EL PASO ELECTRIC CO /TX/
Form 10-Q
May 08, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014

OR

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

Commission file number 001-14206
El Paso Electric Company
(Exact name of registrant as specified in its charter)

Texas	74-0607870
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Stanton Tower, 100 North Stanton, El Paso, Texas	79901
(Address of principal executive offices)	(Zip Code)

(915) 543-5711
(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 x NO o

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

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

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

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

As of April 30, 2014, there were 40,310,281 shares of the Company’s no par value common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

EL PASO ELECTRIC COMPANY
BALANCE SHEETS

	March 31, 2014 (Unaudited)	December 31, 2013
ASSETS		
(In thousands)		
Utility plant:		
Electric plant in service	$3,086,015	$3,076,549
Less accumulated depreciation and amortization	(1,219,479)	(1,214,088)
Net plant in service	1,866,536	1,862,461
Construction work in progress	304,619	282,647
Nuclear fuel; includes fuel in process of $39,681 and $48,492, respectively	200,454	188,185
Less accumulated amortization	(86,461)	(75,820)
Net nuclear fuel	113,993	112,365
Net utility plant	2,285,148	2,257,473
Current assets:		
Cash and cash equivalents	13,392	25,592
Accounts receivable, principally trade, net of allowance for doubtful accounts of $1,828 and $2,261, respectively	58,750	65,350
Accumulated deferred income taxes	23,972	26,965
Inventories, at cost	45,300	45,942
Undercollection of fuel revenues	4,189	7,248
Prepayments and other	10,501	7,694
Total current assets	156,104	178,791
Deferred charges and other assets:		
Decommissioning trust funds	217,509	214,095
Regulatory assets	96,603	101,050
Other	36,409	34,879
Total deferred charges and other assets	350,521	350,024
Total assets	$2,791,773	$2,786,288

See accompanying notes to financial statements.

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EL PASO ELECTRIC COMPANY
BALANCE SHEETS (Continued)

	March 31, 2014 (Unaudited)	December 31, 2013
CAPITALIZATION AND LIABILITIES		
(In thousands except for share data)		
Capitalization:		
Common stock, stated value $1 per share, 100,000,000 shares authorized, 65,642,538 and 65,639,091 shares issued, and 154,144 and 120,534 restricted shares, respectively	$65,797	$65,760
Capital in excess of stated value	315,177	314,443
Retained earnings	979,604	985,665
Accumulated other comprehensive income, net of tax	13,059	2,612
	1,373,637	1,368,480
Treasury stock, 25,492,919 shares at cost	(424,647)	(424,647)
Common stock equity	948,990	943,833
Long-term debt	999,643	999,620
Total capitalization	1,948,633	1,943,453
Current liabilities:		
Short-term borrowings under the revolving credit facility	45,951	14,352
Accounts payable, principally trade	46,597	61,795
Taxes accrued	22,107	25,206
Interest accrued	13,028	12,189
Overcollection of fuel revenues	—	1,048
Other	23,766	22,932
Total current liabilities	151,449	137,522
Deferred credits and other liabilities:		
Accumulated deferred income taxes	455,535	449,925
Accrued pension liability	62,212	84,012
Accrued postretirement benefit liability	51,954	50,655
Asset retirement obligation	66,665	65,214
Regulatory liabilities	25,969	26,416
Other	29,356	29,091
Total deferred credits and other liabilities	691,691	705,313
Commitments and contingencies		
Total capitalization and liabilities	$2,791,773	$2,786,288

See accompanying notes to financial statements.

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

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2014	2013	2014	2013
Operating revenues	$185,516	$177,290	$898,588	$861,593
Energy expenses:				
Fuel	51,586	44,399	233,955	196,041
Purchased and interchanged power	17,915	12,877	67,401	60,569
	69,501	57,276	301,356	256,610
Operating revenues net of energy expenses	116,015	120,014	597,232	604,983
Other operating expenses:				
Other operations	56,138	55,967	237,326	238,108
Maintenance	14,282	12,552	62,798	56,923
Depreciation and amortization	20,568	19,368	80,826	77,406
Taxes other than income taxes	15,362	12,782	60,327	56,585
	106,350	100,669	441,277	429,022
Operating income	9,665	19,345	155,955	175,961
Other income (deductions):				
Allowance for equity funds used during construction	2,906	2,663	10,251	10,134
Investment and interest income, net	4,241	1,231	10,043	4,730
Miscellaneous non-operating income	1,517	1	2,425	1,346
Miscellaneous non-operating deductions	(419)	(471)	(3,583)	(2,002)
	8,245	3,424	19,136	14,208
Interest charges (credits):				
Interest on long-term debt and revolving credit facility	14,579	14,596	58,618	55,665
Other interest	173	149	455	1,139
Capitalized interest	(1,246)	(1,302)	(5,243)	(5,245)
Allowance for borrowed funds used during construction	(1,684)	(1,623)	(6,116)	(6,043)
	11,822	11,820	47,714	45,516
Income before income taxes	6,088	10,949	127,377	144,653
Income tax expense	1,473	3,315	41,813	49,517
Net income	$4,615	$7,634	$85,564	$95,136
Basic earnings per share	$0.11	$0.19	$2.13	$2.37
Diluted earnings per share	$0.11	$0.19	$2.12	$2.37
Dividends declared per share of common stock	$0.265	$0.25	$1.06	$1.00
Weighted average number of shares outstanding	40,149,083	40,078,061	40,132,106	40,015,380
Weighted average number of shares and dilutive potential shares outstanding	40,149,083	40,078,061	40,144,159	40,074,820

