Southwest Power Pool, Inc.

Independent Auditor's Report and Financial Statements

December 31, 2019 and 2018

Southwest Power Pool, Inc.
December 31, 2019 and 2018

Contents

BKD
CPAs & Advisors

400 W. Capitol Avenue, Suite 2500 | P.O. Box 3667 | Little Rock, AR 72203-3667
501.372.1040 | Fax 501.372.1250 | bkd.com

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, 2019 and 2018, and the related statements of income, 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.

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, 2019 and 2018, 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 27, 2020

Southwest Power Pool, Inc.

Balance Sheets (*in Thousands*)

December 31, 2019 and 2018

Assets

	2019	2018
Current Assets		
Cash and cash equivalents	$ 48,694	$ 93,593
Restricted cash deposits	401,478	344,904
Accounts receivable, net	74,285	65,542
Prepaid expenses and other	11,714	12,456
Total current assets	536,171	516,495
Property and Equipment, at Cost		
Land	4,812	4,812
Building and improvements	68,373	67,811
Furniture and fixtures	10,328	10,352
Equipment and machinery	56,025	48,608
Software	185,622	181,065
Software in development	7,081	6,573
Equipment under capital lease	-	4,876
	332,241	324,097
Less accumulated depreciation and amortization	258,151	246,606
	74,090	77,491
Investments (*Note 2*)	35,276	25,239
Other Assets, Net	6,349	6,842
	$ 651,886	$ 626,067

See Notes to Financial Statements

Liabilities and Members’ Deficit

	2019	2018
Current Liabilities		
Accounts payable	$ 60,811	$ 77,645
Customer deposits	401,478	344,904
Current maturities of long-term debt (*Note 4*)	22,596	22,281
Current maturities of obligations under capital lease (*Note 5*)	-	1,966
Accrued expenses	79,569	97,246
Deferred revenue	5,203	187
Total current liabilities	569,657	544,229
Line of Credit *(Note 3)*	12,760	340
Long-term Debt (*Note 4*)	169,603	192,199
Less unamortized debt issuance costs	(613)	(708)
	168,990	191,491
Other Long-term Liabilities	44,241	40,101
Members’ Deficit	(143,762)	(150,094)
	$ 651,886	$ 626,067

Southwest Power Pool, Inc.

Statements of Income (*in Thousands*)

Years Ended December 31, 2019 and 2018

	2019	2018
Operating Income		
Tariff fees and member assessments	$ 188,518	$ 192,451
Other member services	7,171	7,062
	195,689	199,513
Operating Expenses		
Salaries and benefits	101,221	96,109
Employee travel	1,907	1,895
Administrative	4,865	4,602
Regulatory assessment	20,591	21,060
Meetings	933	919
Communications system	4,449	3,840
Maintenance	16,308	17,180
Consulting services	14,909	12,370
Depreciation	16,930	18,163
	182,113	176,138
Operating Income	13,576	23,375
Other Income (Expense)		
Investment income	665	355
Interest expense	(8,550)	(9,268)
Change in fair market value of interest rate swaps	(322)	725
Other expense	(744)	(1,014)
	(8,951)	(9,202)
Income Before Unrealized Gain (Loss) and Change in Funded Status of Employee Benefit Plans	4,625	14,173
Unrealized Gain (Loss) on Investments	2,552	(528)
Change in Funded Status of Employee Benefit Plans	(845)	(7,018)
Net Income	$ 6,332	$ 6,627

Southwest Power Pool, Inc.
Statements of Members' Deficit (*in Thousands*)
Years Ended December 31, 2019 and 2018

	2019	2018
Balance, Beginning of Year	$ (150,094)	$ (156,721)
Net income	6,332	6,627
Balance, End of Year	$ (143,762)	$ (150,094)

Southwest Power Pool, Inc.
Statements of Cash Flows (*in Thousands*)
Years Ended December 31, 2019 and 2018

