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GROWTH | STABILITY

2007 ANNUAL REPORT

EL PASO ELECTRIC

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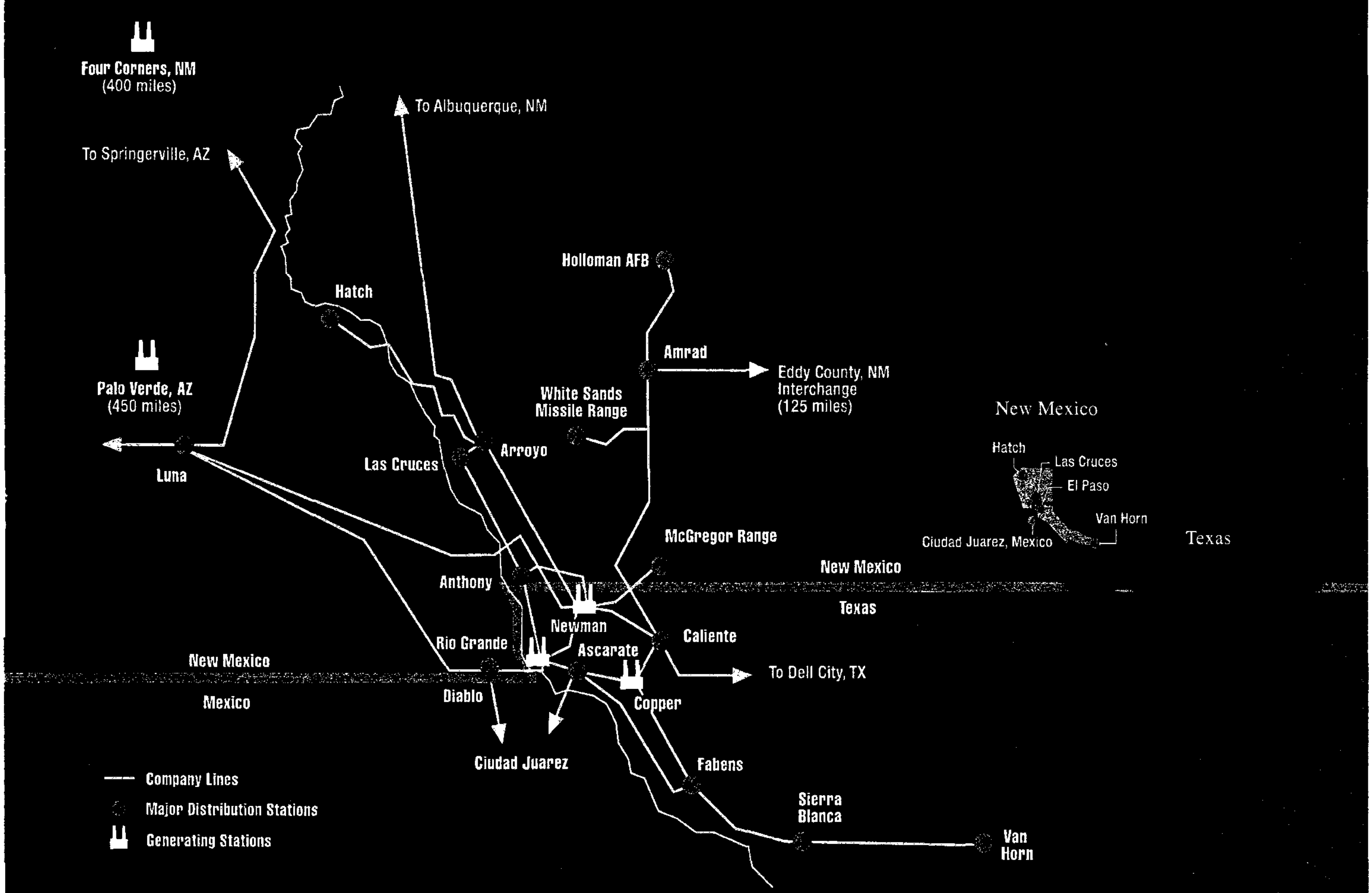


SERVICE AREA

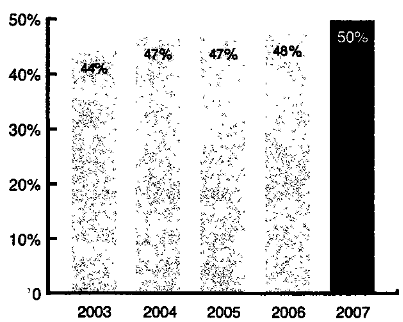
This document includes statements that may constitute forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. This information may involve risks and uncertainties that could cause actual results to differ materially from such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to: (i) increased prices for fuel and purchased power and the possibility that regulators may not permit El Paso Electric (EPE) to pass through all such increased costs to customers; (ii) determinations by regulators that may adversely affect EPE's ability to recover previously incurred fuel costs in rates; (iii) fluctuations in off-system sales margins due to uncertainty in the economy power market and the availability of generating units; (iv) unanticipated increased costs associated with scheduled and unscheduled outages; (v) costs at Palo Verde, including additional costs relating to an enhanced Nuclear Regulatory Commission oversight and inspection regimen; (vi) the costs of legal defense and possible judgments which may accrue as the result of ongoing litigation or any regulatory proceeding; (vii) deregulation of the electric utility industry; (viii) reduced wholesale margins; (ix) possible increased costs of compliance with environmental or other laws, regulations and policies; (x) possible income tax and interest payments as a result of audit adjustments proposed by the Internal Revenue Service; (xi) possible warranty obligations attributable to MiraSol Energy Services, a subsidiary of EPE; (xii) other factors detailed by EPE in its public filings with the Securities and Exchange Commission (SEC). EPE's filings are available from the SEC or may be obtained through EPE's web site, http://www.epelectric.com. Any such forward-looking statement is qualified by reference to these risks and factors. EPE cautions that these risks and factors are not exclusive. EPE does not undertake to update any forward-looking statement that may be made from time to time by or on behalf of EPE except as required by law.

Financial ($000)		2005		2006		2007
Operating Revenues						
Retail Non-Fuel Base Revenues	$	436,466	$	445,940	$	464,508
Off-System Sales Gross Margins	$	20,267	$	22,600	$	19,581
Retained Margins	$	13,750	$	18,261	$	15,514
Net Income (after extraordinary gain and cumulative effect of accounting change)	$	35,522 (a)	$	67,450 (b)	$	74,753
Total Assets	$	1,665,449	$	1,714,654	$	1,853,888

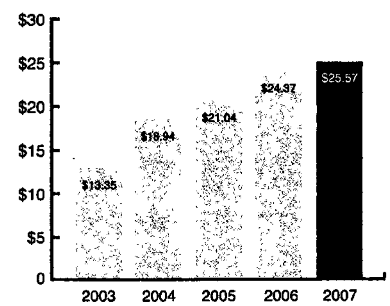
Common Stock Data						
Earnings Per Share (diluted weighted average)	$	0.74 (a)	$	1.40 (b)	$	1.63
Market Price Per Share (year-end close)	$	21.04	$	24.37	$	25.57
Book Value Per Share	$	11.56	$	12.60	$	14.76
Weighted Average Number of Shares & Dilutive Potential Shares Outstanding		48,307,910		48,164,067		45,928,478
Number of Registered Holders as of 12/31		4,291		4,145		3,852

(a) 2005 information includes the effect of the charge taken in 2005 for the early extinguishment of debt of $12.1 million, net of tax or $0.25 loss per diluted share and a cumulative effect of an accounting change for the adoption of FIN 47 of $1.1 million, net of tax or $0.02 loss per diluted share.
(b) 2006 information includes an extraordinary gain of $6.1million, net of tax, or $0.13 diluted earnings per share for the re-application of SFAS No. 71 to the Texas jurisdiction.

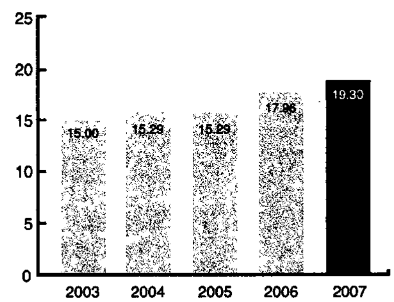
Common Stock Equity
(percent of capitalization)



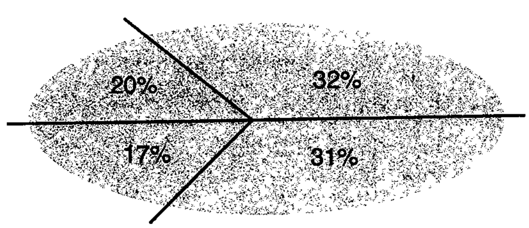
Market Price Per Share
(year-end)



Cumulative Share Repurchases
(in millions)

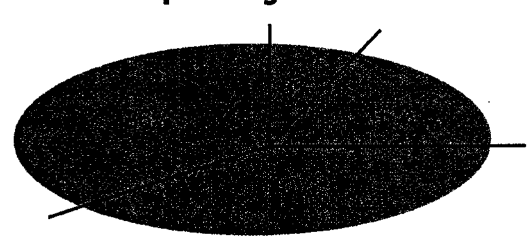


2007 Retail MWh Sales



Residential:32%
Commercial & Ind. Small:31%
Commercial & Ind. Large:17%
Public Authorities:20%

2007 Retail Non-Fuel Base Operating Revenues



Residential:40%
Commercial & Ind. Small:36%
Commercial & Ind. Large:8%
Public Authorities:16%

DEAR SHAREHOLDERS

El Paso Electric (EPE) had another very good year in 2007 as our financial performance and customer growth remained strong. Our core business also remains strong, and EPE continues to remain focused on planning for the significant growth that it sees in its future.

EPE's most significant asset continues to be its people; we are fortunate to have a team of skilled, dedicated employees that constitute the backbone of our Company and are active members of the communities in which they live.

EPE continues to remain focused on planning for the significant growth that it sees in its future.

In May 2007, Gary R. Hedrick retired from his position as President and Chief Executive Officer. Ershel C. Redd, Jr. was selected in May 2007 to replace Mr. Hedrick, who had served as President and CEO since November 5, 2001.

In February 2008, Mr. Redd notified the Board of Directors that he was leaving the Company to pursue other business opportunities. We accepted and respected his decision. On February 12, 2008, J. Frank Bates, Executive Vice President and Chief Operating Officer, was selected as interim President and CEO. Mr. Bates' 35-year history with the Company and strong knowledge of its operations and finances makes him well-qualified to serve in this capacity. The Board of Directors has begun a search for a new President and CEO.

On behalf of your Board of Directors, I want to thank you for your confidence in our Company and to assure you that we are continuing to work hard to increase the value of El Paso Electric for you — our shareholders.

George W. Edwards, Jr.
Chairman of the Board

El Paso Electric is proud of the financial and operational accomplishments we achieved during 2007. Our stock price rose to a record all-time-high closing price; we delivered another solid year of earnings growth; retail kWh sales increased at an above-average rate; and for the eighth consecutive year, we were ranked as one of the most reliable investor-owned utilities in the state of Texas. In addition, we continue to take steps to secure future service reliability for our customers and filed the necessary applications to begin the process of adding new generation to our system. We also expanded our revolving credit facility to enhance our financial flexibility, and we obtained regulatory approval to implement new rates in New Mexico.

2007 marked the fifth consecutive year of stock price appreciation ...

During the year, we conducted a review of our business operations to capitalize on new technology, improve processes, increase efficiency, and reduce our overall cost structure. We are committed to operating our business in the most efficient manner possible and to maximizing value to our shareholders.

2007 marked the fifth consecutive year of stock price appreciation, and we ended the year with a closing stock price of $25.57. Over the past five years (2003-2007), our Company has created significant value to shareholders as reflected by the 18 percent compound annual growth rate of its stock. We continue to be pleased with the performance of our stock over the long term.

In 2007, we posted basic earnings per share of $1.64, compared to 2006 earnings per share of $1.29 (before an extraordinary gain in 2006 of $0.13 per share). In 2007, earnings were favorably impacted by retail kWh sales growth of three percent, lower operating expenses at gas-fired power plants, and increased capitalized interest and AFUDC (allowance for funds used during construction). Partially offsetting these items were higher operation and maintenance expenses at the Palo Verde Nuclear Generating Station (Palo Verde).

Our Company also maintained a healthy balance sheet in 2007, as reflected by its common stock equity of approximately 50 percent of total capitalization at year-end. Going forward, we will continue to manage our common equity ratio in a judicious manner, balancing the need to minimize borrowing costs by maintaining a strong credit rating with the requirements of a significant capital program and our desire to continue to provide cash returns to our shareholders through our ongoing share buyback program. We increased the size of our credit facility from $150 million to $200 million in July 2007 to provide adequate liquidity in the face of rising uranium prices and the need to create a strategic nuclear fuel inventory at Palo Verde.

In 2007, we repurchased 1.3 million shares of stock at a total cost of $31.4 million and completed the share repurchase program authorized by the Board of Directors in September 2006. Since the inception of the program in 1999, we have repurchased 19.3 million shares at a total cost of approximately $269.4 million. Additionally, our Board of Directors authorized another two million share repurchase program on November 15, 2007.

We continue to experience above-average growth in our core business, as our customer base grew by 2.1 percent in 2007 and our power demands resulted in a new record-high native peak of 1,508 MW set in August, which surpassed the previous record of 1,428 MW set in July 2006.

During the year, every segment of our retail business posted revenue growth, with the exception of our Large Commercial & Industrial segment, which posted a slight decline. Our residential MWh sales increased at a robust rate of 5.6 percent during the year. Overall, our total retail MWh sales grew at a 3 percent rate in 2007. Our service area should continue to realize an influx of troops stationed at Fort Bliss due to the United States Government's Base Realignment and Closure Plan.