See accompanying notes to financial statements.

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

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2014	2013	2014	2013
Net income	$4,615	$7,634	$85,564	$95,136
Other comprehensive income (loss):				
Unrecognized pension and postretirement benefit costs:				
Net gain (loss) arising during period	19,700	—	102,664	(2,109)
Prior service benefit	—	—	97	—
Reclassification adjustments included in net income for amortization of:				
Prior service benefit	(1,459)	(1,400)	(5,619)	(5,719)
Net loss	1,123	2,675	8,920	11,521
Net unrealized gains/losses on marketable securities:				
Net holding gains arising during period	998	6,793	11,904	8,562
Reclassification adjustments for net (gains) losses included in net income	(2,865)	158	(3,576)	1,413
Net losses on cash flow hedges:				
Reclassification adjustment for interest expense included in net income	107	101	417	392
Total other comprehensive income before income taxes	17,604	8,327	114,807	14,060
Income tax benefit (expense) related to items of other comprehensive income (loss):				
Unrecognized pension and postretirement benefit costs	(7,422)	(570)	(40,418)	(1,479)
Net unrealized losses (gains) on marketable securities	357	(1,287)	(1,456)	(2,166)
Losses on cash flow hedges	(92)	(52)	(208)	(138)
Total income tax expense	(7,157)	(1,909)	(42,082)	(3,783)
Other comprehensive income, net of tax	10,447	6,418	72,725	10,277
Comprehensive income	$15,062	$14,052	$158,289	$105,413

See accompanying notes to financial statements.

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

	Three Months Ended March 31, 2014	2013
Cash flows from operating activities:		
Net income	$4,615	$7,634
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of electric plant in service	20,568	19,368
Amortization of nuclear fuel	11,476	11,510
Deferred income taxes, net	761	3,103
Allowance for equity funds used during construction	(2,906)	(2,663)
Other amortization and accretion	4,141	4,081
Gain on sale of assets	(1,499)	—
Other operating activities	(2,811)	179
Change in:		
Accounts receivable	6,600	(3,645)
Inventories	525	(1,220)
Net overcollection of fuel revenues	2,011	3,844
Prepayments and other	(2,968)	(3,519)
Accounts payable	(8,958)	(18,585)
Taxes accrued	(379)	(866)
Other current liabilities	1,673	2,004
Deferred charges and credits	(1,537)	(13,492)
Net cash provided by operating activities	31,312	7,733
Cash flows from investing activities:		
Cash additions to utility property, plant and equipment	(48,255)	(55,406)
Cash additions to nuclear fuel	(11,822)	(9,888)
Capitalized interest and AFUDC:		
Utility property, plant and equipment	(4,590)	(4,286)
Nuclear fuel	(1,246)	(1,302)
Allowance for equity funds used during construction	2,906	2,663
Decommissioning trust funds:		
Purchases, including funding of $1.1 million	(31,242)	(13,378)
Sales and maturities	28,827	10,907
Proceeds from sale of assets	1,679	—
Other investing activities	375	3,285
Net cash used for investing activities	(63,368)	(67,405)
Cash flows from financing activities:		
Dividends paid	(10,676)	(10,050)
Borrowings under the revolving credit facility:		
Proceeds	51,563	12,586
Payments	(19,964)	(9,702)
Other financing activities	(1,067)	(544)
Net cash provided by (used for) financing activities	19,856	(7,710)
Net decrease in cash and cash equivalents	(12,200)	(67,382)
Cash and cash equivalents at beginning of period	25,592	111,057

Cash and cash equivalents at end of period	$13,392	$43,675

See accompanying notes to financial statements.

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EL PASO ELECTRIC COMPANY
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

A. Principles of Preparation

These condensed financial statements should be read in conjunction with the financial statements and notes thereto in the Annual Report of El Paso Electric Company on Form 10-K for the year ended December 31, 2013 (the "2013 Form 10-K"). Capitalized terms used in this report and not defined herein have the meaning ascribed to such terms in the 2013 Form 10-K. In the opinion of the Company's management, the accompanying financial statements contain all adjustments necessary to present fairly the financial position of the Company at March 31, 2014 and December 31, 2013; the results of its operations and comprehensive operations for the three and twelve months ended March 31, 2014 and 2013; and its cash flows for the three months ended March 31, 2014 and 2013. The results of operations and comprehensive operations and cash flows for the three months ended March 31, 2014 are not necessarily indicative of the results to be expected for the full calendar year.

