
granted based on the current performance of the Company over the performance cycle
APB Opinion No. 25, compensation expense for performance shares determined using
adjusted for subsequent changes (such as the number of shares to be granted, if any, a
Company s stock) in the expected outcome of the performance-related conditions unt
Any such adjustments are accounted for as a change in estimate, and the cumulative e
prior periods is recognized in the period of the change. The actual number of shares gr
285,000 shares. During 2005 and 2004, the Company expensed $1.5 million and $1.6
performance stock awards.

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Common Stock Repurchase Program

Since the inception of the stock repurchase programs in 1999, the Company has repur
15.3 million shares of its common stock at an aggregate cost of $175.6 million, includ
1.7 million shares remain authorized to be repurchased under the currently authorized
repurchased during 2005. The Company may continue making purchases of its stock p
plan at open market prices and may engage in private transactions, where appropriate.
available for issuance under employee benefit and stock option plans, or may be retire

Reconciliation of Basic and Diluted Earnings Per Share

The reconciliation of basic and diluted earnings per share before cumulative effect of
extraordinary item is presented below:

	(In
Basic earnings per share:	
Income before cumulative effect of accounting change and extraordinary item	$
Effect of dilutive securities:	
Unvested restricted stock	
Stock options	
Diluted earnings per share:	
Income before cumulative effect of accounting change and extraordinary item	$

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	(In
Basic earnings per share:	
Income before cumulative effect of accounting change and extraordinary item	$
Effect of dilutive securities:	
Unvested restricted stock	
Stock options	
Diluted earnings per share:	
Income before cumulative effect of accounting change and extraordinary item	$

	th
Basic earnings per share:	
Income before cumulative effect of accounting change and extraordinary item	$
Effect of dilutive securities:	
Unvested restricted stock	
Stock options	
Diluted earnings per share:	
Income before cumulative effect of accounting change and extraordinary item	$

Options excluded from the computation of diluted earnings per share because the exer
average market price for the periods presented are as follows:

	2005
Options excluded	
Exercise price range	$

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F. Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consists of the following component

	Net Unrealized Gains (Losses) on Marketable Securities	Minimu Pension Liability Adjustme
Balance at December 31, 2002	$ (955)	$ (13,4
Other comprehensive income (loss)	9,486	(4,2
Income tax (expense) benefit	(2,117)	1,6
Balance at December 31, 2003	6,414	(16,0
Other comprehensive loss	(74)	(1,4
Income tax benefit	15	5
Balance at December 31, 2004	6,355	(16,9
Other comprehensive loss	(2,359)	(6,1
Income tax benefit	472	2,2
Balance at December 31, 2005	$ 4,468	$ (20,7

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G. Long-Term Debt and Financing Obligations

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

Long-Term Debt:
First Mortgage Bonds (1):
8.90% Series D, issued 1996, due 2006
9.40% Series E, issued 1996, due 2011
Pollution Control Bonds (2):
2005 Series B refunding bonds, due 2040
4.80% 2005 Series A refunding bonds, due 2040
2005 Series C, due 2040
4.00% 2002 Series A refunding bonds, due 2032
Senior Notes (3):
Senior Notes, net of discount
Promissory note, due 2005 (4)
Total long-term debt
Financing Obligations:
Nuclear fuel ($21,727 due in 2006) (5)
Total long-term debt and financing obligations
Current Portion (amount due within one year)

(1) First Mortgage Bonds

Substantially all of the Company s utility plant is subject to liens under the First Mor
Indenture imposes certain limitations on the ability of the Company to (i) declare or p
(ii) incur additional indebtedness or liens on mortgaged property and (iii) enter into a
assets. At December 31, 2005, the Company had $100 million of Collateral Series Fir
under the First Mortgage Indenture which secures its credit facility, as discussed belov

In May 2005, the Company commenced a cash tender offer for any and all of its 8.90
due February 1, 2006 and its 9.40% Series E First Mortgage Bonds due May 1, 2011,
Company beginning on February 1, 2006 (collectively the Bonds). The total outsta
subject to the offer was approximately $359.4 million. On June 3, 2005, the Company
and

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paid approximately $289.9 million for principal, premium and accrued and unpaid inte
accepted for payment. On June 7, 2005, the Company exercised its right to legally def
tendered by the expiration date of the tender offer by depositing approximately $95.7
of principal, premium and accrued interest through February 1, 2006. The cash tender
mortgage bonds was financed through the issuance of Senior Notes (see below). As a
legal defeasance, the Company has concluded that the liabilities associated with the B
accordance with SFAS No. 140, Accounting for Transfers and Services of Financial
Liabilities.

Repurchases of First Mortgage Bonds made during 2004 and 2003 are as follows (in t

8.25% Series C
8.90% Series D
9.40% Series E
Total

Internally generated funds were used for the repurchases in 2004 and 2003. A loss of
relating to these repurchases and include premiums paid and unamortized issuance co

(2) Pollution Control Bonds
The Company has four series of tax exempt Pollution Control Bonds in an aggregate p
$193.1 million. Upon the occurrence of certain events which includes the remarketing
required to be repurchased at the holder s option or are subject to mandatory redempt
Company reissued three series of pollution control bonds in the amounts of $63.5 mill
$37.1 million. The $59.2 million bonds which mature in 2040, were reissued with a fi
effective interest rate of 5.27% after considering related insurance and issuance costs.
$37.1 million bonds, which also mature in 2040, were reissued with a variable rate tha
3.25% at December 31, 2005, respectively. The Company also remarketed $33.3 milli
which bear a fixed interest rate of 4% until August 1, 2012 which is the date the bonds
effective interest rate for these bonds is 4.70% after considering related insurance and
will remain at its current fixed interest rate until remarketing in August 2012. The reis
four series of bonds which were subject to mandatory tender or remarketing as of Aug

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(3) Senior Notes
The Company filed a shelf registration statement on Form S-3 with the Securities and
became effective in May 2005. The shelf registration statement enables the Company
first mortgage bonds, shares of stock and certain other securities from time to time in
$1.0 billion.

In May 2005, the Company issued $400.0 million aggregate principal amount of its 6
(the Notes) under its shelf registration statement. The proceeds from the issuance o
$2.3 million discount) were used to fund the retirement of the First Mortgage Bonds.

(4) Promissory Note
The note was paid in full in 2005.

(5) Nuclear Fuel Financing
The Company has available a $100 million credit facility that was renewed for a five-
credit facility provides for up to $70 million for the financing of nuclear fuel, which is
borrows under the facility to acquire and process the nuclear fuel. The Company is ob
borrowings with interest and has secured this obligation with Collateral Series First M
financial statements, the assets and liabilities of the trust are reported as assets and lia
amounts not borrowed by the trust may be borrowed by the Company for working cap

The $100 million credit facility requires compliance with certain total debt and intere
was in compliance with these requirements throughout 2005. No amounts are current
working capital needs.

Excluding future obligations and maturities related to nuclear fuel purchase commitm
scheduled maturities of long-term debt and financing obligations for the next five yea

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H. Income Taxes

The tax effects of temporary differences that give rise to significant portions of the de
December 31, 2005 and 2004 are presented below (in thousands):

Deferred tax assets:
Alternative minimum tax credit carryforward
Pensions and benefits
Benefits of tax loss carryforwards
Asset retirement obligation
Investment tax credit carryforward
Other
Total gross deferred tax assets
Less federal valuation allowance
Net deferred tax assets
Deferred tax liabilities:
Plant, principally due to depreciation and basis differences
Decommissioning
Deferred fuel
Other
Total gross deferred tax liabilities
Net accumulated deferred income taxes

The deferred tax asset valuation allowance decreased by approximately $2.9 million i
2004, and decreased $0.8 million in 2003. The 2005 valuation allowance decrease of $
expired investment tax credits of $5.7 million less deferred tax benefits of $2.0 millio
increase of $0.6 million consists of a revaluation of investment tax credits as a result o
valuation allowance decrease of $0.8 million consists of (i) a $0.3 million adjustment
in accordance with Statement of Position (SOP) 90-7, Financial Reporting by Ent
Bankruptcy Code to recognize a tax benefit for valuation allowance that was not use
that were utilized in 2003 and (ii) a $0.5 million write-down related to expired investm
deferred tax benefits of $0.3 million.

Based on the average annual book income before taxes for the prior three years, exclu
and unusual or infrequent items, the Company believes that the net deferred tax assets
levels of book and taxable income.