BOARD OF DIRECTORS

George W. Edwards, Jr.
Chairman of the Board (a)
Retired in 1995 from
Kansas City Southern Railway Company
Kansas City, MO,
as President, CEO and Director

Gary R. Hedrick
Executive Vice President and CFO (b)
TVO North America
El Paso, TX

Stephen N. Wertheimer
Managing Director (c)
W Capital Partners
New York, NY

Patricia Z. Holland-Branch
CEO and Owner (d)
Facilities Connection, Inc.
El Paso, TX

Ramiro Guzmán
Director of Business Development (e)
James Edwards & Companies
El Paso, TX

Kenneth R. Heitz
Partner (f)
Irell & Manella, LLP
Los Angeles, CA

OFFICERS

J. Frank Bates
Interim President & Chief
Executive Officer

Scott D. Wilson
Executive Vice President,
Chief Financial and
Administrative Officer

Hector Gutierrez, Jr.
Executive Vice President,
External Affairs

Steven P. Busser
Vice President,
Treasurer and Chief Risk Officer

David G. Carpenter
Vice President,
Corporate Planning and Controller

Robert C. Doyle
Vice President,
New Mexico Affairs

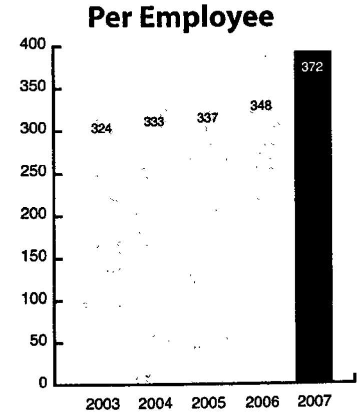
2007 OPERATIONAL HIGHLIGHTS

Operational	**2005**	**2006**	**2007**
Retail GWh Sold	6,653	6,821	7,029
% Change	1.09%	2.53%	3.05%
Native Peak (MW)	1,376	1,428	1,508
Customers at Year-End	340,853	349,731	357,144
% Change	2.63%	2.60%	2.12%
Employees at Year-End	1,010	1,006	961

Generating Capacity

Plant	**Net Dependable Generating Capability**	**Fuel Source**	**Energy Mix**
Palo Verde	633 MW	Nuclear	43%
Newman	474 MW	Natural Gas	
Rio Grande	229 MW	Natural Gas	28%
Copper	62 MW	Natural Gas	
Four Corners	104 MW	Coal	7%
		Purchased Power	22%
Hueco Mountain Wind Ranch	1 MW	Wind	
TOTAL	**1,503 MW**		**100%**

Customers Served Per Employee



BOARD OF DIRECTORS

James W. Cicconi
Sr. Executive Vice President (g)
External & Legislative Affairs
AT&T, Inc.
Washington, D.C.

James W. Harris
Founder and President (h)
Seneca Financial Group, Inc.
Greenwich, CT

J. Robert Brown
Owner/President (i)
of Brownco Capital, LLC
El Paso, TX

Eric B. Siegel
Retired Limited Partner (j)
of Apollo Advisors, L.P.
Los Angeles, CA

Michael K. Parks
Vice Chairman of the Board (k)
Managing Director
TCW Group
Los Angeles, CA

Charles A. Yamarone
Executive Vice President (l)
Libra Securities, LLC
Los Angeles, CA

Fernando J. Gireud
Vice President, Safety, Environmental, Power Marketing and International Affairs

Richard G. Gonzalez
Vice President, Human Resources

Helen Knopp
Vice President, Public Affairs

Kerry B. Lore
Vice President, Administration

Hector R. Puente
Vice President, Transmission and Distribution

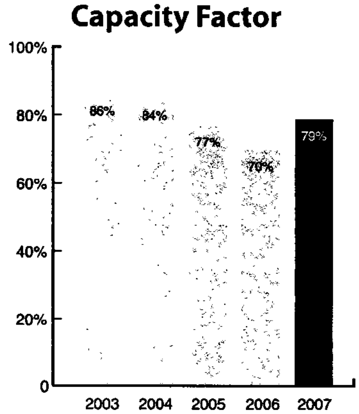
Andres Ramirez
Vice President, Power Generation

Gary D. Sanders
General Counsel

Guillermo Silva, Jr.
Corporate Secretary

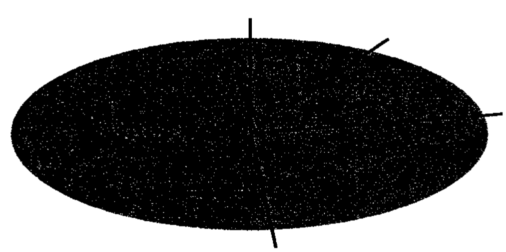
John A. Whitacre
Vice President, System Operations and Planning

Palo Verde Capacity Factor



2008-2011 Estimated Construction Costs

(in millions)



Transmission: **$94**
General: **$105**
Distribution: **$213**
Production: **$430** (1) (2)

(1) Does not include acquisition costs for nuclear fuel.
(2) Includes $193 million for new gas-fired generating capacity and $60 million for other local generation, $18 million for Four Corners and $159 million for Palo Verde.

Currently, the Army anticipates that approximately 33,000 troops and their families will ultimately be stationed at Fort Bliss by 2012, which will more than double the size of the current base population and significantly add to our total customer base of approximately 357,000 customers. Since 2005, Fort Bliss has already amassed over 6,000 new troops. We are excited by the opportunities presented by this unprecedented military growth in our service area, and we look forward to continuing our long-standing relationship with Fort Bliss.

As part of our plan to ensure that sufficient electric energy is available to serve our growth, we began the regulatory process of obtaining approval for the construction of a combined-cycle unit at our Newman Plant in El Paso. Certificates of Convenience and Necessity (CCN) applications were filed in Texas and New Mexico. In late January 2008, we received final approval of our CCN application in Texas, and we anticipate obtaining final approval in New Mexico in the second quarter of 2008. This new generation unit will enhance system reliability and provide fuel savings through the efficiency of the new unit.

In 2007, the Company sold 2.2 million MWh in the off-system (economy) market, which represented an increase of 34.6 percent over 2006 levels. Despite the significant increase in off-system sales volume, EPE's retained margins (before taxes) declined from $18.3 million in 2006 to $15.5 million in 2007, due primarily to lower market pricing and higher costs of energy to generate off-system sales.

In 2007, Palo Verde continued to experience operational issues as evidenced by the Nuclear Regulatory Commission (NRC) placing Palo Verde in the multiple repetitive degraded cornerstone column of its action matrix in February. Subsequently, the NRC increased the level and the scope of inspections at Palo Verde, and required that Palo Verde undertake a plant-wide self-assessment and cultural survey to identify any other possible issues at the plant. In response to this NRC action, a new management team was brought in at Palo Verde to address these issues and to identify action plans to improve performance. The new team has established an environment of open communication with all owners and is working toward developing corrective action and plans to address performance issues.

At Palo Verde, all of the steam generators and low pressure turbines at each of the three units have now been successfully replaced. Palo Verde Unit 3 underwent its steam generator and low pressure turbine outage in the fall of 2007, and the replacements were completed in mid-January 2008. These replacements are expected to increase output, extend the life of the unit, and increase the probability of obtaining a license extension. We will continue to monitor all activities at the plant and will work closely with the operating agent and other plant owners in order to improve the operating performance of Palo Verde.

We are committed to educating our customers on how to be more energy efficient and developing renewable energy in the El Paso and Las Cruces areas. In addition, both states have set renewable energy requirements. The New Mexico Public Regulatory Commission has mandated a renewable portfolio standard (RPS) for all electric utilities in New Mexico. Under the RPS, we must meet a percentage of our New Mexico energy sales with renewable energy. We have an ongoing 2008 Diversity Request for Proposals (RFP) process to evaluate renewable options for meeting the RPS obligations.

Our renewable energy requirements in Texas are based on an allocated share of a statewide goal for renewable energy. Achievement of the goal is measured by Renewable Energy Credits (REC), with a REC representing one MWh of actual output from a renewable generation facility. In 2008, we will issue an RFP to secure renewable energy generation in Texas near El Paso to meet future Texas requirements.

During July 2007, we implemented new base rates in New Mexico and revised the formula for pricing the energy and capacity we provide to our New Mexico customers from Palo Verde Unit 3, which is deregulated in New Mexico. This new pricing formula provides us a better opportunity to recover our costs of providing power from Palo Verde Unit 3. The stipulation reached in that case requires us to file our next general rate case by May 30, 2009, which will be based on a test-year ending December 31, 2008.

In Texas, the current rate settlement prevents us from seeking an increase in base rates prior to July 1, 2010, unless our return on equity is below the bottom of an allowed range. We anticipate filing a general rate case in Texas sometime in the second half of 2009, such that new base rates would be implemented by July 1, 2010.

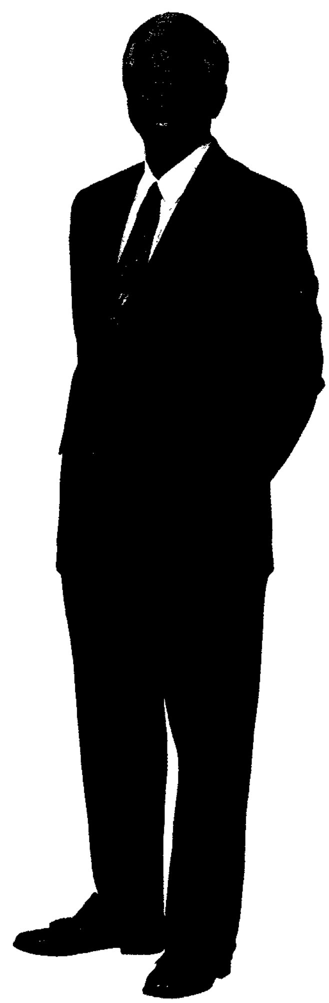
Through the hard work of our employees, our Company once again ranked among the most reliable investor-owned electric utilities in Texas ...

Through the hard work of our employees, our Company once again ranked among the most reliable investor-owned electric utilities in Texas as measured by both frequency and duration of service interruptions. These rankings reflect our employees' continued dedication to maintaining our systems and infrastructure and to providing the most reliable electric service possible. After more than a year of negotiations, the Company and the International Brotherhood of Electrical Workers (IBEW) Local 960 signed a new three-year contract that became effective on September 3, 2007.

We believe that our employees are the foundation of our success. They continue their commitment to the communities in which they live and work. More than 300 employees contributed over 14,000 hours of volunteer time in our service territory. More than 300 units of blood were donated to local blood service centers, and more than $105,000 was contributed to local United Way agencies. In addition, our employees' ideas on how to improve operations and financial processes at the Company resulted in estimated savings of more than $1 million dollars in 2007. We are extremely proud of the hard work and dedication of our employees.

We are committed to meeting the growing demands of our service territory and continuing to provide our customers with reliable electric service at a reasonable cost. We will continue to strive to improve our operational and financial performance and to become one of the most efficiently run electric utilities in the nation.

As we continue through this exciting and critical period of growth in our business, again, I thank you — our shareholders — for your continued trust and support.



J. Frank Bates
Interim President &
Chief Executive Officer

OPERATING STATISTICS

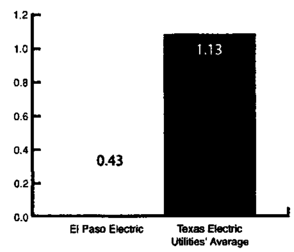
	2007	2006	2005	2004
Operating Revenues (in thousands):				
Non-Fuel Base Revenues:				
Retail:				
Residential	$ 184,562	$ 175,641	$ 173,007	$ 164,791
Commercial and Industrial, Small	168,091	161,359	158,406	157,188
Commercial and Industrial, Large	39,092	40,502	39,192	41,096
Sales to Public Authorities	72,763	68,438	65,861	65,351
Total Retail Base Revenues	464,508	445,940	436,466	428,426
Wholesale:				
Sales for Resale	1,919	1,794	1,687	1,675
Total Non-Fuel Base Revenues	466,427	447,734	438,153	430,101
Fuel Revenues:				
Recovered from customers during the period	197,383	225,441	164,500	143,692
Under (over) collection of fuel	17,828	(3,655)	79,539	17,360
New Mexico Fuel in Base Rates	51,487	30,033	29,440	27,956
Total Fuel Revenues	266,698	251,819	273,479	189,008
Off-System (Economy) Sales	125,974	95,932	78,209	78,533
Other	18,328	20,970	14,072	10,986
Total Operating Revenues	$ 877,427	$ 816,455	$ 803,913	$ 708,628
Number of Customers (end of year):				
Residential	317,091	311,923	304,031	296,435
Commercial and Industrial, Small	35,147	32,950	31,969	31,079
Commercial and Industrial, Large	53	58	61	58
Other	4,853	4,800	4,792	4,553
Total	357,144	349,731	340,853	332,125
Average annual kWh use per residential customer	7,085	6,852	6,936	6,769
Energy Sales, MWh:				
Generated	7,707,095	6,908,006	7,500,144	7,611,455
Purchased and Interchanged	2,188,904	2,208,661	1,255,626	1,410,114
Total Energy Supplied	9,895,999	9,116,667	8,755,770	9,021,569
Energy Sales, MWh:				
Retail:				
Residential	2,232,668	2,113,733	2,090,098	1,986,085
Commercial and Industrial, Small	2,216,428	2,159,599	2,126,918	2,115,822
Commercial and Industrial, Large	1,195,038	1,204,707	1,165,506	1,236,426
Sales to Public Authorities	1,384,380	1,343,129	1,270,116	1,243,003
Total Retail	7,028,514	6,821,168	6,652,638	6,581,336
Wholesale:				
Sales for Resale	48,290	45,397	41,883	41,094
Off-System (Economy) Sales	2,201,294	1,635,407	1,420,778	1,838,467
Total Wholesale	2,249,584	1,680,804	1,462,661	1,879,561
Total Energy Sales	9,278,098	8,501,972	8,115,299	8,460,897
Losses and Company Use	617,901	614,695	640,471	560,672
Total, Net	9,895,999	9,116,667	8,755,770	9,021,569
Native System:				
Peak Load, MW	1,508	1,428	1,376	1,332
Net Dependable Generating Capability for Peak, MW	1,492	1,492	1,479	1,472
Total System:				
Peak Load, MW	1,680	1,675	1,628	1,575
Net Dependable Generating Capability for Peak, MW	1,492	1,492	1,479	1,472
System Capacity Factor	65.2%	59.7%	58.6%	61.3%

