

# **Southwest Power Pool, Inc.**

Accountants' Report and Financial Statements

December 31, 2011 and 2010

**Southwest Power Pool, Inc.**  
**December 31, 2011 and 2010**

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## Independent Accountants' Report

Board of Directors  
Southwest Power Pool, Inc.  
Little Rock, Arkansas

We have audited the accompanying balance sheets of Southwest Power Pool, Inc. as of December 31, 2011 and 2010, and the related statements of operations, members' deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Southwest Power Pool, Inc. as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*BKD, LLP*

April 17, 2012

# Southwest Power Pool, Inc.

## Balance Sheets

(In Thousands)

December 31, 2011 and 2010

### Assets

	<u>2011</u>	<u>2010</u>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 73,763	\$ 81,041
Restricted cash deposits	34,903	25,668
Accounts receivable	15,901	18,509
Prepaid expenses and other	<u>6,636</u>	<u>3,351</u>
Total current assets	<u>131,203</u>	<u>128,569</u>
<b>Property and Equipment, at Cost</b>		
Land	4,812	4,812
Building	5,965	5,965
Furniture and fixtures	4,613	4,395
Equipment and machinery	31,846	20,994
Leasehold improvements	1,309	1,283
Software	74,646	71,082
Software in development	34,351	10,689
Construction in progress	<u>46,779</u>	<u>6,114</u>
	204,321	125,334
Less accumulated depreciation and amortization	<u>92,133</u>	<u>79,334</u>
	<u>112,188</u>	<u>46,000</u>
<b>Other Assets, Net</b>	<u>2,915</u>	<u>3,192</u>
	<u>\$ 246,306</u>	<u>\$ 177,761</u>

## Liabilities and Members' Deficit

	<u>2011</u>	<u>2010</u>
<b>Current Liabilities</b>		
Accounts payable	\$ 17,816	\$ 10,348
Customer deposits	34,903	25,668
Current maturities of long-term debt <i>(Note 4)</i>	11,206	13,206
Accrued expenses	25,741	26,448
Deferred revenue	<u>7,450</u>	<u>6,174</u>
Total current liabilities	<u>97,116</u>	<u>81,844</u>
<b>Long-term Debt <i>(Note 4)</i></b>	170,958	112,163
<b>Other Long-term Liabilities</b>	7,654	4,136
<b>Members' Deficit</b>	<u>(29,422)</u>	<u>(20,382)</u>
	<u>\$ 246,306</u>	<u>\$ 177,761</u>

**Southwest Power Pool, Inc.**  
**Statements of Operations**  
**(In Thousands)**  
**Years Ended December 31, 2011 and 2010**

	<u>2011</u>	<u>2010</u>
<b>Operating Income</b>		
Tariff fees and member assessments	\$ 95,825	\$ 86,563
Other member services	<u>33,115</u>	<u>29,526</u>
	<u>128,940</u>	<u>116,089</u>
<b>Operating Expenses</b>		
Salaries and benefits	64,514	56,896
Employee travel	1,655	1,424
Administrative	3,003	2,899
Regulatory assessment	16,639	14,101
Meetings	838	775
Communications system	3,204	3,079
Leases	1,624	1,707
Maintenance	7,308	6,354
Consulting services	16,124	14,366
Depreciation and amortization	<u>13,107</u>	<u>14,243</u>
	<u>128,016</u>	<u>115,844</u>
<b>Operating Income</b>	<u>924</u>	<u>245</u>
<b>Other Income (Expense)</b>		
Interest income	157	56
Interest expense	(6,307)	(3,619)
Change in fair market value of interest rate swaps	183	53
Other income (expense)	<u>(21)</u>	<u>79</u>
	<u>(5,988)</u>	<u>(3,431)</u>
<b>Loss Before Change in Funded Status of Employee Benefit Plans</b>	(5,064)	(3,186)
<b>Change in Funded Status of Employee Benefit Plans</b>	<u>(3,976)</u>	<u>2,110</u>
<b>Net Loss</b>	<u>\$ (9,040)</u>	<u>\$ (1,076)</u>

**Southwest Power Pool, Inc.**  
**Statements of Members' Deficit**  
**(In Thousands)**  
**Years Ended December 31, 2011 and 2010**

	<u>2011</u>	<u>2010</u>
<b>Balance, Beginning of Year</b>	\$ (20,382)	\$ (19,306)
Net loss	<u>(9,040)</u>	<u>(1,076)</u>
<b>Balance, End of Year</b>	<u>\$ (29,422)</u>	<u>\$ (20,382)</u>

**Southwest Power Pool, Inc.**  
**Statements of Cash Flows**  
**(In Thousands)**  
**Years Ended December 31, 2011 and 2010**