	2019	As Adjusted- Note 1 2018
Operating Activities		
Net income	$ 6,332	$ 6,627
Items not requiring cash		
Depreciation and amortization	17,036	18,263
Change in funded status of employee benefit plans	845	7,018
Unrealized loss (gain) on investments	(2,552)	528
Loss on disposal of fixed assets	46	-
Change in fair market value of interest rate swaps	(322)	(725)
Changes in assets and liabilities		
Accounts receivable, net	(8,743)	8,849
Prepaid expenses and other	743	(3,917)
Other assets	288	(1,348)
Accounts payable	(16,495)	2,223
Accrued expenses and other liabilities	(12,519)	(5,482)
Other current liabilities	56,573	4,292
Other long-term liabilities	3,617	1,506
Net cash provided by operating activities	44,849	37,834
Investing Activities		
Acquisition of property and equipment	(14,056)	(16,116)
Purchase of investments	(55,859)	(42,222)
Proceeds from investment maturities	47,042	40,808
Proceeds from sale of investments	1,526	103
Net cash used in investing activities	(21,347)	(17,427)
Financing Activities		
Repayments of long-term debt	(22,281)	(21,469)
Repayments of capital lease obligation	(1,966)	(1,890)
Repayment of borrowings under lines of credit	(76,583)	(13,600)
Borrowings under lines of credit	89,003	13,940
Net cash used in financing activities	(11,827)	(23,019)
Increase (Decrease) in Cash, Cash Equivalents, and Restricted Cash	11,675	(2,612)
Cash, Cash Equivalents, and Restricted Cash, Beginning of Year	438,497	441,109
Cash, Cash Equivalents, and Restricted Cash, End of Year	$ 450,172	$ 438,497
Supplemental Cash Flows Information		
Interest paid on long-term debt (net of interest capitalized of $209 and $122 in 2019 and 2018, respectively)	$ 8,474	$ 9,180
Property and equipment purchases in accounts payable and accrued liabilities	$ 2,431	$ 2,912

Southwest Power Pool, Inc.

Statements of Cash Flows (*in Thousands*)

Years Ended December 31, 2019 and 2018

	2019	2018
Cash and cash equivalents	$ 48,694	$ 93,593
Restricted cash deposits	401,478	344,904
Total cash, cash equivalents and restricted cash shown on the balance sheet	$ 450,172	$ 438,497

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 18 million ultimate customers across all or parts of 14 states. The Company's membership consists of investor-owned utilities, municipal systems, generation and transmission cooperatives, state authorities, federal agencies, 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, reliability coordination, regional scheduling, market operations and regional transmission expansion planning. Market operations encompass day-ahead and real-time markets, transmission congestion rights, reliability unit commitment, operating reserve market and consolidated balancing authority.

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

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, 2019 and 2018, the Company's cash and cash equivalents, including restricted deposits, are invested primarily in money market funds, mutual funds and commercial paper. These investments are typically revalued to the market each day. 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 set aside for disputed invoices.

Investments

The Company's investments include equity and fixed income mutual funds and government securities. These investments are recorded at fair value, with unrealized gains and losses reported as nonoperating income. Dividends, interest income and realized gains and losses are reported as investment income. The Company's investments are intended to be utilized in funding benefits associated with the Company's postretirement health care plan and 457f deferred compensation plan in addition to maintaining collections under Schedule 12 to be utilized for the annual FERC assessment.

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.

Notes to Financial Statements (in Thousands)

Accounts Receivable

Accounts receivable are stated at the amount of consideration from members, customers, and others of which the Company has an unconditional right to receive plus any accrued and unpaid interest. The Company provides an allowance for doubtful accounts, which is based upon a review of outstanding receivables, historical collection information and existing economic conditions. Accounts that are unpaid after the due date are subject to interest at a rate set by FERC. During the years ended December 31, 2019 and 2018, impairment losses on doubtful accounts receivable, where collectability is not reasonably assured, were $0 and $626, respectively.

Property and Equipment

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
Building improvements	Shorter of useful life or remaining life of building
Furniture and fixtures	5 years
Vehicles	5 years
Equipment and machinery	3 years
Software	3 years

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 $209 and $122 in 2019 and 2018, respectively.

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

Long-Lived Asset Impairment

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 it fair value.

No asset impairment was recognized during the years ended December 31, 2019 and 2018.

Revenue Recognition

Revenues, consisting of member assessments, tariff administrative fees, contract services and miscellaneous revenues are recognized when performance obligations are satisfied, 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, market transactions and engineering studies. An offsetting liability equal to the deposit balance is recorded in current liabilities. Funds set aside for disputed invoices are also recorded as customer deposits under current liabilities.

