

Our cash requirements for federal and state income taxes vary from year to year based on taxable income, which is influenced by the timing of revenues and expenses recognized for income tax purposes. Due to net operating loss carryforwards resulting from accelerated depreciation deductions, income tax payments are expected to be minimal in 2016.

We continually evaluate our funding requirements related to our retirement plans, other post-retirement benefit plans, and decommissioning trust funds. We contributed \$10.9 million to our retirement plans during both the twelve months ended December 31, 2015 and 2014. We contributed \$0.5 million to our other post-retirement benefit plans during the twelve months ended December 31, 2015 and we did not make any contributions to our other post-retirement benefit plans during the twelve months ended December 31, 2014. We contributed \$4.5 million to our decommissioning trust funds in both 2015 and 2014. We are in compliance with the funding requirements of the federal government for our benefit plans. In addition, with respect to our nuclear plant decommissioning trust, we are in compliance with the funding requirements of the federal law and the ANPP Participation Agreement. We will continue to review our funding for these plans in order to meet our future obligations.

In 2010, the Company and RGRT, a Texas grantor trust through which we finance our portion of fuel for Palo Verde, entered into a note purchase agreement with various institutional purchasers. Under the terms of the agreement, RGRT sold to the purchasers \$110 million aggregate principal amount of senior notes. In August 2015, \$15.0 million of these senior notes matured and were paid with borrowings from the RCF.

Capital Resources. Cash provided by operations, \$246.7 million in 2015 and \$243.3 million in 2014, is a significant source for funding capital requirements. Cash from operations has been impacted by the timing of the recovery of fuel costs through fuel recovery mechanisms in Texas and New Mexico and our sales for resale customer. We recover actual fuel costs from customers through fuel adjustment mechanisms in Texas, New Mexico, and from our sales for resale customer. We record deferred fuel revenues for the under-recovery or over-recovery of fuel costs until they can be recovered from or refunded to customers. In Texas, fuel costs are recovered through a fixed fuel factor. We can seek to revise our fixed fuel factor at least four months after our last revision except in the month of December based upon our approved formula which allows us to adjust fuel rates to reflect changes in costs of natural gas. We are required to request to refund fuel costs in any month when the over-recovery balance exceeds a threshold material amount and we expect fuel costs to continue to be materially over-recovered. We are permitted to seek to surcharge fuel under-recoveries in any month the balance exceeds a threshold material amount that we expect fuel cost recovery to continue to be materially under-recovered. Fuel over and under-recoveries are considered material when they exceed 4% of the previous twelve months' fuel costs. On May 1, 2015, we reduced our fixed fuel factor charged to our Texas retail customers by approximately 24% to reflect reduced fuel expense.

2015 earnings were adversely impacted by the regulatory lag resulting from placing into service during the first quarter, the first two generating units at MPS together with the related transmission lines and substation as well as the EOC. We incurred approximately \$269.3 million in construction costs for these facilities. With the introduction of these facilities into service, we have begun to incur increased expenses related to depreciation, operations and maintenance, property taxes, and interest cost. Furthermore, we have ceased recognizing AFUDC on these facilities. We have filed for an increase in base rates for our New Mexico and Texas service territory on May 11, 2015 and August 10, 2015, respectively; and we expect new rates to become effective in the second quarter of 2016 in both jurisdictions. The Company also expects 2016 earnings to be adversely impacted by the regulatory lag resulting from the commercialization of MPS Units 3 and 4 which are expected to be placed in service during the second and fourth quarters of 2016, respectively. Base rate increases to seek recovery of these costs are expected to be filed in the first quarter of 2017 for both jurisdictions.

During the twelve months ended December 31, 2015, net fuel recoveries resulted in increased cash from operations when compared to 2014. During the twelve months ended December 31, 2015 the Company had a fuel over-recovery of \$13.3 million compared to an under-recovery of fuel costs of \$3.1 million during the twelve months ended December 31, 2014. At December 31, 2015, we had a net fuel over-recovery balance of \$4.0 million, including an over-recovery balance of \$0.1 million in Texas, \$3.8 million in New Mexico and \$0.1 million in the FERC jurisdiction.

In December 2014, we issued \$150 million aggregate principal amount of 5.00% Senior Notes due December 1, 2044. The gross proceeds from the issuance of the senior notes were \$149.5 million, net of a \$0.5 million discount before commissions and expenses and the effective interest rate was 5.10%. The net proceeds from the sale of these senior notes were used to fund construction expenditures and to repay the outstanding balance of our RCF used for working capital and general corporate purposes.

We maintain the RCF for working capital and general corporate purposes and the financing of nuclear fuel through the RGRT. The RGRT is the trust through which we finance our portion of nuclear fuel for Palo Verde and is consolidated in our financial statements. On January 14, 2014, we amended and extended our \$300 million RCF, which includes an option to expand the size to \$400 million, upon the satisfaction of certain conditions including obtaining commitments from lenders or third party financial institutions. The amended facility extends the maturity from September 2016 to January 2019. In addition, we may extend the January 2019 maturity, subject to lenders' approval, by two additional one year periods. In August 2015, \$15 million Series A

3.67% Senior Notes of the RGRT matured and were paid utilizing the RCF. The total amount borrowed for nuclear fuel by the RGRT was \$128.7 million at December 31, 2015, of which \$33.7 million had been borrowed under the RCF and \$95 million was borrowed through the issuance of senior notes. Borrowings by RGRT for nuclear fuel were \$124.5 million at December 31, 2014, of which \$14.5 million had been borrowed under the RCF and \$110 million was borrowed through senior notes. Interest costs on borrowings to finance nuclear fuel are accumulated by the RGRT and charged to us as fuel is consumed and recovered from customers through fuel recovery charges. The outstanding balance for working capital or general corporate purposes was \$108 million at December 31, 2015. No borrowings were outstanding December 31, 2014 for working capital and general corporate purposes. Total aggregate borrowings under the RCF at December 31, 2015 were \$141.7 million with an additional \$157.8 million available to borrow.

We believe we have adequate liquidity through our current cash balances, cash from operations, available borrowings under the RCF and potential access to capital markets to meet all of our anticipated cash requirements for the next twelve months. We received approval from the NMPRC on October 7, 2015 and from the FERC on October 19, 2015, to issue up to \$310 million in new long-term debt and to guarantee the issuance of up to \$65 million of new debt by the RGRT to finance future purchases of nuclear fuel and to refinance existing nuclear fuel debt obligations. We also received approval from the FERC to continue to utilize our existing RCF without change from the FERC's previously approved authorization. The FERC authorization is effective from November 15, 2015 through November 15, 2017. The approvals granted in these cases supersede prior approvals. The authorizations to issue up to \$310 million of long-term debt and to guarantee up to \$65 million of new long-term debt by RGRT provides us with the flexibility to access the debt capital markets if conditions are favorable.

Contractual Obligations. Our contractual obligations as of December 31, 2015 are as follows (in thousands):

	Payments due by period				
	Total	2016	2017 and 2018	2019 and 2020	2021 and Beyond
Long-Term Debt (including interest):					
Senior notes (1).....	\$ 1,823,275	\$ 47,700	\$ 95,400	\$ 95,400	\$ 1,584,775
Pollution control bonds (2).....	444,836	10,583	53,634	19,918	360,701
RGRT Senior notes (3).....	110,810	4,503	56,771	49,536	—
Financing Obligations (including interest):					
Revolving credit facility (4).....	143,683	143,683	—	—	—
Purchase Obligations:					
Power contracts.....	891	891	—	—	—
Fuel contracts:					
Coal (5).....	2,855	2,855	—	—	—
Gas (5).....	348,962	52,959	63,833	62,009	170,161
Nuclear fuel (6).....	106,332	25,590	28,312	19,875	32,555
Retirement Plans and Other Post-retirement benefits (7).....					
	7,892	7,892	—	—	—
Nuclear decommissioning trust funds (8).....	2,000	2,000	—	—	—
Operating leases (9).....	10,358	900	1,186	1,089	7,183
Total.....	<u>\$ 3,001,894</u>	<u>\$ 299,556</u>	<u>\$ 299,136</u>	<u>\$ 247,827</u>	<u>\$ 2,155,375</u>

- (1) We have four outstanding issuances of Senior Notes. In May 2005, we issued \$400 million aggregate principal amount of 6% Senior Notes due May 15, 2035. In June 2008, we issued \$150 million aggregate principal amount of 7.5% Senior Notes due March 15, 2038. In December 2012, we issued \$150 million aggregate principal amount of 3.3% Senior Notes due December 15, 2022. In December 2014, we issued \$150 million aggregate principal amount of 5.0% Senior Notes due December 1, 2044.
- (2) We have four series of pollution control bonds that are scheduled for remarketing and/or mandatory tender, one in 2017, two in 2040, and one in 2042.
- (3) In 2010, the Company and RGRT entered into a note purchase agreement for \$110 million aggregate principal amount of senior notes consisting of: (a) \$15 million aggregate principal amount of 3.67% RGRT Senior Notes, Series A, which matured and were repaid on August 15, 2015; (b) \$50 million aggregate principal amount of 4.47% RGRT Senior Notes, Series B, due August 15, 2017; and (c) \$45 million aggregate principal amount of 5.04% RGRT Senior Notes, Series C, due August 15, 2020.
- (4) This reflects obligations outstanding under the \$300 million RCF. At December 31, 2015, \$108.0 million was borrowed for working capital and general corporate purposes and \$33.7 million was borrowed by RGRT for nuclear fuel. This balance includes interest based on actual interest rates at the end of 2015 and assumes this amount will be outstanding for the entire year of 2016.
- (5) Amount is based on the minimum volumes per the contract and market and/or contract price at the end of 2015. Gas obligation includes a gas storage contract and a gas transportation contract.
- (6) Some of the nuclear fuel contracts are based on a fixed price, adjusted for a market index. The index used here is the index at the end of 2015.
- (7) This obligation is based on our expected contributions and includes our minimum contractual funding requirements for the non-qualified retirement income plan and the other post-retirement benefits for 2016. We have no minimum cash contractual funding requirement related to our retirement income plan or other post-retirement benefits for 2016. However, we are subject to minimum funding requirements of ERISA. We also may decide to fund at higher levels and expect to contribute \$7.9 million to our retirement plans in 2016, as disclosed in Part II, Item 8, Notes to Financial Statements, Note M. Minimum funding requirements for 2017 and beyond are not included due to the uncertainty of interest rates and the related return on assets.
- (8) This obligation is based on our expected contributions in 2016. We anticipate having no minimum funding obligation in either Texas or New Mexico jurisdiction once new rates become effective given that funding was not requested in either PUCT Docket No. 44941 or NMPRC Case No. 15-00127-UT. The current funding levels of \$0.3 million per month in

Texas and \$0.1 million per month in New Mexico are anticipated to continue until the new rates go into effect. However, funding requirements may change in the future and could require an increase in funding levels in both jurisdictions.

- (9) We lease land in El Paso adjacent to the Newman Power Station under a lease that expires in June 2033 with a renewal option of 25 years. We also have several other leases for office, parking facilities and equipment that expire within the next five years.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The following discussion regarding our market-risk sensitive instruments contains forward-looking information involving risks and uncertainties. The statements regarding potential gains and losses are only estimates of what could occur in the future. Actual future results may differ materially from those estimates presented due to the characteristics of the risks and uncertainties involved.

We are exposed to market risk due to changes in interest rates, equity prices and commodity prices. Substantially all financial instruments and positions we hold are for purposes other than trading and are described below.

Interest Rate Risk

Our long-term debt obligations are all fixed-rate obligations, except for the RCF, which is based on floating rates.

To the extent the RCF is utilized for nuclear fuel purchases, interest rate risk, if any, related to the RCF is substantially mitigated through the operation of the PUCT and the NMPRC rules, which establish energy cost recovery clauses. Under these rules, actual energy costs, including interest expense on nuclear fuel financing, are recovered from our customers.

Our decommissioning trust funds consist of equity securities and fixed income instruments and are carried at fair value. We face interest rate risk on the fixed income instruments, which consist primarily of municipal, federal and corporate bonds and which were valued at \$113.3 million and \$104.7 million as of December 31, 2015 and 2014, respectively. A hypothetical 10% increase in interest rates would reduce the fair values of these funds by \$1.2 million at both December 31, 2015 and 2014.

Equity Price Risk

Our decommissioning trust funds include marketable equity securities of approximately \$117.5 million and \$123.4 million at December 31, 2015 and 2014, respectively. A hypothetical 20% decrease in equity prices would have reduced the fair values of these funds by \$23.5 million and \$24.7 million based on their fair values at December 31, 2015 and 2014, respectively. Declines in market prices could require that additional amounts be contributed to our nuclear decommissioning trusts to maintain minimum funding requirements. We do not expect to expend monies held in trust before 2044 or a later period when decommissioning of Palo Verde begins.

Commodity Price Risk

We utilize contracts of various durations for the purchase of natural gas, uranium concentrates and coal to effectively manage our available fuel portfolio. These agreements contain variable pricing provisions and are settled by physical delivery. The fuel contracts with variable pricing provisions, as well as substantially all of our purchased power requirements, are exposed to fluctuations in prices due to unpredictable factors, including weather and various other worldwide events, which impact supply and demand. However, our exposure to fuel and purchased power price risk is substantially mitigated through the operation of the PUCT and NMPRC rules and our fuel clauses, as discussed previously.

In the normal course of business, we enter into contracts of various durations for the forward sales and purchases of electricity to effectively manage our available generating capacity and supply needs. Such contracts include forward contracts for the sale of generating capacity and energy during periods when our available power resources are expected to exceed the requirements of our retail native load and sales for resale. We also enter into forward contracts for the purchase of wholesale capacity and energy during periods when the market price of electricity is below our expected incremental power production costs or to supplement our generating capacity when demand is anticipated to exceed such capacity. As of January 31, 2016, we had entered into forward sales and purchase contracts for energy as discussed in Part I, Item 1, "Business – Energy Sources – Purchased Power." These agreements are generally fixed-priced contracts that qualify for the "normal purchases and normal sales" exception provided in the FASB guidance for accounting for derivative instruments and hedging activities and are not recorded at their fair value in our financial statements. Because of the operation of the PUCT and the NMPRC rules and our fuel clauses, these contracts do not expose us to significant commodity price risk.

Management Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and affected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and the receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

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

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2015. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission's 2013 Internal Control - Integrated Framework. Based on its assessment, management believes that, as of December 31, 2015, the Company's internal control over financial reporting is effective based on those criteria.

The Company's independent registered public accounting firm, KPMG LLP, has issued an audit report on the Company's internal control over financial reporting. This report appears on page 47 of this report.