OPERATING STATISTICS

2003	2002	2001	2000	1999	1998
$ 161,852	$ 157,122	$ 150,524	$ 148,786	$ 137,678	$ 148,951
156,869	155,311	154,012	150,877	144,777	147,142
41,402	41,657	42,091	43,050	42,565	45,374
65,830	63,908	63,430	63,443	61,842	65,506
425,953	417,998	410,057	406,156	386,862	406,973
3,223	32,228	52,879	45,698	36,992	55,597
429,176	450,226	462,936	451,854	423,854	462,570
135,956	153,141	162,758	106,134	79,885	111,953
(13,195)	5,509	1,577	17,992	3,426	(2,836)
27,370	26,096	25,219	24,490	22,614	3,463
150,131	184,746	189,554	148,616	105,925	112,580
76,536	43,654	92,452	84,918	32,523	20,167
8,519	11,459	24,763	16,261	8,167	6,506
$ 664,362	$ 690,085	$ 769,705	$ 701,649	$ 570,469	$ 601,823
289,179	281,874	276,200	271,588	266,627	260,356
30,254	29,281	28,573	27,947	27,274	26,396
63	64	65	63	60	58
4,524	4,431	4,308	4,054	3,957	3,867
324,020	315,650	309,146	303,652	297,918	290,677
6,761	6,694	6,529	6,553	6,268	6,291
7,740,923	7,785,938	8,183,713	8,706,790	8,392,890	8,586,098
1,250,707	1,549,875	951,359	905,770	328,225	478,396
8,991,630	9,335,813	9,135,072	9,612,560	8,721,115	9,064,494
1,932,171	1,870,931	1,789,199	1,767,928	1,653,859	1,621,436
2,096,860	2,076,758	2,069,517	2,026,768	1,943,120	1,891,703
1,197,065	1,161,815	1,174,235	1,142,163	1,133,751	1,314,428
1,224,349	1,212,180	1,185,521	1,177,883	1,135,438	1,120,654
6,450,445	6,321,684	6,218,472	6,114,742	5,866,168	5,948,221
67,754	986,134	1,460,383	1,282,540	905,975	1,757,880
1,920,882	1,483,465	929,914	1,714,288	1,497,880	888,708
1,988,636	2,469,599	2,390,297	2,996,828	2,403,855	2,646,588
8,439,081	8,791,283	8,608,769	9,111,570	8,270,023	8,594,809
552,549	544,530	526,303	500,990	451,092	469,685
8,991,630	9,335,813	9,135,072	9,612,560	8,721,115	9,064,494
1,308	1,282	1,199	1,159	1,159	1,167
1,459	1,466	1,466	1,466	1,476	1,477
1,546	1,509	1,485	1,427	1,307	1,464
1,459	1,466	1,466	1,466	1,476	1,477
61.7%	62.4%	61.8%	67.7%	64.0%	64.3%

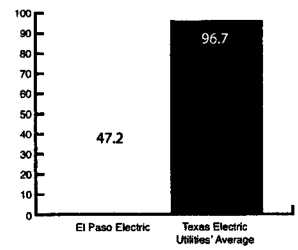
DISTRIBUTION

System Average Interruption Frequency Index - SAIFI



SAIFI - the average number of sustained interruptions (5 minutes or more) that each customer on the system could expect to experience over a one-year period. On average, EPE customers could have expected 0.43 interruptions over one year.

System Average Interruption Duration Index - SAIDI



SAIDI - the average duration of sustained interruptions (5 minutes or more) that each customer on the system could expect to experience over a one-year period. As a complement to SAIFI, customers on EPE's system could expect 0.43 interruptions over one year, and that interruption would last 47.2 minutes.

INVESTOR RELATIONS

Securities and Records
The common stock of El Paso Electric is traded on the New York Stock Exchange. The ticker symbol is EE.
EPE and BNY Mellon act as co-registrars for EPE's common stock. BNY Mellon maintains all shareholder records of EPE.

Form 10-K Report and Shareholder Inquiries
A complete copy of EPE's Annual Report and Form 10-K for the year ended December 31, 2007, which has been filed with the Securities and Exchange Commission, including financial statements and financial statement schedules, is available without charge upon written request to:

Investor Relations
El Paso Electric
P.O. Box 982
El Paso, TX 79960
Or call: (800) 592-1634
E-mail: investor_relations@epelectric.com • Web site: http://www.epelectric.com

Shareowner Services
Shareholders may obtain information relating to their share position, transfer requirements, lost certificates and other related matters by contacting BNY Mellon Shareowner Services at (866) 202-2682 (inside the United States and Canada), (201) 680-6578 (outside the United States and Canada), or (800) 231-5469 (TDD) for the hearing impaired. The phone service is available to all shareholders Monday through Friday, 8 a.m. to 8 p.m., EST.
Web site: https://www.stockbny.com

SHAREHOLDERS

Address Shareowner Inquiries to:

El Paso Electric Company
C/O BNY Mellon Shareowner Services
P.O. Box 358015
Pittsburgh, PA 15252-8015

Annual Meeting of Shareholders

The annual meeting of El Paso Electric's shareholders will be held at 10 a.m. Mountain Daylight Time on Wednesday, May 7, 2008, at the Stanton Tower Building, 100 N. Stanton, El Paso, TX 79901. In connection with the meeting, proxies will be solicited by the Board of Directors of EPE. A notice of meeting, together with a proxy statement, a form of proxy, and the Annual Report to Shareholders for 2007, was mailed on or about March 28, 2008, to shareholders of record as of March 10, 2008.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2007

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 0-296

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)

Registrant's telephone number, including area code: **(915) 543-5711**

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, No Par Value	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES _X_ NO ___

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES ___ NO _X_

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 ___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Act).

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

YES ___ NO _X_

As of June 30, 2007, the aggregate market value of the voting stock held by non-affiliates of the registrant was $1,109,228,847 (based on the closing price as quoted on the New York Stock Exchange on that date).

As of January 31, 2008, there were 45,150,655 shares of the Company's no par value common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2008 annual meeting of its shareholders are incorporated by reference into Part III of this report.

DEFINITIONS

The following abbreviations, acronyms or defined terms used in this report are defined below:

Abbreviations, Acronyms or Defined Terms	Terms
2007 New Mexico Stipulation	Stipulation in Case No. 06-00258-UT dated February 6, 2007, between the Company and other parties to the Company's rate proceeding before the NMPRC
ANPP Participation Agreement	Arizona Nuclear Power Project Participation Agreement dated August 23, 1973, as amended
APS	Arizona Public Service Company
CFE	Comisión Federal de Electricidad de Mexico, the national electric utility of Mexico
Common Plant or Common Facilities	Facilities at or related to Palo Verde that are common to all three Palo Verde units
Company	El Paso Electric Company
DOE	United States Department of Energy
El Paso	City of El Paso, Texas
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
Fort Bliss	The United States Army Air Defense Center located in El Paso, Texas
Four Corners	Four Corners Generating Station
kV	Kilovolt(s)
kW	Kilowatt(s)
kWh	Kilowatt-hour(s)
Las Cruces	City of Las Cruces, New Mexico
MW	Megawatt(s)
MWh	Megawatt-hour(s)
NMPRC	New Mexico Public Regulation Commission
Net dependable generating capability	The maximum load net of plant operating requirements which a generating plant can supply under specified conditions for a given time interval, without exceeding approved limits of temperature and stress
New Mexico Restructuring Act	New Mexico Electric Utility Industry Restructuring Act of 1999
NRC	Nuclear Regulatory Commission
Palo Verde	Palo Verde Nuclear Generating Station
Palo Verde Participants	Those utilities who share in power and energy entitlements, and bear certain allocated costs, with respect to Palo Verde pursuant to the ANPP Participation Agreement
PNM	Public Service Company of New Mexico
SFAS	Statement of Financial Accounting Standards
SPS	Southwestern Public Service Company
TEP	Tucson Electric Power Company
Texas Commission	Public Utility Commission of Texas
Texas Freeze Period	Five-year period beginning July 1, 2005, during which base rates for most Texas retail customers remain frozen pursuant to the City Rate Agreement
Texas Restructuring Law	Texas Public Utility Regulatory Act Chapter 39, Restructuring of the Texas Electric Utility Industry
TNP	Texas-New Mexico Power Company

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FORWARD-LOOKING STATEMENTS

Certain matters discussed in this Annual Report on Form 10-K other than statements of historical information are "forward-looking statements." The Private Securities Litigation Reform Act of 1995 has established that these statements qualify for safe harbors from liability. Forward-looking statements may include words like we "believe", "anticipate", "target", "expect", "pro forma", "estimate", "intend" and words of similar meaning. Forward-looking statements describe our future plans, objectives, expectations or goals. Such statements address future events and conditions concerning and include, but are not limited to such things as:

- capital expenditures,
- earnings,
- liquidity and capital resources,
- litigation,
- accounting matters,
- possible corporate restructurings, acquisitions and dispositions,
- compliance with debt and other restrictive covenants,
- interest rates and dividends,
- environmental matters,
- nuclear operations, and
- the overall economy of our service area.

These forward-looking statements involve known and unknown risks that may cause our actual results in future periods to differ materially from those expressed in any forward-looking statement. Factors that would cause or contribute to such differences include, but are not limited to, such things as:

- our rates in Texas following the end of the Texas Freeze Period,
- our rates in New Mexico following the 2007 New Mexico Stipulation,
- loss of margins on off-system sales due to changes in wholesale power prices or availability of competitive generation resources,
- ability of our operating partners to maintain plant operations and manage operation and maintenance costs at Palo Verde and Four Corners plants including additional costs associated with the degraded cornerstone status of Palo Verde,
- reductions in output at generation plants operated by the Company,
- unscheduled outages including outages at Palo Verde,
- electric utility deregulation or re-regulation,
- regulated and competitive markets,
- ongoing municipal, state and federal activities,
- economic and capital market conditions,
- changes in accounting requirements and other accounting matters,
- changing weather trends,
- rates, cost recoveries and other regulatory matters including the ability to recover fuel costs on a timely basis,
- changes in environmental regulations,
- political, legislative, judicial and regulatory developments,

- the impact of lawsuits filed against us,
- the impact of changes in interest rates,
- changes in, and the assumptions used for, pension and other post-retirement and post-employment benefit liability calculations, as well as actual and assumed investment returns on pension plan assets,
- the impact of changing cost escalation and other assumptions on our nuclear decommissioning liability for the Palo Verde Nuclear Generating Station,
- Texas, New Mexico and electric industry utility service reliability standards,
- homeland security considerations,
- coal, uranium, natural gas, oil and wholesale electricity prices and availability, and
- other circumstances affecting anticipated operations, sales and costs.

These lists are not all-inclusive because it is not possible to predict all factors. A discussion of some of these factors is included in this document under the headings "Risk Factors" and "Management's Discussion and Analysis" "–Summary of Critical Accounting Policies and Estimates" and "–Liquidity and Capital Resources." This report should be read in its entirety. No one section of this report deals with all aspects of the subject matter. Any forward-looking statement speaks only as of the date such statement was made, and we are not obligated to update any forward-looking statement to reflect events or circumstances after the date on which such statement was made except as required by applicable laws or regulations.

PART I

Item 1. Business

General

El Paso Electric Company is a public utility engaged in the generation, transmission and distribution of electricity in an area of approximately 10,000 square miles in west Texas and southern New Mexico. The Company also serves a wholesale customer in Texas and from time to time a customer in the Republic of Mexico. The Company owns or has significant ownership interests in six electrical generating facilities providing it with a net dependable generating capability of approximately 1,503 MW. For the year ended December 31, 2007, the Company's energy sources consisted of approximately 43% nuclear fuel, 28% natural gas, 7% coal, 22% purchased power and less than 1% generated by wind turbines.

The Company serves approximately 360,000 residential, commercial, industrial and wholesale customers. The Company distributes electricity to retail customers principally in El Paso, Texas and Las Cruces, New Mexico (representing approximately 55% and 9%, respectively, of the Company's operating revenues for the year ended December 31, 2007). In addition, the Company's wholesale sales include sales for resale to other electric utilities and power marketers. Principal industrial and other large customers of the Company include United States military installations, including Fort Bliss in Texas and White Sands Missile Range and Holloman Air Force Base in New Mexico, two large universities, and oil, copper refining and steel production facilities.

The Company's principal offices are located at the Stanton Tower, 100 North Stanton, El Paso, Texas 79901 (telephone 915-543-5711). The Company was incorporated in Texas in 1901. As of January 31, 2008, the Company had approximately 1,000 employees, 44% of whom are covered by a collective bargaining agreement.

The Company makes available free of charge through its website, www.epelectric.com, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission ("SEC"). In addition, copies of the annual report will be made available free of charge upon written request. The SEC also maintains an internet site that contains reports, proxy and information statements and other information for issuers that file electronically with the SEC. The address of that site is www.sec.gov. The information on the internet site is not incorporated into this document by reference.

Facilities

The Company's net dependable generating capability of 1,503 MW consists of the following:

Station	Primary Fuel Type	Net Dependable Generating Capability (MW)
Palo Verde Station	Nuclear Fuel	633
Newman Power Station	Natural Gas	474
Rio Grande Power Station	Natural Gas	229
Four Corners Station	Coal	104
Copper Power Station	Natural Gas	62
Hueco Mountain Wind Ranch	Wind	1
Total		1,503

Palo Verde Station

The Company owns a 15.8% interest in each of the three nuclear generating units and Common Facilities at Palo Verde, in Wintersburg, Arizona. The Palo Verde Participants include the Company and six other utilities: APS, Southern California Edison Company ("SCE"), PNM, Southern California Public Power Authority, Salt River Project Agricultural Improvement and Power District ("SRP") and the Los Angeles Department of Water and Power. APS serves as operating agent for Palo Verde, and under the ANPP Participation Agreement, the Company has limited ability to influence operations and costs at Palo Verde.

The NRC has granted facility operating licenses and full power operating licenses for Palo Verde Units 1, 2 and 3, which expire in 2024, 2025 and 2027, respectively. In addition, the Company is separately licensed by the NRC to own its proportionate share of Palo Verde.

Pursuant to the ANPP Participation Agreement, the Palo Verde Participants share costs and generating entitlements in the same proportion as their percentage interests in the generating units, and each participant is required to fund its share of fuel, other operations, maintenance and capital costs. The ANPP Participation Agreement provides that if a participant fails to meet its payment obligations, each non-defaulting participant shall pay its proportionate share of the payments owed by the defaulting participant.

NRC. The NRC regulates the operation of all commercial nuclear power reactors in the United States, including Palo Verde. The NRC periodically conducts inspections of nuclear facilities and monitors performance indicators to enable the agency to arrive at objective conclusions about a licensee's safety performance. Based on this assessment information and using a cornerstone evaluation system, the NRC determines the appropriate level of agency response and oversight, including supplemental inspections and pertinent regulatory actions as necessary.

In October 2006, the NRC conducted an inspection of the Palo Verde emergency diesel generators after a Palo Verde Unit 3 emergency diesel generator did not activate during routine inspections in July and September 2006. On February 22, 2007, the NRC issued a "white" finding (low to moderate safety significance) for this matter. Based upon this finding, coupled with a previous NRC "yellow" finding (substantial safety significance) relating to a 2004 matter involving Palo Verde's safety injection systems, the NRC placed Palo Verde Unit 3 in the "multiple/repetitive degraded cornerstone" column of the NRC's action matrix which has resulted in an enhanced NRC inspection regimen. This enhanced inspection regimen and resulting corrective actions has resulted in increased operating costs at the plant. Of the 104 commercial nuclear reactors in the United States regulated by the NRC, only Palo Verde Unit 3 was listed in the "multiple/repetitive degraded cornerstone" category as of the end of 2007. The Company is currently unable to predict the impact that the NRC's increased oversight may have on Palo Verde's operations and the cost of operations.