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

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

Revenues. Revenues related to the sale of electricity are generally recorded when service is rendered or electricity is delivered to customers. The billing of electricity sales to retail customers is based on the reading of their meters, which occurs on a systematic basis throughout the month. Unbilled revenues are estimated based on monthly generation volumes and by applying an average revenue/kWh to the number of estimated kWhs delivered but not billed. Accounts receivable included accrued unbilled revenues of $17.7 million at March 31, 2014 and $19.8 million at December 31, 2013. The Company presents revenues net of sales taxes in its statements of operations.

Supplemental Cash Flow Disclosures (in thousands)

	Three Months Ended March 31, 2014	2013
Cash paid (received) for:		
Interest on long-term debt and borrowing under the revolving credit facility	$10,174	$9,893
Income tax refund, net	(767)	(3,088)
Non-cash financing activities:		
Grants of restricted shares of common stock	1,197	929
Issuance of performance shares	—	849

New Accounting Standards. In July 2013, the FASB issued new guidance (ASU 2013-11, Income Taxes (Topic 740)) to eliminate the diversity in the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 requires an entity to present an unrecognized tax benefit in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except in certain circumstances when it would be reflected as a liability. ASU 2013-11 is effective prospectively to all unrecognized tax benefits that exist for reporting periods beginning after December 15, 2013 and early adoption is permitted. Retrospective application is also permitted. The Company implemented ASU 2013-11 in the first quarter of 2014 on a prospective basis. This ASU did not have a significant impact on the Company's statement of operations or statement of cash flows.

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EL PASO ELECTRIC COMPANY
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

B. Accumulated Other Comprehensive Income (Loss)

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

	Three Months Ended March 31, 2014				Three Months Ended March 31, 2013			
	Unrecognized Pension and Postretirement Benefit Costs	Net Unrealized Gains (Losses) on Marketable Securities	Net Losses on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)	Unrecognized Pension and Postretirement Benefit Costs	Net Unrealized Gains (Losses) on Marketable Securities	Net Losses on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)
Balance at beginning of period	$(21,330)	$36,240	$(12,298)	$ 2,612	$(75,737)	$ 22,194	$(12,541)	$ (66,084)
Other comprehensive income before reclassifications	12,147	799	—	12,946	—	5,543	—	5,543
Amounts reclassified from accumulated other comprehensive income (loss)	(205)	(2,309)	15	(2,499)	705	121	49	875
Balance at end of period	$(9,388)	$34,730	$(12,283)	$ 13,059	$(75,032)	$ 27,858	$(12,492)	$ (59,666)

	Twelve Months Ended March 31, 2014				Twelve Months Ended March 31, 2013			
	Unrecognized Pension and Postretirement Benefit Costs	Net Unrealized Gains (Losses) on Marketable Securities	Net Losses on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)	Unrecognized Pension and Postretirement Benefit Costs	Net Unrealized Gains (Losses) on Marketable Securities	Net Losses on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)
Balance at beginning of period	$(75,032)	$27,858	$(12,492)	$ (59,666)	$(77,246)	$ 20,049	$(12,746)	$ (69,943)
	63,599	9,738	—	73,337	(1,264)	6,695	—	5,431

Other comprehensive income (loss) before reclassifications								
Amounts reclassified from accumulated other comprehensive income (loss)	2,045	(2,866)	209	(612)	3,478	1,114	254	4,846
Balance at end of period	$(9,388)	$34,730	$(12,283)	$ 13,059	$(75,032)	$ 27,858	$(12,492)	$ (59,666)

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EL PASO ELECTRIC COMPANY
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

Amounts reclassified from accumulated other comprehensive income (loss) for the three and twelve months ended March 31, 2014 and 2013 are as follows (in thousands):

Details about Accumulated Other Comprehensive Income (Loss) Components	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013	Twelve Months Ended March 31, 2014	Twelve Months Ended March 31, 2013	Affected Line Item in the Statement of Operations
Amortization of pension and postretirement benefit costs:					
Prior service benefit	$1,459	1,400	$5,619	$5,719	(a)
Net loss	(1,123)	(2,675)	(8,920)	(11,521)	(a)
	336	(1,275)	(3,301)	(5,802)	(a)
Income tax effect	(131)	570	1,256	2,324	
	205	(705)	(2,045)	(3,478)	(a)
Marketable securities:					
Net realized gain (loss) on sale of securities	2,865	(158)	3,576	(934)	Investment and interest income, net
Unrealized losses on available-for-sale securities included in pre-tax income	—	—	—	(479)	Investment and interest income, net
	2,865	(158)	3,576	(1,413)	Income before income taxes
	(556)	37	(710)	299	Income tax expense
	2,309	(121)	2,866	(1,114)	Net income
Loss on cash flow hedge:					
Amortization of loss	(107)	(101)	(417)	(392)	Interest on long-term debt and revolving credit facility
	(107)	(101)	(417)	(392)	Income before income taxes
	92	52	208	138	Income tax expense
	(15)	(49)	(209)	(254)	Net income
Total reclassifications	$2,499	$(875)	$612	$(4,846)	