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

Income tax expense:
Federal:
Current
Deferred
Total federal income tax
State:
Current
Deferred
Total state income tax
Total income tax expense
Tax benefit (expense) classified as cumulative effect of accounting change
Tax expense classified as extraordinary gain on re-application of SFAS No. 71
Total income tax expense before cumulative effect of accounting change or extraordinary item

The current federal income tax benefit for 2005 results primarily from a reversal of al prior years as a result of increased tax deductions due to several method changes prim repair allowances. The current income tax expense for 2004 and 2003 results primaril significant increase in 2004 from 2003 primarily relates to a settlement with the IRS c federal income tax returns which resulted in additional current tax expense and a redu Deferred federal income tax includes an offsetting AMT expense of $6.7 million for 2 of $18.9 million and $2.1 million for 2004 and 2003, respectively. The state income ta from the state effects of the re-application of SFAS No. 71 to the Company s New M the IRS settlement.

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Federal income tax provisions differ from amounts computed by applying the statutor
before federal income tax as follows (in thousands):

	20
Federal income tax expense computed on income at statutory rate	$ 18
Difference due to:	
State taxes, net of federal benefit	
State taxes, net of federal benefit on re-application of SFAS No. 71	
Other tax regulatory assets and liabilities on re-application of SFAS No. 71	
Reduction in estimated contingent tax liability	
Other	
Total income tax expense	17
Tax benefit (expense) classified as cumulative effect of accounting change	
Tax expense classified as extraordinary gain on re-application of SFAS No. 71	
Total income tax expense before cumulative effect of accounting change and extraordinary income	$ 18
Effective income tax rate	
Effective income tax rate without IRS settlement	

The effective income tax rate without IRS settlement excludes the tax benefit associat
contingent tax liability of $3.5 million and state taxes net of federal benefit of $2.7 mi

As of December 31, 2005, the Company had $91.2 million of federal and $42.0 millio
(NOL) carryforwards, $44.8 million of AMT credit carryforwards, $2.3 million of
and $0.2 million of wind energy credits. If unused, the NOL carryforwards would exp
2025, the state NOL carryforwards would expire at the end of 2010, the research and
expire at the end of 2011 through 2018, the wind energy carryforwards would expire a
and the AMT credit carryforwards have an unlimited life.

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I. Commitments, Contingencies and Uncertainties
Power Contracts

As of December 31, 2005, the Company had entered into the following significant agr
counterparties for forward firm purchases and sales of electricity:

Type of Contract	Quantity	Term
Sale Off-peak Energy	25 MW	2006 (excl
Purchase Capacity	133 MW	2006 throu

In addition to the above transactions, the Company has also entered into several agree
for the forward firm purchases and sales of electricity during the first quarter of 2006:

Type of Contract	Quantity	Term
Purchase Off-peak Energy	50 MW	1st Quarter
Sale On-peak Energy	25 MW	1st Quarter
Sale Off-peak Energy	175 MW	1st Quarter

Environmental Matters

The Company is subject to regulation with respect to air, soil and water quality, solid
environmental matters by federal, state, tribal and local authorities. Those authorities
and have continuing jurisdiction over facility modifications. Failure to comply with th
requirements can result in actions by regulatory agencies or other authorities that migh
administrative, civil, and/or criminal penalties. If the United States regulates green ho
fossil fuel generation assets will be faced with the additional cost of monitoring, contr
emissions. Because a significant portion of the Company s generation assets is nuclea
not believe such regulations would impose greater burdens on the Company than on n
addition, unauthorized releases of pollutants or contaminants into the environment can
obligations that are subject to enforcement by the regulatory agencies. Environmental
are often difficult to predict. While the Company strives to prepare for and implement
changing environmental regulations, substantial expenditures may be required for the
regulations in the future.

The Company analyzes the costs of its obligations arising from environmental matters
it has made adequate provision in its financial statements to meet such obligations. As
Company has a provision for environmental remediation obligations of approximately
2005, which is related to compliance with

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federal and state environmental standards. However, unforeseen expenses associated v
material adverse effect on the future operations and financial condition of the Compar

The Company incurred the following expenditures to comply with federal environmen

Clean Air Act
Clean Water Act (1)

(1) Includes $1.0 million and $0.6 million in remediation costs for the twelve month
2004, respectively.

Along with many other companies, the Company received from the Texas Commissio
(TCEQ) a request for information in 2003 in connection with environmental condit
that has been owned and operated by the San Angelo Electric Service Company (SE
proposed the SESCO site for listing on the registry of Texas state superfund sites and
hundred entities, including the Company, indicating that TCEQ considers each of ther
parties at the SESCO site. The Company received from the SESCO working group o
settlement offer in January 2006 for remediation and other expenses expected to be in
SESCO site. The Company s position is that any liability it may have related to the S
Company s bankruptcy. At this time, the Company has not agreed to the settlement o
cleanup of the SESCO site and is unable to predict the outcome of this matter. While t
present to believe that it will incur material liabilities in connection with the SESCO s
potential costs related to this matter.

Except as described herein, the Company is not aware of any other active investigatio
environmental requirements by the Environmental Protection Agency, the TCEQ or th
Department which is expected to result in any material liability. Furthermore, except a
not aware of any unresolved, potentially material liability it would face pursuant to th
Response, Comprehensive Liability Act of 1980, also known as the Superfund law.

Tax Matters

The Company s federal income tax returns for the years 1999 through 2002 have bee
2005, the Company received the IRS notice of proposed deficiency. The primary audi
related to (i) whether the Company was entitled to currently deduct payments related t
Unit 2 steam generators or whether these payments should be capitalized and deprecia
was entitled to currently

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deduct payments related to the dry cask storage facilities for spent nuclear fuel or whe
capitalized and depreciated. The proposed IRS adjustments would affect the timing of
deductibility for federal tax purposes. The Company has protested the audit adjustmen
and believes that its treatment of the payments is supported by substantial legal author
prevails, the resulting income tax and interest payments could be material to the Comp
currently performing an examination of the 2003 and 2004 income tax returns.

The Company has established, and periodically reviews and re-evaluates, an estimated
consolidated balance sheet to provide for the possibility of adverse outcomes in tax pr
outcome of the ongoing examination cannot be predicted with certainty, and while the
fact be sufficient, the Company believes that the amount of contingent tax liability rec
reasonable estimate of any additional tax that may be due.

MiraSol Warranty Obligations

MiraSol is an energy services subsidiary which offered a variety of services to reduce
costs. MiraSol was not a power marketer. On July 19, 2002, all sales activities of Mira
going concern in order to satisfy current contracts and warranty and service obligation
As of December 31, 2005, the Company has a reserve for warranty claims in the amou
Accruals, charges and balances for the reserve for warranty claims are as follows:

Balance at beginning of year
Accrual of warranty costs
Charges for work performed
Balance at end of year

While no other probable warranty liabilities have been identified at this time, if it is de
MiraSol has further obligations to any customer, and contributions from MiraSol, its s
party are insufficient to honor the warranty obligations, the Company intends to hono
after making appropriate regulatory filings, if any.

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Customer Information System

During 2003, the Company completed an assessment of the Customer Information Sy
alternatives to completion of the project. This assessment included analyzing the impa
implementation of deregulation and resulting changes in billing requirements, and the
specification. Based on this assessment and on events related to the project which occ
CIS project and recognized an asset impairment loss of approximately $17.6 million.

Lease Agreements

The Company has operating leases for administrative offices and certain warehouse fa
lease has a 10-year term ending May 31, 2007. The minimum lease payments are $1.0
each year by 50% of the percentage change of the Consumer Price Index. The wareho
December 2009 and has three concurrent renewal options of one year each. The lease
annually. The lease agreements do not impose any restrictions relating to issuance of a
dividends or entering into other lease arrangements. The Company has no significant

The Company s total annual rental expense related to operating leases was $1.1 milli
2005, 2004 and 2003, respectively. As of December 31, 2005, the Company s minim
next five years are as follows (in thousands):

2006
2007
2008
2009
2010

Union Matters

The collective bargaining agreement with existing union employees expires in June 20
entering into negotiations on a new collective bargaining agreement in the second qua
Company is presently conducting collective bargaining negotiations with an additiona
Company s meter reading and collections area, facilities services area and customer s
representation in 2003 and 2004.