Decommissioning. Pursuant to the ANPP Participation Agreement and federal law, the Company must fund its share of the estimated costs to decommission Palo Verde Units 1, 2 and 3, including the Common Facilities, through the term of their respective operating licenses. The Company is required to maintain a minimum accumulation and a minimum funding level in its decommissioning account at the end of each annual reporting period during the life of the plant. The Company has established external trusts with an independent trustee which enable the Company to record a current deduction for federal income tax purposes of a portion of amounts funded. At December 31, 2007, the Company's decommissioning trust fund had a balance of $130.7 million and the Company was above its minimum funding level. The Company will continue to monitor the status of its decommissioning funds and adjust its deposits, if necessary, to remain at or above its minimum accumulation requirements in the future.

Decommissioning costs are estimated every three years based upon engineering cost studies performed by outside engineers retained by APS. In 2005, the Palo Verde Participants approved the 2004 Palo Verde decommissioning study ("2004 Study"). The 2004 Study estimated that the Company must fund approximately $335.7 million (stated in 2004 dollars) to cover its share of decommissioning costs. Although the 2004 Study was based on the latest available information, there can be no assurance that decommissioning cost estimates will not increase in the future or that regulatory requirements will not change. In addition, until a new low-level radioactive waste repository opens and operates for a number of years, estimates of the cost to dispose of low-level radioactive waste are subject to significant uncertainty. A study of decommissioning costs was performed in 2007 ("2007 Study"). Preliminary results of the 2007 Study indicate a reduction in decommissioning costs from the 2004 Study which, if adopted, will result in lower asset retirement obligations and lower expenses in the future. The 2007 Study is expected to be approved in the second quarter of 2008. See "Spent Fuel Storage" and "Disposal of Low-Level Radioactive Waste" below.

Spent Fuel Storage. The original spent fuel storage facilities at Palo Verde had sufficient capacity to store all fuel discharged from normal operation of all three Palo Verde units through 2003. Alternative on-site storage facilities and casks have been constructed to supplement the original facilities. In March 2003, APS began removing spent fuel from the original facilities as necessary, and placing it in special storage casks which will be stored at the new facilities until accepted by the DOE for permanent disposal. The 2004 Study assumed that costs to store fuel on-site will become the responsibility of the DOE after 2037. APS believes that spent fuel storage or disposal methods will be available to allow each Palo Verde unit to continue to operate through the term of its operating license.

Pursuant to the Nuclear Waste Policy Act of 1982, as amended in 1987 (the "Waste Act"), the DOE is legally obligated to accept and dispose of all spent nuclear fuel and other high-level radioactive waste generated by all domestic power reactors. In accordance with the Waste Act, the DOE entered into a spent nuclear fuel contract with the Company and all other Palo Verde Participants. The DOE has previously reported that its spent nuclear fuel disposal facilities would not be in operation in the near future. Subsequent judicial decisions required the DOE to start accepting spent nuclear fuel by

January 31, 1998. The DOE did not meet that deadline, and the Company cannot currently predict when spent fuel shipments to the DOE's permanent disposal site will commence.

The Company expects to incur significant costs for on-site spent fuel storage during the life of Palo Verde that the Company believes are the responsibility of the DOE. These costs are assigned to fuel requiring the additional on-site storage and amortized as that fuel is burned until an agreement is reached with the DOE for recovery of these costs. In December 2003, APS, in conjunction with other nuclear plant operators, filed suit against the DOE on behalf of the Palo Verde Participants to recover monetary damages associated with the delay in the DOE's acceptance of spent fuel. On February 28, 2007, APS served on the U.S. Department of Justice its "Initial Disclosure of Claimed Damages" of $93.4 million (the Company's portion being $14.8 million). This amount includes expenses associated with design, construction, loading, and operation of the Palo Verde independent spent fuel storage installation through December 2006. This amount represents costs incurred to ensure sufficient storage capacity for Palo Verde spent fuel that would not have been incurred had the DOE complied with its standard contract obligation to begin accepting spent fuel from the commercial nuclear power industry beginning in 1998. The Company is unable to predict the outcome of this matter at this time.

Disposal of Low-Level Radioactive Waste. Congress has established requirements for the disposal by each state of low-level radioactive waste generated within its borders. Arizona, California, North Dakota and South Dakota have entered into a compact (the "Southwestern Compact") for the disposal of low-level radioactive waste. California will act as the first host state of the Southwestern Compact, and Arizona will serve as the second host state. The construction and opening of the California low-level radioactive waste disposal site in Ward Valley has been delayed due to extensive public hearings, disputes over environmental issues and review of technical issues related to the proposed site. Palo Verde is projected to undergo decommissioning during the period in which Arizona will act as host for the Southwestern Compact. The opposition, delays, uncertainty and costs experienced in California demonstrate possible roadblocks that may be encountered when Arizona seeks to open its own waste repository. APS currently believes that interim low-level waste storage methods are or will be available to allow each Palo Verde unit to continue to operate and to store safely low-level waste until a permanent disposal facility is available.

Reactor Vessel Heads. In accordance with applicable NRC requirements, APS conducts regular inspections of reactor vessel heads at Palo Verde Units 1, 2 and 3. In an effort to reduce long-term operating costs at the station related to inspection of the reactor heads, related equipment, and possible repair costs, APS plans to replace reactor vessel heads at Palo Verde. Reactor vessel head replacement is scheduled to occur at Units 1, 2 and 3 in 2010, 2009 and 2009, respectively. The Company's share of the costs for this project is estimated to be $21.3 million.

Liability and Insurance Matters. The Palo Verde participants have insurance for public liability resulting from nuclear energy hazards to the full limit of liability under federal law currently at $10.8 billion. This potential liability is covered by primary liability insurance provided by commercial insurance carriers in the amount of $300 million and the balance by an industry-wide retrospective assessment program. If a loss at a nuclear power plant covered by the programs exceeds the accumulated funds in the primary level of protection, the Company could be assessed retrospective premium adjustments on a per incident basis. Under federal law, the maximum assessment per reactor under the program for each nuclear incident is approximately $100.6 million, subject to an annual limit of $15 million. Based upon the Company's 15.8% interest in the three Palo Verde units, the Company's maximum potential assessment per incident for all three units is approximately $47.7 million, with an annual payment limitation of approximately $7.1 million.

The Palo Verde Participants maintain "all risk" (including nuclear hazards) insurance for property damage to, and decontamination of, property at Palo Verde in the aggregate amount of $2.75 billion, a substantial portion of which must first be applied to stabilization and decontamination. The Company has also secured insurance against portions of any increased cost of generation or purchased power and business interruption resulting from a sudden and unforeseen outage of any of the three units. The insurance coverage discussed in this and the previous paragraph is subject to certain policy conditions and exclusions. A mutual insurance company whose members are utilities with nuclear facilities issues these policies. If losses at any nuclear facility covered by this mutual insurance company were to exceed the accumulated funds for these insurance programs, the Company could be assessed retrospective premium adjustments of up to $11.5 million for the current policy period.

Newman Power Station

The Company's Newman Power Station, located in El Paso, Texas, consists of three steam-electric generating units and one combined cycle generating unit with an aggregate net capability of approximately 474 MW. The units operate primarily on natural gas but can also operate on fuel oil.

Rio Grande Power Station

The Company's Rio Grande Power Station, located in Sunland Park, New Mexico, adjacent to El Paso, Texas, consists of three steam-electric generating units with an aggregate net capability of approximately 229 MW. The units operate primarily on natural gas but can also operate on fuel oil.

Four Corners Station

The Company owns a 7% interest, or approximately 104 MW, in Units 4 and 5 at Four Corners, located in northwestern New Mexico. Each of the two coal-fired generating units has a total net capability of 739 MW. The Company shares power entitlements and certain allocated costs of the two units with APS (the Four Corners operating agent) and the other participants, PNM, TEP, SCE and SRP.

Four Corners is located on land under easements from the federal government and a lease from the Navajo Nation that expires in 2016, with a one-time option to extend the term for an additional 25 years. Certain of the facilities associated with Four Corners, including transmission lines and almost all of the contracted coal sources, are also located on Navajo land. Units 4 and 5 are located adjacent to a surface-mined supply of coal.

Copper Power Station

The Company's Copper Power Station, located in El Paso, Texas, consists of a 62 MW combustion turbine used primarily to meet peak demands. The unit operates primarily on natural gas but can also operate on fuel oil.

Hueco Mountain Wind Ranch

The Company's Hueco Mountain Wind Ranch, located in Hudspeth County, east of El Paso County and adjacent to Horizon City, currently consists of two wind turbines with a total capacity of 1.32 MW of which a portion, currently 28%, can be used as net capability for resource planning purposes.

Transmission and Distribution Lines and Agreements

The Company owns or has significant ownership interests in four major 345 kV transmission lines in New Mexico, three 500 kV lines in Arizona, and owns the transmission and distribution network within its New Mexico and Texas retail service area and operates these facilities under franchise agreements with various municipalities. The Company is also a party to various transmission and power exchange agreements that, together with its owned transmission lines, enable the Company to deliver its energy entitlements from its remote generation sources at Palo Verde and Four Corners to its service area. Pursuant to standards established by the North American Electric Reliability Corporation (formerly the North American Electric Reliability Council) and the Western Electricity Coordinating Council, the Company operates its transmission system in a way that allows it to maintain system integrity in the event that any one of these transmission lines is out of service.

Springerville-Luna-Diablo Line. The Company owns a 310-mile, 345 kV transmission line from TEP's Springerville Generating Plant near Springerville, Arizona, to the Luna Substation near Deming, New Mexico, and to the Diablo Substation near Sunland Park, New Mexico. This transmission line provides an interconnection with TEP for delivery of the Company's generation entitlements from Palo Verde and, if necessary, Four Corners.

West Mesa-Arroyo Line. The Company owns a 202-mile, 345 kV transmission line from PNM's West Mesa Substation located near Albuquerque, New Mexico, to the Arroyo Substation located near Las Cruces, New Mexico. This is the primary delivery point for the Company's generation entitlement from Four Corners, which is transmitted to the West Mesa Substation over approximately 150 miles of transmission lines owned by PNM.

Greenlee-Hidalgo-Luna-Newman Line. The Company owns 40% of a 60-mile, 345 kV transmission line between TEP's Greenlee Substation near Duncan, Arizona to the Hidalgo Substation near Lordsburg, New Mexico, approximately 57% of a 50-mile, 345 kV transmission line between the Hidalgo Substation and the Luna Substation and 100% of an 86-mile, 345 kV transmission line between the Luna Substation and the Newman Power Station. These lines provide an interconnection with TEP for delivery of the Company's entitlements from Palo Verde and, if necessary, Four Corners. The Company owns the Afton 345 kV Substation located approximately 57 miles from the Luna Substation on the Luna-to-Newman portion of the line. The Afton Substation interconnects a generator owned and operated by PNM.

Eddy County-AMRAD Line. The Company owns 66.7% of a 125-mile, 345 kV transmission line from the Company's and PNM's (formerly TNP's) high voltage direct current terminal at the Eddy County Substation near Artesia, New Mexico to the AMRAD Substation near Oro Grande, New Mexico. The Company owns 66.7% of the terminal. This terminal enables the Company to connect its transmission system to that of SPS (a subsidiary of Xcel Energy), providing the Company with access to purchased and emergency power from SPS and power markets to the east.

Palo Verde Transmission and Switchyard. The Company owns 18.7% of two 45-mile, 500 kV lines from Palo Verde to the Westwing Substation located northwest of Phoenix near Peoria, Arizona and 18.7% of a 75-mile, 500 kV line from Palo Verde to the Jojoba Substation, then to the Kyrene Substation located near Tempe, Arizona. These lines provide the Company with a transmission path for delivery of power from Palo Verde. The Company also owns 18.7% of two 500 kV switchyards connected to the Palo Verde-Kyrene 500 kV line: the Hassayampa switchyard adjacent to the southern edge of the Palo Verde 500 kV switchyard and the Jojoba switchyard approximately 24 miles from

Palo Verde. These switchyards were built to accommodate the addition of new generation and transmission in the Palo Verde area.

Environmental Matters

The Company is subject to regulation with respect to air, soil and water quality, solid waste disposal and other environmental matters by federal, state, tribal and local authorities. Those authorities govern current facility operations and have continuing jurisdiction over facility modifications. Failure to comply with these environmental regulatory requirements can result in actions by regulatory agencies or other authorities that might seek to impose on the Company administrative, civil, and/or criminal penalties. In addition, unauthorized releases of pollutants or contaminants into the environment can result in costly cleanup obligations that are subject to enforcement by regulatory agencies.

These laws and regulations are subject to change and, as a result of those changes, the Company may face additional capital and operating costs to comply. For example, recent developments suggest a growing likelihood of future regulation relating to climate change and greenhouse gas emissions. At the federal level, Congress continues to hold many hearings relating to climate change issues and many bills have been introduced to impose regulation through regulatory schemes including a "cap and trade" program. The United States Supreme Court has found carbon dioxide, one of the principal greenhouse gases, to be a "pollutant" under the Clean Air Act, increasing the possibility that the U.S. Environmental Protection Agency will begin to regulate these emissions even in the absence of further action by Congress. In addition, the State of New Mexico, where the Company operates one facility and has an interest in another facility, has joined with California and several other states in the Western Regional Climate Action Initiative and is pursuing initiatives to reduce greenhouse gas emissions in the state. The Company is monitoring these developments and how regulation may affect it. If the United States or individual states in which the Company operates were to regulate greenhouse gas emissions, the Company's fossil fuel generation assets are likely to face additional costs for monitoring, reporting, controlling, or offsetting these emissions.

Another way in which environmental matters may impact the Company's operations and business is the implementation of the U.S. Environmental Protection Agency's Clean Air Interstate Rule which, as applied to the Company, may result in a requirement that it substantially reduce emissions of nitrogen oxides from its power plants in Texas and/or purchase allowances representing other parties' emissions reductions starting in 2009. These requirements become more stringent in 2015, and are anticipated to require even further emissions reductions or additional allowance purchases.

The Company takes these regulatory matters seriously and is monitoring these issues so that the Company is best able to effectively adapt to any such changes. Because the Company's generating portfolio has a carbon footprint that compares favorably with other power generating companies, the Company believes such regulations would not impose greater relative burdens on the Company than on most other electric utilities. Environmental regulations like these can change rapidly and those changes are often difficult to predict. While the Company strives to prepare for and implement actions necessary to comply with changing environmental regulations, substantial expenditures may be required for the Company to comply with such regulations in the future and, in some instances, those expenditures may be material. The Company believes it is impossible at present to meaningfully quantify the costs of these potential impacts.