	<b>2011</b>	<b>2010</b>
<b>Operating Activities</b>		
Net loss	\$ (9,040)	\$ (1,076)
Items not requiring cash		
Depreciation and amortization	13,107	14,243
Impairment loss	152	-
Change in funded status of employee benefit plans	3,976	(2,110)
Change in fair market value of interest rate swaps	(183)	(53)
Changes in assets and liabilities		
Accounts receivable	2,608	(3,426)
Prepaid expenses and other	(3,285)	(213)
Other assets	(121)	(1,120)
Accounts payable	7,468	(1,121)
Accrued expenses	569	5,594
Other long-term liabilities	<u>67</u>	<u>96</u>
Net cash provided by operating activities	<u>15,318</u>	<u>10,814</u>
<b>Investing Activities</b>		
Acquisition of property and equipment	<u>(79,391)</u>	<u>(21,737)</u>
Net cash used in investing activities	<u>(79,391)</u>	<u>(21,737)</u>
<b>Financing Activities</b>		
Repayments of long-term debt	(13,205)	(9,206)
Issuance of long-term debt	<u>70,000</u>	<u>65,000</u>
Net cash provided by financing activities	<u>56,795</u>	<u>55,794</u>
<b>Increase (Decrease) in Cash and Cash Equivalents</b>	<u>(7,278)</u>	<u>44,871</u>
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>81,041</u>	<u>36,170</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 73,763</u>	<u>\$ 81,041</u>
<b>Supplemental Cash Flow Information</b>		
Interest paid (net of interest capitalized of \$1,943 and \$224 in 2011 and 2010, respectively)	\$ 6,498	\$ 3,512



# Southwest Power Pool, Inc.

## Notes to Financial Statements

December 31, 2011 and 2010

### Note 1: Nature of Operations and Summary of Significant Accounting Policies

#### *Nature of Operations*

Southwest Power Pool, Inc. (the Company) is a not-for-profit entity formed in 1941 and incorporated in 1994. The Company is a Federal Energy Regulatory Commission (FERC)-approved regional transmission organization (RTO) serving more than six million ultimate customers across all or parts of nine states. The Company's membership consists of investor-owned utilities, municipal systems, generation and transmission cooperatives, state authorities, independent power producers, contract participants, power marketers and independent transmission companies.

Major services provided by the Company to its members and customers include tariff administration, electric reliability coordination, regional transmission scheduling, energy imbalance service (EIS) market operations and regional transmission expansion planning.

The Company also serves as the Regional Entity (RE) for its region. The primary responsibility of the RE is the enforcement of North American Electric Reliability Corporation (NERC)-approved reliability standards for users, owners and operators of the bulk power system within the region.

#### *Use of Estimates*

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

#### *Cash and Cash Equivalents and Deposits (in Thousands)*

The Company considers all highly liquid interest-earning investments with stated maturities and coupon rate reset dates of no more than three months to be cash equivalents. At December 31, 2011 and 2010, the Company's cash and cash equivalents, including restricted deposits, are invested primarily in money market funds, mutual funds and repurchase agreements. These investments are typically revalued to the market each day and, in the case of repurchase agreements, are collateralized by U.S. government and federal agency securities. The Company's cash and cash equivalents consist primarily of funds accumulated for general operating purposes. Restricted cash deposits consist primarily of customer security deposits, amounts deposited for engineering studies and funds held in escrow for disputed invoices.

Effective July 21, 2010, the FDIC's insurance limits were permanently increased to \$250. At December 31, 2011, the Company's cash accounts did not exceed federally insured limits.

Pursuant to legislation enacted in 2010, the FDIC will fully insure all noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012, at all FDIC-insured institutions.

**Southwest Power Pool, Inc.**  
**Notes to Financial Statements**  
**December 31, 2011 and 2010**

***Income Taxes***

The Company is exempt from income taxes under Section 501c(6) of the Internal Revenue Code and a similar provision of state law. However, the Company is subject to federal income tax on any unrelated business taxable income.

The Company files tax returns in the U.S. federal jurisdiction. With a few exceptions, the Company is no longer subject to U.S. federal examinations by tax authorities for years before 2008.

***Accounts Receivable***

Accounts receivable are stated at the amount billed to members, customers and others plus any accrued and unpaid interest. The Company provides an allowance for doubtful accounts, when necessary, which is based upon a review of outstanding receivables, historical collection information and existing economic conditions. Accounts that are unpaid after the due date bear interest at a rate set by FERC. Interest continues to accrue until the account is paid or deemed uncollectible.

***Property and Equipment (in Thousands)***

Property and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful life of each asset. The estimated useful lives are as follows:

Building	20 years
Furniture and fixtures	5 years
Vehicles	5 years
Equipment and machinery	3 years
Software	3 years
Leasehold improvements	Shorter of useful life or lease term

The Company capitalizes interest cost incurred on funds used to construct property, plant and equipment. The capitalized interest is recorded as part of the asset to which it relates and is amortized over the asset's estimated useful life. Interest cost capitalized was \$1,943 and \$224 in 2011 and 2010, respectively.

The Company capitalizes development costs, including interest, for internal use software costs. These costs are included in software and software in development. Except as noted below, management of the Company is of the opinion that all costs capitalized in association with the software in development are fully recoverable over the anticipated life of the asset.