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

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EL PASO ELECTRIC COMPANY
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

C. Regulation
General
The rates and services of the Company are regulated by incorporated municipalities in Texas, the PUCT, the NMPRC, and the FERC. The PUCT and the NMPRC have jurisdiction to review municipal orders, ordinances and utility agreements regarding rates and services within their respective states and over certain other activities of the Company. The FERC has jurisdiction over the Company's wholesale (sales for resale) transactions, transmission service and compliance with federally-mandated reliability standards. The decisions of the PUCT, NMPRC and the FERC are subject to judicial review.

Texas Regulatory Matters

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

Fuel and Purchased Power Costs. The Company's actual fuel costs, including purchased power energy costs, are recovered from customers through a fixed fuel factor. The PUCT has adopted a fuel cost recovery rule (the "Texas Fuel Rule") that allows the Company to seek periodic adjustments to its fixed fuel factor. The Company can seek to revise its fixed fuel factor based upon the approved formula at least four months after its last revision except in the month of December. On September 9, 2013, the Company filed a request, which was assigned Docket No. 41803, to increase its fixed fuel factor by $16.9 million or 12.2% annually, pursuant to its approved formula. The revised fixed fuel factor reflected increases in prices for natural gas. The increase in the fixed fuel factor was approved on September 23, 2013 and was effective with October 2013 billings. On April 15, 2014, the Company filed a request, which was assigned Docket No. 42384, to increase its fixed fuel factor by $10.7 million or 6.9% annually, pursuant to its approved formula. The revised fixed fuel factor reflects further increases in prices for natural gas. The increase in the fixed fuel factor received interim approval on April 28, 2014 and was effective with May 2014 billings.

Fuel Reconciliation Proceeding. On September 27, 2013, the Company filed an application with the PUCT, designated as Docket No. 41852, to reconcile $545.3 million of fuel and purchased power expenses incurred during the 45-month period from July 1, 2009 through March 31, 2013. The fuel reconciliation requests to recover $3.4 million of rewards for Palo Verde operations. Hearings in the fuel reconciliation have been suspended as the parties in the case seek to negotiate a settlement. The Company is unable to predict the outcome of these settlement negotiations. A final order must be issued by September 26, 2014.

Montana Power Station Approvals. The Company has received a Certificate of Convenience and Necessity ("CCN") authorization from the PUCT to construct the first two (of four) units of the Montana Power Station ("the MPS"). The Company also had to obtain air permits from state and federal regulatory agencies before it could begin construction. On January 22, 2014, the Texas Commission on Environmental Quality ("TCEQ") issued the required permit. The U.S. Environmental Protection Agency ("EPA") issued a permit for greenhouse gas ("GHG") on March 25, 2014. This permit became final on April 25, 2014 when no appeals were filed prior to the expiration of the period for appeal.

On September 6, 2013, the Company filed an application with the PUCT for issuance of a CCN to construct, own and operate two additional 88 MW natural gas-fired generating units designated as the MPS Units 3 and 4 in El Paso County, Texas. The case has been designated PUCT Docket No. 41763. Hearings in this case were held in February 2014. In accordance with PUCT rules, the final order must be issued by September 5, 2014.

The Company filed three transmission line CCN applications with the PUCT as part of the MPS Project:

- MPS to Caliente: a 115-kV transmission line from the MPS to the existing Caliente Substation in east El Paso. (PUCT Docket No. 41360)
- MPS In & Out: a 115-kV transmission line from the MPS to intersect with the existing Caliente - Coyote 115-kV transmission line. (PUCT Docket No. 41359)
- MPS to Montwood: a 115-kV transmission line from the MPS to the existing Montwood Substation in east El Paso. (PUCT Docket No. 41809)

The transmission CCN filings for both the MPS to Caliente and the MPS In & Out were filed on April 15, 2013, and the transmission CCN filing for the MPS to Montwood was filed on September 24, 2013. The Company is requesting to build these transmission lines to connect the new MPS to the electrical grid in order to meet expected customer growth and electric demand and to improve system reliability. A final order approving a unanimous settlement in the MPS to Caliente transmission CCN filing was received on March 10, 2014. Hearings on the MPS to Montwood and MPS In & Out transmission line CCN cases have been suspended as the parties in the cases seek to negotiate settlements. The Company is unable to predict the outcome of these settlement negotiations. A final order is expected in the fall of 2014.