J. Litigation

The Company is a party to various legal actions. In many of these matters, the Compa
insurance that covers the various claims, actions and complaints. Based upon a review
insurance coverage, to the extent that the Company has been able to reach a conclusio
believes that none of these claims will have a material adverse effect on the financial
cash flows of the Company.

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On January 16, 2003, the Company was served with a complaint on behalf of a purpor violations of the federal securities laws (*Roth v. El Paso Electric Company, et al.,* No. was filed in the El Paso Division of the United States District Court for the Western D undisclosed compensatory damages for the class as well as costs and attorneys fees. Pension Fund of Illinois, filed a consolidated amended complaint on July 2, 2003, alle Company and certain of its current and former directors and officers violated securitie some of the Company s revenues and income were derived from an allegedly unlawf allegations arise out of the FERC investigation of the power markets in the western U which the Company previously settled with the FERC Trial Staff and certain interven the Company and the individual defendants filed a motion to dismiss the complaint fo which relief can be granted. On November 26, 2003, the Court denied the motion to d of the individual defendants and granted the motion to dismiss as to two individual de Court granted a motion of the Company and the remaining individual defendants requ interlocutory appeal to the U. S. Court of Appeals for the Fifth Circuit regarding certa Court s denial of the motion to dismiss the complaint as to those defendants. On Apri order staying the district court proceedings until the Fifth Circuit completed its review of Appeals denied the appeal which automatically lifted the stay in the district court. lawsuit was without merit, the parties reached a settlement to resolve this case. The pa Settlement with the Court on June 2, 2005, and the Court issued a final order approvin 2005. The settlement was paid by the Company s insurance carrier since the deductib any further charge to the Company s earnings.

On May 21, 2003, the Company was served with a complaint by the Port of Seattle se Sherman Act, the Racketeer Influenced and Corrupt Organization Act, and state antitr *of Seattle v. Avista Corporation, et al.*, No. CV03-117OP). The complaint was filed in for the Western District of Washington. The complaint alleges that the Company, indi Enron, conspired with the other named defendants to manipulate the California energy artificially inflating the price that the Port of Seattle paid for electricity. The Company defendants, filed a motion to dismiss. On May 12, 2004, the Court granted the Compa dismissed. The Port of Seattle has filed an appeal of the Court s decision with the U. Circuit. The parties are awaiting a hearing and decision on that appeal. While the Con are without merit, the Company is unable to predict the outcome or range of any possi

On May 5, 2004, Wah Chang, a specialty metals manufacturer which operates a plant Company and other defendants in the United States District Court for the District of C *Corporation, et al.,* No. 04-619AS). The complaint makes substantially

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the same allegations as were made in *Port of Seattle* and seeks the same types of dama
the City of Tacoma filed suit against the Company and other defendants in the United
Western District of Washington (*City of Tacoma v. American Electric Power Service*
complaint also makes substantially the same allegations as were made in *Port of Seatt*
(including treble damages) from the Company and the other defendants for violations
under the Sherman Act. Both of these matters were transferred to the same court that
Seattle lawsuit and on February 11, 2005, the Court granted the Company s motion to
the City of Tacoma have both filed notices of appeal with the U.S. Court of Appeals f
have filed briefs in both cases and are awaiting a hearing and decision. While the Com
are without merit and intends to defend itself vigorously, the Company is unable to pr
possible loss.

See Note B for discussion of the effects of government legislation and regulation on t

K. Employee Benefits
Retirement Plans

The Company s Retirement Income Plan (the Retirement Plan) covers employees
with the Company and work at least a minimum number of hours each year. The Reti
noncontributory defined benefit plan. Upon retirement or death of a vested plan partic
are used to pay benefit obligations under the Retirement Plan. Contributions from the
funding amounts required by the IRS under provisions of the Retirement Plan, as actu
Retirement Plan are invested in equity securities, debt securities and cash equivalents
investment managers appointed by the Company.

The Company s non-qualified retirement income plan for 2003 is a non-funded defin
former employees of the Company. During 2004, the Company adopted a new non-qu
cover certain active employees of the Company. The benefit cost for the non-qualified
on substantially the same actuarial methods and economic assumptions as those used

The Company uses a measurement date of December 31 for its retirement plans. The
Retirement Plan and the non-qualified retirement income plans under SFAS No. 87,
In 2003, the Company adopted SFAS No. 132 (revised 2003), Employers Disclosu
Postretirement Benefits, (SFAS No. 132 revised) which expands the original disc

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The obligations and funded status of the plans are presented below (in thousands):

	2005	
	Retirement Income Plan	Q Ret I
Change in benefit obligation:		
Benefit obligation at end of prior year	$ 165,281	$
Service cost	5,021	
Interest cost	9,351	
Amendments		
Actuarial loss	6,528	
Benefits paid	(4,990)	
Benefit obligation at end of year	181,191	
Change in plan assets:		
Fair value of plan assets at end of prior year	105,682	
Actual return on plan assets	4,500	
Employer contribution	18,300	
Benefits paid	(4,990)	
Fair value of plan assets at end of year	123,492	
Funded status at end of year	(57,699)	
Unrecognized net actuarial loss	62,433	
Unrecognized prior service cost	153	
Prepaid/(Accrued) benefit cost	$ 4,887	$

Amounts recognized in the Company s consolidated balance sheets consist of the foll

	2005	
	Retirement Income Plan	N Qu Reti In P
Prepaid benefit cost	$	$
Accrued benefit cost	(24,976)	(

Intangible assets	153		
Accumulated other comprehensive income	29,710		
Net amount recognized	$ 4,887	$ (	

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The accumulated benefit obligation for all retirement plans was $169.4 million and $1
and 2004, respectively.

The accumulated benefit obligation in excess of plan assets is as follows (in thousands

	2005	
	Retirement Income Plan	N Qu Reti In P
Projected benefit obligation	$ (181,191)	$ (
Accumulated benefit obligation	(148,468)	(
Fair value of plan assets	123,492	

The following are the weighted-average actuarial assumptions used to determine the b

		Decen
	2005	
	Retirement Income Plan	Non-Qualified Retirement Income Plans
Discount rate	5.50%	5.50%
Rate of compensation increase	5.00%	5.00%

The components of net periodic benefit cost are presented below (in thousands):

		Years Ended	
	2005		20
	Retirement Income Plan	Non-Qualified Retirement Income Plans	Retirement Income Plan
Service cost	$ 5,021	$ 143	$ 4,382
Interest cost	9,351	1,281	8,891
Expected return on plan assets	(9,426)		(7,926)
Amortization of:			
Net loss	3,938	291	3,329
Prior service cost	21	94	21
Net periodic benefit cost	$ 8,905	$ 1,809	$ 8,697

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The increase in minimum liability included in other comprehensive income is as follo

	Years Ende		
	2005		2
	Retirement Income Plan	Non-Qualified Retirement Income Plans	Retirement Income Plan
Increase in minimum liability included in other comprehensive income	$ 5,757	$ 371	$ 775

The following are the weighted-average actuarial assumptions used to determine the n January 1:

	2005		2004	
	Retirement Income Plan	Non-Qualified Retirement Income Plans	Retirement Income Plan	Non-Qualifie Retireme Income Plans
Discount rate	5.75%	5.75%	6.00%	6.0
Expected long-term return on plan assets	8.50%	N/A	8.50%	N/
Rate of compensation increase	5.00%	5.00%	5.00%	5.0

The Company reassesses various actuarial assumptions at least on an annual basis. Th measurement date based on prevailing market interest rates inherent in high-quality (A would provide the future cash flow needed to pay the benefits included in the benefit well as on publicly available bond indices. The Company changed its discount rate to from 5.75% to 5.50% at December 31, 2005. For determining 2006 benefit costs, the to change. A 1.0% decrease in the discount rate would increase the 2005 retirement pl 16%. A 1.0% increase in the discount rate would decrease the 2005 retirement plans

The Company s overall expected long-term rate of return on assets is 8.50%, which i pension funds are generally not subject to income tax. The expected long-term rate of expected returns on individual asset categories with a target asset allocation of 65% e expected returns for equity securities are based on historical risk premiums above the expected returns for the debt securities are based on the portfolio s yield to maturity.