**Southwest Power Pool, Inc.**  
**Notes to Financial Statements**  
**December 31, 2011 and 2010**

***Long-lived Asset Impairment (in Thousands)***

The Company evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

In 2011, management of the Company determined the system development completed in prior years for the Centralized Balancing Authority (CBA) is now obsolete technology and therefore has no fair value. An impairment loss of \$152 was recognized for the year ended December 31, 2011. The loss is included in consulting services in the accompanying Statement of Operations.

***Revenue Recognition***

Revenues, consisting of member assessments, tariff administrative fees, contract services and miscellaneous revenues are recognized when earned, and expenses are recognized when incurred.

***Customer Deposits***

Customers may be required to make deposits with the Company prior to the performance of transmission services and engineering studies. These amounts are typically held for the duration of the service and applied to the customer's final invoice. An offsetting liability equal to the deposit balance is recorded in current liabilities. Funds held in escrow related to disputed invoices are also recorded as a customer deposit under current liabilities.

***Tariff Fees and Member Assessments (in Thousands)***

An administrative charge is applied to all transmission service under the Company's tariff to cover the expenses related to the administration of the tariff. The charge is calculated in accordance with the terms of the Company's Open Access Transmission Tariff. The administrative rate used for the calculation is established by the board of directors.

Members are assessed monthly based on their prior year average 12-month peak demand multiplied by the total hours in a month and by the monthly assessment rate as established by the board. A member's monthly assessment is offset dollar for dollar for qualifying tariff administrative fees collected from a member in any given assessment period.

The Company collects a membership fee from each member annually. The amount of the membership fee is established by the board of directors of the Company. For 2011 and 2010, all members paid a \$6,000 membership fee.

# **Southwest Power Pool, Inc.**

## **Notes to Financial Statements**

**December 31, 2011 and 2010**

The Company also bills transmission customers and transmission owners a charge under schedule 12 on all energy delivered under point-to-point transmission service and network integration transmission service. This provides a mechanism for recovering from transmission customers and transmission owners the annual charges the Company pays to FERC. The rate is developed by FERC in the prior calendar year and applied to energy transmitted in the second prior calendar year.

### ***Deferred Revenue***

Revenues for contract services received in advance are recognized over the periods to which the revenues relate.

### ***Other Member Services***

The Company provides reliability, tariff administration and scheduling for non-members on a contract basis.

### ***Withdrawing Members***

Members wishing to withdraw their membership from the Company must provide 12 months written notice and are responsible for their portion of the Company's existing obligations as defined in the bylaws, which include unpaid membership fees, any assessments imposed prior to the effective withdrawal date, any costs or expenses imposed upon the Company as a direct consequence of the member's withdrawal, and the member's share of long-term obligations and related interest.

### ***Concentration of Credit Risk***

The Company is exposed to credit risk primarily through accounts receivable and uninsured cash balances. During 2011 and 2010, the Company maintained cash balances that exceeded the insurance limits of the Federal Deposit Insurance Corporation. However, the Company requires the financial institutions holding its cash balances to be rated A or better by nationally recognized rating agencies.

Because the Company considers all accounts receivable to be highly probable of collection, an allowance for doubtful accounts is not maintained. The Company requires its customers to meet certain minimum standards of financial condition and creditworthiness to receive unsecured credit from the Company. If these standards cannot be met by a counterparty, the Company requires the posting of defined financial security instruments to cover potential liabilities.

**Southwest Power Pool, Inc.**  
**Notes to Financial Statements**  
**December 31, 2011 and 2010**

**Note 2: Line of Credit (In Thousands)**

The Company has a \$20,000 revolving line of credit expiring in 2013. At December 31, 2011 and 2010, no amounts were borrowed against this line. The agreement has a variable interest rate equal to the London Interbank Offered Rate (LIBOR) plus a credit margin. The Company's line of credit requires compliance with certain financial and non-financial covenants as well as periodic reporting requirements. The Company was in compliance with the covenant and reporting requirements throughout and at December 31, 2011.

**Note 3: Significant Estimates and Concentrations**

***Current Economic Conditions***

The current protracted economic decline continues to present organizations with difficult circumstances and challenges, which, in some cases, have resulted in large declines in fair value of assets, decrease in revenues, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Company.

In addition, given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments that could negatively impact the Company's ability to meet debt covenants or maintain sufficient liquidity.