Other Required Approvals. The Company has obtained other required approvals for recovery of fuel costs through fixed fuel factors, other tariffs and approvals as required by the Public Utility Regulatory Act (the "PURA") and the PUCT.

New Mexico Regulatory Matters

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

Fuel and purchased power costs in New Mexico are recovered through a Fuel and Purchased Power Cost Adjustment Clause (the "FPPCAC"). On January 8, 2014, the NMPRC approved the continuation of the FPPCAC without modification in NMPRC Case No. 13-00380-UT. The Company recovers its investment in Palo Verde Unit 3 in New Mexico through the FPPCAC as purchased power using a proxy market price approved in the 2009 New Mexico rate stipulation.

Montana Power Station Approvals. The Company has received a CCN authorization from the NMPRC to construct the first two (of four) units of the MPS. As discussed above, the Company also had to obtain air permits from the TCEQ and EPA before it could begin construction. On September 6, 2013, the Company filed an application with the NMPRC for issuance of a CCN to construct, own and operate two additional 88 MW natural gas-fired generating units designated as the MPS Units 3 and 4 in El Paso County, Texas. The case has been designated NMPRC Case No. 13-00297-UT. No protests to the Company's application were filed and the hearing examiner issued a recommended decision to approve the Company's application on February 20, 2014. A final order is expected in the second quarter of 2014.

Revolving Credit Facility, Issuance of Long-Term Debt and Guarantee of Debt. On October 30, 2013, the Company received approval in NMPRC Case No. 13-00317-UT to amend its current $300 million Revolving Credit Facility ("RCF") to include an option, subject to lender's approval, to expand the amount of the potential borrowings available under the facility to $400 million and extend the maturity date by up to four years; issue up to $300 million in new long-term debt; and to guarantee the issuance of up to $50 million of new debt by Rio Grande Resources Trust ("RGRT") to finance future purchases of nuclear fuel and to refinance existing debt obligations related to the financing of purchases of nuclear fuel.

On January 14, 2014, the Company and RGRT entered into a second amended and restated credit agreement related to the RCF with JP Morgan Chase Bank, N.A., as administrative agent and issuing bank, and Union Bank, N.A., as syndication agent, and various lending banks party thereto. Under the terms of the agreement, the Company has available $300 million and the ability to increase the RCF by up to $100 million (up to a total of $400 million) upon the satisfaction of certain conditions, more fully set forth in the agreement, including obtaining commitments from lenders or third party financial institutions. The RCF has a term ending January 2019. The Company may extend the maturity date up to two times, in each case for an additional one year period upon the satisfaction of certain conditions.

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

Federal Regulatory Matters

Public Service Company of New Mexico's ("PNM") 2010 Transmission Rate Case. On October 27, 2010, PNM filed a Notice of Transmission Rate Change for transmission delivery services provided by PNM. These rates went into effect on June 1, 2011. The Company takes transmission service from PNM. On January 2, 2013, the FERC issued a letter order approving a unanimous stipulation and agreement. Pursuant to the stipulation, on January 31, 2013, PNM refunded $1.9 million, for amounts that PNM collected since June 1, 2011, in excess of settlement rates. This amount was recorded in the fourth quarter of 2012 as a reduction of transmission expense.

Revolving Credit Facility, Issuance of Long-Term Debt and Guarantee of Debt. On November 15, 2013, the FERC issued an order in Docket No. ES13-59-000 approving the Company's filing to amend its current $300 million RCF to include an option, subject to lender's approval, to expand the amount of the potential borrowings available under the facility to $400 million and extend the maturity date by up to four years; issue up to $300 million in new long-term debt; and to guarantee the issuance of up to $50 million of new debt by RGRT to finance future purchases of nuclear fuel and to refinance existing debt obligations related to the purchase of nuclear fuel. As noted above, on January 14, 2014, the Company and RGRT entered into a second amended and restated credit agreement related to the RCF.

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

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D. Common Stock

Dividend Policy. The Company paid $10.7 million and $10.1 million in quarterly cash dividends during the three months ended March 31, 2014 and 2013, respectively. The Company paid a total of $42.7 million and $40.1 million in quarterly cash dividends during the twelve months ended March 31, 2014 and 2013, respectively.

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

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2014	2013	2014	2013
Weighted average number of common shares outstanding:				
Basic number of common shares outstanding	40,149,083	40,078,061	40,132,106	40,015,380
Dilutive effect of unvested performance awards	—	—	12,053	50,206
Dilutive effect of stock options	—	—	—	9,234
Diluted number of common shares outstanding	40,149,083	40,078,061	40,144,159	40,074,820
Basic net income per common share:				
Net income	$4,615	$7,634	$85,564	$95,136
Income allocated to participating restricted stock	(36)	(26)	(260)	(248)
Net income available to common shareholders	$4,579	$7,608	$85,304	$94,888
Diluted net income per common share:				
Net income	$4,615	$7,634	$85,564	$95,136
Income reallocated to participating restricted stock	(36)	(26)	(260)	(247)
Net income available to common shareholders	$4,579	$7,608	$85,304	$94,889
Basic net income per common share:				
Distributed earnings	$0.265	$0.25	$1.06	$1.00
Undistributed earnings	(0.155)	(0.06)	1.07	1.37
Basic net income per common share	$0.110	$0.19	$2.13	$2.37
Diluted net income per common share:				
Distributed earnings	$0.265	$0.25	$1.06	$1.00
Undistributed earnings	(0.155)	(0.06)	1.06	1.37
Diluted net income per common share	$0.110	$0.19	$2.12	$2.37