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Given recent market conditions, the Company has emphasized capital preservation an
December 31, 2005 and 2004 do not reflect the targeted long-term asset allocation wh
Company s Retirement Plan weighted-average asset allocations by asset category are

Asset Category:
Equity securities
Debt securities
Cash equivalents
Total

The Company s investment goals for the Retirement Plan are to maximize returns sub
policies. Its risk management policies permit investments in equity and debt securities
equivalents and prohibit direct investments in fixed income derivatives, foreign debt s
funds, private placements and tax-exempt debt of state and local governments. The Co
by the use of mutual fund investments whose underlying investments are in domestic
and domestic fixed income securities. The liquidity of these funds is enhanced throug
securities.

The contributions for the Retirement Plan, as actuarially calculated, are at least the mi
by the IRS. The Company expects to contribute $13.7 million to its retirement plans in
no 2006 minimum funding requirements for the Retirement Plan.

The following benefit payments, which reflect expected future service, as appropriate,
thousands):

2006
2007
2008
2009
2010
2011-2015

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Other Postretirement Benefits

The Company provides certain health care benefits for retired employees and their eli
benefits for retired employees only. Substantially all of the Company s employees ma
if they retire while working for the Company. Those benefits are accounted for under
Accounting for Postretirement Benefits Other Than Pensions. Contributions from th
amounts established in the Texas Rate Stipulation. The assets of the plan are invested
and cash equivalents and are managed by professional investment managers appointed
uses a measurement date of December 31 for its other postretirement benefits plan.

In December 2003, the Company elected to defer recognition of the potential effect of
Improvement, and Modernization Act of 2003 (the Act) until authoritative guidanc
subsidy was issued. In May 2004, the FASB issued FASB Staff Position No. 106-2 A
Requirements Related to the Medicare Prescription Drug, Improvement and Moderniz
which provided guidance on the accounting for the effects of the Act for employers th
defined benefit postretirement healthcare plan for which the employer has concluded t
available under the plan are actuarially equivalent to the Medicare Part D benefit and t
reduce the employer s share of the cost of the benefit. The Company determined that
plan were actuarially equivalent to the Medicare Part D benefit. FSP 106-2 requires m
benefit obligation, the plan assets, and the net periodic postretirement benefit cost to r

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The following table contains a reconciliation of the change in the benefit obligation, t
funded status of the plans shown with and without the recognition of Medicare Part D

	Including Decemb	
	2005	2
Change in benefit obligation:		
Benefit obligation at end of prior year	$ 114,637	$ 1
Service cost	4,749	
Interest cost	6,667	
Amendments	(22,711)	
Actuarial loss (gain)	11,703	
Benefits paid	(2,650)	
Retiree contributions	374	
Benefit obligation at end of year	112,769	1
Change in plan assets:		
Fair value of plan assets at end of prior year	23,207	
Actual return on plan assets	364	
Employer contribution	3,422	
Benefits paid	(2,650)	
Retiree contributions	374	
Fair value of plan assets at end of year	24,717	
Funded status	(88,052)	(
Unrecognized net actuarial loss (gain)	7,284	
Unrecognized prior service benefit	(24,316)	
Accrued postretirement cost	$ (105,084)	$ (

Amounts recognized in the Company s consolidated balance sheets consist of accrue
$105.1 million and $98.8 million for 2005 and 2004, respectively.

The following are the weighted-average actuarial assumptions used to determine the a

Discount rate at end of year
Rate of compensation increase
Trend rates:
Initial
Ultimate
Years ultimate reached

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The components of net periodic benefit cost shown including and excluding the Medi
below (in thousands):

Service cost
Interest cost
Expected return on plan assets
Amortization of:
Prior service cost
Net gain
Net periodic benefit cost

Service cost
Interest cost
Expected return on plan assets
Amortization of:
Prior service cost
Net loss
Net periodic benefit cost

The following are the weighted-average actuarial assumptions used to determine the n
assumptions are the same including and excluding Medicare Part D)

Discount rate at beginning of year
Expected long-term return on plan assets
Rate of compensation increase

The Company reassesses various actuarial assumptions at least on an annual basis. Th
measurement date based on prevailing market interest rates inherent in high-quality (A
would provide the future cash flow needed to pay the benefits included in the benefit o
well as on publicly available bond indices. At December 31, 2005, the Company chan
5.50% for the other postretirement benefits plan. For determining 2006 benefit cost, th

expected to change. A 1.0% decrease in the discount rate would increase the 2005 acc

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postretirement benefit obligation by 18.1%. A 1.0% increase in the discount rate woul
postretirement benefit obligation by 14.2%.

For measurement purposes, a 9.6% annual rate of increase in the per capita cost of co
assumed for 2006; the rate was assumed to decrease gradually to 6% for 2009 and ren
Assumed health care cost trend rates have a significant effect on the amounts reported
of a 1% change in these assumed health care cost trend rates would increase or decrea
$18.6 million or $15.0 million, respectively. In addition, such a 1% change would inc
service and interest cost components of the net periodic benefit cost by $2.1 million o

The Company s overall expected long-term rate of return on assets, on an after-tax ba
the sum of the expected returns on individual asset categories with a target asset alloc
securities. The expected returns for equity securities are based on historical risk premi
income rate, while the expected returns for the debt securities are based on the portfol

Given recent market conditions, the Company has emphasized capital preservation an
December 31, 2005 and 2004 do not reflect the targeted long-term asset allocation wh
Company s other postretirement benefits plan weighted average asset allocations by a

Asset Category:
Equity securities
Debt securities
Cash equivalents
Total

The Company s investment goals for the postretirement benefits plan are to maximiz
management policies. Its risk management policies permit investments in equity and d
cash/cash equivalents and prohibit direct investments in fixed income derivatives, for
commingled funds and private placements. The Company s investment policies and s
benefits plan are based on target allocations for individual asset categories. The Comp
the use of mutual fund investments whose underlying investments are in domestic and
domestic fixed income securities. The liquidity of these funds is enhanced through the
securities.

The Company expects to contribute $3.4 million to its other postretirement benefits pl

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The following benefit payments, which reflect expected future service, as appropriate, thousands):

	Including Medicare Part D Subsidy
2006	$ 2,733
2007	3,202
2008	3,621
2009	4,100
2010	4,795
2011-2015	33,273

401(k) Defined Contribution Plans

The Company sponsors 401(k) defined contribution plans covering substantially all e Company has provided a 50 percent matching contribution up to 6 percent of the emp other limits. Total matching contributions made to the savings plans for the years 200 $1.5 million, $1.3 million and $1.3 million, respectively.

Annual Short-Term Bonus Plan

The Annual Short-Term Bonus Plan (the Bonus Plan) provided for the payment of employees, including each of its named executive officers. Payment of awards was ba performance measures reviewed and approved by the Company s Board of Directors Generally, these performance measures were based on meeting certain financial, oper criteria. For 2005, the financial performance goals were based on earnings per share a goals were based on safety and customer satisfaction. If a certain level of earnings per would have been paid under the Bonus Plan. The Company was able to attain the requ earnings per share and the safety goals for low risk employees which resulted in a 200 the Company was able to attain the required levels of improvement in earnings per sh goals which resulted in a bonus of $3.5 million. The Company was also able to attain in the safety performance measures for medium and high risk employees in 2005, 200 safety bonuses of $1.0 million, $0.9 million and $0.7 million, respectively. The Comp 2006 with similar goals.

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L. Franchises and Significant Customers
City of El Paso Franchise

The Company s largest franchise agreement is with the City. The franchise agreemen
fee and allows the Company to utilize public rights-of-way necessary to serve its retai
franchise with the City extends through July 31, 2030.

Las Cruces Franchise

In February 2000, the Company and Las Cruces entered into a seven-year franchise ag
franchise fee (approximately $1.3 million per year) for the provision of electric distrib
prohibited during this seven-year period from taking any action to condemn or otherw
Company s distribution system, or attempt to operate or build its own electric distribu
90-day non-assignable option at the end of the Company s seven-year franchise agre
Company s distribution system that serves Las Cruces at a purchase price of 130% of
time. The Company must provide the book values of the assets covered by this agreem
Las Cruces by July 31, 2006. If Las Cruces exercises this option, it is prohibited from
two years. If Las Cruces fails to exercise this option, the franchise and standstill agree
additional two years.