The Company analyzes the costs of its obligations arising from environmental matters on an ongoing basis and believes it has made adequate provision in its financial statements to meet such obligations. As a result of this analysis, the Company has a provision for environmental remediation obligations of approximately $1.4 million as of December 31, 2007, which amounts are related to compliance with federal and state environmental standards. However, unforeseen expenses associated with environmental compliance or remediation may occur and could have a material adverse effect on the future operations and financial condition of the Company.

Along with many other companies, the Company received from the Texas Commission on Environmental Quality ("TCEQ") a request for information in 2003 in connection with environmental conditions at a facility in San Angelo, Texas that was operated by the San Angelo Electric Service Company ("SESCO"). In November 2005, TCEQ proposed the SESCO site for listing on the registry of Texas state superfund sites and mailed notice to more than five hundred entities, including the Company, indicating that TCEQ considers each of them to be "potentially responsible parties" at the SESCO site. The Company received from the SESCO working group of potentially responsible parties a settlement offer in May 2006 for remediation and other expenses expected to be incurred in connection with the SESCO site. The Company's position is that any liability it may have related to the SESCO site was discharged in the Company's bankruptcy. At this time, the Company has not agreed to a settlement or to otherwise participate in the cleanup of the SESCO site and is unable to predict the outcome of this matter. While the Company has no reason at present to believe that it will incur material liabilities in connection with the SESCO site, it has accrued $0.3 million for potential costs related to this matter.

On September 26, 2006, the Secretary of the New Mexico Environment Department issued a Compliance Order concerning the Company's Rio Grande Generating Station, located in Dona Ana County, New Mexico. The Compliance Order alleges that, on approximately 650 occasions between May 2000 and September 2005, the Rio Grande Generating Station emitted sulfur dioxide, nitrogen oxides or carbon monoxide in excess of its permitted emission rates and failed to properly report these allegedly excess emissions. The Compliance Order asserts a statutory authority to seek a civil penalty of up to $15,000 per violation for each of the violations alleged. The Company disputes the allegations made and has requested a hearing before the New Mexico Environment Department on the matter. While the Company cannot predict the outcome of this matter, it believes these emissions did not violate applicable legal standards and that penalties, if any, should not involve a material liability.

On April 4, 2007, the Company submitted its application for a New Source Review Air Quality Permit/Prevention of Significant Deterioration ("PSD") permit to the TCEQ for the new natural-gas electric generating units to be located at its existing Newman plant site in the City of El Paso ("Newman Unit 5"). The Company expects to receive approval of its PSD application in the second quarter of 2008. Additional environmental permits other than the PSD are not required to begin construction of these new generating units because Newman Unit 5 will be constructed at an existing plant site and other permits are currently in place which will encompass Newman Unit 5.

In May 2007, the Environmental Protection Agency finalized a new federal implementation plan which addresses emissions at the Four Corners Station in northwestern New Mexico of which the Company owns a 7% interest in Units 4 and 5. Arizona Public Service, the Four Corners operating agent, has filed suit against the Environmental Protection Agency relating to this new federal implementation plan in order to resolve issues involving operating flexibility for emission opacity standards. The Company cannot predict the outcome of the suit filed against the Environmental

Protection Agency or whether compliance with the new requirements could have an adverse effect on its capital and operating costs.

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

Construction Program

Utility construction expenditures reflected in the following table consist primarily of local generation, expanding and updating the transmission and distribution systems, including growth associated with the expansion of Ft. Bliss, and the cost of capital improvements and replacements at Palo Verde. Studies indicate that the Company will need additional power generation resources to meet increasing load requirements on its system, the costs of which are included in the table below.

The Company's estimated cash construction costs for 2008 through 2011 are approximately $842 million. Actual costs may vary from the construction program estimates shown. Such estimates are reviewed and updated periodically to reflect changed conditions.

By Year (1)(2) (In millions)		By Function (In millions)	
2008	$ 210	Production (1)(2)	$ 430
2009	219	Transmission	94
2010	213	Distribution	213
2011	200	General	105
Total	$ 842	Total	$ 842

(1) Does not include acquisition costs for nuclear fuel. See "Energy Sources – Nuclear Fuel."

(2) Includes $193 million for new gas-fired generating capacity and $60 million for other local generation, $18 million for the Four Corners Station and $159 million for the Palo Verde Station.

Energy Sources

General

The following table summarizes the percentage contribution of nuclear fuel, natural gas, coal and purchased power to the total kWh energy mix of the Company. Energy generated by wind turbines accounted for less than 1% of the total kWh energy mix.

Power Source	Years Ended December 31, 2007	2006	2005
Nuclear fuel	43%	42%	46%
Natural gas	28	25	30
Coal	7	9	9
Purchased power	22	24	15
Total	100%	100%	100%

Allocated fuel and purchased power costs are generally recoverable from customers in Texas and New Mexico pursuant to applicable regulations. Historical fuel costs and revenues are reconciled periodically in proceedings before the Texas Commission and the NMPRC. See "Regulation – Texas Regulatory Matters" and "– New Mexico Regulatory Matters."

Nuclear Fuel

The nuclear fuel cycle for Palo Verde consists of the following stages: the mining and milling of uranium ore to produce uranium concentrates; the conversion of the uranium concentrates to uranium hexafluoride ("conversion services"); the enrichment of uranium hexafluoride ("enrichment services"); the fabrication of fuel assemblies ("fabrication services"); the utilization of the fuel assemblies in the reactors; and the storage and disposal of the spent fuel. The Palo Verde Participants have contracts in place that will furnish 100% of Palo Verde's operational requirements for uranium concentrates, conversion services and enrichment services through 2008. Such contracts could also provide 100% of enrichment services in 2009 and 2010. The Palo Verde Participants have a contract that will provide 100% of fabrication services until at least 2015 for each Palo Verde unit.

Nuclear Fuel Financing. Pursuant to the ANPP Participation Agreement, the Company owns an undivided interest in nuclear fuel purchased in connection with Palo Verde. The nuclear fuel material market has recently been affected by supply disruptions and significant price increases with the cost of uranium having increased significantly in the last few years. The Palo Verde Participants have taken steps to mitigate the effects of future supply disruptions and price increases by changing from a procurement strategy under which nuclear fuel arrives at Palo Verde one month prior to being loaded into a reactor to a strategy where (i) nuclear fuel arrives on site three months before being loaded and (ii) a strategic inventory of converted nuclear fuel material sufficient to provide feed stock for one full reactor reload is stored for future use. This change in procurement strategy increased our cash funding requirements in 2007. In July 2007, the Company expanded its revolving credit facility from $150 million to $200 million which provides for both working capital and up to $120 million for the financing of nuclear fuel. This facility has a five-year term ending April 11, 2011. At December 31, 2007, approximately $83.0 million had been drawn to finance nuclear fuel. This financing is accomplished through a trust that borrows under the credit facility to acquire and process the nuclear fuel. The Company is obligated to repay the trust's borrowings with interest. In the Company's financial statements, the assets and liabilities of the trust are consolidated and reported as assets and liabilities of the Company.

Natural Gas

The Company manages its natural gas requirements through a combination of a long-term supply contract and spot market purchases. The long-term supply contract provides for firm deliveries of gas at market-based index prices. In '2007, the Company's natural gas requirements at the Newman and Rio Grande Power Stations were met with both short-term and long-term natural gas purchases from various suppliers and this practice is expected to continue in 2008. Interstate gas is delivered under a base firm transportation contract. The Company anticipates it will continue to purchase natural gas at spot market prices on a monthly basis for a portion of the fuel needs for the Newman and Rio Grande Power Station. The Company will continue to evaluate the availability of short-term natural gas supplies versus long-term supplies to maintain a reliable and economical supply for the Newman and Rio Grande Power Stations.

Natural gas for the Newman and Copper Power Stations is also supplied pursuant to an intrastate natural gas contract that expired in 2007, but was extended on a short-term basis until a new contract can be negotiated. The Company is currently in the process of renegotiating this contract.

Coal

APS, as operating agent for Four Corners, purchases Four Corners' coal requirements from a supplier with a long-term lease of coal reserves owned by the Navajo Nation. The Four Corners coal contract expires in 2016 which coincides with the term of the Four Corners Plant lease with the Navajo Nation. Based upon information from APS, the Company believes that Four Corners has sufficient reserves of coal to meet the plant's operational requirements for its useful life.

Purchased Power

To supplement its own generation and operating reserves, the Company engages in firm and non-firm power purchase arrangements which may vary in duration and amount based on evaluation of the Company's resource needs and the economics of the transactions. In 2004, the Company entered into a 20-year contract, beginning in 2006, for the purchase of up to 133 MW of capacity and associated energy from SPS. This contract includes a demand charge, fuel charge, variable operations and maintenance charge, and a transmission charge. The contract provides that, in the event the transactions thereunder are subject to adverse regulatory action, the affected party may initiate discussions with the other party to assess whether modifications to the agreement may be appropriate. If the parties are unable to reach a mutually satisfactory resolution within six months, either party may terminate the contract by providing not less than two years' prior written notice to the other party.

The Company previously received notice from SPS that SPS had been subject to adverse regulatory action by the Texas Commission regarding transactions under the contract and that SPS wished to exercise its right to terminate the contract early. As a result, on January 29, 2008, the Company and SPS entered into an amendment to the contract and agreed that the contract will terminate on September 30, 2009.

In June 2006, the Company began exchanging up to 100 MW of capacity and associated energy with Phelps Dodge Energy. The contract provides for Phelps Dodge to deliver energy to the Company from its ownership interest in the Luna Energy Facility, an approximate 570 MW natural gas fired combined cycle generation facility located in Luna County, New Mexico and for the Company to deliver a like amount of energy at the Greenlee delivery point. The Company may purchase up to 100 MW at a specified price at times when energy is not exchanged. The agreement was approved by the FERC and continues through December 31, 2021.

Other purchases of shorter duration were made during 2007 primarily to replace the Company's generation resources during planned and unplanned outages and for economic reasons.

Operating Statistics

	Years Ended December 31,		
	2007	2006	2005
Operating revenues (in thousands):			
Non-fuel base revenues:			
Retail:			
Residential	$ 184,562	$ 175,641	$ 173,007
Commercial and industrial, small	168,091	161,359	158,406
Commercial and industrial, large	39,092	40,502	39,192
Sales to public authorities	72,763	68,438	65,861
Total retail base revenues	464,508	445,940	436,466
Wholesale:			
Sales for resale	1,919	1,794	1,687
Total non-fuel base revenues	466,427	447,734	438,153
Fuel revenues:			
Recovered from customers during the period	197,383	225,441	164,500
Under (over) collection of fuel	17,828	(3,655)	79,539
New Mexico fuel in base rates	51,487	30,033	29,440
Total fuel revenues	266,698	251,819	273,479
Off-system sales	125,974	95,932	78,209
Other	18,328	20,970	14,072
Total operating revenues	$ 877,427	$ 816,455	$ 803,913
Number of customers (end of year):			
Residential	317,091	311,923	304,031
Commercial and industrial, small	35,147	32,950	31,969
Commercial and industrial, large	53	58	61
Other	4,853	4,800	4,792
Total	357,144	349,731	340,853
Average annual kWh use per residential customer	7,085	6,852	6,936
Energy supplied, net, kWh (in thousands):			
Generated	7,707,095	6,908,006	7,500,144
Purchased and interchanged	2,188,904	2,208,661	1,255,626
Total	9,895,999	9,116,667	8,755,770
Energy sales, kWh (in thousands):			
Retail:			
Residential	2,232,668	2,113,733	2,090,098
Commercial and industrial, small	2,216,428	2,159,599	2,126,918
Commercial and industrial, large	1,195,038	1,204,707	1,165,506
Sales to public authorities	1,384,380	1,343,129	1,270,116
Total retail	7,028,514	6,821,168	6,652,638
Wholesale:			
Sales for resale	48,290	45,397	41,883
Off-system sales	2,201,294	1,635,407	1,420,778
Total wholesale	2,249,584	1,680,804	1,462,661
Total energy sales	9,278,098	8,501,972	8,115,299
Losses and Company use	617,901	614,695	640,471
Total	9,895,999	9,116,667	8,755,770
Native system:			
Peak load, kW	1,508,000	1,428,000	1,376,000
Net dependable generating capability for peak, kW (1)	1,492,000	1,492,000	1,479,000
Total system:			
Peak load, kW (2)	1,680,000	1,675,000	1,628,000
Net dependable generating capability for peak, kW (1) (3)	1,492,000	1,492,000	1,479,000
System capacity factor (4)	65.2%	59.7%	58.6%

(1) Excludes 11,000 kW increase in generating capability at Palo Verde related to the steam generator replacements for Unit 3 that was completed January 2008.
(2) Includes spot firm sales and net losses of 172,000 kW, 247,000 kW and 252,000 kW for 2007, 2006 and 2005, respectively.
(3) Excludes 133,000 kW for 2007 and 2006 and 103,000 kW for 2005 of firm on and off-peak purchases.
(4) System capacity factor includes average firm system purchases of 133,000 kW for 2007 and 2006 and 103,000 kW for 2005.

Regulation

General

The rates and services of the Company are regulated by incorporated municipalities in Texas, the Texas Commission, the NMPRC, and the FERC. The Texas Commission 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 transactions. The decisions of the Texas Commission, NMPRC and the FERC are subject to judicial review.

Texas Regulatory Matters

Texas Rate Agreements. The Company has entered into agreements ("Texas Rate Agreements") with El Paso, Commission Staff and other parties in Texas that provide for most retail base rates to remain at their current level through June 30, 2010. During the rate freeze period, if the Company's return on equity falls below the bottom of a defined range, the Company has the right to initiate a rate case and seek an adjustment to base rates. If the Company's return on equity exceeds the top of the range, the Company will refund an amount equal to 50% of the pretax return in excess of the ceiling. The range is based upon a risk premium above a twelve month average of comparable credit quality bond yields and at a twelve month average of such bond yields the range would be approximately 8.3% to 12.3%. During 2007 the Company's return on equity fell within this range.

Pursuant to a rate agreement with El Paso in July 2005, the Company agreed to share with its Texas customers 25% of off-system sales margins and wheeling revenues among other provisions. Under the prior rate agreement, the Company shared 50% of off-system sales margins and wheeling revenues with Texas customers. A request for approval of the off-system sales and wheeling revenue sharing provision was filed with the Texas Commission in January 2006 ("PUC Docket No. 32289").

