

Southwest Power Pool, Inc.

Independent Auditor's Report and Financial Statements

December 31, 2012 and 2011

Southwest Power Pool, Inc.
December 31, 2012 and 2011

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Independent Auditor's Report

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

We have audited the accompanying financial statements of Southwest Power Pool, Inc., which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of operations, changes in members' deficit and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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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, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BKD, LLP

Little Rock, Arkansas
April 16, 2013

Southwest Power Pool, Inc.

Balance Sheets

(In Thousands)

December 31, 2012 and 2011

Assets

	<u>2012</u>	<u>2011</u>
Current Assets		
Cash and cash equivalents	\$ 95,693	\$ 73,763
Restricted cash deposits	43,743	34,903
Accounts receivable	17,923	15,901
Prepaid expenses and other	<u>5,412</u>	<u>6,636</u>
Total current assets	<u>162,771</u>	<u>131,203</u>
Property and Equipment, at Cost		
Land	4,812	4,812
Building	67,378	5,965
Furniture and fixtures	9,891	4,613
Equipment and machinery	35,343	31,846
Leasehold improvements	588	1,309
Software	81,344	74,646
Software in development	76,539	34,351
Construction in progress	<u>-</u>	<u>46,779</u>
	275,895	204,321
Less accumulated depreciation and amortization	<u>102,143</u>	<u>92,133</u>
	<u>173,752</u>	<u>112,188</u>
Other Assets, Net	<u>2,997</u>	<u>2,915</u>
	<u>\$ 339,520</u>	<u>\$ 246,306</u>

Liabilities and Members' Deficit

	<u>2012</u>	<u>2011</u>
Current Liabilities		
Accounts payable	\$ 9,831	\$ 17,816
Customer deposits	43,913	34,903
Current maturities of long-term debt <i>(Note 3)</i>	12,700	11,206
Accrued expenses	28,741	25,741
Deferred revenue	<u>6,286</u>	<u>7,450</u>
Total current liabilities	101,471	97,116
Long-term Debt <i>(Note 3)</i>	258,258	170,958
Other Long-term Liabilities	10,519	7,654
Members' Deficit	<u>(30,728)</u>	<u>(29,422)</u>
	<u>\$ 339,520</u>	<u>\$ 246,306</u>

Southwest Power Pool, Inc.
Statements of Operations
(In Thousands)
Years Ended December 31, 2012 and 2011

	2012	2011
Operating Income		
Tariff fees and member assessments	\$ 118,808	\$ 95,825
Other member services	<u>29,111</u>	<u>33,115</u>
	<u>147,919</u>	<u>128,940</u>
Operating Expenses		
Salaries and benefits	72,262	64,514
Employee travel	2,245	1,655
Administrative	3,720	3,003
Regulatory assessment	14,977	16,639
Meetings	983	838
Communications system	4,020	3,204
Leases	1,690	1,624
Maintenance	8,288	7,308
Consulting services	15,160	16,124
Depreciation and amortization	<u>16,590</u>	<u>13,107</u>
	<u>139,935</u>	<u>128,016</u>
Operating Income	<u>7,984</u>	<u>924</u>
Other Income (Expense)		
Interest income	149	157
Interest expense	(6,398)	(6,307)
Change in fair market value of interest rate swaps	674	183
Other expense	<u>(214)</u>	<u>(21)</u>
	<u>(5,789)</u>	<u>(5,988)</u>
Income/(Loss) Before Change in Funded Status of Employee Benefit Plans	2,195	(5,064)
Change in Funded Status of Employee Benefit Plans	<u>(3,501)</u>	<u>(3,976)</u>
Net Loss	<u>\$ (1,306)</u>	<u>\$ (9,040)</u>

Southwest Power Pool, Inc.
Statements of Members' Deficit
(In Thousands)
Years Ended December 31, 2012 and 2011

	2012	2011
Balance, Beginning of Year	\$ (29,422)	\$ (20,382)
Net loss	(1,306)	(9,040)
Balance, End of Year	\$ (30,728)	\$ (29,422)