Military Installations

The Company currently serves Holloman Air Force Base (Holloman), White Sands
United States Army Air Defense Center at Fort Bliss (Ft. Bliss). The Company s s
approximately 3% of annual operating revenues. The Company signed a contract with
which Ft. Bliss will take retail electric service from the Company through December 2
the Company entered into a ten-year contract to provide retail electric service to White
Company signed a new contract, subject to regulatory approval, with Holloman that p
retail electric service and limited wheeling services to Holloman for a ten-year term w

M. Financial Instruments and Investments
SFAS No. 107, Disclosure about Fair Value of Financial Instruments, requires the
values for its financial instruments. The Company has determined that cash and tempo
receivable, decommissioning trust funds, long-term debt and financing obligations, ac
deposits meet the definition of financial instruments. The carrying amounts of cash an
receivable, accounts payable and

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customer deposits approximate fair value because of the short maturity of these items.
carried at market value.

The fair values of the Company s long-term debt and financing obligations, including
based on estimated market prices for similar issues and are presented below (in thousa

	20
	Carrying Amount
First Mortgage Bonds	$
Pollution Control Bonds	193,135
Senior Notes	397,703
Nuclear Fuel Financing (1)	41,907
Total	$ 632,745

(1) The interest rate on the Company s financing for nuclear fuel purchases is reset
market rates. Consequently, the carrying value approximates fair value.

Treasury Rate Locks. During the first quarter of 2005, the Company entered into treas
against potential movements in the treasury reference interest rate pending the issuanc
locks were terminated on May 11, 2005. The treasury rate lock agreements met the cri
were designated as a cash flow hedge. In accordance with cash flow hedge accounting
associated with the fair value of the cash flow hedge of approximately $14.0 million,
accumulated other comprehensive loss. In May 2005, the Company began to recogniz
expense) the accumulated other comprehensive loss associated with the cash flow hed
period, approximately $0.3 million of this accumulated other comprehensive loss item
expense.

Contracts and Derivative Accounting. The Company uses commodity contracts to ma
availability risks for fuel purchases and power sales and purchases and these contracts
of derivatives. The Company does not trade or use these instruments with the objectiv
commodity price fluctuations. The Company has determined that all such contracts, e
commodity contracts with optionality features, that had the characteristics of derivativ
normal sales exception provided in SFAS No. 133, and, as such, were not required t
pursuant to SFAS No. 133 and other guidance.

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The Company determined that certain of its natural gas commodity contracts with opt
the normal purchases exception and, therefore, are required to be accounted for as der
SFAS No. 133. However, as of December 31, 2005, the variable, market-based pricin
contracts are such that these derivative instruments have no significant fair value.

Marketable Securities. The Company s marketable securities, included in decommiss
sheets, are reported at fair value which was $96.0 million at December 31, 2005. Gros
securities and the fair value of the related securities, aggregated by investment catego
securities have been in a continuous unrealized loss position, at December 31, 2005, w

	Less than 12 Months		12 M Lo
	Fair Value	Unrealized Losses	Fair Value
Description of Securities:			
U.S. Treasury Obligations and Direct Obligations of U.S. Government Agencies	$ 15,151	$ (309)	$ 1,301
Federal Agency Mortgage Backed Securities	650	(13)	1,812
Municipal Obligations	5,213	(79)	1,130
Corporate Obligations	4,145	(33)	2,098
Total debt securities	25,159	(434)	6,341
Common stock	26,789	(2,084)	840
Total temporarily impaired securities	$ 51,948	$ (2,518)	$ 7,181

The total impaired securities are comprised of approximately 130 investments that are
Company monitors the length of time the investment trades below its cost basis along
the unrealized loss in determining if a decline in fair value of marketable securities be
be other than temporary. In addition, the Company will research the future prospects o
necessary. As a result of these factors, as well as the Company s intent and ability to
market price recovers, these investments are not considered other-than-temporarily im
a requirement to expend monies held in trust before 2024 or a later period when the C
Palo Verde. For 2005 the Company realized a $0.1 million gain on the sale of investm
considered impaired. During the years ended December 31, 2004 and 2003, the Comp
temporary impairment losses of marketable securities of $0.3 million and $0.6 million

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N. Supplemental Statements of Cash Flows Disclosures

Cash paid for:
Interest on long-term debt and financing obligations
Income taxes
Other interest
Non-cash investing and financing activities:
Grants of restricted shares of common stock
Change in federal and state deferred tax valuation allowance credited to capital in excess of stated value (1)
Plant in service acquired through incurring obligations subject to a service agreement

(1) See Note H.

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O. Selected Quarterly Financial Data (Unaudited)

	2005 Quarters				
	4th	3rd	2nd	1st	4th
			(In thousands except for sha		
Operating revenues (1)	$ 213,397	$ 242,031	$ 189,300	$ 159,185	$ 165,62
Operating income	15,611	51,278	22,333	18,661	7,57
Income (loss) before cumulative effect of accounting change and extraordinary item	7,808	28,012	(3,962)	4,757	(1,18
Cumulative effect of accounting change, net of tax	(1,093)				
Extraordinary gain on re-application of SFAS No. 71, net of tax					
Net income (loss)	6,715	28,012	(3,962)	4,757	(1,18
Basic earnings per share:					
Income (loss) before cumulative effect of accounting change and extraordinary item	0.16	0.59	(0.08)	0.10	(0.0
Cumulative effect of accounting change, net of tax	(0.02)				
Extraordinary gain on re-application of SFAS No. 71, net of tax					
Net income (loss)	0.14	0.59	(0.08)	0.10	(0.0
Diluted earnings per share:					
Income (loss) before cumulative effect of accounting change and extraordinary item	0.16	0.58	(0.08)	0.10	(0.0
Cumulative effect of accounting change, net of tax	(0.02)				
Extraordinary gain on re-application of SFAS No. 71, net of tax					
Net income (loss)	0.14	0.58	(0.08)	0.10	(0.0

(1) Operating revenues are seasonal in nature, with the peak sales periods generally o months. Comparisons among quarters of a year may not represent overall trends a

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Item 9. Changes in and Disagreements with Accountants on Accounting and F
None.

Item 9A. Controls and Procedures
Evaluation of disclosure controls and procedures. During the period covered by this r
executive officer and chief financial officer, after evaluating the effectiveness of the C
procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and
(the Evaluation Date), concluded that as of the Evaluation Date, our disclosure con
paragraph (b) of the Securities Exchange Act of 1934 Rules 13a-15 or 15d-15) were a
material information relating to us and our consolidated subsidiary would be made kn
entities.

Management s Annual Report on Internal Control Over Financial Reporting. Include
Management Report on Internal Control Over Financial Reporting on page 49 of th

Changes in internal control over financial reporting. There were no changes in our in
reporting in connection with the evaluation required by paragraph (d) of the Securities
13a-15 or 15d-15, that occurred during the quarter ended December 31, 2005, that ma
reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information
None.

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PART III

Item 10. Directors and Executive Officers of the Registrant
Information regarding directors is incorporated herein by reference from our definitiv
Annual Meeting of Shareholders (the 2006 Proxy Statement) under the heading N
Information regarding our executive officers, included herein under the caption Exe
Part I, Item 1 above, is incorporated herein by reference.

The information concerning the identification of our standing audit committee require
reference from the 2006 Proxy Statement under the caption Committees under the
Compensation, Committees, Independence and Corporate Governance Matters, and
Report.

The information concerning our audit committee financial experts required by this Ite
the 2006 Proxy Statement under the caption Committees under the heading Direc
Committees, Independence and Corporate Governance Matters.

The information concerning compliance with Section 16(a) of the Exchange Act requi
reference from the 2006 Proxy Statement under the caption Section 16(a) Beneficial
under the heading Security Ownership of Certain Beneficial Owners and Manageme

We have adopted a Code of Ethics that is incorporated by reference from the 2006 Pro
Corporate Governance Matters under the heading Directors Meetings, Compens
Corporate Governance Matters.

Item 11. Executive Compensation
Incorporated herein by reference from the 2006 Proxy Statement under the caption E
heading Certain Additional Information.

Item 12. Security Ownership of Certain Beneficial Owners and Management a
Incorporated herein by reference from the 2006 Proxy Statement under the heading S
Beneficial Owners and Management.

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Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-av exercise pr of outstanding o warrants a rights (b)
Equity compensation plans approved by security holders	1,354,448	$ 11
Equity compensation plans not approved by security holders		
Total	1,354,448	$ 11

Item 13. Certain Relationships and Related Transactions

Incorporated herein by reference from the 2006 Proxy Statement under the heading (

Item 14. Principal Accounting Fees and Services

Incorporated herein by reference from the 2006 Proxy Statement under the heading I

PART IV

Item 15. Exhibits and Financial Statement Schedules

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

1. Financial Statements:

   See Index to Financial Statements

2. Financial Statement Schedules:

   All schedules are omitted as the required information is not applicable or i financial statements or related notes thereto.