Item 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
El Paso Electric Company:

We have audited the accompanying balance sheets of El Paso Electric Company (the Company) as of December 31, 2015 and 2014, and the related statements of operations, comprehensive operations, changes in common stock equity, and cash flows for each of the years in the three-year period ended December 31, 2015. We also have audited El Paso Electric Company's internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). El Paso Electric Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of El Paso Electric Company as of December 31, 2015 and 2014, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles. Also in our opinion, El Paso Electric Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/ KPMG LLP

Kansas City, Missouri
February 29, 2016

**EL PASO ELECTRIC COMPANY
BALANCE SHEETS**

ASSETS (In thousands)	December 31,	
	2015	2014
Utility plant:		
Electric plant in service	\$ 3,616,301	\$ 3,229,255
Less accumulated depreciation and amortization	(1,329,843)	(1,266,672)
Net plant in service	2,286,458	1,962,583
Construction work in progress	293,796	414,284
Nuclear fuel; includes fuel in process of \$51,854 and \$46,996, respectively	190,282	185,185
Less accumulated amortization	(75,031)	(73,701)
Net nuclear fuel	115,251	111,484
Net utility plant	2,695,505	2,488,351
Current assets:		
Cash and cash equivalents	8,149	40,504
Accounts receivable, principally trade, net of allowance for doubtful accounts of \$2,046 and \$2,253, respectively	66,326	71,165
Accumulated deferred income taxes	21,621	13,957
Inventories, at cost	48,697	45,889
Under-collection of fuel revenues	—	10,253
Prepayments and other	9,872	12,213
Total current assets	154,665	193,981
Deferred charges and other assets:		
Decommissioning trust funds	239,035	234,286
Regulatory assets	115,127	112,086
Other	29,520	30,597
Total deferred charges and other assets	383,682	376,969
Total assets	\$ 3,233,852	\$ 3,059,301

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY
BALANCE SHEETS (Continued)

CAPITALIZATION AND LIABILITIES (In thousands except for share data)	December 31,	
	2015	2014
Capitalization:		
Common stock, stated value \$1 per share, 100,000,000 shares authorized, 65,709,819 and 65,725,246 shares issued, and 118,834 and 124,297 restricted shares, respectively.....	\$ 65,829	\$ 65,850
Capital in excess of stated value.....	320,073	318,515
Retained earnings	1,067,396	1,032,537
Accumulated other comprehensive loss, net of tax.....	(13,914)	(8,001)
	1,439,384	1,408,901
Treasury stock, 25,384,834 and 25,492,919 shares, respectively, at cost	(422,846)	(424,647)
Common stock equity.....	1,016,538	984,254
Long-term debt, net of current portion.....	1,134,284	1,134,179
Total capitalization.....	2,150,822	2,118,433
Current liabilities:		
Current maturities of long-term debt.....	—	15,000
Short-term borrowings under the revolving credit facility.....	141,738	14,532
Accounts payable, principally trade	59,978	78,862
Taxes accrued.....	30,351	28,210
Interest accrued.....	12,649	12,758
Over-collection of fuel revenues	4,023	932
Other	28,325	24,715
Total current liabilities.....	277,064	175,009
Deferred credits and other liabilities:		
Accumulated deferred income taxes	516,858	474,154
Accrued pension liability.....	90,527	94,272
Accrued post-retirement benefit liability.....	54,553	59,342
Asset retirement obligation.....	81,621	74,577
Regulatory liabilities	24,303	26,099
Other	38,104	37,415
Total deferred credits and other liabilities.....	805,966	765,859
Commitments and contingencies		
Total capitalization and liabilities.....	\$ 3,233,852	\$ 3,059,301

See accompanying notes to financial statements.

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

	Years Ended December 31,		
	2015	2014	2013
Operating revenues	<u>\$ 849,869</u>	<u>\$ 917,525</u>	<u>\$ 890,362</u>
Energy expenses:			
Fuel	188,400	251,005	226,768
Purchased and interchanged power	53,545	64,804	62,363
	<u>241,945</u>	<u>315,809</u>	<u>289,131</u>
Operating revenues net of energy expenses	<u>607,924</u>	<u>601,716</u>	<u>601,231</u>
Other operating expenses:			
Other operations	242,950	238,832	237,155
Maintenance	65,223	65,629	61,068
Depreciation and amortization	89,824	83,342	79,626
Taxes other than income taxes	63,736	62,750	57,747
	<u>461,733</u>	<u>450,553</u>	<u>435,596</u>
Operating income	<u>146,191</u>	<u>151,163</u>	<u>165,635</u>
Other income (deductions):			
Allowance for equity funds used during construction	10,639	14,662	10,008
Investment and interest income, net	17,508	13,633	7,033
Miscellaneous non-operating income	2,062	4,075	909
Miscellaneous non-operating deductions	(4,328)	(4,199)	(3,635)
	<u>25,881</u>	<u>28,171</u>	<u>14,315</u>
Interest charges (credits):			
Interest on long-term debt and revolving credit facility	65,851	59,028	58,635
Other interest	1,313	1,250	431
Capitalized interest	(4,968)	(5,092)	(5,299)
Allowance for borrowed funds used during construction	(6,937)	(8,368)	(6,055)
	<u>55,259</u>	<u>46,818</u>	<u>47,712</u>
Income before income taxes	<u>116,813</u>	<u>132,516</u>	<u>132,238</u>
Income tax expense	<u>34,895</u>	<u>41,088</u>	<u>43,655</u>
Net income	<u>\$ 81,918</u>	<u>\$ 91,428</u>	<u>\$ 88,583</u>
Basic earnings per share	<u>\$ 2.03</u>	<u>\$ 2.27</u>	<u>\$ 2.20</u>
Diluted earnings per share	<u>\$ 2.03</u>	<u>\$ 2.27</u>	<u>\$ 2.20</u>
Dividends declared per share of common stock	<u>\$ 1.165</u>	<u>\$ 1.105</u>	<u>\$ 1.045</u>
Weighted average number of shares outstanding	<u>40,274,986</u>	<u>40,190,991</u>	<u>40,114,594</u>
Weighted average number of shares and dilutive potential shares outstanding	<u>40,308,562</u>	<u>40,211,717</u>	<u>40,126,647</u>

See accompanying notes to financial statements.

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

	Years Ended December 31,		
	2015	2014	2013
Net income	\$ 81,918	\$ 91,428	\$ 88,583
Other comprehensive income (loss):			
Unrecognized pension and post-retirement benefit costs:			
Net gain (loss) arising during period	5,429	(54,328)	82,964
Prior service benefit	824	34,200	97
Reclassification adjustments included in net income for amortization of:			
Prior service benefit	(6,574)	(7,659)	(5,560)
Net loss	8,622	6,182	10,472
Net unrealized gains/losses on marketable securities:			
Net holding (losses) gains arising during period	(2,906)	10,827	17,699
Reclassification adjustments for net gains included in net income	(11,114)	(7,350)	(553)
Net losses on cash flow hedges:			
Reclassification adjustment for interest expense included in net income ...	467	438	411
Total other comprehensive income (loss) before income taxes	(5,252)	(17,690)	105,530
Income tax benefit (expense) related to items of other comprehensive income (loss):			
Unrecognized pension and post-retirement benefit costs	(3,286)	8,051	(33,566)
Net unrealized losses (gains) on marketable securities	2,828	(760)	(3,100)
Losses on cash flow hedges	(203)	(214)	(168)
Total income tax benefit (expense)	(661)	7,077	(36,834)
Other comprehensive income (loss), net of tax	(5,913)	(10,613)	68,696
Comprehensive income	\$ 76,005	\$ 80,815	\$ 157,279

See accompanying notes to financial statements.

EL PASO ELECTRIC COMPANY
STATEMENTS OF CHANGES IN COMMON STOCK EQUITY
(In thousands except for share data)

	Common Stock		Capital in Excess of Stated Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax	Treasury Stock		Common Stock Equity
	Shares	Amount				Shares	Amount	
Balances at December 31, 2012.	65,604,997	\$ 65,605	\$ 310,994	\$ 939,131	\$ (66,084)	25,492,919	\$ (424,647)	\$ 824,999
Restricted common stock grants and deferred compensation	96,279	96	2,702					2,798
Performance share awards vested	64,275	64	785					849
Stock awards withheld for taxes	(23,808)	(23)	(788)					(811)
Forfeited restricted common stock	(1,549)	(1)						(1)
Deferred taxes on stock incentive plan			427					427
Stock options exercised	15,000	15	177					192
Compensation paid in shares	4,431	4	146					150
Net income				88,583				88,583
Other comprehensive income (loss)				(42,049)	68,696			68,696
Dividends declared								(42,049)
Balances at December 31, 2013.	65,759,625	65,760	314,443	985,665	2,612	25,492,919	(424,647)	943,833
Restricted common stock grants and deferred compensation	103,672	104	4,175					4,279
Stock awards withheld for taxes	(4,696)	(5)	(183)					(188)
Forfeited restricted common stock	(19,162)	(19)						(19)
Deferred taxes on stock incentive plan			(302)					(302)
Compensation paid in shares	10,104	10	382					392
Net income				91,428	(10,613)			91,428
Other comprehensive income (loss)				(44,556)				(10,613)
Dividends declared								(44,556)
Balances at December 31, 2014.	65,849,543	65,850	318,515	1,032,537	(8,001)	25,492,919	(424,647)	984,254
Restricted common stock grants and deferred compensation	6,356	6	2,266			(93,455)	1,557	3,829
Stock awards withheld for taxes	(15,031)	(15)	(556)					(571)
Forfeited restricted common stock	(12,215)	(12)				871	(14)	(26)
Deferred taxes on stock incentive plan			(475)					(475)
Compensation paid in shares			323			(15,501)	258	581
Net income				81,918	(5,913)			81,918
Other comprehensive income (loss)				(47,059)				(5,913)
Dividends declared								(47,059)
Balances at December 31, 2015.	65,828,653	\$ 65,829	\$ 320,073	\$ 1,067,396	\$ (13,914)	25,384,834	\$ (422,846)	\$ 1,016,538

See accompanying notes to financial statements.

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

	Years Ended December 31,		
	2015	2014	2013
Cash Flows From Operating Activities:			
Net income	\$ 81,918	\$ 91,428	\$ 88,583
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of electric plant in service	89,824	83,342	79,626
Amortization of nuclear fuel	43,099	43,864	42,537
Deferred income taxes, net	30,846	39,129	44,678
Allowance for equity funds used during construction	(10,639)	(14,662)	(10,008)
Other amortization and accretion	17,707	18,380	16,556
Gain on sale of property, plant and equipment	(658)	(2,092)	(112)
Net gains on sale of decommissioning trust funds	(11,114)	(7,350)	(553)
Other operating activities	517	(93)	(260)
Change in:			
Accounts receivable	4,839	(5,815)	(2,450)
Inventories	(2,859)	(786)	(3,673)
Net over-collection (under-collection) of fuel revenues	13,344	(3,121)	(10,843)
Prepayments and other	(3,984)	(2,750)	(4,295)
Accounts payable	(11,235)	9,684	8,180
Taxes accrued	4,512	(2,209)	(627)
Other current liabilities	3,719	1,198	958
Deferred charges and credits	(3,165)	(4,807)	(822)
Net cash provided by operating activities	246,671	243,340	247,475
Cash Flows From Investing Activities:			
Cash additions to utility property, plant and equipment	(281,458)	(277,078)	(237,411)
Cash additions to nuclear fuel	(41,966)	(37,877)	(30,535)
Capitalized interest and AFUDC:			
Utility property, plant and equipment	(17,576)	(23,030)	(16,063)
Nuclear fuel	(4,968)	(5,092)	(5,299)
Allowance for equity funds used during construction	10,639	14,662	10,008
Decommissioning trust funds:			
Purchases, including funding of \$4.5 million	(110,223)	(117,675)	(65,491)
Sales and maturities	102,567	108,311	56,148
Proceeds from sale of property, plant and equipment	721	2,395	112
Other investing activities	(470)	4,192	5,767
Net cash used for investing activities	(342,734)	(331,192)	(282,764)
Cash Flows From Financing Activities:			
Dividends paid	(47,059)	(44,556)	(42,049)
Borrowings under the revolving credit facility:			
Proceeds	344,398	231,399	44,883
Payments	(217,192)	(231,219)	(52,686)
Payment on maturing RGRT senior notes	(15,000)	—	—
Proceeds from issuance of senior notes	—	149,468	—
Other financing activities	(1,439)	(2,328)	(324)
Net cash provided by (used for) financing activities	63,708	102,764	(50,176)
Net increase (decrease) in cash and cash equivalents	(32,355)	14,912	(85,465)
Cash and cash equivalents at beginning of period	40,504	25,592	111,057
Cash and cash equivalents at end of period	\$ 8,149	\$ 40,504	\$ 25,592

See accompanying notes to financial statements.

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EL PASO ELECTRIC COMPANY
NOTES TO FINANCIAL STATEMENTS

A. Summary of Significant Accounting Policies

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 full requirements wholesale customer in Texas.

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

Use of Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company evaluates its estimates on an on-going basis, including those related to depreciation, unbilled revenue, income taxes, fuel costs, pension and other post-retirement obligations and asset retirement obligations ("ARO"). Actual results could differ from those estimates.

Application of the Financial Accounting Standards Board (the "FASB") Guidance for Regulated Operations. Regulated electric utilities typically prepare their financial statements in accordance with the FASB guidance for regulated operations. The FASB guidance for regulated operations requires the Company to include an allowance for equity and borrowed funds used during construction ("AEFUDC" and "ABFUDC") as a cost of construction of electric plant in service. AEFUDC is recognized as income and ABFUDC is shown as capitalized interest charges in the Company's statement of operations. The FASB guidance for regulated operations also requires the Company to show certain recoverable costs as either assets or liabilities on a utility's balance sheet if the regulator provides assurance that these costs will be charged to and collected from the utility's customers (or has already permitted such cost recovery) or will be credited or refunded to the utility's customers. The resulting regulatory assets or liabilities are amortized in subsequent periods based upon the respective amortization periods reflected in a utility's regulated rates. See Part II, Item 8, Financial Statements and Supplementary Data, Note D. The Company applies the FASB guidance for regulated operations for all three of the jurisdictions in which it operates.

Comprehensive Income. Certain gains and losses that are not recognized currently in the statements of operations are reported as other comprehensive income in accordance with the FASB guidance for reporting comprehensive income.

Utility Plant. Utility plant is generally reported at cost. The cost of renewals and betterments are capitalized and the costs of repairs and minor replacements are charged to the appropriate operating expense accounts. Depreciation is provided on a straight-line basis over the estimated remaining lives of the assets (ranging in average from 5 to 48 years). The average composite depreciation rate utilized in 2015, 2014 and 2013 was 2.64%, 2.60%, and 2.61%, respectively. When property subject to composite depreciation is retired or otherwise disposed of in the normal course of business, its cost together with the cost of removal, less salvage is charged to accumulated depreciation. For other property dispositions, the applicable cost and accumulated depreciation is removed from the balance sheet accounts and a gain or loss is recognized.

The Company currently reports gains and losses on dispositions of vehicles in earnings when realized. Beginning in 2016, the Company will adopt composite depreciation rates for vehicles. As such, the Company will charge the cost together with the cost of removal, less salvage on the disposition of vehicles to accumulated depreciation.

The cost of nuclear fuel is amortized to fuel expense on a units-of-production basis. The Company is also amortizing its share of costs associated with on-site spent fuel storage casks at Palo Verde over the burn period of the fuel that will necessitate the use of the storage casks. See Part II, Item 8, Financial Statements and Supplementary Data, Note E.

Impairment of Long-Lived Assets. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset.

AFUDC and Capitalized Interest. The Company capitalizes interest ("ABFUDC") and common equity ("AEFUDC") costs to construction work in progress and capitalizes interest to nuclear fuel in process in accordance with the FERC Uniform System of Accounts as provided for in the FASB guidance. AFUDC is a non-cash component of income and is calculated monthly and

EL PASO ELECTRIC COMPANY
NOTES TO FINANCIAL STATEMENTS

charged to all new eligible construction and capital improvement projects. AFUDC is compounded on a semi-annual basis. The average AFUDC rates used in 2015, 2014 and 2013 were 7.18%, 8.15% and 8.10%, respectively.

Asset Retirement Obligation. The FASB guidance sets forth accounting requirements for the recognition and measurement of liabilities associated with the retirement of tangible long-lived assets. An ARO associated with long-lived assets included within the scope of the FASB guidance is that for which a legal obligation exists under enacted laws, statutes, written or oral contracts, including obligations arising under the doctrine of promissory estoppel and legal obligations to perform an asset retirement activity even if the timing and/or settlement are conditioned on a future event that may or may not be within the control of an entity. See Part II, Item 8, Financial Statements and Supplementary Data, Note F. Under the FASB guidance, these liabilities are recognized as incurred if a reasonable estimate of fair value can be established and are capitalized as part of the cost of the related tangible long-lived assets. The Company records the increase in the ARO due to the passage of time as an operating expense (accretion expense).

Cash and Cash Equivalents. All temporary cash investments with an original maturity of three months or less are considered cash equivalents.

Investments. The Company's marketable securities, included in decommissioning trust funds in the balance sheets, are reported at fair value and consist of cash, equity securities and municipal, federal and corporate bonds in trust funds established for decommissioning of its interest in Palo Verde. Such marketable securities are classified as "available-for-sale" securities and, as such, unrealized gains and losses are included in accumulated other comprehensive loss as a separate component of common stock equity. However, if declines in fair value of marketable securities below original cost basis are determined to be other than temporary, then the declines are reported as losses in the statement of operations and a new cost basis is established for the affected securities at fair value. Gains and losses are determined using the cost of the security based on the specific identification basis. See Part II, Item 8, Financial Statements and Supplementary Data, Note O.

Derivative Accounting. Accounting for derivative instruments and hedging activities requires the recognition of derivatives as either assets or liabilities in the balance sheet with measurement of those instruments at fair value. Any changes in the fair value of these instruments are recorded in earnings or other comprehensive income. See Part II, Item 8, Financial Statements and Supplementary Data, Note O.