Tariff Fees and Member Assessments

An administrative charge is applied to all transmission service under the Company's Open Access Transmission Tariff (tariff) to cover the expenses related to its administration. The charge is calculated in accordance with the terms of the Company's 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 of directors.

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 2019 and 2018, all members paid a $6 membership fee.

The Company also bills transmission customers 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 the annual charges the Company pays to FERC.

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. The Company also provides engineering study services for long-term transmission service and generation interconnection requests.

Withdrawing Members

Prior to December 2019, members wishing to withdraw their membership from the Company must provide 24 months' written notice and were responsible for their portion of the Company's existing obligations as defined in the bylaws, which included 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. Additionally, withdrawing members were responsible for all financial obligations incurred and costs allocated to its load for transmission facilities approved prior to their withdrawal. As a result of a complaint, FERC ordered the Company in its ruling dated December 19, 2019 to revise its membership agreement and bylaws to eliminate for non-transmission owners the membership exit fee comprised of member's share of long-term obligations and related interest. FERC also ordered the Company to revise its exit fee formula to ensure that the

Company's debt is fully covered by the continued application of the exit fee to transmission-owning members. As of December 31, 2019, the Company had not been notified by any member of their intent to withdraw their membership from the Company.

Concentration of Credit Risk

The Company is exposed to credit risk primarily through accounts receivable and uninsured cash balances. During 2019 and 2018, the Company maintained cash balances, including transaction accounts and short-term investment accounts that are not insured by the Federal Deposit Insurance Corporation. At December 31, 2019 and 2018, the Company did not have transaction accounts exceeding federal insurance limits. The Company's investment accounts were primarily invested in highly liquid short-term investments such as money market funds, mutual funds, and commercial paper. The Company also requires the financial institutions holding its cash balances to be rated A or better by nationally recognized rating agencies.

The Company considers its accounts receivable to be highly probable of collection. No allowance for doubtful accounts was recorded at December 31, 2019. The Company had recorded an allowance of $626 at December 31, 2018.

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 customer, the Company requires the posting of defined financial security instruments to cover potential liabilities.

Changes in Accounting Principles

Revenue

In 2014, FASB issued Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*, replacing the existing accounting standard and industry-specific guidance for revenue recognition with a five-step model for recognizing and measuring revenue from contracts with customers. The underlying principle of the standard is to recognize revenue to depict the transfer of goods or services to customers at the amount expected to be collected. For non-public entities, ASC 606 is effective for annual reporting periods beginning after December 15, 2018, and the Company adopted it using the modified retrospective method applied to open contracts and only to the version of contracts in effect as of January 1, 2019.

In accordance with the modified retrospective method, the Company's previously issued financial statements have not been restated to comply with ASC 606 and the Company did not have a cumulative-effect adjustment to retained earnings. Under the new guidance, revenue is to be recognized when performance obligations are satisfied. The Company has historically recognized billed and unbilled revenues as services were provided in accordance with the Company's tariff and various contracts with customers. This practice is consistent with the new revenue recognition guidance. As a result, the adoption of ASC 606 had no significant impact on the timing of revenue recognition compared to previously reported results. The guidance requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and the related cash flows arising from contracts with customers, which are included in *Note 7*. Comparative prior period information has not been adjusted and continues to be reported in accordance with previous revenue recognition guidance in ASC Topic 605 – Revenue Recognition.

Notes to Financial Statements (*in Thousands*)

The Company elected the following practical expedient with implementation of ASC 606:

> Measuring Progress for Revenue Recognized Over Time (606-10-55-18). The Company elected to use the right to invoice practical expedient. This practical expedient allows an entity to recognize revenue in the amount of consideration to which the entity has the right to invoice when the amount that the entity has the right to invoice corresponds directly to the value transferred to the customer.