3. Exhibits

Certain of the following documents are filed herewith. Certain other of the following with the Securities and Exchange Commission, and, pursuant to Rule 12b-32 and Reg

herein by reference.

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INDEX TO EXHIBITS

Exhibit Number	Title
Exhibit 3	Articles of Incorporation and Bylaws:
3.01	Restated Articles of Incorporation of the Company, dated Februar 1996. (Exhibit 3.01 to the Company s Annual Report on Form 10-K for
3.02	Bylaws of the Company, dated February 6, 1996. (Exhibit 3.02 to Form 10-K for the year ended December 31, 1995)
Exhibit 4	Instruments Defining the Rights of Security Holders, including Indenture
4.01	General Mortgage Indenture and Deed of Trust, dated as of Februa Indenture, dated as of February 1, 1996, including form of Series A throu (Exhibit 4.01 to the Company s Annual Report on Form 10-K for the ye
4.01-01	Second Supplemental Indenture, dated as of August 19, 1997, to E Company s Quarterly Report on Form 10-Q for the quarter ended Septe
4.01-02	Fifth Supplemental Indenture, dated as of December 17, 2004, to E
4.01-03	Sixth Supplemental Indenture to Exhibit 4.01, dated as of May 5, and Deed of Trust dated as of February 1, 1996 between the Company ar as trustee. (Exhibit 4.01 to the Company s Quarterly Report on Form 10 2005)
4.02	Reserved
4.03	Indenture of Trust between Maricopa County, Arizona Pollution C of California, N.A. as Trustee dated as of July 1, 2005 relating to $59,23 Pollution Control Corporation Pollution Control Refunding Revenue Bo Company Palo Verde Project). (Exhibit 4.30 to the Company s Quarterl quarter ended June 30, 2005)
4.04	Loan Agreement dated July 1, 2005 between Maricopa County, A and El Paso Electric Company relating to the Pollution Control Bonds re (Exhibit 4.31 to the Company s Quarterly Report on Form 10-Q for the

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INDEX TO EXHIBITS

Exhibit Number	Title
4.05	Representation and Indemnity Agreement dated July 27, 2005 am Citigroup Global Markets Inc., BNY Capital Markets, Inc., J.P. Morgan County, Arizona Pollution Control Corporation, relating to the Pollution Exhibit 4.03. (Exhibit 4.32 to the Company s Quarterly Report on Form 2005)
4.06	Indenture of Trust between Maricopa County, Arizona Pollution of California, N.A. as Trustee dated as of July 1, 2005 relating to $63,5 Pollution Control Corporation Pollution Control Refunding Revenue Bo Electric Company Palo Verde Project). (Exhibit 4.33 to the Company s the quarter ended June 30, 2005)
4.07	Loan Agreement dated July 1, 2005 between Maricopa County, A Corporation and El Paso Electric Company relating to the Pollution Co 4.06. (Exhibit 4.34 to the Company s Quarterly Report on Form 10-Q f
4.08	Indenture of Trust between Maricopa County, Arizona Pollution of California, N.A. as Trustee dated as of July 1, 2005 relating to $37,1 Pollution Control Corporation Pollution Control Refunding Revenue Bo Electric Company Palo Verde Project). (Exhibit 4.35 to the Company s the quarter ended June 30, 2005)
4.09	Loan Agreement dated July 1, 2005 between Maricopa County, A Corporation and El Paso Electric Company relating to the Pollution Co 4.08. (Exhibit 4.35 to the Company s Quarterly Report on Form 10-Q f
4.10	Remarketing Agreement dated August 1, 2005 between El Paso E Global Markets Inc. relating to the Pollution Control Bonds referred to i (Exhibit 4.37 to the Company s Quarterly Report on Form 10-Q for the
4.11	Tender Agreement dated August 1, 2005 between El Paso Electri Markets Inc. relating to the Pollution Control Bonds referred to in Exhib (Exhibit 4.38 to the Company s Quarterly Report on Form 10-Q for the

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Exhibit Number	Title
4.12	Broker-Dealer Agreement dated August 1, 2005 among The Banl Citigroup Global Markets Inc., as Broker-Dealer and El Paso Electric C the Pollution Control Bonds referred to in Exhibits 4.06 and 4.08. (Exhi Report on Form 10-Q for the quarter ended June 30, 2005)
4.13	Auction Agent Agreement dated as of August 1, 2005 among El I Bank of California, N.A., as Trustee and The Bank Of New York, as Au Pollution Control Bonds referred to in Exhibits 4.06 and 4.08. (Exhibit 4 Report on Form 10-Q for the quarter ended June 30, 2005)
4.14	Representation and Indemnity Agreement dated July 27, 2005 am Citigroup Global Markets Inc., BNY Capital Markets, Inc., J.P. Morgan County, Arizona Pollution Control Corporation, relating to the Pollution Exhibits 4.06 and 4.08. (Exhibit 4.41 to the Company s Quarterly Repo ended June 30, 2005)
4.15	Remarketing and Purchase Agreement dated July 27, 2005 among Citigroup Global Markets Inc., as remarketing agent, and Citigroup Glo Markets, Inc., and J.P. Morgan Securities Inc. relating to the Pollution C 4.22 to the Company s Annual Report on Form 10-K for the year ended to the Company s Quarterly Report on Form 10-Q for the quarter ended
4.16	Tender Agreement dated August 1, 2005 between El Paso Electri Markets Inc. relating to the Pollution Control Bonds referred to in Exhib Report on Form 10-K for the year ended December 31, 2004. (Exhibit 4 Report on Form 10-Q for the quarter ended June 30, 2005)
4.17	Remarketing Agreement dated August 1, 2005 between El Paso E Global Markets Inc. relating to the Pollution Control Bonds referred to i Annual Report on Form 10-K for the year ended December 31, 2004. (E Quarterly Report on Form 10-Q for the quarter ended June 30, 2005)

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Exhibit Number	Title
4.18	Ordinance No. 2002-1134 adopted by the City Council of Farmin authorizing and providing for the issuance by the City of Farmington, N principal amount of its Pollution Control Revenue Refunding Bonds, 20 Company Four Corners Project). (Exhibit 4.22 to the Company s Quart quarter ended September 30, 2002)
Exhibit 10	Material Contracts:
10.01	Co-Tenancy Agreement, dated July 19, 1966, and Amendments N Participants of the Four Corners Project, defining the respective owners Parties. (Exhibit 10.01 to the Company s Annual Report on Form 10-K 1995)
10.01-01	Amendment No. 6, dated February 3, 2000, to Exhibit 10.01. (Ex Annual Report on Form 10-K for the year ended December 31, 2002)
10.02	Supplemental and Additional Indenture of Lease, dated May 27, supplements to original Lease Four Corners Units 1, 2 and 3, between th Arizona Public Service Company, and including new Lease Four Corne Navajo Tribe of Indians and Arizona Public Service Company, the Com New Mexico, Salt River Project Agricultural Improvement and Power D Company and Tucson Gas & Electric Company. (Exhibit 4-e to Registra Form S-9)
10.02-01	Amendment and Supplement No. 1, dated March 21, 1985, to Ex Company s Quarterly Report on Form 10-Q for the quarter ended June
10.03	El Paso Electric Company 1996 Long-Term Incentive Plan. (Exh No. 333-17971 on Form S-8)
10.04	Four Corners Project Operating Agreement, dated May 15, 1969, Company, the Company, Public Service Company of New Mexico, Salt Improvement and Power District, Southern California Edison Company Company, and Amendments 1 through 10 thereto. (Exhibit 10.04 to the 10-K for the year ended December 31, 1995)
10.04-01	Amendment No. 11, dated May 23, 1997, to Exhibit 10.04. (Exhi Quarterly Report on Form 10-Q for the quarter ended June 30, 1997)