In PUC Docket No. 32289, the Company entered into settlement agreements with the Texas Commission Staff, a large industrial customer, El Paso, Texas Ratepayers Organization to Save Energy, and the Office of the Attorney General of the State of Texas (the "State") which (i) extended the rate freeze to all customers in Texas; (ii) extended the earnings sharing provisions to all customers in Texas; (iii) expanded the Company's support of low-income energy efficiency programs; and (iv) provided that after the expiration of the Texas Rate Agreements, the Company will treat wheeling revenues and expenses associated with non-native load in a manner consistent with then-existing Texas Commission rules and other substantive and procedural law. In addition, the agreement with the State provides for the Company to share 90% of off-system sales margins with customers after June 30, 2010 through June 30, 2015. This provision is not binding on the Texas Commission or other settling parties. In addition, the Company agreed that upon the expiration of the rate freeze, it would file a full base rate case with the Texas Commission and the applicable cities having original jurisdiction if requested to do so by the Texas Commission staff, El Paso, the State or the Texas Office of Public Utility Counsel. The Company also retained the right to voluntarily file a full base rate case. The Company currently anticipates that it will need base rate relief in that time frame. On December 8, 2006, the Texas Commission approved the margin sharing provisions of the Texas Rate Agreements in PUC Docket No. 32289 pursuant to the settlement agreements.

Fuel and Purchased Power Costs. Although the Company's base rates are frozen under the Texas Rate Agreements, pursuant to Texas Commission rules and the Texas Rate Agreements, the Company's fuel costs including purchased power energy costs are recoverable from its customers. In January and July of each year, the Company can request adjustments to its fixed fuel factor to more accurately reflect projected energy costs associated with providing electricity, seek recovery of past undercollections of fuel revenues, and refund past overcollections of fuel revenues. All such fuel revenue and expense activities are subject to periodic final review by the Texas Commission in fuel reconciliation proceedings.

On August 31, 2007, the Company filed for authority to reconcile its eligible fuel expenses and revenues for the period of March 1, 2004 through February 28, 2007 ("Reconciliation Period"), which was assigned PUC Docket No. 34695. The Company is seeking to reconcile a total of $548.4 million in eligible fuel, fuel-related, and purchased power expenses to generate and purchase electric energy for its Texas retail customers. At the conclusion of the Reconciliation Period, the Company had a cumulative under-recovery of such expenses of $18.2 million of which $17.6 million was subject to an existing fuel surcharge. The Company is seeking to carry over the cumulative Reconciliation Period fuel under-recovery balance into the subsequent reconciliation period beginning March 2007. Hearings on the fuel reconciliation are scheduled in May 2008. A final order is not expected to be issued until the third quarter of 2008.

On January 8, 2008, the Company filed a request with the Texas Commission to surcharge approximately $30.1 million of under-recovered fuel and purchased power costs and interest over a twelve month period beginning in March 2008. The fuel under-recoveries were incurred during the period December 2005 through November 2007. A decision from the Texas Commission is expected in the first quarter of 2008.

On January 5, 2006, the Company filed a petition ("PUC Docket No. 32240") with the Texas Commission to increase its fixed fuel factors and to surcharge under-recovered fuel costs. The Company requested an increase in its Texas jurisdiction fixed fuel factors of $30.8 million or 16% annually to reflect an average cost of natural gas of $9.35 per MMBtu. The Company also requested a fuel surcharge to recover over a twelve-month period approximately $34 million of fuel undercollections, including interest, for under-recoveries for the period September 2005 through November 2005. The requested fuel factor and fuel surcharge were placed into effect on an interim basis subject to refund effective with February 2006 bills to customers. This proceeding was abated pending the Texas Commission's decision in the margin sharing proceeding, PUC Docket No. 32289, which was approved December 8, 2006. The Company filed a unanimous settlement with the Texas Commission to resolve all issues in this docket on January 24, 2007. The settlement provided for approval of the fuel surcharge and fuel factor for the period February 2006 through January 2007, the end of the surcharge period. In addition, the Company agreed to reduce its fixed fuel factors by 10% effective February 1, 2007 reducing annual fuel recoveries by approximately $20.0 million per year. The revised fixed fuel factors reflect natural gas prices of approximately $7.80 per MMBtu. A final order approving the settlement in PUC Docket No. 32240 was issued by the Texas Commission on March 15, 2007.

Generation CCN Filing. On July 6, 2007, the Company filed a petition with the Texas Commission requesting a Certificate of Convenience and Necessity ("CCN") for two generating facilities in PUC Docket No. 34494. The first such facility is a natural-gas fueled power generating unit to be located at an existing plant site in El Paso. This facility is known as Newman Unit 5. The Newman Unit 5 project consists of 280 to 290 MW of natural gas-fired combined cycle generating capacity that the Company presently plans to construct in two phases. The first phase includes two 70 MW gas turbines to be installed by the peak of 2009. The second phase converts the unit into a combined cycle combustion turbine with a total capacity of 280 to 290 MW and is expected to be completed by late 2010 or early 2011.

The Newman Unit 5 will operate mostly in a baseload manner, but can also be used in a load following manner. It will be the most efficient gas-fired unit on the Company's system when operated in combined cycle. The total estimated cost of the project including allowance for funds used during construction is $245 million.

The Company also requested a CCN for two renewable energy wind turbines currently operating at the Hueco Mountains Wind Ranch, the acquisition of which the Texas Commission had previously found to be consistent with the public interest.

On December 17, 2007, the parties to PUC Docket No. 34494 filed a Stipulation, signed by all parties, which recommended approval of the Company's requests. On January 31, 2008, the Texas Commission issued an order approving the requested CCNs. The costs of the project have not been approved.

Palo Verde Performance Standards. The Texas Commission established performance standards for the operation of Palo Verde pursuant to which each Palo Verde unit is evaluated annually to determine whether its three-year rolling average capacity factor entitles the Company to a reward or subjects it to a penalty. The capacity factor is calculated as the ratio of actual generation to maximum possible generation. If the capacity factor, as measured on a station-wide basis for any consecutive 36-month period, should fall below 52.5%, the parties to the Texas Rate Agreements can seek different rate treatment for Palo Verde. The removal of Palo Verde from rate base could have a significant negative impact on the Company's revenues and financial condition. The Company has calculated the performance rewards for the reporting periods ending in 2007 and 2006 to be approximately $0.6 million and $0.4 million, respectively. The 2006 reward was included along with energy costs incurred and fuel revenue billed as part of the Texas Commission's review during the 2007 fuel reconciliation proceeding as discussed above. Under the performance standards the Company did not earn a performance reward nor incur a penalty for the 2005 reporting period. Performance rewards are not recorded on the Company's books until the Texas Commission has ordered a final determination in a fuel proceeding or comparable evidence of collectibility is obtained. Performance penalties would be recorded when assessed as probable by the Company.

In a prior fuel reconciliation proceeding ("PUC Docket No. 20450"), the Company agreed to contribute any Palo Verde rewards in its next fuel reconciliation to assist low-income customers in paying their utility bills. In compliance with the Texas Commission's order, the Company sought and received approval by the El Paso City Council in January 2006 to remit to El Paso approximately $5.8 million in Palo Verde performance reward funds to fund demand side management programs such as weatherization with a focus on programs to assist small business and commercial customers. As of December 31, 2007 $5.6 million, including accrued interest, remains to be paid under these agreements and is recorded as a liability on the Company's balance sheet.

Deregulation. The Texas Restructuring Law required certain investor-owned electric utilities to separate power generation activities and retail service activities from transmission and distribution activities by January 1, 2002, and on that date, retail competition for generation services was instituted in some parts of Texas. However, the Texas Commission has delayed retail competition in the Company's Texas service territory by approving a rule which identifies various milestones for the Company to reach before competition can begin. The first milestone calls for the development, approval by the FERC, and commencement of independent operation of a regional transmission organization (RTO) in the area that includes the Company's service territory, including the development of retail market protocols to facilitate retail competition (see "FERC Regulatory Matters – RTO" below). The complete transition to retail competition would occur upon the completion of the last milestone, which would be the Texas Commission's final evaluation of the market's readiness to offer fair competition and reliable service to all retail customers. The Company believes this rule delays retail competition in El Paso indefinitely. There is substantial uncertainty about both the regulatory framework and market conditions that will exist if and when retail competition is implemented in the Company's service territory, and the Company may incur substantial preparatory, restructuring and other costs that may not ultimately be recoverable. There can be no assurance that deregulation would not adversely affect the future operations, cash flows and financial condition of the Company.

Renewable Energy Requirements. Notwithstanding the Texas Commission's approval of a rule further delaying competition in the Company's Texas service territory, the Company became subject to the renewable energy and energy efficiency requirements of the Texas Restructuring Law on January 1, 2006. Under the renewable energy requirements, the Company is required to annually obtain its pro rata share of renewable energy credits as determined by the Program Administrator (the Electric Reliability Council of Texas). The Company's ultimate obligation to obtain renewable energy credits will not be known until January 31 of the year following the compliance year, and it will have until March 31 to obtain, if necessary, and submit to the Program Administrator, sufficient credits. The Company obtained the required renewable energy credits to meet its expected obligations through 2007.

2007 Energy Efficiency Legislation. New energy efficiency legislation was approved in Texas in June 2007. The new legislation establishes new and increased goals for additional cost-effective energy efficiency for residential and commercial customers equivalent to at least (i) 10% of the annual growth in peak demand for residential and commercial customers by December 31, 2007; (ii) 15% of the annual growth in demand by December 31, 2008; and (iii) 20% of the annual growth in demand by December 31, 2009. Among other things, the new legislation requires the Texas Commission to establish an energy efficiency cost recovery factor for ensuring cost recovery for utility expenditures made to satisfy the energy efficiency goal. The legislation provides that utilities that are unable to establish an energy efficiency cost recovery factor in a timely manner due to a rate freeze will be allowed to defer the costs of complying with the energy efficiency goal and recover such deferred costs at the end of the rate freeze period.

New Mexico Regulatory Matters

2007 New Mexico Stipulation. On July 3, 2007, the NMPRC issued a final order approving a stipulation ("2007 New Mexico Stipulation") addressing all issues in the 2006 rate filing in Case No. 06-00258-UT. On July 26, 2007, the NMPRC modified its final order to clarify that its approval of the Stipulation did not preclude the NMPRC from examining the Company's rates upon its own motion at any time prior to the date stipulated for the Company's next rate filing. The 2007 New Mexico Stipulation provides for a $5.8 million non-fuel base rate increase and a $0.3 million fuel and purchased power decrease relative to test year rates. The 2007 New Mexico Stipulation reflects average natural gas costs of $7.20 per MMBtu for the June 2007 through May 2008 forecast period. Most of the Company's fuel and purchased power costs during the period of the 2007 New Mexico Stipulation are expected to be recovered through base rates. Any difference between actual fuel and purchased power costs and the amount included in base rates will be recovered or refunded through the Fuel and Purchased Power Cost Adjustment Clause ("FPPCAC"). Rates will continue in effect until changed by the NMPRC after the Company's next rate case. The 2007 New Mexico Stipulation requires the Company to file its next general rate case no later than May 30, 2009 using a base period of the twelve months ending December 31, 2008. Under NMPRC statutes, new rates would become effective no later than June 2010.

The 2007 New Mexico Stipulation provides for energy from the deregulated Palo Verde Unit 3 to be recovered through fuel and purchased power costs based upon the contract cost of capacity and fuel for power purchased under the existing SPS purchased power contract. The 2007 New Mexico Stipulation eliminates the fixed fuel and purchased power cost of $0.021 per kWh for 10% of New Mexico kWh sales and requires 25% of jurisdictional off-system sales margins to be credited to customers through the FPPCAC. Consistent with the Texas settlement in PUC Docket No. 32289, beginning in July 2010 through June 2015, the Company will credit 90% of the New Mexico jurisdictional portion of off-system sales margins to New Mexico customers through the FPPCAC. No later than two years after implementation, the 2007 New Mexico Stipulation requires the Company to file to continue its FPPCAC according to NMPRC rules, at which time any party may propose to change the price of capacity and related energy from Palo Verde Unit 3 since the SPS purchased power contract will terminate in September 2009. The 2007 New Mexico Stipulation results in final reconciliation of fuel and purchased power costs for the period May 31, 2004 through December 31, 2005. The Company will continue to file annual reconciliation statements for fuel and purchased power costs in accordance with NMPRC rules. The Company filed a reconciliation statement for the period June 1, 2006 through May 31, 2007 on August 31, 2007.

Fuel and Purchased Power Costs. The Company currently recovers fuel and purchased power costs in base rates in an average amount of $0.04288 per kWh and recovers the remaining fuel and purchased power costs through its FPPCAC. See discussion of 2007 New Mexico Stipulation above.

Notice of Investigation of Rates. On August 3, 2007, the Company received by mail a "Notice of Investigation of Rates of El Paso Electric Company" from the NMPRC in Case No. 07-00317-UT (the "Notice"). On August 21, 2007, the NMPRC requested the Company to file a response to the issues, including the reasonableness of fuel and purchased power costs. On September 7, 2007, the Company filed its response and requested that the NMPRC suspend its investigation and close the docket. No further action has been taken by the Commission. The Company is unable at this time to predict any potential negative financial impact from this docket.

Renewables. The New Mexico Renewable Energy Act of 2004 as amended by the 2007 New Mexico legislature requires that, by January 1, 2006, renewable energy comprise no less than 5% of the Company's total retail sales to New Mexico customers. This requirement has been fixed at 6% until January 1, 2011, when the renewable portfolio standard increases to 10% of the Company's total retail sales to New Mexico customers. After 2011, the renewable portfolio standard, as a percentage of total retail sales to New Mexico customers, increases to 15% by 2015 and 20% by 2020. The Company has met all requirements to date.

The NMPRC approved the Company's 2006 annual procurement plan ("Procurement Plan") in December 2006, including the purchase of renewable energy certificates ("RECs") and the issuance of a diversity RFP for renewable resources to meet future requirements. In addition, the NMPRC authorized the Company to enter into two 20-year purchased power agreements to purchase energy from an 8 MW low-emissions biomass generating facility and from a 6 kW solar energy generating facility. Both generating facilities would have been located within the Company's New Mexico service area. The biomass renewable supplier defaulted on its contract obligations. In the Order approving the 2006 Plan, the NMPRC approved recovery of REC costs, without associated energy, through the FPPCAC. The NMPRC's decision to allow recovery of REC costs, without associated energy, through the FPPCAC was appealed to the New Mexico Supreme Court (the "Court") by the New Mexico Industrial Energy Consumers. The Court issued a decision on August 28, 2007, ordering that RECs without associated energy could not be recovered through the FPPCAC, but the costs would be recovered through the ratemaking process. The Company filed a request to create a deferral as provided under New Mexico law, with carrying costs, to recover these costs and refunded to customers the previously-collected REC costs recovered through the FPPCAC. NMPRC action to approve the deferral, with carrying costs, is pending.