**Southwest Power Pool, Inc.**  
**Notes to Financial Statements**  
**December 31, 2011 and 2010**

**Note 4: Long-term Debt and Interest Rate Swaps (in Thousands)**

***Long-term Debt***

	2011	2010
4.78% notes due 2011 (A)	\$ -	\$ 5,000
Variable Rate Term Note due 2027 (B)	4,164	4,369
Variable Rate Term Note due 2014 (C)	16,000	21,000
Variable Rate Term Note due 2016 (D)	27,000	30,000
4.82% Series 2010-A Senior Notes due 2042 (E)	30,000	30,000
4.82% Series 2010-B Senior Notes due 2042 (F)	35,000	35,000
3.55% Series 2010-C Senior Notes due 2024 (G)	70,000	-
	182,164	125,369
Less current maturities	11,206	13,206
	\$ 170,958	\$ 112,163

- (A) Due June 25, 2011; principal payable annually, beginning on June 25, 2007; interest payable semi-annually at 4.78%. The note agreement requires mandatory prepayments of outstanding principal upon withdrawal from the Company of various aggregates of membership. The Company was not subject to any mandatory prepayments during 2010 and 2011. The notes are unsecured.
- (B) Due February 1, 2027; principal and interest are payable quarterly based on a 25-year amortization. Payments commenced on May 1, 2007. The interest rate adjusts monthly based on the London Interbank Offered Rate (LIBOR) plus 0.85%. The note is secured by a first mortgage on the Company's operation facility.
- (C) Due December 25, 2014; interest is payable monthly and principal is payable quarterly based on a seven-year amortization. Payments commenced on March 25, 2008. The interest rate adjusts monthly based on the London Interbank Offered Rate (LIBOR) plus 0.30%. The note is unsecured.
- (D) Due July 23, 2016; principal and interest are payable quarterly based on a seven-year amortization. Payments commenced on September 30, 2011. The interest rate is fixed at 5.45%. The note is unsecured.
- (E) Due December 30, 2042; principal and interest are payable quarterly based on a 32-year amortization. Principal payments commence on March 30, 2013. The interest rate is fixed at 4.82%. The note is unsecured.
- (F) Due December 30, 2042; principal and interest are payable quarterly based on a 32-year amortization. Principal payments commence on March 30, 2013. The interest rate is fixed at 4.82%. The note is unsecured.

**Southwest Power Pool, Inc.**  
**Notes to Financial Statements**  
**December 31, 2011 and 2010**

- (G) Due March 30, 2024; principal and interest are payable quarterly based on 13-year amortization. Principal payments commence on June 30, 2014. The interest rate is fixed at 3.55%. The note is unsecured.

Aggregate annual maturities of long term debt at December 31, 2011, are:

2012	\$	11,206
2013		12,700
2014		17,998
2015		14,300
2016		11,353
Thereafter		<u>114,607</u>
	\$	<u><u>182,164</u></u>

Certain of the Company's term notes require compliance with financial and non-financial covenants, as well as periodic reporting requirements. The Company was in compliance with the covenant and reporting requirements throughout and at December 31, 2011.

***Variable-to-Fixed Interest Rate Swap***

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flows due to interest rate fluctuations, the Company entered into an interest rate swap agreement on September 15, 2006 with U.S. Bank National Association. The agreement provides for the Company to receive interest from the counterparty at LIBOR and to pay interest to the counterparty at a fixed rate of 5.51% on notional amounts of \$4,131 and \$4,335 at December 31, 2011 and 2010, respectively. Under the agreement, the Company pays or receives the net interest amount quarterly, with the quarterly settlements included in interest expense. The swap was established to hedge interest rate risk on its floating rate debt obligation (Loan B).

The Company entered into another interest rate swap agreement on August 23, 2007, with U.S. Bank National Association. The agreement provides for the Company to receive interest from the counterparty at LIBOR and to pay interest to the counterparty at a fixed rate of 5.31% on notional amounts of \$16,000 and \$21,000 at December 31, 2011 and 2010, respectively. Under the agreement, the Company pays or receives the net interest amount monthly, with the monthly settlements included in interest expense. The swap was established to hedge interest rate risk on its floating rate debt obligation (Loan C).

**Southwest Power Pool, Inc.**  
**Notes to Financial Statements**  
**December 31, 2011 and 2010**

The table below presents certain information regarding the Company's interest rate swap agreements.

	<u>2011</u>	<u>2010</u>
Fair value of interest rate swap agreements	\$ 2,531	\$ 2,714
Balance sheet location of fair value amounts	Other Long-term Liabilities	Other Long- term Liabilities
Gain recognized in statement of operations	\$ 183	\$ 53
Location of gain recognized in statement of operations	Change in Fair Market Value of Interest Rate Swaps	Change in Fair Market Value of Interest Rate Swaps

**Note 5: Operating Leases (In Thousands)**

The Company has noncancellable operating leases for office space and certain office equipment, which expire at various times through 2014. The Company incurred lease expense related to these operating leases of \$1,624 and \$1,707 in 2011 and 2010, respectively.

Future minimum lease payments at December 31, 2011, were:

2012	\$ 1,563
2013	743
2014	<u>246</u>
	<u>\$ 2,552</u>

**Note 6: Employee Benefit Plans (in Thousands)**

***Pension and Other Postretirement Benefit Plans***

The Company has a noncontributory defined benefit pension plan covering all employees meeting eligibility requirements. The Company's funding policy is to make the minimum annual contribution that is required by applicable regulations, plus such amounts as the Company may determine to be appropriate from time to time. The Company expects to contribute approximately \$3,600 to the plan in 2012.