Southwest Power Pool, Inc.
Statements of Cash Flows
(In Thousands)
Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating Activities		
Net loss	\$ (1,306)	\$ (9,040)
Items not requiring cash		
Depreciation and amortization	16,590	13,107
Impairment loss	-	152
Change in funded status of employee benefit plans	3,501	3,976
Loss on disposal of fixed assets	264	-
Change in fair market value of interest rate swaps	(674)	(183)
Changes in assets and liabilities		
Accounts receivable	(2,023)	2,608
Prepaid expenses and other	1,224	(3,285)
Other assets	(180)	(121)
Accounts payable	(7,985)	7,468
Accrued expenses	1,836	569
Other long-term liabilities	<u>229</u>	<u>67</u>
Net cash provided by operating activities	<u>11,476</u>	<u>15,318</u>
Investing Activities		
Acquisition of property and equipment	<u>(78,340)</u>	<u>(79,391)</u>
Net cash used in investing activities	<u>(78,340)</u>	<u>(79,391)</u>
Financing Activities		
Repayments of long-term debt	(11,206)	(13,205)
Issuance of long-term debt	<u>100,000</u>	<u>70,000</u>
Net cash provided by financing activities	<u>88,794</u>	<u>56,795</u>
Increase (Decrease) in Cash and Cash Equivalents	<u>21,930</u>	<u>(7,278)</u>
Cash and Cash Equivalents, Beginning of Year	<u>73,763</u>	<u>81,041</u>
Cash and Cash Equivalents, End of Year	<u>\$ 95,693</u>	<u>\$ 73,763</u>
Supplemental Cash Flow Information		
Interest paid (net of interest capitalized of \$2,723 and \$1,943 in 2012 and 2011, respectively)	\$ 6,261	\$ 6,498

Southwest Power Pool, Inc.

Notes to Financial Statements

December 31, 2012 and 2011

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, 2012 and 2011, 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.

Pursuant to legislation enacted in 2010, FDIC fully insured all noninterest-bearing transaction accounts beginning December 31, 2010, through December 31, 2012, at all FDIC-insured institutions. This legislation expired on December 31, 2012. Beginning January 1, 2013, noninterest-bearing transaction accounts are subject to the \$250,000 limit on FDIC insurance per covered institution. At December 31, 2012, the Company's cash accounts did not exceed federally insured limits.

Southwest Power Pool, Inc.

Notes to Financial Statements

December 31, 2012 and 2011

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 2009.

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 \$2,723 and \$1,943 in 2012 and 2011, respectively.

The Company capitalizes development costs, including interest, for internal use software costs. These costs are included in 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, 2012 and 2011

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) was obsolete technology and therefore had 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. No asset impairment was recognized during the year ended December 31, 2012.

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 2012 and 2011, all members paid a \$6,000 membership fee.

Southwest Power Pool, Inc.

Notes to Financial Statements

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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 2012 and 2011, the Company maintained cash balances that are not insured by the Federal Deposit Insurance Corporation. However, these cash balances were primarily invested in highly liquid short-term investments such as money market funds, mutual funds and repurchase agreements. The Company also 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 currently 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, 2012 and 2011

Note 2: Line of Credit (In Thousands)

The Company has a \$20,000 revolving line of credit expiring in 2013. At December 31, 2012 and 2011, 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, 2012.

Note 3: Long-term Debt and Interest Rate Swaps (in Thousands)

Long-term Debt

	2012	2011
Variable Rate Term Note due 2027 (A)	\$ 3,958	\$ 4,164
Variable Rate Term Note due 2014 (B)	11,000	16,000
5.45% Senior Notes due 2016 (C)	21,000	27,000
4.82% Series 2010-A Senior Notes due 2042 (D)	30,000	30,000
4.82% Series 2010-B Senior Notes due 2042 (E)	35,000	35,000
3.55% Series 2010-C Senior Notes due 2024 (F)	70,000	70,000
3.00% Series 2012-D-1 Senior Notes due 2024 (G)	50,000	-
3.25% Series 2012-D-2 Senior Notes due 2024 (H)	50,000	-
	270,958	182,164
Less current maturities	12,700	11,206
	\$ 258,258	\$ 170,958

- (A) 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.
- (B) 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.
- (C) 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.

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- (D) 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.
- (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 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.
- (G) Due March 30, 2024; principal and interest are payable quarterly based on 10-year amortization. Principal payments commence on June 30, 2014. The interest rate is fixed at 3.00%. The note is unsecured.
- (H) Due September 30, 2024; principal and interest are payable quarterly based on 10-year amortization. Principal payments commence on December 30, 2014. The interest rate is fixed at 3.25%. The note is unsecured.

Aggregate annual maturities of long term debt at December 31, 2012, are:

2013	\$	12,700
2014		22,998
2015		24,299
2016		21,353
2017		18,409
Thereafter		<u>171,199</u>
	\$	<u>270,958</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, 2012.

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 \$3,927 and \$4,131 at December 31, 2012 and 2011, 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 A).

Southwest Power Pool, Inc.

Notes to Financial Statements

December 31, 2012 and 2011

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 \$11,000 and \$16,000 at December 31, 2012 and 2011, 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 B).

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

	2012	2011
Fair value of interest rate swap agreements	\$ 1,857	\$ 2,531
Balance sheet location of fair value amounts	Other Long-term Liabilities	Other Long- term Liabilities
Gain recognized in statement of operations	\$ 674	\$ 183
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 4: 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 \$1,690 and \$1,624 in 2012 and 2011, respectively.