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Exhibit Number	Title
10.04-02	Amendment No. 12, dated February 3, 2000, to Exhibit 10.04. (E Annual Report on Form 10-K for the year ended December 31, 2002)
10.05	Arizona Nuclear Power Project Participation Agreement, dated A Public Service Company, Public Service Company of New Mexico, Sal Improvement and Power District, Tucson Gas & Electric Company and respective participation ownerships of the various utilities having undiv Nuclear Power Project and in general terms defining the respective own construction and operating arrangements of the Parties, and Amendmen (Exhibit 10.05 to the Company s Annual Report on Form 10-K for the
10.05-01	Amendment No. 14, dated June 20, 2000, to Exhibit 10.05. (Exhi Annual Report on Form 10-K for the year ended December 31, 2002)
10.06	ANPP Valley Transmission System Participation Agreement, dat Amendments No. 1 and 2 thereto. APS Contract No. 2253-419.00. (Exh Report on Form 10-K for the year ended December 31, 1995)
10.07	Arizona Nuclear Power Project High Voltage Switchyard Partici 1981. APS Contract No. 2252-419.00. (Exhibit 20.14 to the Company s the year ended December 31, 1981)
10.07-01	Amendment No. 1, dated November 20, 1986, to Exhibit 10.07. (Annual Report on Form 10-K for the year ended December 31, 1986)
10.08	Firm Palo Verde Nuclear Generating Station Transmission Servic Project Agricultural Improvement and Power District and the Company (Exhibit 19.12 to the Company s Annual Report on Form 10-K for the
10.09	Interconnection Agreement, as amended, dated December 8, 198 Southwestern Public Service Company, and Service Schedules A throu Company s Annual Report on Form 10-K for the year ended December

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Exhibit Number	Title
10.10	Amrad to Artesia 345 KV Transmission System and DC Termina December 8, 1981, between the Company and Texas-New Mexico Pow Third Supplemental Agreements thereto. (Exhibit 10.14 to the Company the year ended December 31, 1995)
10.11	Reserved
10.12	Interconnection Agreement and Amendment No. 1, dated July 19 Public Service Company of New Mexico. (Exhibit 19.01 to the Compar for the year ended December 31, 1982)
10.13	Southwest New Mexico Transmission Project Participation Agre Public Service Company of New Mexico, Community Public Service C Amendments 1 through 5 thereto. (Exhibit 10.16 to the Company s An year ended December 31, 1995)
10.13-01	Amendment No. 6, dated as of June 17, 1999, to Exhibit 10.16. (I Quarterly Report on Form 10-Q for the quarter ended June 30, 1999)
10.14	Tucson-El Paso Power Exchange and Transmission Agreement, c Tucson Electric Power Company and the Company. (Exhibit 19.26 to th Form 10-K for the year ended December 31, 1982)
10.15	Southwest Reserve Sharing Group Participation Agreement, date Company, Arizona Electric Power Cooperative, Arizona Public Service Los Alamos County, Nevada Power Company, Plains Electric G&T Co Company of New Mexico, Tucson Electric Power and Western Area Po to the Company s Annual Report on Form 10-K for the year ended Dec
10.16	Arizona Nuclear Power Project Transmission Project Westwing S Agreement, dated August 14, 1986, between The United States of Amer Company; Department of Water and Power of the City of Los Angeles; Service Company of New Mexico; Salt River Project Agricultural Impr Tucson Electric Power Company; and the Company. (Exhibit 10.72 to t Form 10-K for the year ended December 31, 1986)
10.17	Form of Indemnity Agreement, between the Company and its dir the Company s Annual Report on Form 10-K for the year ended Decen

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Exhibit Number	Title
10.18	Interchange Agreement, executed April 14, 1982, between Comisi Company. (Exhibit 19.2 to the Company s Quarterly Report on Form 10 1991)
10.19	Trust Agreement, dated as of February 12, 1996, between the Com National Association, as Trustee of the Rio Grande Resources Trust II. (I Annual Report on Form 10-K for the year ended December 31, 1995)
10.20	Purchase Contract, dated as of February 12, 1996, between the Co National Association, as Trustee of the Rio Grande Resources Trust II. (I Annual Report on Form 10-K for the year ended December 31, 1995)
10.21	Form of Stock Option Agreement, dated as of June 11, 1996, betw Hedrick and J. Frank Bates; officers of the Company. (Exhibit 99.07 to t Form 10-K for the year ended December 31, 1996)
10.22	Decommissioning Trust Agreement, dated as of December 18, 200 of America, N.A., as Decommissioning Trustee for Palo Verde Unit 1.
10.23	Decommissioning Trust Agreement, dated as of December 18, 200 of America, N.A., as Decommissioning Trustee for Palo Verde Unit 2.
10.24	Decommissioning Trust Agreement, dated as of December 18, 200 of America, N.A., as Decommissioning Trustee for Palo Verde Unit 3.
10.25	Employment Agreement for Helen Knopp, dated April 30, 1999. (Annual Report on Form 10-K for the year ended December 31, 1999)
10.26	Amended and Restated Change in Control Agreement between the of the Company. (Exhibit 10.02 to the Company s Quarterly Report on I September 2005)
10.27	Form of Restricted Stock Award Agreement between the Compan Company. (Exhibit 99.04 to the Company s Quarterly Report on Form 1 1998)
10.28	Form of Stock Option Agreement between the Company and certa (Exhibit 99.01 to the Company s Quarterly Report on Form 10-Q for the

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Exhibit Number	Title
10.29	Form of Directors Restricted Stock Award Agreement betwe of the Company. (Exhibit 10.07 to the Company s Quarterly Report June 30, 1999)
10.30	Form of Directors Stock Option Agreement between the Con Company. (Exhibit 99.17 to the Company s Annual Report on Form December 31, 1997)
10.31	El Paso Electric Company 1999 Long-Term Incentive Plan. (E No. 333-82129 on Form S-8)
10.32	Settlement Agreement, dated as of February 24, 2000, with the to the Company s Quarterly Report on Form 10-Q for the quarter en
10.33	Franchise Agreement, dated April 3, 2000, between the Comp (Exhibit 10.02 to the Company s Quarterly Report on Form 10-Q fo
10.34	Employment Agreement for Hector Puente, dated April 23, 20 Quarterly Report on Form 10-Q for quarter ended June 30, 2001)
10.35	Shiprock Four Corners Project 345 kV Switchyard Intercon 2002. APS Contract No. 51999. (Exhibit 10.06 to the Company s Q quarter ended March 31, 2002)
10.36	Interconnection Agreement dated as of May 23, 2002, betwee Service Company of New Mexico. (Exhibit 10.09 to the Company s the quarter ended June 30, 2002)
10.36-01	First Amended and Restated Interconnection Agreement, date (Exhibit 10.52.01 to the Company s Annual Report on Form 10-K f 2003)
10.37	Reserved
10.38	Credit Agreement dated as of December 17, 2004, among the Trustee, the lenders party hereto and JPMorgan Chase Bank as Admi and Issuing Bank.
10.39	Eight Treasury Rate Lock agreements between the Company a International. (Exhibit 10.02 to the Company s Quarterly Report on March 31, 2005)

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Exhibit Number	Title
10.40	Master Power Purchase and Sale Agreement and Transaction Agr between the Company and Southwestern Public Service Company. (Exh Quarterly Report on Form 10-Q for the quarter ended March 31, 2005)
10.41	Rate Agreement between the Company and the City of El Paso, T
*10.42	Power Purchase and Sale Agreement, dated as of December 16, 2 Phelps Dodge Energy Services, LLC.
Exhibit 21	Subsidiaries of the Company:
21.01	MiraSol Energy Services, Inc., a Delaware corporation
Exhibit 23	Consent of Experts:
*23.01	Consent of KPMG LLP (set forth on page 133 of this report)
Exhibit 24	Power of Attorney:
*24.01	Power of Attorney (set forth on page 132 of the Original Form 10
*24.02	Certified copy of resolution authorizing signatures pursuant to po
Exhibit 31 and 32	Certifications:
*31.01	Certifications pursuant to Section 302 of the Sarbanes-Oxley Act
*32.01	Certifications pursuant to Section 906 of the Sarbanes-Oxley Act
Exhibit 99	Additional Exhibits:
99.01	Agreed Order, entered August 30, 1995, by the Public Utility Cor to Registration Statement No. 33-99744 on Form S-1)
99.02	Stock Option Agreement, dated as of January 17, 1997, with Dav the Company s Annual Report on Form 10-K for the year ended Decen
99.03	Final Order, entered September 24, 1998, by the New Mexico Pu 99.31 to the Company s Annual Report on Form 10-K for the year end
99.04	Final Order, entered June 8, 1999, by the Public Utility Commiss Company s Quarterly Report on Form 10-Q for the quarter ended June

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Exhibit Number	Title
99.05	Final Order, entered January 8, 2002, by the New Mexico Public U the Company s Annual Report on Form 10-K for the year ended Decem
99.06	News Release, dated as of December 5, 2002, by the El Paso Elect with the FERC Trial Staff. (Exhibit 99.01 to the Company s Form 8-K,
99.07	Stipulated Facts and Remedies, dated as of December 5, 2002, part of its written testimony. (Exhibit 99.02 to the Company s Form 8-K

* Filed herewith.