# Southwest Power Pool, Inc.

## Notes to Financial Statements

December 31, 2011 and 2010

The Company has a noncontributory defined benefit postretirement health care plan covering eligible retirees, including those retiring between the ages of 55–65 and hired prior to January 1, 1996. Employees hired after June 1, 2006, are not eligible to participate in the defined postretirement health care plan. The Company’s funding policy is to make the minimum annual contribution that is required by applicable regulations, plus such amounts as the Company may determine to be appropriate from time to time. The Company expects to contribute approximately \$444 to the plan in 2012.

The Company uses a December 31 measurement date for the plans. Information about the plans’ funded status is as follows:

	Pension Benefits		Postretirement Health Care Benefits	
	2011	2010	2011	2010
Benefit obligation	\$ 28,921	\$ 23,862	\$ 5,950	\$ 5,298
Fair value of plan assets	<u>25,263</u>	<u>23,536</u>	<u>6,751</u>	<u>6,440</u>
Funded status	<u>\$ (3,658)</u>	<u>\$ (326)</u>	<u>\$ 801</u>	<u>\$ 1,142</u>

Amounts recognized in the balance sheets:

	Pension Benefits		Postretirement Health Care Benefits	
	2011	2010	2011	2010
Noncurrent assets	\$ -	\$ -	\$ 801	\$ 1,142
Noncurrent liabilities	<u>(3,658)</u>	<u>(326)</u>	-	-
	<u>\$ (3,658)</u>	<u>\$ (326)</u>	<u>\$ 801</u>	<u>\$ 1,142</u>

Amounts recognized in members’ equity not yet recognized as components of net periodic benefit cost as of December 31, 2011, consist of:

	Pension Benefits	Postretirement Health Care Benefits
Net (gain)/loss	\$ 6,457	\$ (810)
Prior service credit	(19)	-
Transition obligation	<u>148</u>	<u>40</u>
	<u>\$ 6,586</u>	<u>\$ (770)</u>

# Southwest Power Pool, Inc.

## Notes to Financial Statements

December 31, 2011 and 2010

The accumulated benefit obligation for the defined benefit pension plan was \$22,317 and \$18,104 at December 31, 2011 and 2010, respectively.

Other significant balances and costs are:

	<b>Pension Benefits</b>		<b>Postretirement Health Care Benefits</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Employer contributions	\$ 3,133	\$ 3,122	\$ 445	\$ 511
Benefits paid	144	129	20	20
Benefit costs	2,830	2,763	445	511

The following amounts have been recognized in the statements of operations for the year ended December 31, 2011:

	<b>Pension Benefits</b>		<b>Postretirement Health Care Benefits</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Amounts arising during the period				
Net gain or (loss)	\$	(2,900)	\$	(77)
Amounts recognized as components of net periodic benefit cost of the period				
Net (gain) or loss		25		(26)
Net prior service credit		1		-
Net transition obligation		16		4

The estimated net loss, prior service cost and transition obligation for the defined benefit pension plan that will be amortized from members' equity into net period benefit cost over the next fiscal year are \$210, \$1 and \$16, respectively. There is no prior service credit for the defined benefit postretirement health care plan that will be amortized from members' equity into net periodic benefit cost over the next fiscal year.

Weighted-average assumptions used to determine benefit obligations and costs:

	<b>Pension Benefits</b>		<b>Postretirement Health Care Benefits</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Discount rate benefit obligation	6.25%	6.5%	6.25%	6.5%
Expected return on plan assets	7.0%	7.0%	7.0%	7.0%
Rate of compensation increase	4.25%	4.5%	-	-

The Company has estimated the long-term rate of return on plan assets based primarily on historical returns on plan assets, adjusted for changes in target portfolio allocations and recent changes in long-term interest rates based on publicly available information.

# Southwest Power Pool, Inc.

## Notes to Financial Statements

December 31, 2011 and 2010

For measurement purposes, a 10% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2011 and 2010. The rate was assumed to decrease gradually to 5% by the year 2017 and remain at that level thereafter.

On December 8, 2003, the *Medicare Prescription Drug, Improvement and Modernization Act of 2003* (the Act) was signed into law. The Act introduces a prescription drug benefit under Medicare Part D, as well as a federal subsidy to sponsors of retiree health care benefit plans that provide benefits at least actuarially equivalent to Medicare Part D. The Company has not determined whether its plan provides benefits that are actuarially equivalent to Medicare Part D.