Inventories. Inventories, primarily parts, materials, supplies, fuel oil and natural gas are stated at average cost not to exceed recoverable cost.

Operating Revenues Net of Energy Expenses. The Company accrues revenues for services rendered, including unbilled electric service revenues. Energy expenses are stated at actual cost incurred. The Company's Texas retail customers are billed under base rates and a fixed fuel factor approved by the Public Utility Commission of Texas ("PUCT"). The Company's New Mexico retail customers are billed under base rates and a fuel adjustment clause which is adjusted monthly, as approved by the New Mexico Public Regulation Commission ("NMPRC"). The Company's FERC sales for resale customers are billed under formula base rates and fuel factors and a fuel adjustment clause which is adjusted monthly. The Company's recovery of energy expenses is subject to periodic reconciliations of actual energy expenses incurred to actual fuel revenues collected. The difference between energy expenses incurred and fuel revenues charged to customers is reflected as over/under-collection of fuel revenues in the balance sheets. See Part II, Item 8, Financial Statements and Supplementary Data, Note C.

Revenues. Revenues related to the sale of electricity are generally recorded when service is provided or electricity is delivered to customers. The billing of electricity sales to retail customers is based on the reading of their meters, which occurs on a systematic basis throughout the month. Unbilled revenues are recorded for estimated amounts of energy delivered in the period following the customers billing cycle to the end of the month. Unbilled revenues are estimated based on monthly generation volumes and by applying an average revenue/kWh to the number of estimated kWhs delivered but not billed. Accounts receivable included accrued unbilled revenues of \$21.7 million and \$21.2 million at December 31, 2015 and 2014, respectively. The Company presents revenues net of sales taxes in its statements of operations.

Allowance for Doubtful Accounts. The allowance for doubtful accounts represents the Company's estimate of existing accounts receivable that will ultimately be uncollectible. The allowance is calculated by applying estimated write-off factors to various classes of outstanding receivables. The write-off factors used to estimate uncollectible accounts are based upon consideration of both historical collections experience and management's best estimate of future collections success given the existing collections environment. Additions, deductions and balances for allowance for doubtful accounts for 2015, 2014 and 2013 are as follows (in thousands):

EL PASO ELECTRIC COMPANY
NOTES TO FINANCIAL STATEMENTS

	2015	2014	2013
Balance at beginning of year	\$ 2,253	\$ 2,261	\$ 2,906
Additions:			
Charged to costs and expense.....	2,057	2,755	2,098
Recovery of previous write-offs.....	1,613	1,516	1,929
Uncollectible receivables written off.....	3,877	4,279	4,672
Balance at end of year	<u>\$ 2,046</u>	<u>\$ 2,253</u>	<u>\$ 2,261</u>

Income Taxes. The Company accounts for federal and state income taxes under the asset and liability method of accounting for income taxes. Deferred income taxes are recognized for the estimated future tax consequences of "temporary differences" by applying enacted statutory tax rates for each taxable jurisdiction applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities. Certain temporary differences are accorded flow-through treatment by the Company's regulators and impact the Company's effective tax rate. The FASB guidance requires that rate-regulated companies record deferred income taxes for temporary differences accorded flow-through treatment at the direction of the regulatory commission. The resulting deferred tax assets and liabilities are recorded at the expected cash flow to be reflected in future rates. Because the Company's regulators have consistently permitted the recovery of tax effects previously flowed-through earnings, the Company has recorded regulatory liabilities and assets offsetting such deferred tax assets and liabilities. The effect on deferred tax assets and liabilities of a change in tax rate is recognized in income in the period that includes the enactment date. The Company recognizes tax assets and liabilities for uncertain tax positions in accordance with the recognition and measurement criteria of the FASB guidance for uncertainty in income taxes. See Part II, Item 8, Financial Statements and Supplementary Data, Note J.

Earnings per Share. The Company's restricted stock awards are participating securities and earnings per share must be calculated using the two-class method in both the basic and diluted earnings per share calculations. For the basic earnings per share calculation, net income is allocated to the weighted average number of restricted stock awards and to the weighted average number of shares outstanding. The net income allocated to the weighted average number of shares outstanding is then divided by the weighted average number of shares outstanding to derive the basic earnings per share. For the diluted earnings per share, net income is allocated to the weighted average number of restricted stock awards and to the weighted average number of shares and dilutive potential shares outstanding. The Company's dilutive potential shares outstanding amount is calculated using the treasury stock method for the unvested performance shares. Net income allocated to the weighted average number of shares and dilutive potential shares is then divided by the weighted average number of shares and dilutive potential shares outstanding to derive the diluted earnings per share. See Part II, Item 8, Financial Statements and Supplementary Data, Note G.

Stock-Based Compensation. The Company has a stock-based long-term incentive plan. The Company is required under the FASB guidance to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. Such costs are recognized over the period during which an employee is required to provide service in exchange for the award (the "requisite service period") which typically is the vesting period. Compensation cost is not recognized for anticipated forfeitures prior to vesting of equity instruments. See Part II, Item 8, Financial Statements and Supplementary Data, Note G.

Pension and Post-retirement Benefit Accounting. See Part II, Item 8, Financial Statements and Supplementary Data, Note M for a discussion of the Company's accounting policies for its employee benefits.

EL PASO ELECTRIC COMPANY
NOTES TO FINANCIAL STATEMENTS

B. New Accounting Standards

In May 2014, the FASB issued new guidance (Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers (Topic 606)) to provide a framework that replaces the existing revenue recognition guidance. ASU 2014-09 is the result of a joint effort by the FASB and the International Accounting Standards Board intended to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. Generally Accepted Accounting Principles ("GAAP") and International Financial Reporting Standards. ASU 2014-09 provides that an entity should recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 was originally intended to be effective for annual periods and interim periods within that reporting period beginning after December 15, 2016, for public business entities. In August 2015, the FASB issued ASU 2015-14 to defer the effective date of ASU 2014-09 for all entities by one year. Public business entities will apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017 and interim periods within that reporting period. Early adoption of ASU 2014-09 is permitted after December 15, 2016. The Company has not selected a transition method and is currently assessing the future impact of this ASU.

In April 2015, the FASB issued ASU 2015-03, Interest - Imputation of Interest (Topic 715) to simplify the presentation of debt issuance costs. ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. ASU 2015-03 is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. In August 2015, the FASB issued ASU 2015-15, Interest - Imputation of Interest (Subtopic 835-30), to provide further clarification to ASU 2015-03 as it relates to the presentation and subsequent measurement of debt issuance costs associated with line of credit arrangements. The Company does not expect ASU 2015-03 and ASU 2015-15 to materially impact the Company's results of operations and cash flows.

In May 2015, the FASB issued ASU 2015-07, Fair Value Measurement (Topic 820) to eliminate the requirement to categorize investments in the fair value hierarchy if the fair value is measured at net asset value ("NAV") per share (or its equivalent) using the practical expedient in the FASB's fair value measurement guidance. Reporting entities must still provide sufficient information to enable users to reconcile total investments in the fair value hierarchy and total investments measured at fair value in the financial statements. Additionally, the scope of current disclosure requirements for investments eligible to be measured at NAV will be limited to investments to which the practical expedient is applied. This ASU is effective in fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The ASU requires retrospective application. Early adoption is permitted. This guidance requires a revision of the fair value disclosures but will not impact the Company's financial statements.

In November 2015, the FASB issued new guidance (ASU 2015-17, Balance Sheet Classification of Deferred Taxes) to simplify the presentation of deferred income taxes. ASU 2015-17 requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. ASU 2015-17 can be applied prospectively or retrospectively and is effective for financial statements issued for annual periods beginning after December 15, 2016 and interim periods within those annual periods and early adoption is permitted. The Company is currently assessing the future impact of this ASU.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities to enhance the reporting model for financial instruments by addressing certain aspects of recognition, measurement, presentation, and disclosure. ASU 2016-01 requires entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value and recognize any changes in fair value in net income unless the investments qualify for the new practicability exception. The guidance for classifying and measuring investments in debt securities and loans are not changed by this ASU, but requires entities to record changes in instrument-specific credit risk for financial liabilities measured under the fair value option in other comprehensive income. Financial assets and financial liabilities must be separately presented by measurement category and form of financial asset on the balance sheet or in the accompanying notes to the financial statements. ASU 2016-01 clarifies the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The standard includes a requirement that businesses must report changes in the fair value of their own liabilities in other comprehensive income instead of earnings, and this is the only provision of the update for which the FASB is permitting early adoption. The remaining provisions of this ASU become effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently assessing the future impact of this ASU.

EL PASO ELECTRIC COMPANY
NOTES TO FINANCIAL STATEMENTS

C. Regulation

General

The rates and services of the Company are regulated by incorporated municipalities in Texas, the PUCT, the NMPRC and the FERC. Municipal orders, ordinances and other agreements regarding rates and services adopted by Texas municipalities are subject to review and approval by the PUCT. The FERC has jurisdiction over the Company's wholesale (sales for resale) transactions, transmission service and compliance with federally-mandated reliability standards. The decisions of the PUCT, the NMPRC and the FERC are subject to judicial review.

Texas Regulatory Matters

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

2015 Texas Retail Rate Case Filing. On August 10, 2015, the Company filed with the City of El Paso, other municipalities incorporated in its Texas service territory, and the PUCT in Docket No. 44941, a request for an increase in non-fuel base revenues of approximately \$71.5 million. The request includes recovery of new plant placed into service since 2009. On January 15, 2016, the Company filed its rebuttal testimony modifying the requested increase to \$63.3 million. The Company has invoked its statutory right to have its new rates relate back for consumption on and after January 12, 2016, which is the 155th day after the filing. The difference in rates that would have been collected will be surcharged or refunded to customers beginning after the PUCT's final order in Docket No. 44941, which is expected to be in the second quarter of 2016. The PUCT has the authority to require the Company to surcharge or refund such difference over a period not to exceed 18 months. On January 21, 2016, the Company, the City of El Paso, the PUCT staff, the Office of Public Utility Counsel and the Texas Industrial Energy Consumers filed a joint motion to abate the procedural schedule to facilitate settlement talks. This motion was granted. The Company cannot predict the outcome of the rate case at this time.

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

On May 1, 2015, the Company made its annual filing to establish its energy efficiency cost recovery factor for 2016. In addition to projected energy efficiency costs for 2016 and true-up to prior year actual costs, the Company requested approval of a \$1.0 million bonus for the 2014 energy efficiency program results in accordance with PUCT rules. This case was assigned PUCT Docket No. 44677. A stipulation and settlement agreement was filed September 24, 2015 and the PUCT approved the settlement on November 5, 2015. The settlement approved by the PUCT includes a performance bonus of \$1.0 million. The Company recorded the performance bonus as operating revenue in the fourth quarter of 2015.

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

EL PASO ELECTRIC COMPANY
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On April 15, 2015, the Company filed a request, which was assigned PUCT Docket No. 44633, to reduce its fixed fuel factor by approximately 24% to reflect an expected reduction in fuel expense. The over-recovered balance was below the PUCT's materiality threshold. The reduction in the fixed fuel factor was effective on an interim basis May 1, 2015 and approved by the PUCT on May 20, 2015. As of December 31, 2015, the Company had over-recovered fuel costs in the amount of \$0.1 million for the Texas jurisdiction.

Fuel Reconciliation Proceeding. Pursuant to the 2012 Texas retail rate settlement discussed above, on September 27, 2013, the Company filed an application with the PUCT, designated as PUCT Docket No. 41852, to reconcile \$545.3 million of fuel and purchased power expenses incurred during the 45-month period from July 1, 2009 through March 31, 2013. A settlement was reached and a final order was issued by the PUCT on July 11, 2014. The PUCT's final order completes the regulatory review and reconciliation of the Company's fuel expenses for the period through March 31, 2013. The Company is required to file an application in 2016 for fuel reconciliation of the Company's fuel expenses for the period through March 31, 2016.

Montana Power Station ("MPS") Approvals. The Company has received a Certificate of Convenience and Necessity ("CCN") from the PUCT to construct four natural gas fired generating units at MPS in El Paso County, Texas. The Company also obtained air permits from the Texas Commission on Environmental Quality (the "TCEQ") and the U.S. Environmental Protection Agency (the "EPA"). MPS Units 1 and 2 and associated transmission lines and common facilities were completed and placed into service in March 2015.

Community Solar. On June 8, 2015, the Company filed a petition with the PUCT to initiate a community solar program to include construction and ownership of a 3 MW solar photovoltaic system located at MPS. Participation will be on a voluntary basis, and customers will contract for a set capacity (kW) amount and receive all energy produced. This case was assigned PUCT Docket No. 44800. The Company presented the other parties a proposed structure for settlement of this proceeding and the other parties are in the process of evaluating it.

Four Corners Generating Station ("Four Corners"). On February 17, 2015, the Company and Arizona Public Service Company ("APS") entered into an asset purchase agreement (the "Purchase and Sale Agreement") providing for the purchase by APS of the Company's interests in Four Corners. The Purchase and Sale Agreement included a projected cash purchase price which will be equal to the net book value of our interest in Four Corners at the date of close. The net book value at June 30, 2016 is expected to approximate \$20 million. The Company will also be reimbursed for certain undepreciated capital expenditures, that are projected to approximate \$10 million at June 30, 2016. The purchase price will be adjusted downward to reflect APS's assumption of the Company's obligation to pay for future plant decommissioning and mine reclamation expenses estimated at July 6, 2016 to be \$7.0 million and \$19.3 million, respectively.

On June 10, 2015, the Company filed an application in Texas requesting reasonableness and public interest findings and certain rate and accounting findings related to the Purchase and Sale Agreement. The anticipated closing date of the sale is July 6, 2016, pending regulatory approval. This case was assigned PUCT Docket No. 44805. It is expected that the final coal mine closing and reclamation costs, which the Company historically has been permitted to recover in its fuel recovery mechanism, will be addressed in the proceeding, as well as other issues related to post-participation events such as the ARO. On January 11, 2016, the PUCT referred the case to the State Office of Administrative Hearings ("SOAH") for an administrative hearing. On February 5, 2016, an administrative law judge ("ALJ") of the SOAH issued an order adopting a procedural schedule. The procedural schedule calls for a hearing on the merits to be held in the fourth quarter of 2016. At December 31, 2015 the regulatory asset associated with mine reclamation costs for our Texas jurisdiction approximates \$7.6 million. At the PUCT's February 11, 2016 open meeting, Commissioners discussed whether the Company's application should be addressed in a rate case. On February 11, 2016, the PUCT issued its Order Requesting Briefing on Threshold Legal/Policy Issues, seeking briefs from the parties on the issue "Should the Commission dismiss this docket?" Such briefs were due by February 22, 2016. The PUCT is expected to consider that issue at its open meeting currently scheduled for March 3, 2016.

The Company currently continues to recover its mine reclamation costs in Texas under previous orders and decisions of the PUCT. If any future determinations made by our regulators result in changes to how existing regulatory assets or previously incurred costs for Four Corners are recovered in rates, any such changes would be recognized only when it becomes probable future cash flows will change as a result of such regulatory actions.

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

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New Mexico Regulatory Matters

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

2015 New Mexico Rate Case Filing. On May 11, 2015, the Company filed with the NMPRC (NMPRC Case No. 15-00127-UT) for an annual increase in non-fuel base rates of approximately \$8.6 million or 7.1%. The request includes recovery of new plant placed into service since the last time rates were adjusted in 2009. The filing also requests an annual reduction of \$15.4 million, or 21.5%, for fuel and purchased power costs recovered in base rates. The reduction in fuel and purchased power rates reflects reduced fuel prices and improvements in system heat rates due to new generating unit additions. Subsequently, the Company reduced its requested increase in non-fuel base rates to approximately \$6.4 million. On February 16, 2016, the Hearing Examiner issued a Recommended Decision to the NMPRC proposing an annual increase in non-fuel base rates of approximately \$640 thousand. On February 17, 2016, the NMPRC issued an order extending the suspension period in the rate case from March 10, 2016 until April 8, 2016, by which time the NMPRC is expected to either issue a final order with new rates to go into effect in the second quarter of 2016 or again extend the suspension period further to as late as June 10, 2016. All parties will be allowed to file exceptions before the NMPRC ultimately rules on the issues by final order. The Company cannot predict the outcome of the rate case at this time.