Eleven agreements, dated March 10, 2005, substantially identical in all material r been entered into with Gary R. Hedrick; J. Frank Bates; Scott D. Wilson; Steven Kerry B. Lore; Robert C. McNiel; Hector Puente; Guillermo Silva, Jr.; John A. W Williams Knopp; officers of the Company.

One agreement, dated July 11, 2005, substantially identical in all material respects to with Andy Ramirez, officer of the Company.

One agreement, dated August 10, 2005, substantially identical in all material respects into with David G. Carpenter, officer of the Company.

Eight agreements, dated as of February 28, 2001, substantially identical in all ma Exhibit, have been entered into with Terry D. Bassham; J. Frank Bates; Gary R. John C. Horne; Helen Williams Knopp; Kerry B. Lore; Robert C. McNiel; and G the Company.

One agreement, dated as of November 8, 2001, identical in all material respects to thi Gary R. Hedrick; officer of the Company.

Nine agreements, dated as of February 28, 2002, substantially identical in all material entered into with J. Frank Bates; Gary R. Hedrick; Kathryn Hood; Helen Williams Kn McNiel; Hector R. Puente; and Guillermo Silva; officers of the Company.

Two agreements, dated as of July 15, 2002, substantially identical in all material respe entered into with Fernando J. Gireud and John A. Whitacre; officers of the Company.

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INDEX TO EXHIBITS

Exhibit Number	Title
	Two agreements, dated as of December 4, 2003, substantially identical i been entered into with Steven P. Busser and Scott D. Wilson; officers o
	Two agreements, dated January 3, 1998, identical in all material respect into with J. Frank Bates and Gary R. Hedrick; officers of the Company.
	One agreement, dated as of May 28, 1999, identical in all material respe into with Helen Knopp; officer of the Company.
	One agreement, dated as of January 3, 2000, identical in all material res entered into with John C. Horne; officer of the Company.
	One agreement, dated as of April 23, 2001, identical in all material resp entered into with Hector Puente; officer of the Company.
	One agreement, dated as of November 5, 2001, identical in all material entered into with Gary R. Hedrick; officer of the Company.
	One agreement, dated as of November 26, 2001, identical in all materia entered into with J. Frank Bates; officer of the Company.
	Three agreements, dated as of May 10, 2001, identical in all material re entered into with Kathryn Hood, Kerry B. Lore and Guillermo Silva, Jr.
	Two agreements, dated as of July 15, 2002, identical in all material resp entered into with Fernando J. Gireud and John A. Whitacre; officers of
	Two agreements, dated as of December 4, 2003, identical in all material entered into with Steven P. Busser and Scott D. Wilson; officers of the
	In lieu of non-employee director cash compensation, three agreements, April 1, 2004, substantially identical in all material respects to this Exhi Kenneth R. Heitz; Patricia Z. Holland-Branch; and Charles A. Yamaron
	Eleven agreements, dated as of May 5, 2004, substantially identical in a were entered into with George W. Edwards, Jr.; Ramiro Guzman; James James W. Cicconi; Patricia Z. Holland-Branch; Michael K. Parks; Eric Charles A. Yamarone; and J. Robert Brown; directors of the Company.

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Exhibit Number	Title
	In lieu of non-employee director cash compensation, four agreements, da October 1, 2004, substantially identical in all material respects to this Ex Kenneth R. Heitz and Patricia Z. Holland-Branch; directors of the Comp
	In lieu of non-employee director cash compensation, four agreements, da 1, 2005, substantially identical in all material respects to this Exhibit, hav R. Heitz and Patricia Z. Holland-Branch directors of the Company.
	In lieu of non-employee director cash compensation, eleven agreements, substantially identical in all material respects to this Exhibit, were entere James W. Cicconi; George W. Edwards, Jr.; Ramiro Guzman; James W. Patricia Z. Holland-Branch; Michael K. Parks; Eric B. Siegel; Stephen N Yamarone; directors of the Company.
	In lieu of non-employee director cash compensation, four agreements, da 1, 2005, substantially identical in all material respects to this Exhibit, hav R. Heitz; and Patricia Z. Holland-Branch; directors of the Company.
	Eight agreements, dated as of May 8, 1997, identical in all material respe entered into with George W. Edwards, Jr.; Ramiro Guzman; James W. H K. Parks; Eric B. Siegel; Stephen N. Wertheimer and Charles A. Yamaro
	Ten agreements, dated as of May 29, 1998, identical in all material respe entered into with George W. Edwards, Jr.; James W. Cicconi; Ramiro Gu Kenneth R. Heitz; Patricia Z. Holland-Branch; Michael K. Parks; Eric B. and Charles A. Yamarone; directors of the Company.
	In lieu of non-employee director cash compensation, two agreements, da 1, 2002, substantially identical in all material respects to this Exhibit, hav Heitz; director of the Company.
	In lieu of non-employee director cash compensation, two agreements, da 1, 2003, substantially identical in all material respects to this Exhibit, hav Heitz; director of the Company.
	Confidential treatment has been requested and received for the redacted p filed herewith omits the information subject to the confidentiality request ****. A complete version of this Exhibit has been filed separately wit Commission.

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UNDERTAKING

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may
and controlling persons of the registrant pursuant to the foregoing provisions, or other
advised that in the opinion of the Securities and Exchange Commission such indemnif
expressed in the Securities Act of 1933 and is, therefore, unenforceable. In the event t
against such liabilities (other than the payment by the registrant of expenses incurred
controlling person of the registrant in the successful defense of any action, suit or pro
director, officer or controlling person in connection with the securities being registere
opinion of its counsel the matter has been settled by controlling precedent, submit to a
the question of whether such indemnification by it is against public policy as expresse
by the final adjudication of such issue.

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POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each of El Paso Electric Company, undersigned directors and officers of El Paso Electric Company, hereby constitutes an Scott D. Wilson, J. Frank Bates and Gary D. Sanders, its, his or her true and lawful att him or her and its, his or her name, place and stead, in any and all capacities, with full report and any and all amendments to this report, and to file each such amendment to and any and all documents in connection therewith, with the Securities and Exchange said attorneys-in-fact and agents, and each of them, full power and authority to do and things requisite and necessary to be done in and about the premises, as fully to all inte might or could do in person, hereby ratifying and confirming all that said attorneys-in may lawfully do or cause to be done by virtue hereof.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of caused this report to be signed on its behalf by the undersigned, thereunto duly author 2006.

EL PASO E

By:

Presi

(

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has b persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Title
/s/ GARY R. HEDRICK (Gary R. Hedrick)	President and Chief Executive (Principal Executive Officer) a
/s/ SCOTT D. WILSON (Scott D. Wilson)	Senior Vice President and Chie Officer (Principal Financial Officer)
/s/ DAVID G. CARPENTER (David G. Carpenter)	Vice President, Corporate Plan Controller
/s/ J. ROBERT BROWN (J. Robert Brown)	Director
/s/ JAMES W. CICCONI	Director

(James W. Cicconi)	
/s/ GEORGE W. EDWARDS, JR.	Director
(George W. Edwards, Jr.)	
/s/ RAMIRO GUZMAN	Director
(Ramiro Guzman)	
/s/ JAMES W. HARRIS	Director
(James W. Harris)	
/s/ KENNETH R. HEITZ	Director
(Kenneth R. Heitz)	
/s/ PATRICIA Z. HOLLAND-BRANCH	Director
(Patricia Z. Holland-Branch)	
/s/ MICHAEL K. PARKS	Director
(Michael K. Parks)	
/s/ ERIC B. SIEGEL	Director
(Eric B. Siegel)	
/s/ STEPHEN N. WERTHEIMER	Director
(Stephen N. Wertheimer)	
/s/ CHARLES A. YAMARONE	Director
(Charles A. Yamarone)	