Financial Accounting Standards Board Staff Position 106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2005*, subsequently incorporated into FASB Accounting Standards Codification (ASC) 715-60, requires federal subsidies, if any, attributable to past service to be accounted for as an actuarial gain and federal subsidies, if any, attributable to current service to be accounted for as a reduction of net periodic benefit cost. The measures of projected benefit obligation and periodic benefit costs do not reflect any amounts associated with the subsidy because the Company has been unable to conclude whether the benefits provided by the plan are actuarially equivalent to Medicare Part D. The effect of adopting the provisions of ASC 715-60, if and when the Company makes such a determination, is not expected to be material.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as of December 31:

	<u>Pension Benefits</u>	<u>Postretirement Health Care Benefits</u>
2012	\$ 236	\$ 58
2013	348	87
2014	440	104
2015	552	119
2016	656	134
2017–2021	5,817	1,457

# Southwest Power Pool, Inc.

## Notes to Financial Statements

December 31, 2011 and 2010

The Company's investment strategy is based on an expectation that equity securities will outperform fixed income securities over the long-term. Accordingly, the composition of the Company's plan assets is broadly characterized as a 70/30 allocation between equity and fixed income securities. The strategy utilizes indexed and actively managed mutual fund instruments as well as direct investment in individual equity and fixed income securities. Investments in the plans must adhere to the Investment Policy Statement developed by the Company. The Investment Policy Statement limits investments in foreign securities to 20% of the total fair value of plan assets. The Investment Policy Statement is reviewed annually. At December 31, 2011 and 2010, plan assets by category are as follows:

	Pension Plan Assets		Postretirement Health Care Plan Assets	
	2011	2010	2011	2010
Fixed income securities	14%	15%	30%	28%
Equity securities	74	75	67	71
Cash and equivalents	<u>12</u>	<u>10</u>	<u>3</u>	<u>1</u>
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

### ***Pension and Other Postretirement Plan Assets***

Following is a description of the valuation methodologies used for the pension and postretirement plan assets measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of the assets pursuant to the valuation hierarchy.

Where quoted market prices are available in an active market, plan assets are classified within Level 1 of the valuation hierarchy. Level 1 plan assets include cash, money market accounts, mutual funds and common stock. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of plan assets with similar characteristics or discounted cash flows. Level 2 plan assets include foreign company stock, corporate debt obligations, foreign corporate debt obligations, government securities and foreign government securities. In certain cases where Level 1 or Level 2 inputs are not available, plan assets are classified within Level 3 of the hierarchy. At December 31, 2011, the Company does not hold any plan assets valued using Level 3 inputs.

# Southwest Power Pool, Inc.

## Notes to Financial Statements

December 31, 2011 and 2010

The fair values of the Company's pension plan assets at December 31, 2011, by asset category are as follows:

Asset Category	Total Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	\$ 3	\$ 3	\$ -	\$ -
Money market mutual funds	343	343	-	-
Mutual funds				
Foreign large blend	565	565	-	-
Mid cap value	1,180	1,180	-	-
Mid cap growth	3,031	3,031	-	-
Small cap growth	922	922	-	-
Large growth	3,572	3,572	-	-
Common stock				
Industrial materials	1,368	1,368	-	-
Consumer goods	670	670	-	-
Energy	1,375	1,375	-	-
Healthcare services	1,677	1,677	-	-
Hardware	25	25	-	-
Business services	464	464	-	-
Foreign company stock				
Industrial materials	1,087	-	1,087	-
Hardware	508	-	508	-
Business services	204	-	204	-
Energy	879	-	879	-
Financial services	811	-	811	-
Telecommunications	83	-	83	-
Healthcare services	223	-	223	-
Corporate debt obligations	2,668	-	2,668	-
Foreign corporate debt obligations	616	-	616	-
Government securities	<u>2,989</u>	<u>-</u>	<u>2,989</u>	<u>-</u>
Total	\$ <u>25,263</u>	\$ <u>15,195</u>	\$ <u>10,068</u>	\$ <u>0</u>

# Southwest Power Pool, Inc.

## Notes to Financial Statements

December 31, 2011 and 2010

The fair values of the Company's pension plan assets at December 31, 2010, by asset category are as follows:

Asset Category	Total Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	\$ 3	\$ 3	\$ -	\$ -
Money market mutual funds	267	267	-	-
Mutual funds				
Foreign large blend	535	535	-	-
Mid cap value	704	704	-	-
Mid cap growth	1,638	1,638	-	-
Large growth	5,072	5,072	-	-
Common stock				
Industrial materials	2,324	2,324	-	-
Consumer goods	117	117	-	-
Financial Services	604	604	-	-
Energy	1,361	1,361	-	-
Healthcare services	1,111	1,111	-	-
Hardware	48	48	-	-
Business services	99	99	-	-
Foreign company stock				
Industrial materials	1,501	-	1,501	-
Hardware	334	-	334	-
Business services	235	-	235	-
Energy	682	-	682	-
Financial services	770	-	770	-
Consumer Goods	231	-	231	-
Telecommunications	90	-	90	-
Healthcare services	197	-	197	-
Corporate debt obligations	2,350	-	2,350	-
Foreign corporate debt obligations	580	-	580	-
Government securities	2,381	-	2,381	-
Foreign government securities	302	-	302	-
<b>Total</b>	<b>\$ 23,536</b>	<b>\$ 13,883</b>	<b>\$ 9,653</b>	<b>\$ 0</b>

# Southwest Power Pool, Inc.

## Notes to Financial Statements

December 31, 2011 and 2010

The fair value of the Company's other postretirement benefit plan assets at December 31, 2011, by asset category are as follows:

Asset Category	Total	Fair Value Measurements		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	\$ 8	\$ 8	\$ -	\$ -
Money market mutual funds	190	190	-	-
Mutual funds				
Equities				
Foreign large blend	249	249	-	-
Foreign large growth	248	248	-	-
Mid cap value	154	154	-	-
Mid cap growth	356	356	-	-
Small cap value	140	140	-	-
Small blend	149	149	-	-
Real estate	327	327	-	-
Emerging markets	203	203	-	-
Commodities	298	298	-	-
Fixed income				
Bond funds	1,735	1,735	-	-
Inflation protected	280	280	-	-
Common stock				
Industrial materials	293	293	-	-
Consumer goods and services	553	553	-	-
Financial services	180	180	-	-
Energy	222	222	-	-
Healthcare services	321	321	-	-
Hardware	125	125	-	-
Business services	235	235	-	-
Software	60	60	-	-
Telecommunications	84	84	-	-
Media	59	59	-	-
Utilities	107	107	-	-
Foreign company stock				
Business services	69	-	69	-
Financial services	56	-	56	-
Energy	50	-	50	-
<b>Total</b>	<b>\$ 6,751</b>	<b>\$ 6,576</b>	<b>\$ 175</b>	<b>\$ 0</b>

# Southwest Power Pool, Inc.

## Notes to Financial Statements

December 31, 2011 and 2010

The fair value of the Company's other postretirement benefit plan assets at December 31, 2010, by asset category are as follows:

Asset Category	Total	Fair Value Measurements		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	\$ 2	\$ 2	\$ -	\$ -
Money market mutual funds	78	78	-	-
Mutual funds				
Equities				
Foreign large blend	311	311	-	-
Foreign large growth	287	287	-	-
Mid cap value	266	266	-	-
Mid cap growth	278	278	-	-
Small cap value	142	142	-	-
Small blend	142	142	-	-
Real estate	422	422	-	-
Emerging markets	204	204	-	-
Commodities	382	382	-	-
Fixed income				
Bond funds	183	183	-	-
Inflation protected	1,634	1,634	-	-
Common stock				
Industrial materials	323	323	-	-
Consumer goods and services	390	390	-	-
Financial services	207	207	-	-
Energy	186	186	-	-
Healthcare services	251	251	-	-
Hardware	142	142	-	-
Business services	61	61	-	-
Software	166	166	-	-
Telecommunications	128	128	-	-
Media	31	31	-	-
Utilities	66	66	-	-
Foreign company stock				
Business services	63	-	63	-
Financial services	50	-	50	-
Energy	45	-	45	-
<b>Total</b>	<b>\$ 6,440</b>	<b>\$ 6,282</b>	<b>\$ 158</b>	<b>\$ 0</b>



**Southwest Power Pool, Inc.**  
**Notes to Financial Statements**  
**December 31, 2011 and 2010**

***Defined Contribution Plans***

The Company has a 401(k) defined contribution plan covering substantially all employees. The Company contributes funds to the plan on behalf of plan participants equal to 75% of the participants' elective deferrals up to 6% of deferred compensation. Contributions to the plan were \$1,966 and \$1,658 for 2011 and 2010, respectively.

The Company has a 457(b) non-qualified tax-deferred compensation plan. This plan is an unfunded plan maintained for the purpose of providing deferred compensation for a select group of management or highly-compensated employees and, therefore, is intended to be exempt from the participation, vesting, funding and fiduciary requirements of Title I of ERISA. Accumulated contributions and earnings of \$775 and \$652 are recorded in other long-term liabilities at December 31, 2011 and 2010, respectively. The Company also offers a 457(f) non-qualified tax-deferred compensation plan to a select group of executive management. The 457(f) plan is intended to be exempt from the participation, vesting, funding and fiduciary requirements of Title I of ERISA and serves to further supplement benefits lost due to IRS limits on compensation and benefits. Accrued benefits of \$691 and \$443 are recorded in other long-term liabilities for the 457(f) plan participants at December 31, 2011 and 2010, respectively.

**Note 7: Related Party Transactions (in Thousands)**

General disbursements of the Company are apportioned to members based on the formula described in the bylaws of the Company (see *Note 1*). The Company's receivables from members totaled \$8,984 and \$9,986 as of December 31, 2011 and 2010, respectively. The Company recognized revenues of \$88,257 and \$84,698, including assessments and tariff administrative fees, from members for the years ended December 31, 2011 and 2010, respectively.

The Southwest Power Pool Regional State Committee (RSC) was incorporated on April 7, 2004, in the State of Arkansas. The RSC is comprised of commissioners from public service commissions or equivalent, having regulatory authority over Company members. FERC, in its February 20, 2004, order regarding the Company's RTO application, stated, "the RSC should have primary responsibility for determining regional proposals and the transition process for funding of regional transmission enhancements, rate structure for a regional access charge and allocation of transmission rights." The RSC prepares budgets annually for the expected costs of its operations. This budget is submitted to the Company's board of directors for approval. The Company includes in its annual budget funds sufficient to cover 100% of the operating costs of the RSC. During 2011 and 2010, the Company incurred \$311 and \$178, respectively, in expenses attributable to RSC operations. Management of the Company expects such expenditures for 2012 to be approximately \$394.