Fuel and Purchased Power Costs. Fuel and purchased power costs are recovered through base rates and a Fuel and Purchased Power Cost Adjustment Clause (the "FPPCAC") that accounts for changes in the costs of fuel relative to the amount included in base rates. On January 8, 2014, the NMPRC approved the continuation of the FPPCAC without modification in NMPRC Case No. 13-00380-UT. Fuel and purchased power costs are reconciled to actual costs on a monthly basis and recovered or refunded to customers the second succeeding month. The Company recovers costs related to Palo Verde Unit 3 capacity and energy in New Mexico through the FPPCAC as purchased power using a proxy market price approved in the 2014 FPPCAC continuation. At December 31, 2015, we had a net fuel over-recovery balance of \$3.8 million in New Mexico.

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

Four Corners. On February 17, 2015, the Company and APS entered into the Purchase and Sale Agreement providing for the purchase by APS of the Company's interests in Four Corners. On April 27, 2015, the Company filed an application requesting all necessary regulatory approvals to sell its ownership interest in Four Corners. The anticipated closing date of the sale is July 6, 2016, pending regulatory approval. This case was assigned NMPRC Case No. 15-00109-UT. On February 2, 2016, the Company filed a joint stipulation with the NMPRC reflecting a settlement agreement among the Commission Utility Division Staff, the Company and the New Mexico Attorney General proposing approval of abandonment and sale of its seven percent minority ownership interest in Four Corners Units 4 and 5 and common facilities to APS. An addendum to the joint stipulation was subsequently filed to include non-opposition by other non-stipulating parties. A hearing in the case was held on February 16, 2016, and a final order approving the joint stipulation is expected in the first half of 2016. Based on the joint stipulation and addendum, no significant gain or loss is expected to be realized upon closing of the sale.

5 MW Holloman Air Force Base ("HAFB") Facility CCN. On June 15, 2015, the Company filed a petition with the NMPRC requesting CCN authorization to construct a 5 MW solar-powered generation facility to be located at HAFB in the Company's service territory in New Mexico. The new facility will be a dedicated Company-owned resource serving HAFB. This case was assigned NMPRC Case No. 15-00185-UT. On October 7, 2015, the NMPRC issued a Final Order accepting the Hearing Examiner's Recommended Decision to approve the CCN, as modified, that the Company shall not seek to recover any revenue requirement associated with the facility from New Mexico jurisdictional customers other than HAFB without prior NMPRC approval.

Issuance of Long-Term Debt and Guarantee of Debt. On October 7, 2015 the Company received approval in NMPRC Case No. 15-00280-UT to issue up to \$310 million in new long-term debt; and to guarantee the issuance of up to \$65 million of new debt by Rio Grande Resources Trust ("RGRT") to finance future purchases of nuclear fuel and to refinance existing nuclear fuel debt obligations. This approval supersedes prior approvals.

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

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Federal Regulatory Matters

Four Corners. On June 26, 2015, APS filed an application requesting authorization from FERC to purchase 100% of the Company's ownership interest in Units 4 and 5 of Four Corners and the associated transmission interconnection facilities and rights. On December 22, 2015, FERC issued an order approving the proposed transaction.

Public Service Company of New Mexico ("PNM") Transmission Rate Case. On December 31, 2012, PNM filed with FERC to change its method of transmission rate recovery for its transmission delivery services from stated rates to formula rates. The Company takes transmission service from PNM and is among the PNM transmission customers affected by PNM's shift to formula rates. On March 1, 2013, the FERC issued an order rejecting in part PNM's filing, and establishing settlement judge and hearing procedures. On March 20, 2015, PNM filed with FERC a settlement agreement and offer of settlement resolving all issues set for hearing in the proceeding. On March 25, 2015, the Chief Judge issued an order granting PNM's motion to implement the settled rates. However, the Company is still awaiting a final decision from the FERC on whether the settlement will be approved. The Company cannot predict the outcome of the case at this time.

Revolving Credit Facility; Issuance of Long-Term Debt and Guarantee of Debt. On October 19, 2015, the FERC issued an order in Docket No. ES15-66-000 approving the Company's filing to issue short-term debt under its existing revolving credit facility up to \$400 million outstanding at any time, to issue up to \$310 million in long-term debt, and to guarantee the issuance of up to \$65 million of new long-term debt by RGRT to finance future nuclear fuel purchases. The authorization is effective from November 15, 2015 through November 15, 2017. This approval supersedes prior approvals.

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

United States Department of Energy ("DOE"). The DOE regulates the Company's exports of power to the Comisión Federal de Electricidad in Mexico pursuant to a license and two presidential permits issued by the DOE.

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 Part II, Item 8, Financial Statements and Supplementary Data, Note E for discussion of spent fuel storage and disposal costs.

Sales for Resale

The Company provides firm capacity and associated energy to the Rio Grande Electric Cooperative ("RGEC") pursuant to an ongoing contract with a two-year notice to terminate provision. The Company also provides network integrated transmission service to the RGEC pursuant to the Company's Open Access Transmission Tariff ("OATT"). The contract includes a formula-based rate that is updated annually to recover non-fuel generation costs and a fuel adjustment clause designed to recover all eligible fuel and purchased power costs allocable to the RGEC.

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D. Regulatory Assets and Liabilities

The Company's operations are regulated by the PUCT, the NMPRC and the FERC. Regulatory assets represent probable future recovery of previously incurred costs, which will be collected from customers through the ratemaking process. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are to be credited to customers through the ratemaking process. Regulatory assets and liabilities reflected in the Company's balance sheets are presented below (in thousands):

	Amortization Period Ends	December 31, 2015	December 31, 2014
Regulatory assets			
Regulatory tax assets (a)	(b)	\$ 69,359	\$ 66,134
Loss on reacquired debt (c)	May 2035	16,632	17,486
Final coal reclamation (d)	(e)	9,520	10,702
Nuclear fuel postload daily financing charge.....	(e)	4,195	4,127
Unrecovered issuance costs due to reissuance of PCBs (c) ...	August 2042	827	860
Texas energy efficiency.....	(f)	25	1,817
Texas 2015 rate case costs.....	(g)	1,882	169
New Mexico procurement plan costs	(g)	139	139
New Mexico renewable energy credits	(g)	6,258	5,456
New Mexico 2010 FPPCAC audit	(g)	434	434
New Mexico Palo Verde deferred depreciation.....	(b)	4,568	4,720
New Mexico 2015 rate case costs	(g)	1,288	42
Total regulatory assets		<u>\$ 115,127</u>	<u>\$ 112,086</u>
Regulatory liabilities			
Regulatory tax liabilities (a).....	(b)	\$ 17,266	\$ 17,252
Accumulated deferred investment tax credit (h)	(b)	4,011	4,334
New Mexico energy efficiency	(f)	2,238	3,904
Texas military base discount and recovery factor.....	(i)	788	609
Total regulatory liabilities		<u>\$ 24,303</u>	<u>\$ 26,099</u>

- (a) We do not earn a return on these items since the related accumulated deferred income tax assets and liabilities offset.
- (b) The amortization periods for these assets and liabilities are based upon the life of the associated assets or liabilities.
- (c) This item is recovered as a component of the weighted cost of debt and amortized over the life of the related debt issuance.
- (d) This item relates to coal reclamation costs associated with Four Corners. See Part II, Item 8, Financial Statements and Supplementary Data, Note C.
- (e) This item is recovered through fuel recovery mechanisms established by tariff.
- (f) This item is recovered or credited through a recovery factor that is set annually.
- (g) Amortization period is anticipated to be established in next general rate case.
- (h) This item is excluded from rate base.
- (i) This item represents the net asset/net liability related to the military discount which is recovered from non-military customers through a recovery factor.

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

The table below presents the balance of each major class of depreciable assets at December 31, 2015 (in thousands):

	Gross Plant	Accumulated Depreciation	Net Plant
Nuclear production	\$ 917,483	\$ (304,060)	\$ 613,423
Steam and other	907,351	(311,081)	596,270
Total production	1,824,834	(615,141)	1,209,693
Transmission	459,188	(256,899)	202,289
Distribution	1,068,108	(353,713)	714,395
General	185,862	(53,993)	131,869
Intangible	78,309	(50,097)	28,212
Total	\$ 3,616,301	\$ (1,329,843)	\$ 2,286,458

Amortization of intangible plant (software) is provided on a straight-line basis over the estimated useful life of the asset (ranging from 3 to 15 years). Effective July 2015, the Company changed the estimated useful life of certain large intangible software systems which decreased depreciation during 2015 by \$1.8 million. The expected annual effect for 2016 is approximately \$3.6 million. The table below presents the actual and estimated amortization expense for intangible plant for the previous three years and for the next five years (in thousands):

2013	\$ 7,683
2014	8,051
2015	6,482
2016 (estimated)	5,022
2017 (estimated)	4,602
2018 (estimated)	3,818
2019 (estimated)	3,382
2020 (estimated)	2,935

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.

Other jointly-owned utility plant includes a 7% interest in Units 4 and 5 at Four Corners and certain other transmission facilities. A summary of the Company's investment in jointly-owned utility plant, excluding fuel inventories, at December 31, 2015 and 2014 is as follows (in thousands):

	December 31, 2015		December 31, 2014	
	Palo Verde	Other	Palo Verde	Other
Electric plant in service	\$ 917,483	\$ 229,627	\$ 874,817	\$ 219,318
Accumulated depreciation	(304,060)	(181,886)	(286,585)	(176,492)
Construction work in progress	48,938	9,528	55,632	6,900
Total	\$ 662,361	\$ 57,269	\$ 643,864	\$ 49,726

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Palo Verde

The operation of Palo Verde and the relationship among the Palo Verde Participants is governed by the Arizona Nuclear Power Project Participation Agreement (the "ANPP Participation Agreement"). 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. 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 Company's share of direct expenses in Palo Verde and other jointly-owned utility plants is reflected in fuel expense, other operations expense, maintenance expense, miscellaneous other deductions, and taxes other than income taxes in the Company's statements of operations. 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. Because it is impracticable to predict defaulting participants, the Company cannot estimate the maximum potential amount of future payment, if any, which could be required under this provision.

Nuclear Regulatory Commission ("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.

Palo Verde Operating Licenses. Operation of each of the three Palo Verde Units requires an operating license from the NRC. The NRC issued full power operating licenses for Unit 1 in June 1985, Unit 2 in April 1986 and Unit 3 in November 1987, and issued renewed operating licenses for each of the three units in April 2011, which extended the licenses for Units 1, 2 and 3 to June 2045, April 2046 and November 2047, respectively.

Decommissioning. Pursuant to the ANPP Participation Agreement and federal law, the Company funds 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 and is required to maintain a minimum accumulation and 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 enables the Company to record a current deduction for federal income tax purposes for most of the amounts funded. At December 31, 2015, the Company's decommissioning trust fund had a balance of \$239.0 million, which is above its minimum funding level. The Company monitors the status of its decommissioning funds and adjusts its deposits, if necessary.

Decommissioning costs are estimated every three years based upon engineering cost studies performed by outside engineers retained by APS. In December 2013, the Palo Verde Participants approved the 2013 Palo Verde decommissioning study (the "2013 Study"). The 2013 Study estimated that the Company must fund approximately \$380.7 million (stated in 2013 dollars) to cover its share of decommissioning costs which was an increase in decommissioning costs of \$23.3 million (stated in 2013 dollars) from the 2010 Palo Verde decommissioning study. However, because the cash flows from the 2013 Study were less than the inflated amounts from the 2010 Study, the effect of this change lowered the ARO by \$1.9 million which lowered annual expenses starting in January 2014. Although the 2013 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. While the Company attempts to seek amounts in rates to meet its decommissioning obligations, it is not able to conclude given the evidence available to it now that it is probable these costs will continue to be collected over the period until decommissioning begins in 2044. The Company is ultimately responsible for these costs and its future actions combined with future decisions from regulators will determine how successful the Company is in this effort.

Spent Nuclear Fuel and Waste Disposal. Pursuant to the Nuclear Waste Policy Act of 1982, as amended in 1987 (the "NWPAA"), 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 by 1998. The DOE's obligations are reflected in a contract for Disposal of Spent Nuclear Fuel and/or High-Level Radioactive Waste (the "Standard Contract") with each nuclear power plant. The DOE failed to begin accepting spent nuclear fuel by 1998. On December 19, 2012, APS, acting on behalf of itself and the Palo Verde Participants, filed a second breach of contract lawsuit against the DOE. This lawsuit sought to recover damages incurred due to the DOE's failure to accept Palo Verde's spent nuclear fuel for the period beginning January 1, 2007 through June 30, 2011. On August 18, 2014, APS and the DOE entered into a settlement agreement, stipulating to a dismissal of the lawsuit and payment of \$57.4 million by the DOE to the Palo Verde Participants for certain specified costs incurred by Palo Verde during the period January 1, 2007 through June 30, 2011. On October 8, 2014, the Company received approximately \$9.1 million, representing its share of the award. The majority of the award was refunded to customers through the applicable fuel adjustment clauses. On October 31, 2014, APS acting on behalf of itself

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and the Palo Verde Participants, submitted to the government an additional request for reimbursement of spent nuclear fuel storage costs for the period July 1, 2011 through June 30, 2014. The accepted claim amount was \$42.0 million. On June 1, 2015, the Company received approximately \$6.6 million, representing its share of the award. The majority of the award was credited to customers through the applicable fuel adjustment clauses in March 2015. Thereafter APS will file annual claims for the period July 1 of the then-previous year to June 30 of the then-current year. On November 2, 2015, APS filed a \$12.0 million claim for the period July 1, 2014 through June 30, 2015. In February 2016, the DOE notified APS of the approval of the claim. Funds related to this claim are expected to be received in the second quarter of 2016. The Company's share of this claim is approximately \$1.9 million.

DOE's Construction Authorization Application for Yucca Mountain. The DOE had planned to meet its disposal obligations by designing, licensing, constructing and operating a permanent geologic repository at Yucca Mountain, Nevada. In March 2010, the DOE filed a motion to dismiss with prejudice its Yucca Mountain construction authorization application that was pending before the NRC. Several interested parties have intervened in the NRC proceeding, and the proceeding has not been conclusively decided by the NRC or the courts. Additionally, a number of interested parties have filed a variety of lawsuits in different jurisdictions around the country challenging the DOE's authority to withdraw the Yucca Mountain construction authorization application and NRC's cessation of its review of the Yucca Mountain construction authorization application. The cases have been consolidated into one matter at the U.S. Court of Appeals for the District of Columbia Circuit (the "D.C. Circuit"). In August 2013, the D.C. Circuit ordered the NRC to resume its review of the application with available appropriated funds.

On October 16, 2014, the NRC issued Volume 3 of the safety evaluation report developed as part of the Yucca Mountain construction authorization application. This volume addresses repository safety after permanent closure, and its issuance is a key milestone in the Yucca Mountain licensing process. Volume 3 contains the NRC staff's finding that the DOE's repository design meets the requirements that apply after the repository is permanently closed, including but not limited to the post-closure performance objectives in NRC's regulations.

On December 18, 2014, the NRC issued Volume 4 of the safety evaluation report developed as part of the Yucca Mountain construction authorization application. This volume covers administrative and programmatic requirements for the repository. It documents the NRC staff's evaluation of whether the DOE's research and development and performance confirmation programs, as well as other administrative controls and systems, meet applicable NRC requirements. Volume 4 contains the NRC staff's finding that most administrative and programmatic requirements in NRC regulations are met, except for certain requirements relating to ownership of land and water rights.

Publication of Volumes 3 and 4 does not signal whether or when the NRC might authorize construction of the repository. The Company cannot predict when spent fuel shipments to the DOE will commence.

Waste Confidence. On June 8, 2012, the D.C. Circuit issued its decision on a challenge by several states and environmental groups of the NRC's rulemaking regarding temporary storage and permanent disposal of high level nuclear waste and spent nuclear fuel. The petitioners challenged the NRC's 2010 update to the agency's Waste Confidence Decision and temporary storage rule ("Waste Confidence Decision").

The D.C. Circuit found that the agency's 2010 Waste Confidence Decision update constituted a major federal action, which, consistent with the National Environmental Policy Act ("NEPA"), requires either an environmental impact statement or a finding of no significant impact from the agency's actions. The D.C. Circuit found that the NRC's evaluation of the environmental risks from spent nuclear fuel was deficient, and therefore remanded the 2010 Waste Confidence Decision update for further action consistent with NEPA.