Future minimum lease payments at December 31, 2012, were:

2013	\$ 368
2014	59
	\$ 427

Note 5: 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 \$4,000 to the plan in 2013.

Southwest Power Pool, Inc.

Notes to Financial Statements

December 31, 2012 and 2011

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 \$542 to the plan in 2013.

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	
	2012	2011	2012	2011
Benefit obligation	\$ 38,014	\$ 28,921	\$ 7,353	\$ 5,950
Fair value of plan assets	<u>31,295</u>	<u>25,263</u>	<u>7,963</u>	<u>6,751</u>
Funded status	\$ <u>(6,719)</u>	\$ <u>(3,658)</u>	\$ <u>610</u>	\$ <u>801</u>

Amounts recognized in the balance sheets:

	Pension Benefits		Postretirement Health Care Benefits	
	2012	2011	2012	2011
Noncurrent assets	\$ -	\$ -	\$ 610	\$ 801
Noncurrent liabilities	<u>(6,719)</u>	<u>(3,658)</u>	-	-
	\$ <u>(6,719)</u>	\$ <u>(3,658)</u>	\$ <u>610</u>	\$ <u>801</u>

Amounts recognized in members’ equity not yet recognized as components of net periodic benefit cost as of December 31, 2012, consist of:

	Pension Benefits	Postretirement Health Care Benefits
	2012	2012
Net (gain)/loss	\$ 9,784	\$ (615)
Prior service credit	(20)	-
Transition obligation	<u>132</u>	<u>35</u>
	\$ <u>9,896</u>	\$ <u>(580)</u>

Southwest Power Pool, Inc.

Notes to Financial Statements

December 31, 2012 and 2011

The accumulated benefit obligation for the defined benefit pension plan was \$29,577 and \$22,317 at December 31, 2012 and 2011, respectively.

Other significant balances and costs are:

	Pension Benefits		Postretirement Health Care Benefits	
	2012	2011	2012	2011
Employer contributions	\$ 3,892	\$ 3,133	\$ 469	\$ 445
Benefits paid	177	144	26	20
Benefit costs	3,643	2,830	469	445

The following amounts have been recognized in the statements of operations for the year ended December 31, 2012:

	Pension Benefits		Postretirement Health Care Benefits	
Amounts arising during the period				
Net gain	\$	823	\$	820
Amounts recognized as components of net periodic benefit cost of the period				
Net (gain) or loss		210		(7)
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 \$352, \$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:

	Pension Benefits		Postretirement Health Care Benefits	
	2012	2011	2012	2011
Discount rate benefit obligation	5.5%	6.25%	5.5%	6.25%
Expected return on plan assets	7.0%	7.0%	7.0%	7.0%
Rate of compensation increase	4.0%	4.25%	-	-

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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.

For measurement purposes, a 10% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2012 and 2011. The rate was assumed to decrease gradually to 5% by the year 2018 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 2003*, 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:

	Pension Benefits	Postretirement Health Care Benefits
2013	\$ 308	\$ 68
2014	474	116
2015	590	143
2016	691	172
2017	818	207
2018–2022	7,053	1,611

Southwest Power Pool, Inc.

Notes to Financial Statements

December 31, 2012 and 2011

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, 2012 and 2011, plan assets by category are as follows:

	Pension Plan Assets		Postretirement Health Care Plan Assets	
	2012	2011	2012	2011
Fixed income securities	14%	14%	29%	30%
Equity securities	72	74	65	67
Cash and equivalents	<u>14</u>	<u>12</u>	<u>6</u>	<u>3</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, 2012 and 2011, the Company does not hold any plan assets valued using Level 3 inputs.

Southwest Power Pool, Inc.

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The fair values of the Company's pension plan assets at December 31, 2012, 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	\$ 5	\$ 5	\$ -	\$ -
Money market mutual funds	657	657	-	-
Mutual funds				
Foreign large blend	734	734	-	-
Mid cap value	1,189	1,189	-	-
Mid cap growth	4,734	4,734	-	-
Small cap growth	1,215	1,215	-	-
Large growth	4,099	4,099	-	-
Common stock				
Industrial materials	1,300	1,300	-	-
Consumer goods	978	978	-	-
Financial Services	550	550	-	-
Energy	1,941	1,941	-	-
Healthcare services	1,566	1,566	-	-
Hardware	21	21	-	-
Business services	293	293	-	-
Foreign company stock				
Industrial materials	666	-	666	-
Hardware	834	-	834	-
Business services	133	-	133	-
Energy	1,956	-	1,956	-
Financial services	289	-	289	-
Corporate debt obligations	2,729	-	2,729	-
Foreign corporate debt obligations	1,134	-	1,134	-
Government securities	3,826	-	3,826	-
Foreign government securities	446	-	446	-
Total	\$ 31,295	\$ 19,282	\$ 12,013	\$ -

Southwest Power Pool, Inc.