Restricted Cash

In 2019, the Company changed its method of accounting for restricted cash and restricted cash equivalents by adopting the provisions of Accounting Standards Update (ASU) 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash.* The new accounting guidance in ASU 2016-18 requires balances generally described as restricted cash or restricted cash equivalents to be included with cash and cash equivalents when reconciling beginning and end of the period balances on the accompanying statements of cash flows. This change was applied retrospectively to all periods presented, which resulted in the following changes within the statement of cash flows:

		2018	
	As Previously Reported	As Reported Under Current Method	Effect of Change
Changes in other current liabilities	$ -	$ 4,292	$ 4,292
Net cash provided by operating activities	33,542	37,834	4,292
Increase (Decrease) in Cash, Cash Equivalents, and Restricted Cash	(6,904)	(2,612)	4,292
Cash, Cash Equivalents, and Restricted Cash, Beginning of Year	100,496	441,109	340,613
Cash, Cash Equivalents, and Restricted Cash, End of Year	93,593	438,497	344,904

	2019	2018
Cash and cash equivalents	$ 48,694	$ 93,593
Restricted cash deposits	401,478	344,904
Total cash, cash equivalents and restricted cash shown on the balance sheet	$ 450,172	$ 438,497

The adoption of ASU 2016-18 had no effect on the previously reported net income. The financial statement lines in the statement of cash flows previously titled cash and cash equivalents, beginning of the year and cash and cash equivalents, end of year have been modified to include restricted cash in the current year presentation as a result of the adoption of the standard.

Pension Cost

In 2019, the Company adopted the provisions of ASU 2017-07, *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The new accounting guidance provided for in ASU 2017-07 requires the service cost component of net periodic pension cost and net periodic postretirement benefit cost to be presented with other compensation costs arising from services rendered by employees during the year. Among other things, it requires enhanced disclosures for the presentation of net periodic pension cost and net periodic postretirement cost in the notes to the financial statements. This change was applied retrospectively using the practical expedient for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement cost in the statement of income.

Notes to Financial Statements (in Thousands)

Note 2: Investment and Investment Returns

Investments at December 31 consisted of the following:

	2019	2018
Mutual Funds		
Equity	$ 10,354	$ 8,571
Fixed income	3,737	4,173
Total mutual funds	14,091	12,744
U.S. Government Securities		
Treasury Notes	21,185	12,495
Total Government Securities	21,185	12,495
	$ 35,276	$ 25,239

Total investment return is comprised of the following:

	2019	2018
Interest and dividends reported at fair value	$ 665	$ 355
Unrealized gains (losses) on investments reported at fair value	2,552	(528)
	$ 3,217	$ (173)

Interest, dividends and realized gains and losses are reported as investment income, while unrealized gains and losses are reported separately in the Statements of Income.

Note 3: Lines of Credit

The Company has a $30,000 revolving line of credit with a commercial bank expiring in 2021. At December 31, 2019 and 2018, no amounts were borrowed against this line. The agreement has a variable interest rate equal to the 2019 and 2018 London Interbank Offered Rate (LIBOR) plus a 1.00% and 1.25% credit margin, respectively. The interest rate at December 31, 2019, was 2.75%. 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, 2019.

Notes to Financial Statements (in Thousands)

The Company has a $80,000 revolving line of credit expiring in 2023. At December 31, 2019 and 2018, $12,760 and $340, respectively, was borrowed against this line. The agreement has a variable interest rate equal to London Interbank Offered Rate (LIBOR) plus a 1.5 % credit margin. The interest rate at December 31, 2019, was 3.19%. 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, 2019.

Note 4: Long-term Debt and Interest Rate Swaps

Long-term Debt

	2019	2018
Variable Rate Term Note due 2027 (A)	$ 2,519	$ 2,725
4.82% Series 2010-A and B Senior Notes due 2042 (B)	56,930	58,255
3.55% Series 2010-C Senior Notes due 2024 (C)	29,750	36,750
3.00% Series 2012-D-1 Senior Notes due 2024 (D)	21,250	26,250
3.25% Series 2012-D-2 Senior Notes due 2024 (E)	23,750	28,750
3.80% Series 2014-E Senior Notes due 2025 (F)	37,000	37,000
Floating Series Note - 2024 (G)	21,000	24,750
	192,199	214,480
Less unamortized debt issuance costs	613	708
Less current maturities	22,596	22,281
	$ 168,990	$ 191,491

(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 quarterly based on LIBOR plus 0.85%. At December 31, 2019 and 2018, the interest rate was 2.81% and 3.44%, respectively. The note is secured by a first mortgage on the Company's operation facility.

(B) Due December 30, 2042; principal and interest are payable quarterly based on a 32-year amortization. Principal payments commenced on March 30, 2013. The interest rate is fixed at 4.82%. The notes are unsecured.

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

(D) Due March 30, 2024; principal and interest are payable quarterly based on a 10-year amortization. Principal payments commenced on June 30, 2014. The interest rate is fixed at 3.00%. The notes are unsecured.