On September 6, 2012, the NRC Commissioners issued a directive to the NRC staff to proceed directly with development of a generic environmental impact statement to support an updated Waste Confidence Decision. The NRC Commissioners also directed the NRC staff to establish a schedule to publish a final rule and environmental impact study within 24 months of September 6, 2012.

In September 2013, the NRC issued its draft Generic Environmental Impact Statement ("GEIS") to support an updated Waste Confidence Decision. On August 26, 2014, the NRC approved a final rule on the environmental effects of continued storage of spent nuclear fuel. The continued storage rule adopted the findings of the GEIS regarding the environmental impacts of storing spent fuel at any reactor site after the reactor's licensed period of operations. As a result, those generic impacts do not need to be re-analyzed in the environmental reviews for individual licenses. Although Palo Verde has not been involved in any licensing actions affected by the D.C. Circuit's June 8, 2012 decision, the NRC lifted its suspension on final licensing actions on all nuclear

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power plant licenses and renewals that went into effect when the D.C. Circuit issued its June 2012 decision. The August 2014 final rule has been subject to continuing legal challenges before the NRC and the Court of Appeals.

Palo Verde has sufficient capacity at its on-site independent spent fuel storage installation ("ISFSI") to store all of the nuclear fuel that will be irradiated during the initial operating license period, which ends in December 2027. Additionally, Palo Verde has sufficient capacity at its on-site ISFSI to store a portion of the fuel that will be irradiated during the period of extended operation, which ends in November 2047. If uncertainties regarding the United States government's obligation to accept and store spent fuel are not favorably resolved, APS will evaluate alternative storage solutions that may obviate the need to expand the ISFSI to accommodate all of the fuel that will be irradiated during the period of extended operation.

The One-Mill Fee. In 2011, the National Association of Regulatory Utility Commissioners and the Nuclear Energy Institute challenged DOE's 2010 determination of the adequacy of the one tenth of a cent per kWh fee (the "one-mill fee") paid by the nation's commercial nuclear power plant owners pursuant to their individual obligations under the Standard Contract. This fee was recovered by the Company through applicable fuel adjustment clauses. In June 2012, the D.C. Circuit held that DOE failed to conduct a sufficient fee analysis in making the 2010 determination. The D.C. Circuit remanded the 2010 determination to the Secretary of the DOE ("Secretary") with instructions to conduct a new fee adequacy determination within six months. In February 2013, upon completion of DOE's revised one-mill fee adequacy determination, the court reopened the proceedings. On November 19, 2013, the D.C. Circuit ordered the Secretary to notify Congress of his intent to suspend collecting annual fees for nuclear waste disposal from nuclear power plant operators, as he is required to do pursuant to the NWPA and the court's order. On January 3, 2014, the Secretary notified Congress of his intention to suspend collection of the one-mill fee, subject to Congress' disapproval and on May 12, 2014, APS was notified by the DOE that, effective May 16, 2014, the one-mill fee would be suspended. Electricity generated and sold prior to May 16, 2014 remained subject to the one-mill fee.

NRC Oversight of the Nuclear Energy Industry in the Wake of the Earthquake and Tsunami in Japan. 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. Following the March 11, 2011 earthquake and tsunami in Japan, the NRC established a task force to conduct a systematic and methodical review of NRC processes and regulations to determine whether the agency should make additional improvements to its regulatory system. On March 12, 2012, the NRC issued the first regulatory requirements based on the recommendations of the NRC's Near Term Task Force. With respect to Palo Verde, the NRC issued two orders requiring safety enhancements regarding: (1) mitigation strategies to respond to extreme natural events resulting in the loss of power at plants; and (2) enhancement of spent fuel pool instrumentation.

The NRC has issued a series of interim staff guidance documents regarding implementation of these requirements. Palo Verde has met the NRC's imposed deadlines for installation of equipment to address these requirements, but has minor additional work to perform in 2016. Palo Verde has spent approximately \$125 million (the Company's share is \$19.7 million) on capital enhancements related to these requirements as of December 31, 2015.

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, which is currently at \$13.5 billion. This potential liability is covered by primary liability insurance provided by commercial insurance carriers in the amount of \$375 million, and the balance is covered 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 \$127.3 million, subject to an annual limit of \$19.0 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 \$60.4 million, with an annual payment limitation of approximately \$9.0 million.

The Palo Verde Participants maintain \$2.8 billion of "all risk" nuclear property insurance. The insurance provides coverage for property damage and decontamination at Palo Verde. For covered incidents involving property damage not accompanied by a release of radioactive material, the policy's coverage limit is \$2.25 billion. 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 \$12.7 million for the current policy period.

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Four Corners

The Company owns a 7% interest in Units 4 and 5 at Four Corners and shares power entitlements and allocated costs with APS, the operating agent, and the other Four Corners participants. The Company notified the other participants in 2013 that it would not continue in Four Corners after the termination of the 50-year contractual term of the participation agreement in July 2016 but that it would offer to sell its interest to them in order to facilitate their decision to extend the life of the plant. On February 17, 2015, the Company and APS entered into the Purchase and Sale Agreement providing for the purchase by APS of the Company's interests in Four Corners. The cash purchase price is equal to the net book value of the Company's interest in Four Corners at the date of closing. The anticipated closing date for the sale is July 6, 2016, pending regulatory approval. See Part II, Item 8, Financial Statements and Supplementary Data, Note C. The purchase price will be adjusted downward to reflect APS's assumption in the Agreement of the Company's obligation to pay for future plant decommissioning and mine reclamation expenses. At the closing, APS will also reimburse the Company for the undepreciated value of certain capital expenditures made prior thereto. APS will assume responsibility for all capital expenditures made after July 2016 and, with certain exceptions, any pre-2016 capital expenditures to be put into service following the closing. In addition, APS will indemnify the Company against liabilities and costs related to the future operation of Four Corners. Included in the Company's balance sheet at December 31, 2015 are obligations of \$6.7 million and \$19.3 million for plant decommissioning and mine reclamation costs, respectively, which the Company expects to pay at closing in accordance with the Agreement. Four Corners is expected to continue to provide energy to serve the native load up to the closing date. See Part II, Item 8, Financial Statements and Supplementary Data, Note C for a discussion of regulatory filings associated with Four Corners.

F. Accounting for Asset Retirement Obligation

The Company complies with the FASB guidance for ARO. This guidance affects the accounting for the decommissioning of the Company's Palo Verde and Four Corners Stations and the method used to report the decommissioning obligation. The Company also complies with the FASB guidance for conditional ARO which primarily affects the accounting for the disposal obligations of the Company's fuel oil storage tanks, water wells, evaporative ponds and asbestos found at the Company's gas-fired generating plants. The Company's ARO are subject to various assumptions and determinations such as: (i) whether a legal obligation exists to remove assets; (ii) estimation of the fair value of the costs of removal; (iii) when final removal will occur; (iv) future changes in decommissioning cost escalation rates; and (v) the credit-adjusted interest rates to be utilized in discounting future liabilities. Changes that may arise over time with regard to these assumptions and determinations will change amounts recorded in the future as an expense for ARO. The Company records the increase in the ARO due to the passage of time as an operating expense (accretion expense). If the Company incurs or assumes any liability in retiring any asset at the end of its useful life without a legal obligation to do so, it will record such retirement costs as incurred.

The ARO liability for Palo Verde is based upon the estimated cost of decommissioning the plant from the 2013 Palo Verde decommissioning study. See Part II, Item 8, Financial Statements and Supplementary Data, Note E. The ARO liability is calculated by adjusting the estimated decommissioning costs for spent fuel storage and a profit margin and market-risk premium factor. The resulting costs are escalated over the remaining life of the plant and finally discounted using a credit-risk adjusted discount rate. As Palo Verde approaches the end of its estimated useful life, the difference between the ARO liability and future current cost estimates will narrow over time due to the accretion of the ARO liability. Because the DOE is obligated to assume responsibility for the permanent disposal of spent fuel, spent fuel costs have not been included in the ARO calculation. The Company maintains six external trust funds with an independent trustee that are legally restricted to settling its ARO at Palo Verde. The fair value of the funds at December 31, 2015 is \$239.0 million.

The FASB guidance requires the Company to revise its previously recorded ARO for any changes in estimated cash flows including changes in estimated probabilities related to timing of settlements. Any changes that result in an upward revision to estimated cash flows shall be treated as a new liability. Any downward revisions to the estimated cash flows result in a reduction to the previously recorded ARO. In December 2013, the Company implemented the 2013 Palo Verde decommissioning study, and as a result, revised its ARO related to Palo Verde to decrease its estimated cash flows from the 2010 Study to the 2013 Study (see Part II, Item 8, Financial Statements and Supplementary Data, Note E). The assumptions used to calculate the Palo Verde ARO liability are as follows:

	Escalation Rate	Credit-Risk Adjusted Discount Rate
Original ARO liability.....	3.60%	9.50%
Incremental ARO liability.....	3.60%	6.20%

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An analysis of the activity of the Company's total ARO liability from January 1, 2013 through December 31, 2015, including the effects of each year's estimate revisions, is presented below. In 2014, the estimate revision includes an adjustment to Four Corners due to the early recognition of the obligation resulting from the purchase agreement with APS. In 2013, the estimate revision includes a change to the probability of extending Four Corners' operating term and decreases in the estimated cash flows related to Palo Verde's decommissioning due to implementing the 2013 Palo Verde decommissioning study.

	2015	2014	2013
ARO liability at beginning of year	\$ 74,577	\$ 65,214	\$ 62,784
Liabilities incurred	189	—	—
Liabilities settled	—	—	(36)
Revisions to estimate	—	3,561	(3,401)
Accretion expense	6,855	5,802	5,867
ARO liability at end of year	<u>\$ 81,621</u>	<u>\$ 74,577</u>	<u>\$ 65,214</u>

The Company has transmission and distribution lines which are operated under various property easement agreements. If the easements were to be released, the Company may have a legal obligation to remove the lines; however, the Company has assessed the likelihood of this occurring as remote. The majority of these easements include renewal options which the Company routinely exercises. The amount of cost of removal collected in rates for non-legal liabilities has not been material.

G. Common Stock

Overview

The Company's common stock has a stated value of \$1 per share, with no cumulative voting rights or preemptive rights. Holders of the common stock have the right to elect the Company's directors and to vote on other matters.

Long-Term Incentive Plan

On May 29, 2014, the Company's shareholders approved an amended and restated stock-based long-term incentive plan (the "Amended and Restated 2007 LTIP") and authorized the issuance of up to 1.7 million shares of the Company's common stock for the benefit of directors and employees. Under the Amended and Restated 2007 LTIP, shares of the Company's common stock may be issued through the award or grant of non-statutory stock options, incentive stock options, stock appreciation rights, restricted stock, bonus stock, performance stock, cash-based awards and other stock-based awards. The Company may issue new shares, purchase shares on the open market, or issue shares from shares of the Company's common stock the Company has repurchased to meet the share requirements of the Amended and Restated 2007 LTIP. Beginning in 2015, shares of the Company's common stock issued for employee benefit and stock incentive plans have been issued from the shares repurchased and held in treasury stock. As discussed in Part II, Item 8, Financial Statements and Supplementary Data, Note A, the Company accounts for its stock-based long-term incentive plan under the FASB guidance for stock-based compensation.

Stock Options. Stock options have been granted at exercise prices equal to or greater than the market value of the underlying shares at the date of grant. The fair value for these options was estimated at the grant date using the Black-Scholes option pricing model. The options expired ten years from the date of grant unless terminated earlier by the Board of Directors (the "Board"). Stock options have not been granted since 2003.

The 15,000 options outstanding at December 31, 2012 were exercised during 2013 with a weighted average exercise price of \$12.78. The Company received \$0.2 million in cash and realized a current tax benefit of \$0.1 million. The Company had no stock options outstanding as of December 31, 2014 and December 31, 2015.

The intrinsic value of stock options exercised in 2013 was \$0.3 million. No options were forfeited, vested or expired during 2015, 2014 and 2013. No compensation cost was recognized in 2015, 2014 and 2013 for stock options.

Restricted Stock with Service Condition and Other Stock-Based Awards. The Company has awarded restricted stock and other stock-based awards under its long-term incentive plan. Restrictions from resale on restricted stock awards generally lapse and awards vest over periods of one to three years. The market value of the unvested restricted stock at the date of grant is amortized to expense over the restriction period net of anticipated forfeitures.

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Other stock-based awards are fully vested and are expensed at fair value on the date of grant. Previously directors could elect to receive retainers and meeting fees in cash, restricted stock, or a combination of cash and stock. On May 29, 2014, the Board of Directors voted to revise the terms of the restricted stock awards granted to directors in lieu of cash for retainers and meeting fees. Stock elections by directors in lieu of cash for retainer and meeting fees are now fully vested and are expensed at fair value on the date of grant. The modification to 13,863 outstanding restricted stock awards granted to directors resulted in forfeiture of those awards and the granting of new awards which were fully vested and expensed at \$37.81 per share, the fair value on the date of grant. Effective fiscal year ended December 31, 2015, other stock-based awards are not included in the tables below.

The expense, deferred tax benefit, and current tax expense recognized related to restricted stock and other stock-based awards in 2015, 2014 and 2013 is presented below (in thousands):

	2015	2014	2013
Expense (a).....	\$ 2,755	\$ 3,471	\$ 2,458
Deferred tax benefit	964	1,215	860
Current tax benefit recognized.....	43	39	109

(a) Any capitalized costs related to these expenses is less than \$0.3 million for all years.

The aggregate intrinsic value and fair value at grant date of restricted stock and other stock-based awards which vested in 2015, 2014 and 2013 is presented below (in thousands):

	2015	2014	2013
Aggregated intrinsic value.....	\$ 3,451	\$ 3,441	\$ 2,077
Fair value at grant date	3,327	3,330	1,765

The unvested restricted stock transactions for 2015 are presented below:

	Total Shares	Weighted Average Grant Date Fair Value	Unrecognized Compensation Expense (a) (In thousands)	Aggregate Intrinsic Value (In thousands)
Restricted shares outstanding at December 31, 2014	124,297	\$ 35.81		
Stock awards.....	72,187	37.17		
Vested	(92,188)	36.09		
Forfeitures.....	(13,086)	35.76		
Restricted shares outstanding at December 31, 2015	91,210	36.61	\$ 1,397	\$ 3,512

(a) The unrecognized compensation expense is expected to be recognized over the weighted average remaining contractual term of the outstanding restricted stock of approximately one year.

The weighted average fair value per share at grant date for restricted stock and other stock-based awards granted during 2015, 2014 and 2013 were:

	2015	2014	2013
Weighted average fair value per share	\$ 37.17	\$ 36.95	\$ 35.48

The holder of a restricted stock award has rights as a shareholder of the Company, including the right to vote and receive cash dividends on restricted stock.

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Restricted Stock with a Performance Condition. On December 15, 2015, the Company issued a stock based retention grant to the Chief Executive Officer of 27,624 shares in accordance with of the Company's Amended and Restated 2007 LTIP that is eligible for vesting based on the achievement of certain performance conditions and a five year service period, as stated in the employment agreement. As of December 31, 2015, the adjusted grant date fair value for the award was \$30.43, unrecognized compensation expense was \$0.7 million, and the intrinsic value was \$1.1 million. For 2015, the Company recognized \$6,000 as compensation expense and \$2,000 of deferred tax benefit related to this grant.

Restricted Stock with a Market Condition (Performance Shares). The Company has granted performance share awards to certain officers under the Company's Amended and Restated 2007 LTIP, which provides for issuance of Company stock based on the achievement of certain performance criteria over a three-year period. The payout varies between 0% to 200% of performance share awards.

Detail of performance shares vested follows:

Date Vested	Payout Ratio	Performance Shares Awarded	Compensation Costs Expensed	Period Compensation Costs Expensed	Aggregated Intrinsic Value
			(In thousands)		(In thousands)
January 27, 2016	0%	0	\$ 851	2013-2015	\$ —
February 20, 2015	0%	0	1,502	2012-2014	—
February 18, 2014	0%	0	954	2011-2013	—
January 29, 2013	150.0%	64,275	849	2010-2012	2,176

In 2016, 2017 and 2018, subject to meeting certain performance criteria, additional performance shares could be awarded. In accordance with the FASB guidance related to stock-based compensation, the Company recognizes the related compensation expense by ratably amortizing the grant date fair value of awards over the requisite service period and the compensation expense is only adjusted for forfeitures. Excluding the 2013 award, the actual number of shares to be issued can range from zero to 155,970 shares.