The Company filed its 2007 annual Procurement Plan on August 31, 2007. The Company has proposed procurement of Texas RECs to complete its 2008 and 2009 renewable obligations. The Company also requested funding to conduct a proposal process in 2008 to attempt to procure diverse renewable energy resources to meet NMPRC requirements. The Company is seeking a deferral of the costs associated with renewable compliance, including carrying costs. Hearings were held on November 29, 2007. The Hearing Examiner issued the Recommended Decision on December 5, 2007 recommending that the Company's request to replace the biomass project with Texas RECs be rejected and that the Company include a plan to replace these RECs with New Mexico RECs in its next procurement plan filing. The Company filed exceptions to the Recommended Decision on December 14, 2007. A NMPRC order adopting the Recommended Decision was issued on February 27, 2008.

New Mexico Energy Efficiency Plan Filing. On November 5, 2007, the Company filed its Application for Approval of Energy Efficiency and Load Management Programs. This case has been designated as NMPRC Case No. 07-00411-UT. In this filing, the Company requests approval of a number of energy efficiency programs. The Company also proposed a methodology to address disincentives and barriers to utility-provided energy efficiency and proposed to recover the costs of energy efficiency programs through a cost recovery factor. The hearing is scheduled to begin March 19, 2008. The final order is expected in June 2008.

New Mexico Energy Efficiency Legislation. On February 12, 2008, the New Mexico legislature passed House Bill 305, the Utility Customer Load Management bill. This bill modifies the 2005 Efficient Use of Energy Act and requires that electric utilities provide cost-effective energy efficiency programs that will produce savings of 5% of 2005 total retail kWh sales to New Mexico customers in calendar year 2014 and 10% of 2005 retail kWh sales to New Mexico customers in 2020. This legislation is expected to be signed by the governor.

2007 Long-Term Incentive Plan. On May 18, 2007, the Company filed for NMPRC approval for issuance of common stock for purposes of incentives and compensation. After the filing of supplemental testimony, the Hearing Examiner issued a Recommended Decision in July 2007 recommending that the securities transactions related to issuance of new stock be approved. The NMPRC requested additional supplemental testimony on the reasonableness of executive compensation and the effect on capital structure and rates to be set in the next general rate case. The Company filed supplemental testimony addressing these issues on October 31, 2007. Hearings on this matter were held on November 9, 2007. The Company is awaiting a final decision by the NMPRC.

New Mexico Investigation into Executive Compensation. In December 2007, the NMPRC initiated an investigation into executive compensation of investor-owned gas and electric public utilities. In its order initiating the investigation, the NMPRC required each utility to provide information on compensation of executive officers and directors for the period 1977-2006. The Company has provided the requested information. No further action has been taken by the NMPRC.

Generation CCN Filing. On July 18, 2007, the Company filed its application for issuance of a CCN to construct and operate Newman Unit 5. This case has been designated as NMPRC Case No. 07-00301-UT. The hearing was held on January 24, 2008. The Hearing Examiner issued a Recommended Decision on January 29, 2008 recommending Commission approval of the CCN. Pursuant to a request by the NMPRC, the Commission Staff and the Company provided additional information on February 26, 2008. A final order is expected in April 2008.

Federal Regulatory Matters

Transmission Dispute with Tucson Electric Power Company ("TEP"). In January 2006, the Company filed a complaint with the FERC to interpret the terms of a Power Exchange and Transmission Agreement (the "Transmission Agreement") entered into with TEP in 1982. TEP filed a complaint with the FERC one day later raising virtually identical issues. TEP claimed that, under the Transmission Agreement, it was entitled to up to 400 MW of firm transmission rights on the Company's transmission system that would enable it to transmit power from a new generating station (the Luna Energy Facility ("LEF") located near Deming, New Mexico) to Springerville or Greenlee in Arizona. The Company asserted that TEP's rights under the Transmission Agreement do not include transmission rights necessary to transmit such power as contemplated by TEP and that TEP must acquire any such rights in the open market from the Company at applicable tariff rates or from other transmission providers. On April 24, 2006, the FERC ruled in the Company's favor, finding that TEP does not have the transmission rights under the Transmission Agreement to transmit power from the LEF to Arizona. The ruling was based on written evidence presented and without an evidentiary hearing. TEP's request for a rehearing of the FERC's decision was granted in part and denied in part in an order issued October 4, 2006. The

October 4 order granted a hearing to examine the disputed evidence, and a hearing before an administrative law judge on the dispute was held on May 22 through May 24, 2007 and June 20, 2007.

The initial decision of the administrative law judge was issued September 6, 2007. The Presiding Judge generally found that the Transmission Agreement allows TEP to transmit power from the Deming Plant to Arizona but limits that transmission to 200 MW on any segment of the circuit and to non-firm service on the segment from Luna to Greenlee. The Company and TEP filed briefs on exceptions and replies to briefs on exceptions to the Initial Decision. In its brief on exceptions, TEP argued that it is entitled to a refund of the revenues the Company has received from TEP for transmission service to the Deming Plant during the pendency of these proceedings. In its response, the Company vigorously contested TEP's request for refunds. The Commission will issue a decision on the merits after review of the Initial Decision and the briefs on exceptions and replies to exceptions. While the Company believes that it will prevail on all points, the Company cannot predict the outcome of this case. During 2006 and 2007, TEP paid the Company $6.6 million for transmission service relating to the LEF. The Company has established a reserve for rate refund for $3.5 million related to this issue. If the FERC were to rule in TEP's favor, the Company may be required to refund all of the $6.6 million it has received from TEP for transmission service relating to the LEF and may lose the opportunity to receive compensation from TEP for such transmission service in the future. An adverse ruling by the FERC could have a negative effect on the Company's results of operations.

RTOs. FERC's rule on RTOs ("Order 2000") strongly encourages, but does not require, public utilities to form and join RTOs. The Company is an active participant in the development of WestConnect. The Company has entered into a Memorandum of Understanding ("MOU") with ten other transmission owners that obligates the parties to participate in and commit resources to ongoing joint efforts, including involvement with stakeholders, customers, local, state and federal regulatory personnel, and other Western Grid transmission providers to identify, develop and implement cost-effective wholesale market enhancements on a voluntary, phased-in basis to add value in transmission accessibility, wholesale market efficiency and reliability for wholesale users of the Western Grid. These enhancements may ultimately include formation of an RTO. WestConnect will continue to work with the FERC and two other proposed RTOs in the west to achieve a seamless market structure. The Company comprises approximately 7% of WestConnect and cannot control the terms or timing of its development. WestConnect as an RTO will not be operational for several years.

Department of Energy. The DOE regulates the Company's exports of power to the CFE in Mexico pursuant to a license granted by the DOE and a presidential permit. The DOE has determined that all such exports over international transmission lines shall be made in accordance with Order No. 888, which established the FERC rules for open access.

The DOE is authorized to assess operators of nuclear generating facilities a share of the costs of decommissioning the DOE's uranium enrichment facilities and for the ultimate costs of disposal of spent nuclear fuel. See "Facilities – Palo Verde Station – Spent Fuel Storage" for discussion of spent fuel storage and disposal costs.

Nuclear Regulatory Commission. The NRC has jurisdiction over the Company's licenses for Palo Verde and regulates the operation of nuclear generating stations to protect the health and safety of the public from radiation hazards. The NRC also has the authority to grant license extensions pursuant to the Atomic Energy Act of 1954, as amended.

Sales for Resale

The Company entered into a contract to sell up to 100 MW firm energy and 50 MW of contingent energy to Imperial Irrigation District ("IID") which began May 1, 2007 and continues through April 30, 2009. The contract also provides for the Company to sell up to 100 MW firm energy and 40 MW of contingent energy beginning May 1, 2009 through April 30, 2010. To ensure that power is available to meet the IID contract demand, the Company entered into a contract effective May 1, 2007 to purchase up to 100 MW of firm energy from CreditSuisse Energy, LLC. This contract provides for firm energy to be delivered at Palo Verde through April 30, 2010 and/or 50 MW of energy delivered at Four Corners in the months of July through September 2007 and May through September for the years 2008 through 2010.

The Company provides up to 10 MW of firm capacity, associated energy, and transmission service to the Rio Grande Electric Cooperative pursuant to an ongoing contract which requires a two-year notice to terminate. In 2006 the Company provided RGEC with a notice of termination. Such termination will be effective as of March 31, 2008. The Company is discussing the provision of future electric service with RGEC.

Power Sales Contracts

The Company has entered into several short-term (three months or less) off-system sales contracts for the first quarter of 2008. The Company has also entered into other longer-term sales for which the supply is fully hedged.

Franchises and Significant Customers

El Paso Franchise

The Company has a franchise agreement with El Paso, the largest city it serves, through July 31, 2030. The franchise agreement includes a franchise fee of 3.25% of revenues and allows the Company to utilize public rights-of-way necessary to serve its retail customers within El Paso.

Las Cruces Franchise

In February 2000, the Company and Las Cruces entered into a seven-year franchise agreement with a franchise fee of 2% of revenues (approximately $1.5 million per year) for the provision of electric distribution service. Las Cruces exercised its right to extend the franchise for an additional two-year term ending April 30, 2009 and waived its option to purchase the Company's distribution system pursuant to the terms of the February 2000 settlement agreement.

Military Installations

The Company currently serves Holloman Air Force Base ("Holloman"), White Sands Missile Range ("White Sands") and the United States Army Air Defense Center at Fort Bliss ("Ft. Bliss"). The Company's sales to the military bases represent approximately 2% of annual operating revenues. The Company signed a contract with Ft. Bliss in December 1998 under which Ft. Bliss will take retail electric service from the Company through December 2008. In May 1999, the Army and the Company entered into a ten-year contract to provide retail electric service to White Sands. In March 2006, the Company signed a contract with Holloman that provides for the Company to provide retail electric service and limited wheeling services to Holloman for a ten-year term which expires in January 2016.

Item 1A. Risk Factors

Like other companies in our industry, our consolidated financial results will be impacted by weather, the economy of our service territory, market prices for power, fuel prices, and the decisions of regulatory agencies. Our common stock price and creditworthiness will be affected by local, regional and national macroeconomic trends, general market conditions and the expectations of the investment community, all of which are largely beyond our control. In addition, the following statements highlight risk factors that may affect our consolidated financial condition and results of operations. These are not intended to be an exhaustive discussion of all such risks, and the statements below must be read together with factors discussed elsewhere in this document and in our other filings with the SEC.

Our Costs Could Increase or We Could Experience Reduced Revenues if There are Problems at the Palo Verde Nuclear Generating Station

A significant percentage of our generating capacity, off-system sales margins, assets and operating expenses is attributable to Palo Verde. Our 15.8% interest in each of the three Palo Verde units totals approximately 633 MW of generating capacity. Palo Verde represents approximately 42% of our available net generating capacity and represented approximately 43% of our available energy for the twelve months ended December 31, 2007. Palo Verde comprises 41% of our total net plant-in-service and Palo Verde expenses comprise a significant portion of operation and maintenance expenses. APS is the operating agent for Palo Verde, and we have limited ability under the ANPP Participation Agreement to influence operations and costs at Palo Verde. Palo Verde operated at a capacity factor of 78.5% and 70.4% in the twelve months ended December 31, 2007 and 2006, respectively.

The NRC has placed Palo Verde Unit 3 in the "multiple repetitive degraded cornerstone" column of its action matrix which results in an enhanced NRC inspection regimen. We face the risk of additional or unanticipated costs at Palo Verde resulting from (i) increases in operation and maintenance expenses, including additional costs relating to the enhanced NRC oversight; (ii) increases in the cost of uranium; (iii) the replacement of reactor vessel heads at the Palo Verde units; (iv) an extended outage of any of the Palo Verde units; (v) increases in estimates of decommissioning costs; (vi) the storage of radioactive waste, including spent nuclear fuel; (vii) prolonged reductions in generating output; (viii) insolvency of other Palo Verde Participants; and (ix) compliance with the various requirements and regulations governing commercial nuclear generating stations.

Our ability to increase retail base rates in Texas is limited through June 2010. We cannot seek approval to increase our base rates in Texas in the event of increases in non-fuel costs or loss of revenue unless our return on equity falls below the bottom of a defined range which currently is approximately 8.3%. Our rates in New Mexico will be fixed until after the conclusion of the May 2009 rate filing. We cannot assure that revenues will be sufficient to recover any increased costs, including any increased costs in connection with Palo Verde or other operations, whether as a result of inflation, changes in tax laws or regulatory requirements, or other causes.

We May Not Be Able to Recover All of Our Fuel Expenses from Customers

In general, by law, we are entitled to recover our prudently incurred fuel and purchased power expenses from our customers in Texas and New Mexico. The 2007 New Mexico Stipulation provides for energy from the deregulated Palo Verde Unit 3 to be recovered through fuel and purchased power costs based upon the contract cost of capacity and fuel for power purchased under the existing SPS purchased power contract. The 2007 New Mexico Stipulation requires the Company to file its FPPCAC according to NMPRC rules, at which time any party may propose to change the price of capacity and related energy from Palo Verde Unit 3 after the SPS purchased power contract is terminated September 30, 2009. The fuel expense in New Mexico and Texas is subject to reconciliation by the Texas Commission and the NMPRC. Prior to the completion of a reconciliation, we record fuel and purchased power costs transactions such that fuel revenues equal fuel and purchased power expense including the repriced energy costs for Palo Verde Unit 3 in New Mexico. In the event that a disallowance occurs during a reconciliation proceeding, the amounts recorded for fuel and purchased power expenses could differ from the amounts we are allowed to collect from our customers and we would incur a loss to the extent of the disallowance.

In New Mexico, the FPPCAC allows us to reflect current fuel and purchased power expenses in the FPPCAC and to adjust for under-recoveries and over-recoveries with a two-month lag. In Texas, fuel costs are recovered through a fixed fuel factor that may be adjusted two times per year. If we materially under-recover fuel costs, we may seek a surcharge to recover those costs at the time of the next fuel factor filing. During periods of significant increases in natural gas prices such as occurred in 2005, the Company realizes a lag in the ability to reflect increases in fuel costs in its fuel recovery mechanisms. As a result, cash flow is impacted due to the lag in payment of fuel costs and collection of fuel costs from customers. At December 31, 2007 and December 31, 2006, the Company had deferred fuel balances of $27.7 million and $32.6 million, respectively. To the extent the fuel and purchased power recovery processes in Texas and New Mexico do not provide for the timely recovery of such costs, we could experience a material negative impact on our cash flow.