Notes to Financial Statements (*in Thousands*)

(E) Due September 30, 2024; principal and interest are payable quarterly based on a 10-year amortization. Principal payments commenced on December 30, 2014. The interest rate is fixed at 3.25%. The notes are unsecured.

(F) Due December 30, 2025; principal and interest are payable quarterly based on an 11 year and 9 months amortization. Principal payments commence on March 30, 2024. The interest rate is fixed at 3.80%. The notes are unsecured.

(G) Due March 30, 2024; principal and interest are payable monthly based on an eight-year amortization. Payments commenced on June 30, 2016. The interest rate adjusts monthly based on LIBOR plus 1.75%. At December 31, 2019 and 2018, the interest rate was 3.46% and 4.10%, respectively. The note is unsecured.

Aggregate annual maturities of long term debt at December 31, 2019, are:

2020	$ 22,596
2021	23,414
2022	23,735
2023	24,560
2024	25,139
Thereafter	72,754
	$ 192,199

Certain of the Company's term notes require compliance with financial and nonfinancial covenants, as well as periodic reporting requirements. The Company was in compliance with the covenant and reporting requirements throughout and at December 31, 2019.

In an April 2019 Order, Federal Energy Regulatory Commission (FERC) directed the Company to eliminate the membership exit fee from non-transmission owners and revise the exit fee formula to ensure that the continued application to transmission owners ensures that the Company's debt is fully secured. In August 2019, the Company submitted a Section 206 compliance filing to FERC, which amends the Company's Membership Agreement and Bylaws to clearly establish an exit fee that only applies to transmission owning members in compliance with the FERC order.

The Company notified its debt holders of a potential event of default under the agreements as a result of the April 2019 Order. The Company received waivers from its commercial lenders and a limited waiver from the Senior Note holders. The limited waiver temporarily waived any defaults or events of default until the earlier of (a) January 31, 2020 or (b) sixty days from the date when FERC issues its final order associated with the April 2019 Order and such order is not subject to further rehearing or appeal. As FERC's process has yet to be completed, the Limited Waiver expired on January 31, 2020. Subsequent to year end, the Company executed amendments to all of its note agreements to bring the terms of the agreements in line with the requirements imposed on the Company by the FERC, thereby eliminating the potential event of default.

Notes to Financial Statements (*in Thousands*)

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 enters into interest rate swap agreements. On September 15, 2006, the Company entered into an interest rate swap agreement 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 $2,499 and $2,703 at December 31, 2019 and 2018, 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).

The Company entered into another interest rate swap agreement on March 10, 2014, with Regions Bank. 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 3.225% on notional amounts of $21,000 and $24,750 at December 31, 2019 and 2018, 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 G).

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

	2019		2018	
Fair value of interest rate swap agreements		1,314	$	992
Balance sheet location of fair value amounts	Other Long-term Liabilities		Other Long-term Liabilities	
Gain (loss) recognized in statement of income	$	(322)	$	725
Location of gain (loss) recognized in statement of inc	Change in Fair Market Value of Interest Rate Swaps		Change in Fair Market Value of Interest Rate Swaps	

Note 5: Capital Lease Obligation

The Company entered into a capital lease obligation on February 1, 2015, in the amount of $6,901 to finance data storage equipment. The term of the financing was five years and expired on November 1, 2019. At December 31, 2019 and 2018, accumulated depreciation for equipment purchased under the capital lease was $4,876.

Notes to Financial Statements (*in Thousands*)

Note 6: Employee Benefit Plans

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 $5,000 to the plan in 2020.

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 noncontributory defined postretirement health care plan. Eligible retirees are provided monies through a tax-free health reimbursement account to pay for individual Medicare supplemental health insurance plans or other eligible health care expenses.