Notes to Financial Statements

December 31, 2012 and 2011

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>-</u>

Southwest Power Pool, Inc.

Notes to Financial Statements

December 31, 2012 and 2011

The fair value of the Company's other postretirement benefit plan assets at December 31, 2012, 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	\$ 3	\$ 3	\$ -	\$ -
Money market mutual funds	455	455	-	-
Mutual funds				
Equities				
Foreign large blend	392	392	-	-
Foreign large growth	390	390	-	-
Mid cap growth	615	615	-	-
Small cap value	312	312	-	-
Real estate	367	367	-	-
Emerging markets	214	214	-	-
Commodities	292	292	-	-
Fixed income				
Bond funds	2,028	2,028	-	-
Inflation protected	292	292	-	-
Common stock				
Industrial materials	301	301	-	-
Consumer goods and services	631	631	-	-
Financial services	314	314	-	-
Energy	223	223	-	-
Healthcare services	316	316	-	-
Hardware	41	41	-	-
Business services	194	194	-	-
Software	77	77	-	-
Telecommunications	92	92	-	-
Media	71	71	-	-
Utilities	93	93	-	-
Foreign company stock				
Business services	135	-	135	-
Financial services	64	-	64	-
Energy	51	-	51	-
Total	\$ 7,963	\$ 7,713	\$ 250	\$ -

Southwest Power Pool, Inc.

Notes to Financial Statements

December 31, 2012 and 2011

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	-
Total	\$ 6,751	\$ 6,576	\$ 175	\$ -

Southwest Power Pool, Inc.

Notes to Financial Statements

December 31, 2012 and 2011

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 \$2,157 and \$1,966 for 2012 and 2011, 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 \$968 and \$775 are recorded in other long-term liabilities at December 31, 2012 and 2011, 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 \$975 and \$691 are recorded in other long-term liabilities for the 457(f) plan participants at December 31, 2012 and 2011, respectively.

Note 6: 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 \$9,587 and \$8,984 as of December 31, 2012 and 2011, respectively. The Company recognized revenues of \$110,707 and \$88,257, including assessments and tariff administrative fees, from members for the years ended December 31, 2012 and 2011, 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 2012 and 2011, the Company incurred \$455 and \$311, respectively, in expenses attributable to RSC operations. Management of the Company expects such expenditures for 2013 to be approximately \$344.

Southwest Power Pool, Inc.

Notes to Financial Statements

December 31, 2012 and 2011

Note 7: 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, 2012 and 2011, the Company billed transmission customers \$ 1,118,542 and \$944,613, respectively. For the years ended December 31, 2012 and 2011, the Company remitted to transmission owners \$1,016,886 and \$864,380, respectively. At December 31, 2012 and 2011, the Company was due to collect from customers and remit to owners transmission service charges of \$85,613 and \$71,590, 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 8: Commitments and Contingencies (in Thousands)

Litigation and Regulatory Matters

In 2011, a suit was filed against the Company claiming a violation of the Arkansas Minimum Wage Act for overtime hours. While the Company believes it has meritorious defenses against the suit, the ultimate resolution of the matter could result in a loss to the Company. An estimate of loss cannot be made at this time.

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.

Integrated Marketplace Contracts

The company entered into long term contracts totaling \$73,986 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, 2012, was approximately \$28,060.

Southwest Power Pool, Inc.
Notes to Financial Statements
December 31, 2012 and 2011

Note 9: 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, 2012 and 2011, the fair value measurement of the interest rate swaps as recognized in the accompanying balance sheets was a liability of \$1,857 and \$2,531, 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, 2012 and 2011, the fair value measurement of the cash equivalents as recognized in the accompanying balance sheets was \$13,413 and \$12,636, respectively.

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.

Southwest Power Pool, Inc.

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December 31, 2012 and 2011

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, 2012 and 2011.

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 95,693	\$ 95,693	\$ 73,763	\$ 73,763
Restricted cash deposits	\$ 43,743	\$ 43,743	\$ 34,903	\$ 34,903
Financial liabilities				
Customer deposits	\$ 43,913	\$ 43,913	\$ 34,903	\$ 34,903
Long-term debt	\$ 270,958	\$ 274,518	\$ 182,164	\$ 171,540
Swap agreements	\$ 1,857	\$ 1,857	\$ 2,531	\$ 2,531

Note 10: Subsequent Events

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