The fair value at the date of each separate grant of performance shares was based upon a Monte Carlo simulation. The Monte Carlo simulation reflected the structure of the performance plan which calculates the share payout on performance of the Company relative to a defined peer group over a three-year performance period based upon total return to shareholders. The fair value was determined as the average payout of one million simulation paths discounted to the grant date using a risk-free interest rate based upon the constant maturity treasury rate yield curve at the grant date. The expected volatility of total return to shareholders is calculated in accordance with the plan's term structure and includes the volatilities of all members of the defined peer group.

The outstanding performance share awards at the 100% performance level is summarized below:

	Number Outstanding	Weighted Average Grant Date Fair Value	Unrecognized Compensation Expense (a)	Aggregate Intrinsic Value
			(In thousands)	(In thousands)
Performance shares outstanding at December 31, 2014 ...	121,481	\$ 30.71		
Performance share awards	52,948	35.72		
Performance shares expired	(57,299)	29.51		
Performance shares forfeited	(14,618)	35.13		
Performance shares outstanding at December 31, 2015 ...	102,512	33.34	\$ 1,112	\$ 3,947

(a) The unrecognized compensation expense is expected to be recognized over the weighted average remaining contractual term of the awards of approximately one year.

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A summary of information related to performance shares for 2015, 2014 and 2013 is presented below:

	2015	2014	2013
Weighted average per share grant date fair value per share of performance shares awarded	\$ 35.72	\$ 26.36	\$ 34.69
Fair value of performance shares vested (in thousands)	—	—	849
Intrinsic value of performance shares vested (in thousands) (a)	—	—	1,450
Compensation expense (in thousands) (b)	1,042	1,181	1,188
Deferred tax benefit related to compensation expense (in thousands)	365	413	416

(a) Based on a 100% performance level.

(b) Includes adjustments for forfeiture of performance share awards by certain executives.

Repurchase Program

No shares of the Company's common stock were repurchased during the twelve months ended December 31, 2015. Detail regarding the Company's stock repurchase program are presented below:

	Since 1999 (a)	Authorized Shares
Shares repurchased (b)	25,406,184	
Cost, including commission (in thousands)	\$ 423,647	
Total remaining shares available for repurchase at December 31, 2015		393,816

(a) Represents repurchased shares and cost since inception of the stock repurchase program in 1999.

(b) Shares repurchased does not include 86,735 treasury shares related to employee compensation arrangements outside of the Company's repurchase programs. Beginning in 2015, shares of the Company's common stock issued for employee benefit and stock incentive plans have been issued from the shares repurchased and held in treasury stock. The Company awarded 108,085 shares out of treasury stock during 2015.

The Company may in the future make purchases of shares of its common stock pursuant to its authorized program in open market transactions at prevailing prices and may engage in private transactions where appropriate. The repurchased shares will be available for issuance under employee benefit and stock incentive plans, or may be retired.

Dividend Policy

On December 30, 2015, the Company paid \$11.9 million in quarterly cash dividends to shareholders. The Company paid a total of \$47.1 million, \$44.6 million and \$42.0 million in cash dividends during the twelve months ended December 31, 2015, 2014 and 2013, respectively. On January 28, 2016, the Board of Directors declared a quarterly cash dividend of \$0.295 per share payable on March 31, 2016 to shareholders of record as of the close of business on March 15, 2016.

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Basic and Diluted Earnings Per Share

The FASB guidance requires the Company to include share-based compensation awards that qualify as participating securities in both basic and diluted earnings per share to the extent they are dilutive. A share-based compensation award is considered a participating security if it receives non-forfeitable dividends or may participate in undistributed earnings with common stock. The Company awards unvested restricted stock which qualifies as a participating security. The basic and diluted earnings per share are presented below:

	Years Ended December 31,		
	2015	2014	2013
Weighted average number of common shares outstanding:			
Basic number of common shares outstanding	40,274,986	40,190,991	40,114,594
Dilutive effect of unvested performance awards	33,576	20,726	12,053
Diluted number of common shares outstanding	40,308,562	40,211,717	40,126,647
Basic net income per common share:			
Net income	\$ 81,918	\$ 91,428	\$ 88,583
Income allocated to participating restricted stock	(243)	(301)	(254)
Net income available to common shareholders	\$ 81,675	\$ 91,127	\$ 88,329
Diluted net income per common share:			
Net income	\$ 81,918	\$ 91,428	\$ 88,583
Income reallocated to participating restricted stock	(243)	(301)	(254)
Net income available to common shareholders	\$ 81,675	\$ 91,127	\$ 88,329
Basic net income per common share:			
Distributed earnings	\$ 1.165	\$ 1.105	\$ 1.045
Undistributed earnings	0.865	1.165	1.155
Basic net income per common share	\$ 2.030	\$ 2.270	\$ 2.200
Diluted net income per common share:			
Distributed earnings	\$ 1.165	\$ 1.105	\$ 1.045
Undistributed earnings	0.865	1.165	1.155
Diluted net income per common share	\$ 2.030	\$ 2.270	\$ 2.200

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

	Year Ended December 31,		
	2015	2014	2013
Restricted stock awards	56,375	60,455	51,489
Performance shares (a)	66,804	96,208	115,044

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

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H. Accumulated Other Comprehensive Income (Loss)

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

	Unrecognized Pension and Post- retirement Benefit Costs	Net Unrealized Gains (Losses) on Marketable Securities	Net Losses on Cash Flow Hedges	Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 2012.....	\$ (75,737)	\$ 22,194	\$ (12,541)	\$ (66,084)
Other comprehensive income before reclassifications.....	51,371	14,482	—	65,853
Amounts reclassified from accumulated other comprehensive income (loss).....	3,036	(436)	243	2,843
Balance at December 31, 2013.....	(21,330)	36,240	(12,298)	2,612
Other comprehensive income (loss) before reclassifications.....	(12,628)	8,694	—	(3,934)
Amounts reclassified from accumulated other comprehensive income (loss).....	(926)	(5,977)	224	(6,679)
Balance at December 31, 2014.....	(34,884)	38,957	(12,074)	(8,001)
Other comprehensive income (loss) before reclassifications.....	3,777	(2,255)	—	1,522
Amounts reclassified from accumulated other comprehensive income (loss).....	1,238	(8,937)	264	(7,435)
Balance at December 31, 2015.....	\$ (29,869)	\$ 27,765	\$ (11,810)	\$ (13,914)

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Amounts reclassified from accumulated other comprehensive income (loss) for the twelve months ended December 31, 2015, 2014 and 2013 are as follows (in thousands):

Details about Accumulated Other Comprehensive Income (Loss) Components	2015	2014	2013	Affected Line Item in the Statement of Operations
Amortization of pension and post- retirement benefit costs:				
Prior service benefit	\$ 6,574	\$ 7,659	\$ 5,560	(a)
Net loss.....	<u>(8,622)</u>	<u>(6,182)</u>	<u>(10,472)</u>	(a)
	(2,048)	1,477	(4,912)	(a)
Income tax effect.....	<u>810</u>	<u>(551)</u>	<u>1,876</u>	
	<u>(1,238)</u>	<u>926</u>	<u>(3,036)</u>	(a)
Marketable securities:				
Net realized gain on sale of securities..	<u>11,114</u>	<u>7,350</u>	<u>553</u>	Investment and interest income, net
	11,114	7,350	553	Income before income taxes
Income tax effect.....	<u>(2,177)</u>	<u>(1,373)</u>	<u>(117)</u>	Income tax expense
	<u>8,937</u>	<u>5,977</u>	<u>436</u>	Net income
Loss on cash flow hedge:				
Amortization of loss.....	<u>(467)</u>	<u>(438)</u>	<u>(411)</u>	Interest on long- term debt and RCF
	(467)	(438)	(411)	Income before income taxes
Income tax effect.....	<u>203</u>	<u>214</u>	<u>168</u>	Income tax expense
	<u>(264)</u>	<u>(224)</u>	<u>(243)</u>	Net income
Total reclassifications.....	<u>\$ 7,435</u>	<u>\$ 6,679</u>	<u>\$ (2,843)</u>	

(a) These items are included in the computation of net periodic benefit cost. See Part II, Item 8, Financial Statements and Supplementary Data, Note M for additional information.

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I. Long-Term Debt and Financing Obligations

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

	December 31,	
	2015	2014
	(In thousands)	
Long-Term Debt:		
Pollution Control Bonds (1):		
7.25% 2009 Series A refunding bonds, due 2040 (7.46% effective interest rate).....	\$ 63,500	\$ 63,500
4.50% 2012 Series A refunding bonds, due 2042 (4.63% effective interest rate).....	59,235	59,235
7.25% 2009 Series B refunding bonds, due 2040 (7.49% effective interest rate).....	37,100	37,100
1.875% 2012 Series A refunding bonds, due 2032 (2.35% effective interest rate).....	33,300	33,300
Total Pollution Control Bonds.....	193,135	193,135
Senior Notes (2):		
6.00% Senior Notes, net of discount, due 2035 (7.12% effective interest rate).....	398,069	398,021
7.50% Senior Notes, net of discount, due 2038 (7.67% effective interest rate).....	148,838	148,818
3.30% Senior Notes, net of discount, due 2022 (3.43% effective interest rate).....	149,766	149,737
5.00% Senior Notes, net of discount, due 2044 (5.10% effective interest rate).....	149,476	149,468
Total Senior Notes.....	846,149	846,044
RGRT Senior Notes (3):		
3.67% Senior Notes, Series A, due 2015 (3.87% effective interest rate).....	—	15,000
4.47% Senior Notes, Series B, due 2017 (4.62% effective interest rate).....	50,000	50,000
5.04% Senior Notes, Series C, due 2020 (5.16% effective interest rate).....	45,000	45,000
Total RGRT Senior Notes.....	95,000	110,000
Total long-term debt.....	1,134,284	1,149,179
Financing Obligations:		
Revolving Credit Facility (\$141,738 due in 2016) (4).....	141,738	14,532
Total long-term debt and financing obligations.....	1,276,022	1,163,711
Current Portion (amount due within one year):		
Current maturities of long term debt	—	(15,000)
Short-term borrowings under the revolving credit facility	(141,738)	(14,532)
	\$ 1,134,284	\$ 1,134,179

(1) Pollution Control Bonds ("PCBs")

The Company has four series of tax exempt unsecured PCBs in aggregate principal amount of \$193.1 million. The 1.875% 2012 Series A (El Paso Electric Company Four Corners Project) Pollution Control Refunding Revenue Bonds with an aggregate principal amount of \$33.3 million are subject to mandatory tender for purchase in September 2017.

(2) Senior Notes

The Senior Notes are unsecured obligations of the Company. They were issued pursuant to bond covenants that provide limitations on the Company's ability to enter into certain transactions. The 6.00% Senior Notes have an aggregate principal amount of \$400.0 million and were issued in May 2005. The proceeds, net of a \$2.3 million discount, were used to fund the retirement of the Company's first mortgage bonds. The Company amortizes the loss associated with a cash flow hedge recorded in accumulated other comprehensive income to earnings as interest expense over the life of the 6.00% Senior Notes. See Part II, Item 8, Financial Statements and Supplementary Data, Note O. This amortization is included in the effective interest rate of the 6.00% Senior Notes.

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The 7.50% Senior Notes have an aggregate principal amount of \$150.0 million and were issued in June 2008. The proceeds, net of a \$1.3 million discount, were used to repay short-term borrowings of \$44.0 million, fund capital expenditures and for other general corporate purposes.

The 3.30% Senior Notes have an aggregate principal amount of \$150.0 million and were issued in December 2012. The proceeds, net of a \$0.3 million discount, were used to fund construction expenditures and for working capital and general corporate purposes.

The 5.00% Senior Notes have an aggregate principal amount of \$150.0 million and were issued in December 2014. The proceeds, net of a \$0.5 million discount, were used to fund construction expenditures and for working capital and general corporate purposes.

(3) RGRT Senior Notes

In 2010, the Company and RGRT, a Texas grantor trust through which the Company finances its portion of fuel for Palo Verde, entered into a note purchase agreement with various institutional purchasers. Under the terms of the agreement, RGRT sold to the purchasers \$110 million aggregate principal amount of Senior Notes (the "Notes"). In August 2015, \$15.0 million of these Notes matured and were paid with borrowings from the RCF. The Company guarantees the payment of principal and interest on the Notes. In the Company's financial statements, the assets and liabilities of the RGRT are reported as assets and liabilities of the Company.

RGRT pays interest on the Notes on February 15, and August 15 of each year until maturity. RGRT may redeem the Notes, in whole or in part, at any time at a redemption price equal to 100% of the principal amount to be redeemed together with the interest on such principal amount accrued to the date of redemption, plus a make-whole amount based on the prevailing market interest rates. The agreement requires compliance with certain covenants, including a total debt to capitalization ratio. The Company was in compliance with these requirements throughout 2015.

The sale of the Notes was made by RGRT in reliance on a private placement exemption from registration under the Securities Act of 1933, as amended. The proceeds of \$109.4 million, net of issuance costs, from the sale of the Notes was used by RGRT to repay amounts borrowed under the revolving credit facility and will enable future nuclear fuel financing requirements of RGRT to be met with a combination of the Notes and amounts borrowed from the RCF.

(4) Revolving Credit Facility

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

The RCF provides that amounts borrowed by the Company may be used for, among other things, working capital and general corporate purposes. Any amounts borrowed by RGRT may be used, among other things, to finance the acquisition and processing of nuclear fuel. Amounts borrowed by RGRT are guaranteed by the Company and the balance borrowed under the RCF is recorded as short-term borrowings on the balance sheet. The RCF is unsecured. The RCF requires compliance with certain covenants, including a total debt to capitalization ratio. The Company was in compliance with these requirements throughout 2015. In August 2015, \$15.0 million aggregate principal amount of Series A 3.67% Senior Notes of RGRT matured and were paid utilizing borrowings under the RCF. As of December 31, 2015, the total amount borrowed by RGRT was \$33.7 million for nuclear fuel under the RCF. As of December 31, 2015, \$108.0 million of borrowings were outstanding under this facility for working capital and general corporate purposes. The weighted average interest rate on the RCF was 1.4% as of December 31, 2015.

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As of December 31, 2015, the scheduled maturities for the next five years of long-term debt are as follows (in thousands):

2016.....	\$	—
2017.....		83,300
2018.....		—
2019.....		—
2020.....		45,000

The \$33.7 million outstanding on the RCF for nuclear fuel financing purposes is anticipated to be paid in 2016.

J. Income Taxes

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at December 31, 2015 and 2014 are presented below (in thousands):

	December 31,	
	2015	2014
Deferred tax assets:		
Benefit of tax loss carryforwards	\$ 35,153	\$ —
Alternative minimum tax credit carryforward.....	16,620	17,701
Pensions and benefits	61,673	64,407
Asset retirement obligation.....	28,042	25,725
Deferred fuel.....	1,488	—
Other	15,421	15,768
Total gross deferred tax assets.....	158,397	123,601
Deferred tax liabilities:		
Plant, principally due to depreciation and basis differences	(608,738)	(536,264)
Decommissioning	(41,100)	(40,373)
Deferred fuel.....	—	(3,531)
Other	(3,796)	(3,630)
Total gross deferred tax liabilities.....	(653,634)	(583,798)
Net accumulated deferred income taxes	<u>\$ (495,237)</u>	<u>\$ (460,197)</u>

Based on the average annual book income before taxes for the prior three years, excluding the effects of unusual or infrequent items, the Company believes that the deferred tax assets will be fully realized at current levels of book and taxable income.

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The Company recognized income tax expense for 2015, 2014 and 2013 as follows (in thousands):

	Years Ended December 31,		
	2015	2014	2013
Income tax expense:			
Federal:			
Current	\$ 2,319	\$ (1,250)	\$ (2,877)
Deferred	32,819	38,810	45,024
Total federal income tax.....	35,138	37,560	42,147
State:			
Current	1,730	3,209	1,854
Deferred	(1,650)	641	(414)
Total state income tax.....	80	3,850	1,440
Generation (amortization) of accumulated investment tax credits	(323)	(322)	68
Total income tax expense.....	\$ 34,895	\$ 41,088	\$ 43,655

As of December 31, 2015, the Company had \$16.6 million of AMT credit carryforwards that have an unlimited life. As of December 31, 2015, the Company had \$34.1 million of federal and \$1.1 million of state tax loss carryforwards. If unused, both the federal and state tax loss carryforwards have lives of 20 years and 5 years respectively.