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	
	2019	2018	2019	2018
Benefit obligation	$ 115,547	$ 96,516	$ 11,476	$ 10,339
Fair value of plan assets	87,657	71,578	-	-
Funded status	$ (27,890)	$ (24,938)	$ (11,476)	$ (10,339)

Amounts recognized in the balance sheets:

	Pension Benefits		Postretirement Health Care Benefits	
	2019	2018	2019	2018
Other long-term liabilities	$ (27,890)	$ (24,938)	$ (11,476)	$ (10,339)

Amounts recognized in members' deficit not yet recognized as components of net periodic benefit cost as of December 31, 2019 and 2018, consist of:

	Pension Benefits		Postretirement Health Care Benefits	
	2019	2018	2019	2018
Net loss	$ 21,291	$ 20,500	$ 4,553	$ 4,406
Prior service credit	(25)	(24)	(1,157)	(1,240)
Transition obligation	16	33	4	9
	$ 21,282	$ 20,509	$ 3,400	$ 3,175

Notes to Financial Statements (*in Thousands*)

The accumulated benefit obligation for the defined benefit pension plan was $93,595 and $78,417 at December 31, 2019 and 2018, respectively.

Other significant balances and costs are:

	Pension Benefits		Postretirement Health Care Benefits	
	2019	2018	2019	2018
Employer contributions	$ 5,400	$ 4,500	$ -	$ -
Benefits paid	3,341	941	139	138
Benefit costs	7,633	6,560	1,050	1,020

No amounts for the postretirement plan were funded by the Company into the investment account intended to be utilized in providing benefits for eligible retirees in 2019 and 2018.

The following amounts have been recognized in the Statements of Income for the years ended December 31, 2019 and 2018:

	Pension Benefits		Postretirement Health Care Benefits	
	2019	2018	2019	2018
Amounts arising during the period				
Net gain (loss)	$ 8,757	$ (5,738)	$ 677	$ 323
Amounts recognized as benefit components of net periodic cost of the period				
Net loss	775	338	187	197
Net prior service cost (credit)	1	1	(83)	(83)
Net transition obligation	16	16	4	4

The components of net periodic benefit cost other than the service cost component are included in the line item Other Expense in the statements of income and shown below:

Pension Benefits		Postretirement Health Care Benefits	
2019	2018	2019	2018
$ 778	$ (103)	$ 642	$ 610

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 credit over the next fiscal year are $695, $1 and $16, respectively. The estimated net loss, prior service credit and net obligation 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 are $200, $83 and $4, respectively.

Notes to Financial Statements (*in Thousands*)

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

	Pension Benefits		Postretirement Health Care Benefits	
	2019	2018	2019	2018
Discount rate benefit obligation	4.5%	5.0%	4.5%	5.0%
Expected return on plan assets	7.0%	7.0%	N/A	N/A
Rate of compensation increase	4.0%	4.0%	N/A	N/A

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 9% annual rate of increase in the per capita cost of covered health care benefits in the next year was assumed for 2019 and 2018. The rate was assumed to decrease gradually to 5% by the year 2023 and remain at that level thereafter.

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
2020	$ 1,254	$ 179
2021	1,503	221
2022	1,785	262
2023	2,042	306
2024	2,444	355
2025-2029	20,334	2,365

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 plan 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.

Notes to Financial Statements (*in Thousands*)

At December 31, 2019 and 2018, plan assets by category are as follows:

	Pension Plan Assets	
	2019	**2018**
Fixed income securities	30%	32%
Equity securities	65	56
Cash and equivalents	5	12
	100%	100%

Pension Plan Assets

Following is a description of the valuation methodologies used for the pension 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, closed-end mutual funds and common and foreign company 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 open-end mutual funds, corporate debt obligations, foreign corporate debt obligations 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, 2019 and 2018, the Company does not hold any plan assets valued using Level 3 inputs.

The fair values of the Company’s pension plan assets at December 31, 2019 and 2018, by asset category are as follows:

Notes to Financial Statements (*in Thousands*)

2019	Fair Value	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable (Level 3)
Money market mutual funds	$ 3,987	$ 3,987	$ -	$ -
Mutual funds				
Equity funds	45,828	30,342	15,486	-
Fixed income funds	23,314	16,878	6,436	-
Other Funds	523	-	523	-
	69,665	47,220	22,445	-
Domestic common stock				
Financials	4,170	4,170	-	-
Healthcare	2,146	2,146	-	-
Industrials	2,271	2,271	-	-
Telecommunications	632	632	-	-
Other	765	765	-	-
Energy	1,294	1,294	-	-
	11,278	11,278	-	-
Corporate debt obligations	2,727	-	2,727	-
Total	$ 87,657	$ 62,485	$ 25,172	$ -