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

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2014	2013	2014	2013
Restricted stock awards	79,413	56,101	57,017	44,253
Performance shares (a)	128,508	124,997	90,384	78,112

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

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E. Income Taxes

The Company files income tax returns in the United States ("U.S.") federal jurisdiction and in the states of Texas, New Mexico and Arizona. The Company is no longer subject to tax examination by the taxing authorities in the federal and New Mexico jurisdictions for years prior to 2009 and in Arizona for years prior to 2008. The Company is currently under audit in Texas for tax years 2007 through 2011. The Company reached a settlement with the Arizona Department of Revenue in March 2014 in their audit of income tax returns for the years 1998 through 2007 which did not have a material effect on income tax expense.

For the three months ended March 31, 2014 and 2013, the Company’s effective tax rate was 24.2% and 30.3%, respectively. For the twelve months ended March 31, 2014 and 2013, the Company's effective tax rate was 32.8% and 34.2%, respectively. The Company's effective tax rate for the three months ended March 31, 2014 differs from the federal statutory tax rate of 35.0% primarily due to capital gains in the decommissioning trusts realized in the first quarter of 2014, which are taxed at a federal rate of 20.0%, the allowance for equity funds used during construction and state income taxes. The Company's effective tax rate for the three months ended March 31, 2013 and the twelve months ended March 31, 2014 and 2013 differs from the federal statutory tax rate of 35.0% primarily due to the allowance for equity funds used during construction and state income taxes.

F. Commitments, Contingencies and Uncertainties

For a full discussion of commitments and contingencies, see Note K of Notes to Financial Statements in the 2013 Form 10-K. In addition, see Note C above and Notes C and E of Notes to Financial Statements in the 2013 Form 10-K regarding matters related to wholesale power sales contracts and transmission contracts subject to regulation and Palo Verde, including decommissioning, spent nuclear fuel and waste disposal, and liability and insurance matters.

Power Purchase and Sale Contracts

To supplement its own generation and operating reserves, and to meet required renewable portfolio standards, the Company engages in firm power purchase arrangements which may vary in duration and amount based on evaluation of the Company’s resource needs, the economics of the transactions, and specific renewable portfolio requirements. For a full discussion of power purchase and sale contracts that the Company has entered into with various counterparties, see Note K of Notes to Financial Statements in the 2013 Form 10-K. In addition the 50 MW Macho Springs solar photovoltaic project located in Luna County, New Mexico, is projected to begin commercial operation before June 2014.

Environmental Matters

General. The Company is subject to extensive laws, regulations and permit requirements with respect to air and greenhouse gas emissions, water discharges, soil and water quality, waste management and disposal, natural resources and other environmental matters by federal, state, regional, tribal and local authorities. Failure to comply with such laws, regulations and requirements can result in actions by authorities or other third parties that might seek to impose on the Company administrative, civil and/or criminal penalties or other sanctions. In addition, releases of pollutants or contaminants into the environment can result in costly cleanup liabilities. These laws, regulations and requirements are subject to change through modification or reinterpretation, or the introduction of new laws and regulations and, as a result, the Company may face additional capital and operating costs to comply. For a full discussion of certain key environmental issues, laws and regulations facing the Company see Note K of Notes to Financial Statements in the 2013 Form 10-K.

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

("CAIR"). While the U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Court of Appeals") vacated CSAPR in August 2012 and allowed CAIR to stand until the EPA issued a proper replacement, on April 29, 2014, the U.S. Supreme Court upheld CSAPR, remanding certain portions of CSAPR to the D.C. Court of Appeals for consideration. The Company will evaluate what impact, if any, the D.C. Court of Appeals subsequent holdings on remand will have on its operations.