Equipment Failures and Other External Factors Can Adversely Affect Our Results

The generation and transmission of electricity require the use of expensive and complex equipment. While we have a maintenance program in place, generating plants are subject to unplanned outages because of equipment failure. We are particularly vulnerable to this due to the advanced age of several of our gas-fired generating units in or near El Paso. In addition, we are seeking to extend the lives of these plants. In the event of unplanned outages, we must acquire power from others at unpredictable costs in order to supply our customers and comply with our contractual agreements. This can materially increase our costs and prevent us from selling excess power at wholesale, thus reducing our profits. In addition, actions of other utilities may adversely affect our ability to use transmission lines to deliver or import power, thus subjecting us to unexpected expenses or to the cost and uncertainty of public policy initiatives. We are particularly vulnerable to this because a significant portion of our available energy (at Palo Verde and Four Corners) is located hundreds of miles from El Paso and Las Cruces and must be delivered to our customers over long distance transmission lines. In addition, Palo Verde's availability is an important factor in realizing off-system sales margins. These factors, as well as weather, interest rates, economic conditions, fuel prices and price volatility, are largely beyond our control, but may have a material adverse effect on our consolidated earnings, cash flows and financial position.

We May Not Be Able To Recover All Costs of New Generation

We have obtained from the Texas Commission, and have pending with the NMPRC, CCNs to construct a new generating unit (Newman Unit 5) in El Paso to meet our expected customers' demand for electricity. We have provided the estimated cost of constructing Newman Unit 5 to the Texas Commission and NMPRC. We have risks associated with completing the construction of Newman Unit 5 on time and within projected costs. In addition, we have risks associated with obtaining financing for Newman Unit 5 at reasonable rates as we expect to issue debt to finance a portion of the plant.

The cost of financing and constructing Newman Unit 5 will be reviewed in future rate cases in both Texas and New Mexico. To the extent that the Texas Commission or NMPRC determines that the costs of construction are not reasonable because of cost overruns, delays or other reasons, we may not be allowed to recover these costs from customers in base rates.

In addition, if the unit is not completed on time, we may be required to purchase power or operate less efficient generating units to meet customer requirements. Any replacement purchased power or fuel costs will be subject to regulatory review by the Texas Commission and NMPRC. We face financial risks to the extent that recovery is not allowed for any replacement fuel costs resulting from delays in the completion of Newman Unit 5.

Competition and Deregulation Could Result in a Loss of Customers and Increased Costs

As a result of changes in federal law, our wholesale and large retail customers already have, in varying degrees, alternate sources of power, including co-generation of electric power. Deregulation legislation is in effect in Texas requiring us to separate our transmission and distribution functions, which would remain regulated, from our power generation and energy services businesses, which would operate in a competitive market, in the future. In 2004, the Texas Commission approved a rule delaying retail competition in our Texas service territory. This rule identified various milestones that we must reach before retail competition can begin. The first milestone calls for the development, approval by the FERC, and commencement of independent operation of an RTO in the area that includes our service territory. This and other milestones are not likely to be achieved for a number of years. There is substantial uncertainty about both the regulatory framework and market conditions that would exist if and when retail competition is implemented in our Texas service territory, and we may incur substantial preparatory, restructuring and other costs that may not ultimately be recoverable. There can be no assurance that deregulation would not adversely affect our future operations, cash flows and financial condition.

Item 1B. Unresolved Staff Comments

None.

Executive Officers of the Registrant

The executive officers of the Company as of February 15, 2008, were as follows:

Name	Age	Current Position and Business Experience
J. Frank Bates	57	Interim President and Chief Executive Officer since February 2008; Executive Vice President and Chief Operating Officer from May 2005 to February 2008; Executive Vice President and Chief Operations Officer from November 2001 to May 2005.
Scott D. Wilson	54	Executive Vice President, Chief Financial and Administrative Officer since February 2006; Senior Vice President, Chief Financial Officer from May 2005 to February 2006; Vice President – Corporate Planning and Controller from February 2005 to May 2005; Controller from September 2003 to February 2005; Owner of Wilson Consulting Group from June 1992 to September 2003.
Steven P. Busser	39	Vice President – Treasurer and Chief Risk Officer since May 2006; Vice President – Regulatory Affairs and Treasurer from February 2005 to April 2006; Treasurer from February 2003 to February 2005; Assistant Chief Financial Officer from June 2002 to February 2003.
David G. Carpenter	52	Vice President – Corporate Planning and Controller since August 2005; Director – Texas Regulatory Services for American Electric Power Services Corporation from June 2000 to August 2005.
Robert C. Doyle	48	Vice President – New Mexico Affairs since February 2007; Director – New Mexico Affairs from January 2007 to February 2007; Manager – Corporate Projects Office from August 2004 to January 2007; Project Manager – Corporate Transition to Competition from January 2004 to August 2004; Supervisor – Distribution Dispatch December 2003; Project Manager – Transition November 2003; Supervisor – Distribution Dispatch from August 1999 to October 2003.
Fernando J. Gireud	50	Vice President – Safety, Environmental, Power Marketing and International Affairs since February 2006; Vice President – Power Marketing and International Business from February 2003 to February 2006; Vice President – International Business from July 2002 to February 2003.
Richard G. Gonzalez	51	Vice President – Human Resources since November 2007; Director of Human Resources for Petro Stopping Centers, L.P., from March 2004 to November 2007; Director of Human Resources for Electrolux from March 1996 to March 2004.
Hector Gutierrez, Jr.	60	Executive Vice President – External Affairs since June 2006; Managing Director – Governmental Operations, Hillco Partners from October 2002 to June 2006.
Helen Knopp	65	Vice President – Public Affairs since May 2006; Vice President – Customer and Public Affairs from April 1999 to April 2006.
Kerry B. Lore	48	Vice President – Administration since May 2003; Controller from October 2000 to May 2003.
Hector R. Puente	51	Vice President – Transmission and Distribution since May 2006; Vice President – Distribution from February 2006 to April 2006; Vice President – Power Generation from April 2001 to February 2006.
Andres Ramirez	47	Vice President – Power Generation since February 2006; Vice President – Safety, Environmental and Resource Planning from July 2005 to February 2006; Executive Director – Operations for Sempra Energy Texas Service from August 2004 to July 2005; Senior Vice President – Power Production for Austin Energy from 2001 to 2004.
Gary D. Sanders	49	General Counsel since February 2006; Assistant General Counsel and Assistant Secretary from July 2004 to February 2006; Assistant General Counsel from January 2003 to July 2004.
Guillermo Silva, Jr.	54	Corporate Secretary since February 2006; Vice President – Information Services from February 2003 to February 2006; Corporate Secretary from January 1994 to February 2003.
John A. Whitacre	58	Vice President – System Operations and Planning since May 2006; Vice President – Transmission from February 2006 to April 2006; Vice President – Transmission and Distribution from July 2002 to February 2006.

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

Item 2. Properties

The principal properties of the Company are described in Item 1, "Business," and such descriptions are incorporated herein by reference. Transmission lines are located either on private rights-of-way, easements, or on streets or highways by public consent.

In July 2007, the Company entered into an agreement to lease executive and administrative offices in El Paso, Texas under a lease which expires in May 2018 with three concurrent renewal options of five years each. On February 8, 2008, the Company exercised its right of first refusal in the lease agreement to purchase this office building. All obligations previously incurred relating to this lease were terminated.

In addition, the Company leases certain warehouse facilities in El Paso, Texas under a lease which expires in December 2009 with three concurrent renewal options of one year each. The Company also has several other leases for office and parking facilities which expire within the next six years.

Item 3. Legal Proceedings

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 upon a review of these claims and applicable insurance coverage, to the extent that the Company has been able to reach a conclusion as to its ultimate liability, it 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.

On June 7, 2004, the City of Tacoma filed suit against the Company and other defendants in the United States District Court for the Western District of Washington *(City of Tacoma v. American Electric Power Service Corp., et al.,* C04-5325RBL). This complaint sought civil damages (including treble damages) from the Company and the other defendants for violations of certain antitrust provisions under the Sherman Act. This matter was filed in the United States District Court for the Western District of Washington and on February 11, 2005, the Court granted the Company's motion to dismiss the case. The City of Tacoma filed a notice of appeal with the U.S. Court of Appeals for the Ninth Circuit. On March 20, 2007, the Ninth Circuit entered an order dismissing the appeal pursuant to a stipulation of the parties. The dismissal is final and no further appeal may be filed.

On May 5, 2004, Wah Chang, a specialty metals manufacturer which operates a plant in Oregon, filed suit against the Company and other defendants in the United States District Court for the District of Oregon. *(Wah Chang v. Avista Corporation, et al.,* No. 04-619AS). The complaint also makes substantially the same allegations as were made in *City of Tacoma* and seeks the same types of damages. This matter was transferred to the same court that heard and dismissed the *City of Tacoma* lawsuit and on February 11, 2005, the Court granted the Company's motion to dismiss the case. Wah Chang filed notice of appeal with the U.S. Court of Appeals for the Ninth Circuit, and in November 2007, the Ninth Circuit upheld the dismissal of the suit. Wah Chang filed a motion for rehearing of the appeal, and on January 15, 2008, the Ninth Circuit denied Wah Chang's motion. While the Company believes that this matter is without merit and intends to defend itself vigorously in any further appeal by Wah Chang to the U.S. Supreme Court, the Company is unable to predict the outcome or range of possible loss.

See "Regulation" for discussion of the effects of government legislation and regulation on the Company.

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 solicitation of proxies or otherwise during the fourth quarter of 2007.

PART II

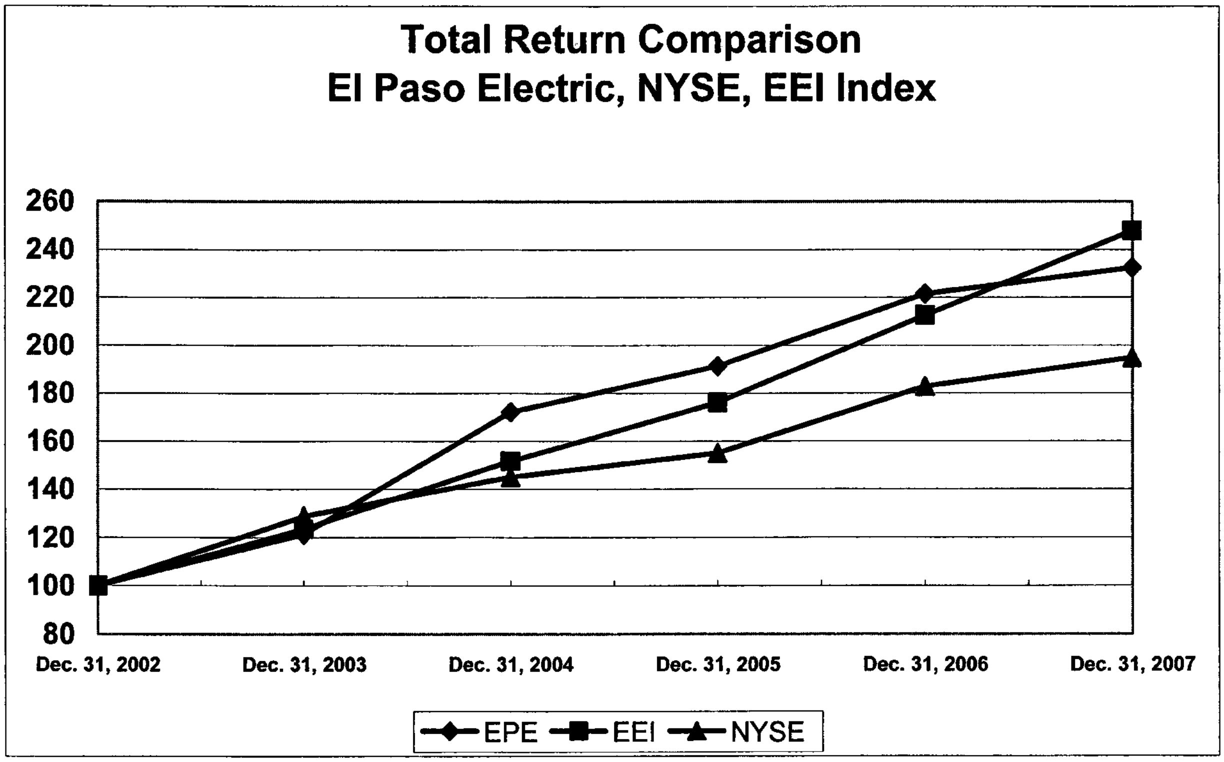
Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Repurchases of Equity Securities

The Company's common stock trades on the New York Stock Exchange under the symbol "EE." The high, low and close sales prices for the Company's common stock, as reported in the consolidated reporting system of the New York Stock Exchange for the periods indicated below were as follows:

	Sales Price		
	High	**Low**	**Close (End of period)**
2006			
First Quarter	$ 21.74	$ 18.80	$ 19.04
Second Quarter	20.37	18.15	20.16
Third Quarter	24.07	19.91	22.34
Fourth Quarter	25.05	22.16	24.37
2007			
First Quarter	$ 27.24	$ 22.95	$ 26.35
Second Quarter	28.19	24.08	24.56
Third Quarter	25.58	20.76	23.13
Fourth Quarter	26.81	22.27	25.57

Performance Graph

The following graph compares the performance of the Company's Common Stock to the performance of the NYSE Composite, and the Edison Electric Institute's Index of investor-owned electric utilities setting the value of each at December 31, 2002 to a base of 100. The table sets forth the relative yearly percentage change in the Company's cumulative total shareholder return as compared to the NYSE, and the EEI, as reflected in the graph.



	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07
EPE	100	121	172	191	222	232
EEI	100	123	152	176	213	248
NYSE US	100	129	145	155	183	195

As of January 31, 2008, there were 3,856 holders of record of the Company's common stock. The Company does not anticipate paying dividends on its common stock in the near-term. The Company intends to continue its stock repurchase programs with the goal of managing its capital structure and enhancing shareholder value.

Since the inception of the stock repurchase programs in 1999, the Company has repurchased a total of approximately 19.3 million shares of its common stock at an aggregate cost of $269.4 million, including commissions. In September 2006, the Board of Directors (the "Board") authorized the repurchase of up to 2.3 million shares of the Company's outstanding common stock (the "2006 Plan"). During 2006 and 2007, the Company repurchased 4,005,158 shares of common stock under the 2006