2018	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)
Money market mutual funds	$ 8,455	$ 8,455	$ -	$ -
Mutual funds				
Equity funds	34,061	22,940	11,121	-
Fixed income funds	14,846	10,035	4,811	-
Other funds	3,066	279	2,787	-
	51,973	33,254	18,719	-
Domestic common stock				
Financials	2,019	2,019	-	-
Healthcare	1,958	1,958	-	-
Industrials	923	923	-	-
Telecommunications	240	240	-	-
Energy	695	695	-	-
	5,835	5,835	-	-
Corporate debt obligations	5,315	-	5,315	-
Total	$ 71,578	$ 47,544	$ 24,034	$ -

Notes to Financial Statements (*in Thousands*)

Defined Contribution Plans

The Company has a 401(k) defined contribution plan covering substantially all employees. The Company matches contributions at 4.75% for those employees deferring 6% of compensation, with the match fluctuating from 1% to 4.75% for each percentage of compensation contributed under 6%. Contributions to the plan were $3,035 and $2,804 for 2019 and 2018, 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 the *Employee Retirement Income Security Act of 1974* (ERISA). Accumulated contributions and earnings of $3,561 and $2,585 are recorded in other long-term liabilities at December 31, 2019 and 2018, 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 was 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. There were accrued benefits of $554 and $1,246 recorded in other long-term liabilities for the 457(f) plan participants December 31, 2019 and 2018, respectively.

Note 7: *Revenue from Contracts with Customers*

In 2019 and 2018, the Company's revenues were derived from a number of sources including tariff administration fees, FERC fees, North American Reliability Corporation (NERC) revenues, engineering studies, contract services, and other miscellaneous income sources. The table below presents a complete breakdown of the Company's revenues:

	2019	2018
Tariff administration fees (Schedule 1A)	$ 157,997	$ 164,968
FERC fees (Schedule 12)	29,927	21,581
NERC revenues	-	5,319
Engineering studies	4,902	3,968
Contract services	669	856
Membership dues	594	582
Virtual market participation fees	691	503
Other miscellaneous income	909	1,736
	$ 195,689	$ 199,513

The Company recovers its costs of operating through the Schedule 1-A tariff administration fee that is billed to transmission customers on a monthly basis. With this fee, the Company seeks to recover the costs associated with providing tariff administration, reliability coordination, regional scheduling, expansion planning, and integrated marketplace services. A per MWh fee is charged based on each customer's prior year average 12 month peak demand multiplied by the total hours in a month. The fee is established by the board of directors annually. The Company also bills transmission customers a charge under Schedule 12 to recover the annual fees the Company pays to FERC. The rate is determined by the Company annually and applied monthly to all energy delivered under point-to-point transmission service and network integration transmission service. Revenues are recognized, customers are billed, and payments are collected on a monthly basis for both Schedule 1A and Schedule 12 revenues.

The Company collected revenues from NERC which represented costs of operations of the Southwest Power Pool Regional Entity (SPP RE), an independent and functionally separate division of the Company created according to a delegation agreement signed with NERC in 2007, responsible for developing regional reliability standards, monitoring and enforcing compliance, and assessing and evaluating the reliability of the bulk power system. SPP RE was dissolved in 2018. The Company recognized revenues on a monthly basis based on actual costs of operations of the SPP RE, and billed and collected payments from NERC on a quarterly basis.

The Company performs engineering studies for its customers, mainly for long-term transmission service and generator interconnection requests. Prior to commencement of studies, customers sign contracts with the Company and are responsible for actual costs of the study which are generally comprised of staff time of internal and external resources. The Company recognizes revenues on a monthly basis as costs are incurred for such resources. Deposits are required from customers when they register for the studies. Actual costs are applied against such deposits at the conclusion of studies and customers are refunded their excess deposits. Customers will be invoiced at the end of or during a study if their deposit is not sufficient to cover the actual costs.

The Company provides reliability, tariff administration, scheduling and other administrative and billing services for non-members on a contract basis. Similar to engineering studies, revenues are determined based on actual costs of providing such services and recognized on a monthly basis evenly over the service period which is usually one year. Customers are generally billed and payments collected from customers prior to the service period.

The Company collects a membership fee from each member annually. The amount of the membership fee is established by the board of directors. For 2019 and 2018, all members paid a $6 fee which is billed and recognized in January of each year.