Other Laws and Regulations and Risks. The Company intends to cease its participation in Four Corners Generating Station ("Four Corners") at the expiration of the 50-year participation agreement in 2016. The Company believes that it has better economic and cleaner alternatives for serving the energy needs of its customers than coal-fired generation, which is subject to extensive regulation and litigation. For example, as a result of Arizona Public Service Company's ("APS") recent Best Available Retrofit

Technology Federal Implementation Plan compliance strategy notification to the EPA, Four Corners is required to install expensive pollution control equipment in order to continue operation in the future. The Company's share of the cost of these controls is currently estimated by APS to be approximately $39 million if the Company were to extend its participation in the plant. In addition, the EPA has entered into a consent decree which would require it to issue its final rulemaking regarding the regulation of coal combustion residuals ("CCR") under the federal Resource, Conservation and Recovery Act by December 19, 2014. Once issued, the Company may be required to incur significant costs to address CCRs either generated in the past and disposed of at or from Four Corners, as well as CCRs generated in connection with the ongoing operations of Four Corners. Further, assured supplies of water are important for the Company's operations and assets, including Four Corners. Four Corners is located in a region that has been experiencing drought conditions which could affect the plant's water supply. Four Corners has accordingly been involved in negotiations and proceedings with third parties relating to water supply issues. The drought conditions and related negotiations and proceedings could adversely affect the amount of power available, or the price thereof, from Four Corners. The Company is negotiating with APS on the disposition of its ownership interest of Four Corners to allow the other participants to pursue a life extension of the Four Corners plant.

Climate Change. On June 25, 2013, President Obama set forth his plan to address climate change. He reiterated a goal of reducing greenhouse gas emissions ("GHG") "in the range of 17 percent" below 2005 levels by 2020. The plan included a variety of executive actions, including future regulatory measures to reduce carbon emissions from power plants. In a White House memorandum of the same date, the President directed the EPA to issue a new proposal for GHG rulemaking addressing new power plants by September 20, 2013, and a rule for existing power plants by June 1, 2014. The formal proposal for new power plants was published in the Federal Register on January 8, 2014. The Company continues its review of the new proposal and plans to participate in the post-publication comment period (with extension) ending May 9, 2014. Given the very significant remaining uncertainties regarding these rules, the Company believes it is impossible to meaningfully quantify the costs of these potential requirements at present.

Environmental Litigation and Investigations. Since 2009, the EPA and certain environmental organizations have been scrutinizing, and in some cases, have filed lawsuits, relating to certain air emissions and air permitting matters related to Four Corners. In particular, since July 2011, the U.S. Department of Justice (the "DOJ"), on behalf of the EPA, and APS have been engaged in substantive settlement negotiations in an effort to resolve the pending matters. The allegations being addressed through settlement negotiations are that APS failed to obtain the necessary permits and install the controls necessary under the U.S. Clean Air Act ("CAA") to reduce SO2, NOx, and particular matter ("PM"), and that defendants failed to obtain an operating permit under Title V of the CAA that reflects applicable requirements imposed by law. In March 2012, the DOJ provided APS with a draft consent decree to settle the EPA matter, which decree contains specific provisions for the reduction and control of NOx, SO2, and PM, as well as provisions for a civil penalty, and expenditures on environmental mitigation projects with an emphasis on projects that address alleged harm to the Navajo Nation. Settlement discussions are on-going and the Company is unable to predict the outcome of these settlement negotiations. The Company has accrued a total of $0.5 million as a loss contingency related to this matter.

The Company received notice that Earthjustice filed a lawsuit in the United States District Court for New Mexico on October 4, 2011 for alleged violations of the Prevention of Significant Deterioration ("PSD") provisions of the CAA related to Four Corners. On January 6, 2012, Earthjustice filed a First Amended Complaint adding claims for violations of the CAA's New Source Performance Standards ("NSPS") program. Among other things, the plaintiffs seek to have the court enjoin operations at Four Corners until APS applies for and obtains any required PSD permits and complies with the referenced NSPS program. The plaintiffs further request the court to order the payment of civil penalties, including a beneficial mitigation project. On April 2, 2012, APS and the other Four Corners' participants filed motions to dismiss with the court. The case is being held in abeyance while the parties seek to negotiate a settlement. On March 30, 2013, upon joint motion of the parties, the court issued an order deeming the motions to dismiss withdrawn without prejudice during pendency of the stay. At such time as the stay is lifted, APS, the Company and the other Four Corners participants may reinstate the motions to dismiss. On April 25, 2014, the stay was extended until May 15, 2014. The Company is unable to predict the outcome of this litigation.

New Mexico Tax Matter Related to Coal Supplied to Four Corners

On May 23, 2013, the New Mexico Taxation and Revenue Department issued a notice of assessment for coal severance surtax, penalty, and interest totaling approximately $30 million related to coal supplied under the coal supply agreement for Four Corners (the "Assessment"). The Company's share of the Assessment is approximately $1.5 million. On behalf of the Four Corners participants, the coal supplier made a partial payment of the Assessment and immediately filed a refund claim with respect to that partial payment in August 2013. The New Mexico Taxation and Revenue Department denied the refund claim. On December 19, 2013, the coal supplier and APS, on its own behalf and as operating agent for Four Corners, filed complaints with the New

Mexico District Court contesting both the validity of the Assessment and the refund claim denial. APS believes the Assessment and the refund claim denial are without merit. The Company cannot predict the timing, results, or potential impacts of the outcome of this litigation.