**Southwest Power Pool, Inc.**  
**Notes to Financial Statements**  
**December 31, 2011 and 2010**

**Note 8: Open Access Transmission and EIS Market Operations (In Thousands)**

The Company provides short- and long-term firm and non-firm point-to-point transmission services and network integration transmission service across 15 providers in nine states. The Company is responsible for the billing of the transmission customers for the respective services and the remittance of the subsequent collections to the transmission owner on a monthly basis. Billings for these transmission services are not included in the statements of operations. The Company receives a fee for facilitating the transmission process, which is recorded as tariff fees in the Company's statements of operations. For the years ended December 31, 2011 and 2010, the Company billed transmission customers \$944,613 and \$698,748, respectively. For the years ended December 31, 2011 and 2010, the Company remitted to transmission owners \$864,380 and \$627,931, respectively. At December 31, 2011 and 2010, the Company was due to collect from customers and remit to owners transmission service charges of \$71,590 and \$53,810, respectively.

The Company's EIS market is a wholesale market that operates under a tariff approved by FERC and is consistent with the mandate of the FERC Order No. 2000, which requires RTOs to provide real-time energy imbalance services and market monitoring functions. Weekly settlements of market participants' energy transactions are not reflected in the Company's statements of operations since they do not represent revenues or expenses of the Company, as the Company merely acts as an intermediary in the settlement process. In this role, the Company receives and disburses funds to/from market participants on a weekly basis.

**Note 9: Commitments and Contingencies (in Thousands)**

***Litigation and Regulatory Matters***

The Company is engaged in various regulatory proceedings at both the federal and state levels. The Company is also subject to claims and lawsuits that arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such proceedings, claims and lawsuits will not have a material adverse effect on the financial position, results of operations and cash flows of the Company.

***Construction Contract***

The Company entered into a \$52,691 contract for the construction of a new facility. The remaining commitment on the contract at December 31, 2011, was approximately \$13,517.

***Integrated Marketplace Contracts***

The company entered into long term contracts totaling \$72,491 with numerous vendors for the development of various components of systems that will comprise the Integrated Marketplace. The remaining commitment on these contracts at December 31, 2011, was approximately \$54,331.

**Southwest Power Pool, Inc.**  
**Notes to Financial Statements**  
**December 31, 2011 and 2010**

***Building Lease Decommissioning***

The Company is constructing a new corporate campus and expects to complete the employee migration to the new facility in July 2012. The Company is currently leasing office space that will expire on September 30, 2012. In accordance with the lease agreement, the Company has agreed to pay a vacation services fee to the lessor in 2012 upon vacating the rented office space. An expense of \$631 was recognized for the year ended December 31, 2011, and is included in consulting services in the accompanying Statement of Operations.

**Note 10: Disclosures About Fair Value of Financial Instruments (in Thousands)**

ASC Topic 820, *Fair Value Measurements*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also specifies a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
- Level 3** Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities

Following is a description of the valuation methodologies used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy.

***Interest Rate Swap Agreements***

The fair value is estimated using forward-looking interest rate curves and discounted cash flows that are observable or that can be corroborated by observable market data and, therefore, are classified within Level 2 of the valuation hierarchy. At December 31, 2011 and 2010, the fair value measurement of the interest rate swaps as recognized in the accompanying balance sheets was a liability of \$2,531 and \$2,714, respectively.

***Cash Equivalents***

The fair value of money market mutual funds included in cash equivalents are estimated using quoted prices in active markets for identical assets or liabilities. At December 31, 2011 and 2010, the fair value measurement of the cash equivalents as recognized in the accompanying balance sheets was \$12,636 and \$4,261, respectively.

# Southwest Power Pool, Inc.

## Notes to Financial Statements

December 31, 2011 and 2010

The Company has no assets or liabilities measured and recognized in the accompanying balance sheets on a nonrecurring basis.

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying balance sheets at amounts other than fair value.

### **Restricted Cash Deposits**

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

### **Customer Deposits**

The carrying amount is a reasonable estimate of fair value.

### **Long-term Debt**

Fair value is estimated based on the borrowing rates currently available to the Company for bank loans with similar terms and maturities.

The following table presents estimated fair values of the Company's financial instruments at December 31, 2011 and 2010.

	2011		2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 73,763	\$ 73,763	\$ 81,041	\$ 81,041
Restricted cash deposits	\$ 34,903	\$ 34,903	\$ 25,668	\$ 25,668
Financial liabilities				
Customer deposits	\$ 34,903	\$ 34,903	\$ 25,668	\$ 25,668
Long-term debt	\$ 182,164	\$ 171,540	\$ 125,369	\$ 101,799
Swap agreements	\$ 2,531	\$ 2,531	\$ 2,714	\$ 2,714

### **Note 11: Subsequent Events**

Subsequent events have been evaluated through the date of the Independent Accountants' Report, which is the date the financial statements were available to be issued.