Income tax provisions differ from amounts computed by applying the statutory federal income tax rate of 35% to book income before federal income tax as follows (in thousands):

	Years Ended December 31,		
	2015	2014	2013
Federal income tax expense computed on income at statutory rate.....	\$ 40,885	\$ 46,381	\$ 46,283
Difference due to:			
State taxes, net of federal benefit.....	52	1,902	936
AEFUDC	(2,345)	(3,757)	(2,149)
Permanent tax differences.....	(2,898)	(2,921)	(1,153)
Other	(799)	(517)	(262)
Total income tax expense.....	\$ 34,895	\$ 41,088	\$ 43,655
Effective income tax rate	29.9%	31.0%	33.0%

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

On December 18, 2015, the President signed the Protecting Americans from Tax Hikes Act of 2015. This act included the extension of bonus depreciation and certain credits which impacted the Company. The Company recorded the impacts of the law change in December 2015, which did not have a material impact on the financial position of the Company.

The FASB guidance prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In January 2010, the Company filed for a change of accounting method with the Internal Revenue Service ("IRS") related to the way in which units of property are determined for purposes of determining capitalized tax assets. The change was included in the 2009 federal income tax return, with additional amounts included in the 2010 to 2013 federal income tax returns. In 2013, a \$4.5 million decrease was made to the reserve related to the change in accounting method. The decrease was primarily the result of the completion of IRS audits for tax years 2009 to 2012. In September 2014, the Company received an Issue Resolution Agreement ("IRA") from IRS regarding the generation repairs deduction for all years. In the IRA, the IRS declared that the method used by the Company to calculate the generation repair deduction was substantially the same as the method outlined in the Revenue Procedure and declared that therefore no

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adjustment to the deduction taken in previous tax returns by the Company was required. As a result of the IRA, in 2014 the Company recorded a \$2.8 million decrease to eliminate the balance of the reserve related to the change in accounting method. The Company recorded an unrecognized tax position of \$0.8 million, \$2.1 million, and \$0.5 million in 2015, 2014, and 2013, respectively, related to depreciation and other amounts deducted in current and prior year Texas franchise tax returns. The Company recorded a decrease of \$1.3 million (net of an increase of \$0.4 million) in 2014 and an increase of \$1.3 million (net of a decrease of \$0.4 million) in 2013 related to tax credits taken in prior year Arizona income tax returns, which have been settled through audit. A reconciliation of the December 31, 2015, 2014 and 2013 amounts of unrecognized tax benefits are as follows (in thousands):

	2015	2014	2013
Balance at January 1	\$ 5,200	\$ 7,200	\$ 9,800
Additions for tax positions related to the current year.....	500	300	600
Reductions for tax positions related to the current year	—	—	—
Additions for tax positions of prior years	300	2,200	1,700
Reductions for tax positions of prior years	—	(4,500)	(4,900)
Balance at December 31	<u>\$ 6,000</u>	<u>\$ 5,200</u>	<u>\$ 7,200</u>

If recognized, \$3.6 million of the unrecognized tax position at December 31, 2015, would affect the effective tax rate. The Company recognized income tax expense for an unrecognized tax position of \$0.8 million for the year ended December 31, 2015.

The Company recognizes in tax expense interest and penalties related to tax benefits that have not been recognized. For the years ended December 31, 2015, 2014, and 2013 the Company recognized interest expense of \$0.2 million, \$0.1 million, and \$0.2 million, respectively. The Company had approximately \$0.7 million and \$0.5 million accrued for the payment of interest and penalties at December 31, 2015 and 2014, respectively.

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K. Commitments, Contingencies and Uncertainties

Power Purchase and Sale Contracts

To supplement its own generation and operating reserve requirements and to meet required renewable portfolio standards, the Company engages in power purchase arrangements that may vary in duration and amount based on an evaluation of the Company's resource needs, the economics of the transactions, and specific renewable portfolio requirements. The Company has entered into the following significant agreements with various counterparties for the purchase and sale of electricity:

Type of Contract	Counterparty	Quantity	Term	Commercial Operation Date
Power Purchase and Sale Agreement	Freeport	25 MW	December 2008 through December 2016	N/A
Power Purchase and Sale Agreement	Freeport	100 MW	June 2006 through December 2021	N/A
Power Purchase Agreement	Hatch Solar Energy Center I, LLC	5 MW	July 2011 through June 2036	July 2011
Power Purchase Agreement	NRG	20 MW	August 2011 through August 2031	August 2011
Power Purchase Agreement	SunE EPE1, LLC	10 MW	June 2012 through June 2037	June 2012
Power Purchase Agreement	SunE EPE2, LLC	12 MW	May 2012 through May 2037	May 2012
Power Purchase Agreement	Macho Springs Solar, LLC	50 MW	May 2014 through April 2034	May 2014
Power Purchase Agreement	Newman Solar LLC	10 MW	December 2014 through November 2044	December 2014

The Company has a firm Power Purchase and Sale Agreement with Freeport-McMoran Copper & Gold Energy Services LLC ("Freeport") that provides for Freeport to deliver energy to the Company from the Luna Energy Facility (a 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 Greenlee, Arizona. The Company may purchase the quantities noted in the table above at a specified price at times when energy is not exchanged under the Power Purchase and Sale Agreement. The agreement was approved by the FERC and will continue through an initial term ending December 31, 2021, with subsequent rollovers until terminated. Upon mutual agreement, the Power Purchase and Sale Agreement allows the parties to increase the amount of energy that is purchased and sold under the agreement. The parties have agreed to increase the amount up to 125 MW through December 2016.

The Company has entered into several power purchase agreements to help meet its renewable portfolio requirements. Namely, the Company has a 25-year purchase power agreement with Hatch Solar Energy Center I, LLC to purchase all of the output from a solar photovoltaic plant located in southern New Mexico which began commercial operation in July 2011. In June 2015, the Company entered into a consent agreement with Hatch Solar Energy Center I, LLC to provide for additional or replacement photovoltaic modules. The Company also entered into a 20-year contract with NRG Solar Roadrunner LLC ("NRG") to purchase all of the output of a solar photovoltaic plant built in southern New Mexico which began commercial operation in August 2011. In addition, the Company has 25-year purchase power agreements to purchase all of the output of two additional solar photovoltaic plants located in southern New Mexico, SunE EPE1, LLC and SunE EPE2, LLC which began commercial operation in June 2012 and May 2012, respectively.

Furthermore, the Company has a 20-year purchase power agreement with Macho Springs Solar, LLC to purchase the entire generation output delivered from the 50 MW Macho Springs solar photovoltaic plant located in Luna County, New Mexico which began commercial operation in May 2014. Finally, the Company has a 30-year purchase power agreement with Newman Solar LLC to purchase the total output of approximately 10 MW from a solar photovoltaic plant on land subleased from the Company in proximity to its Newman Power Station. This solar photovoltaic plant began commercial operation in December 2014.

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Environmental Matters

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

Air Emissions. The U.S. Clean Air Act ("CAA"), associated regulations and comparable state and local laws and regulations relating to air emissions impose, among other obligations, limitations on pollutants generated during the operations of the Company's facilities and assets, including sulfur dioxide ("SO₂"), particulate matter ("PM"), nitrogen oxides ("NO_x") and mercury.

Clean Air Interstate Rule/Cross State Air Pollution Rule. The EPA promulgated the Cross-State Air Pollution Rule ("CSAPR") in August 2011, which rule involves requirements to limit emissions of NO_x and SO₂ from certain of the Company's power plants in Texas and/or purchase allowances representing other parties' emissions reductions. CSAPR was intended to replace the EPA's 2005 Clean Air Interstate Rule ("CAIR"). While the U.S. Court of Appeals for the District of Columbia Circuit ("D.C. Circuit") vacated CSAPR in August 2012 and allowed CAIR to stand until the EPA issued a proper replacement, on April 29, 2014, the U.S. Supreme Court reversed and upheld CSAPR, remanding certain portions of CSAPR to the D.C. Circuit for further consideration. On June 26, 2014, the EPA filed a motion asking the D.C. Circuit to lift its stay on CSAPR, and on October 23, 2014, the D.C. Circuit lifted its stay of CSAPR. On July 28, 2015, the D.C. Circuit ruled that the EPA's emissions budgets for 13 states including Texas are invalid but left the rule in place on remand. On December 3, 2015, EPA published the proposed CSAPR Update Rule with a 60-day public comment period. While we are unable to determine the full impact of this decision until EPA takes further action, the Company believes it is currently positioned to comply with CSAPR.

National Ambient Air Quality Standards ("NAAQS"). Under the CAA, the EPA sets NAAQS for six criteria pollutants considered harmful to public health and the environment, including PM, NO_x, carbon monoxide ("CO"), ozone and SO₂. NAAQS must be reviewed by the EPA at five-year intervals. In 2010, the EPA tightened the NAAQS for both nitrogen dioxide ("NO₂") and SO₂. The EPA is considering a 1-hour secondary NAAQS for NO₂ and SO₂. In January 2013, the EPA tightened the NAAQS for fine PM. On October 1, 2015, following on its November 2014 proposal, EPA released a final rule tightening the primary and secondary NAAQS for ground-level ozone from its 2008 standard levels of 75 parts per billion ("ppb") to 70 ppb. Ozone is the main component of smog. While not directly emitted into the air, it forms from precursors, including NO_x and volatile organic compounds, in combination with sunlight. The EPA is expected to make attainment/nonattainment designations for the revised ozone standards by October 1, 2017. While it is currently unknown how the areas in which we operate will be designated, for nonattainment areas classified as "Moderate" and above, states, and any tribes that choose to do so, are expected to be required to complete development of implementation plans in the 2020-2021 timeframe. Most nonattainment areas are expected to have until 2020 or 2023 to meet the primary (health) standard, with the exact attainment date varying based on the ozone level in the area. The Company continues to evaluate what impact these final and proposed NAAQS could have on its operations. If the Company is required to install additional equipment to control emissions at its facilities, the NAAQS, individually or in the aggregate, could have a material impact on its operations and financial results.

Mercury and Air Toxics Standards. The operation of coal-fired power plants, such as Four Corners, results in emissions of mercury and other air toxics. In December 2011, the EPA finalized Mercury and Air Toxics Standards (known as the "MATS Rule") for oil- and coal-fired power plants, which requires significant reductions in emissions of mercury and other air toxics. Several judicial and other challenges have been made to this rule, and on June 29, 2015, the U.S. Supreme Court remanded the rule to the D.C. Circuit Court. On December 15, 2015, the D.C. Circuit Court issued an order remanding the rule to EPA but did not vacate the rule during remand. EPA expects to issue a revised "appropriate and necessary" finding by April 15, 2016. The legal status of the MATS Rule notwithstanding, the Four Corners plant operator, APS, believes Units 4 and 5 will require no additional modifications to achieve compliance with the MATS Rule, as currently written. We cannot currently predict, however, what additional modifications or costs may be incurred if the EPA rewrites the MATS Rule on remand.

Other Laws and Regulations and Risks. The Company has entered into an agreement to sell its interest in Four Corners to APS at the expiration of the 50-year participation agreement in July 2016. The Company believes that it has better economic and cleaner alternatives for serving the energy needs of its customers than coal-fired generation, which is subject to extensive regulation and litigation. By ceasing its participation in Four Corners, the Company expects to avoid the significant cost required to install

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expensive pollution control equipment in order to continue operation of the plant as well as the risks of water availability that might adversely affect the amount of power available, or the price thereof, from Four Corners in the future. The closing of the transaction is subject to the receipt of regulatory approvals (see Part II, Item 8, Financial Statements and Supplementary Data, Note C).

Coal Combustion Waste. On October 19, 2015 the EPA's final rule regulating the disposal of coal combustion residuals (the "CCR Rule") from electric utilities as solid waste took effect. The Company has a 7% ownership interest in Units 4 and 5 of Four Corners, the only coal-fired generating facility for which the Company has an ownership interest subject to the CCR Rule. The Company entered into a Purchase and Sale Agreement with APS in February 2015 to sell the Company's entire ownership interest in Four Corners. The CCR Rule requires plant owners to treat coal combustion residuals as Subtitle D (as opposed to a more costly Subtitle C) waste. In general, the Company is liable for only 7% of costs to comply with the CCR Rule (consistent with our ownership percentage). The Company, however, believes under the terms of the Purchase Agreement and after the pending sale, as a former owner, that the Company is not responsible for a significant portion of the costs under the CCR Rule, such as ongoing operational costs after July 2016. Accordingly, the Company does not expect the CCR Rule to have a significant impact on our financial condition or results of operations.

On November 3, 2015, the EPA published a final rule revising wastewater effluent limitation guidelines for steam electric power generators (the "Revised ELG Rule"). The Revised ELG Rule establishes requirements for wastewater streams from certain processes at affected facilities, including limits on toxic metals in wastewater discharges. Facilities must comply with the Revised ELG Rule between 2018 and 2023. The EPA anticipates that the new requirements in the Revised ELG Rule will only affect certain coal-fired steam electric power plants. Because the Company is not expected to have an interest in Four Corners after July 2016, the Company does not expect the Revised ELG Rule will have a significant impact on our financial condition or results of operations.

In 2012, several environmental groups filed a lawsuit in federal district court against the Office of Surface Mining Reclamation and Enforcement ("OSM") of the U.S. Department of the Interior challenging OSM's 2012 approval of a permit revision which allowed for the expansion of mining operations into a new area of the mine that serves Four Corners ("Area IV North"). In April 2015, the court issued an order invalidating the permit revision, thereby prohibiting mining in Area IV North until OSM takes action to cure the defect in its permitting process identified by the court. On December 29, 2015, OSM took action to cure the defect in its permitting process by issuing a revised environmental assessment and finding of no new significant impact, and reissued the permit. This action is subject to possible judicial review.

Climate Change. In recent years, there has been increasing public debate regarding the potential impact on global climate change. There has been a wide-ranging policy debate, both nationally and internationally, regarding the impact of GHG and possible means for their regulation. In addition, efforts have been made and continue to be made in the international community toward the adoption of international treaties or protocols that would address global climate change issues. Most recently, in 2015, the United States participated in the United Nations Conference on Climate Change, which led to creation of the Paris Agreement. The Paris Agreement will be open for signing on April 22, 2016 and will require countries to review and "represent a progression" in their intended nationally determined contributions, which set GHG emission reduction goals, every five years beginning in 2020.

The U.S. federal government has either considered, proposed and/or finalized legislation or regulations limiting GHG emissions, including carbon dioxide. In particular, the U.S. Congress has considered legislation to restrict or regulate GHG emissions. In the past few years, the EPA began using the CAA to regulate carbon dioxide and other GHG emissions, such as the 2009 GHG Reporting Rule and the EPA's sulfur hexafluoride ("SF6") reporting rule, both of which apply to the Company, as well as the EPA's 2010 actions to impose permitting requirements on new and modified sources of GHG emissions. After announcing his plan to address climate change in 2013, the President directed the EPA to issue proposals for GHG rulemaking addressing power plants. In October 2015, the EPA published a final rule establishing new source performance standards ("NSPS") limiting CO₂ emissions from new, modified and reconstructed electric generating units. In October 2015, the EPA also published a rule establishing guidelines for states to regulate CO₂ emissions from existing power plants, as well as a proposed "federal plan" to address CO₂ emissions from affected units in those states that do not submit an approvable compliance plan. The standards for existing plants are known as the Clean Power Plan ("CPP"), under which rule interim emissions performance rates must be achieved beginning in 2022 and final emissions performance rates by 2030. Legal challenges to the CPP have been filed by groups of states and industry members. On February 9, 2016, the U.S. Supreme Court issued a decision to stay the rule until legal issues are resolved. We cannot at this time determine the impact of the CPP and related rules and legal challenges may have on our financial position, results of operations or cash flows.

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While a significant portion of the Company's generation assets are nuclear or gas-fired, and as a result, the Company believes that its GHG emissions are low relative to electric power companies who rely more on coal-fired generation, current and future legislation and regulation of GHG or any future related litigation could impose significant costs and/or operating restrictions on the Company, reduced demand for the power the Company generates and/or require the Company to purchase rights to emit GHG, any of which could be material to the Company's business, financial condition, reputation or results of operations.