G. Litigation

The Company is a party to various legal actions. In many of these matters, the Company has excess casualty liability insurance that covers the various claims, actions and complaints. Based on a review of these claims and applicable insurance coverage, the Company believes that none of these claims will have a material adverse effect on the financial position, results of operations or cash flows of the Company. See Note C above and Note C of the Notes to Financial Statements in the 2013 Form 10-K for discussion of the effects of government legislation and regulation on the Company.

H. Employee Benefits

Retirement Plans

The net periodic benefit cost recognized for the three and twelve months ended March 31, 2014 and 2013 is made up of the components listed below as determined using the projected unit credit actuarial cost method (in thousands):

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2014	2013	2014	2013
Components of net periodic benefit cost:				
Service cost	$2,173	$2,400	$9,100	$9,004
Interest cost	3,870	3,400	14,084	13,579
Expected return on plan assets	(4,680)	(4,275)	(17,513)	(15,108)
Amortization of:				
Net loss	1,773	2,675	10,196	11,066
Prior service (benefit) cost	(259)	25	(187)	113
Net periodic benefit cost	$2,877	$4,225	$15,680	$18,654

During the three months ended March 31, 2014, the Company contributed $3.5 million of its projected $8.7 million 2014 annual contribution to its retirement plans.

During the quarter ended March 31, 2014, the Company implemented certain amendments to the Retirement Income Plan and Excess Benefit Plan. In the first quarter of 2014, the Company offered a cash balance pension plan as an alternative to its current final average pay pension plan for employees hired prior to January 1, 2014. The cash balance pension plan also included an enhanced employer matching contribution to the employee's respective 401(k) Defined Contribution Plan. The revisions in the benefit plans were effective April 1, 2014. As a result of these actions, the Company remeasured the assets and liabilities of the retirement plans based on actuarially determined estimates, using the end of alternative choice date of February 28, 2014 as the remeasurement date. The discount rate used to remeasure the benefit obligation at February 28, 2014 was 4.6% for the Retirement Income Plan and 4.5% for the Excess Benefit Plan, compared to 4.9% for both plans at December 31, 2013. As a result of the changes described above, the benefit obligation of the affected plans decreased $19.7 million, accumulated other comprehensive income before income taxes increased $19.7 million, estimated future benefit payments from 2014 through 2018 increased $17.2 million compared to the previous estimates. The 2014 net periodic benefit cost is estimated to decrease by $8.4 million compared to the net periodic benefit cost incurred in 2013 due to the changes described above and revisions to actuarial assumptions.

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Other Postretirement Benefits

The net periodic benefit cost recognized for the three and twelve months ended March 31, 2014 and 2013 is made up of the components listed below (in thousands):

	Three Months Ended March 31,		Twelve Months Ended March 31,	
	2014	2013	2014	2013
Components of net periodic benefit cost:				
Service cost	$700	$1,100	$3,443	$4,408
Interest cost	1,125	1,375	4,906	5,611
Expected return on plan assets	(525)	(475)	(2,001)	(1,754)
Amortization of:				
Prior service benefit	(1,200)	(1,425)	(5,432)	(5,832)
Net (gain) loss	(650)	—	(1,276)	455
Net periodic benefit cost (benefit)	$(550)	$575	$(360)	$2,888

The Company has not contributed to its other postretirement benefits plan during the three months ended March 31, 2014 and does not expect to contribute to its other postretirement benefit plan in 2014.

I. Financial Instruments and Investments

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

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

	March 31, 2014		December 31, 2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Pollution Control Bonds	$193,135	$202,897	$193,135	$193,990
Senior Notes	696,508	744,856	696,485	734,515
RGRT Senior Notes (1)	110,000	116,560	110,000	115,850
RCF (1)	45,951	45,951	14,352	14,352
Total	$1,045,594	$1,110,264	$1,013,972	$1,058,707

(1) Nuclear fuel financing as of March 31, 2014 and December 31, 2013 is funded through the $110 million RGRT Senior Notes and $20.0 million and $14.4 million, respectively under the RCF. As of March 31, 2014, $26.0 million was outstanding under the RCF for working capital or general corporate purposes. As of December 31, 2013, no amount was outstanding under the RCF for working capital or general corporate purposes. The interest rate on the Company’s borrowings under the RCF is reset throughout the quarter reflecting current market rates. Consequently, the carrying value approximates fair value.

Marketable Securities. The Company’s marketable securities, included in decommissioning trust funds in the balance sheets, are reported at fair value which was $217.5 million and $214.1 million at March 31, 2014 and December 31, 2013, respectively. These securities are classified as available for sale under FASB guidance for certain investments in debt and equity securities and are valued using prices and other relevant information generated by market transactions involving identical or comparable securities. The reported fair values include gross unrealized losses on marketable securities whose impairment the Company has deemed to

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be temporary. The tables below present the gross unrealized losses and the fair value of these securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

March 31, 2014