The Company charges financial-only market participants a transaction fee of $0.05 per virtual energy bid and virtual energy offer in the day-ahead market. Invoicing, settlements, and revenue recognition occur on a weekly basis.

Other miscellaneous income is comprised of various pass-thru costs, purchase and tax rebates, small administrative service fees, and sales of maps.

Note 8: Related Party Transactions

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 $23,756 and $11,296 as of December 31, 2019 and 2018, respectively. The Company recognized revenues $146,574 and $143,645, including assessments and tariff administrative fees, from members for the years ended December 31, 2019 and 2018, 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 2019 and 2018, the Company incurred $301and $220, respectively, in expenses attributable to the RSC operations. Management of the Company expects such expenditures for 2020 to be approximately $528.

Note 9: Open Access Transmission and Market Operations

The Company provides short- and long-term firm and non-firm point-to-point transmission services and network integration transmission service across 46 providers in 14 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 owners on a monthly basis. Billings for these transmission services are not included in the statements of income. The Company receives a fee for facilitating the transmission process, which is recorded as tariff fees in the Company's Statements of Income.

For the years ended December 31, 2019 and 2018, the Company billed transmission customers $2,325,085 and $2,515,785, respectively. For the years ended December 31, 2019 and 2018, the Company remitted to transmission owners $2,086,986 and $2,269,671, respectively. At December 31, 2019 and 2018, the Company was due to collect from customers and remit to owners transmission service charges of $172,920 and $183,425, respectively.

The Company's Integrated Marketplace includes a day-ahead market with transmission congestion rights, a reliability unit commitment process, a real-time balancing market, an operating reserve market and a consolidated balancing authority. Weekly settlements of market participants' energy transactions are not reflected in the Company's Statements of Income 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. At December 31, 2019 and 2018, the Company held $35,494 and $52,894, respectively, in cash collections from the settlement of auction revenue rights in accordance with terms of the Company's tariff. These funds are disbursed annually in June for collections from the previous twelve months. A corresponding liability is reflected in accrued expenses on the Balance Sheets.

Note 10: Commitments and Contingencies

Litigation and Regulatory Matters

The Company is engaged in various legal and 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.

Note 11: Disclosures About Fair Value of Financial Instruments

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

Notes to Financial Statements (*in Thousands*)

	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)
December 31, 2019				
Mutual funds				
Equity	$ 10,354	$ -	$ 10,354	$ -
Fixed income	3,737	-	3,737	-
U.S. Government Securities				
Treasury Notes	21,185	21,185	-	-
Interest rate swap agreements	(1,314)	-	(1,314)	-

	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)
December 31, 2018				
Cash equivalents	$ 1,398	$ 1,398	$ -	$ -
Mutual funds				
Equity	8,571	-	8,571	-
Fixed income	4,173	-	4,173	-
U.S. Government Securities				
Treasury Notes	12,495	12,495	-	-
Interest rate swap agreements	(992)	-	(992)	-

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. There have been no significant changes in the valuation techniques during the year ended December 31, 2019.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. At December 31, 2019 and 2018, the Company does not hold any assets valued using Level 3 inputs.

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.

Cash Equivalents

The fair value of money market mutual funds included in cash equivalents is estimated using quoted prices in active markets for identical assets and, therefore, is classified within Level 1 of the valuation hierarchy.

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.

Line of Credit

The carrying amount is a reasonable estimate of fair value.

Long-term Debt and Capital Lease Obligations

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

Notes to Financial Statements (in Thousands)

The following table presents estimated fair values of the Company's financial instruments at December 31, 2019 and 2018:

	2019		2018	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	$ 48,694	$ 48,694	$ 93,593	$ 93,593
Restricted cash deposits	$ 401,478	$ 401,478	$ 344,904	$ 344,904
Investments	$ 35,276	$ 35,276	$ 25,239	$ 25,239
Financial liabilities				
Customer deposits	$ 401,478	$ 401,478	$ 344,904	$ 344,904
Line of credit	$ 12,760	$ 12,760	$ 340	$ 340
Capital lease obligations	$ -	$ -	$ 1,966	$ 1,977
Long-term debt	$ 192,199	$ 199,412	$ 214,480	$ 214,825
Swap agreements	$ 1,314	$ 1,314	$ 992	$ 992

Note 12: Subsequent Events

Subsequent events have been evaluated through April 27, 2020, which is the date the financial statements were available to be issued.