Climate change also has potential physical effects that could be relevant to the Company's business. In particular, some studies suggest that climate change could affect the Company's service area by causing higher temperatures, less winter precipitation and less spring runoff, as well as by causing more extreme weather events. Such developments could change the demand for power in the region and could also impact the price or ready availability of water supplies or affect maintenance needs and the reliability of Company equipment. The Company believes that material effects on the Company's business or results of operations may result from the physical consequences of climate change, the regulatory approach to climate change ultimately selected and implemented by governmental authorities, or both. Given the very significant remaining uncertainties regarding whether and how these issues will be regulated, as well as the timing and severity of any physical effects of climate change, the Company believes it is impossible to meaningfully quantify the costs of these potential impacts at present.

Environmental Litigation and Investigations. Since 2009, the EPA and certain environmental organizations have been scrutinizing, and in some cases, have filed lawsuits, relating to certain air emissions and air permitting matters related to Four Corners. In particular, since July 2011, the U.S. Department of Justice (the "DOJ"), on behalf of the EPA, and APS have been engaged in substantive settlement negotiations in an effort to resolve certain of the pending matters. The allegations being addressed through settlement negotiations are that APS failed to obtain the necessary permits and install the controls necessary under the CAA to reduce SO₂, NO_x, and PM, and that defendants failed to obtain an operating permit under Title V of the CAA that reflects applicable requirements imposed by law. In November 2014, the DOJ provided APS with a draft consent decree to settle the EPA matter, which decree contains specific provisions for the reduction and control of NO_x, SO₂, and PM, as well as provisions for a civil penalty, and expenditures on environmental mitigation projects with an emphasis on projects that address alleged harm to the Navajo Nation. On June 24, 2015, the parties filed with the U.S. District Court for New Mexico a settlement agreement ("CAA Settlement Agreement") resolving this matter. On August 17, 2015, the U.S. District Court for New Mexico entered the CAA Settlement Agreement. The agreement imposes a total civil penalty payable by the co-owners of Four Corners collectively in the amount of \$1.5 million, and it requires the co-owners to pay \$6.7 million for environmental mitigation projects. At December 31, 2015, the Company has accrued for its share of approximately \$0.5 million related to this matter.

In a related action, on October 4, 2011, Earthjustice filed a lawsuit in the United States District Court for New Mexico alleging violations of the Prevention of Significant Deterioration ("PSD") provisions of the CAA related to Four Corners. Thereafter, on January 6, 2012, Earthjustice filed a First Amended Complaint adding claims for violations of the CAA's NSPS program. The lawsuit addressed allegations similar to those raised in the DOJ pre-enforcement action described in the preceding paragraph. Because the allegations in the DOJ pre-enforcement action and this lawsuit were substantially similar, the negotiations between the DOJ and APS regarding the pre-enforcement action also included Earthjustice. Accordingly, in response to the CAA Settlement Agreement, the parties to the case moved to dismiss the proceedings. Accordingly, the proceedings were terminated as of August 17, 2015. The CAA Settlement Agreement represents the final judgment in this case.

New Mexico Tax Matter Related to Coal Supplied to Four Corners

On May 23, 2013, the New Mexico Taxation and Revenue Department ("NMTRD") issued a notice of assessment for coal severance surtax, penalty, and interest totaling approximately \$30 million related to coal supplied under the coal supply agreement for Four Corners (the "Assessment"). The Company's share of the assessment was approximately \$1.5 million. On behalf of the Four Corners participants, the coal supplier made a partial payment of the Assessment and immediately filed a refund claim with respect to that partial payment in August 2013. The NMTRD denied the refund claim. On December 19, 2013, the coal supplier and APS, on its own behalf and as operating agent for Four Corners, filed complaints with the New Mexico District Court contesting both the validity of the Assessment and the refund claim denial. On June 30, 2015, the court ruled that the Assessment was not valid and further ruled that APS and the other Four Corners participants receive a refund of all the contested amounts previously paid under the applicable tax statute. The NMTRD filed a Notice of Appeal on August 31, 2015 with respect to the decision. The parties are engaged in settlement discussions and the Company does not expect the outcome to have a material impact on the Company's financial position, results of operations or cash flows.

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Lease Agreements

The Company leases land in El Paso adjacent to the Newman Power Station under a lease which expires in June 2033 with a renewal option of 25 years. In addition, the Company leased certain warehouse facilities in El Paso under a lease which expired in December 2015. The Company also has several other leases for office, parking facilities and equipment which expire within the next five years. The Company has transmission and distribution lines which are operated under various property easement agreements. The majority of these easements include renewal options which the Company routinely exercises. These lease agreements do not impose any restrictions relating to issuance of additional debt, payment of dividends or entering into other lease arrangements. The Company has no significant capital lease agreements.

The Company's total annual rental expense related to operating leases was \$1.9 million, \$1.8 million, and \$1.2 million for 2015, 2014 and 2013, respectively. As of December 31, 2015, the Company's minimum future rental payments for the next five years are as follows (in thousands):

2016.....	\$	900
2017.....		648
2018.....		538
2019.....		541
2020.....		548

L. Litigation

The Company is involved in various legal, environmental, tax and regulatory proceedings before various courts, regulatory commissions and governmental agencies regarding matters arising in the ordinary course of business. In many of these matters, the Company has excess casualty liability insurance that covers the various claims, actions and complaints. The Company regularly analyzes current information and, as necessary, makes provisions in its financial statements for probable liabilities for the eventual disposition of these matters. While the outcome of these matters cannot be predicted with certainty, based upon a review of the matters and applicable insurance coverage, the Company believes that none of these matters will have a material adverse effect on the financial position, results of operations or cash flows of the Company. The Company expenses legal costs, including expenses related to loss contingencies, as they are incurred.

See Part II, Item 8, Financial Statements and Supplementary Data, Note C and Note K for discussion of the effects of government legislation and regulation on the Company as well as certain pending legal proceedings.

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M. Employee Benefits

Retirement Plans

The Company's Retirement Income Plan (the "Retirement Plan") is a qualified noncontributory defined benefit plan. Upon retirement or death of a vested plan participant, assets of the Retirement Plan are used to pay benefit obligations under the Retirement Plan. Contributions from the Company are at least the minimum funding amounts required by the IRS, as actuarially calculated. The assets of the Retirement Plan are primarily invested in common collective trusts which hold equity securities, debt securities and cash equivalents and are managed by a professional investment manager appointed by the Company.

The Company has two non-qualified retirement plans that are non-funded defined benefit plans. The Company's Supplemental Retirement Plan covers certain former employees and directors of the Company. The Excess Benefit Plan, was adopted in 2004 and covers certain active and former employees of the Company. The benefit cost for the non-qualified retirement plans are based on substantially the same actuarial methods and economic assumptions as those used for the Retirement Plan.

During the quarter ended March 31, 2014, the Company implemented certain amendments to the Retirement Plan and Excess Benefit Plan. In the first quarter of 2014, the Company offered a cash balance pension plan as an alternative to its current final average pay pension plan for employees hired prior to January 1, 2014. The cash balance pension plan also included an enhanced employer matching contribution to the employee's respective 401(k) Defined Contribution Plan (discussed below). For employees that elected the new cash balance feature of the plans, the pension benefit earned under the existing final average pay feature of the plans was frozen as of March 31, 2014. Employees hired after January 1, 2014 were automatically enrolled in the cash balance pension plan. The amendments to the plans were effective April 1, 2014. As a result of these actions, the Company remeasured the assets and liabilities of the plans, based on actuarially determined estimates, using the close of the alternative choice election period of February 28, 2014, as the remeasurement date.

Prior to December 31, 2013, employees who completed one year of service with the Company and worked at least a minimum number of hours each year were covered by the final average pay formula of the plan. For participants that continue to be covered by the final average pay formula, retirement benefits are based on the employee's final average pay and years of service. The cash balance pension plan covers employees beginning on their employment commencement date or re-employment commencement date in any plan year in which the employee completes at least a minimum number of hours of service. Retirement benefits under the cash balance pension plan are based on the employee's cash balance account, consisting of pay credits and interest credits.

The Company complies with the FASB guidance on disclosure for pension and other post-retirement plans that requires disclosure of investment policies and strategies, categories of investment and fair value measurements of plan assets, and significant concentrations of risk.

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

	December 31,			
	2015		2014	
	Retirement Income Plan	Non-Qualified Retirement Plans	Retirement Income Plan	Non-Qualified Retirement Plans
Change in projected benefit obligation:				
Benefit obligation at end of prior year.....	\$ 341,133	\$ 28,397	\$ 317,815	\$ 25,898
Service cost.....	8,530	262	8,284	303
Interest cost.....	13,477	1,018	14,001	1,041
Amendments (a).....	—	—	(33,700)	(500)
Actuarial (gain) loss.....	(19,290)	(810)	50,741	3,508
Benefits paid.....	(18,144)	(1,909)	(16,008)	(1,853)
Benefit obligation at end of year	325,706	26,958	341,133	28,397
Change in plan assets:				
Fair value of plan assets at end of prior year	272,939	—	257,831	—
Actual return (loss) on plan assets	(3,760)	—	22,116	—
Employer contribution	9,000	1,909	9,000	1,853
Benefits paid	(18,144)	(1,909)	(16,008)	(1,853)
Fair value of plan assets at end of year	260,035	—	272,939	—
Funded status at end of year	\$ (65,671)	\$ (26,958)	\$ (68,194)	\$ (28,397)

(a) Amendments relate to the modification of the Company's Retirement Plan and Excess Benefit Plan discussed above.

Amounts recognized in the Company's balance sheets consist of the following (in thousands):

	December 31,			
	2015		2014	
	Retirement Income Plan	Non-Qualified Retirement Plans	Retirement Income Plan	Non-Qualified Retirement Plans
Current liabilities	\$ —	\$ (2,102)	\$ —	\$ (2,319)
Noncurrent liabilities	(65,671)	(24,856)	(68,194)	(26,078)
Total.....	\$ (65,671)	\$ (26,958)	\$ (68,194)	\$ (28,397)

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

	December 31,			
	2015		2014	
	Retirement Income Plan	Non-Qualified Retirement Plans	Retirement Income Plan	Non-Qualified Retirement Plans
Projected benefit obligation.....	\$ (325,706)	\$ (26,958)	\$ (341,133)	\$ (28,397)
Accumulated benefit obligation	(302,446)	(25,785)	(312,762)	(27,603)
Fair value of plan assets	260,035	—	272,939	—

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Amounts recognized in accumulated other comprehensive income consist of the following (in thousands):

	Years Ended December 31,			
	2015		2014	
	Retirement Income Plan	Non-Qualified Retirement Plans	Retirement Income Plan	Non-Qualified Retirement Plans
Net loss	\$ 118,963	\$ 9,592	\$ 124,407	\$ 11,341
Prior service benefit.....	(27,344)	(224)	(30,811)	(264)
Total.....	<u>\$ 91,619</u>	<u>\$ 9,368</u>	<u>\$ 93,596</u>	<u>\$ 11,077</u>

The following are the weighted-average actuarial assumptions used to determine the benefit obligations:

	December 31,					
	2015			2014		
	Retirement Income Plan	Supplemental Retirement Plan	Excess Benefit Plan	Retirement Income Plan	Supplemental Retirement Plan	Excess Benefit Plan
Discount rate	4.57%	3.99%	4.59%	4.0%	3.4%	4.1%
Rate of compensation increase.	4.5%	N/A	4.5%	4.5%	N/A	4.5%

The Company reassesses various actuarial assumptions at least on an annual basis. The discount rate is reviewed at each measurement date. For 2015, the discount rate used to measure the fiscal year end obligation is based on a segmented spot rate yield curve that matches projected future payments with the appropriate interest rate applicable to the timing of the projected future benefit payments. A 1% increase in the discount rate would decrease the December 31, 2015 retirement plans' projected benefit obligation by 11.4%. A 1% decrease in the discount rate would increase the December 31, 2015 retirement plans' projected benefit obligation by 14%.

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

	Years Ended December 31,					
	2015		2014		2013	
	Retirement Income Plan	Non-Qualified Retirement Plans	Retirement Income Plan	Non-Qualified Retirement Plans	Retirement Income Plan	Non-Qualified Retirement Plans
Service cost	\$ 8,530	\$ 262	\$ 8,284	\$ 303	\$ 9,137	\$ 190
Interest cost	13,477	1,018	14,001	1,041	12,742	872
Expected return on plan assets.	(19,795)	—	(18,699)	—	(17,108)	—
Amortization of:						
Net loss	9,710	937	8,178	675	10,437	661
Prior service cost (benefit)	(3,467)	(39)	(2,889)	(17)	3	94
Net periodic benefit cost.....	<u>\$ 8,455</u>	<u>\$ 2,178</u>	<u>\$ 8,875</u>	<u>\$ 2,002</u>	<u>\$ 15,211</u>	<u>\$ 1,817</u>

In fiscal 2016, the Company expects to change the method used to estimate the service and interest components of net periodic benefit cost for pension benefits. This change compared to the previous method will result in a decrease in the service and interest components in future periods. Historically, the Company estimated service and interest costs utilizing a single weighted-average discount rate derived from the yield curve used to measure the benefit obligation at the beginning of the period. For fiscal 2016, the Company has elected to utilize a full yield curve approach to estimate these components by applying the specific spot rates along the yield curve used in the determination of the benefit obligation to the relevant projected cash flows. The Company believes the new approach provides a more precise measurement of service and interest costs by aligning the timing of the plan's liability cash flows to the corresponding spot rates on the yield curve. The Company will account for this change as a change in accounting estimate and accordingly will account for this prospectively. The change in estimate is anticipated to decrease the service and interest components of net periodic benefit cost starting in 2016 by \$2.9 million.

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The changes in benefit obligations recognized in other comprehensive income are presented below (in thousands):

	Years Ended December 31,					
	2015		2014		2013	
	Retirement Income Plan	Non-Qualified Retirement Plans	Retirement Income Plan	Non-Qualified Retirement Plans	Retirement Income Plan	Non-Qualified Retirement Plans
Net (gain) loss	\$ 4,266	\$ (811)	\$ 47,324	\$ 3,508	\$ (30,065)	\$ (533)
Prior service benefit	—	—	(33,700)	(500)	—	—
Amortization of:						
Net loss.....	(9,710)	(937)	(8,178)	(675)	(10,437)	(661)
Prior service (cost) benefit	3,467	39	2,889	17	(3)	(94)
Total recognized in other comprehensive income.....	\$ (1,977)	\$ (1,709)	\$ 8,335	\$ 2,350	\$ (40,505)	\$ (1,288)

The total amount recognized in net periodic benefit costs and other comprehensive income are presented below (in thousands):

	Years Ended December 31,					
	2015		2014		2013	
	Retirement Income Plan	Non-Qualified Retirement Plans	Retirement Income Plan	Non-Qualified Retirement Plans	Retirement Income Plan	Non-Qualified Retirement Plans
Total recognized in net periodic benefit cost and other comprehensive income.....	\$ 6,478	\$ 469	\$ 17,210	\$ 4,352	\$ (25,294)	\$ 529

The following are amounts in accumulated other comprehensive income that are expected to be recognized as components of net periodic benefit cost during 2016 (in thousands):

	Retirement Income Plan	Non-Qualified Retirement Plans
Net loss	\$ 6,830	\$ 715
Prior service benefit.....	(3,470)	(40)

The following are the weighted-average actuarial assumptions used to determine the net periodic benefit cost for the twelve months ended December 31:

	2015			2014 (a)			2013		
	Retirement Income Plan	Non-Qualified Supplemental Retirement Plan	Excess Benefit Plan	Retirement Income Plan	Non-Qualified Supplemental Retirement Plan	Excess Benefit Plan	Retirement Income Plan	Non-Qualified Supplemental Retirement Plan	Excess Benefit Plan
Discount rate.....	4.0%	3.4%	4.1%	4.9%	3.9%	4.9%	4.0%	3.1%	4.0%
Expected long- term return on plan assets.....	7.5%	N/A	N/A	7.5%	N/A	N/A	7.5%	N/A	N/A
Rate of compensation increase	4.5%	N/A	4.5%	4.75%	N/A	4.75%	4.75%	N/A	4.75%

- (a) The Retirement Plan and the Excess Benefit Plan were remeasured on February 28, 2014 due to the above mentioned plan amendment. The discount rate used to remeasure the benefit obligation was 4.6% for the Retirement Plan and 4.5% for the Excess Benefit Plan, compared to 4.9% for both plans as of January 1, 2014. All other assumptions remained consistent with assumptions used at January 1, 2014.